



STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT PEMBROKE

PEMBROKE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT PEMBROKE

PEMBROKE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

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THE UNIVERSITY OF NORTH CAROLINA

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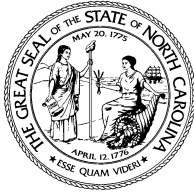
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Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, The University of North Carolina at Pembroke

We have completed a financial statement audit of The University of North Carolina at Pembroke for the year ended June 30, 2006, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements disclosed certain deficiencies that are detailed in the Audit Findings and Recommendation section of this report. The University's response is included following the first finding. The second finding was resolved during the audit period.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

January 31, 2007

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The University of North Carolina at Pembroke
Pembroke, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Pembroke, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2006, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of The University of North Carolina at Pembroke's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of The University of North Carolina at Pembroke Foundation, Inc., The UNCP University Foundation, LLC, and The UNCP Student Housing Foundation, LLC, which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of The University of North Carolina at Pembroke Foundation, Inc., The UNCP University Foundation, LLC, and The UNCP Student Housing Foundation, LLC were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Pembroke and its discretely presented component units as

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 22, 2006, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

December 22, 2006

THE UNIVERSITY OF NORTH CAROLINA AT PEMBROKE MANAGEMENT'S DISCUSSION AND ANALYSIS

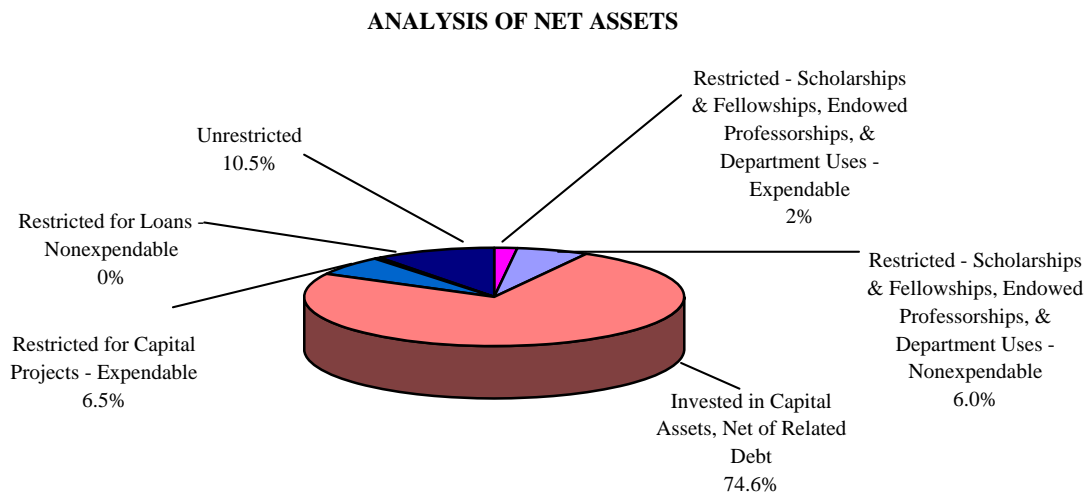
OVERVIEW OF THE FINANCIAL STATEMENT INFORMATION

The University of North Carolina at Pembroke (the University) provides the following discussion and analysis as an overview of the financial position and activities of the University for the year ended June 30, 2006. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The University's financial report includes three financial statements: Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows.

STATEMENT OF NET ASSETS

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. It is prepared under the accrual basis of accounting, where revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. The difference between total assets and total liabilities - net assets - is one indicator of the current financial condition of the University, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Restricted expendable net assets consist of income from endowment funds, gifts, pledges with specific restrictions, and grants from third party agencies with expenditure restrictions. Restricted nonexpendable net assets consist of endowment gifts with specific restrictions on spending the principal given and certain loan funds.

The University's endowment funds consist of both permanent endowments and funds functioning as endowments. Permanent endowments are those funds received from donors with the stipulation that the principal remain inviolate and be invested in perpetuity to produce income that is to be expended for the purposes specified by the donor. Funds functioning as endowments consist of amounts (restricted gifts or unrestricted funds) that have been designated by the University for long-term investment purposes, although amounts are not subject to donor restrictions requiring the University to preserve the principal in perpetuity. Permanent endowments increased \$1,352,197.06. Programs supported by endowments include scholarships, professorships, and various other programs and activities. The University uses its endowments to support operations in a way that strikes a balance between generating a predictable stream of annual support for current needs and preserving the purchasing power of the endowment funds for future periods.

The University's Statement of Net Assets at June 30, 2006, reflects that the University continues to build upon its strong financial foundation. This financial health reflects the prudent utilization of its financial resources, including careful cost controls and conservative utilization of debt.

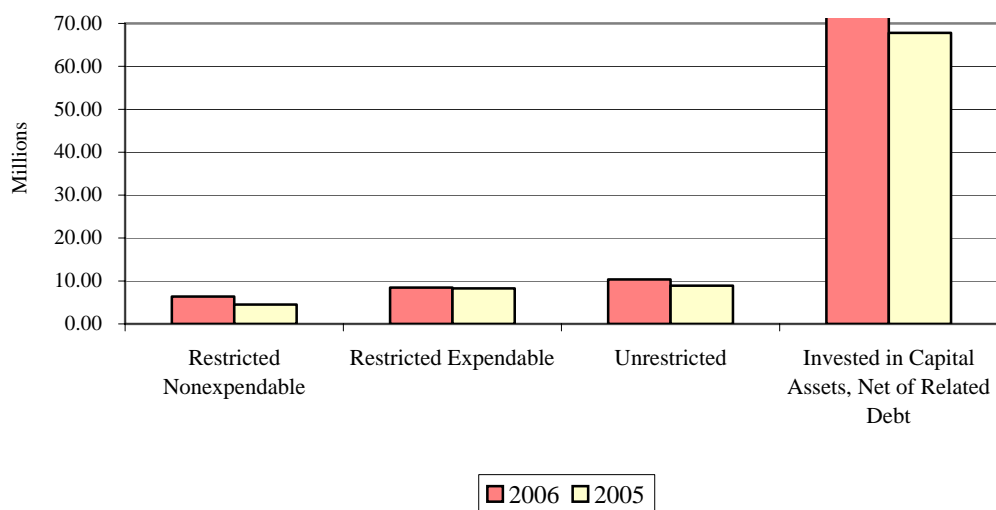
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University's financial position remained strong at June 30, 2006, with total assets of \$127,937,633.28.

Condensed Statement of Net Assets

	2006	2005	Increase/ (Decrease)	Percent Change
Assets:				
Current Assets	\$ 19,978,271.68	\$ 18,989,904.80	\$ 988,366.88	5.2 %
Noncurrent Assets:				
Capital	93,892,387.79	88,959,266.90	4,933,120.89	5.5 %
Other	14,066,973.81	10,578,436.65	3,488,537.16	33.0 %
Total Assets	127,937,633.28	118,527,608.35	9,410,024.93	7.9 %
Liabilities:				
Current Liabilities	5,054,843.14	4,729,651.41	325,191.73	6.9 %
Noncurrent Liabilities	23,804,719.26	24,305,490.02	(500,770.76)	(2.1) %
Total Liabilities	28,859,562.40	29,035,141.43	(175,579.03)	(0.6) %
Net Assets:				
Invested in Capital Assets, Net of Related Debt	73,886,477.79	67,799,912.90	6,086,564.89	9.0 %
Restricted	14,828,883.69	12,800,346.78	2,028,536.91	15.8 %
Unrestricted	10,362,709.40	8,892,207.24	1,470,502.16	16.5 %
Total Net Assets	\$ 99,078,070.88	\$ 89,492,466.92	\$ 9,585,603.96	10.7 %

ANALYSIS OF NET ASSETS



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The increase in other assets includes an increase in noncurrent restricted cash, which represents increased bond allotments, and an increase in endowment investments. The University received two new endowments in fiscal year 2006. University liabilities totaled \$28,859,562.40 at June 30, 2006. In 2004, the University entered into a capital lease agreement for student housing in the amount of \$12,219,354.00. The capital lease is reflected under noncurrent liabilities. Current liabilities, which totaled \$5,054,843.14 at June 30, 2006, consist primarily of trade accounts, accrued compensation, current portion of debt payable for capital facilities, and other miscellaneous payables.

Noncurrent liabilities consist of:

	<u>2006</u>	<u>2005</u>
Deposits Payable	\$ 202,523.88	\$ 180,934.00
Funds Held for Others	1,084,430.52	707,981.22
U.S. Government Grants Refundable	1,290,032.80	1,290,032.80
Accrued Compensation	2,362,505.00	2,120,632.00
Capital Lease Payable	10,055,227.06	10,730,910.00
Bonds Payable	8,810,000.00	9,275,000.00
Total	<u>\$ 23,804,719.26</u>	<u>\$ 24,305,490.02</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

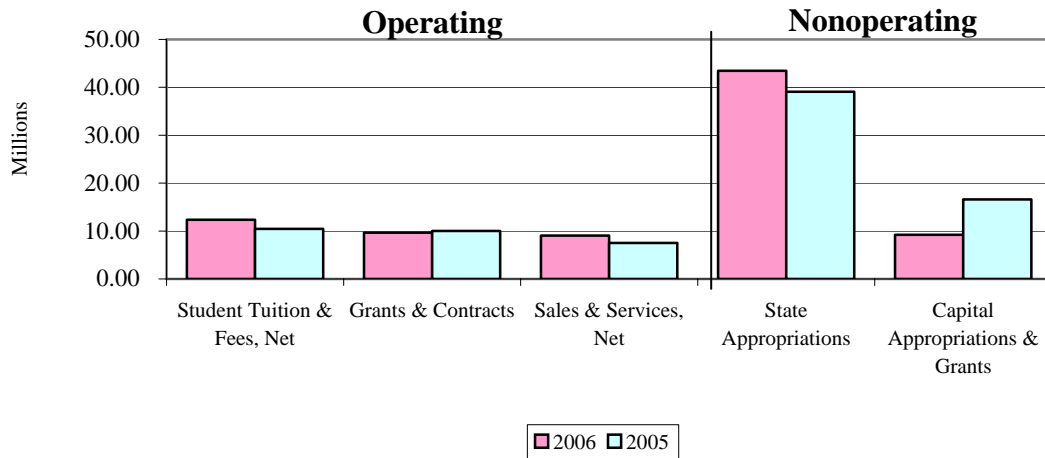
The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the year. Activities are reported as either operating or nonoperating. The financial reporting model classifies State appropriations, noncapital grants, and noncapital gifts as nonoperating revenues. Total revenues increased from \$85,169,541.89 to \$86,372,709.77. A summarized comparison of the University's revenues, expenses, and changes in net assets for the years ended June 30 is as follows:

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	2006	2005	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees, Net	\$ 12,344,496.91	\$ 10,447,685.12	\$ 1,896,811.79	18.2 %
Grants and Contracts	9,656,583.52	10,028,954.90	(372,371.38)	(3.7) %
Sales and Services, Net	9,047,264.71	7,499,761.71	1,547,503.00	20.6 %
Other Operating Revenues	148,224.51	278,914.48	(130,689.97)	(46.9) %
Net Operating Revenues	31,196,569.65	28,255,316.21	2,941,253.44	10.4 %
Operating Expenses	76,787,105.81	69,126,919.12	7,660,186.69	11.1 %
Operating Loss	(45,590,536.16)	(40,871,602.91)	(4,718,933.25)	11.5 %
Nonoperating Revenues:				
State Appropriations	43,451,040.09	39,083,668.98	4,367,371.11	11.2 %
Noncapital Grants and Gifts	587,537.39	803,720.28	(216,182.89)	(26.9) %
Other Nonoperating Revenues, Net	571,177.91	364,105.29	207,072.62	56.9 %
Net Nonoperating Revenues	44,609,755.39	40,251,494.55	4,358,260.84	10.8 %
Loss Before Other Revenues	(980,780.77)	(620,108.36)	(360,672.41)	58.2 %
Capital Grants	7,838,387.67	15,928,055.01	(8,089,667.34)	(50.8) %
Capital Appropriations	1,375,800.00	687,700.00	688,100.00	100.1 %
Additions to Permanent Endowments	1,352,197.06	46,976.12	1,305,220.94	2,778.5 %
Total Other Revenues	10,566,384.73	16,662,731.13	(6,096,346.40)	(36.6) %
Increase in Net Assets	9,585,603.96	16,042,622.77	(6,457,018.81)	(40.2) %
Net Assets				
Beginning of Year	89,492,466.92	73,449,844.15	16,042,622.77	21.8 %
End of Year	\$ 99,078,070.88	\$ 89,492,466.92	\$ 9,585,603.96	10.7 %

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

ANALYSIS OF MAJOR REVENUE SOURCES



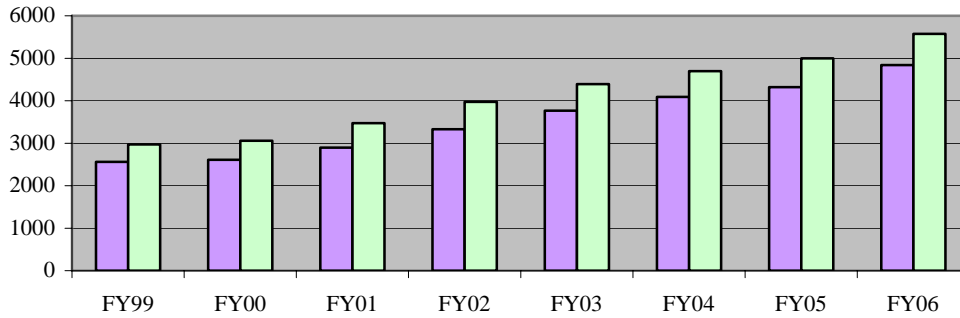
Operating revenues increased as a result of enrollment increases, which in turn resulted in increased tuition and fees and sales and services revenue. Additions to permanent endowments increased as a result of the University receiving two new endowments in fiscal year 2006. The University continues to aggressively seek alternate sources of funding to supplement various academic pursuits and student tuition and fee cost. This effort coupled with prudent management practices continues to serve the University's mission to promote excellence in teaching and learning.

Total operating loss for fiscal year (FY) 2006 was \$45,590,536.16. Since the State of North Carolina appropriation is not included within operating revenue per Governmental Accounting Standards Board Statement No. 35, the University shows a significant operating loss.

Enrollment continues to climb toward the University's goal of 6,000 students. On-campus fall full time equivalent (FTE) enrollment increased 12.1% from FY05 to FY06 with a corresponding 11.6% increase in headcount (HC). Distance education fall enrollment increased 21.9% FTE and 13.4% HC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

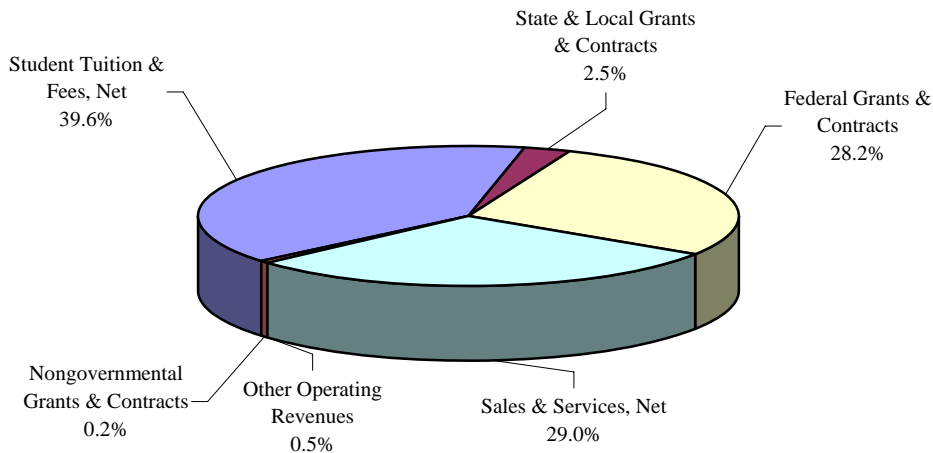
**THE UNIVERSITY OF NC AT PEMBROKE
Total Enrollment 1999-2006**



	FY99	FY00	FY01	FY02	FY03	FY04	FY05	FY06
Fall FTE	2,560	2,611	2,897	3,328	3,768	4,110	4,320	4,841
Fall Count	2,971	3,059	3,471	3,975	4,390	4,698	4,997	5,575

The following graph details operating revenues. As previously noted, State appropriations of \$43,451,040.09 are considered nonoperating revenues; therefore, they are not included in the graph. State appropriations increased \$4,367,371.11 or 11.2% this year.

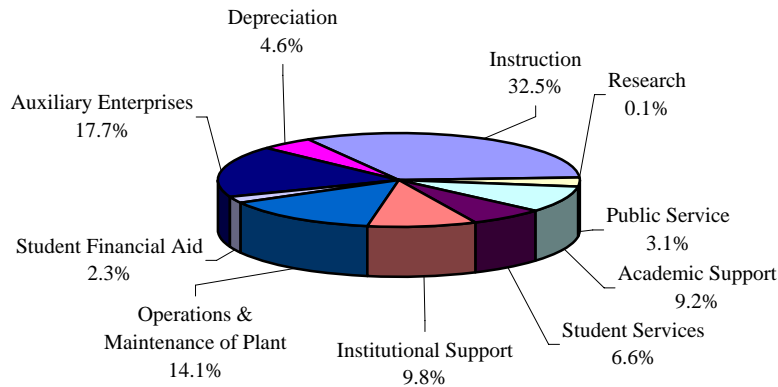
OPERATING REVENUES



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University has successfully sought a balance between increasing performance and service while reducing the overall cost of providing the service. Operating expenses totaling \$76,787,105.81 include salaries and benefits of \$41,832,568.60, supplies and materials of \$12,685,895.23, services of \$13,647,628.92, scholarships and fellowships of \$1,727,628.52, utilities of \$3,341,539.97, and depreciation of \$3,551,844.57. The following two graphs detail the current use of funds by function and natural (object) classification.

OPERATING EXPENSES BY FUNCTION

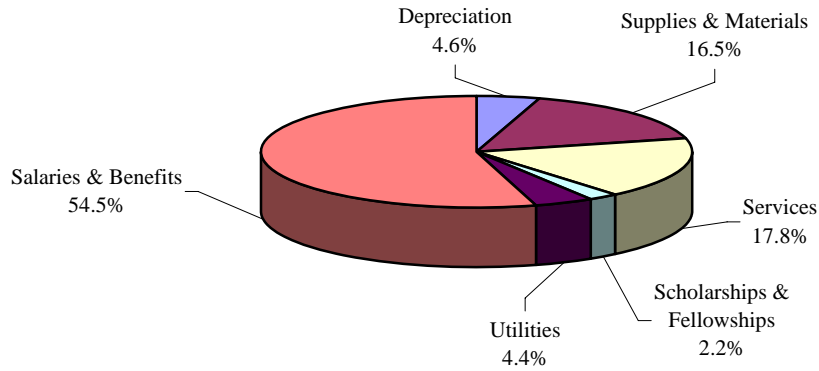


A comparative summary of the University's expenses by functional classification for the years ended June 30 is as follows:

	2006	2005
Instruction	\$ 24,931,852.97	\$ 23,346,740.88
Research	51,191.64	47,003.28
Public Service	2,378,152.50	2,891,980.69
Academic Support	7,069,694.49	6,507,070.77
Student Services	5,069,707.39	4,943,279.77
Institutional Support	7,511,492.11	6,951,415.68
Operations & Maintenance of Plant	10,814,450.86	8,086,140.37
Student Financial Aid	1,775,827.21	2,055,195.69
Auxiliary Enterprises	13,632,892.07	11,762,838.17
Depreciation	3,551,844.57	2,535,253.82
Total Operating Expenses	\$ 76,787,105.81	\$ 69,126,919.12

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

OPERATING EXPENSES BY OBJECT



A comparative summary of the University's expenses for the years ended June 30 is as follows:

	<u>2006</u>	<u>2005</u>
Depreciation	\$ 3,551,844.57	\$ 2,535,253.82
Supplies and Materials	12,685,895.23	9,349,336.19
Services	13,647,628.92	13,623,834.19
Scholarships and Fellowships	1,727,628.52	1,973,562.39
Utilities	3,341,539.97	2,659,581.10
Salaries and Benefits	41,832,568.60	38,985,351.43
Total Operating Expenses	<u><u>\$ 76,787,105.81</u></u>	<u><u>\$ 69,126,919.12</u></u>

STATEMENT OF CASH FLOWS

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. The statement also helps users assess the ability to generate future net cash flows, the ability to meet obligations as they come due, as well as the need for external financing.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Cash Flows

	2006	2005	Increase/ (Decrease)	Percent Change
Cash Provided/(Used) by:				
Operating Activities	\$ (40,966,048.26)	\$ (40,540,404.35)	\$ (425,643.91)	1.0 %
Noncapital Financing Activities	45,313,239.99	39,941,336.29	5,371,903.70	13.4 %
Capital Financing and Related Financing Activities	(150,393.97)	1,387,221.44	(1,537,615.41)	(110.8) %
Investing Activities	(1,155,296.19)	(428,523.44)	(726,772.75)	169.6 %
Net Increase in Cash and Cash Equivalents	3,041,501.57	359,629.94	2,681,871.63	745.7 %
Cash and Cash Equivalents - Beginning of Year	17,327,371.26	16,967,741.32	359,629.94	2.1 %
Cash and Cash Equivalents - End of Year	\$ 20,368,872.83	\$ 17,327,371.26	\$ 3,041,501.57	17.6 %

Major sources of funds included in operating activities include sales and services, student tuition and fees, and grants and contracts. Major uses of funds were payments to employees of \$41,832,568.60, payments for services of \$13,647,628.92, and supply expenses of \$12,685,895.23. The largest inflow of cash in the noncapital financing activities group is State appropriations of \$43,451,040.09.

CAPITAL AND DEBT ACTIVITIES

The University has completed over 80% of its current bond projects as of this date. Projects in the construction phase include the New Classroom Building (Oscar R. Sampson Hall) and the Auxiliary Services Building. Projects in the design phase include the Biotechnology Building, renovation of the Lowry Building, and the Business Building.

The University has to borrow an additional \$2,000,000 to supplement the \$3,000,000 UNC System 2003 Pool General Revenue Bonds in order to fund the expansion of the Chavis University Center. This additional debt will be repaid with student fees of \$20 per year.

Repair and Renovation funds are being used for numerous small capital projects. Many of these projects are infrastructure type projects that are needed to support the growing number of students, faculty, staff, and facilities.

ECONOMIC FACTORS THAT WILL AFFECT THE FUTURE

With national economic indicators showing a more positive national economy, the State of North Carolina has entered an economic recovery and thus State resources are somewhat more plentiful. Fiscal year 2006 saw funding for higher education taking an upturn and the outlook for fiscal year 2007 is even better. The most obvious positive financial recovery was seen in terms of a higher salary increase for faculty and staff for the first time in several years. We are hopeful that such a trend will continue for the next several years. We know enrollment will continue to increase for the University and with that increase will come additional enrollment growth that translates into more faculty and staff along with increased operating budgets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

On a less positive note is the threat that our Focused Growth Enrollment funding will be discontinued next year. This money has been used primarily for student recruitment and without such funding a new source will have to be identified. This may mean using enrollment growth funding, which will limit the number of new positions being supported.

The State continues to fund repair and renovations and while we could use more, a steady flow of such funding is very important to our capital maintenance program. We look for this pool of funding to at least remain steady, if not increase. Discussions have begun to emerge regarding a second bond program and such funding is very important if our facilities planning program is to keep pace with enrollment growth.

The University of North Carolina at Pembroke
Statement of Net Assets
June 30, 2006

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 11,918,091.07
Restricted Cash and Cash Equivalents	4,583,505.49
Receivables, Net (Note 4)	2,497,183.57
Inventories	823,605.58
Notes Receivable, Net (Note 4)	155,885.97
	<hr/>
Total Current Assets	19,978,271.68
	<hr/>

Noncurrent Assets:

Restricted Cash and Cash Equivalents	3,867,276.27
Receivables, Net (Note 4)	147,020.66
Restricted Due from Primary Government	1,747,949.26
Endowment Investments	6,595,908.61
Other Long-Term Investments	581,409.12
Notes Receivable, Net (Note 4)	1,127,409.89
Capital Assets - Nondepreciable (Note 5)	8,434,900.06
Capital Assets - Depreciable, Net (Note 5)	85,457,487.73
	<hr/>
Total Noncurrent Assets	107,959,361.60
	<hr/>
Total Assets	127,937,633.28
	<hr/>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	3,568,054.38
Due to Primary Government	14,744.53
Funds Held for Others	2,461.00
Interest Payable	101,516.29
Long-Term Liabilities - Current Portion (Note 8)	1,368,066.94
	<hr/>
Total Current Liabilities	5,054,843.14
	<hr/>

Noncurrent Liabilities:

Deposits Payable	202,523.88
Funds Held for Others	1,084,430.52
U. S. Government Grants Refundable	1,290,032.80
Long-Term Liabilities (Note 8)	21,227,732.06
	<hr/>
Total Noncurrent Liabilities	23,804,719.26
	<hr/>
Total Liabilities	28,859,562.40
	<hr/>

The University of North Carolina at Pembroke
Statement of Net Assets
June 30, 2006

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	73,886,477.79
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,180,776.53
Endowed Professorships	2,562,522.38
Departmental Uses	189,417.69
Loans	445,897.99
Expendable:	
Scholarships and Fellowships	622,040.28
Endowed Professorships	555,085.43
Departmental Uses	837,325.67
Capital Projects	6,435,817.72
Unrestricted	<u>10,362,709.40</u>
Total Net Assets	<u><u>\$ 99,078,070.88</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

***The University of North Carolina at Pembroke
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2006***

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 10)	\$ 12,344,496.91
Federal Grants and Contracts	8,797,540.60
State and Local Grants and Contracts	792,872.70
Nongovernmental Grants and Contracts	66,170.22
Sales and Services, Net (Note 10)	9,047,264.71
Interest Earnings on Loans	11,850.25
Other Operating Revenues	136,374.26
	<hr/>
Net Operating Revenues	31,196,569.65

EXPENSES

Operating Expenses:

Salaries and Benefits	41,832,568.60
Supplies and Materials	12,685,895.23
Services	13,647,628.92
Scholarships and Fellowships	1,727,628.52
Utilities	3,341,539.97
Depreciation	3,551,844.57
	<hr/>
Total Operating Expenses	76,787,105.81

Operating Loss	<hr/> <u>(45,590,536.16)</u>
----------------	------------------------------

NONOPERATING REVENUES (EXPENSES)

State Appropriations	43,451,040.09
Noncapital Grants	229,954.30
Noncapital Gifts	357,583.09
Investment Income (Net of Investment Expense of \$78,121.93)	972,815.75
Interest and Fees on Debt	(427,798.86)
Other Nonoperating Revenues	26,161.02
	<hr/>
Net Nonoperating Revenues	44,609,755.39

Loss Before Other Revenues	(980,780.77)
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Capital Appropriations	1,375,800.00
Capital Grants	7,838,387.67
Additions to Endowments	1,352,197.06
	<hr/>
Increase in Net Assets	9,585,603.96

NET ASSETS

Net Assets - July 1, 2005	<hr/> 89,492,466.92
Net Assets - June 30, 2006	<hr/> <u>\$ 99,078,070.88</u>

The accompanying notes to the financial statements are an integral part of this statement

The University of North Carolina at Pembroke
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 31,805,151.80
Payments to Employees and Fringe Benefits	(42,133,576.54)
Payments to Vendors and Suppliers	(28,777,041.33)
Payments for Scholarships and Fellowships	(2,339,469.17)
Loans Issued	(343,134.78)
Collection of Loans	416,950.44
Interest Earned on Loans	20,840.41
Student Deposits Received	313,689.00
Student Deposits Returned	(111,165.12)
Other Receipts	181,707.03
	<hr/>
Net Cash Used by Operating Activities	(40,966,048.26)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	43,451,040.09
Noncapital Grants	244,954.30
Noncapital Gifts	265,048.54
Additions to Endowments	1,352,197.06
	<hr/>
Cash Provided by Noncapital Financing Activities	45,313,239.99

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

State Capital Appropriations	2,138,700.45
Capital Grants	7,838,387.67
Acquisition and Construction of Capital Assets	(8,546,239.23)
Principal Paid on Capital Debt and Leases	(1,153,444.00)
Interest and Fees Paid on Capital Debt and Leases	(427,798.86)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(150,393.97)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	60,000.00
Investment Income	954,519.99
Purchase of Investments and Related Fees	(2,169,816.18)
	<hr/>
Net Cash Used by Investing Activities	(1,155,296.19)
	<hr/>
Net Increase in Cash and Cash Equivalents	3,041,501.57
Cash and Cash Equivalents - July 1, 2005	17,327,371.26
	<hr/>
Cash and Cash Equivalents - June 30, 2006	\$ 20,368,872.83

The University of North Carolina at Pembroke
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3
Page 2

**RECONCILIATION OF NET OPERATING EXPENSES
TO NET CASH USED BY OPERATING ACTIVITIES**

Operating Loss	\$	(45,590,536.16)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		3,551,844.57
Allowances and Write-Offs		4,226.12
Nonoperating Other Income		26,161.02
Changes in Assets and Liabilities:		
Receivables (Net)		9,268.84
Inventories		(67,439.71)
Accounts Payable and Accrued Liabilities		753,377.60
Due to Primary Government		1,239.33
Compensated Absences		271,245.00
Deposits Payable		21,589.88
Note Principal Repayments		396,110.03
Notes Issued		(343,134.78)
Net Cash Used by Operating Activities	\$	<u>(40,966,048.26)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	\$	11,918,091.07
Restricted Cash and Cash Equivalents		4,583,505.49
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		<u>3,867,276.27</u>
Total Cash and Cash Equivalents - June 30, 2006	\$	<u><u>20,368,872.83</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

The University of North Carolina at Pembroke Foundations
Statement of Financial Position
June 30, 2006

Exhibit B-1

	The University of North Carolina at Pembroke Foundation, Inc.	The UNCP University Foundation, LLC	The UNCP Student Housing Foundation, LLC
ASSETS			
Cash and Cash Equivalents	\$ 699,938	\$ 19,182	\$ 84,810
Pooled Investments Held by Fiscal Agent	1,577,761		
Accrued Interest Receivable	2,116		9,504
Cash Surrender Value of Life Insurance	40,560		
Security Deposits Held in Trust		69,888	
Assets Held by Trustees		1,342,771	14,118,689
Accounts Receivable - Tenants		26,038	
Contributions Receivable, Net	485,145		
Prepaid Expenses		25,846	
Deferred Financing Costs, Net		500,340	
Construction in Progress	338,710		1,421,163
Property and Equipment, Net		7,900,664	7,669,713
Total Assets	3,144,230	9,884,729	23,303,879
LIABILITIES			
Accounts Payable and Accrued Expenses	341,220	32,387	42,128
Deferred Income		37,037	
Interest Payable		40,886	51,644
Accrued Management Fees Payable		6,484	
Tenant Security Deposits Payable		63,119	
Mortgage Payable		11,160,000	
Interest Rate Swap Fair Value Liability		333,558	
Certificate of Participation Bonds Payable			22,970,000
Total Liabilities	341,220	11,673,471	23,063,772
NET ASSETS			
Unrestricted	57,451	(1,788,742)	240,107
Temporarily Restricted	979,405		
Permanently Restricted	1,766,154		
Total Net Assets	\$ 2,803,010	\$ (1,788,742)	\$ 240,107

The accompanying notes to the financial statements are an integral part of this statement.

***The University of North Carolina at Pembroke Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2006***

Exhibit B-2

	The University of North Carolina at Pembroke Foundation, Inc.	The UNCP University Foundation, LLC	The UNCP Student Housing Foundation, LLC
CHANGES IN UNRESTRICTED NET ASSETS			
Revenues and Gains:			
Contributions	\$ 79,927	\$ 0	\$ 0
Income Earned on Investments	6,270		
Unrealized Gains on Investments	91		
Rental and Lease Income		1,304,174	756,000
Interest Income		46,319	111,152
Miscellaneous Income		35,228	
Total Unrestricted Revenues and Gains	<u>86,288</u>	<u>1,385,721</u>	<u>867,152</u>
Net Assets Released from Restrictions:			
Satisfaction of Program Restrictions	<u>253,189</u>		
Total Unrestricted Revenues, Gains, and Other Support	<u>339,477</u>	<u>1,385,721</u>	<u>867,152</u>
Expenses:			
Contributions to The University of North Carolina at Pembroke	80,778		
Development	208,626		
Administrative		27,127	
Leasing		745	
Advertising and Promotional		11,379	
Property Management Fees		75,816	
Payroll and Related		104,682	
Maintenance and Repairs		79,481	
Utilities		321,244	
Taxes and Insurance		33,884	
Interest		487,425	309,445
Professional Fees		10,720	1,000
Fiscal Agent Fees			7,245
Depreciation		270,652	323,894
Amortization		20,611	
Management and General	54,392		415
Bond Fees		176,562	
Change in the Fair Value of Interest Rate Swap		(618,440)	
Total Expenses	<u>343,796</u>	<u>1,001,888</u>	<u>641,999</u>
Increase (Decrease) in Unrestricted Net Assets	<u>(4,319)</u>	<u>383,833</u>	<u>225,153</u>
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS			
Contributions	878,614		
Income Earned on Investments	121,928		
Unrealized Gains on Investments	7,525		
Net Assets Released from Restrictions:			
Satisfaction of Program Restrictions	<u>(253,189)</u>		
Increase in Temporarily Restricted Net Assets	<u>754,878</u>		
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS			
Contributions	333,685		
Income Earned on Investments	499		
Unrealized Gains on Investments	10		
Increase in Permanently Restricted Net Assets	<u>334,194</u>		
Increase in Net Assets	1,084,753	383,833	225,153
Net Assets at Beginning of Year	<u>1,718,257</u>	<u>(2,172,575)</u>	<u>14,954</u>
Net Assets at End of Year	<u>\$ 2,803,010</u>	<u>\$ (1,788,742)</u>	<u>\$ 240,107</u>

The accompanying notes to the financial statements are an integral part of this statement.

THE UNIVERSITY OF NORTH CAROLINA AT PEMBROKE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Pembroke is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are discretely presented in the University's financial statements. Discretely presented component units' financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

Discretely Presented Component Units – The University of North Carolina at Pembroke Foundation, Inc., The UNCP University Foundation, LLC, and The UNCP Student Housing Foundation, LLC (the "Foundations") are legally separate not-for-profit corporations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The University of North Carolina at Pembroke Foundation, Inc., (the "Foundation") is a legally separate, tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 16 elected public directors, five elected non-public directors, and two ex-officio directors. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University and is reported in separate financial statements because of the difference in its reporting model, as described below.

The UNCP University Foundation, LLC and The UNCP Student Housing Foundation, LLC are legally separate, tax-exempt component units of the University and provide housing for University students. The UNCP University Foundation, LLC (the “Courtyard”) was organized as a limited liability company on October 16, 2000, under the laws of the State of North Carolina for the purpose of acquiring, developing, constructing, and operating a 336-bed student housing rental project. The property location is in Pembroke, North Carolina and is currently known as the University Courtyard Apartments. The activities of the Courtyard are governed by an operating agreement. The Foundation is the sole member of the Courtyard. The UNCP Student Housing Foundation, LLC (the “Village”) was organized as a limited liability company on December 5, 2003, under the laws of the State of North Carolina for the purpose of acquiring, developing, constructing, and operating a student housing project. The property location is on the campus of the University of North Carolina at Pembroke and is currently known as the University Village Apartments. The major activities of the Village are governed by an operating agreement. The Foundation is the sole member of the Village. The Foundations are reported in separate financial statements because of the difference in their reporting model, as described below.

The Foundations are private not-for-profit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Foundations’ financial information in the University’s financial reporting entity for these differences.

During the year ended June 30, 2006, The University of North Carolina at Pembroke Foundation, Inc. distributed \$80,778.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundations can be obtained from the University’s Office of Business Affairs.

- B. Basis of Presentation** - The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – for Public Colleges and Universities*, the full scope of the University’s activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the University does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

- C. Basis of Accounting** - The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange, include State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

- E. Investments** - This classification includes long-term fixed income investments, equity investments, money market funds, real estate investment trusts, and other asset holdings by the University. Except for money market funds, and other asset holdings, investments are accounted for at fair value, as determined by quoted market prices. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Money market funds and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

- F. Receivables** – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of expendable supplies, are valued at the lower of cost or market value using the first-in, first-out method. Textbooks are valued at the lower of cost or market value using the weighted average method.
- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 25 years for general infrastructure, 25 to 40 years for buildings, and 3 to 15 years for equipment.

The Native American Resource Museum and portrait collections are capitalized at cost or fair value at the date of donation. These collections are considered inexhaustible and are therefore not depreciated.

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations. Certain other assets are classified as restricted because their use is limited by external parties or statute.
- J. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable, a capital lease obligation,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and compensated absences that will not be paid within the next fiscal year.

The University's bond premiums/discounts are considered immaterial and are expensed with the issuance costs.

- K. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days, which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method.

There is no liability for unpaid accumulated sick leave because the University has no obligation to pay sick leave upon termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

- L. Net Assets** – The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt – This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted Net Assets – Nonexpendable – Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Restricted Net Assets – Expendable – Expendable restricted net assets include resources for which the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets – Unrestricted net assets include resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

M. Scholarship Discounts – Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

N. Revenue and Expense Recognition – The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and*

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and State appropriations that represent subsidies or gifts to the University, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

- O. Internal Sales Activities** – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as central stores, the print shop, motor pool, and auxiliaries with interdepartmental activities. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** – Unless specifically exempt, the University is required by *North Carolina General Statute 147-77* to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2006, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$18,375,047.18, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.18 years as of June 30, 2006. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2006, was \$1,970,399.51. The carrying amount of the University's deposits not with the State Treasurer was \$23,426.14 and the bank balance was \$49,697.84. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2006, the University's bank balance was covered by federal depository insurance and was not exposed to custodial credit risk.

B. Investments

University - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as discussed below.

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper; and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

local governments; and obligations of certain entities with specified ratings.

In accordance with the bond resolutions, bond proceeds and debt service funds are invested in obligations that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

G.S. 116-36(e) provides that the trustees of the Endowment Fund shall be responsible for the prudent investment of the Fund in the exercise of their sound discretion, without regard to any statute or rule of law relating to the investment of funds by fiduciaries but in compliance with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the University's component units, The University of North Carolina at Pembroke Foundation, Inc., The UNCP University Foundation, LLC, and The UNCP Student Housing Foundation, LLC, are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The University utilizes investment pools to manage investments and distribute investment income.

Investments are subject to the following risks.

Interest Rate Risk: Interest rate risk is the risk the University may face should interest rate variances affect the fair value of investments. The University does not have a formal policy that addresses interest rate risk.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University does not have a formal policy that addresses credit risk.

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University does not have a formal policy for custodial credit risk.

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unit value method. Under this method, each participating fund's investment balance is determined on its prorata share

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

of the principal value and undistributed earnings. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the Long-Term Investment Pool.

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
U.S. Agencies	\$ 139,768.88	\$ 114,924.38	\$ 0.00	\$ 0.00	\$ 24,844.50
Money Market Mutual Funds	592,504.11	592,504.11			
Domestic Corporate Bonds	780,674.67	273,829.11	483,089.81		23,755.75
		<u>\$ 981,257.60</u>	<u>\$ 483,089.81</u>	<u>\$ 0.00</u>	<u>\$ 48,600.25</u>
Other Securities					
Real Estate Investment Trust	281,135.56				
Domestic Stocks	6,379,586.39				
Total Long-Term Investment Pool	<u>\$ 8,173,669.61</u>				

At June 30, 2006, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa
U.S. Agencies	\$ 139,768.88	\$ 139,768.88	\$ 0.00	\$ 0.00	\$ 0.00
Domestic Corporate Bonds	780,674.67		280,362.23	338,686.99	161,625.45

Rating Agency: S&P

At June 30, 2006, investments in the Long-Term Investment Pool were not exposed to custodial credit risk.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	<u>Fair Value</u>
Other Mutual Funds	<u>\$ 581,409.12</u>

Total Investments – The following table presents the fair value of the total investments at June 30, 2006:

Investment Type	<u>Fair Value</u>
Debt Securities	
U.S. Agencies	\$ 139,768.88
Money Market Funds	592,504.11
Domestic Corporate Bonds	780,674.67
Other Securities	
Other Mutual Funds	581,409.12
Real Estate Investment Trust	281,135.56
Domestic Stocks	<u>6,379,586.39</u>
Total Investments	<u>\$ 8,755,078.73</u>

Total investments include \$1,577,761.44 held in the Endowment Fund for component units that are discretely presented in the accompanying financial statements.

Component Units - Investments of the University's discretely presented component units, [the UNCP University Foundation, LLC and The UNCP Student Housing Foundation, LLC,] are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements. Because they report under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments and reserves.

UNCP University Foundation, LLC

The funds held by the Bond Trustees consist of cash, money market investments, and securities that are primarily issued by the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

U.S. Government. These short-term investments are stated at cost, which approximates their market value.

Under the terms of the Trust Indenture, various funds such as Construction, Reimbursement, Capitalized Interest, and Debt Service must be established and maintained for the Organization.

The bond indentures contain significant limitations and restrictions on annual debt service requirements, maintenance of and flow of monies through various restricted accounts, minimum amounts to be maintained in various sinking funds, and minimum bond coverages.

At June 30, funds held by the Trustee consist of:

Revenue	\$	55,940.00
Reimbursement		6,550.00
Bond Fund Principal		187,260.00
Debt Service Reserve		931,706.00
Renewal and Replacement		46,665.00
Residual		68,707.00
Miscellaneous		60.00
Future Operations and Maintenance		163.00
Future Management		12.00
Bond Fund Reimbursement		40,000.00
Future Exchange		2,185.00
Rebate		3,523.00
		<hr/>
		1,342,771.00
Less current portion		<hr/> (124,647.00) <hr/>
	\$	<hr/> <u>1,218,124.00</u> <hr/>

The UNCP Student Housing Foundation, LLC

Under the terms of the Trust Indenture, various funds such as Construction, Reimbursement, Capitalized Interest, and Debt Service must be established and maintained for the Housing LLC.

The bond indentures contain significant limitations and restrictions on annual debt service requirements, maintenance of and flow of monies through various restricted accounts, minimum amounts to be maintained in various sinking funds, and minimum bond coverages.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, funds held by the Trustee consist of:

Revenue	\$	232,010.36
Construction		12,660,116.99
Debt Service Reserve		2,395.84
Capitalized Interest		1,224,165.58
		<hr/>
	\$	<u>14,118,688.77</u>

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, State law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy, which limits spending to 5.5% of the "average market value" of the endowment funds. The "average market value" is defined as an average of the market values on December 31 of the previous three years. The actual spending may be less than the 5.5% maximum rate due to the economic environment. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2006, net appreciation of \$604,457.33 was available to be spent, of which \$595,334.91 was restricted to specific purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 1,760,249.67	\$ 110,787.93	\$ 1,649,461.74
Accounts	275,554.79		275,554.79
Intergovernmental	485,672.21		485,672.21
Pledges	21,873.99	5,516.32	16,357.67
Investment Earnings	54,061.62		54,061.62
Interest on Loans	4,690.74		4,690.74
Other	11,384.80		11,384.80
Total Current Receivables	<u>\$ 2,613,487.82</u>	<u>\$ 116,304.25</u>	<u>\$ 2,497,183.57</u>
Noncurrent Receivables:			
Pledges	<u>\$ 210,029.51</u>	<u>\$ 63,008.85</u>	<u>\$ 147,020.66</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 67,659.10	\$ 36,119.08	\$ 31,540.02
Institutional Student Loan Programs	124,345.95		124,345.95
Total Notes Receivable - Current	<u>\$ 192,005.05</u>	<u>\$ 36,119.08</u>	<u>\$ 155,885.97</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 1,359,640.84</u>	<u>\$ 232,230.95</u>	<u>\$ 1,127,409.89</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2006, is presented as follows:

	Balance July 1, 2005	Increases	Decreases	Balance June 30, 2006
Capital Assets, Nondepreciable:				
Land	\$ 1,768,194.56	\$ 204,269.88	\$ 0.00	\$ 1,972,464.44
Art, Literature, and Artifacts	168,729.87			168,729.87
Construction in Progress	42,002,095.54	3,366,407.19	39,074,796.98	6,293,705.75
Total Capital Assets, Nondepreciable	<u>43,939,019.97</u>	<u>3,570,677.07</u>	<u>39,074,796.98</u>	<u>8,434,900.06</u>
Capital Assets, Depreciable:				
Buildings	54,554,683.38	36,753,073.91		91,307,757.29
Machinery and Equipment	7,776,273.17	817,593.97	1,101,324.15	7,492,542.99
General Infrastructure	6,923,723.07	6,420,929.08		13,344,652.15
Total Capital Assets, Depreciable	<u>69,254,679.62</u>	<u>43,991,596.96</u>	<u>1,101,324.15</u>	<u>112,144,952.43</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	16,478,796.86	2,366,285.52		18,845,082.38
Machinery and Equipment	6,137,968.14	512,799.58	1,098,812.56	5,551,955.16
General Infrastructure	1,617,667.69	672,759.47		2,290,427.16
Total Accumulated Depreciation	<u>24,234,432.69</u>	<u>3,551,844.57</u>	<u>1,098,812.56</u>	<u>26,687,464.70</u>
Total Capital Assets, Depreciable, Net	<u>45,020,246.93</u>	<u>40,439,752.39</u>	<u>2,511.59</u>	<u>85,457,487.73</u>
Capital Assets, Net	<u>\$ 88,959,266.90</u>	<u>\$ 44,010,429.46</u>	<u>\$ 39,077,308.57</u>	<u>\$ 93,892,387.79</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2006, were as follows:

	Amount
Accounts Payable	\$ 2,797,796.43
Accrued Payroll	389,397.72
Contract Retainage	378,717.98
Other	2,142.25
Total Accounts Payable and Accrued Liabilities	<u>\$ 3,568,054.38</u>

NOTE 7 - LETTER OF CREDIT

Component Unit – UNCP University Foundation, LLC

In connection with the long-term debt the Organization has a letter of credit in the amount of \$11,775,445 with Wachovia Bank, National Association, formerly known as First Union National Bank. The letter of credit serves as a credit enhancement to the bonds and expires February 15, 2007.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2006, is presented as follows:

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Current Portion
Bonds Payable	\$ 9,720,000.00	\$ 0.00	\$ 445,000.00	\$ 9,275,000.00	\$ 465,000.00
Capital Lease Payable	11,439,354.00		708,444.00	10,730,910.00	675,682.94
Compensated Absences	2,318,644.00	3,270,465.00	2,999,220.00	2,589,889.00	227,384.00
Total Long-Term Liabilities	\$ 23,477,998.00	\$ 3,270,465.00	\$ 4,152,664.00	\$ 22,595,799.00	\$ 1,368,066.94

Additional information regarding capital lease obligations is included in Note 9.

B. Bonds Payable - The University was indebted for bonds payable for the purposes shown in the following table:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2006	Principal Outstanding June 30, 2006
<u>The University of North Carolina System Pool Revenue Bonds</u>						
Housing System	A	4.0%-5.25%	10/01/2018	\$ 3,130,000.00	\$ 725,000.00	\$ 2,405,000.00
Recreational Facilities	B	5.0%-5.75%	10/01/2020	1,025,000.00	165,000.00	860,000.00
Dining System	B	5.0%-5.75%	10/01/2015	755,000.00	190,000.00	565,000.00
Recreational Center Improvements	C	3.5%-5.0%	04/01/2012	605,000.00	195,000.00	410,000.00
Surface Parking Lot	C	3.5%-5.0%	04/01/2012	285,000.00	90,000.00	195,000.00
University Center Renovation & Expansion Auxiliary Services Complex & Student Recreational Facility	D	2.0%-4.75%	04/01/2028	5,270,000.00	430,000.00	4,840,000.00
Total Bonds Payable (principal only)				<u>\$ 11,070,000.00</u>	<u>\$ 1,795,000.00</u>	<u>\$ 9,275,000.00</u>

(A) The University of North Carolina System Pool Revenue Bonds, Series 1998B

(B) The University of North Carolina System Pool Revenue Bonds, Series 2000

(C) The University of North Carolina System Pool Revenue Bonds, Series 2002B

(D) The University of North Carolina System Pool Revenue Bonds, Series 2003B

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- C. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2006, are as follows:

<u>Fiscal Year</u>	<u>Annual Requirements</u>	
	<u>Bonds Payable</u>	
	<u>Principal</u>	<u>Interest</u>
2007	\$ 465,000.00	\$ 411,202.52
2008	475,000.00	394,677.50
2009	495,000.00	376,752.52
2010	520,000.00	356,940.02
2011	540,000.00	334,245.64
2012-2016	2,575,000.00	1,302,282.46
2017-2021	2,160,000.00	734,578.73
2022-2026	1,390,000.00	359,447.50
2027-2028	655,000.00	47,025.02
Total Requirements	\$ 9,275,000.00	\$ 4,317,151.91

Interest on the revenue bonds is calculated at 2.0%-5.75% at June 30, 2006.

D. Component Units – Long-Term Debt

UNCP University Foundation, LLC

Long-term debt consists of \$11,160,000.00 at June 30, 2006. Tax-exempt series 2001A term bonds dated January 24, 2001, are due at various intervals through 2031, and are payable in monthly installments of interest and annual installments of principal. The bonds bear interest at various interest rates up to 12 percent, as defined in the Trust Indenture, and are secured by deed and assignment of rents.

As described above, the mortgage payable bears interest at a variable rate. To minimize the effect of changes in interest rates, the Organization entered into an interest rate swap agreement under which it pays interest at a fixed rate of 4.365 percent and receives interest at a variable rate. The variable rate under the swap is based on the same notional amount as the underlying mortgage. However, the variable rate of interest is calculated differently on the swap than on the variable rate bonds plus portions of the bond have fixed interest rates. As a result, the swap is only partially effective as a hedge. Valued separately, the interest rate swap agreement represents a liability as of June 30, 2006, in the amount of \$333,558. This value represents the fair value of the current difference in interest paid and received under the swap agreement over the remaining term of the agreement. Payments are recognized in current operating results as settlements as they occur under the agreement as a component of interest expense.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The portion of the settlement payments that are effective as a cash flow hedge are included as a component of interest expense and result in an effective interest rate of 4.365 percent. The ineffective portion of the settlement payments in fiscal year 2006 was \$10,310 and has been included in the change in fair value of the interest rate swap. The swap matures July 1, 2011. Only interest payments are due under the swap agreement. Total payments due during the next 12 months, net of receipts, are not reasonably estimable because fluctuations in interest rates cannot be estimated.

The liability of the Organization under the loan agreements is limited to the value of the building and improvements, pledged revenues and amounts deposits with the trustee.

The first monthly interest payment on the bonds began on July 1, 2001. As of June 30, 2006, \$40,886 is accrued.

Maturities of long-term debt at June 30, 2006, are as follows:

2007	\$	110,000.00
2008		135,000.00
2009		170,000.00
2110		205,000.00
2111		240,000.00
Thereafter		<u>10,300,000.00</u>
Total		11,160,000.00
Less current maturities		<u>(110,000.00)</u>
Net long-term portion	\$	<u>11,050,000.00</u>

The UNCP Student Housing Foundation, LLC

Long-term debt at June 30, 2006, consists of tax exempt Series 2004 Certificate of Participation bonds dated January 1, 2004, and due at various intervals through 2034 used (1) to refinance the cost of the construction, acquisition and equipping of an existing 216-bed student housing facility and to finance the cost of the construction, acquisition and equipping of a 144-bed student housing facility, each on the campus of UNCP in Pembroke, North Carolina, (2) to pay capitalized interest with respect to the portion of the 2004 Certificates allocable to the expansion project during construction thereof, (3) to fund a debt service, and (4) to pay expenses related to the 2004 Certificates. The Housing LLC is leasing the land on which the housing is located from the State of North Carolina pursuant to a Ground Lease Agreement dated April 29, 2003, between the Foundation as lessee, and the State, as lessor,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

which was assigned by the Foundation to the Housing LLC pursuant to an Assignment and Amendment of Lease Agreement January, 2004 between the Foundation, the State and the Housing LLC. The Housing LLC leased all of the leasehold interest to the State pursuant to a Lease Agreement between the Housing LLC and the State dated January 27, 2004, for a period of 30 years through March 1, 2034. UNCP discharged the obligations of the State to pay the rental payments required under the lease pursuant to the terms of a Use Agreement dated as of January 1, 2004, between the Housing LLC and UNCP and agreed to pay the Trustee (First-Citizens Bank & Trust Company) as base rentals amounts that correspond to the rental payments required to be paid by the State under the Lease.

The principal and interest are payable in semi-annual installments of interest and annual installments of principal from the amounts payable by UNCP and amounts held under the Indenture and its provisions. The bonds bear interest at various rates up to 5 percent, as defined in the Indenture of Trust. The bonds are secured by a Leasehold Deed of Trust, Security Agreement and Assignment of Rents and Leases dated as of January 1, 2004, from the Housing LLC to the deed of trust trustee, granting a lien of record on the mortgaged property which includes the Housing LLC's leasehold interest in the land described in the Ground Lease. Payment of the principal and interest is insured by a financial guaranty insurance policy issued by XL Capital Assurance Inc.

The 2004 Certificates are subject to optional, mandatory and extraordinary prepayment prior to their maturity.

Long-term debt at June 30, 2006, also consists of tax exempt Series 2006 Certificate of Participation bonds dated April 19, 2006, and due at various intervals through 2037 used to finance (1) the cost of the construction, acquisition and equipping of an approximately 360-bed student housing facility on the campus of The University of North Carolina at Pembroke, (2) the payment capitalized interest with respect to the 2006 Certificates during construction of the New Project, (3) the payment of the premium for the financial guaranty insurance policy, (4) the payment of premiums on debt service reserve fund policies, and (5) the Payment of certain expenses incurred in connection with the execution and delivery of the 2006 Certificates. The Housing LLC is leasing the land on which the housing is located from the State of North Carolina pursuant to a Ground Lease Agreement dated April 29, 2003, between the Foundation as lessee, and the State, as lessor, which was assigned by the Foundation to the Housing LLC pursuant to an Assignment and Amendment of Lease Agreement January, 2004 between the Foundation, the State and the Housing LLC. The Housing LLC leased all of the leasehold interest to

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the State pursuant to a Lease Agreement between the Housing LLC and the State dated January 27, 2004, for a period of 30 years through March 1, 2034. UNCP discharged the obligations of the State to pay the rental payments required under the lease pursuant to the terms of a Use Agreement dated as of January 1, 2004, between the Housing LLC and UNCP and agreed to pay the Trustee (First-Citizens Bank & Trust Company) as base rentals amounts that correspond to the rental payments required to be paid by the State under the Lease.

The principal and interest are payable in semi-annual installments of interest and annual installments of principal from the amounts payable by UNCP and amounts held under the Indenture and its provisions. The bonds bear interest at various rates up to 5 percent, as defined in the Indenture of Trust. The bonds are secured by a Leasehold Deed of Trust, Security Agreement and Assignment of Rents and Leases dated as of January 1, 2004, from the Housing LLC to the deed of trust trustee, granting a lien of record on the mortgaged property which includes the Housing LLC's leasehold interest in the land described in the Ground Lease. Payment of the principal and interest is insured by a financial guaranty insurance policy issued by XL Capital Assurance Inc.

The 2006 Certificates are subject to optional, mandatory and extraordinary prepayment prior to their maturity.

Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2006, are as follows:

<u>Fiscal Year</u>	<u>Annual Requirements</u>	
	<u>Bonds Payable</u>	
	<u>Principal</u>	<u>Interest</u>
2007	\$ 195,000.00	\$ 891,658.00
2008	335,000.00	993,607.00
2009	380,000.00	981,707.00
2010	415,000.00	969,582.00
2011	450,000.00	956,132.00
2012-2016	2,705,000.00	4,494,004.00
2017-2021	3,295,000.00	3,904,126.00
2022-2037	15,195,000.00	6,134,267.00
Total Requirements	\$ 22,970,000.00	\$ 19,325,083.00

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - LEASE OBLIGATIONS

- A. Capital Lease Obligation** – The capital lease obligation relating to University student housing is recorded at the present value of the minimum lease payments. Future minimum lease payments under the capital lease obligation consist of the following at June 30, 2006:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 780,000.00
2008	780,000.00
2009	780,000.00
2010	780,000.00
2011	780,000.00
2012-2016	3,900,000.00
2017-2021	3,900,000.00
2022-2026	3,900,000.00
2027-2031	3,900,000.00
2032-2034	<u>2,340,000.00</u>
Total Minimum Lease Payments	21,840,000.00
Amount Representing Interest (4.84% Rate of Interest)	<u>11,109,090.00</u>
Present Value of Future Lease Payments	<u><u>\$ 10,730,910.00</u></u>

Buildings acquired under the capital lease amounted to \$10,730,910.00 at June 30, 2006.

- B. Operating Lease Obligations** – The University did not enter into any noncancelable operating leases during fiscal year 2006.

Rental expense for all operating leases during the year was \$449,369.14.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - REVENUES

A summary of eliminations and allowances by revenue classification and revenues pledged as security for revenue bonds is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	\$ 16,662,192.39	\$ 0.00	\$ 4,214,001.17	\$ 103,694.31	\$ 12,344,496.91	\$ 211,511.65 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 4,263,785.49	\$ 477,963.33	\$ 1,207,247.65	\$ 0.00	\$ 2,578,574.51	\$ 2,578,574.51 (B)
Dining	2,533,209.12	283,968.57	698,093.44		1,551,147.11	1,551,147.11 (C)
Student Union Services	72,878.86	8,169.60			64,709.26	
Health, Physical Education, and Recreation Services	746,112.26	83,637.95	501,796.25		160,678.06	
Bookstore	3,893,450.10	436,449.34	698,836.51		2,758,164.25	2,758,164.25 (E)
Parking	323,685.00	36,284.56			287,400.44	287,400.44 (D)
Athletic	50,213.66	5,628.87			44,584.79	
Other	1,573,864.12	176,427.57			1,397,436.55	
Sales and Services of Education and Related Activities	319,684.68	115,114.94			204,569.74	
Total Sales and Services	<u>\$ 13,776,883.29</u>	<u>\$ 1,623,644.73</u>	<u>\$ 3,105,973.85</u>	<u>\$ 0.00</u>	<u>\$ 9,047,264.71</u>	<u>\$ 7,175,286.31</u>

Revenue Bonds Secured by Pledged Revenues:

- (A) Recreational Facilities and University Center Expansion
- (B) Housing System
- (C) Dining System
- (D) Surface Parking
- (E) Bookstore

NOTE 11 - OPERATING EXPENSES BY FUNCTION

The University's operating expenses by functional classification are presented as follows:

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 22,311,461.91	\$ 1,413,544.13	\$ 1,205,807.45	\$ 0.00	\$ 1,039.48	\$ 0.00	\$ 24,931,852.97
Research	42,224.36	6,250.83	2,716.45				51,191.64
Public Service	1,443,531.56	142,372.09	761,923.85	30,325.00			2,378,152.50
Academic Support	4,861,446.89	1,501,877.66	705,991.17	378.77			7,069,694.49
Student Services	2,570,264.19	259,069.38	2,240,373.82				5,069,707.39
Institutional Support	5,149,034.38	378,672.06	1,982,901.22		884.45		7,511,492.11
Operations and Maintenance of Plant	3,918,511.86	4,271,508.07	437,290.08		2,187,140.85		10,814,450.86
Student Financial Aid			79,352.46	1,696,474.75			1,775,827.21
Auxiliary Enterprises	1,536,093.45	4,712,601.01	6,231,272.42	450.00	1,152,475.19		13,632,892.07
Depreciation						3,551,844.57	3,551,844.57
Total Operating Expenses	<u>\$ 41,832,568.60</u>	<u>\$ 12,685,895.23</u>	<u>\$ 13,647,628.92</u>	<u>\$ 1,727,628.52</u>	<u>\$ 3,341,539.97</u>	<u>\$ 3,551,844.57</u>	<u>\$ 76,787,105.81</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - PENSION PLANS

- A. Retirement Plans** - Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2006, these rates were set at 2.34% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2006, the University had a total payroll of \$34,366,842.92, of which \$16,932,273.39 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$1,015,936.40 and \$396,215.20, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were \$396,215.20, \$329,563.25, and \$31,362.21, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.state.nc.us/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2006, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2006, the University had a total payroll of \$34,366,842.92, of which \$13,429,287.29 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$805,757.24 and \$918,563.25, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$190,696.48 for the year ended June 30, 2006.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2006, were \$21,417.25. The voluntary contributions by employees amounted to \$112,308.40 for the year ended June 30, 2006.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$827,313.98 for the year ended June 30, 2006.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.8% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2006, the University's total contribution to the Plan was

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$1,153,739.31. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

- B. Long-Term Disability** - The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the year ended June 30, 2006, the University's total contribution to the DIPNC was \$157,880.12. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 14 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$5,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$500 per occurrence

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

deductible, except theft losses carry a \$1,000 per occurrence deductible. The University also purchased through the Fund all risk coverage for auxiliary buildings and contents.

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses occurring in-State are \$500,000 per claim and \$5,000,000 per occurrence and out-of-State are \$1,000,000 per claim and \$5,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence with a \$50,000 deductible and a 10% participation in each loss above the deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance.

University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the University's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The University is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The University is self-insured for workers' compensation for employees paid by State appropriations and purchased coverage for all other employees with a private insurance company.

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

Additional details on the State-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 15 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$10,081,346.74 at June 30, 2006.
- B. Pending Litigation and Claims** – The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.
- C. Other Contingent Receivables** – The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied or, in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting principles generally accepted in the United States of America, these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year-end is as follows:

Purpose	Amount
Capital Improvement - State General Obligation Bonds	\$ 12,156,388.63

NOTE 16 - SUBSEQUENT EVENTS

On November 1, 2006, the University of North Carolina Board of Governor's ratified the issuance of bonds for a system-wide tax-exempt bond financing. On November 30, 2006, the University borrowed \$3,300,000.00 through the financing.



STATE OF NORTH CAROLINA
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**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Trustees
The University of North Carolina at Pembroke
Pembroke, North Carolina

We have audited the financial statements of The University of North Carolina at Pembroke, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2006, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 22, 2006. Our report was modified to include a reference to other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Audit Findings and Recommendation section of this report.

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

Findings

1. Information System Access Rights Inconsistent with Adequate Segregation of Duties
2. Deficiencies in Internal Control over Bookstore Receipts

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe none of the reportable conditions described above are material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Audit Committee, the Board of Governors, the Board of Trustees, management of the University, the Governor, the State Controller, and the General Assembly, and is not intended to be and should not be used by anyone other than these specified parties.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

December 22, 2006

AUDIT FINDINGS AND RECOMMENDATION

Matters Related to Financial Reporting

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control. Finding number two was also reported in the prior year.

1. INFORMATION SYSTEM ACCESS RIGHTS INCONSISTENT WITH ADEQUATE SEGREGATION OF DUTIES

The University granted information system access rights inconsistent with adequate segregation of duties. The University had three employees in management positions who had system access rights that allowed them to create vendors, create purchase orders, enter invoices for payment, print checks, and post journal entries. Another employee in management had the same access rights, with the exception of check printing. Because these employees are in management, they are also responsible for oversight of the transactions that they are capable of initiating.

Segregation of duties is a basic internal control that requires limitations of information system access rights that could allow any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties.

Recommendation: The University should limit information system access rights to assure that employees are only assigned access rights necessary to perform their jobs and that adequate segregation of duties is achieved.

University's Response: The University's Controller's Office has limited the access rights for the four employees noted in the audit to achieve adequate segregation of duties. The Controller's office has begun the process of reviewing the access rights to employees assigned to Controller financial programs.

2. DEFICIENCIES IN INTERNAL CONTROL OVER BOOKSTORE RECEIPTS

The University did not have adequate controls in place to ensure proper segregation of duties and proper review of transactions in the bookstore.

- Cash handling responsibilities were not properly segregated. One individual was responsible for all aspects of the daily deposit including receipting money, processing returns without prior approval, running cash reports, reconciling the cash to reports, and preparing the deposit. There was no indication of review of this individual's work by management.

AUDIT FINDINGS AND RECOMMENDATION (CONCLUDED)

- The cash report summary generated daily from the system was used to balance with cash receipts. In order to generate this summary report, the individual responsible for running cash reports had to prompt the system with the register numbers used each day to include all register transactions in the summary. As a result, this report was susceptible to manipulation by not entering all of the register numbers used in a day when generating the report.
- All bookstore employees, including student employees, processed their own returns without prior approval.

This finding has been resolved. The University implemented controls in the bookstore that ensure proper segregation of duties over cash handling, including returns, and proper review of transactions and daily reports.

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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