STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2007

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

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FINANCIAL STATEMENT AUDIT REPORT

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STATE OF NORTH CAROLINA
Office of the State Auditor

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

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of The University of North Carolina at Chapel Hill for the year ended June 30, 2007, 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 resulted in no audit findings.

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

March 24, 2008

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2007, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of The University of North Carolina at Chapel Hill'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 Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 7, 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

December 7, 2007

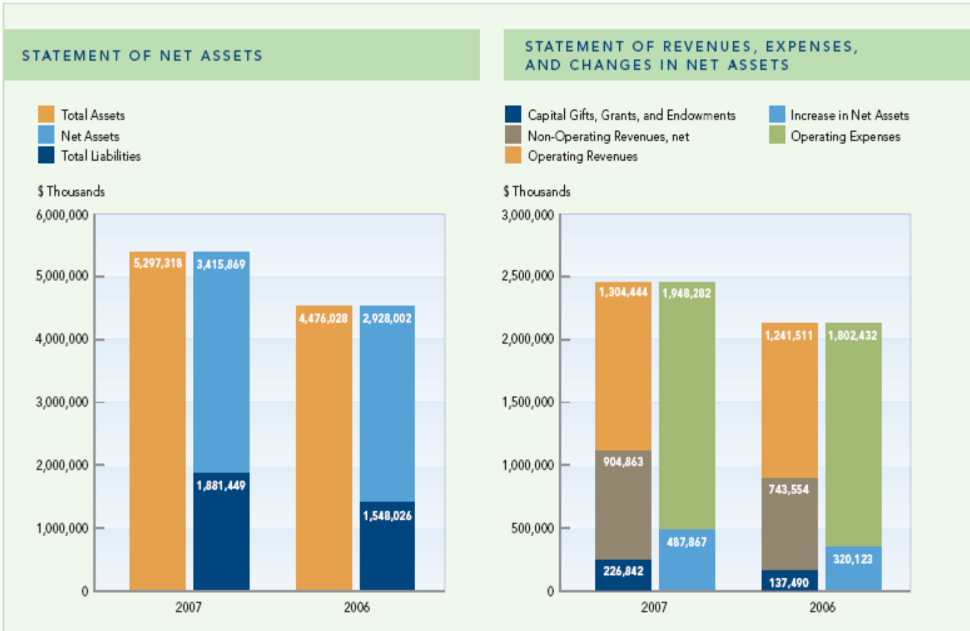
Introduction

Management's Discussion and Analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year ended June 30, 2007, with comparative information for the fiscal year ended June 30, 2006. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying Notes to the Financial Statements.

The University is a constituent institution of the multi-campus University of North Carolina System (UNC System), a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report (CAFR).* The Financial Reporting Entity for the financial statements is comprised of the University and 11 component units. Eight component units are reported as if they were part of the University, and three are reported as discretely presented component units based on the nature and significance of their relationship to the University. The reader may refer to note 1A for detail information on the financial reporting entity.

Financial Highlights

The University's financial position at June 30, 2007, remained solid with total assets of $5.3 billion. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were $3.4 billion at June 30, 2007. The University's net assets increased by $487.9 million in fiscal 2006-2007, when operating, nonoperating, and other changes are included. A comparison of the total assets, liabilities, and net assets at June 30, 2007, and June 30, 2006, and a comparison of the major components of the changes in net assets for the two fiscal years are presented below:



Net assets increased 16.7% on June 30, 2007, over the prior year. Total assets increased 18.3% and total liabilities rose 21.5% for the same period. Operating revenues increased at a lower rate than operating expenses in 2006-2007 over the prior year, 5.1% and 8.1%, respectively. Net nonoperating revenues and expenses increased 21.7% in 2006-2007 over the prior year. The growth in State appropriations - 11.9% - was significant. Investment income growth remained substantial with a 53.5% increase in 2006-2007 over the prior year. Research funding, fund raising for operational and capital needs, and construction funding through the North Carolina Higher Education Bond Referendum of 2000 continued to be positive factors in the sustained financial well-being of the University.

Using the Financial Statements

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the University as a whole. 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.

The University's Annual Financial Report includes the following three financial statements.

- Statement of Net Assets
- Statement of Revenues, Expenses, and Changes in Net Assets
- Statement of Cash Flows

Management's Discussion and Analysis provides information regarding each of these financial statements.

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and noncurrent components. Net assets represent the difference between total assets and total liabilities and are one indicator of the University's current financial condition. The following table summarizes the University's assets, liabilities, and net assets on June 30, 2007, and 2006.

Assets, Liabilities, and Net Assets
(Dollars in Thousands)

	2007	2006	% Change
Assets:			
Current Assets	$ 1,007,274	$ 912,751	10.4
Noncurrent Assets:			
Endowment and Restricted Investments	2,001,979	1,604,529	24.8
Capital Assets, Net	2,082,829	1,874,486	11.1
Other Noncurrent Assets	205,236	84,262	143.6
Total Assets	5,297,318	4,476,028	18.3
Liabilities:			
Current Liabilities	471,718	391,685	20.4
Noncurrent Liabilities:			
Funds Held in Trust for Pool Participants	588,099	326,419	80.2
Long-Term Liabilities	789,568	797,852	(1.0)
Other Noncurrent Liabilities	32,064	32,070	(0.0)
Total Liabilities	1,881,449	1,548,026	21.5
Net Assets:			
Invested in Capital Assets, Net of Related Debt	1,211,805	1,119,040	8.3
Restricted	1,586,491	1,283,449	23.6
Restricted expendable			
Unrestricted	617,573	525,513	17.5
Total Net Assets	$ 3,415,869	$ 2,928,002	16.7

Current Assets and Liabilities

The Statement of Net Assets shows that working capital, which is current assets less current liabilities, was $535.6 million at June 30, 2007, an increase of 2.8%, or $14.5 million, over the previous year. The Statement of Net Assets details the current asset and current liability categories.

Endowment and Restricted Investments

Endowment investments increased 21.5% during 2006-2007 and were $1.39 billion at June 30, 2007, and $1.15 billion at June 30, 2006, and include permanent endowments, funds internally designated as endowments and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were $1.37 billion at June 30, 2007, and $1.12 billion for the prior year.

The endowment assets are invested with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. ("Investment Fund"), which is reported as a governmental external investment pool in the financial statements. The Investment Fund is a 501(c)(3) nonprofit corporation established to support the University by operating an investment pool for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University.

The investment objective is to earn an average real total return of at least 5.5% per year, net of all fees, over rolling five- and 10-year periods. The earnings distribution policy is to provide a stable source of spending support that is sustainable over the long term while preserving the purchasing power of the endowment investments. The earnings distribution rate was established at 5% of the previous year's market value, with annual increases based on inflationary factors. Each year's distribution is subject to a 4% floor and a 7% cap based on estimated fiscal year-end market value.

Restricted investments of $609.9 million at June 30, 2007, include funds of $565.9 million of affiliated entities that are neither part of the University's reporting entity nor reported discretely but do invest through the System Fund. The remaining component is bond reserves and related funds of $44 million.

Most of the University's endowment investments are currently managed within the System Fund, a pooled investment fund vehicle. The System Fund is designed to provide long-term, stable rates of return on the invested assets through the use of a highly diversified portfolio strategy. As reported by UNC Management Company, Inc., the investment return on the endowment assets invested in the System Fund for fiscal 2006-2007 was 23.4%. The investment return for fiscal 2005-2006 was 19.2%. The System Fund return of 23.4% for 2006-2007 significantly outperformed the Strategic Investment Policy Portfolio ("SIPP") return of 16.7%. The System Fund's return also exceeded the 70% S&P 500/30% Lehman Brothers Bond Index ("70/30") return of 16.1% for the year.

The continuing strong investment performance has increased the three-year annualized return to 19.3% at June 30, 2007. This three-year return measure compares well with the corresponding measure of 14.9% for the SIPP and 9.4% for the 70/30. For the five years ended June 30, 2007, the System Fund earned a 15.3% annualized return compared to 12.3% for the SIPP and 9% for the 70/30.

The System Fund has also outperformed its long-term objective of real return, after inflation, of 5.5% for each of the periods noted above as well as for longer time periods. For the 10-, 15-, and 20-year time periods ended June 30, 2007, the System Fund returned 12.1%, 12.7%, and 12.1% respectively. Comparatively, the CPI plus 5.5% has been 8.3%, 8.3%, and 8.7% respectively for the corresponding time periods. The System Fund is very well positioned in the current environment and remains invested according to the approved investment policy that is designed to capture a significant portion of the upside returns during bull markets while protecting the down side during bear markets.

Capital Assets and Debt Management

An essential aspect for enhancing and maintaining the University's academic, research, and service programs and its residential life is the development and renewal of its capital assets. The University Board of Trustees approved the campus master plan in March 2001 to guide the University's physical development in the 21st Century. The master plan and subsequent modifications mesh the critical pieces needed for smart growth in the 21st Century - transportation, parking, housing, utilities, and sustainability - with the program needs of a growing campus. The master plan combines the practical requirements of a research university with the beauty that inspired its founders. The University expects continued growth in the future, including advancing plans for Carolina North, a satellite campus on property about two miles north of main campus.

A summary of changes in capital assets is disclosed in Note 5. Capital assets, net of accumulated depreciation, at June 30, 2007, and June 30, 2006, were as follows:

Capital Assets
(Dollars in Thousands)

	2007	2006	% Change
Construction in Progress	$ 535,332	$ 585,216	(8.5)
Land and Other Nondepreciable Assets	97,030	93,980	3.2
Buildings	1,156,417	910,763	27.0
General Infrastructure	191,413	190,898	0.3
Machinery and Equipment	102,637	93,629	9.6
Total	$ 2,082,829	$ 1,874,486	11.1

The University is engaged in a $2.1 billion capital construction program that began in 2000 and will continue through the next several years. The 165 projects in the capital program include major capital renewal of existing buildings and infrastructure to address both deferred maintenance and programmatic needs. The 72 completed projects total $764 million, or 37% of the $2.1 billion capital construction program. The 38 projects under construction total $614 million or 30%, and the 55 projects under design represent $683 million or 33%.

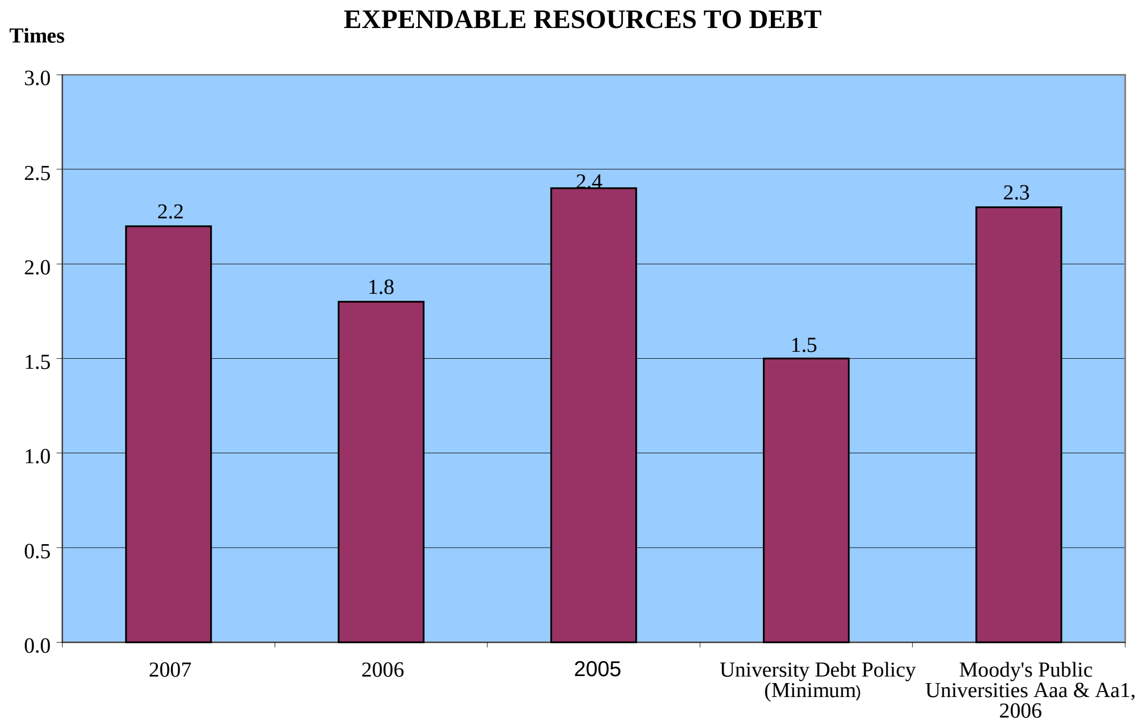
Capital funds resulting from North Carolina Higher Education Bonds continue to provide essential resources for construction. The University is directly investing in its capital construction program using a variety of other funding sources including general revenue bonds, cost reimbursements from research grants, internal reserves, and private gifts.

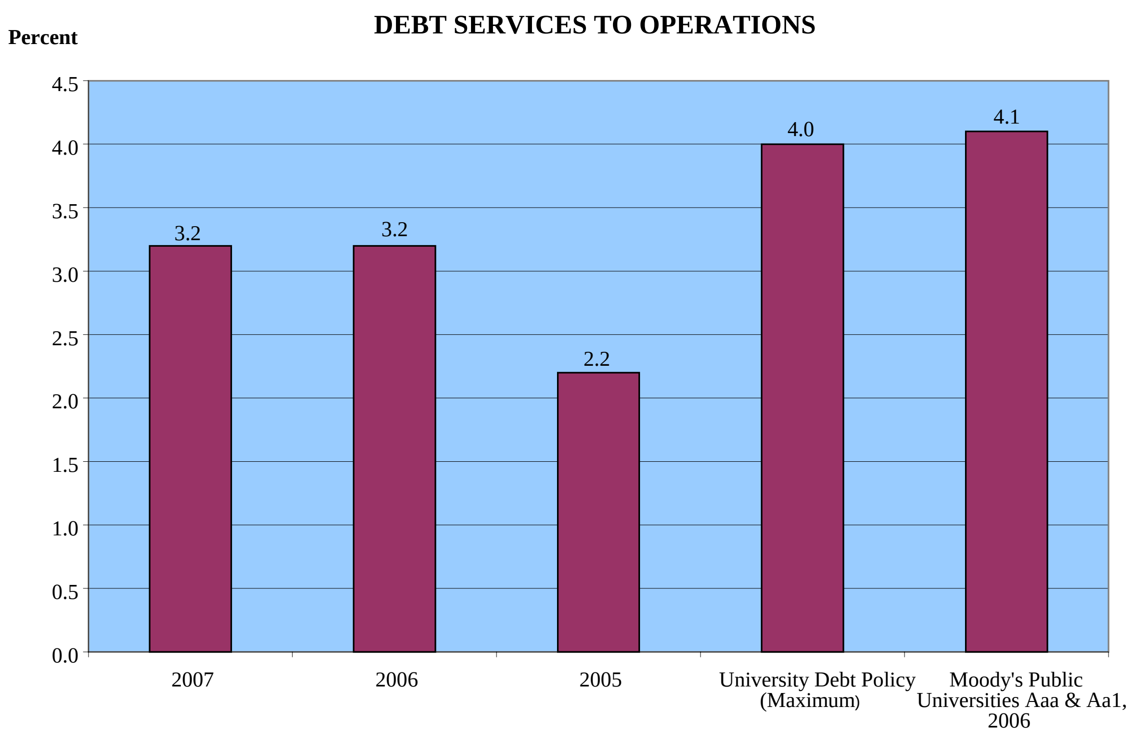
The University continues to use its commercial paper program to provide low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was $192.4 million at June 30, 2007, and $117.4 million at June 30, 2006. The University is currently planning to issue a long-term bond in December 2007 to refund a significant portion of outstanding commercial paper and to provide additional funds for capital projects.

The commercial paper program and the general revenue bonds allow the University to use a central bank concept for funding capital projects. The University issues fixed and variable rate debt externally and blends the average borrowing rate to allocate debt costs to individual capital projects and campus divisions. This concept provides a stable and flexible debt-funding source for capital projects.

The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The effective, combined interest rate for variable and fixed rate debt was 4.72% for fiscal 2006-2007 and 4.65% for fiscal 2005-2006. The interest rate on the commercial paper program for fiscal 2006-2007 was 3.6% and for 2005-2006 was 3%. Interest rates on the University's variable rate, long-term bonds were 3.59% for fiscal 2006-2007 and 2.93% for fiscal 2005-2006. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements. The University's financial strength allowed it to achieve ratings of AA+/Aa1 by the national rating agencies.

The University's debt policy uses two key ratios to measure debt capacity, financial health, and credit quality. The expendable resources to debt ratio measures the availability of expendable assets to cover long-term obligations should the University be required to repay all of its obligations immediately. The debt service to operations ratio measures the University's ability to repay annual principal and interest associated with all outstanding debt and its impact on the overall budget. Each ratio is compared to the University's debt policy standard and the appropriate peer group comparison for fiscal 2005-2006 (the latest available numbers). The debt policy floor for expendable resources to debt is 1.5 times, and the metrics indicate the University has sufficient expendable resources to pay its long-term debt obligations. The debt policy ceiling for debt service to operations is 4%, and the metrics indicate the University's annual debt service requirements are a reasonable proportion of the operating budget.


EXPENDABLE RESOURCES TO DEBT
Times
3.0
2.5
2.0
1.5
1.0
0.5
0.0
2.2
1.8
2.4
1.5
2.3
2007
2006
2005
University Debt Policy (Minimum)
Moody's Public Universities Aaa & Aa1, 2006


DEBT SERVICES TO OPERATIONS
Percent
4.5
4.0
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
3.2
3.2
2.2
4.0
4.1
2007
2006
2005
University Debt Policy (Maximum)
Moody's Public Universities Aaa & Aa1, 2006

Other Noncurrent Assets

Other noncurrent assets were $205.2 million at June 30, 2007, and $84.3 million at June 30, 2006, a 143.6% increase. The change in other noncurrent assets from the prior year included a $58.4 million increase in restricted resources due from the primary government. Restricted resources due from the primary government include receivables for designated capital construction projects funded from proceeds from Statewide higher education bonds and other State resources. The increase resulted from $59.6 million additional resources in Statewide higher education bonds due for capital construction projects.

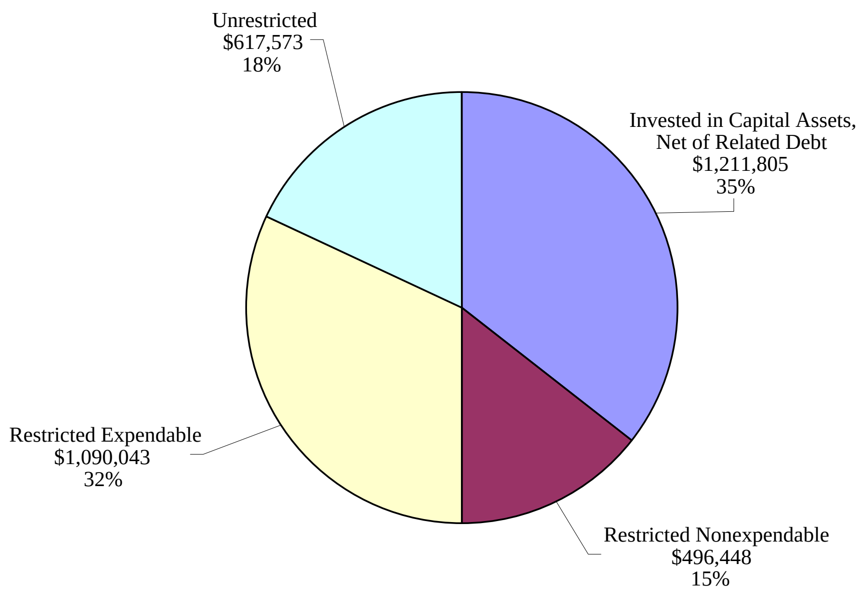
Noncurrent Liabilities

Noncurrent liabilities were $1.4 billion at June 30, 2007, and $1.2 billion at June 30, 2006, and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of $588.1 million and $326.4 million, respectively. These entities are not part of the University's financial reporting entity and are not discretely presented, but the entities do invest through the System Fund. The increase in funds held in trust of 80.2% over the prior year resulted from strong investment performance, participant contributions, and new participants in the System Fund.

Net Assets

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were $3.4 billion at June 30, 2007, an increase of $487.9 million over the prior year. Net assets invested in capital assets, net of related debt, 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. Nonexpendable restricted net assets include endowment and similar 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. Expendable restricted net assets include resources in which the University is legally obligated to spend the resources in accordance with restrictions provided by external parties. Unrestricted net assets are not subject to externally imposed stipulations; however, most of these resources have been designated for particular academic, research, or other programs, as well as capital projects.

2007 NET ASSETS: $3,415,869
(IN THOUSANDS)



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

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2007, and the prior year are summarized as follows:

University Operations
(Dollars in Thousands)

	2007	2006	% Change
Operating Revenues:			
Student Tuition and Fees, Net	$ 210,651	$ 195,882	7.5
Grants and Contracts	566,887	554,047	2.3
Sales and Services, Net	521,653	485,627	7.4
Other	5,253	5,955	(11.8)
Total Operating Revenues	1,304,444	1,241,511	5.1
Operating Expenses	1,948,282	1,802,432	8.1
Operating Loss	(643,838)	(560,921)	14.8
Nonoperating Revenues (Expenses):			
State Appropriations	492,471	440,070	11.9
Noncapital Gifts and Grants	136,960	136,212	0.5
Investment Income	318,442	207,423	53.5
Other Net Nonoperating Expenses	(43,010)	(40,151)	(7.1)
Income Before Other Changes	261,025	182,633	42.9
Capital Grants and Appropriations	171,738	68,053	152.4
Capital Gifts	15,662	13,368	17.2
Additions to Permanent Endowments	39,442	56,069	(29.7)
Increase in Net Assets	487,867	320,123	52.4
Net Assets – July 1	2,928,002	2,607,879	12.3
Net Assets – June 30	$ 3,415,869	$ 2,928,002	16.7

Fiscal year 2006-2007 revenues and other changes total $2,479,159 and expenses total $1,991,292.
Fiscal year 2005-2006 revenues and other changes total $2,162,706, and expenses total $1,842,583.

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was $51.1 million for fiscal 2006-2007 and $45.3 million for the prior year. Total net revenues from student tuition and fees increased 7.5% over the prior year. The 2006-2007 tuition rates increased 7.8% for undergraduate resident students, 6.5% for undergraduate nonresidents, 13.8% for graduate residents, and 2.8% for graduate nonresidents.

Operating revenues from grants and contracts increased 2.3% over the prior year as reflected in the financial statements. Discussion of grants and contracts in terms of awards provides another useful perspective. The University is among the nation's leading public research universities, with a diversified portfolio of research that attracted more than $610 million in sponsored program funding during fiscal 2006-2007, a 2.9% increase over the previous year. As federal funding for research stalls and competition for investment from other sources increases, the University was able to sustain growth in awards.

While competition for funding from the National Institutes of Health (NIH) funding has increased significantly, the University share of those funds improved 6.6% to $314 million. Health-related research continues to receive the bulk of research dollars, with the medical school bringing in $298 million in 2006-2007, almost two-thirds from the NIH. The School of Public Health received $115 million, and the College of Arts and Sciences received $95 million. Interdisciplinary research centers, institutes and other units that do not fall under one particular school accounted for $138 million. The University averages 120 technology transfer agreements each fiscal year, providing resources of $2.5 to $4 million in royalties. The University is ranked 10th in the nation in patent strength.

Sales and services include the revenues of campus auxiliary operations such as student housing, student stores, student health services, the utilities system, and parking and transportation, as well as revenues from patient services provided by the professional health-care clinics. Other revenues represent operating resources not separately identified and include, for example, an assessment to the Investment Fund to support administrative services.

Operating Expenses

The University's operating expenses were $1.9 billion for the fiscal year ended June 30, 2007, an increase of 8.1% over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in the Notes to the Financial Statements (Note 12). The following table illustrates the University's operating expenses by functional classification and by natural classification:

Operating Expenses by Function
(Dollars in Thousands)

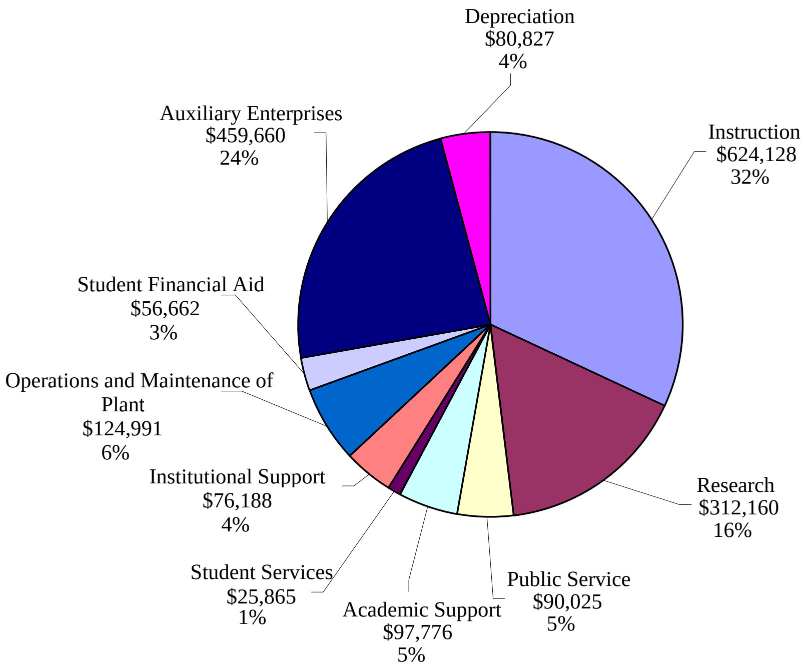
	2007	2006	% Change
Instruction	$ 624,128	$ 595,319	4.8
Research	312,160	285,646	9.3
Public Service	90,025	85,330	5.5
Academic Support	97,776	86,229	13.4
Student Services	25,865	23,957	8.0
Institutional Support	76,188	71,609	6.4
Operations and Maintenance of Plant	124,991	111,720	11.9
Student Financial Aid	56,662	54,105	4.7
Auxiliary Enterprises	459,660	424,042	8.4
Depreciation	80,827	64,475	25.4
Total Operating Expenses	$ 1,948,282	$ 1,802,432	8.1

Operating Expenses by Nature
(Dollars in Thousands)

	2007	2006	% Change
Salaries and Benefits	$ 1,122,269	$ 1,042,452	7.7
Supplies and Materials	165,704	152,911	8.4
Services	462,093	432,212	6.9
Scholarships and Fellowships	56,662	54,105	4.7
Utilities	60,727	56,277	7.9
Depreciation	80,827	64,475	25.4
Total Operating Expenses	$ 1,948,282	$ 1,802,432	8.1

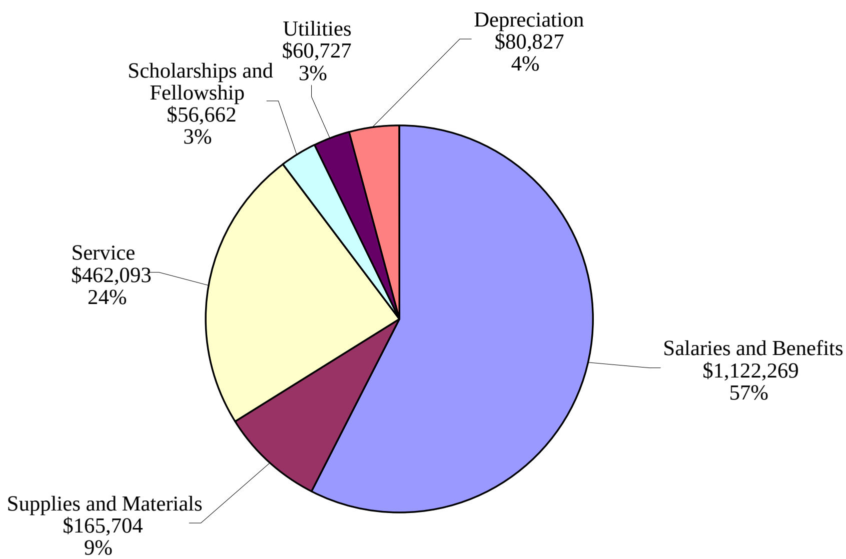
The following graph illustrates the University's operating expenses by function.

2007 OPERATING EXPENSES BY FUNCTION: $1,948,282
(IN THOUSANDS)



The following graph illustrates the University's operating expenses by the natural classification.

2007 OPERATING EXPENSES BY NATURE: $1,948,282
(IN THOUSANDS)



Operating expense categories reported by natural classification generally increased at a comparable rate to total operating expenses. The 25.4% increase in depreciation expenses in 2006-2007 over the prior year resulted from the completion of several major buildings. The $2.1 billion capital construction that began in 2000 has resulted in an increased depreciable capital asset base of $2.3 billion at June 30, 2007, an increase of 76.7% from five years earlier. Operations and maintenance of plant expenses increased 11.9% to keep pace with additional facilities. Academic support expenses increased 13.4% in large part from additional resources provided for information technology needs.

Nonoperating Revenues and Expenses

State appropriations, noncapital gifts and grants, and investment income are considered nonoperating because they were not generated by the University's principal, ongoing operations. For example, State appropriations were not generated by the University but were provided to help fund operating expenses.

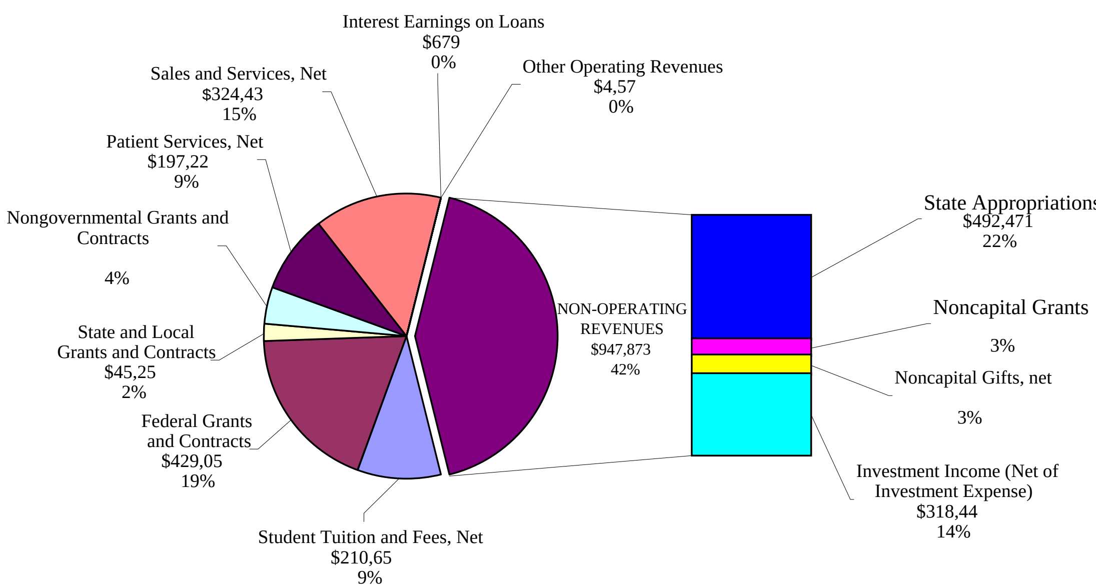
State appropriations were $492.5 million for fiscal 2006-2007, an 11.9% increase. The University received budget increases totaling $25.9 million to fund salary and benefit increases, $10.9 million for enrollment increases and program enhancements, $8.5 million for operating costs for new facilities, $5.9 million for the Renaissance Computing Institute, and $1.2 million for other purposes.

Noncapital gifts and grants remained stable and include expendable gifts and federal awards that are not considered to be operating revenues. Net investment income of $318.4 million, an increase of 53.5% over 2005-2006, includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. An investment return of 23.4% by the System Fund, a 21.5% increase in endowment investments, and increased levels of short-term investments contributed to the higher level of revenues. For detail discussion, the reader may refer to Endowment and Restricted Investments section of Management's Discussion and Analysis.

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as State appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and non-operating revenues which total $2.3 billion for fiscal year 2006-2007.

2007 TOTAL REVENUES BY SOURCE
$2,252,317 (IN THOUSANDS)



Other Changes in Net Assets

Capital grants and appropriations of $171.7 million for 2006-2007 and $68.1 million for 2005-2006 are from Statewide higher education bond proceeds and State appropriations for capital construction projects. Capital gifts of $15.7 million for 2006-2007 and $13.4 million for the prior year resulted from fund-raising efforts and also provided funding for construction projects. Nonexpendable gifts and funds from the state's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of $39.4 million during fiscal year 2006-2007 and $56.1 million during fiscal year 2005-2006.

Economic Outlook

Management believes the University is financially well-positioned for the future and will continue to maintain and generate sufficient resources to successfully fulfill its teaching, research, and service missions. The fiscal improvement during 2006-2007 enhanced the University's solid financial foundation. The University's tuition levels are appealing to prospective students and provide important resources for key University priorities including salaries and graduate teaching assistant stipends. The University's support from the State continues to improve, sponsored awards are a proven and reliable source in support of the University's research mission, philanthropic efforts have demonstrated outstanding success, and investment returns provide a stable stream of earnings. The University's strong debt credit ratings of Aa1 and AA+ allow it to obtain competitive financing for capital construction.

Tuition rates increased for fiscal 2007-2008 by 7.2% for undergraduate residents, 6.9% for undergraduate nonresidents, 12.2% for graduate residents, and 2.8% for graduate nonresidents. The University's academic standing allows it to continuously attract top students.

The Governor and the General Assembly of North Carolina have continued to demonstrate strong financial support for higher education. The budgeted funding level for State appropriations for 2007-2008 totals $539.7 million, which represents an increase of 9.6% over fiscal 2006-2007 actual State appropriations. This level of State appropriation funding includes faculty and staff pay and benefit increases of $26.4 million. The fiscal 2007-2008 pay increase of 4% for faculty and staff is the fourth consecutive year of base salary increases for all employees. An additional 1% pay increase was authorized as incentive funding tied to the University's strategic goal of competing with peer campuses to improve competitive salary levels for faculty. Other budget changes included $20.9 million for enrollment increases and program enhancements, $9.7 million for operating costs for new facilities, and $9.8 million in net budget reductions. Additional budget reductions are not anticipated for fiscal 2007-2008.

External funding from contracts and grants increased to $610 million in 2006-2007. The growth in research occurs as the University continues to work with the local community on plans for Carolina North, the research campus to be located near the main campus. The first component of Carolina North will be the Innovation Center. More than an incubator, the facility will provide space for research start-ups and capital management teams to attract seed capital and accelerate research into the marketplace. In 2008, the University also plans to open a Nutrition Research Institute as part of the North Carolina Research Campus, a public-private partnership, in Kannapolis, N.C.

The General Assembly made a major commitment to research by creating the University Cancer Research Fund which will invest $25 million in 2007-2008, $40 million the following year and then an annual investment of $50 million. The funds will support cancer research and patient care through the School of Medicine, Lineberger Comprehensive Cancer Center, and the UNC Health Care System, which is currently building the North Carolina Cancer Hospital.

State appropriations and tuition are key resources for faculty salaries. The University's goal is to take average faculty salaries, now at approximately the 50th percentile of the peer group of institutions, to the 80th percentile, possibly as soon as fiscal 2008-2009. Faculty retention is essential to the objective of maintaining the quality of education at the University. Faculty attrition through retirements or resignations is a key challenge. Other challenges will require resources as well. For the fall semester of fiscal year 2007-2008 and for the first time in the University's history, student enrollment exceeded 28,000.

Resources to meet these important needs will be a key factor, and the University's diverse revenue base will be invaluable. It is the University's goal to secure $1 billion in external research funding by 2015. Management believes the investment performance of its endowment fund will continue to earn attractive returns and provide important resources for University operations. The University's investment management operation is separately organized as the UNC Management Company, Inc., the nonprofit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated nonprofit foundations as appropriate. Management believes this structure will continue to enhance the ability to attract and retain investment professionals and increase the pool of funds and resulting investment returns.

The Carolina First Campaign is the largest fund-raising drive in University history to support the vision to become the nation's leading public university. The campaign will conclude December 31, 2007, and surpassed its $2 billion goal on February 21, 2007. Private gifts and grants, along with State matching funds, exceeded $250 million in fiscal 2006-2007, marking the fourth consecutive year that the University surpassed its previous high. New gifts, pledges, and other commitments raised the campaign total to $2.17 billion. The goal of the Carolina First Campaign, which began in July 1999, was increased to $2 billion in October 2005 from the initial goal of $1.8 billion.

The University's diverse and sound revenue streams, its endowment, and its capital asset base provide a strong financial foundation and provide resources to continue the excellent teaching, research, and public service endeavors provided to students, citizens, and other constituents. Support from the State of North Carolina, the ability to attract top prospective students, vibrant research funding, superior investment performance, a dynamic capital construction program, and an exceptional fund-raising campaign all contribute to a positive outlook for the University. The University's commitment to sound financial and budgetary planning, protection and enhancement of its endowed and physical assets, as well as its observance of compliance and control standards, support a solid financial future for the University.

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2007

Exhibit A-1

ASSETS	
Current Assets:	
Cash and Cash Equivalents	$ 168,157,134
Restricted Cash and Cash Equivalents	399,669,945
Short-Term Investments	164,752,029
Restricted Short-Term Investments	103,568,237
Receivables, Net (Note 4)	145,707,432
Due from State of North Carolina Component Units	2,712,529
Inventories	19,505,876
Notes Receivable, Net (Note 4)	3,200,439
Total Current Assets	1,007,273,621
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	79,492,910
Receivables, Net (Note 4)	23,672,776
Restricted Due from Primary Government	61,645,345
Endowment Investments	1,392,068,332
Restricted Investments	609,911,090
Notes Receivable, Net (Note 4)	32,106,309
Investment in Joint Venture	8,318,917
Capital Assets - Nondepreciable (Note 5)	632,361,431
Capital Assets - Depreciable, Net (Note 5)	1,450,467,489
Total Noncurrent Assets	4,290,044,599
Total Assets	5,297,318,220
LIABILITIES	
Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	96,318,357
Due to Primary Government	94,172
Due to State of North Carolina Component Units	4,226,441
Deposits Payable	1,681,775
Funds Held for Others	5,178,573
Unearned Revenue	54,659,696
Interest Payable	4,330,711
Short-Term Debt (Note 7)	192,414,000
Long-Term Liabilities - Current Portion (Note 8)	112,814,609
Total Current Liabilities	471,718,334
Noncurrent Liabilities:	
U. S. Government Grants Refundable	32,064,079
Funds Held in Trust for Pool Participants	588,098,709
Long-Term Liabilities (Note 8)	789,568,351
Total Noncurrent Liabilities	1,409,731,139
Total Liabilities	1,881,449,473

NET ASSETS		
Invested in Capital Assets, Net of Related Debt		1,211,804,330
Restricted for:		
Nonexpendable:		
Nonexpendable (Note 10)		496,448,465
Expendable (Note 10)		1,090,042,641
Unrestricted		617,573,311
Total Net Assets	$	3,415,868,747

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

The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2007 — *Exhibit A-2*

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 11)	$	210,651,518
Patient Services, Net (Note 11)		197,221,518
Federal Grants and Contracts		429,058,855
State and Local Grants and Contracts		45,255,927
Nongovernmental Grants and Contracts		92,571,877
Sales and Services, Net (Note 11)		324,431,513
Interest Earnings on Loans		679,573
Other Operating Revenues		4,573,793
Total Operating Revenues		1,304,444,574
EXPENSES		
Operating Expenses:		
Salaries and Benefits		1,122,269,124
Supplies and Materials		165,703,903
Services		462,092,772
Scholarships and Fellowships		56,662,461
Utilities		60,727,000
Depreciation		80,826,849
Total Operating Expenses		1,948,282,109
Operating Loss		(643,837,535)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		492,471,029
Noncapital Grants		62,668,734
Noncapital Gifts, Net (Note 11)		74,291,599
Investment Income (Net of Investment Expense of $4,595,146)		318,441,609
Interest and Fees on Capital-Asset Related Debt		(42,926,147)
Other Nonoperating Expenses		(84,091)
Net Nonoperating Revenues		904,862,733
Income Before Other Revenues		261,025,198
Capital Appropriations		52,887,775
Capital Grants		118,849,967
Capital Gifts		15,661,798
Additions to Endowments		39,441,876
Increase in Net Assets		487,866,614
NET ASSETS		
Net Assets - July 1, 2006		2,928,002,133
Net Assets - June 30, 2007	$	3,415,868,747

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

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2007 ***Exhibit A-3***

CASH FLOWS FROM OPERATING ACTIVITIES	
Received from Customers	$ 1,306,740,163
Payments to Employees and Fringe Benefits	(1,111,960,376)
Payments to Vendors and Suppliers	(701,767,039)
Payments for Scholarships and Fellowships	(56,662,461)
Loans Issued	(8,907,039)
Collection of Loans	7,906,231
Other Payments	(5,691,002)
Net Cash Used by Operating Activities	(570,341,523)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State Appropriations	492,471,029
Noncapital Grants	64,163,318
Noncapital Gifts	74,695,006
Additions to Endowments	39,441,876
Related Activity Agency Receipts	266,636,823
Cash Provided by Noncapital Financing Activities	937,408,052
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES	
Proceeds from Capital Debt	76,180,965
Capital Appropriations	52,887,775
Capital Grants	60,415,641
Capital Gifts	13,003,044
Acquisition and Construction of Capital Assets	(301,452,335)
Principal Paid on Capital Debt and Leases	(43,344,021)
Interest and Fees Paid on Capital Debt and Leases	(43,675,710)
Net Cash Used by Capital Financing and Related Financing Activities	(185,984,641)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales and Maturities of Investments	944,361,874
Investment Income	70,176,913
Purchase of Investments and Related Fees	(1,062,535,927)
Net Cash Used by Investing Activities	(47,997,140)
Net Increase in Cash and Cash Equivalents	133,084,748
Cash and Cash Equivalents - July 1, 2006	514,235,241
Cash and Cash Equivalents - June 30, 2007	$ 647,319,989

RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH BY OPERATING ACTIVITIES

Operating Loss	$	(643,837,535)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		80,826,849
Allowances, Write-Offs, and Amortizations		90,404
Changes in Assets and Liabilities:		
Receivables, Net		(21,797,719)
Inventories		(2,078,379)
Notes Receivable, Net		(1,688,719)
Accounts Payable and Accrued Liabilities		(5,854,779)
Due to Primary Government		(96,536)
US Government Grants Refundable		(5,699)
Unearned Revenue		19,095,916
Compensated Absences		5,004,674
Net Cash Used by Operating Activities	$	(570,341,523)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	168,157,134
Restricted Cash and Cash Equivalents		399,669,945
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		79,492,910
Total Cash and Cash Equivalents - June 30, 2007	$	647,319,989

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	$	966,892
Assets Acquired through a Gift		2,658,754
Change in Fair Value of Investments		143,345,326

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

The University of North Carolina at Chapel Hill Foundations
Statement of Financial Position
June 30, 2007

Exhibit B-1

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
ASSETS			
Current Assets:			
Cash and Cash Equivalents	$ 9,781,745	$ 9,116,463	$ 40,889,829
Investments		176,385,349	123,760,320
Unconditional Promises to Give, Net	8,381,433	8,160,296	5,329,213
Contributions Receivable from Split-Interest Agreements		4,083,169	
Accounts Receivable	460,369		
Funds Held in Trust	207,296		
Accrued Income Receivable	41,461		239,969
Prepaid Expenses			119,688
Miscellaneous Receivables			244,069
Total Current Assets	18,872,304	197,745,277	170,583,088
Property and Equipment:			
Building			549,641
Furniture and Equipment	650,324		406,646
Leasehold Interest - Building	3,750,483		
Vehicle	8,930		
	4,409,737		956,287
Less: Allowance for Depreciation	(305,078)		(330,019)
Total Property and Equipment	4,104,659		626,268
Other Assets:			
Investments	127,941,398		52,310,810
Unconditional Promises to Give, Net	18,435,542		10,242,668
Restricted Cash	3,474,660		62,080
Split-interest agreements	1,518,748		
Restricted Investments			545,182
Real Estate Interests Held for Investment	49,500		
Student Loans Receivable			48,049
Cash Surrender Value of Life Insurance		2,073,802	392,632
Total Other Assets	151,419,848	2,073,802	63,601,421
Total Assets	$ 174,396,811	$ 199,819,079	$ 234,810,777
LIABILITIES			
Current Liabilities:			
Accounts Payable	$ 296,394	$ 0	$ 405,640
Annuities Payable		117,367	
Accrued Expenses	152,494		291,660
Total Current Liabilities	448,888	117,367	697,300
Long-Term Debt	2,100,000		
Total Liabilities	2,548,888	117,367	697,300
NET ASSETS			
Unrestricted	15,592,993		13,033,948
Temporarily Restricted	84,768,974	108,021,706	168,768,719
Permanently Restricted	71,485,956	91,680,006	52,310,810
Total Net Assets	171,847,923	199,701,712	234,113,477
Total Liabilities and Net Assets	$ 174,396,811	$ 199,819,079	$ 234,810,777

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

The University of North Carolina at Chapel Hill Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2007

Exhibit B-2

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
REVENUES			
Support:			
Contributions	$ 21,448,195	$ 10,400,567	$ 19,294,750
Development Assessment Fee	1,575,000		
Change in Value of Split-Interest Agreements	185,590		
Donated Facilities	40,000		
Actuarial Adjustment of Annuities Payable		70,501	
Endowment Investment Return Designated for Current Operations		6,202,071	
Total Support	23,248,785	16,673,139	19,294,750
Revenue:			
Interest and Dividend Income			9,072,890
Net Unrealized and Realized Gains (Losses) on Investments	21,515,964		23,363,640
Investment Income	3,586,033		
Gain on Sale of Real Estate Investments			18,120
Loss on Sale of Property and Equipment			(7,084)
Other Income	22,375		785,444
Total Revenues	25,124,372		33,233,010
Total Support and Revenue	48,373,157	16,673,139	52,527,760
EXPENSES			
Program Services:			
Grants	8,281,289		15,409,135
Scholarship Expense Distribution		6,190,200	
Annuity Payments		11,871	
Other Expense/Loss		234,300	
Total Program Services	8,281,289	6,436,371	15,409,135
Supporting Services:			
Fundraising Expenses	2,027,874		1,360,198
Management and General	911,092		1,364,698
Total Supporting Services	2,938,966		2,724,896
Total Expenses	11,220,255	6,436,371	18,134,031
Change in Net Assets From Operations	37,152,902	10,236,768	34,393,729
Transfers:			
Transfers to UNC-CH Foundation	(356,669)		
OTHER CHANGES:			
Investment Return in Excess of Amounts Designated for Current Operations		27,533,904	
Changes in Net Assets	36,796,233	37,770,672	34,393,729
NET ASSETS			
Net Assets - Beginning of Year	134,442,602	161,931,040	200,814,685
Prior Period Adjustment	609,088		(1,094,937)
Net Assets - Beginning of Year (as Restated)	135,051,690	161,931,040	199,719,748
Net Assets - End of Year	$ 171,847,923	$ 199,701,712	$ 234,113,477

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. The University of North Carolina at Chapel Hill (University) is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

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

Blended Component Units - Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), UNC Investment Fund, LLC (System Fund), UNC Management Company, Inc. (Management Company), The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-Chapel Hill Foundation), The Kenan-Flager Business School Foundation (Business School Foundation), The School of Social Work Foundation, Inc. (Social Work Foundation), U.N.C. Law Foundation, Inc. (Law Foundation), and The University of North Carolina at Chapel Hill School of Education Foundation, Inc. (School of Education Foundation), are reported as if they were part of the University.

The Investment Fund is governed by a board consisting of 11 ex officio directors and one or two elected directors. Ex-officio directors include all of the members of the Board of Trustees of the Endowment Fund of the University, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement. The UNC-Chapel Hill Foundation Board may, in its discretion, elect one or two of its at-large members to the Investment Fund Board. The Investment Fund supports the University by operating an investment fund for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. Because members of the Board of Directors of the Investment Fund are officials or appointed by officials of the University and the Investment Fund's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The System Fund was organized by the Investment Fund to allow the University , the University of North Carolina and its other constituent institutions (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured and arranged by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Investment Fund contributed and assigned all of its assets to the System Fund effective January 1, 2003, in exchange for its membership interest in the System Fund. Upon such contribution and assignment, and in consideration thereof, the System Fund has assumed all liabilities and obligations of the Investment Fund in respect of such contributed assets. At June 30, 2007, the Investment Fund membership interest was approximately 91.8% of the System Fund total membership interests. Because the Investment Fund is the organizer and a predominant member of the System Fund, the financial statements of the System Fund have been blended with those of the University.

The Management Company is a North Carolina nonprofit corporation organized and operated exclusively to support the educational mission of the University. The Management Company provides investment management services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and performs other functions for and generally carries out the purposes of the University. The Management Company is governed by five ex-officio directors and one or two additional directors as fixed or changed from time to time by the board, elected by the ex-officio directors. The ex-officio directors consist of the Chancellor of the University, the Vice Chancellor for Finance and

Administration of the University, the Chairman of the University's Board of Trustees, the Chairman of the Board of Directors of the Investment Fund, and the President of the Management Company. Because members of the Board of Directors of the Management Company are officials or appointed by officials of the University and the Management Company's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The UNC-Chapel Hill Foundation is governed by a 17-member board consisting of nine ex-officio directors and eight elected directors. Ex-officio directors include the Chairman of the University Board of Trustees, the Chancellor, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement (nonvoting). In addition, the Board of Trustees elects two ex-officio directors from among its own members as well as three ex-officio directors from the Board of Trustees of the Endowment Fund who have not otherwise been selected. The eight remaining directors are elected as members of the UNC-Chapel Hill Foundation Board of Directors by action of the ex-officio directors. The UNC-Chapel Hill Foundation aids, supports, and promotes teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because members of the Board of Directors of the UNC-Chapel Hill Foundation are officials or appointed by officials of the University and the UNC-Chapel Hill Foundation's sole purpose is to benefit the University, its financial statements have been blended with those of the University.

The Business School Foundation is governed by a board consisting of four ex-officio directors and four or more elected directors. Ex-officio directors include the Dean of the Kenan-Flagler Business School (Business School), as well as the school's Chief Financial Officer, Associate Dean of Academic Affairs, and Associate Dean for MBA Programs. The remaining directors are elected to the Business School Foundation Board of Directors by action of the ex-officio directors. The Business School Foundation aids, promotes, and supports the Kenan-Flagler Business School at the University. Because members of the Board of Directors of the Business School Foundation are officials or appointed by officials of the University, the financial statements of the Business School Foundation have been blended with those of the University.

The Social Work Foundation is governed by a board consisting of two ex-officio directors and eight elected directors. Ex-officio directors include the Dean of the School of Social Work and the Chairman of the School's Board of Advisors. The remaining eight directors are elected to the Social Work Foundation Board of Directors by action of a majority of board members. The remaining eight directors as of June 30, 2007, were elected by the ex-officio directors based on Foundation bylaws in effect prior to 2006-2007. The Social Work Foundation fosters and promotes the growth, progress, and general welfare of social work practice and research at the School of Social Work of the University. Because members of the Board of Directors of the Social Work Foundation are officials or appointed by officials of the University, the financial statements of the Social Work Foundation have been blended with those of the University.

The Law Foundation is governed by a board consisting of one ex-officio director, six appointed directors, and six elected directors. The ex-officio director is the Dean of the School of Law of the University. The ex-officio director appoints six directors and the Board of Directors of the Law Alumni Association of the UNC, Inc. elects the other six directors. The Law Foundation provides support, fosters, and encourages the study and teaching of law at the University Law School. Because a majority of the members of the Board of Directors of the Law Foundation are officials or appointed by officials of the University, the financial statements of the Law Foundation have been blended with those of the University.

The School of Education Foundation is governed by a board consisting of six ex-officio directors and five elected directors. Ex-officio directors include the Dean of the School of Education, as well as the school's Assistant Dean for External Relations, Assistant Dean for Administration and Finance, Director of Alumni Relations, President of the Alumni Council, and President-elect of the Alumni Council. The remaining directors are elected to the School of Education Foundation Board of Directors by action of the ex-officio directors. The School of Education Foundation aids, supports and promotes teaching, research, and service at the School of Education. Because members of the Board of Directors of the School of Education Foundation are officials or appointed by officials of the University, the financial statements of the School of Education Foundation have been blended with those of the University.

Separate financial statements for the Investment Fund, System Fund, the Management Company, and blended foundations may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1279, or by calling (919) 962-1370.

Discretely Presented Component Units – The Medical Foundation of North Carolina, Inc. (Medical Foundation), The Educational Foundation Scholarship Endowment Trust (Educational Foundation Trust), and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. (Arts and Sciences Foundation) are legally separate, nonprofit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Medical Foundation is governed by a 46-member Board of Directors elected annually by its members. Its purpose is to support educational and research efforts of the University's Medical School and UNC Hospitals. Historically, the University's Medical School has been the major recipient of financial support from the Medical Foundation as compared to UNC Hospitals. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

The Arts and Sciences Foundation is governed by a board consisting of four ex-officio directors, 30 elected directors and such number of emeritus directors determined from time to time by the Board of Directors. The 30 elected directors are elected for staggered terms, by the Board of Directors in office at the time of election. The purpose of the Arts and Sciences Foundation is to promote and support the University's College of Arts and Sciences. Although the University does not control the timing or amount of receipts from the Arts and Sciences Foundation, the majority of resources or income that the Arts and Sciences Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Arts and Sciences Foundation can only be used by, or for the benefit of the University, the Arts and Sciences Foundation is considered a component unit of the University.

The Educational Foundation Trust is governed by The Educational Foundation Scholarship Endowment Trust Agreement which designates the voting members of the Investment Committee of The Educational Foundation, Inc. as trustees. The Investment Committee consists of five members elected from the membership of the Educational Foundation, Inc. The Educational Foundation Trust operates solely to assist the University in providing financial assistance to students at the University. On an annual basis, the Board of Trustees of the Educational Foundation Trust appropriates a portion of the net appreciation on its assets to the Educational Foundation, Inc. in its capacity as agent for the Educational Foundation Trust. The distribution from the Educational Foundation Trust to the Educational Foundation, Inc. is then forwarded by the Educational Foundation, Inc. to the University to provide financial assistance to students at the University. Although the University does not control the timing or amount of receipts from the Educational Foundation Trust, the majority of resources or income that the Educational Foundation Trust holds and invests are restricted to the students of the University by the donors. Because these restricted resources held by the Educational Foundation Trust can only be used for the benefit of the students of the University, the Educational Foundation Trust is considered a component unit of the University.

The Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust are private, nonprofit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2007, the Medical Foundation, Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total $29,880,624 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Other related foundations and similar nonprofit corporations for which the University 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 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, regardless of the timing of the cash flows.

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, savings accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. **Investments** - This classification includes long-term fixed income investments, equity investments, mutual funds, money market funds, certificates of deposit, investment agreements, limited partnerships, real estate, and other asset holdings by the University. The fair values of all debt and equity securities with readily determinable fair market values are based on quoted market prices. Investments for which readily determinable fair value does not exist include investments in certain commingled funds and limited partnerships. These investments are carried at estimated fair values as provided by the respective fund managers of these investments. The Management Company reviews and evaluates the values provided by the fund managers as well as the valuation methods and assumptions used in determining the fair value of such investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds, certificates of deposit, investment agreements, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

Short-term investments include marketable securities representing the investment of cash that is available for current operations. A majority of this available cash is invested in the University's Temporary Pool, a governmental external investment pool.

F. **Receivables** - Receivables consist of tuition and fees charged to students and charges to patients for services provided by the UNC Physicians & Associates and the Dental Faculty Practices. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied, and notes receivables from loans to students. Patients, pledges, and notes receivables are recorded net of the allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.

G. **Inventories** - Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost or market. Inventories consist of expendable supplies, postage, fuel held for consumption, textbooks, and other merchandise for resale.

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 estimated 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 10 to 40 years for general infrastructure, 10 to 50 years for buildings, and four to 10 years for equipment.

The University's historic property, artworks, and literary collections are capitalized at cost or fair value at the date of donation. These property and collections are considered inexhaustible and are therefore not depreciated.

I. **Restricted Assets** - Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as non-current 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. **Funds Held in Trust for Pool Participants** - Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.

K. **Funds Held in Trust by Others** - Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2007, is approximately $33,062,216.

L. **Noncurrent Long-Term Liabilities –** Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, annuity payable, and compensated absences that are not scheduled to be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refundings are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method. Issuance costs are expensed.

M. **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.

N. 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.

O. 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.

P. 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.

Q. 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 utility services, telecommunications, central stores, printing and copy centers, postal services, repairs, and maintenance services. 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.

R. Related Parties - Related parties are non-profit organizations established to assist and provide support to University programs by funding scholarships, fellowships, professorships, and other needs of specific schools as well as the University's overall academic endeavors. Except as described in Note 1A, the University's financial statements do not include the assets, liabilities, net assets or operational transactions of these organizations except for support from each organization to the University.

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, 2007, the amount shown on the Statement of Net Assets as cash and cash equivalents includes $551,690,001, 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 1.6 years as of June 30, 2007. 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, 2007 was $185,201. The carrying amount of the University's deposits not with the State Treasurer, including certificates of deposit, was $96,444,787 and the bank balance was $22,652,238. 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, 2007, $21,205,508 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

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 units, UNC-Chapel Hill Foundation, Investment Fund, System Fund, Business School Foundation, Social Work Foundation, Law Foundation, School of Education Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust, are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

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

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

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The University does not have a formal policy for foreign currency risk.

Temporary Investment Pool (Temporary Pool) - This is a fixed income portfolio managed by the UNC Management Company, Inc. (Management Company) and Tanglewood Asset Management LLC. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals, and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. The Temporary Pool is not registered with the SEC and the University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Northern Trust Company is the custodian for the Temporary Pool and provides the University with monthly statements defining income and market value information. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, corporate bonds, mutual funds, and money market funds. The University has elected to invest a portion of the Temporary Pool assets in the University's Investment Fund.

By request to accounting services, participants may purchase and sell shares in the Temporary Pool at a fixed value of $1 per share. Generally, the purchase and sale of participation shares occur only at the beginning of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are provided via internet website to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund balance. The rates are set in coordination between the Management Company and the Vice Chancellor for Finance and Administration.

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2007.

Temporary Pool Investments

		Investment Maturities (in Years)			
	Fair Value	Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
U.S. Treasuries	$ 10,036,140	$ 0	$ 10,036,140	$ 0	$ 0
U.S. Agencies	8,151,805	1,990,628	3,989,892	2,171,285	
Mortgage Pass Throughs	33,668,282		6,988,105	5,297,003	21,383,174
Collateralized Mortgage Obligations	149,570,785		1,718,785	6,355,635	141,496,365
State and Local Government	1,440,031		1,440,031		
Asset-Backed Securities	3,455,211				3,455,211
Mutual Bond Funds	7,345,191			7,345,191	
Money Market Mutual Funds	73,257,532	73,257,532			
Domestic Corporate Bonds	7,413,044		4,680,055		2,732,989
Foreign Corporate Bonds	5,000,000		5,000,000		
Total Debt Securities	299,338,021	$ 75,248,160	$ 33,853,008	$ 21,169,114	$ 169,067,739
Other Securities					
Certificates of Deposit	1,000,000				
Other Mutual Funds	5,630,560				
Domestic Stocks	30,000				
Total Temporary Pool Investments	$ 305,998,581				

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

At June 30, 2007, investments in the Temporary Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	Unrated
U.S. Agencies	$ 5,980,520	$ 5,980,520	$ 0	$ 0	$ 0	$ 0
Mortgage Pass Throughs	33,668,282					33,668,282
Collateralized Mortgage Obligations	149,570,785	58,796,816	12,056,609	33,122,272		45,595,088
State and Local Government	1,440,031	1,440,031				
Asset-Backed Securities	3,455,211	317,360	2,056,464	581,387	500,000	
Mutual Bond Funds	7,345,191			4,862,992		2,482,199
Money Market Mutual Funds	73,257,532			73,257,532		
Domestic Corporate Bonds	7,413,044	1,544,705		5,868,339		
Foreign Corporate Bonds	5,000,000		5,000,000			
Total	$ 287,130,596	$ 68,079,432	$ 19,113,073	$ 117,692,522	$ 500,000	$ 81,745,569

Rating Agencies: Moody's / Standard & Poor's / Fitch

Since a separate annual financial report of the Temporary Investment Pool has not and is not planned to be issued, the following additional disclosures are being provided in the University's financial statements.

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2007, are as follows:

Statement of Net Assets
June 30, 2007

	Amount
Assets:	
Accrued Investment Income	$ 1,579,923
Investments Fund Equity	48,662,078
Investments	305,998,581
Total Assets	$ 356,240,582
Liabilities:	
Deferred Income	$ 1,222,063
Total Liabilities	1,222,063
Net Assets:	
Internal Portion	247,341,402
External Portion	107,677,117
Total Net Assets	355,018,519
Total Liabilities and Net Assets	$ 356,240,582

Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2007

	Amount
Increase in Net Assets from Operations:	
Revenues:	
Investment Income	$ 16,446,496
Expenses:	
Investment Management	(441,330)
Net Increase in Net Assets Resulting from Operations	16,005,166
Distributions to Participants:	
Distributions Paid and Payable	(16,005,166)
Share Transactions:	
Net Share Liquidations	(9,679,965)
Total Decrease in Net Assets	(9,679,965)
Net Assets:	
Beginning of Year	364,698,484
End of Year	$ 355,018,519

UNC-Chapel Hill Foundation Investment Fund, Inc. (Investment Fund) - This is a North Carolina nonprofit corporation exempt from income tax pursuant to Section 501(c)(3). It was established in January 1997 and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The University's Endowment, UNC-Chapel Hill Foundation, Business School Foundation, Social Work Foundation, School of Education Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust are participants in the Investment Fund and are included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants.

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Board of Directors (See Note 1 A).

The Northern Trust Company is the custodian for the Investment Fund and provides the University with monthly statements defining income and market value information. The Investment Fund uses a unit basis to determine each participant's market value and to distribute the fund's earnings according to the fund's spending policy. There are no involuntary participants in the Investment Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the Investment Fund. The audited financial statements for the Investment Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Investment Fund consists of an approximately 91.8% membership in the System Fund categorized below.

UNC Investment Fund, LLC (System Fund) - This is a limited liability company organized under the laws of the State of North Carolina. It was established in December 2002 by the Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Investment Fund, with an approximately 91.8% membership interest as of June 30, 2007, is the predominant member of the System Fund. The University's reporting entity portion of the Investment Fund is characterized as the internal portion. Other affiliated organizations in the Investment Fund in addition to other members of the System Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the System Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the System Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

The System Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund as the controlling member and the Management Company (See Note 1A). Effective January 1, 2003, the Management Company entered into an investment management services agreement with the System Fund and will provide investment management and administrative services.

The Northern Trust Company is the custodian for the System Fund and provides the University with monthly statements defining income and market value information. The System Fund uses a unit basis to determine each member's market value and to distribute the fund's earnings. There are no involuntary participants in the System Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the System Fund investments. The audited financial statements for the System Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The following table presents the fair value of the System Fund investments by type and investments subject to interest rate risk at June 30, 2007.

System Fund Pool Investments

		Investment Maturities (in Years)			
	Fair Value	Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
U.S. Treasuries	$ 23,190,275	$ 0	$ 0	$ 0	$ 23,190,275
U.S. Agencies	3,711,663			63,350	3,648,313
Mortgage Pass Throughs	5,999,275			2,580,100	3,419,175
Collateralized Mortgage Obligations	4,057,320				4,057,320
Mutual Bond Funds	14,540,471			14,540,471	
Money Market Mutual Funds	23,502,257	23,502,257			
Domestic Corporate Bonds	14,248,969			1,998,123	12,250,846
Total Debt Securties	89,250,230	$ 23,502,257	$ 0	$ 19,182,044	$ 46,565,929
Other Securities					
International Mutual Funds	15,429,125				
Other Mutual Funds	177,935,457				
Hedge Equity	683,727,286				
Limited Partnerships	906,839,906				
Domestic Stocks	94,757,769				
Foreign Stocks	41,081,603				
Absolute Return	159,452,832				
Other	33,948,583				
Total System Fund Pool Investments	$ 2,202,422,791				

At June 30, 2007, investments in the System Fund Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and Below	Unrated
U.S. Agencies	$ 3,648,313	$ 2,294,671	$ 0	$ 0	$ 0	$ 0	$ 1,353,642
Mortgage Pass Throughs	5,999,275	3,419,175					2,580,100
Collateralized Mortgage Obligations	4,057,320		936,729				3,120,591
Mutual Bond Funds	14,540,471	750,200	966,450	1,728,550		9,677,005	1,418,266
Money Market Mutual Funds	23,502,257			23,502,257			
Domestic Corporate Bonds	14,248,969	483,592	962,821	5,151,354	7,651,202		
Total	$ 65,996,605	$ 6,947,638	$ 2,866,000	$ 30,382,161	$ 7,651,202	$ 9,677,005	$ 8,472,599

Rating Agencies: Moody's / Standard & Poor's / Fitch

Foreign Currency Risk: At June 30, 2007, the System Fund Pool's exposure to foreign currency risk is as follows:

Investment	Currency	Fair Value (U.S. Dollars)
Limited Partnerships	Euro	$ 30,928,110
Limited Partnerships	British Pound Sterling	3,031,860
Foreign Stock	Canadian Dollar	8,197,317
Foreign Stock	Euro	2,229,742
Foreign Stock	Hong Kong Dollar	1,971,504
Foreign Stock	Japanese Yen	16,870,636
Foreign Stock	New Zealand Dollar	845,070
Foreign Stock	Singapore Dollar	1,991,579
Foreign Stock	British Pound Sterling	1,016,800
Foreign Stock	Norwegion Krone	1,248,827
Foreign Stock	South Korean Won	683,767
Foreign Stock	Polish Zloty	711,482
Hedge Equity	Euro	26,497,552
Total		$ 96,224,246

In addition to the foreign currency risk disclosed above, the System Fund includes investments with fair values highly sensitive to interest rate changes. The System Fund invests in hedge funds containing securities that are highly sensitive to rate changes.

Non-pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2007.

Non-Pooled Investments

	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	$ 2,725,660	$ 2,482,664	$ 113,377	$ 13,906	$ 115,713
U.S. Agencies	510,952	59,681	451,271		
Mortgage Pass Throughs	391,202				391,202
Collateralized Mortgage Obligations	104,676		38,858		65,818
State and Local Government	132,323				132,323
Asset-Backed Securities	35,000				35,000
Mutual Bond Funds	10,544,310			9,466,964	1,077,346
Money Market Mutual Funds	34,790,547	34,790,547			
Domestic Corporate Bonds	55,135		25,213		29,922
Total Debt Securities	49,289,805	$ 37,332,892	$ 628,719	$ 9,480,870	$ 1,847,324
Other Securities					
Investment Agreements	5,058,649				
International Mutual Funds	7,934,806				
Other Mutual Funds	12,641,488				
Investments in Real Estate	14,715,245				
Domestic Stocks	11,620,025				
Foreign Stocks	176,442				
Other	18,857,799				
Total Non-Pooled Investments	$ 120,294,259				

At June 30, 2007, the University's Non-pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and Below	Unrated
U.S. Agencies	$ 510,952	$ 506,101	$ 0	$ 0	$ 0	$ 0	$ 4,851
Mortgage Pass Throughs	391,202	300,132		91,070			
Collateralized Mortgage Obligations	104,676	104,676					
State and Local Government	132,323			92,494	39,829		
Asset-Backed Securities	35,000			35,000			
Mutual Bond Funds	10,544,310	4,574,797	3,898,467	816,673	380,480	873,893	
Money Market Mutual Funds	34,790,547	31,954,292		2,834,915			1,340
Domestic Corporate Bonds	55,135		55,135				
Total	$ 46,564,145	$ 37,439,998	$ 3,953,602	$ 3,870,152	$ 420,309	$ 873,893	$ 6,191

Rating Agencies: Moody's/Standard & Poor's/Fitch

Total Investments - The following table presents the fair value of the total investments at June 30, 2007:

	Fair Value
Investment Type	
Debt Securities	
U.S. Treasuries	$ 35,952,075
U.S. Agencies	12,374,420
Mortgage Pass Throughs	40,058,759
Collateralized Mortgage Obligations	153,732,781
State and Local Government	1,572,354
Asset-Backed Securities	3,490,211
Mutual Bond Funds	32,429,972
Money Market Mutual Funds	131,550,336
Domestic Corporate Bonds	21,717,148
Foreign Corporate Bonds	5,000,000
Total Debt Securities	437,878,056
Other Securities	
Certificates of Deposit	1,000,000
Investment Agreements	5,058,649
International Mutual Funds	23,363,931
Other Mutual Funds	196,207,505
Investments in Real Estate	14,715,245
Limited Partnerships	906,839,906
Domestic Stocks	106,407,794
Foreign Stocks	41,258,045
Hedge Equity	683,727,286
Absolute Return	159,452,832
Other	52,806,382
Total Investments	$ 2,628,715,631

Total investments include $358,415,943 held in the System Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 78.05% of the System Fund.

Component Units - Investments of the University's discretely presented component unit, the Medical Foundation of North Carolina, Inc., 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 Medical Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments not held by the University by type:

Investment Type	Carrying Value
Bonds	$ 29,189,596
Mutual Funds	22,824,212
Common Stock	63,260,092
Total Investments	$ 115,273,900

NOTE 3 - ENDOWMENT INVESTMENTS

Substantially all of the investments of the University's endowment funds are pooled in the Investment Fund. Investment return of the University's pooled endowment funds is predicted on the total return concept (yield plus appreciation). Annual distributions from the Investment Fund to the University's pooled endowment funds are generally based on an adopted distribution policy. Under this policy, the prior year distribution is increased by the rate of inflation as measured by the Consumer Price Index (CPI). Each year's distribution, however, is subject to a minimum of 4% and a maximum of 7% of the pooled endowment fund's average market value for the previous year.

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2007, accumulated income and appreciation of $662,367,019 was available in the University's pooled endowment funds of which $596,954,626 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2007, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 2,875,414	$ 0	$ 2,875,414
Patients	83,313,757	53,029,681	30,284,076
Accounts	47,921,738		47,921,738
Intergovernmental	45,715,813		45,715,813
Pledges	14,721,839	368,046	14,353,793
Investment Earnings	3,957,233		3,957,233
Interest on Loans	574,785		574,785
Other	24,580		24,580
Total Current Receivables	$ 199,105,159	$ 53,397,727	$ 145,707,432
Noncurrent Receivables:			
Pledges	$ 24,279,770	$ 606,994	$ 23,672,776
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	$ 2,610,568	$ 93,441	$ 2,517,127
Institutional Student Loan Programs	761,885	78,573	683,312
Total Notes Receivable - Current	$ 3,372,453	$ 172,014	$ 3,200,439
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 28,855,394	$ 1,074,575	$ 27,780,819
Institutional Student Loan Programs	4,460,788	135,298	4,325,490
Total Notes Receivable - Noncurrent	$ 33,316,182	$ 1,209,873	$ 32,106,309

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of 3.58% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

Scheduled receipts, the discounted amount under these pledge commitments, and allowances for uncollectible pledges are as follows:

Fiscal Year	Amount
2008	$ 14,721,839
2009	8,822,381
2010	7,394,240
2011	5,976,599
2012	1,400,295
2013-2017	3,791,453
Total Pledge Receipts Expected	42,106,807
Discount Amount Representing Interest (3.58% Rate of Interest)	(3,105,198)
Present Value of Pledge Receipts Expected	39,001,609
Less Allowance for Uncollectible	(975,040)
Pledges Receivable	$ 38,026,569

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2007, is presented as follows:

	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable:				
Land	$ 29,252,036	$ 36,827	$ 529,036	$ 28,759,827
Art, Literature, and Artifacts	63,727,792	3,557,397	15,254	67,269,935
Construction in Progress	585,216,057	195,983,647	245,868,035	535,331,669
Intangible	1,000,000			1,000,000
Total Capital Assets, Nondepreciable	679,195,885	199,577,871	246,412,325	632,361,431
Capital Assets, Depreciable:				
Buildings	1,373,375,954	296,887,330		1,670,263,284
Machinery and Equipment	232,487,366	30,807,398	16,028,602	247,266,162
General Infrastructure	367,569,830	15,373,537		382,943,367
Total Capital Assets, Depreciable	1,973,433,150	343,068,265	16,028,602	2,300,472,813
Less Accumulated Depreciation/Amortization for:				
Buildings	462,612,852	51,232,993		513,845,845
Machinery and Equipment	138,858,374	14,734,756	8,964,322	144,628,808
General Infrastructure	176,671,571	14,859,100		191,530,671
Total Accumulated Depreciation	778,142,797	80,826,849	8,964,322	850,005,324
Total Capital Assets, Depreciable, Net	1,195,290,353	262,241,416	7,064,280	1,450,467,489
Capital Assets, Net	$ 1,874,486,238	$ 461,819,287	$ 253,476,605	$ 2,082,828,920

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2007, were as follows:

		Amount
Accounts Payable	$	51,224,018
Accrued Payroll		30,170,077
Contract Retainage		14,795,393
Intergovernmental Payables		128,869
Total Accounts Payable and Accrued Liabilities	$	96,318,357

NOTE 7 - SHORT-TERM DEBT - COMMERCIAL PAPER

Short-term debt activity for the year ended June 30, 2007, was as follows:

	Balance July 1, 2006	Issued	Redeemed	Balance June 30, 2007
Commercial Paper Program	$ 117,414,000	$ 75,000,000	$ 0	$ 192,414,000

The University's Commercial Paper Program provides up to $400,000,000 in short-term financing for the University's capital improvement projects and is supported by a pledge of the University's available funds. The University will typically utilize the Commercial Paper Program for construction financing and will periodically issue long-term bonds to refund the outstanding balances under this program in order to provide permanent financing for these capital improvement projects.

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2007, is presented as follows:

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Current Portion
Bonds Payable	$ 826,650,000	$ 0	$ 21,775,000	$ 804,875,000	$ 105,307,125
Add/Deduct Premium/Discount	(18,563,668)		(2,833,811)	(15,729,857)	
Deduct Deferred Charge on Refunding	(4,240,260)		(401,922)	(3,838,338)	
Total Bonds Payable	803,846,072		18,539,267	785,306,805	105,307,125
Notes Payable	21,054,002	1,180,965	20,872,967	1,362,000	1,362,000
Capital Leases Payable	379,186	2,721,218	696,054	2,404,350	875,282
Compensated Absences	102,305,703	48,048,663	43,043,989	107,310,377	4,358,711
Annuity and Life Income Payable	6,045,475	674,401	720,448	5,999,428	911,491
Total Long-Term Liabilities	$ 933,630,438	$ 52,625,247	$ 83,872,725	$ 902,382,960	$ 112,814,609

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

B. Bonds Payable - The University was indebted for bonds payable and certificates of participation 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, 2007	Discount on Capital Appreciation Bonds	Principal Outstanding June 30, 2007
Housing System							
	1997A	5.000%	11/01/2017	$ 9,170,000	$ 8,730,000	$ 0	$ 440,000
	1997B	4.600% - 5.000%	11/01/2011	7,210,000	3,285,000		3,925,000
Total Housing System				16,380,000	12,015,000		4,365,000
Parking System							
	1997A	5.000%	05/15/2007	11,750,000	11,750,000		
	1997B	5.100%	05/15/2009	8,245,000	6,470,000		1,775,000
Total Parking System				19,995,000	18,220,000		1,775,000
General Revenue							
	2001A	5.000% - 5.375%	12/01/2025	89,930,000	45,920,000		44,010,000
	2001B	Variable	12/01/2025	54,970,000	10,995,000		43,975,000
	2001C	Variable	12/01/2025	54,970,000	10,995,000		43,975,000
	2002B	5.000%	12/01/2011	66,555,000	26,885,000		39,670,000
	2003	2.500% - 5.000%	12/01/2033	107,960,000	4,950,000		103,010,000
	2005	3.250% - 5.000%	12/01/2034	404,960,000	620,000		404,340,000
Total General Revenue				779,345,000	100,365,000		678,980,000
Utilities System	1997	5.250% - 5.500%	08/01/2021	84,135,000		(33,212,660)	50,922,340
Student Union	2000	5.000%	06/01/2010	12,465,000	11,040,000		1,425,000
Student Recreation Center	1997	4.700% - 5.000%	06/01/2011	3,545,000	2,025,000		1,520,000
U.S. EPA Project	1991	9.050%	02/15/2015	58,125,000	25,450,000	(9,179,848)	23,495,152
Total Bonds Payable (principal only)				$ 973,990,000	$ 169,115,000	$ (42,392,508)	762,482,492
Less: Unamortized Loss on Refunding							(3,838,338)
Plus: Unamortized Premium							26,662,651
Total Bonds Payable							$ 785,306,805

C. Demand Bonds - Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a "put" feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the University's remarketing or paying agents.

With regards to the following demand bonds, the University has not entered into legal agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

General Revenue, Series 2001B and 2001C: In 2001 the University issued two series of variable rate demand bonds in the amount of $54,970,000 (2001B) and $54,970,000 (2001C) that each have a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and

Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agent, Lehman Brothers, Inc. (2001B) and UBS Financial Services, Inc. (2001C).

The University entered into a new line of credit agreement in the amount of $300,000,000 with Wachovia Bank on September 21, 2006, and canceled its line of credit in the amount of $107,460,000 with JP Morgan Chase Bank. Under the new line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal and accrued interest on variable rate demand bonds or commercial paper bonds delivered to purchase. Under the new line of credit agreement, the University may request that Wachovia Bank increase the commitment by increments of $25,000,000 for a total commitment of up to $400,000,000. A request for increase is subject to the bank's sole discretion, and the University cannot be in default under the agreement.

The University is required to pay a quarterly facility fee for the line of credit in the amount of 0.08% per annum based on the size of the commitment. If a long-term debt rating assigned by S&P, Moody's, or Fitch is lowered, the facility fee assigned to the lowest rating in the table below shall apply:

S&P	Fitch	Moody's	Facility Fee
AA	AA	Aa2	0.10%
AA-	AA-	Aa3	0.11%
A+	A+	A1	0.14%
A	A	A2	0.18%

In the event that the bank increases the available commitment prior to the due date for payment of a facility fee, the University must pay a supplemental fee based on the facility fee applied to the amount of the increase at the time of the commitment to increase. The University will also pay an accrued interest fee equal to the amount of accrued interest, at the time of purchase of bonds, multiplied by the prime rate multiplied by the ratio of the number of days from the date of purchase of bonds until the date of payment of the accrued interest 365 days.

Under the line of credit agreement, draws to purchase bonds will accrue interest at the prime rate payable on the same interest date as provided in the trust agreement for the original bonds. The University is required to begin making a series of ten fully amortizing semi-annual principal payments on bonds held by the bank six months after the date of purchase. Commercial paper bonds held by the bank may be rolled over for a period of 180 days and must be reduced by 1/10 of the original amount of the commercial paper bonds for a period of up to 10 rollovers. All outstanding principal and accrued but unpaid interest is due in full at the maturity of the line of credit. At June 30, 2007, no purchase draws had been made under the line of credit.

The line of credit agreement expires on September 21, 2011, and is subject to covenants customary to this type of transaction, including a default provision in the event that the University's long-term bond ratings were lowered to below a BBB- for S&P, BBB- for Fitch, and Baa3 for Moody's.

Interest Rate Swaps

Lehman Brothers Special Financing, Inc.: To protect against the risk of interest rate changes, effective October 3, 2000, the University entered into an interest rate swap agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) related to $22,000,000 of The University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Demand Bonds, Series 2001B (2001B Bonds), and the interest rate swap agreement was amended to reflect the refunding.

Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the Securities Industry and Financial Markets Association (SIFMA) index on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. The notional amount of the swap reduces annually in conjunction with the 2001B Bonds; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2007, rates were as follows:

Fixed Payment to Lehman	Fixed	5.24
Variable Payment from Lehman	SIFMA	3.73
Net Interest Rate Swap Payments		1.51
Variable Rate Bond Coupon Payments		3.70
Synthetic Interest Rate on Bonds		5.21

As of June 30, 2007, the swap had a fair value of negative $2,473,616. The fair value was developed by Lehman Brothers. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for

London Interbank Offered Rate (LIBOR) due on the date of each future net settlement on the swap.

As of June 30, 2007, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than $1,000,000, at that point Lehman would be required to collateralize 103% of their exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A1 by Moody's, A+ by S&P, and AA- by Fitch for unsecured long-term debt.

The University receives the SIFMA index from Lehman Brothers and pays a floating rate to its bondholders set by the remarketing agent. The University incurs basis risk when its bonds begin to trade at a yield above the SIFMA index. Basis risk also exists since swap payments are made quarterly while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a SIFMA swap to a percentage of LIBOR swap. This would introduce basis risk. If the weekly reset interest rates on the University's bonds are in excess of 65% of LIBOR, the University will experience an increase in debt service above the fixed rate on the swap to the extent that the interest rates on the bonds exceed 65% of LIBOR.

The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Lehman Brothers fails to perform under terms of the contract.

Bank of New York: To protect against the risk of interest rate changes, the University entered into an interest rate swap agreement with the Bank of New York (BNY) on April 19, 2006, based on a notional amount of $150,000,000, effective December 1, 2007, maturing in April 1, 2036.

Under the agreement, BNY pays the University 67% of the one-month LIBOR index times the notional amount, payable monthly. The University pays BNY a fixed rate of 3.785% on the notional amount, payable monthly. Since the effective date is in the future, there is no expected cash flow until after that date, but the agreement carries with it a market fair value based on swap market conditions. The University anticipates that changes in the cost of issuing traditional fixed-rate debt will be offset by the change in the fair value of the swap, and additionally, that interest on variable rate bonds will correlate highly with 67% of the one-month LIBOR index, such that the University has the option to (1) issue variable rate bonds in December 2007, thereby effectively creating synthetic fixed-rate debt, or (2) unwind the swap, capturing the value of the movement of interest rates from the issuance date, and issuing traditional fixed rate bonds.

As of June 30, 2007, the swap had a fair value of $350,244. The fair value was developed by BNY. Market value represents the amount that would be paid to (or received from) another swap dealer to assume the payments under the swap.

As of June 30, 2007, the University was exposed to credit risk because of the derivative's positive fair value. In the event that the swap carried a positive fair value for the University and in the event of a specified ratings downgrade of BNY's unsecured long-term debt, BNY would be required to post collateral in the amount of the difference between the positive fair value of the swap and the thresholds in the below table.

Ratings Moody's/S&P/Fitch	Threshold
Aa3/AA- or above	$Infinity
A1/A+	$15,000,000
A2/A	$10,000,000
A3/A- or below	$0

The University is also subject to the same provisions. BNY was rated AA- by S&P, AA- by Fitch and Aaa by Moody's. Since there have been no ratings downgrade, no posted collateral was required. In the event collateralization was required, the University is entitled to hold posted collateral or appoint a custodian to hold posted collateral. Collateral could be in the form of U.S. lawful currency, U.S. government or agency securities, or other collateral acceptable to the University.

Changes in swap interest rates and tax-exempt bond interest rates may differ, introducing basis risk in the event the swap is unwound and traditional fixed-rate debt is issued. In the event that the University issues variable rate debt to create synthetic fixed rate debt, the University will pay a rate on the bonds that may not correlate with 67% of the one-month LIBOR index, altering the "fixed" cost of synthetic debt.

The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or BNY fails to perform under terms of the contract.

Wachovia: To protect against the risk of interest rate changes, the University entered into an interest rate swap agreement with Wachovia on December 5, 2006, based on a notional amount of $100,000,000, effective December 1, 2007, maturing in December 1, 2036.

Under the agreement, Wachovia pays the University 67% of the one-month LIBOR index times the notional amount, payable monthly. The University pays Wachovia a fixed rate of 3.314% on the notional amount, payable monthly. Since the effective date is in the future, there is no expected cash flow until after that date, but the agreement carries with it a market fair value based on swap market conditions. The University anticipates that changes in the cost of issuing traditional fixed-rate debt will be offset by the change in the fair value of the swap, and additionally, that interest on variable rate bonds will correlate highly with 67% of the one-month LIBOR index, such that the University has the option to (1) issue variable rate bonds in December 2007, thereby effectively creating synthetic fixed-rate debt, or (2) unwind the swap, capturing the value of the movement of interest rates from the issuance date, and issuing traditional fixed rate bonds.

As of June 30, 2007, the swap had a fair value of $6,788,368. The fair value was developed by Wachovia. Market value represents the amount that would be paid to (or received from) another swap dealer to assume the payments under the swap.

As of June 30, 2007, the University was exposed to credit risk because of the derivative's positive value in the amount of the fair value. In the event that the swap carried a positive fair value for the University and in the event of a specified ratings downgrade of Wachovia's unsecured long-term debt, Wachovia would be required to post collateral in the amount of the difference between positive fair value of the swap and the thresholds in the below table.

Ratings Moody's/S&P/Fitch	Threshold
Aa3/AA- or above	$Infinity
A1/A+	$15,000,000
A2/A	$10,000,000
A3/A- or below	$0

The University is also subject to the same provisions. Wachovia was rated AA by S&P, AA- by Fitch and Aa1 by Moody's. Since there have been no ratings downgrade, no posted collateral was required. In the event collateralization was required, the University is entitled to hold posted collateral or appoint a custodian to hold posted collateral. Collateral could be in the form of U.S. lawful currency, U.S. government or agency securities, or other collateral acceptable to the University.

Changes in swap interest rates and tax-exempt bond interest rates may differ, introducing basis risk in the event the swap is unwound and traditional fixed-rate debt is issued. In the event that the University issues variable rate debt to create synthetic fixed rate debt, the University will pay a rate on the bonds that may not correlate with 67% of the one-month LIBOR index, altering the “fixed” cost of synthetic debt.

The swap agreement uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Wachovia fails to perform under terms of the contract.

D. **Capital Appreciation Bonds** - The University’s Series 1997 Utility System and the Series 1991 U.S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of $30,379,142 and $3,828,921, respectively. These bonds are recorded in the amounts of $50,922,340 ($84,135,000 ultimate maturity less $33,212,660 discount) and $16,095,152 ($25,275,000 ultimate maturity less $9,179,848 discount), respectively, which is the accreted value at June 30, 2007. These bonds mature in the years from 2015 to 2021.

E. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2007, are as follows:

	Annual Requirements				
	Bonds Payable			Notes Payable	
Fiscal Year	Principal	Interest	Interest Rate Swaps, Net *	Principal	Interest
2008	$ 22,515,000	$ 32,976,376	$ 312,419	$ 1,362,000	$ 19,477
2009	24,055,000	31,795,679	308,304		
2010	24,470,000	30,529,974	304,039		
2011	24,905,000	29,608,487	299,546		
2012	25,530,000	28,635,472	294,865		
2013-2017	119,695,000	133,482,135	1,305,018		
2018-2022	110,785,000	118,636,924	882,293		
2023-2027	66,025,000	102,653,598	241,449		
2028-2032	28,225,000	92,416,400			
2033-2037	358,670,000	26,754,375			
Total Requirements	$ 804,875,000	$ 627,489,420	$ 3,947,933	$ 1,362,000	$ 19,477

Interest on the variable rate General Revenue Bonds 2001B is calculated at 3.70% at June 30, 2007
Interest on the variable rate General Revenue Bonds 2001C is calculated at 3.67% at June 30, 2007

This schedule also includes the debt service requirements for debt associated with interest rate swaps. More detailed information about interest rate swaps is presented in Note 8C.

*Computed using (5.24% - 3.73%) X ($22,000,000 - annual swap reduction)

F. Bond Defeasance - During the prior year, the University extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

Housing System: On August 30, 2005, the University defeased $6,250,000 of outstanding Housing System Revenue Bonds, Series 1997A. 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 Statement of Net Assets. At June 30, 2007, the outstanding balance of the defeased Housing System, Series 1997A bonds was $5,850,000.

Parking System: On August 30, 2005, the University defeased $9,900,000 of outstanding Parking System Revenue Bonds, Series 1997A. 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 Statement of Net Assets. At June 30, 2007, the outstanding balance of the defeased Parking System, Series 1997A bonds was $0.

Student Union: On August 30, 2005, the University defeased $8,750,000 of outstanding Student Fee Revenue Bonds, Series 2000. 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 Statement of Net Assets. At June 30, 2007, the outstanding balance of the defeased Student Fee Revenue Bonds, Series 2000 bonds was $8,750,000.

General Revenue Bonds, Series 2001A: On August 30, 2005, the University defeased $33,310,000 of outstanding General Revenue Bonds, Series 2001A. 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 Statement of Net Assets. At June 30, 2007, the outstanding balance of the defeased General Revenue Bonds, Series 2001A bonds was $33,310,000.

Dining System: On February 7, 2001, the University defeased $13,205,000 of outstanding Dining System Revenue Bonds, Series 1997. 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 Statement of Net Assets. At June 30, 2007, the outstanding balance of the defeased Dining System bonds was $0.

Student Union: On December 1, 1999, the University defeased $620,000 of outstanding Student Union Revenue Bonds, Series 1967. Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2007, the outstanding balance of the defeased Student Union bonds was $85,000.

G. Notes Payable - The University was indebted for notes payable for the purposes shown in the following table:

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Beginning Balance June 1, 2006	Draws	Repayments	Principal Outstanding June 30, 2007
Rizzo Center	Wachovia Bank	6.52%	09/22/2006	$ 18,537,556	$ 1,180,965	$ 19,718,521	$ 0
Real Property Purchases	Bank of America	5.72%	09/30/2007	2,516,446		1,154,446	1,362,000
Total Notes Payable				$ 21,054,002	$ 1,180,965	$ 20,872,967	$ 1,362,000

The Kenan-Flagler Business School Foundation, part of the University's financial reporting entity, closed a $20,000,000 unsecured line of credit with Wachovia Bank on September 22, 2004. This credit facility was used to fund the expansion of the Paul J. Rizzo Business Conference Center and expired on September 22, 2006. The line of credit with Wachovia Bank was paid February 22, 2007.

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, originally in the aggregate principal amount up to $10,000,000 to finance the costs of projects benefiting the foundation or the University. The line of credit had a maturity date of September 30, 2007 and subsequent to year end, it was extended to June 30, 2009. The aggregate principal amount remained at $6,000,000. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 0.40%. An unused commitment fee is due each quarter calculated as 0.25% of the difference between the commitment amount and the average balance outstanding for the quarter through June 30, 2005, and 0.225% thereafter. The University repays draws on the note with capital improvement funds designated for land acquisition.

H. Annuities Payable – The University participates in split-interest agreements with donors that require benefits payments for a specified period to a designated beneficiary out of assets held in trust for this purpose. At the end of the predetermined period (e.g., the lifetime of the beneficiary specified by the donor), the remaining assets of the trust revert to the University for its use or for a purpose specified by the donor. At the end of each fiscal year, annuities and life income payable to the beneficiaries is calculated using IRS issued 90CM table, taking into consideration beneficiary's age and the amount of the gift, and using IRS issued Life Table 90CM.

NOTE 9 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to medical and research 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, 2007:

Fiscal Year	Amount
2008	$ 1,020,531
2009	949,262
2010	440,520
2011	201,105
2012	71,610
Total Minimum Lease Payments	2,683,028
Amount Representing Interest (4.6% -29.9% Rate of Interest)	278,678
Present Value of Future Lease Payments	$ 2,404,350

Machinery and equipment acquired under capital lease amounted to $2,839,792 at June 30, 2007.

B. Operating Lease Obligations - Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2007:

Fiscal Year	Amount
2008	$ 4,675,614
2009	2,672,604
2010	1,798,646
2011	866,105
2012	48,122
Total Minimum Lease Payments	$ 10,061,091

Rental expense for all operating leases during the year was $14,068,702.

C. Other Lease Obligations: The UNC-Chapel Hill Foundation issued certificates of participation to provide for construction of alumni facilities. The University constructed the facilities as an agent for the UNC-Chapel Hill Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-Chapel Hill Foundation and simultaneously entered into a sublease agreement with the General

Alumni Association, an affiliated organization, for the same time period for the use of the alumni facilities.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2007, the aggregate principal amount of the certificates was $9,950,000.

If the University complies with all the terms of the lease agreement, title to the alumni facilities will be conveyed to the University.

NOTE 10 - RESTRICTED NET ASSETS

Restricted net assets at June 30, 2007, were as follows:

	Amount
Nonexpendable	
Scholarships and Fellowships	$ 109,478,435
Research	14,917,590
Library Acquisitions	26,133,509
Endowed Professorships	204,597,234
Departmental Uses	95,467,393
Loans	15,876,831
Other	29,977,473
Total Nonexpendable	$ 496,448,465
Expendable	
Scholarships and Fellowships	$ 219,159,265
Research	25,416,168
Library Acquisitions	58,276,312
Endowed Professorships	376,059,961
Departmental Uses	304,194,803
Instruction and Educational Agreements	11,926,061
Plant Improvements	16,207,776
Capital Projects	69,817,295
Debt Service	8,985,000
Total Expendable	$ 1,090,042,641

NOTE 11 - 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 Change in Allowance for Uncollectibles	Less Indigent Care and Contractual Adjustments	Net Revenues	Revenues Pledged as Security for Debt	
Operating Revenues:								
Student Tuition and Fees	$ 261,744,652	$ 0	$ 51,093,134	$ 0	$ 0	$ 210,651,518	$ 4,613,811	(A)
Patient Services	$ 521,439,391	$ 0	$ 0	$ 7,733,642	$ 316,484,231	$ 197,221,518	$ 0	
Sales and Services:								
Sales and Services of Auxiliary Enterprises:								
Residential Life	$ 38,755,995	$ 0	$ 7,352,245	$ 0	$ 0	$ 31,403,750	$ 31,403,750	(B)
Dining	22,583,850					22,583,850		
Student Union Services	416,651	376,550				40,101		
Health, Physical Education, and Recreation Services	6,413,205	143	275,478			6,137,584		
Bookstore	28,616,292	4,099,352	345,144			24,171,796		
Parking	21,568,587	740				21,567,847	21,567,847	(C)
Athletic	38,197,319	23,396				38,173,923		
Utilities	90,612,131	70,620,283				19,991,848	19,991,848	(D)
Telecommunications	15,925,201	12,753,215				3,171,986		
Other Professional Income	87,368,259	139,575				87,228,684		
Printing/Carolina Copy	9,045,039	6,024,949				3,020,090		
Repairs & Maintenance	29,294,025	28,031,181				1,262,844		
Material Management and Disbursements	21,961,085	21,255,206				705,879		
Other	102,634,903	37,663,572				64,971,331	3,612,495	(E)
Total Sales and Services	$ 513,392,542	$ 180,988,162	$ 7,972,867	$ 0	$ 0	$ 324,431,513	$ 76,575,940	
Nonoperating - Noncapital Gifts	$ 74,253,058	$ 0	$ 0	$ (38,541)	$ 0	$ 74,291,599	$ 0	

Revenue Bonds Secured by Pledged Revenues:
(A) Student Fee Revenue Bonds, Series 1997 & 2000
(B) Housing System Revenue Bonds, Series 1997 A & B
(C) Parking System Revenue Bonds, Series 1997A & B
(D) Utility System Revenue Bonds, Series 1997
(E) US EPA Project, Series 1991 & 1996

NOTE 12 - 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	$ 477,946,300	$ 29,763,639	$ 116,311,429	$ 0	$ 106,969	$ 0	$ 624,128,337
Research	205,659,528	41,049,571	65,432,962		18,154		312,160,215
Public Service	32,602,817	1,720,649	55,610,097		91,534		90,025,097
Academic Support	63,489,935	14,460,453	19,764,116		61,259		97,775,763
Student Services	11,914,848	943,564	13,001,994		3,739		25,864,145
Institutional Support	49,993,306	6,921,372	19,250,178		23,501		76,188,357
Operations and Maintenance of Plant	39,398,479	11,746,874	21,193,350		52,652,430		124,991,133
Student Financial Aid				56,662,461			56,662,461
Auxiliary Enterprises	241,263,911	59,097,781	151,528,646		7,769,414		459,659,752
Depreciation						80,826,849	80,826,849
Total Operating Expenses	$ 1,122,269,124	$ 165,703,903	$ 462,092,772	$ 56,662,461	$ 60,727,000	$ 80,826,849	$ 1,948,282,109

NOTE 13 - 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, 2007, these rates were set at 2.66% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2007, the University had a total payroll of $969,440,038, of which $401,055,925 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $24,063,356 and $10,668,088, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2007, 2006, and 2005, which were $10,668,088, $8,587,084, and $7,633,965, 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.ncosc.net/ 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, 2007, 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, 2007, the University had a total payroll of $969,440,038, of which $386,278,029 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were $23,176,682 and $26,421,417, 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 $5,735,239 for the year ended June 30, 2007.

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, 2007, were $238,968. The voluntary contributions by employees amounted to $3,239,665 for the year ended June 30, 2007.

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 $25,313,393 for the year ended June 30, 2007.

NOTE 14 - 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, 2007, the University's total contribution to the Plan was $29,918,690. 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. **Disability Income** - 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, 2007, the University's total contribution to the DIPNC was $4,094,137. 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 15 - 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.

Public Officer's and Employee's Liability Insurance - 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.

System Fund (Blended Component Unit) Liability Insurance - The System Fund is exposed to various risks of loss related to torts, theft of assets and errors and omissions. The Management Company is a separate legal entity from The University of North Carolina System and the University. However, the Management Company's employees conduct System Fund's affairs. Therefore, exposures to loss are handled by the purchase of commercial insurance by the Management Company. This insurance is independent of the risk management programs of The University of North Carolina System and the University.

Fire and Other Property Loss - 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. Fire and lightning losses covered by the Fund are subject to a $500 per occurrence deductible. Effective this year, the University also purchased through the Fund extended coverage for all campus buildings and contents with a $500,000 per occurrence deductible. This extended coverage provides insurance against an additional set of perils, most notably for windstorms.

Automobile Liability Insurance - 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.

Employee and Computer Fraud - 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 $75,000 deductible and a 10 % participation in each loss above the deductible.

Other authorized coverage not handled by the North Carolina Department of Insurance is purchased through the State's insurance agent of record. Examples include, but are not limited to, fine arts, boiler and machinery, medical professional liability, athletic accident and revenues, and study abroad health insurance.

Comprehensive Major Medical Plan - 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.

Liability Insurance Trust Fund - The University participates in the Liability Insurance Trust Fund (Trust Fund), a claims-servicing public entity risk pool for healthcare professional liability protection. The Trust Fund services professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Trust Fund.

The Trust Fund is an unincorporated entity created by Chapter 116, Article 26, of the *North Carolina General Statutes* and The University of North Carolina Board of Governors Resolution of June 9, 1978. The Trust Fund is a self-insurance program established to provide professional medical malpractice liability covering The University of North Carolina Hospitals at Chapel Hill (UNC Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (UNC P&A), the program participants. The Trust Fund provides coverage for program participants and individual health care practitioners working as employees, agents, or officers of program participants. The Trust Fund is exempt from federal and State income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

Participation in the Trust Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the UNC Hospitals, and any health-care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the UNC Hospitals. Only the

UNC P&A and the UNC Hospitals have participated in the Trust Fund to date. Participants provide management and administrative services to the Trust Fund at no cost.

The Trust Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of 13 members as follows: one member each appointed by the State Attorney General, the State Auditor, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and eight members appointed to three-year terms (with no limit on the number of terms) by the UNC System's Board of Governors.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation, and other factors. Participant assessments are determined at a level to fund claim liabilities, discounted for future investment earnings. Each participant is required by statute to maintain a fund balance of $100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

For the period July 1, 2006, through June 30, 2007, the Trust Fund provided coverage on an occurrence basis of $3,000,000 per individual and $7,000,000 in the aggregate per claim. The Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer in prior years. However, excess reinsurance coverage was not purchased for the policy year ended June 30, 2007, as the Trust Fund chose to retain 100% of the liability. In lieu of reinsurance, the participants contributed $10,000,000 in the aggregate toward the reimbursement fund for future losses.

For the fiscal year ending June 30, 2007, the Trust Fund purchased a direct insurance policy to cover the first $1,000,000 per occurrence and $3,000,000 in the aggregate for dental residents. *North Carolina General Statutes* Chapter 116 was amended during 1987 to authorize the Trust Fund to borrow necessary amounts up to $30,000,000, in the event that the Trust Fund may have insufficient funds to pay existing and future claims. Any such borrowing would be repaid from the assets and revenues of program participants. No line of credit or borrowing has been established pursuant to this authorization. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

The Trust Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation.

The related claim liabilities have been removed from estimated malpractice costs.

The Council may choose to terminate the Trust Fund, or the respective participants may choose to terminate their participation. In the event of such termination by either the Council or a participant, an updated actuarial study will be performed to determine amounts due to or from the participants based on loss experience up to the date of termination.

At June 30, 2007, University assets in the Trust Fund totaled $38,414,642 while University liabilities totaled $26,520,695 resulting in net assets of $11,893,947.

Additional disclosures relative to the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund for the years ended June 30, 2007 and 2006. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 4030 Bondurant Hall, CB# 7000, Chapel Hill, North Carolina 27599-7000, or by calling (919) 966-1712.

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 0.16% 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 16 - COMMITMENTS AND CONTINGENCIES

A. **Commitments** - The University has commitments of $96,381,242 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

B. **Pending Litigation and Claims** - The Supreme Court of North Carolina issued a ruling on July 1, 2005, regarding litigation between North Carolina School Boards Association, et. al. v. Richard H. Moore, State Treasurer, et. al. which involves various state officials in their official capacity seeking a judicial determination as to whether the State constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. The complaint alleged in part that the monetary payments collected pursuant to statutory authority by the University for violations of parking and traffic regulations and library fines are "civil penalties" which the State Constitution requires to be paid to the school fund in the county where they are collected. The lawsuit sought declaratory judgment that the State Civil Penalty and Forfeiture Fund, the State School Technology Fund, and the Public Settlement Reserve Fund are unconstitutional.

On December 14, 2001, the Wake County Superior Court ruled in favor of the plaintiffs but has stayed enforcement of the ruling, pending appeal. The defendants did appeal this judgment. The Court of Appeals affirmed in part and reversed in part the order of summary judgment by the Superior Court. The North Carolina Supreme Court affirmed the Court of Appeals ruling that library fines are not civil penalties. The North Carolina Supreme Court reversed the ruling that fines for parking and traffic regulations are not civil penalties. The civil penalties case is still pending in Wake Superior Court. This Court has not scheduled a final hearing or issued a judgment because the plaintiffs and State legislative leadership have been involved in settlement negotiations, which are being facilitated by the State Attorney General Office.

At issue is the effective date of the ruling. Approximately $10.2 million representing net fines from the Department of Public Safety has been collected from 1994-95 through 2004-05, and of that amount 10% may be retained by the University to fund related operating expenses. Therefore, $9.2 million may be payable by the University. Approximately $3.6 million in collected fines remains unexpended should it be needed for possible payment. Annual fines are approximately $850,000. Fines net of approved operating expenses have been remitted to the State Treasurer on a monthly basis beginning July 1, 2005. The current unexpended amount is based on the initial lawsuit date of December 14, 2001. An additional amount up to $5.6 million could be needed for possible payment if the effective date is determined to be earlier. It is not expected that the effective date of the ruling will be prior to fiscal year 1994-95.

The University is undertaking environmental remediation efforts on the Old Sanitary Landfill. The amount of the liability associated with this site cannot reasonably be estimated at this time.

The University is a party to other 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
Pledges to permanent endowments	$ 37,852,053

NOTE 17 - RELATED PARTIES

There are 13 separate nonprofit organizations that are considered related to the University. They include Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The School of Government Foundation, Inc., The Law Alumni Association of N.C., Inc., The Morehead Scholarship Foundation, Inc., The Pharmacy Foundation of North Carolina, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc., and Carolina for Kibera, Inc. Some of these organizations serve, in conjunction with the University's component units (See Note 1A), as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support totaled $16,783,999 for the year ended June 30, 2007.

NOTE 18 - SUBSEQUENT EVENTS

On November 9, 2007, the Board of Governors of the University approved the issuance of $298,475,000 of General Revenue Bonds in December 2007. Approximately $170,000,000 of the issued amount is expected to refund outstanding commercial paper.

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

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2007, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 7, 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 the discretely presented component units, as described in our report on the University's financial statements. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the University's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

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

Leslie W. Merritt, Jr.

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

December 7, 2007

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