STATE OF NORTH CAROLINA

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, 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

Fayetteville State University

Fayetteville, North Carolina

Financial Statement Audit Report

For the Year Ended June 30, 2006

Board of Governors

The University of North Carolina

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STATE OF NORTH CAROLINA
Office of the State Auditor

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of Fayetteville State University 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 and our consideration of the University's administration of federal programs in accordance with applicable laws, regulations, contracts, and grants disclosed certain deficiencies and instances of noncompliance that are detailed in the Audit Findings and Recommendations section of this report. The University's response is included following each finding.

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

December 7, 2007

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the accompanying financial statements of Fayetteville State University, 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 unit, 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 Fayetteville State University'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 Fayetteville State University Foundation, Inc., and Subsidiary, the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the report 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 Fayetteville State University Foundation, Inc., and Subsidiary 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 report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Fayetteville State University and its discretely presented component unit as 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 November 5, 2007, 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

November 5, 2007

Introduction

This section of the Fayetteville State University (University) annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2006, and includes comparative data for the year ended June 30, 2005. The discussion describes important trends and events that have impacted the fiscal health of the University and that may continue to exert influence in future years. This discussion has been prepared by University management along with the financial statements and related notes and should be read in conjunction with and is qualified in its entirety by the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of the University's management.

Using the Annual Report

This annual report consists of a series of financial statements prepared in accordance with the Governmental Accounting Standards Board (GASB). The GASB establishes standards for external financial reporting for public colleges and universities and requires that financial statements be presented on a consolidated basis for the University as a whole. One of the most important questions asked is whether the University as a whole is better or worse off as a result of the year's activities. The key to understanding this question is the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets. These statements present financial information in a form similar to that used by corporations. They are prepared under the accrual basis of accounting, whereby 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 Notes to the Financial Statements should be read in conjunction with the financial statements. The Notes to the Financial Statements provide detailed information about the University regarding significant accounting principles, deposits and investments, endowment investments, receivables, capital assets, accounts payable and accrued liabilities, long-term liabilities, revenues, operating expenses by function, pension plans, other post employment benefits, risk management, and commitments. Overall, these disclosures provide information to better understand details, risks, and uncertainty associated with amounts reported in the financial statements.

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used by private-sector companies. The University's supporting organization, the Fayetteville State University Foundation, Inc., and Subsidiary, (Foundation) is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. Therefore, the results of its operations are not blended with the University's financial statements, but are discretely presented, and are not included in this Management's Discussion and Analysis.

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2006. Its combined net assets increased $11,944,419.28 in the current year, which is an increase of 21.02 percent. The $11,944,419.28 overall increase in net assets was largely attributable to the increase in capital assets, net of related debt, of $11,335,707.54 and an increase in current assets cash and cash equivalents of $2,979,277.95. Cash and cash equivalents increased because the University had more expenses that were due at June 30, 2006, that the University had not paid, as compared to the prior year. The cash to pay these expenses was still on the books at year end. The State cash carried forward also increased.

Summary of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The Statement of Net Assets is a point-in-time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of Fayetteville State University. The Statement of Net Assets presents end-of-year data concerning assets (property that we own and what we are owed by others); liabilities (what we owe to others and have collected from others before we have provided the service); and net assets (assets minus liabilities). 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 to us, regardless of when cash is exchanged.

From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the University. They are also able to determine how much the University owes vendors, investors, and lending universities. Finally, the Statement of Net Assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the University.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the University's equity in property, plant, and equipment. The second asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. Restricted nonexpendable net assets consist primarily of the University's permanent endowment funds and are only available for investment purposes. Restricted expendable net assets are available for expenditures by the University but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The third category is unrestricted net assets. Unrestricted net assets are available to the University for any lawful purpose of the University. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the University's unrestricted net assets have been designated for various academic and research programs and initiatives.

Condensed Summary of Net Assets

	2006	2005	Increase / (Decrease)	Percent Change
Assets:				
Current Assets	$ 16,014,563.00	$ 11819709.82	$ 4,194,853.18	35.49 %
Noncurrent Assets:				
Capital	60,271,489.04	49,477,781.50	10,793,707.54	21.82 %
Other	10,906,453.82	12,759,441.27	(1,852,987.45)	(14.52) %
Total Assets	87,192,505.86	74,056,932.59	13,135,573.27	17.74 %
Liabilities:				
Current Liabilities	6,524,035.98	5,163,063.35	1,360,972.63	26.36 %
Noncurrent Liabilities	11,889,955.06	12,059,773.70	(169,818.64)	(1.41) %
Total Liabilities	18,413,991.04	17,222,837.05	1,191,153.99	6.92 %
Net Assets:				
Invested in Capital Assets, Net of Related Debt	54,196,489.04	42,860,781.50	11,335,707.54	26.45 %
Restricted:				
Nonexpendable	5,948,562.77	5,893,788.96	54,773.81	0.93 %
Expendable	4,722,658.08	5,147,585.92	(424,927.84)	(8.25) %
Unrestricted	3,910,804.93	2,931,939.16	978,865.77	33.39 %
Total Net Assets	$ 68,778,514.82	$ 56,834,095.54	$ 11,944,419.28	21.02 %

Net Assets categories are defined in Note 1 L of the Notes to the Financial Statements.

As of June 30, 2006, total University assets were $87,192,505.86, which is an increase of $13,135,573.27. Current assets increased by $4,194,853.18 primarily due to an increase in cash and cash equivalents of $2,979,277.95 and an increase in receivables of $1,169,085.61. Receivables increased due to student accounts not being billed and collected timely. In addition, intergovernmental receivables increased.

The University's largest asset is its capital assets of $60,271,489.04, representing 69.12 percent of total assets at June 30, 2006. Noncurrent capital assets increased by $10,793,707.54 primarily due to completed construction on the Bronco Residence Hall, Seabrook Auditorium, Spaulding Building, and the stadium upgrade. Noncurrent other assets decreased by $1,852,987.45 primarily due to a decrease in the amount due from primary government for the 2000 Higher Ed Bonds of $1,709,651.54 and a decrease in noncurrent restricted cash and cash equivalents of $238,312.64.

The University's liabilities totaled $18,413,991.04 at June 30, 2006, which is an increase of $1,191,153.99. Noncurrent long-term liabilities of $8,407,104.62, consisting of $5,525,000.00 in bonds payable and $2,882,104.62 in compensated absences, are the largest liabilities. Other liabilities consist of contracts and retainage payables of $2,855,905.41, U. S. government grants refundable of $1,913,491.98, and funds held for others of $1,569,358.46.

The University recorded an increase in current liabilities of $1,360,972.63. The change was due in large part to the increase in accounts payable and accrued compensation of $1,693,337.62. Payables increased due to general obligations and one large bill for student insurance that was due at June 30 but not processed until July.

The University's current assets of $16,014,563.00 covered the current liabilities of $6,524,035.98, as the current ratio was $2.46 in current assets to every $1.00 in current liabilities.

The University's long-term liabilities consist of compensated absences and bonds payable. Bonds payable is the University's largest liability at June 30, 2006, representing 32.99 percent of total University liabilities. At June 30, 2006, the University had outstanding bonds of $6,075,000.00. The University issued no new debt this fiscal year. More detailed information on the University's bonds is presented in Note 7 of the financial statements.

Summary of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. A public University's dependency on State aid and gifts will result in operating deficits. The GASB requires that State appropriations and gifts be classified as nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The change in total net assets as presented on the Condensed Summary of Revenues, Expenses, and Changes in Net Assets is based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the statement is to present the revenues received by the University, both operating and nonoperating, the expenses paid by the University, operating and nonoperating, and any other revenues, expenses, gains, and losses received or spent by the University.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided. Capital grants and gifts are considered neither operating nor nonoperating revenues and are reported after "Loss Before Other Revenues."

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

	2006	2005	Increase / (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees, Net	$ 14,698,723.86	$ 12,692,314.47	$ 2,006,409.39	15.81 %
Grants and Contracts	10,307,061.95	10,064,951.66	242,110.29	2.41 %
Auxiliary Activities	5,337,398.21	4,912,266.01	425,132.20	8.65 %
Other Educational Activities	129,970.49	148,344.96	(18,374.47)	(12.39) %
Net Operating Revenues	30,473,154.51	27,817,877.10	2,655,277.41	9.55 %
Total Operating Expenses	86,907,526.74	80,131,201.36	6,776,325.38	8.46 %
Operating Loss	(56,434,372.23)	(52,313,324.26)	(4,121,047.97)	7.88 %
Nonoperating Revenues:				
State Appropriations	44,358,265.51	38,340,345.44	6,017,920.07	15.70 %
Other Nonoperating Revenues	9,541,296.79	9,662,941.85	(121,645.06)	(1.26) %
Net Nonoperating Revenues	53,899,562.30	48,003,287.29	5,896,275.01	12.28 %
Loss Before Other Revenues	(2,534,809.93)	(4,310,036.97)	1,775,227.04	(41.19) %
Capital Contributions	14,416,440.17	10,805,314.17	3,611,126.00	33.42 %
Permanent Endowment Additions	62,789.04	60,423.90	2,365.14	3.91 %
Increase in Net Assets	11,944,419.28	6,555,701.10	5,388,718.18	82.20 %
Net Assets:				
Beginning of Year	56,834,095.54	50,278,394.44	6,555,701.10	13.04 %
End of Year	$ 68,778,514.82	$ 56,834,095.54	$ 11,944,419.28	21.02 %

The Condensed Summary of Revenues, Expenses, and Changes in Net Assets reflects a positive year with an increase in net assets of $11,944,419.28 at the end of the year. Net assets increased from general operations activities. Cash and other assets held increased more than the related liabilities.

Total operating loss for fiscal year 2006 was $56,434,372.23. Since the State of North Carolina appropriation is not included within operating revenue per GASB, the University shows a significant operating loss.

The sources of operating revenue for the University are tuition and fees, grants and contracts, auxiliary services, and other educational activities. The increase in operating revenue is mainly due to an increase in the student tuition and fees account. The increase in tuition and fees is mainly due an increase in summer school revenue of about $800,000.00 and the regular-term enrollment increases.

The increase in nonoperating revenues is due to the increase in capital contributions. The capital funding increased in the areas of the COPS (Certificates of Participation Bonds), the

Statewide bond programs, and capital appropriations. All of these funding sources are provided through State budget and the bonds are backed by Statewide revenues.

The University strives to provide students with the opportunity to obtain a quality education. Future University enrollments may be affected by a number of factors, including any material increase in tuition and other mandatory charges, stemming from any material decrease in appropriation funding from the State of North Carolina.

Operating expenses, including depreciation of $2,512,522.57, totaled $86,907,526.74. Of this total, $39,603,073.20, or 45.57 percent, was used for instruction and student support; $9,773,218.85, or 11.25 percent, was used for institutional support; $10,979,071.27, or 12.63 percent, was used for operations and maintenance of plant; and $10,666,060.22, or 12.27 percent, was used for auxiliary enterprises. The increase in operating expenses is mainly due to increases in salaries and benefits, services, and student financial aid. Salaries and benefits increased primarily due to positions created from enrollment growth and focus growth funding, although about $450,000.00 reflects the increased cost of providing health insurance to employees. Services increased due to regular operating increases to most areas included in this caption. The largest individual increase was to the dining services contract. The University increased the number of students participating in the dining plan. Student financial aid increased due to an increase in federal aid and increases in University scholarships.

The University's largest source of nonoperating revenue is the State of North Carolina appropriation. This is received in monthly payments, beginning in July of each year, since the State's fiscal year begins on July 1st. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year beginning July 1, 2005, and ending June 30, 2006, the appropriations from the State for the University were $44,358,265.51 for operations. This appropriation was fully recorded by the University during the University's fiscal year ending June 30, 2006.

One of the University's greatest strengths is the diverse streams of revenues that supplement its student tuition and fees, including voluntary private support from individuals, foundations, and corporations, along with government and other sponsored programs, State appropriations, and investment income. The University has in the past and will continue to seek funding aggressively from all possible sources consistent with its mission, to supplement student tuition, and manage prudently the financial resources realized from these efforts to fund its operating activities.

Capital Assets

With the successful passage of the higher education bond referendum in November 2000 the University received a $46,021,400.00 allocation to enhance campus facilities. Major capital expenditures through the year ended June 30, 2006, include the Residence Hall

($6,523,244.25), Seabrook Renovation ($7,779,397.31), Lyons Renovation and Addition ($7,652,153.52), Cook Dining Conversion ($2,434,864.79), Taylor Gymnasium Conversion ($4,133,039.28), Spaulding Renovation Conversion ($1,450,885.09), Stadium Complex Renovations ($2,654,512.68), and Lilly Gymnasium ($175,833.00).

Factors Impacting Future Periods

Management believes that the University is well positioned to continue its strong financial condition and level of excellence in service to students, the community, and governmental agencies. This flexibility, along with the University’s ongoing efforts toward revenue diversification and cost containment, will enable the University to provide the necessary resources to support this level of excellence.

A crucial element to the University’s future will continue to be our relationship with the State of North Carolina, as we work to manage tuition to make it competitive while providing an outstanding college education for our students. There is a direct relationship between the growth of State support and the University’s ability to control tuition growth, as declines in State appropriations generally result in increased tuition levels.

The University continues to execute its long-range plan to modernize and expand its complement of facilities with a balance of new construction. This strategy addresses the University’s growth and the continuing effects of technology on teaching methodologies.

Private gifts are an important supplement to the fundamental support from the State and student tuition, and a significant factor in the growth of academic units. Economic pressures affecting donors may also affect the future level of support the University receives from corporate and individual giving.

The University will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate the University’s operations from temporary market volatility.

While it is not possible to predict the ultimate results, management believes that the University’s financial condition is strong enough to weather any economic uncertainties.

Fayetteville State University
Statement of Net Assets
June 30, 2006 ***Exhibit A-1***

ASSETS	
Current Assets:	
Cash and Cash Equivalents	$ 8,235,090.91
Restricted Cash and Cash Equivalents	2,177,667.05
Receivables, Net (Note 4)	4,775,128.58
Inventories	191,932.65
Notes Receivable (Note 4)	634,743.81
Total Current Assets	16,014,563.00
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	3,228,267.80
Restricted Due from Primary Government	632,104.05
Endowment Investments	4,927,011.61
Other Long-Term Investments	429,213.60
Notes Receivable, Net (Note 4)	1,689,856.76
Capital Assets - Nondepreciable (Note 5)	17,138,659.05
Capital Assets - Depreciable, Net (Note 5)	43,132,829.99
Total Noncurrent Assets	71,177,942.86
Total Assets	87,192,505.86
LIABILITIES	
Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	4,917,634.43
Due to Primary Government	39,107.32
Unearned Revenue	511,003.20
Interest Payable	69,909.37
Long-Term Liabilities - Current Portion (Note 7)	986,381.66
Total Current Liabilities	6,524,035.98
Noncurrent Liabilities:	
Funds Held for Others	1,569,358.46
U. S. Government Grants Refundable	1,913,491.98
Long-Term Liabilities (Note 7)	8,407,104.62
Total Noncurrent Liabilities	11,889,955.06
Total Liabilities	18,413,991.04
NET ASSETS	
Invested in Capital Assets, Net of Related Debt	54,196,489.04
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,733,870.79
Endowed Professorships	1,632,882.00
Loans	581,809.98
Expendable:	
Scholarships and Fellowships	1,151,612.43
Endowed Professorships	861,125.88
Departmental Uses	300,032.67
Capital Projects	1,043,739.59
Debt Service	1,366,147.51
Unrestricted	3,910,804.93
Total Net Assets	$ 68,778,514.82

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

Fayetteville State University
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 8)	$	14,698,723.86
Federal Grants and Contracts		10,301,262.95
State and Local Grants and Contracts		5,799.00
Sales and Services, Net (Note 8)		5,337,398.21
Interest Earnings on Loans		6,747.52
Other Operating Revenues		123,222.97
Net Operating Revenues		30,473,154.51
EXPENSES		
Operating Expenses:		
Salaries and Benefits		48,665,914.84
Supplies and Materials		10,859,274.27
Services		15,218,760.15
Scholarships and Fellowships		7,400,404.73
Utilities		2,250,650.18
Depreciation		2,512,522.57
Total Operating Expenses		86,907,526.74
Operating Loss		(56,434,372.23)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		44,358,265.51
Noncapital Grants		8,272,617.20
Noncapital Gifts		998,622.88
Investment Income (Net of Investment Expense of $17,977.40)		567,425.87
Interest and Fees on Debt		(297,569.71)
Other Nonoperating Revenues		200.55
Net Nonoperating Revenues		53,899,562.30
Loss Before Other Revenues		(2,534,809.93)
Capital Appropriations		2,075,800.00
Capital Grants		12,340,640.17
Additions to Endowments		62,789.04
Increase in Net Assets		11,944,419.28
NET ASSETS		
Net Assets - July 1, 2005		56,834,095.54
Net Assets - June 30, 2006	$	68,778,514.82

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

Fayetteville State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES	
Received from Customers	$ 28,948,035.54
Payments to Employees and Fringe Benefits	(48,334,513.41)
Payments to Vendors and Suppliers	(27,242,300.97)
Payments for Scholarships and Fellowships	(7,400,404.73)
Loans Issued	(527,534.67)
Collection of Loans	501,212.50
Interest Earned on Loans	2,277.44
Other Receipts	67,358.42
Net Cash Used by Operating Activities	(53,985,869.88)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State Appropriations	44,358,265.51
Noncapital Grants	8,272,617.20
Noncapital Gifts	998,622.88
Additions to Endowments	62,789.04
Federal Family Education Loan Receipts	22,781,790.00
Federal Family Education Loan Disbursements	(22,566,900.96)
Related Activity Agency Receipts	269,911.23
Net Cash Provided by Noncapital Financing Activities	54,177,094.90
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES	
State Capital Appropriations	2,075,800.00
Capital Grants	14,050,291.71
Acquisition and Construction of Capital Assets	(13,063,739.47)
Principal Paid on Capital Debt	(542,000.00)
Interest and Fees Paid on Capital Debt	(299,275.67)
Other Receipts	200.55
Net Cash Provided by Capital Financing and Related Financing Activities	2,221,277.12
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales and Maturities of Investments	848,000.00
Investment Income	329,934.42
Purchase of Investments and Related Fees	(849,471.25)
Net Cash Provided by Investing Activities	328,463.17
Net Increase in Cash and Cash Equivalents	2,740,965.31
Cash and Cash Equivalents - July 1, 2005	10,900,060.45
Cash and Cash Equivalents - June 30, 2006	$ 13,641,025.76

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

Operating Loss	$	(56,434,372.23)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		2,512,522.57
Allowances, Write-Offs, and Amortizations		104,630.54
Changes in Assets and Liabilities:		
Receivables (Net)		(1,474,009.66)
Inventories		(29,934.36)
Accounts Payable and Accrued Liabilities		1,141,665.29
Due to Primary Government		7,299.90
U. S. Government Grants Refundable		67,358.42
Unearned Revenue		(128,841.57)
Compensated Absences		274,133.39
Student Loans Issued		(527,534.67)
Student Loan Principal Repayments		501,212.50
Net Cash Used by Operating Activities	$	(53,985,869.88)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	8,235,090.91
Restricted Cash and Cash Equivalents		2,177,667.05
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		3,228,267.80
Total Cash and Cash Equivalents - June 30, 2006	$	13,641,025.76

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Change in Fair Value of Investments	$	231,013.68

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

Fayetteville State University Foundation, Inc., and Subsidiary
Statement of Financial Position
June 30, 2006 — *Exhibit B-1*

ASSETS		
Current Assets:		
Cash in Bank	$	1,292,807
Restricted Cash - Housing Foundation		1,092,914
Accounts Receivable		426,769
Prepaid Expenses		12,801
Due from Fayetteville State University		36,957
Investments		2,175,723
Property, Plant, and Equipment, Net		13,047,942
Total Assets		18,085,913
LIABILITIES		
Current Liabilities:		
Accounts Payable		87,657
Current Maturities of Long-Term Debt		210,000
Unearned Revenue		447,536
Long-Term Debt		14,255,000
Total Liabilities		15,000,193
NET ASSETS		
Unrestricted:		
Fayetteville State University Housing Foundation		(1,740,268)
Fayetteville State University Foundation		1,389,097
Permanently Restricted		3,436,891
Total Net Assets	$	3,085,720

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

Fayetteville State University Foundation, Inc., and Subsidiary
Statement of Activities
For the Fiscal Year Ended June 30, 2006 — *Exhibit B-2*

CHANGES IN UNRESTRICTED NET ASSETS		
Revenues:		
Gifts and Donations	$	109,188
Interest and Dividend Income		42,822
Rental Income		1,192,366
Total Unrestricted Revenues		1,344,376
Net Assets Released from Restrictions		86,944
Total Unrestricted Revenues and Net Assets Released from Restrictions		1,431,320
Expenses:		
Program Services		2,123,504
Management and General		16,998
Fund Raising		4,236
Total Expenses		2,144,738
Decrease in Unrestricted Net Assets		(713,418)
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Revenues and Gains:		
Gifts and Donations		74,963
Interest and Dividend Income		80,473
Unrealized Gain on Investments		121,623
Total Permanently Restricted Revenues and Gains		277,059
Net Assets Released from Restrictions		(86,944)
Increase in Permanently Restricted Net Assets		190,115
Decrease in Net Assets		(523,303)
Net Assets at Beginning of Year		3,609,023
Net Assets at End of Year	$	3,085,720

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

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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. Fayetteville State University 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 unit is discretely presented in the University's financial statements. The discretely presented component units' financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize their legal separateness.

Discretely Presented Component Unit – The Fayetteville State University Foundation Inc., and Subsidiary (Foundation) is a legally separate, tax-exempt, not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. The Fayetteville State University Housing Foundation, LLC is a wholly owned subsidiary of the Foundation. Its primary purpose is to build, maintain, and manage a student housing facility for students of Fayetteville State 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 40 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

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 Foundation is a private not-for-profit organization that reports its 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 Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2006, the Foundation distributed $130,264.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Fayetteville State University Foundation, Inc., and Subsidiary at (910) 672-1151.

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.

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 includes 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 mutual funds and United States Government Securities held by the University. These investments are accounted for at fair value, as determined by quoted market prices. The net increase in the fair value of investments is recognized as a component of investment income.

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, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.

G. **Inventories –** Inventories, consisting of expendable supplies and merchandise for resale, are valued at the lower of cost or market value using the first-in, first-out 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. Interest costs incurred are capitalized during the period of construction.

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 25 years for general infrastructure, 30 years for buildings, and three to 11 years for equipment.

The University does not capitalize its art collection. This collection adheres to the University's policy to maintain for public exhibition, education or research; protect, keep unencumbered, care for and preserve; and requires proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized.

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 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.

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.

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 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 and printing. 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 $13,499,026.45, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within 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 $11,700.00. The carrying amount of the University's deposits not with the State Treasurer was $130,299.31 and the bank balance was $132,742.28. 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, $12,949.48 of the University's bank balance was exposed to custodial credit risk and held as uninsured and uncollateralized by the bank per bond covenants.

B. **Investments** – 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 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 unit, the Fayetteville State University Foundation, Inc., and Subsidiary, 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 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. The University's investments were not exposed to custodial credit risk at year end.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006.

	Fair Value	Investment Maturities (in Years) Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities:					
U.S. Treasuries	$ 429,213.60	$ 426,213.60	$ 0.00	$ 0.00	$ 0.00
Mutual Bond Funds	1,727,788.88			1,727,788.88	
		$ 426,213.60	$ 0.00	$ 1,727,788.88	$ 0.00
Other Securities:					
Other Mutual Funds	3,199,222.73				
Total Non-Pooled Investments	$ 5,356,225.21				

The University's mutual bond funds held at June 30, 2006, were all unrated.

Component Unit – Investments of the University's discretely presented component unit, the Fayetteville State University Foundation, Inc., and Subsidiary 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 the Foundation report is under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type:

Fayetteville State University Foundation, Inc., and Subsidiary

Investments are presented in the financial statements at fair market value. Investments earned $46,663.00 during the year ended June 30, 2006, and incurred management fees of $8,030.00. Investments within the account are composed of the following:

	Cost	Market	Unrealized Appreciation
Common Fund:			
Multi Strategy Equity Fund	$ 960,000.00	$ 1,517,752.00	$ 557,752.00
Multi Strategy Bond Fund	640,000.00	656,921.00	16,921.00
Equity Securities	3,500.00	1,050.00	(2,450.00)
Total Investments	$ 1,603,500.00	$ 2,175,723.00	$ 572,223.00

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 under classical trust doctrines. Unless the donor has stipulated otherwise, capital gains and losses are accounted for as part of the endowment principal and are not available for expenditure. The University's endowment spending policy governs the rate at which funds are released to the operating budget from the endowment. The University uses a disciplined spending rate with a long-term spending rule. The target rate for spending is set between 4% and 6% of the endowment's three-year average, year end market value. In order to preserve the purchasing power of the endowment, the portfolio is invested with the expectation of generating a long-term rate of return at least equal to the payout plus the rate of inflation. At June 30, 2006, there was no net appreciation available to be spent.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 1,764,766.18	$ 541,833.61	$ 1,222,932.57
Accounts	313,944.72		313,944.72
Intergovernmental	2,907,078.31		2,907,078.31
Investment Earnings	30,899.33		30,899.33
Interest on Loans	53,669.00		53,669.00
Other	246,604.65		246,604.65
Total Current Receivables	$ 5,316,962.19	$ 541,833.61	$ 4,775,128.58
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	$ 604,009.64	$ 0.00	$ 604,009.64
Institutional Student Loan Programs	30,734.17		30,734.17
Total Notes Receivable - Current	$ 634,743.81	$ 0.00	$ 634,743.81
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 2,114,025.71	$ 424,168.95	$ 1,689,856.76

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	$ 963,243.22	$ 0.00	$ 0.00	$ 963,243.22
Construction in Progress	22,811,449.96	11,772,005.20	18,408,039.33	16,175,415.83
Total Capital Assets, Nondepreciable	23,774,693.18	11,772,005.20	18,408,039.33	17,138,659.05
Capital Assets, Depreciable:				
Buildings	64,002,267.27	18,768,300.41	3,000.00	82,767,567.68
Machinery and Equipment	5,079,017.07	1,173,963.83	174,980.69	6,078,000.21
General Infrastructure	2,693,400.77			2,693,400.77
Total Capital Assets, Depreciable	71,774,685.11	19,942,264.24	177,980.69	91,538,968.66
Less Accumulated Depreciation for:				
Buildings	41,316,658.45	1,797,265.04	3,000.00	43,110,923.49
Machinery and Equipment	3,232,261.72	645,296.67	174,980.69	3,702,577.70
General Infrastructure	1,522,676.62	69,960.86		1,592,637.48
Total Accumulated Depreciation	46,071,596.79	2,512,522.57	177,980.69	48,406,138.67
Total Capital Assets, Depreciable, Net	25,703,088.32	17,429,741.67		43,132,829.99
Capital Assets, Net	$ 49,477,781.50	$ 29,201,746.87	$ 18,408,039.33	$ 60,271,489.04

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	$ 3,533,699.29
Accrued Payroll	772,660.30
Contract Retainage	611,185.30
Intergovernmental Payables	14.86
Other	74.68
Total Accounts Payable and Accrued Liabilities	$ 4,917,634.43

NOTE 7 - 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	$ 6,617,000.00	$ 0.00	$ 542,000.00	$ 6,075,000.00	$ 550,000.00
Compensated Absences	3,044,352.89	5,003,788.62	4,729,655.23	3,318,486.28	436,381.66
Total Long-Term Liabilities	$ 9,661,352.89	$ 5,003,788.62	$ 5,271,655.23	$ 9,393,486.28	$ 986,381.66

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
Dormitory System						
Dormitory System Revenue Bond	A	3.0%-3.625%	10/01/2005	$ 920,000.00	$ 920,000.00	$ 0.00
Dormitory System Revenue Bond	B	8.0%-10.0%	10/01/2009	1,750,000.00	1,285,000.00	465,000.00
Total Dormitory System				2,670,000.00	2,205,000.00	465,000.00
The University of North Carolina System Pool Revenue Bonds						
Refunding of U.S. Department of Education Notes Payable	2002B	3.5%-5.375%	04/01/2022	1,245,000.00	150,000.00	1,095,000.00
Stadium Renovation	2002B	3.5%-5.0%	04/01/2012	2,735,000.00	875,000.00	1,860,000.00
Dining	2005B	3.5%-4.5%	04/01/2023	2,770,000.00	115,000.00	2,655,000.00
Total The University of North Carolina System Pool Revenue Bonds				6,750,000.00	1,140,000.00	5,610,000.00
Total Bonds Payable (principal only)				$ 9,420,000.00	$ 3,345,000.00	$ 6,075,000.00

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

	Annual Requirements Bonds Payable	
Fiscal Year	Principal	Interest
2007	$ 550,000.00	$ 275,332.50
2008	570,000.00	251,517.50
2009	590,000.00	225,737.50
2010	625,000.00	197,887.50
2011	515,000.00	169,057.50
2012-2016	1,400,000.00	573,046.26
2017-2021	1,315,000.00	300,943.78
2022-2023	510,000.00	32,350.00
Total Requirements	$ 6,075,000.00	$ 2,025,872.54

D. Bond Defeasance – The University has extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

In fiscal year 2005, the University defeased $2,530,000.00 of outstanding Fayetteville State University Dining System Facility Fee Revenue Bonds, Series 1997 (original issue amount $3,040,000.00). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2006, the outstanding balance of the defeased Fayetteville State University Dining System Facility Fee Revenue Bonds, Series 1997, was $2,445,000.00.

E. Component Unit – Long-Term Debt

Fayetteville State University Foundation, Inc., and Subsidiary

Long-term debt at June 30, 2006, consisted of a North Carolina Student Housing Facilities Revenue Bond with a balance of $14,465,000.00, secured by real property. The Foundation has entered into an interest rate swap arrangement to lock in the interest rate on 75% of the bond at 3.09%. The remainder of the bond is at a variable interest rate based on the BMA index. The buildings are used as housing for students of Fayetteville State University.

Maturities of long-term debt are as follows:

Year Ending June 30,		
2007 (included in current maturities)	$	210,000.00
2008		220,000.00
2009		235,000.00
2010		245,000.00
2011		260,000.00
2012 and thereafter		13,295,000.00
	$	14,465,000.00

NOTE 8 - 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	
Operating Revenues:						
Student Tuition and Fees	$ 19,772,043.79	$ 0.00	$ 4,230,640.66	$ 842,679.27	$ 14,698,723.86	
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	$ 3,264,176.81	$ 0.00	$ 698,438.63	$ 0.00	$ 2,565,738.18	(A)
Dining	2,221,709.18		475,380.96		1,746,328.22	(B)
Bookstore	225,102.01				225,102.01	
Other	1,620,529.44	569,232.44	346,746.03		704,550.97	
Sales and Services of Education and Related Activities	95,678.83				95,678.83	
Total Sales and Services	$ 7,427,196.27	$ 569,232.44	$ 1,520,565.62	$ 0.00	$ 5,337,398.21	

Revenue Bonds Secured by Pledged Revenues:
(A) Housing and Student Center System
(B) Dining System Facility Fee Revenue Bonds

NOTE 9 - 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	$ 26,592,601.00	$ 1,108,175.86	$ 1,330,614.98	$ 18,100.00	$ 0.00	$ 0.00	$ 29,049,491.84
Research	605,128.81	172,307.48	405,687.90	6,860.00			1,189,984.19
Public Service	2,045,186.20	159,127.29	980,747.34	37,625.00			3,222,685.83
Academic Support	4,653,639.13	2,491,364.98	1,815,906.50				8,960,910.61
Student Services	2,601,023.21	264,686.19	656,828.04				3,522,537.44
Institutional Support	4,840,857.58	1,346,670.61	3,399,040.41	186,650.25			9,773,218.85
Operations and Maintenance of Plant	4,171,834.50	3,974,994.93	1,223,370.45		1,608,871.39		10,979,071.27
Student Financial Aid	293,441.68	9,813.64	23,342.12	6,704,446.48			7,031,043.92
Auxiliary Enterprises	2,862,202.73	1,332,133.29	5,383,222.41	446,723.00	641,778.79		10,666,060.22
Depreciation						2,512,522.57	2,512,522.57
Total Operating Expenses	$ 48,665,914.84	$ 10,859,274.27	$ 15,218,760.15	$ 7,400,404.73	$ 2,250,650.18	$ 2,512,522.57	$ 86,907,526.74

NOTE 10 - 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 $40,173,400.05, of which $24,290,291.70 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $1,457,417.50 and $568,392.83, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were $568,392.83, $512,004.87, and $51,436.28, 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

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 $40,173,400.05, of which $11,060,687.62 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were $663,641.26 and $756,551.03, 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 the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to $129,042.00 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 $27,889.39. The voluntary contributions by employees amounted to $136,676.00 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 $518,297.18 for the year ended June 30, 2006.

NOTE 11 - 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

$1,343,337.21. 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 $183,825.09. 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 12 - 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 deductible. The University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, and "all risks" for all 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 Intercollegiate Sports Accident Insurance from a private insurance company through the North Carolina Department of Insurance. This policy covers medical expenses incurred for the treatment of injury to covered persons.

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.

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.

NOTE 13 - 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 $6,459,778.85 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	$ 13,124,597.36

NOTE 14 - SUBSEQUENT EVENT

On August 14, 2006, the University entered into a five-year operating lease agreement with the Fayetteville State University Housing Foundation, LLC. The University will lease 190 beds in the fall and spring semesters in order to expand the on-campus living space for students. The lease was later amended to for an additional 151 beds. The University is obligated to pay $1,590 per bed, per semester.

On September 20, 2007, the University entered into a capital lease agreement in order to purchase turf for the football field. Principal and interest payments will begin in January 2008 and continue for seven years. Total payments will be $842,511.60.

STATE OF NORTH CAROLINA
Office of the State Auditor

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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
Fayetteville State University
Fayetteville, North Carolina

We have audited the financial statements of Fayetteville State University, 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 unit, 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 November 5, 2007. We did not audit the financial statements of the Fayetteville State University Foundation, Inc., and Subsidiary, the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the discretely presented component unit, is based on the report of the other auditor.

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. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards,* and accordingly, this report does not extend to the discretely presented component unit.

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 opinion 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 Recommendations section of this report.

Finding

1. Procedures to Implement New Accounting System Deficient
2. Financial Statements and Notes Required Significant Corrections
3. Information System Access Rights Inconsistent with Job Duties
4. Inadequate Bank Reconciliations
5. Inadequate Management Response to Audit Findings and Consultant Recommendations
6. Unauthorized Purchases of Goods and Services
7. University Students Not Billed in Timely Manner
8. Monitoring of Cash Collected Outside of Main Cashiering Office is Inadequate
9. Students Paid Financial Aid Refunds Twice
10. Inappropriate Information System Access Rights to Financial Aid Data
11. Errors in University's Calculations of Students' Need for Financial Aid
12. Weak Internal Controls Over Federal Awards
13. Errors in Eligibility Determinations
14. Weak Internal Controls Over University Verification of Students' Eligibility
15. Federal Aid Recipients Not Meeting Satisfactory Academic Progress
16. University Not in Compliance with Federal Regulations Regarding Reconciliations

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, of the reportable conditions described above, we consider Findings 1, 2, 3, and 4 to be material weaknesses.

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)

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, which are reported in the Audit Findings and Recommendations section of this report, disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Finding

7. University Students Not Billed In Timely Manner
11. Errors in University's Calculations of Students' Need for Financial Aid
13. Errors in Eligibility Determinations
14. Weak Internal Controls Over University Verification of Students' Eligibility
15. Federal Aid Recipients Not Meeting Satisfactory Academic Progress
16. University Not in Compliance with Federal Regulations Regarding Reconciliations
17. Management Eliminated Students' Debt Owed to University

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

November 5, 2007

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AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements or other matters. Finding numbers 3 and 6 were also reported in the prior year.

1. PROCEDURES TO IMPLEMENT NEW ACCOUNTING SYSTEM DEFICIENT

   The University did not adequately assess and respond to risks associated with implementing its new accounting system. As a result, numerous errors appeared in the University's accounting records, as well as in the statewide accounting system. Furthermore, management was hesitant to disclose these problems to auditors, which is an indication of a poor control environment.

   At the time the new system was implemented, the University had not set up its chart of accounts to properly transmit data to the State's accounting system. Consequently, not all transactions were posted to the State system. The University did not reconcile its records to the State system regularly, which resulted in the situation going undetected for four months. In an attempt to correct the problems, adjusting journal entries, some of which were hundreds of lines long, were prepared by many different employees. The adjustments were often erroneous, which meant entries to correct the corrections were required. As many as seven attempts were made in some cases before one journal entry was posted correctly. Supporting documentation was not maintained to explain most of the entries.

   The University also made errors in setting up the accounting rules within the system. The accounting rules cause predetermined accounts to be automatically updated for particular transactions; however, management did not properly identify the accounts. This resulted in the need for even more correcting journal entries, which also did not have supporting documentation to help ensure their propriety.

   Management did not mention these problems or the University's attempts to correct them in response to our initial inquiries. Instead, management indicated that there were no areas of concern.

   Implementing a new accounting system presents significant risks to the accounting and financial reporting process. Management is responsible for identifying and assessing these risks and then developing plans, programs, or actions to address them.

   Recommendation: University management should improve the control environment by stressing the importance of internal control procedures and the accounting and financial reporting objectives, as well as the need for open discourse with auditors. Accounting functions should be assigned to staff with adequate experience and expertise, and sufficient resources should be dedicated to these functions. Whenever significant changes occur, such as the implementation of new information systems, management must realize that additional controls may be required to ensure that the change does not adversely affect University objectives. Adjusting journal entries are often risky, and thus should be clearly supported by documentation and should be subjected to thorough review.

University Response: FSU acknowledges the shortcomings associated with the implementation of the Banner System without adequately training the staff and testing the system. New staff members have been hired and training is continuing for all staff, including utilization of SCT training hours. The university has also hired new technical support to continue the on-going training and implementation of the system.

2. FINANCIAL STATEMENTS AND NOTES REQUIRED SIGNIFICANT CORRECTIONS

The University's financial statements and notes presented for audit contained significant errors. Had the financial statements and notes not been corrected as a result of our audit, they could have been misleading to users.

Included in the errors were the following:

a. Cash was understated by $831,825. The University reported the wrong cash balance at June 30, 2006, because they did not reconcile the bank accounts to the accounting records for the entire audit period and did not know the correct cash balance at the end of the fiscal year.

b. Accounts Payable and Services expense were understated by $657,926. The University did not record all expenses that were payable at June 30, 2006.

c. Student Tuition and Fees revenue was understated by $2,224,826. The misstatement was the result of erroneous adjusting journal entries.

d. Sales and Services revenue was overstated by $1,456,424. The overstatement was the result of recording cash collected and held on behalf of students as University revenue, misclassification of revenue, and duplicate recording of revenue.

e. Services expense was overstated by $794,110 because the University recorded expenses paid from funds held on behalf of students as University expense.

f. Supplies and Materials expense was understated by $1,081,898. The University erroneously reduced Student Tuition and Fees revenue and Cash for transactions that should have increased Supplies and Materials expense.

g. Intergovernmental Receivables were understated and Unearned Revenue was understated by $467,609. The University misclassified transactions between these asset and liability accounts.

Management is responsible for the fair presentation of its financial statements and notes in accordance with accounting principles generally accepted in the United States of America and the policies of the Office of the State Controller. To meet this responsibility, management must establish and maintain internal controls over financial reporting to detect and correct material misstatements in a timely manner.

Recommendation: The University should strengthen the review of the financial statements to ensure that misstatements and presentation errors are corrected prior to submission of the statements and notes to the Office of the State Controller and the Office of the State Auditor.

University Response: The Banner system implementation problems identified in the first finding contributed to many of the errors made in the financial statements for the 2006 fiscal year. Procedures and reports have now been developed and tested to aid in accurate financial statement preparation. FSU is also working to train current staff for the financial statement preparation, rather than relying on consultants to complete reporting requirements. The new employees in the Business and Finance Division are making sure that financial statements and information submitted to the Office of the State Controller, The University of North Carolina General Administration, and other external agencies are properly reviewed for accuracy before submission. Staff will work to ensure that financial statements are presented without material misstatements or material presentation errors.

3. INFORMATION SYSTEM ACCESS RIGHTS INCONSISTENT WITH JOB DUTIES

As previously reported, the University did not have adequate procedures in place to ensure that employees only had information systems access rights necessary to perform their jobs. This could result in unauthorized or inappropriate transactions.

Inappropriate access rights included the following:

a. The University's Vice Chancellor for Business and Finance, Associate Vice Chancellor for Business and Finance, and Controller are responsible for approving system transactions that have been entered by their subordinates. These employees had unlimited system access rights to the entire purchasing and payment process. They could create vendors, create requisitions, create and modify purchase orders, indicate the receipt of purchased goods, create returns of goods, enter invoices, and print checks. In addition, they could add and delete assets from the equipment inventory, change departmental budgets, enter and update grant information, and enter charges and payments on students' accounts. These employees were also allowed to create journal entries and approve them.

b. The Systems Accountant had the same access rights as the Vice Chancellor for Business and Finance, Associate Vice Chancellor for Business and Finance, and Controller. In addition, this employee had the ability to set user restrictions in the system.

c. The Director of Information Technology Operations had the same access rights as the Vice Chancellor for Business and Finance, Associate Vice Chancellor for Business and Finance, and Controller. In addition, this employee could update admission decisions and register students for classes. This is not a Business and Finance Office position.

d. The Director of Purchasing was responsible for approving purchase orders. This employee had the system access rights to initiate the purchases that the employee was also responsible for approving. This employee could create vendors, create requisitions, and create and modify purchase orders. This employee was also allowed to create journal entries and approve them.

e. The Director of Financial Reporting was responsible for approving the asset additions and deletions made in the system by the Fixed Asset Coordinator. The Director of Financial Reporting had the same system access rights as the Fixed Asset Coordinator, which would enable this employee to add or delete assets and it not be detected. This employee was also allowed to create journal entries and approve them.

f. Some employees in the Information Technology Department had unnecessary access rights to student information. They could enter student applications, update admissions decisions, and register students for classes. One employee could also update tuition and fee rates.

g. The University had 34 employees who were allowed to create journal entries. Of the 34 employees, nine could also approve journal entries. Nothing would prevent these nine employees from approving the journal entries they created. The system was not set up where journal entries were sent to specific managers for approval. All journal entries went to the same system location for approval and anyone with approval authority could post the entry. This could result in employees approving transactions that did not fall within their job responsibilities.

h. The University had 19 system user accounts that were not assigned to a particular employee. System transactions performed under any of these user accounts could not be linked to a system user.

i. Five employees who resigned from the University in the prior fiscal year still had active system user accounts.

Segregation of duties is a basic internal control that requires assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. This would reduce the opportunities for 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 system access rights to ensure that employees are assigned the least amount of system access necessary to perform their jobs and that adequate segregation of duties is maintained in employees' access to the system. System access rights should be reviewed on a regular basis.

University Response: System access rights were not tested and limited prior to the new accounting system implementation. Many users still have both group access and individual access. FSU agrees that user access should be reviewed periodically. Currently the user access is under review and authorized access for each position is under review. In establishing the protocol for user access by position, care will be taken to avoid allowing access that could result in the possibility or opportunity for misuse or fraud. Once the protocol is established, the access rights will be reviewed on a regular basis by the Associate Vice Chancellor and the Director of Systems and Procedures with recommendations for changes to the Vice Chancellor as appropriate.

4. INADEQUATE BANK RECONCILIATIONS

The University did not perform monthly cash reconciliations between the University's bank statements and the accounting records. As a result, the University understated their June 30, 2006, cash balance by $831,825 and significantly increased their risk for error or fraud.

At June 30, 2006, the University had unresolved problems in their accounting records and was unable to reconcile their records to their bank statements. Management accumulated information, which included deposits that had been made and checks that had been written, in an attempt to estimate their June 30, 2006, cash balance. They compared their estimated cash balance to the amount that was recorded in their accounting records and determined that the balance in their accounting records exceeded their estimate by $1,906,115. Rather than obtaining resolution for the large difference, they posted a journal entry to reduce the cash balance in their accounting records by $1,906,115. Months later, when management was finally able to reconcile their accounting records to their bank statements, they realized that their estimated cash balance calculation was understated by $831,825.

Fundamental internal controls require the reconciliation between accounting records and bank accounts on a monthly basis.

Recommendation: The University should reconcile their bank accounts on a monthly basis. Differences should be resolved timely.

University Response: The University agrees bank statements should be reconciled and differences resolved timely. Many reports were not developed on the new accounting system to allow for timely reconciliations prior to the "go-live" date. The reports needed to prepare bank reconciliations are now available in the new system and reconciliations are prepared timely.

5. INADEQUATE MANAGEMENT RESPONSE TO AUDIT FINDINGS AND CONSULTANT RECOMMENDATIONS

The University repeatedly has audit findings in the areas of cash disbursements and information system access rights. In addition, Management pays consultants to review operations in departments where there is need for improvements and then does not respond to the recommendations made by consultants.

The University has had an information system access rights finding reported for three consecutive years and a cash disbursements finding reported for two consecutive years. Each time these findings have been reported in prior years, management has told auditors that the findings have been resolved.

We obtained documentation of procedures performed by consultants to review the operations of one of the University's departments. The consultants wrote an initial report, which included recommendations, and two additional reports after they followed up on the University's progress. There were unresolved issues still pending two years after the initial report.

Sound internal controls require that management promptly resolve problems identified in audits and other reviews.

Recommendation: Management should promptly evaluate, respond, and take corrective action to resolve audit findings and problems identified in other reviews.

University Response: Current staff and management are dedicated to resolving problems identified in audits and other reviews. Full attention will be given to issues identified by auditors and corrective action will be taken so that future audits do not identify repeat deficiencies. The University will also review recommendations from consultants and will implement those that are cost effective and efficient.

6. UNAUTHORIZED PURCHASES OF GOODS AND SERVICES

As previously reported, we noted deficiencies in internal control procedures over cash disbursements. Purchase orders were created after services were performed or after supplies and materials were received. Failure to obtain authorization for purchases could result in misappropriation of assets and budget overruns.

We reviewed 46 payments for services. In five instances, or 10.9% of the payments reviewed, purchase orders were created after services were provided. We reviewed 77 payments for supplies and materials. In seven instances, or 9.1% of the payments reviewed, purchase orders were created after supplies and materials were received.

Authorization of transactions is a basic internal control. This reduces the potential for misappropriation of assets and budget overruns.

Recommendation: University Management should enforce its written policies and procedures, which require authorization for purchases.

University Response: FSU agrees with the recommendation to follow the written guidelines for purchase of goods and services. Currently, those written guidelines are under review for possible changes. While FSU will continue to abide by State Guidelines, our threshold for creating an official purchase order will be raised to a more appropriate level.

7. UNIVERSITY STUDENTS NOT BILLED IN TIMELY MANNER

The University did not bill students for Fall 2005 semester and Spring 2006 semester charges in a timely manner and continued to allow students with unpaid charges to register for subsequent semesters. Required collection efforts were not made on student accounts. The University is in violation of General Statues, the Statewide accounts receivable policy, and their own cash management policy. By billing students late, the University more than doubled its unpaid charges at June 30, 2006, as compared to the prior year.

Management did not bill students for Fall 2005 semester charges until December 2005. The first bills for Spring 2006 semester charges were not mailed until February 2006. We reviewed collection efforts on 25 student accounts that were unpaid at June 30, 2006. One year later, nine of the accounts still had not been turned over to the Attorney General for collection.

Statewide policy dictates that student accounts are due at the time of registration and must be paid in full by the close of the semester or be considered delinquent. The University must turn over delinquent accounts to the Attorney General for collection. Students with unpaid charges cannot register for subsequent semesters until their account is either paid in full or an approved payment plan has been established.

Recommendation: The University should comply with General Statutes, the Statewide policy for student accounts, and their cash management policy.

University Response: FSU agrees and will comply with the standards set forth in the auditor recommendation. Procedural changes were made in the spring of 2006 and tightened in the fall of 2006 to prevent students from registering for future terms if they have a significant outstanding balance. Due diligence in collecting outstanding balances is underway as described in the University Cash Management Plan.

8. MONITORING OF CASH COLLECTED OUTSIDE OF MAIN CASHIERING OFFICE IS INADEQUATE

Cash collected outside of the University's main cashiering office was not adequately monitored. Management did not ensure that cash collected was submitted to the

University's main cashiers in a timely manner or that all of the cash collected was turned in. As a result, the University significantly increased its risk for error or fraud.

The University's student purchasing cards are called Bronco One cards. Students pay for a variety of services on campus using their Bronco One cards. University employees in the Bronco One Card Office collect cash from students on a daily basis and are responsible for updating students' Bronco One accounts for the funds collected. In the 2006 fiscal year, Bronco One Card Office employees only sporadically submitted cash collections to the University's main cashier's office for deposit in the University's account. No reconciliation was prepared between the amount of cash collected and credited to students' Bronco One accounts and the amount of cash submitted by the Bronco One Card Office for deposit.

Sound internal controls require a reconciliation between cash collected and credited to students' accounts and cash submitted to the main cashiering office for deposit.

Recommendation: Cash collected in the Bronco One Card Office should be submitted to the main cashiering office for deposit on a daily basis. A reconcilation between cash collected and credited to students' accounts and cash submitted to the main cashiering office for deposit should be prepared regularly. This reconcilation should be reviewed and approved by someone outside of the Bronco One Card Office.

University Response: FSU agrees cash should be submitted to the main cashiering office, reconciled and deposited in accordance with the cash management plan. Procedures are being implemented to ensure accurate and timely reconciliation of cash collected and deposited on the Bronco Card account with cash deposited in the main cashiering office. Cashiers will verify the reconciliation at the time of deposit.

9. STUDENTS PAID FINANCIAL AID REFUNDS TWICE

Some of the University's students were paid their financial aid refunds twice. The University overpaid 430 students a total of $163,577.

Students whose financial aid awards exceed their University charges receive a refund of the excess award. These students were given the option of receiving a cash refund or transferring the excess awards to their Bronco One card. Bronco One cards are student purchasing cards that can be used on campus to pay for a variety of services. In 430 instances, the University credited the excess awards to the students' Bronco One cards but failed to record the transfer in the student accounts system. These students received a check for the excess awards and a credit for the same amount on their Bronco One cards.

Sound internal controls require that procedures be in place to ensure that students' account balances are accurate and that students are not overpaid.

Recommendation: The University should implement procedures to ensure that students' account balances are correct and that students are not overpaid. Collection procedures should be followed on these accounts.

University Response: Procedures have now been implemented to reconcile the transfers to the Bronco card to the refunds posted to the Banner student system prior to releasing any additional refunds to a student. Efforts are underway to identify all overpayments to students and apply these amounts to the student accounts. Collection procedures will be followed on these and all student accounts.

10. INAPPROPRIATE INFORMATION SYSTEM ACCESS RIGHTS TO FINANCIAL AID DATA

The University adminstered information system access rights inconsistent with adequate internal controls over financial aid data.

Access rights granted to the financial aid system did not maintain proper segregation of duties for financial aid councelors, administration personnel, and management. All employees in the financial aid department were granted the same access rights to the financial aid system. Sound internal controls require limitations of 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.

Financial aid employees were granted access rights to modify financial aid data different from the access rights documented in a University report as appropriate. The University prepared a matrix defining the approved access rights for the financial aid system by positions. The actual access rights granted to the system did not agree with the matrix.

Default user ids setup when the system was implemented are still active and used by individuals. There is no documentation indicating the individuals using these ids. These default ids have total access to the system and provide the individuals using the ids access rights above what the individual may actually need to perform their job duties.

Three employees who either resigned from the University or transferred out of the financial aid department did not have their user ids removed from the financial aid system in a timely manner as indictated by the existing University policy.

Access rights to modify financial aid data were granted to three individuals who did not work in the financial aid department. These individuals include a consultant employed by the University, an information systems employee working in a support capacity to the financial aid department, and an associate vice chancellor. The ability to modify data should only be provided to employees in the financial aid department whose job responsibilities require the entry and modification of data. Consultants and other support personnel should provide financial aid department employees the correct entry to be made but allow the department's employee to actually enter or correct the data.

Employees were assigned access rights to update screens for the financial aid system through both individual and group level privileges. This makes it more difficult to administer and monitor access rights to the financial aid data. An employee's access may be removed by deleting the employee's user id from the group level but the employee may still have access through individual level privileges if not detected.

Employees had the ability to turn off the information system's audit trail. Financial aid department employees had access to the screen which turns on and off audit trails for certain tables.

Access rights were not reviewed on a regular basis. The security administrator grants access to the system in accordance with the approval and request of the financial aid department director and security manager. Best practices recommend data owners review on a regular basis the actual access rights granted by the system administrators.

Recommendation: The University should limit access rights to the financial aid data to ensure employees are assigned the least level of access necessary to perform their jobs and that adequate segregation of duties is maintained in employees' access to the system. Access to the financial aid system should be granted in accordance to the access rights approved by positions and documented in the access rights matrix report. System access rights should be reviewed on a regular basis. User ids should be assigned to individuals and access rights for the id based on the individual's job duties. If an individual needs special access only occasionally those rights should be given to their user ids as needed and then removed when no longer required or a separate user id be given to the individual with the required access rights and the use of the special id monitored. System access rights should be revoked and the user id removed from the financial aid system in a timely manner in accordance with written policies and procedures for employees leaving the University or transferring from the department. With the exception of extraordinary circumstances which require temporary system access rights, consultants and information systems employees should not have the ability to modify financial aid data. If access is granted temporarily, all activity should be reviewed and approved by the data owner. In most circumstances, a vice chancellor does not need access to modify financial aid data. Employees should not be granted access rights to the financial aid data through both group and individual level privilege. Access rights should only be granted through the group level privilege. Employees should not be able to access the screen to turn off or on audit trails. This authority should be limited to the security managers and security administrator. The financial aid department's security manager should review all activities performed by the security administrator to ensure activities are in accordance with the department's requests. As data owner, the director should review actual access rights for the financial aid system on a regular basis but at least yearly. This review should be documented.

(Award #s A053097, P050322, K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: Once this concern was brought to our attention, the University took immediate corrective action. The University has limited access rights to the financial aid data. All employee access rights were reviewed and inconsistent rights were removed. Access to the screen to turn on and off the audit trails was removed from all employees except the security manager and security administrator. The security manager reviews all activities performed by the security administrator to ensure activities are in accordance with the department's requests. The Financial Aid Director reviews and documents the access rights for the financial aid system. The Banner Security policy issued by ITTS was revised to ensure access rights are properly assigned to positions and removed when an employee leaves the University or transfers to another department.

11. ERRORS IN UNIVERSITY'S CALCULATIONS OF STUDENTS' NEED FOR FINANCIAL AID

The University was inconsistent in its calculation of undergraduate students' need for financial aid. A student's need for financial aid is calculated as the difference between the cost to attend the University and the amount the student is considered able to pay toward their education. The University determines the cost component of the need calculation. Federal regulations require that the University either set standard cost budgets for groups of similar students or calculate cost for each individual financial aid applicant. The goal of the regulation is to allow equitable treatment of all students in the amount and type of financial aid awarded. Auditors reviewed the cost budgets derived by the University for each group of undergraduate students. Undergraduate students are grouped based on enrollment (full-time, three quarter time, half time), residency (in-State, out-of-State), and housing (on campus, off campus, at home) status. The following represent inconsistencies in various components of the University's cost budgets used to calculate need for undergraduate students. These inconsistencies resulted in inequitable treatment of groups of similar students in the amount of direct loans awarded and in the type of direct loans awarded (government subsidized or unsubsidized).

- Tuition and fees budgets were $1,682 more for a resident student registered at three-quarter time status living on-campus than for the same category of students living off-campus and at home.
- Tuition and fees budgets were $8,092 more for a non-resident student registered at three-quarter time status living on-campus and off-campus than for the same category of students living at home.
- Tuition and fees budgets were $2,354 more for a resident student registered at half-time time status living on-campus than for the same category of students living off-campus and at home.
- Tuition and fees budgets were $11,120 more for a non-resident student registered at half-time status living on-campus and off-campus than for the same category of students living at home.

- Room and board budgets for all students living on-campus and off-campus were $2,060 higher than resident students registered at three-quarter time status living off-campus and $2,210 higher than resident students registered at half-time status living off-campus. Resident students registered at three-quarter time status and half-time status living at home were not affected by the error.
- Transportation budgets for all non-resident students who lived on campus were $140 less than transportation budgets for all other students, including resident students who lived on campus.

The University had 480 students in the fall and 568 students in the spring whose financial aid need was based on University calculated cost budgets that were created using the inconsistent figures noted above. Likely questioned costs are estimated to exceed $10,000.

The Federal Student Aid Handbook states that when calculating cost of attendance, a University can have standard costs for different categories of students. If a University establishes standard cost categories, they must apply the cost allowances uniformly to all students in those categories.

Recommendation: The University should implement controls to ensure the accuracy of the calculation of students' need.

(Award # K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: Effective 2006-2007, the University established a Cost of Attendance policy of standard costs categories such as tuition and fees, loan fees, room and board, books and supplies, transportation and miscellaneous fees to ensure the accuracy of the calculation of students' need.

12. WEAK INTERNAL CONTROLS OVER FEDERAL AWARDS

Internal controls over financial aid awards and student accounts were insufficient to prevent errors and misappropriation of assets. A financial aid counselor was responsible for awarding federal funds and disbursing the funds to students' accounts. This is a violation of basic internal controls that are required to provide adequate segregation of duties.

The Code of Federal Regulations states that the University must divide the functions of authorizing payments and disbursing or delivering funds.

Recommendation: The University should implement internal controls that require the segregation of duties between the financial aid department and the business and finance department for awarding federal funds and for disbursing those awards to students' accounts.

(Award #s A053097, P050322, K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: The University implemented internal controls to ensure segregation of duties for awarding and disbursing federal funds to students' accounts. Effective July 1, 2006, the University revised its procedures for processing and disbursing student aid. The Office of Financial Aid performs verification and awards aid to eligible students. The Division of Business and Finance disburses awards to student accounts.

13. ERRORS IN ELIGIBILITY DETERMINATIONS

The University miscalculated federal awards for direct loan recipients. Auditors selected a sample of 81 students to test for eligibility. One direct loan recipient was overawarded $461. Likely questioned costs are estimated to exceed $10,000.

In the auditor's sample of 81 students tested for eligibility, two student files included Institutional Student Information Records that were flagged by the Department of Education when ran against data base edit checks. One student had a student loan in active bankruptcy warning and one student had an excess student loan warning. The University was required to resolve the warnings prior to awarding the funds. The University was able to show auditors that these issues had been resolved by referring to the National Student Loan Data System, but no documentation was included in the students' files to indicate that resolution was obtained by the University for the warnings prior to the disbursement of awards. Loan awards associated with these two students totaled $19,838; therefore, we question the amount.

Federal regulations set rules governing the amount of financial aid awards that can be disbursed. Awards cannot be disbursed to students prior to resolving eligibility flags documented by the Department of Education.

Recommendation: The University's financial aid counselors should be trained to calculate financial aid awards accurately. A management review process should be in place to ensure the accuracy of award calculations and appropriate University response to items flagged by the Department of Education that require resolution prior to the disbursement of awards.

(Award # K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: Effective 2006-07, the financial aid counselors have had extensive training on verification, resolving eligibility flags, conflicting information and calculating financial aid awards. Additionally, a verification policy was established to include procedures for resolving verification issues, eligibility flags, and any other conflicting information. A management review process was implemented to ensure the accuracy of award calculations and items flagged by the Department of Education.

14. WEAK INTERNAL CONTROLS OVER UNIVERSITY VERIFICATION OF STUDENTS' ELIGIBILITY

Student files are randomly flagged by the Department of Education for verification of information submitted by students to the University that is used in the determination of federal awards eligibility. Thirty-six students in the auditor's sample of 81 students tested for eligibility requirements were flagged for verification. In one of the 36 cases, there was no documentation in the student's file that verification had been performed by the University. In two of the 36 cases, verification documents were included in the students' files, but inconsistent data was indicated within the documents related to items that federal regulations require to be verifed by the University. Federal financial aid awards associated with these three students total $28,925. We question these costs.

Federal regulations require the University to establish written policies and procedures that incorporate the provisions of the Code of Federal Regulations for verifying applicant data. The University did not have written policies and procedures in place during the audit period.

Recommendation: The University should have written policies and procedures in place that incorporate the provisions of the Code of Federal Regulations for verifying applicant data. Applicant data selected for verification should be verified in accordance with the University's written policies and procedures.

(Award #s A053097, P050322, K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: Effective 2006-07, a verification policy was established. This written policy and procedures incorporate the provisions of the Code of Federal Regulations which includes verifying adjusted gross income, U.S. income tax paid, household size and any additional untaxed income. Applicant data selected for verification is verified in accordance with the policy.

15. FEDERAL AID RECIPIENTS NOT MEETING SATISFACTORY ACADEMIC PROGRESS

Students received federal awards while not meeting the University's satisfactory academic progress requirements. Eleven students in the auditor's sample of 81 students tested for eligibility requirements did not meet the satisfactory academic progress standards published by the University. In five of the 11 cases, the University provided auditors with documentation of the students' academic appeals process, which supported the appeals committee's decision to continue awarding financial aid. In the other six cases, the University provided auditors with letters stating that the students could continue to receive aid but did not provide documentation of the students' academic appeals process. Federal awards made to these five students totaled $70,149. According to the University's policy for satisfactory academic progress, students whose financial aid eligibilty has been cancelled must appeal in writing. We question these associated costs.

Federal regulations State that students must maintain satisfactory academic progress in their course of study according to the University's published standards of satisfactory academic progress.

Recommendation: The University should maintain records that support students' academic appeals that subsequently result in a decision to continue awarding federal aid to students not meeting the University's satisfactory academic progress requirements.

(Award #s A053097, P050322, K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: The University revised its academic appeals policy to ensure all supporting documentations are maintained in the Academic Advising Center. The revised policy will be implemented May, 2007 for the 2007-2008 academic year. In addition, all approved reinstatements will be sent to the Office of Financial Aid to be placed in the students' files. Additionally, all current appeals for the 2006-2007 academic year will be forwarded to the Office of Financial Aid to be filed.

16. UNIVERSITY NOT IN COMPLIANCE WITH FEDERAL REGULATIONS REGARDING RECONCILIATIONS

The University did not reconcile their Direct Loan School Account Statement (SAS) to the University's financial records during the audit period. The University must report all loan disbursements to the Direct Loan Servicing System within 30 days of disbursement. Each month, the University receives a SAS data file which consists of a Cash Summary and Cash Detail report from the Direct Loan Serving System. The University is required to reconcile these files to their financial records. Auditors compared direct loan disbursements per the Direct Loan SAS Year-to-Date Cash Summary from the Department of Education to direct loan disbursements per the University's records and noted unreconciled differences greater than $10,000.

Federal regulations require the University to reconcile their Direct Loan School Account Statement to the University's records each month.

Recommendation: The University should implement internal controls that include a timely reconciliation of the University's financial records and the Direct Loan System records to ensure compliance with Federal regulations and accurate financial reporting.

(Award # K060322 – Award year 7/1/2005 – 6/30/2006)

University Response: Based on the Code of Federal Regulations, the University has implemented internal controls to ensure compliance and accurate financial reporting. The University has developed a written reconciliation policy and procedure for federal funding to ensure monthly reconciliations are performed and documented between the Financial Aid and Business Offices. The University is reviewing and reconciling federal awards.

Matter Not Related to Financial Reporting or Federal Compliance Objectives

The following finding was identified during the current audit and describes a condition that represents a significant deficiency in the management control processes for a matter not directly related to financial reporting or federal compliance objectives.

17. MANAGEMENT ELIMINATED STUDENTS' DEBT OWED TO UNIVERSITY

The University implemented a student "Debt Forgiveness Program" in the 2006 fiscal year that had no systematic basis for debt write-offs. There were no student eligibility criteria established for the program, and the University's student population was not notified when the program was established. Students were selected by management for inclusion in the program rather than allowing students to apply for consideration. This led to inconsistent treatment of University students.

In December 2006, the University credited 100 student accounts a total of $180,255 under the description of "Debt Forgiveness Program." We reviewed seven accounts of students that were part of the Debt Forgiveness Program. In five cases, the debt forgiveness credit was placed on the students' accounts for semesters when the students were not enrolled in classes. There was no attempt to match the credit to specific charges. In four cases, students received refunds from the University within one week of the debt forgiveness credit having been applied to their account. This happened because at the time that the debt forgiveness credit was applied to students' accounts, payments and financial aid for the Spring 2006 semester had already been posted to the account. The University did not reimburse the State for the the Debt Forgiveness Program until June 25, 2007, after auditors made inquires as to how the program was funded.

Good management control requires that the University have clear criteria for the programs that they implement that impact students and that all students are treated equitably.

Recommendation: Management should establish and publish eligibility criteria for any program they implement that impacts students. State funds should never be used to pay for a University initiated debt reduction program.

University Response: This program was an effort to relieve some student debt that arose from the inadequate billings discussed in a previous audit finding. There are no plans to provide similar debt relief to students in the future. However, if programs are established in the future that impact students, management will establish and publish eligibility criteria and will not use state funds, unless they are specifically allocated for that purpose.

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