STATE OF NORTH CAROLINA

MITCHELL COMMUNITY COLLEGE

STATESVILLE, 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

MITCHELL COMMUNITY COLLEGE

STATESVILLE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

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Office of the State Auditor

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

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
http://www.ncauditor.net

AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, Mitchell Community College

We have completed a financial statement and compliance audit of Mitchell Community College 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 College's administration of federal programs in accordance with applicable laws, regulations, contracts and grant disclosed certain deficiencies that are detailed in the Audit Findings and Recommendations section of this report. The College'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

May 18, 2007

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Mitchell Community College
Statesville, North Carolina

We have audited the accompanying basic financial statements of Mitchell Community College, a component unit of the State of North Carolina, as of and for the year ended June 30, 2006, as listed in the table of contents. These financial statements are the responsibility of the College's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of Mitchell Community College Endowment for Excellence, which represent 37.59 percent, 38.14 percent, and 5.53 percent, respectively, of the assets, net assets, and revenues of the College. 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 Mitchell Community College Endowment for Excellence, 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 Mitchell Community College Endowment for Excellence 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 opinion.

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 financial position of Mitchell Community College as of June 30, 2006, and the changes in its financial position and its cash flows 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 April 24, 2007, on our consideration of the College'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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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 supplementary information. However, we did not audit the information and express no opinion on it.

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

April 24, 2007

This discussion and analysis of Mitchell Community College's financial statements provides an overview of the College's financial activities for the year ended June 30, 2006. Please read it in conjunction with the financial statements and notes to the financial statements.

Public colleges and universities are required to include the management's discussion and analysis as part of the financial statements. This section is intended to provide a narrative analysis that users need to interpret the basic financial statements. The discussion and analysis is required to include condensed financial information comparing the current year to the prior year.

Institutional Financial Highlights

Mitchell Community College's State budget allocation increased $340,198.00 or 3.1% over the 2005 State allocation. During the year the North Carolina Community Colleges collected less than anticipated receipts for tuition and fees. As a result, Mitchell Community College had to revert $116,321.00 or 1.1% of its allocated State budget.

Iredell County's financial situation improved considerably from 2005. In addition, the College completed a new 37,000 square foot building in the fall of 2005. As a result, the College was allocated $1,944,638.00 for operational expenses, which represented an additional $166,533.00 or 9.4% over the previous year. In recent years, the College has been receiving increases for operational expenses between two (2) to five (5) percent each year.

County capital allocations also increased from 2005 by $312,073.00 or 63.37%. The increase in the county's capital allocation was primarily due to additional allocations to service the debt of a $6 million local bond referendum for the College that was passed in the fall of 2005.

The College's financial position improved significantly during the fiscal year ended June 30, 2006. Its combined net assets increased $1,433,316.33 or 5.06% from the previous year. The increase was largely due to the completion of a new classroom building, the purchase of equipment and furniture, the purchase of property for the projected growth of the College, and the addition of the College's parking lot of $771,350.21, $223,370.13, $352,660.37 and $298,503.26 respectively. All purchases were from this year's State or county allocations.

The College's full time equivalent (FTE) students decreased by one (1) for the year ended June 30, 2006. Tuition increased to $38.00 from $35.50 per semester hour for in-State students and increased to $211.00 from $197.00 per semester hour for out-of-State students with a maximum charge of $608.00 and $3,376.00 per semester respectively.

Overview of the Financial Statements

Three basic financial statements are included with this report along with management's discussion and analysis. The three basic financial statements include the Statement of Net

Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows, which provide information on the whole operations of the College.

The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets report information on the institution as a whole and on its activities. These statements help the users of this report to analyze the current year's operations to determine if the institution is better or worse off than the prior year. When revenues and other support exceed expenses, the result is an increase in net assets. When expenses exceed revenues and support, the result is a decrease in net assets.

The College's net assets are the difference between assets and liabilities and are one of the measures on the financial health of the institution. Over a period of time, increases or decreases in the College's net assets are one of several indicators that determine if its financial situation is improving or deteriorating. The user will need to take into account other financial and nonfinancial factors to access the complete health of the College. The age and condition of its buildings and grounds are just a couple of the non-financial factors that could have an impact on the total health of the institution.

The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets use the accrual basis of accounting, which is similar to the accounting used by most private-sector institutions. Revenues and expenses of the current year are taken into account regardless when cash is received or paid.

The Statement of Net Assets

Total assets of the College increased $1,387,022.90 from the prior year. This change is primarily due to an increase in capital assets of $1,182,948.60. The increase in capital assets is due to purchases of additional machinery and equipment, completion of several construction projects, and the purchase of additional land and buildings.

Condensed Statement of Net Assets

	6/30/06	6/30/05	Increase (Decrease)
Assets			
Current Assets	$ 3,992,568.82	$ 3,637,437.99	$ 355,130.83
Noncurrent Assets	11,716,438.14	11,867,494.67	(151,056.53)
Capital Assets	15,348,299.56	14,165,350.96	1,182,948.60
Total Assets	31,057,306.52	29,670,283.62	1,387,022.90
Liabilities			
Current Liabilities	942,814.10	1,069,594.70	(126,780.60)
Long-Term Liabilities	372,369.07	291,881.90	80,487.17
Total Liabilities	1,315,183.17	1,361,476.60	(46,293.43)
Net Assets			
Invested in Capital Assets	15,274,620.14	14,011,435.26	1,263,184.88
Restricted	3,254,665.67	13,569,391.17	(10,314,725.50)
Unrestricted	11,212,837.54	727,980.59	10,484,856.95
Total Net Assets	$ 29,742,123.35	$ 28,308,807.02	$ 1,433,316.33

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

Total net assets of the College increased $1,433,316.33 from the prior year. This change was primarily due to increases in sales and services and other nonoperating revenues of $290,396.77, and $907,383.06, respectively. Total revenues decreased $5,033,589.90 from $25,195,535.82 in the prior year to $20,161,945.92 in the current year. This change was primarily a result of the initial inclusion of gifts from the former Mitchell College Foundation, Inc., in the prior fiscal year. The change in net assets restricted and unrestricted is the result of correction of classification of $10,294,619.04 of restricted nonexpendable net assets to unrestricted net assets.

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

	6/30/06	6/30/05	Increase (Decrease)
Operating Revenues			
Student Tuition and Fees, Net	$ 1,713,115.73	$ 1,783,964.75	$ (70,849.02)
Grants and Contracts	2,080,607.77	2,225,995.05	(145,387.28)
Sales and Services, Net	1,107,800.91	817,404.14	290,396.77
Other	1,095.00	875.00	220.00
Total Operating Revenue	4,902,619.41	4,828,238.94	74,380.47
Total Operating Expenses	18,728,629.59	16,750,967.98	1,977,661.61
Operating Loss	(13,826,010.18)	(11,922,729.04)	(1,903,281.14)
Nonoperating Revenues			
State Aid	8,686,625.81	8,516,688.08	169,937.73
County Appropriations	1,944,638.00	1,778,105.00	166,533.00
Other Nonoperating Revenues	2,504,828.17	1,597,445.11	907,383.06
Total Nonoperating Revenues	13,136,091.98	11,892,238.19	1,243,853.79
Loss Before Other Revenue	(689,918.20)	(30,490.85)	(659,427.35)
Capital Contributions	2,090,204.53	2,244,731.20	(154,526.67)
Additions to Endowments	33,030.00	6,230,327.49	(6,197,297.49)
Increase in Net Assets	1,433,316.33	8,444,567.84	(7,011,251.51)
Net Assets Beginning of Year, as Restated	28,308,807.02	19,864,239.18	8,444,567.84
Net Assets End of Year	$ 29,742,123.35	$ 28,308,807.02	$ 1,433,316.33

The most significant change in this Statement is the change in the additions to endowments account. During the 2005 fiscal year Mitchell Community College Endowment for Excellence, Inc. (MCCEE), received approximately $6 million from the former Mitchell College Foundation, Inc. The nonoperating revenues also increased significantly due to gifts from the MCCEE.

Capital Assets

On June 30, 2006, the College's capital assets totaled $15,348,229.56 net of accumulated depreciation of $6,536,216.68. The $1,182,948.60 increase in capital assets was primarily due to increase in construction in progress of $771,350.21, and the purchase of land for $443,028.81.

Capital Assets

	6/30/06	6/30/05	Increase (Decrease)
Capital Assets, Nondepreciable			
Land	$ 1,238,513.55	$ 795,484.74	$ 443,028.81
Construction in Progress	1,229,331.69	5,260,281.51	(4,030,949.82)
Total Capital Assets, Nondepreciable	2,467,845.24	6,055,766.25	(3,587,921.01)
Capital Assets, Depreciable, Net			
Buildings	11,844,486.24	7,451,674.18	4,392,812.06
General Infrastructure	381,597.78	91,409.68	290,188.10
Machinery and Equipment	654,370.30	566,500.85	87,869.45
Total Capital Assets, Depreciable	12,880,454.32	8,109,584.71	4,770,869.61
Total Capital Assets	$ 15,348,299.56	$ 14,165,350.96	$ 1,182,948.60

Economic Factors That Will Affect the Future

The economic position of the College is closely tied to that of the State and to a lesser degree to the county. The College received its 2006-2007 State budget allocation of $11,721,056.00 in July 2006. This represented an increase of $761,285.00 or 6.95% from the previous year. Mitchell Community College, like many other community colleges in the State, experienced a leveling of enrollment growth for the 2005-2006 academic year. The 2006-2007 State allocation reflects this change. Of the total increase in State funding, $593,670.00 is for salary increases and $117,778.00 is for increases in equipment allocations.

Mitchell Community College, unlike the majority of North Carolina Community Colleges, experienced an approximate 12% enrollment increase for the fall 2006. The State will be allocating additional funds to assist the College in meeting the increase in expenses of serving these students.

The North Carolina System of Community Colleges has recommended that all community colleges establish a 2006-2007 reserve of 1.0% for a possible reversion. This reserve request represents $117,210.00 for Mitchell Community College.

The $134,597.00 or 6.9% increase in the county's 2006-2007 operational appropriation was due in a large part to the improving economic condition of the county finances and the completion of the Technology/Workforce Development Center requiring additional operating funds.

Mitchell Community College
Statement of Net Assets
June 30, 2006 — *Exhibit A-1*

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	1,074,861.27
Restricted Cash and Cash Equivalents		1,434,475.55
Short-Term Investments		953,868.64
Restricted Short-Term Investments		26,441.36
Receivables, Net (Note 4)		312,763.63
Inventories		168,800.22
Prepaid Items		21,358.15
Total Current Assets		3,992,568.82
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		438,610.87
Restricted Due from Primary Government		186,699.29
Endowment Investments		973,869.58
Other Long-Term Investments		10,117,258.40
Capital Assets - Nondepreciable (Note 5)		2,467,845.24
Capital Assets - Depreciable, Net (Note 5)		12,880,454.32
Total Noncurrent Assets		27,064,737.70
Total Assets		31,057,306.52
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 6)		684,147.06
Deferred Revenue		76,503.56
Funds Held for Others		60,801.46
Long-Term Liabilities - Current Portion (Note 7)		121,362.02
Total Current Liabilities		942,814.10
Noncurrent Liabilities:		
Long-Term Liabilities (Note 7)		372,369.07
Total Liabilities		1,315,183.17
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		15,274,620.14
Restricted for:		
Nonexpendable:		
Scholarships and Fellowships		975,000.00
Other		51,265.00
Expendable:		
Scholarships and Fellowships		337,448.16
Loans		18,440.69
Capital Projects		1,186,256.84
Other		686,254.98
Unrestricted		11,212,837.54
Total Net Assets	$	29,742,123.35

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

Mitchell Community College
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 9)	$	1,713,115.73
Federal Grants and Contracts		1,902,780.04
State and Local Grants and Contracts		177,827.73
Sales and Services, Net (Note 9)		1,107,800.91
Other Operating Revenues		1,095.00
Total Operating Revenues		4,902,619.41
EXPENSES		
Operating Expenses:		
Personal Services		11,723,823.92
Supplies and Materials		2,339,547.22
Services		2,169,609.18
Scholarships and Fellowships		1,435,122.97
Utilities		537,748.24
Depreciation		522,778.06
Total Operating Expenses		18,728,629.59
Operating Loss		(13,826,010.18)
NONOPERATING REVENUES		
State Aid		8,686,625.81
County Appropriations		1,944,638.00
Noncapital Grants		508,772.13
Noncapital Gifts		1,126,304.41
Investment Income		771,042.67
Other Nonoperating Revenues		98,708.96
Net Nonoperating Revenues		13,136,091.98
Loss Before Other Revenues		(689,918.20)
State Capital Aid		622,472.57
County Capital Appropriations		804,545.00
Capital Grants		580,927.17
Capital Gifts		82,259.79
Additions to Endowments		33,030.00
Increase in Net Assets		1,433,316.33
NET ASSETS		
Net Assets, July 1, 2005 as Restated (Note 15)		28,308,807.02
Net Assets, June 30, 2006	$	29,742,123.35

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

Mitchell Community College
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006 — *Exhibit A-3*

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	5,002,485.38
Payments to Employees and Fringe Benefits		(11,552,059.30)
Payments to Vendors and Suppliers		(5,197,276.54)
Payments for Scholarships and Fellowships		(1,435,122.97)
Other Receipts		120,855.02
Net Cash Used by Operating Activities		(13,061,118.41)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Aid Received		8,686,625.81
County Appropriations		1,944,638.00
Noncapital Grants Received		508,772.13
Noncapital Gifts and Endowments Received		1,153,124.36
Cash Provided by Noncapital Financing Activities		12,293,160.30
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
State Capital Aid Received		884,931.95
County Capital Appropriations		804,545.00
Capital Grants Received		580,927.17
Capital Gifts Received		82,259.79
Proceeds from Sale of Capital Assets		3,958.75
Acquisition and Construction of Capital Assets		(1,815,525.72)
Principal Paid on Capital Debt and Leases		(80,236.28)
Net Cash Provided by Capital and Related Financing Activities		460,860.66
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		843,864.99
Investment Income		311,314.83
Purchase of Investments and Related Fees		(2,188,077.38)
Net Cash Provided by Investing Activities		(1,032,897.56)
Net Decrease in Cash and Cash Equivalents		(1,339,995.01)
Cash and Cash Equivalents, July 1, 2005		4,287,942.70
Cash and Cash Equivalents, June 30, 2006	$	2,947,947.69

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES

Operating Loss	$	(13,826,010.18)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		522,778.06
Provision for Uncollectible Loans and Write-Offs		638.92
Miscellaneous Nonoperating Income		104,151.29
Changes in Assets and Liabilities:		
Receivables, Net		23,422.41
Inventories		(20,875.70)
Prepaid Items		435.96
Accounts Payable and Accrued Liabilities		(98,311.02)
Deferred Revenue		76,443.56
Funds Held for Others		16,703.73
Compensated Absences		139,504.56
Net Cash Used by Operating Activities	$	(13,061,118.41)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	1,074,861.27
Restricted Cash and Cash Equivalents		1,434,475.55
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		438,610.87
Total Cash and Cash Equivalents - June 30, 2006	$	2,947,947.69

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	$	6,210.05
Change in Fair Value of Investments		377,807.30
Increase in Receivables Related to Nonoperating Income		228,724.00
Capital Asset Write-Offs		84,589.96

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

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. Mitchell Community College 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 of the College and its component unit for which the College's Board of Trustees is financially accountable. The College's component unit is blended in the financial statements. The blended component unit, although legally separate, is, in substance, part of the College's operations and therefore, is reported as if it were part of the College.

Blended Component Unit – The Mitchell Community College Endowment for Excellence (Endowment) is governed by a minimum of 25 elected directors. The Endowment's purpose is to aid, support, and promote the educational endeavors of the College. Because the elected directors of the Endowment must first be nominated by the Executive Committee of the Mitchell Community College Board of Trustees and the Endowment's sole purpose is to benefit Mitchell Community College, its financial statements have been blended with those of the College.

Separate financial statements for the Endowment may be obtained from the office of the Vice President for Finance and Administration of the College at 500 West Broad Street, Statesville, NC 28677, or by calling (704) 878-3202. Other related foundations and similar nonprofit corporations for which the College is not financially accountable are not part of the accompanying financial statements.

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 Governmental Accounting Standards Board (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 College'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 College does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

C. **Basis of Accounting –** The financial statements of the College 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. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

D. **Cash and Cash Equivalents –** This classification includes petty cash, cash on deposit with private bank accounts, money market accounts, 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 equity investments, mutual funds, a certificate of deposit, real estate investment trusts, and bonds held by the College. Investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices is not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

The certificate of deposit is reported at cost.

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, are valued at cost using the last invoice cost method. Merchandise for resale is valued using the retail inventory 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 College capitalizes assets that have a value or cost in excess of $5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 40 years for general infrastructure, 10 to 50 years for buildings, and 3 to 15 years for equipment.

I. **Restricted Assets –** Unexpended capital contributions are classified as restricted assets because their use is limited by donor/grantor agreements. 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 capital lease obligations and compensated absences that will not be paid within the next fiscal year.

K. **Compensated Absences –** The College'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 July 1st 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.

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 June 30 is retained by employees and transferred into the next fiscal 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 method.

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

Invested in Capital Assets, Net of Related Debt – This represents the College's total investment in capital assets, net of outstanding debt obligations related to those capital assets.

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 College 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, 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 College.

M. **Scholarship Discounts –** Student tuition and fees revenues and certain other revenues from College 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 College 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 College has recorded a scholarship discount.

N. **Revenue and Expense Recognition –** The College 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 College'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, and (3) certain federal, State and local grants and contracts. 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 aid that represent subsidies or gifts to the College, 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 College departments, as well as to its customers. In addition, the College has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to College departments from the College bookstore 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.

P. County Appropriations – County appropriations are provided to the College primarily to fund its plant operation and maintenance function and to fund construction projects, motor vehicle purchases, and maintenance of equipment. Unexpended county current appropriation and county capital appropriation do not revert and are available for future use by the College.

NOTE 2 - DEPOSITS AND INVESTMENTS

A. Deposits – All funds of the College are deposited in board-designated official depositories and are required to be collateralized in accordance with *North Carolina General Statute* 115D-58.7. Official depositories may be established with any bank or savings and loan association whose principal office is located in North Carolina. Also, the College may establish time deposit accounts, money market accounts, and certificates of deposit. The amount shown on the Statement of Net Assets as cash and cash equivalents includes cash on hand totaling $3,170.00, and deposits in private financial institutions with a carrying value of $1,747,682.20, and a bank balance of $1,798,413.79. The amount shown on the Statement of Net Assets as Endowment Investments includes $50,000.00 in certificates of deposit with private financial institutions.

The North Carolina Administrative Code (20 NCAC 7) requires all depositories to collateralize public deposits in excess of federal depository insurance coverage by using one of two methods, dedicated or pooled. Under the dedicated method, a separate escrow account is established by each depository in the name of each local governmental unit and the responsibility of monitoring collateralization rests with the local unit. Under the pooling method, each depository establishes an escrow account in the name of the State Treasurer to secure all of its public deposits. This method shifts the monitoring responsibility from the local unit to the State Treasurer.

Custodial credit risk is the risk that in the event of a bank failure, the College's deposits may not be returned to it. As of June 30, 2006, the College's bank balance in excess of federal depository insurance coverage was covered under the pooling method.

B. Investments – The College is authorized to invest idle funds as provided by G.S. 115D-58.6. In accordance with this statute, the College and the Board of Trustees manage investments to ensure they can be converted into cash when needed.

Generally, funds belonging to the College may be invested in the form of investments pursuant to G.S. 159-30(c), as follows: a commingled investment pool established and administered by the State Treasurer pursuant to G.S. 147-69.3 (STIF), obligations of or fully guaranteed by the United States; obligations of the State of North Carolina; bonds and notes of any North Carolina local government or public authority; obligations of certain nonguaranteed federal agencies; prime quality commercial paper bearing specified ratings and banker's acceptances; The North Carolina Capital Management Trust, an SEC registered mutual fund; repurchase agreements; and evidences of ownership of, or fractional undivided interests in, future interest and principal payments on either direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity.

At June 30, 2006, the amount shown on the Statement of Net Assets as cash and cash equivalents includes $1,197,095.49, which represents the College'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.

Except as specified by the donor, endowment funds belonging to the College may be invested pursuant to G.S. 147-69.2. This statute authorizes investments for special funds held by the State Treasurer and includes the following investments: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; certificates of deposit of specified institutions; prime quality commercial paper; specified bills of exchange; asset-backed securities, corporate bonds and notes with specified ratings; general obligations of other states; general obligations of North Carolina local governments; certain venture capital limited partnerships; and the obligations or securities of the North Carolina Enterprise Corporation.

Investments of the College's component unit, the Endowment 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.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the College's investments. Interest rate risk is defined by GASB Statement No. 40 as the risk a government may face should interest rate variances affect the fair value of investments. The College does not have a formal investment policy that addresses interest rate risk.

Investments

	Fair Value	Investment Maturities (in Years) 1 to 5	More than 10
Investment Type			
Debt Securities			
U.S. Treasuries	$ 982,456.57	$ 1,000,000.00	$ 2,102.51
Domestic Corporate Bonds	595,495.50	603,505.00	
		$ 1,603,505.00	$ 2,102.51
Other Securities			
Certificate of Deposit	50,000.00		
Real Estate Investment Trust	39,654.55		
Mutual Funds	3,008,885.21		
Domestic Stocks	7,023,445.30		
Foreign Stocks	371,500.85		
Total Investments	$ 12,071,437.98		

Certificates of deposit reported as investments are also a component of the deposit totals reported in the deposits section of this note.

In addition to the interest rate risk disclosed above, the College's investments include investments with fair values highly sensitive to interest rate changes.

Credit Risk: The College does not have a formal policy that addresses credit risk. As of June 30, 2006, the College's investments were rated as follows:

	Fair Value	AAA Aaa	BBB Baa
U.S. Treasuries	$ 982,456.57	X	
Domestic Corporate Bonds	595,495.50		X

Rating Agency: Moody's

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

Investment Type	Held by Counterparty
U.S. Treasuries	$ 982,456.57
Domestic Corporate Bonds	595,495.50
Mutual Funds	3,008,885.21
Domestic Stocks	7,023,445.30
Foreign Stocks	371,500.85
Real Estate Investment Trust	39,654.55
Total	$ 12,021,437.98

Concentration of Credit Risk: The College places no limit on the amount that may be invested in any one issuer. More than 5% of the College's investments are in Government Bonds, Corporate Bonds, and Domestic Stocks. These investments are 8%, 30%, and 58% respectively, of College's investments.

A reconciliation of deposits and investments for the College to the basic financial statements at June 30, 2006, is as follows:

Cash on Hand	$ 3,170.00
Carrying Amount of Deposits with Private Financial Institutions	1,747,682.20
Investments in the Short Term Investment Fund	1,197,095.49
Other Investments	12,071,437.98
Total Deposits and Investments	$ 15,019,385.67
Current:	
Cash and Cash Equivalents	$ 1,074,861.27
Restricted Cash and Cash Equivalents	1,434,475.55
Short-Term Investments	953,868.64
Restricted Short-Term Investments	26,441.36
Noncurrent:	
Restricted Cash and Cash Equivalents	438,610.87
Endowment Investments	973,869.58
Other Long-Term Investments	10,117,258.40
Total	$ 15,019,385.67

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the College'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 College's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the College's endowment funds are based on an adopted spending policy which limits spending to no less than 5% of the endowment principal's market value. If current year earnings do not meet the payout requirements, the College uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 170,393.56	$ 8,467.69	$ 161,925.87
Intergovernmental	28,906.73		28,906.73
Investment Earnings	318.50		318.50
Other	121,612.53		121,612.53
Total Current Receivables	$ 321,231.32	$ 8,467.69	$ 312,763.63
Notes Receivable - Current:			
Institutional Student Loan Programs	$ 1,340.42	$ 1,340.42	$ 0.00

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	$ 795,484.74	$ 443,028.81	$ 0.00	$ 1,238,513.55
Construction in Progress	5,260,281.51	771,350.21	4,802,300.03	1,229,331.69
Total Capital Assets, Nondepreciable	6,055,766.25	1,214,379.02	4,802,300.03	2,467,845.24
Capital Assets, Depreciable:				
Buildings	12,239,055.67	4,781,175.36	3,958.75	17,016,272.28
Machinery and Equipment	1,456,387.22	223,370.13	84,589.96	1,595,167.39
General Infrastructure	506,728.07	298,503.26		805,231.33
Total Capital Assets, Depreciable	14,202,170.96	5,303,048.75	88,548.71	19,416,671.00
Less Accumulated Depreciation:				
Buildings	4,787,381.49	384,404.55		5,171,786.04
Machinery and Equipment	889,886.37	130,058.35	79,147.63	940,797.09
General Infrastructure	415,318.39	8,315.16		423,633.55
Total Accumulated Depreciation	6,092,586.25	522,778.06	79,147.63	6,536,216.68
Total Capital Assets, Depreciable, Net	8,109,584.71	4,780,270.69	9,401.08	12,880,454.32
Capital Assets, Net	$ 14,165,350.96	$ 5,994,649.71	$ 4,811,701.11	$ 15,348,299.56

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	$ 317,143.71
Accrued Payroll	333,420.12
Contract Retainage	29,704.89
Other	3,878.34
Total Accounts Payable and Accrued Liabilities	$ 684,147.06

NOTE 7 - LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities is presented as follows:

	Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Current Portion
Notes Payable	$ 30,000.00	$ 0.00	$ 30,000.00	$ 0.00	$ 0.00
Capital Leases Payable	123,915.70		50,236.28	73,679.42	51,942.24
Compensated Absences	280,547.11	140,943.37	1,438.81	420,051.67	69,419.78
Total Long-Term Liabilities	$ 434,462.81	$ 140,943.37	$ 81,675.09	$ 493,731.09	$ 121,362.02

Additional information regarding capital lease obligations is included in Note 8.

NOTE 8 - CAPITAL LEASE OBLIGATIONS

Capital lease obligations relating to cosmetology, computer and telephone equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2006:

Fiscal Year	Amount
2007	$ 52,977.97
2008	22,260.78
Total Minimum Lease Payments	75,238.75
Amount Representing Interest (2.41076% Rate of Interest)	1,559.33
Present Value of Future Lease Payments	$ 73,679.42

Machinery and equipment acquired under capital lease amounted to $295,002.99 at June 30, 2006.

NOTE 9 - REVENUES

A summary of eliminations and allowances by revenue classification is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees	$ 2,170,643.18	$ 0.00	$ 458,353.26	$ (825.81)	$ 1,713,115.73
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Bookstore	$ 1,056,407.02	$ 7,416.48	$ 271,980.62	$ 1,956.39	$ 775,053.53
Vending	28,797.67				28,797.67
Other	303,949.71				303,949.71
Total Sales and Services	$ 1,389,154.40	$ 7,416.48	$ 271,980.62	$ 1,956.39	$ 1,107,800.91

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Personal Services	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	$ 6,430,528.67	$ 992,857.87	$ 551,659.30	$ 0.00	$ 1,650.00	$ 0.00	$ 7,976,695.84
Academic Support	1,284,147.42	98,263.98	40,881.99				1,423,293.39
Student Services	896,912.00	53,781.41	49,196.28				999,889.69
Institutional Support	2,529,967.55	156,733.90	1,188,600.03	4,400.50	1,879.59		3,881,581.57
Operations and Maintenance of Plant	481,796.14	268,900.31	288,499.12		534,218.65		1,573,414.22
Student Financial Aid			4,894.91	1,430,722.47			1,435,617.38
Auxiliary Enterprises	100,472.14	769,009.75	45,877.55				915,359.44
Depreciation						522,778.06	522,778.06
Total Operating Expenses	$ 11,723,823.92	$ 2,339,547.22	$ 2,169,609.18	$ 1,435,122.97	$ 537,748.24	$ 522,778.06	$ 18,728,629.59

NOTE 11 - PENSION PLANS

A. Retirement Plans – Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System. The Teachers' and State Employees' Retirement System (System) is a cost sharing multiple-employer defined benefit pension plan 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 College had a total payroll of $9,721,077.57, of which $7,561,067.03 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $453,658.19 and $176,928.97, respectively. The College made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were $176,928.97, $157,104.66, and $14,542.19, 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.

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 College. The voluntary contributions by employees amounted to $22,920.21 for the year ended June 30, 2006.

IRC Section 401(k) Plan – All members of the Teachers' and State Employees' Retirement System 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 College. The voluntary contributions by employees amounted to $45,056.00 for the year ended June 30, 2006.

IRC Section 403(b) and 403(b)(7) Plans – Eligible College 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 colleges 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 College. The voluntary contributions by employees amounted to $77,263.02 for the year ended June 30, 2006.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees – The College participates in State-administered programs which 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. 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 College contributed 3.8% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended June 30, 2006, the College's total contribution to the Plan was $287,320.55. The College 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 College 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. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The College contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. For the year ended June 30, 2006, the College's total contribution to the DIPNC was $39,317.55. The College 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 13 - RISK MANAGEMENT

The College 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, and can include 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 premium, based on a composite rate, is paid by the North Carolina Community College System Office directly to the private insurer.

Fire and other property losses are covered by the Public School Insurance Fund, a State-administered public entity risk pool. This fund is financed by premiums and interest and incurs a $10 million self-insured deductible per occurrence. Reinsurance is purchased by the fund to cover catastrophic events in excess of the $10 million deductible. 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.

Liability insurance for other College-owned vehicles is covered by contracts with private insurance companies.

The College is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from State funds. The blanket honesty bond is with a private insurance company and is handled by the North Carolina Department of Insurance with coverage of $5,000,000 per occurrence and a $50,000 deductible. Losses for employees paid from county and institutional funds are covered through a contract with a private company with coverage of $100,000 per occurrence and no deductible.

Employees and retirees are provided health care coverage by the Comprehensive Major Medical Plan (Plan), a component unit of the State. The Plan is funded by employer and employee contributions and is administered by a third-party contractor.

The State Board of Community Colleges makes the necessary arrangements to carry out the provisions of the Workers' Compensation Act which are applicable to employees whose wages are paid in whole or in part from State funds. The College purchases workers' compensation insurance for employees whose salaries or wages are paid by the Board entirely from county or institutional funds.

Term life insurance of $25,000 to $50,000 is provided to eligible workers. This self-insured death benefit program 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 14 - COMMITMENTS AND CONTINGENCIES

The College has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were $1,503,333.44 at June 30, 2006.

NOTE 15 - NET ASSET RESTATEMENT

As of July 1, 2005, net assets as previously reported were restated as follows:

	Amount
July 1, 2005, Net Assets as Previously Reported	$ 28,306,273.27
Restatements:	
Capital Assets Corrections from 2005	3,958.75
2004 Receivable removed in 2006	(1,425.00)
July 1, 2005, Net Assets as Restated	$ 28,308,807.02

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STATE OF NORTH CAROLINA
Office of the State Auditor

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

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
http://www.ncauditor.net

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
Mitchell Community College
Statesville, North Carolina

We have audited the financial statements of Mitchell Community College, a component unit of the State of North Carolina, as of and for the year ended June 30, 2006, and have issued our report thereon dated April 24, 2007. Our report was modified to include a reference to other auditors.

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the College'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 College'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.

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)

Finding

1. Financial Statement Presentation
2. Payment of Salary Supplements with State Funds

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 Finding 1 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the College'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*.

This report is intended solely for the information and use of the Board of Trustees, the State Board of Community Colleges, management of the College, 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

April 24, 2007

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

The following findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control.

1. FINANCIAL STATEMENT PRESENTATION

The June 30, 2006, financial statements and related notes prepared by Mitchell Community College contained numerous misstatements. As a result, the financial statements could be misleading to readers.

During our audit of the June 30, 2006, financial statements, we noted the following misstatements:

- The College misclassified $10,294,619.04 as other nonexpendable net assets when the proper classification was unrestricted net assets. Associated with this misclassification is a misclassification of $10,117,258.40 as endowment investments when the proper classification was other long-term investments. The College also misclassified $170,512.06 as restricted scholarships and fellowships-nonexpendable when the proper classification was restricted scholarships and fellowships-expendable.
- The College inappropriately reported $580,927.17 of capital grants as county capital appropriations, $30,717.09 of other nonoperating revenues as sales and services, and $4,288.40 of State and local grants and contracts as federal grants and contracts.
- The College inappropriately reported $604,445.01 of cash and cash equivalents as investments.
- The College recorded the incorrect value of government securities, resulting in a $39,380.00 overstatement of investments and investment income.
- The College incorrectly recorded retainage payable, resulting in a $10,607.83 overstatement of capital assets.

Various other misstatements were made in the financial statements, notes to the financial statements, and management's discussions and analysis.

Recommendation: We recommend that the College implement effective controls to ensure the completeness and accuracy of the financial statements and to ensure that the financial statements are reviewed and misstatements and presentation errors are detected and corrected prior to submission of the statements and related notes to the Office of the State Controller.

College's Response: The College accepts the reclassification of $10,294,619.04 from nonexpendable net assets to unrestricted net assets and has reclassified the investment assets accordingly. The College agrees with the reclassification of $170,512.00 in scholarship funds as restricted scholarships and fellowships-expendable and has reclassified the scholarship funds accordingly.

The College agrees that it incorrectly classified $580,927.17 of county bonds and COPS funds as being county appropriations instead of county capital grants, that $30,717.19 of lease receipts were classified as sales and services instead of other nonoperating revenues, and that $4,288.40 of federal grants passed through the state account being recorded as federal grants instead of state and local grants. These are all coding errors which have been corrected. Measures have been taken to assure correct coding in the future.

The College agrees that it failed to separate cash and cash equivalent assets of $604,445.01 in the College's investment reports from investments. Additional measures have been taken to assure the segregation of the investment account into the correct classifications of the investment components.

The College agrees that $39,380.00 was assigned to government securities at year-end due to an incorrect journal entry. Additional procedures have been implemented to assure the accuracy of journal entries.

The College agrees that there was a duplicate entry made in recording retainage payables resulting in an overstatement in capital assets of $10,607.83. Additional procedures have been implemented to assure the accuracy of journal entries.

The College has implemented procedures to ensure that the financial statements are sufficiently reviewed and misstatements and presentation errors are detected and corrected prior to submission of the statements and related notes to the Office of the State Controller. No other misstatements have been identified.

Matters Not Related to Financial Reporting or Federal Compliance Objectives

The following findings were identified during the current audit and describe conditions that represent significant deficiencies in the management control processes for matters not directly related to financial reporting or federal compliance objectives.

2. PAYMENT OF SALARY SUPPLEMENTS WITH STATE FUNDS

During our audit of payroll, we noted that the College used State funds to pay $188,350 in salary supplements. These salaries were paid to curriculum faculty in accordance with a salary plan approved by the Mitchell Community College Board of Trustees. The payments began in fiscal year 2005 and continued through December 2006. The College also paid the $17,340 match for Federal Work-Study student salaries inappropriately from State funds.

State funds may not be used to fund salary supplements per the North Carolina Community College System's Office and a related opinion letter form the North Carolina Attorney General's Office dated June 1998. The North Carolina Community College System Accounting Procedures Manual, Section 3, states that State funds may not be used to match student salaries funded with Federal Work-Study funds.

Recommendation: We recommend that the College ensure that the policies and procedures of the Office of the State Controller and the North Carolina Community College System are followed with regards to State appropriated funds.

College's Response: The College accepts the opinion of the State Auditors that it improperly used state funds to pay faculty salary supplements. The College for the 2006-2007 fiscal year is funding the faculty's additional pay with county funds and will continue this practice for all employees in the future.

The College believes that no state funds were improperly used in the payment of additional monthly wages to full-time faculty.

The State's definition of a salary supplement is that a supplement is additional pay for additional services. The additional pay for faculty is part of the salary plan approved by the Board of Trustees of the College. No additional services are required to be performed by the faculty members to receive the additional pay. In addition, all full-time faculty of the College receive the extra compensation to help make the salaries of the college more competitive.

It is the understanding of the College that if the additional pay were included in a signed contract it would have been a proper use of state funds. The reason the College did not include the additional pay in its full-time faculty salary contracts was to give the College more budget flexibility in case of unexpected financial needs that may have made it difficult for the college to meet all of its financial obligations (i.e., routine budget reversion). Each faculty member was paid the same amount ($1,200 annually) and the additional wages were paid on a monthly basis ($100 per month). In addition, community colleges were encouraged to use any state funds available to assist in raising faculty salaries. The North Carolina Community College Annual Budget Plan approved by the State Board of Community Colleges encouraged each college to utilize any funds available to increase faculty salaries to the faculty national average as published by the Integrated Post-Secondary Education Data System (IPEDS). Mitchell Community College ranks in the top five in faculty pay among the fifty-eight (58) North Carolina community colleges.

The College recognizes that it did mistakenly use state funds to match Federal Work-Study student salaries in the 2006 audit year, but the error was identified and corrected prior to the current audit.

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