



STATE OF NORTH CAROLINA

UNIVERSITY OF NORTH CAROLINA WILMINGTON

WILMINGTON, 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

UNIVERSITY OF NORTH CAROLINA WILMINGTON

WILMINGTON, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2007

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

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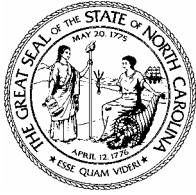
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STATE OF NORTH CAROLINA
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Leslie W. Merritt, Jr., CPA, CFP
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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of University of North Carolina Wilmington 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 the Research and Development Cluster in accordance with applicable laws, regulations, contracts and grants disclosed certain deficiencies and/or instances of noncompliance that are detailed in the Audit Findings and Responses section of this report. The University's response is included following each finding.

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

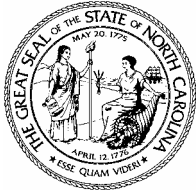
Leslie W. Merritt, Jr.

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

February 15, 2008

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Leslie W. Merritt, Jr., CPA, CFP
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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
University of North Carolina Wilmington
Wilmington, North Carolina

We have audited the accompanying financial statements of University of North Carolina Wilmington, 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 unit, 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 Wilmington'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 UNCW Corporation, Inc., the University's discretely presented component unit. Those financial statements were audited by another auditor whose report thereon has been furnished to us, and our opinions, insofar as they relate to the amounts included for that entity, are based on the report of the other auditor.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 UNCW Corporation, 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 report of the other auditor provides a reasonable basis for our opinions.

In our opinion, based on our audit and the report of the other auditor, the financial statements referred to above present fairly, in all material respects, the respective financial position of University of North Carolina Wilmington and its discretely presented component unit 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.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2008, 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., CPA, CFP
State Auditor

January 7, 2008

**UNIVERSITY OF NORTH CAROLINA WILMINGTON
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Financial Analysis

The University of North Carolina at Wilmington provides the following management's discussion and analysis (MD&A) as an overview of the financial activities for the fiscal year ending June 30, 2007. The following financial statements and notes to the financial statements comprise our complete set of financial information. The MD&A identifies significant transactions that have financial impact and highlights favorable and unfavorable trends. Comparative data for the previous year is presented to help better understand the financial information.

Using the Financial Statements

The University's financial report includes three basic comprehensive financial statements that depict the financial activity and fiscal condition of the University for the current year: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. These financial statements are prepared in accordance with Government Accounting Standards Board (GASB) principles. The accrual basis of accounting has been used to prepare the statements. This method of accounting requires that revenues and assets are recognized when the service is provided. Expenses and liabilities are recognized when others provide services, regardless of when cash is exchanged.

The Statement of Net Assets includes all University assets and liabilities. The University's net assets (the monetary difference between total assets and total liabilities) are one indicator of the University's financial viability. Over time, changes in net assets provide information on the improvement or erosion of the University's financial condition when considered with non-financial facts such as enrollment levels and the condition of facilities.

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the fiscal year. Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 classifies State appropriations and gifts as nonoperating revenues. With State appropriations and gifts being classified as nonoperating revenues, most public institutions will report an operating deficit.

Another important factor to consider when evaluating the financial viability of the University is the ability to meet financial obligations as they mature. The Statement of Cash Flows presents information that allows the reader to evaluate the University's ability to meet its financial obligations on a current basis.

Financial Highlights

For the first time in many years, the State was able to meet fiduciary commitments without imposing budget reductions on the universities. The result was the University's general fund budgets growing by 16.4 percent from June 30, 2006 to June 30, 2007. A large portion of the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

increase was associated with enrollment growth, which totaled \$6.3 million and 40.26 new faculty positions. In addition the State provided salary increases of 6 percent for faculty and administrators and 5.5 percent for SPA employees. These increases totaled nearly \$5.0 million. Still one of the lowest funded institutions (State appropriation per student FTE) in the UNC system, the additional funds will be used to meet strategic goals and priorities set by the institution in the long-rang planning.

Capital projects continued to move ahead on campus. The largest construction projects completed during the year were the Cultural Arts building at \$31.2 million and the Computer and Information Systems building at \$11.9 million. Ongoing projects include the renovations of the University Union and Burney Center, Friday Hall, and Kenan Hall and the completion of the CMS Operations Building.

Along with the opening of Seahawk Village in 2006, the Seahawk Landing is the second apartment style complex completed this year on the University campus. Seahawk Landing provides additional two, three, and four bedroom completely furnished apartments with both clubhouse and pool amenities. The completion of the project resulted in the University signing a capital lease for \$38 million with the UNCW Corporation.

In 2007, the combined University and Foundation endowment was \$53.1 million. Gifts were \$3,413,815. Appreciation and investment income amounted to \$8,067,000 with other withdrawals, including spendable income, in the amount of \$3,032,000.

Statement of Net Assets

The Statement of Net Assets presents the assets (current and noncurrent), liabilities (current and noncurrent), and net assets (total assets minus total liabilities) of the University. This statement provides a fiscal snapshot of the University's financial position as of June 30, 2007. The data provides readers of this statement information on assets available to continue operations; amounts due vendors, investors, and lending institutions; and the net assets available for expenditure by the University.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Net Assets June 30, as Indicated

	2007	2006	Change	% Change
Assets				
Current Assets	\$ 67,026,548	\$ 56,835,434	\$ 10,191,114	17.9%
Noncurrent Assets	120,450,306	69,537,424	50,912,882	73.2%
Capital Assets, Net	334,399,344	271,582,676	62,816,668	23.1%
Total Assets	521,876,198	397,955,534	123,920,664	31.1%
Liabilities				
Current Liabilities	26,939,077	25,823,036	1,116,041	4.3%
Noncurrent Liabilities	151,576,498	102,509,586	49,066,912	47.9%
Total Liabilities	178,515,575	128,332,622	50,182,953	39.1%
Net Assets				
Invested in Capital Asset	189,381,760	175,047,776	14,333,984	8.2%
Restricted Nonexpendable	42,874,293	32,487,015	10,387,278	32.0%
Restricted Expendable	71,930,720	33,195,893	38,734,827	116.7%
Unrestricted	39,173,850	28,892,228	10,281,622	35.6%
Total Net Assets	\$ 343,360,623	\$ 269,622,912	\$ 73,737,711	27.3%

On June 30, 2007, total University assets were \$521.9 million. The largest asset categories include the University's net investment in capital assets (\$189.4 million), cash and cash equivalents (\$107.3 million) and the endowment (\$53.1 million). The \$53.1 million in endowment investments was made up of the University endowment of \$49.8 million and the Foundation endowments of \$3.3 million.

The noncurrent assets increase of \$50.9 million this year is attributable to the increase in capital improvement funds of \$31.6 million to fund the new Nursing Building. Secondly, the other large increase is \$13.7 million in the endowment due to gifts and an increase in the investments market value. University liabilities totaled \$178.5 million on June 30, 2007. Long term debt of \$145 consisting of bonds payable, notes payable, and capitalized lease obligations, is the largest liability category. Total liabilities increased \$50.2 million from June 30, 2006 primarily due to an increase in capital leases. This increase was due to the fact that the University now leases additional apartments on campus from the UNCW Corporation, Inc. The restricted expendable assets increased by \$38.7 million mainly due to the \$27.0 million in capital appropriation received from the State for the Nursing building which was unspent at year end.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total net assets as presented on the Statement of Net Assets section are based on the activity reported in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of this statement is to present the revenues received by the institution, both

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

operating and nonoperating, and the expenses paid by the institution, operating and nonoperating, as well as any other revenues, expenses, gains and losses received or expended by the institution.

Operating revenues are received for providing goods and services to the various customers and constituencies of the University. Operating expenses are used to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided; i.e., State appropriations and investment income.

Condensed Statement of Revenues, Expenses, and Changes in Net Assets For Year Ended June 30, as Indicated

	<u>2007</u>	<u>2006</u>	<u>Change</u>	<u>% Change</u>
Operating Revenue				
Tuition and Fees (Net)	\$ 62,750,863	\$ 55,290,336	\$ 7,460,527	13.5%
Sales and Service (Net)	34,592,654	23,565,510	11,027,144	46.8%
Grant and Contracts	21,816,999	21,382,118	434,881	2.0%
Other	2,175,138	3,414,815	(1,239,677)	-36.3%
Total Operating Revenue	<u>121,335,654</u>	<u>103,652,779</u>	<u>17,682,875</u>	17.1%
Operating Expenses				
Salaries and Benefits	124,872,738	110,449,815	14,422,923	13.1%
Supplies and Materials	21,630,086	16,395,409	5,234,677	31.9%
Services	40,307,238	33,069,918	7,237,320	21.9%
Scholarships	7,141,196	6,663,908	477,288	7.2%
Utilities	6,923,661	6,639,617	284,044	4.3%
Depreciation	9,655,486	7,077,205	2,578,281	36.4%
Total Operating Expense	<u>210,530,405</u>	<u>180,295,872</u>	<u>30,234,533</u>	16.8%
Operating Loss	<u>(89,194,751)</u>	<u>(76,643,093)</u>	<u>(12,551,658)</u>	16.4%
Nonoperating Revenues				
State Appropriation	91,843,298	81,638,044	10,205,254	12.5%
Capital Gifts and Grants	54,405,614	24,581,395	29,824,219	121.3%
Noncapital Gifts and Grants	3,184,752	6,063,007	(2,878,255)	-47.5%
Other	13,498,798	4,555,801	8,942,997	196.3%
Total Nonoperating Revenues	<u>162,932,462</u>	<u>116,838,247</u>	<u>46,094,215</u>	39.5%
Increase in Net Assets	<u>73,737,711</u>	<u>40,195,154</u>	<u>33,542,557</u>	83.4%
Net Assets - Beginning of Year	<u>269,622,912</u>	<u>229,427,758</u>	<u>40,195,154</u>	17.5%
Net Assets - End of Year	<u>\$ 343,360,623</u>	<u>\$ 269,622,912</u>	<u>\$ 73,737,711</u>	27.3%

Student tuition and fees (\$62.8 million) and sales and services from auxiliary enterprises (\$34.6 million) account for 80.2% of the University's operating revenue. The increase in

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

sales and services of \$11.0 million is from the revenues for the new apartments (Seahawk Village) and associated food revenue. The \$29.8 million increase in capital gifts and grants is due to the \$27.0 million increase in capital appropriations for the Nursing building. Per GASB Statement No.35, State appropriations must be reported as nonoperating revenue even though this revenue source covers operating expenses.

The major operating expense categories include salary and benefit payments to faculty and staff (\$124.9 million) and payments to vendors and suppliers for services and goods (\$39.9 million).

Component Unit Reported Using Discrete Presentation

The University evaluates all of the affiliated organizations to determine which groups should be presented as a component unit. Currently the University has one component unit that must be reported discretely in the financial statements. The component unit of the University continued to grow with the UNCW Corporation leasing student apartments to the housing system on campus. In the summer of 2007 the second apartment complex was completed and turned over to the University. Other projects of the corporation are purchasing parking areas and other property which may be used in the University. The UNCW Corporation issued notes and bonds to finance these projects.

UNCW Corporation, Inc.

Total Net Assets

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Asset and Liabilities:			
Total Assets	\$ 77,475,903	\$ 75,493,697	\$ 1,982,206
Total Liabilities	<u>77,638,558</u>	<u>75,496,202</u>	<u>2,142,356</u>
Total Net Deficit	<u>\$ (162,655)</u>	<u>\$ (2,505)</u>	<u>\$ (160,150)</u>
Net Deficit:			
Restricted Net Assets - Expendable	<u>\$ (162,655)</u>	<u>\$ (2,505)</u>	<u>\$ (160,150)</u>
Total Net Deficit	<u>\$ (162,655)</u>	<u>\$ (2,505)</u>	<u>\$ (160,150)</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Unrestricted net assets have no external restrictions and are expendable. Temporarily restricted assets are also expendable but have a restriction on how they may be spent.

UNCW Corporation, Inc.

Changes in Net Assets

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Total Revenues	\$ 1,286,492	\$ 255,067	\$ 1,031,425
Total Expenses	<u>1,446,642</u>	<u>263,285</u>	<u>1,183,357</u>
Net Decrease	(160,150)	(8,218)	(151,932)
Net Assets - Beginning of Year	<u>(2,505)</u>	<u>5,713</u>	<u>(8,218)</u>
Net Assets - End of Year	<u>\$ (162,655)</u>	<u>\$ (2,505)</u>	<u>\$ (160,150)</u>

Rental income and direct financing lease income contributed to the large increase in revenues; while the large increase in expense is related to accrued construction expense.

Statement of Cash Flows

The Statement of Cash Flows provides information about cash receipts and cash payments during the year. The Statement of Cash Flows also helps users assess the University's:

- Ability to generate future net cash flows
- Ability to meet its obligations as they come due
- Need for external financing

Condensed Statement of Cash Flows For Year Ended June 30, as Indicated

	<u>2007</u>	<u>2006</u>	<u>Change</u>	<u>Change</u>
Cash Provided by:				
Operating Activities	\$ (77,931,704)	\$ (69,847,560)	\$ (8,084,144)	12%
Noncapital Financing Activities	100,753,297	84,152,990	16,600,307	20%
Capital Financing Activities	22,146,662	(21,745,108)	43,891,770	-202%
Investing Activities	<u>(3,926,500)</u>	<u>(1,663,614)</u>	<u>(2,262,886)</u>	136%
Net Change in Cash	<u>41,041,755</u>	<u>(9,103,292)</u>	<u>50,145,047</u>	-551%
Cash Beginning of Year	<u>66,238,043</u>	<u>75,341,335</u>	<u>(9,103,292)</u>	-12%
Cash Ending of Year	<u>\$ 107,279,798</u>	<u>\$ 66,238,043</u>	<u>\$ 41,041,755</u>	62%

Major sources of funds included in operating activities are student tuition and fees (\$62.6 million), auxiliary enterprises (\$30.5 million), and contracts and grants (\$22.1 million).

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Major uses of funds in operating activities are compensation to employees (\$123.1 million) and payments to suppliers for goods and services (\$65.8 million).

The largest inflow of cash in the noncapital financing activities is the State of North Carolina appropriation of \$91.8 million. The accounting standards require the University to reflect this source of revenue as nonoperating even though the University's budget depends on these funds to continue the current level of operations. Other noncapital financing activity includes gifts received (\$2.6 million).

Cash provided by capital financing activities during fiscal year 2007 includes capital grants from the State of North Carolina of \$20.7 million, bond proceeds of \$20.1 million and capital appropriations of \$27.0 million. Cash used in capital financing activities during fiscal year 2007 was primarily for the acquisition of capital assets (\$36.3 million) and the repayment of debt (\$9.9 million). This large increase in revenues resulted in the capital financing activity going from (\$21.7) million in 2006 to \$22.1 million in 2007.

Capital Asset and Debt Administration

Capital Assets

The University had \$334.4 million invested in capital assets at year end. This represents an increase of \$62.8 million from the prior year. This increase is comprised of a \$81.9 million increase in buildings which are the result of addition of the Seahawk Landing apartments, Cultural Arts and Computer Information System buildings. The decreases in construction in progress are due mainly to the same three building being completed and occupied.

Capital Assets Net of Depreciation June 30, as Indicated

	<u>2007</u>	<u>2006</u>	<u>Change</u>
Land	\$ 5,225,871	\$ 4,990,910	\$ 234,961
Art, Literature and Artifacts	1,278,971	1,219,578	59,393
Construction in Progress	46,956,800	70,000,194	(23,043,394)
Building	254,741,636	172,852,094	81,889,542
Machinery and Equipment	10,713,356	9,803,523	909,833
Infrastructure	15,482,710	12,716,377	2,766,333
Total Capital Assets	<u>\$ 334,399,344</u>	<u>\$ 271,582,676</u>	<u>\$ 62,816,668</u>

Capital projects scheduled for completion in 2007-2008 are the renovations of the University Union and Burney Center, Friday Hall, and Kenan Hall. Also, the new CMS Operations Building will be completed during the 2007-2008 fiscal year.

More detailed information on the University's capital assets is presented in Note 5 to the Financial Statements.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Debt

As of June 30, 2007, the University has \$145.0 million in outstanding bonds, notes and capital leases, of which \$73.7 million is for outstanding bonds. Through public/private agreement the University is leasing the new student apartments from the UNCW Corporation. There have been no significant changes in credit ratings or debt limitations that would affect future financing for the University.

More detailed information on the University's long-term obligations is presented in Note 7 to the Financial Statements.

Economic Forecast

The University believes it is well positioned to continue and maintain its strong financial condition and level of excellence in service to students, the community, and other constituencies. The University's strong financial position should provide a high degree of flexibility in obtaining debt funds on competitive terms. This flexibility, along with the University's ongoing efforts toward revenue diversification and cost containment, will enable the University to provide the necessary resources to support a continued level of excellence well into the future. The University will continue to execute its long-range strategic goals and expand teaching and research facilities to address the issues of growth and the continuing effects of technology on teaching and research methodologies.

A crucial element to the University's future will continue to be the relationship with the State of North Carolina and its ability to fund higher education. There is a direct relationship between the growth of State support and the University's ability to control increases in tuition rates.

Gifts are an important supplement in meeting the goals and strategic plans of the University, and are also a significant factor in the growth and quality of academic units. The continued success in fund raising will enhance the level of opportunity for the students.

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

Contacting the University's financial management

This financial report is designed to provide our students, citizens, investors and creditors with a general overview of the University's finances and demonstrate accountability of all funds received. Questions or additional financial information may be obtained by contacting the Division of Business Affairs at (910)-962-3067.

University of North Carolina Wilmington
Statement of Net Assets
June 30, 2007

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 51,136,451.02
Restricted Cash and Cash Equivalents	7,457,754.81
Receivables, Net (Note 4)	3,730,744.58
Due from Primary Government	3,287,440.25
Inventories	330,036.11
Notes Receivable, Net (Note 4)	1,084,120.76

Total Current Assets	67,026,547.53
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Noncurrent Assets:

Restricted Cash and Cash Equivalents	48,685,592.30
Receivables, Net (Note 4)	833,113.64
Restricted Due from Primary Government	6,731,994.64
Endowment Investments	53,109,781.89
Other Investments	7,418,926.78
Notes Receivable, Net (Note 4)	3,670,897.58
Capital Assets - Nondepreciable (Note 5)	53,461,642.45
Capital Assets - Depreciable, Net (Note 5)	280,937,701.70

Total Noncurrent Assets	454,849,650.98
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Total Assets	521,876,198.51
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	9,338,047.01
Deposits Payable	324.45
Unearned Revenue	2,961,915.01
Interest Payable	1,626,289.57
Long-Term Liabilities - Current Portion (Note 7)	13,012,500.82

Total Current Liabilities	26,939,076.86
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Noncurrent Liabilities:

Deposits Payable	26,733.38
Funds Held for Others	7,330,643.66
U. S. Government Grants Refundable	4,488,969.55
Long-Term Liabilities (Note 7)	139,730,151.66

Total Noncurrent Liabilities	151,576,498.25
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Total Liabilities	178,515,575.11
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University of North Carolina Wilmington
Statement of Net Assets
June 30, 2007

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	189,381,760.09
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	22,956,195.38
Research	1,333,005.20
Endowed Professorships	7,925,566.14
Departmental Uses	4,943,922.48
Loans	1,163,499.40
Restricted for Specific Programs	4,552,104.64
Expendable:	
Scholarships and Fellowships	2,569,615.06
Research	2,548,915.33
Endowed Professorships	326,711.99
Departmental Uses	8,621,426.89
Loans	320,626.99
Capital Projects	51,589,741.86
Debt Service	5,953,681.81
Unrestricted	<u>39,173,850.14</u>
Total Net Assets	<u><u>\$ 343,360,623.40</u></u>

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

***University of North Carolina Wilmington
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 9)	\$ 62,750,863.00
Federal Grants and Contracts	18,956,520.54
State and Local Grants and Contracts	2,040,616.13
Nongovernmental Grants and Contracts	819,863.28
Sales and Services, Net (Note 9)	34,592,653.99
Interest Earnings on Loans	17,037.90
Other Operating Revenues	2,158,100.04
	<hr/>
Total Operating Revenues	121,335,654.88
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	124,872,738.40
Supplies and Materials	21,630,086.40
Services	40,307,237.91
Scholarships and Fellowships	7,141,196.38
Utilities	6,923,660.70
Depreciation	9,655,486.17
	<hr/>
Total Operating Expenses	210,530,405.96
	<hr/>
Operating Loss	(89,194,751.08)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	91,843,298.16
Noncapital Grants	611,857.59
Noncapital Gifts, Net (Note 9)	2,572,894.92
Investment Income (Net of Investment Expense of \$133,210.52)	10,961,664.77
Interest and Fees on Debt	(3,702,966.40)
Other Nonoperating Revenues	2,826,283.69
	<hr/>
Net Nonoperating Revenues	105,113,032.73
	<hr/>
Loss Before Other Revenues	15,918,281.65
	<hr/>
Capital Appropriations	29,971,400.00
Capital Grants	23,657,324.00
Capital Gifts	776,890.68
Additions to Endowments	3,413,815.54
	<hr/>
Increase in Net Assets	73,737,711.87
	<hr/>

NET ASSETS

Net Assets - July 1, 2006	269,622,911.53
	<hr/>
Net Assets - June 30, 2007	\$ 343,360,623.40
	<hr/> <hr/>

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

University of North Carolina Wilmington
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2007

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 115,215,500.95
Payments to Employees and Fringe Benefits	(123,095,683.56)
Payments to Vendors and Suppliers	(65,796,121.04)
Payments for Scholarships and Fellowships	(7,141,196.38)
Loans Issued	(1,054,093.00)
Collection of Loans	1,190,431.00
Interest Earned on Loans	(3,658.41)
Other Receipts	2,753,116.59
	<hr/>
Net Cash Used by Operating Activities	(77,931,703.85)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	91,843,298.16
Noncapital Grants	611,857.59
Noncapital Gifts	2,546,919.77
Additions to Endowments	3,413,815.54
Related Activity Agency Receipts	2,337,405.66
	<hr/>
Cash Provided by Noncapital Financing Activities	100,753,296.72

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	20,156,317.57
State Capital Appropriations	29,971,400.00
Capital Grants	17,677,300.04
Capital Gifts	785,053.68
Acquisition and Construction of Capital Assets	(36,340,278.96)
Principal Paid on Capital Debt and Leases	(9,585,000.00)
Interest and Fees Paid on Capital Debt and Leases	(3,875,997.21)
Proceeds from Sale of Property	3,326,944.00
Other Receipts	30,923.06
	<hr/>
Net Cash Provided by Capital Financing and Related Financing Activities	22,146,662.18

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	4,446,396.26
Investment Income	3,745,105.95
Purchase of Investments and Related Fees	(12,118,001.72)
	<hr/>
Net Cash Used by Investing Activities	(3,926,499.51)
	<hr/>
Net Increase in Cash and Cash Equivalents	41,041,755.54
Cash and Cash Equivalents - July 1, 2006	66,238,042.59
	<hr/>
Cash and Cash Equivalents - June 30, 2007	<u>\$ 107,279,798.13</u>

***University of North Carolina Wilmington
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2007***

***Exhibit A-3
Page 2***

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

Operating Loss	\$ (89,194,751.08)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	9,655,486.17
Nonoperating Other Income	21,276.79
Changes in Assets and Liabilities:	
Receivables (Net)	696,137.63
Inventories	(53,490.63)
Accounts Payable and Accrued Liabilities	1,428,407.93
Unearned Revenue	(600,412.35)
Note Principal Repayments	1,209,398.00
Notes Issued	(1,093,756.31)
	<hr/>
Net Cash Provided by Operating Activities	<u><u>\$ (77,931,703.85)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 51,136,451.02
Restricted Cash and Cash Equivalents	7,457,754.81
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	48,685,592.30
	<hr/>
Total Cash and Cash Equivalents - June 30, 2007	<u><u>\$ 107,279,798.13</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 38,290,000.00
Assets Acquired through a Gift	165,000.00
Change in Fair Value of Investments	6,892,840.54
Gain on Disposal of Capital Assets	2,826,283.69

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

UNCW Corporation, Inc.
Statement of Net Assets
June 30, 2007

Exhibit B-1

ASSETS

Cash	\$	53,718.00
Investments, Restricted		3,753,088.00
Other Assets		2,844.00
Net Investment in Direct Financing Leases, Current		4,363,416.00
Net Investment in Direct Financing Leases, Noncurrent		64,742,663.00
Debt Issuance Cost		1,396,525.00
Land		3,005,088.00
Buildings, Net		158,561.00
		<hr/>
Total Assets		77,475,903.00

LIABILITIES

Accounts Payable and Accrued Expenses		100,883.00
Accounts Payable-Construction		1,555,194.00
Due to Related Organization		142,313.00
Short-Term Notes Payable		7,500,000.00
Certificates of Participation Payable		68,340,168.00
		<hr/>
Total Liabilities		77,638,558.00

NET ASSETS

Restricted Net Assets - Expendable		(162,655.00)
		<hr/>
Total Net Assets	\$	(162,655.00)

See Note 1 in the Notes to the Financial Statements

UNCW Corporation, Inc.
Statement of Revenues, Expenses, and
Changes in Net Assets
June 30, 2007

Exhibit B-2

Revenues:		
Income on Cash and Investments	\$	1,782.00
Rental Income		465,663.00
Direct Financing Lease Income		792,262.00
Other Revenues		26,785.00
		<hr/>
Total Revenues		1,286,492.00
		<hr/>
Expenses:		
Salaries and Benefits		44,994.00
Contracted Services		51,508.00
Interest Expense		1,128,784.00
Other Expenses		221,356.00
		<hr/>
Total Expenses		1,446,642.00
		<hr/>
Change in Net Deficit		(160,150.00)
NET DEFICIT		
Beginning		(2,505.00)
		<hr/>
Ending	\$	(162,655.00)
		<hr/> <hr/>

See Note 1 in the Notes to the Financial Statements

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UNIVERSITY OF NORTH CAROLINA WILMINGTON
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007

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. University of North Carolina Wilmington 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 unit, although legally separate, is, in substance, part of the University's operations and therefore, is reported as if it were part of the University. The discretely presented component unit's financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize its legal separateness.

Blended Component Unit - Although legally separate, The Donald R. Watson Foundation, Inc. is a component unit of the University and is reported as if it were part of the University.

The Foundation is governed by a five-member board consisting of two ex officio directors and three elected directors. The Foundation's purpose is to aid, support and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because the elected directors of the Foundation are appointed by the members of the University of North Carolina Wilmington Board of Trustees and the Foundation's sole purpose is to benefit selected organizations including the University, its financial statements have been blended with those of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Separate financial statements for the Foundation may be obtained from the University Controller's Office, 601 S. College Rd. Wilmington, NC 28403, or by calling (910) 962-3144. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

Discretely Presented Component Unit – The UNCW Corporation, Inc. is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University.

The UNCW Corporation, Inc. is a legally separate, tax-exempt component unit of the University. The Corporation board consists of five members. The Corporation was organized to enhance the University of North Carolina Wilmington's educational mission, including overseeing and assisting in the acquisition and financing of capital assets for the University.

Separate financial statements for the UNCW Corporation, Inc. may be obtained from the University Controller's Office, 601 S. College Rd., Wilmington, NC 28403, or by calling (910) 962-3144.

- 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 January 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, repurchase agreements, equity investments, mutual funds, money market funds, real estate, and other asset holdings by the University. Except for money market funds, real estate not held by a governmental external investment pool, and other asset holdings, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds, 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.

F. Receivables – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.

G. Inventories – Inventories, consisting of expendable supplies, are valued at cost using first-in, first-out, last invoice cost, or average cost method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Merchandise for resale is valued at the lower of cost or market using the retail inventory method.

- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The 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 75 years for general infrastructure, 10 to 50 years for buildings, and 2 to 25 years for equipment. The Randall Library Special Collection is capitalized at cost or fair value at the date of donation. This collection is considered inexhaustible and is therefore not depreciated.

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations. Certain other assets are classified as restricted because their use is limited by external parties or statute.
- J. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, and compensated absences that will not 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 refunds are amortized over the life of the new debt using the straight line method. Issuance costs are amortized over the life of the bonds using the straight-line method.

- K. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(LIFO) method. 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.

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

L. Net Assets – The University’s net assets are classified as follows:

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

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

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

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

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

funding is transactional based within the departmental management system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

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

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

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

O. Internal Sales Activities – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as copy centers, motor pools, postal services, and telecommunications. In

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2007, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$104,034,375.29 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 \$24,950. The carrying amount of the University's deposits not with the State Treasurer, was \$3,220,472.84 and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the bank balance was \$3,265,171.66. 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, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	<u>\$ 3,165,171.66</u>
--------------------------------	------------------------

- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investments of the University's component unit and the Foundation are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

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

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

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

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.

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unitized method. Under this method, each participating fund's investment balance is determined on the current market value per unit multiplied by the number of units purchased. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)		
		Less Than 1	1 to 5	6 to 10
Debt Securities				
Mutual Bond Funds	\$ 5,555,151.00	\$ 3,322,699.00	\$ 2,157,726.00	\$ 74,726.00
Money Market Mutual Funds	<u>5,581,734.00</u>	<u>5,581,734.00</u>		
		<u>\$ 8,904,433.00</u>	<u>\$ 2,157,726.00</u>	<u>\$ 74,726.00</u>
Other Securities				
UNC Investment Fund	31,997,704.00			
Other Mutual Funds	6,853,638.00			
Investments in Real Estate	290,765.63			
Domestic Stock	<u>1,000,526.00</u>			
Total Long-Term Investment Pool	<u>\$ 51,279,518.63</u>			

At June 30, 2007, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	Unrated
U.S. Agencies:					
Mutual Bond Funds	\$ 5,555,151.00	\$ 76,554.00	\$ 5,163,621.00	\$ 34,532.00	\$ 280,444.00
Money Market Mutual Funds	5,581,734.00	5,581,734.00			

Rating Agency: Standard and Poors

At June 30, 2007, the investments of the University's Long-Term Investment Pool were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty
Domestic Stocks	<u>\$ 1,000,526.00</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)	
		Less Than 1	1 to 5
Debt Securities			
U.S. Treasuries	\$ 1,098,932.00	\$ 1,060,000.00	\$ 38,932.00
Repurchase Agreements	671,930.00	671,930.00	
Mutual Bond Funds	972,721.00	972,721.00	
Money Market Mutual Funds	2,800,061.00	2,800,061.00	
Domestic Corporate Bonds	7,012.16	7,012.16	
		<u>\$ 5,511,724.16</u>	<u>\$ 38,932.00</u>
Other Securities			
Domestic Stocks	8,530.00		
Other Mutual Funds	982,539.00		
Investments in Real Estate	2,404,515.50		
Foreign Mutual Funds	302,949.00		
	<u>302,949.00</u>		
Total Non-Pooled Investments	<u>\$ 9,249,189.66</u>		

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	Unrated
Mutual Bond Funds	\$ 972,721.00	\$ 972,721.00	\$ 0.00	\$ 0.00
Domestic Corporate Bonds	7,012.16		7,012.16	
Money Market Mutual Funds				2,800,061.00

Rating Agency: Standard and Poors

At June 30, 2007, the University's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty
Domestic Corporate Bonds	\$ 7,012.16
Domestic Stocks	8,530.00
Total	<u>\$ 15,542.16</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Investment Type	Fair Value
Debt Securities	
U.S. Treasuries	\$ 1,098,932.14
Repurchase Agreements	671,930.00
Mutual Bond Funds	6,491,683.48
Money Market Funds	8,381,796.00
Domestic Corporate Bonds	7,012.16
Other Securities	
UNC Investment Fund	32,001,039.35
Other Mutual Funds	8,139,126.39
Investments in Real Estate	2,695,281.13
Domestic Stocks	1,009,056.57
Other	32,851.45
Total Investments	\$ 60,528,708.67

Component Units - Investments of the University’s discretely presented component unit, the UNCW Corporation, are subject to and restricted by G.S. 36B “Uniform Management of Institutional Funds Act” (UMIFA) and any requirements placed on them by contract or donor agreements. The UNCW Corporation has invested proceeds from a bond issuance in the amount of \$3,753,088. This investment is professionally managed by a fiscal agent.

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University’s endowment funds is predicated on the total return concept (yield plus appreciation). When administering its power to spend net appreciation, the Board of Trustees is required to consider the University’s long and short term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation that is spent is required to be spent for the purposes for which the endowment was established. The Board of Trustees chooses to spend only a portion of the investment income each year. Under the policy established by the Board, 4.5% of the average market

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

value at the end of the previous three years has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending policy exceeds investment income. At June 30, 2007, net appreciation of \$20,946,110 was available to be spent, of which \$16,631,198 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2007, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 442,882.23	\$ 44,700.72	\$ 398,181.51
Accounts	1,832,483.58		1,832,483.58
Pledges	80,405.78	4,020.29	76,385.49
Investment Earnings	1,229,969.18		1,229,969.18
Interest on Loans	120,544.94		120,544.94
Other	73,179.88		73,179.88
	<u>\$ 3,779,465.59</u>	<u>\$ 48,721.01</u>	<u>\$ 3,730,744.58</u>
Noncurrent Receivables:			
Pledges	\$ 385,743.54	\$ 19,287.18	\$ 366,456.36
Other	466,657.28		466,657.28
	<u>\$ 852,400.82</u>	<u>\$ 19,287.18</u>	<u>\$ 833,113.64</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 1,045,394.29	\$ 101,743.82	\$ 943,650.47
Institutional Student Loan Programs	140,470.29		140,470.29
	<u>\$ 1,185,864.58</u>	<u>\$ 101,743.82</u>	<u>\$ 1,084,120.76</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 4,038,752.27	\$ 403,875.23	\$ 3,634,877.04
Institutional Student Loan Programs	36,020.54		36,020.54
	<u>\$ 4,074,772.81</u>	<u>\$ 403,875.23</u>	<u>\$ 3,670,897.58</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable:				
Land	\$ 4,990,910.23	\$ 1,699,000.00	\$ 1,464,039.38	\$ 5,225,870.85
Art, Literature, and Artifacts	1,219,577.52	59,393.71		1,278,971.23
Construction in Progress	70,000,194.17	30,691,525.00	53,734,918.80	46,956,800.37
Total Capital Assets, Nondepreciable	<u>76,210,681.92</u>	<u>32,449,918.71</u>	<u>55,198,958.18</u>	<u>53,461,642.45</u>
Capital Assets, Depreciable:				
Buildings	229,460,201.99	88,775,227.81	1,115,040.10	317,120,389.70
Machinery and Equipment	27,336,608.61	3,736,021.38	1,192,788.99	29,879,841.00
General Infrastructure	20,642,254.90	3,249,690.99	71,154.17	23,820,791.72
Total Capital Assets, Depreciable	<u>277,439,065.50</u>	<u>95,760,940.18</u>	<u>2,378,983.26</u>	<u>370,821,022.42</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	56,608,108.27	6,573,619.70	802,973.95	62,378,754.02
Machinery and Equipment	17,533,085.97	2,645,134.81	1,011,735.97	19,166,484.81
General Infrastructure	7,925,877.28	436,731.66	24,527.05	8,338,081.89
Total Accumulated Depreciation	<u>82,067,071.52</u>	<u>9,655,486.17</u>	<u>1,839,236.97</u>	<u>89,883,320.72</u>
Total Capital Assets, Depreciable, Net	<u>195,371,993.98</u>	<u>86,105,454.01</u>	<u>539,746.29</u>	<u>280,937,701.70</u>
Capital Assets, Net	<u>\$ 271,582,675.90</u>	<u>\$ 118,555,372.72</u>	<u>\$ 55,738,704.47</u>	<u>\$ 334,399,344.15</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 7,356,707.00
Accrued Payroll	1,008,517.64
Contract Retainage	972,822.37
Total Accounts Payable and Accrued Liabilities	<u>\$ 9,338,047.01</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

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

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Current Portion
Bonds Payable	\$ 62,815,000.00	\$ 19,400,000.00	\$ 9,585,000.00	\$ 72,630,000.00	\$ 4,240,000.00
Add/Deduct Premium/Discount	1,253,316.17	1,093,193.12	413,998.76	1,932,510.53	
Deduct Deferred Charge on Refunding	(627,364.04)	(336,875.55)	(69,314.04)	(894,925.55)	
Total Bonds Payable	63,440,952.13	20,156,317.57	9,929,684.72	73,667,584.98	4,240,000.00
Notes Payable	33,947.37		33,947.37		
Arbitrage Rebate Payable	20,029.76		20,029.76		
Capital Leases Payable	33,060,000.00	38,290,000.00		71,350,000.00	8,562,070.06
Compensated Absences	6,795,370.00	1,337,665.00	407,967.50	7,725,067.50	210,430.76
Total Long-Term Liabilities	\$ 103,350,299.26	\$ 59,783,982.57	\$ 10,391,629.35	\$ 152,742,652.48	\$ 13,012,500.82

Additional information regarding capital lease obligations is included in Note 8

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2007	Principal Outstanding June 30, 2007
Dorm and Dining Hall						
Construction - Dorm	B	7.5-8.0	01/31/2009	\$ 1,400,000.00	\$ 1,185,000.00	\$ 215,000.00
Construction - Honors Dorm	J	4.7-5.4	01/01/2007	6,440,000.00	6,440,000.00	
Total Dorm and Dining Hall Bonds				7,840,000.00	7,625,000.00	215,000.00
Physical Education						
Construction - Trask Coliseum	B	5.1-5.5	01/01/2010	1,140,000.00	845,000.00	295,000.00
Union Revenue System						
Union Refund 1997	1997	4.8-5.0	01/01/2011	4,300,000.00	4,300,000.00	
General Revenue						
Construction - Dorm	2002A	3.0-5.0	01/01/2023	11,500,000.00	1,625,000.00	9,875,000.00
Construction - New Union	2003A	2.5-5.25	01/01/2028	30,000,000.00	2,390,000.00	27,610,000.00
Total General Revenue				41,500,000.00	4,015,000.00	37,485,000.00
The University of North Carolina System Pool Revenue Bonds						
Westside Building, Parking, Apartments	2002B	4.0-5.0	04/30/2022	6,735,000.00	5,060,000.00	1,675,000.00
Refund Series I	2003B	2.0-5.0	04/30/2009	5,100,000.00	3,180,000.00	1,920,000.00
Refund Series J and Recreation	2005A	4.0-5.2	04/30/2019	12,630,000.00	990,000.00	11,640,000.00
Union Addition, Parking, Refund Series 2002B	2006A	4.0-5.0	10/31/2033	19,400,000.00		19,400,000.00
Total General Revenue System Pool Bonds				43,865,000.00	9,230,000.00	34,635,000.00
Total Bonds Payable (principal only)				\$ 98,645,000.00	\$ 26,015,000.00	72,630,000.00
Less: Unamortized Loss on Refunding						894,925.55
Plus: Unamortized Premium						1,932,510.53
Total Bonds Payable						\$ 73,667,584.98

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

<u>Fiscal Year</u>	Annual Requirements	
	Revenue Bonds Payable	
	Principal	Interest
2008	\$ 4,240,000.00	\$ 3,338,220.03
2009	4,405,000.00	3,194,095.02
2010	3,450,000.00	3,006,645.01
2011	3,470,000.00	2,869,232.52
2012	3,110,000.00	2,733,757.51
2013-2017	17,805,000.00	11,429,478.76
2018-2022	16,815,000.00	6,944,562.50
2023-2027	12,815,000.00	3,298,500.02
2028-2032	5,070,000.00	853,506.26
2033	1,450,000.00	73,500.00
Total Requirements	\$ 72,630,000.00	\$ 37,741,497.63

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

On January 14, 2006 the University issued \$5,790,000 in General Revenue Bonds Series 2006A refunding bonds with an average interest rate of 4.59%. The bonds were issued to advance refund \$5,640,000 of outstanding Union 1997 and Pooled Revenue Bonds 2002A bonds with an average interest rate of 5.31%. The net proceeds of the refunding bonds along with other resources were used to purchase U.S. government securities. These securities were deposited into an irrevocable trust to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the University's Statement of Net Assets. This advance refunding was undertaken to reduce total debt service payments by \$324,521 over the next 15 years and resulted in an economic gain of \$197,258. At June 30, 2007, the outstanding balance was \$3,870,000.00 for the defeased General Revenue Bond Series 2002A bonds.

Prior Year Defeasances – During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2007, the outstanding balance of prior year defeased bonds was \$7,195,000.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- E. Component Units** - The UNCW Corporation, Inc., had long term liabilities of bonds payable of \$68,340,168 and notes payable of \$7,500,000 at June 30, 2007.

NOTE 8 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to land, buildings and 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:

<u>Fiscal Year</u>	<u>Amount</u>
2008	\$ 8,562,070.06
2009	4,303,055.44
2010	4,303,055.44
2011	4,303,055.44
2012	4,303,055.44
2013-2017	21,515,277.18
2018-2022	21,515,277.18
2023-2027	21,515,277.18
2028-2032	21,515,277.18
2033-2037	19,631,476.37
2038	2,419,254.63
Total Minimum Lease Payments	<u>133,886,131.54</u>
Amount Representing Interest (5.25% Rate of Interest)	<u>62,536,131.54</u>
Present Value of Future Lease Payments	<u><u>\$ 71,350,000.00</u></u>

- B. Operating Lease Obligations** – The University entered into operating leases for rental of office space and property, rental of dockage, and equipment. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2007:

<u>Fiscal Year</u>	<u>Amount</u>
2008	\$ 734,105.65
2009	267,001.65
2010	250,778.07
2011	<u>2,731.20</u>
Total Minimum Lease Payments	<u><u>\$ 1,254,616.57</u></u>

Rental expense for all operating leases during the year was \$758,545.00.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Less Contractual Adjustments	Net Revenues
Operating Revenues:						
Student Tuition and Fees	\$ 66,333,475.60	\$ 0.00	\$ 3,582,612.60	\$ 0.00	\$ 0.00	\$ 62,750,863.00
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 10,773,895.63	\$ 0.00	\$ 700,348.51	\$ 9,958.55	\$ 0.00	\$ 10,063,588.57 (A)
Dining	9,576,864.99		584,845.95	17,527.97		8,974,491.07 (A)
Parking	1,860,636.79			1,614.53		1,859,022.26 (B)
Athletic	1,470,074.51		368,929.53	10,452.00		1,090,692.98
Other	12,722,244.10	2,453,078.02	810,239.41	7,778.16		9,451,148.51
Sales and Services of Education and Related Activities	3,153,710.60					3,153,710.60
Total Sales and Services	\$ 39,557,426.62	\$ 2,453,078.02	\$ 2,464,363.40	\$ 47,331.21	\$ 0.00	\$ 34,592,653.99
Nonoperating - Noncapital Gifts	\$ 2,596,202.39	\$ 0.00	\$ 0.00	\$ 0.00	\$ 23,307.47	\$ 2,572,894.92

Revenue Bonds Secured by Pledged Revenues:

(A) Housing and Student Center System

(B) Physical Education System

NOTE 10 - 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	\$ 63,433,674.09	\$ 3,400,960.82	\$ 5,513,618.82	\$ 165,625.00	\$ 0.00	\$ 0.00	\$ 72,513,878.73
Research	8,611,899.65	1,340,687.41	3,775,432.90	41,123.04	18,464.44		13,787,607.44
Public Service	1,589,085.30	184,252.72	1,103,605.15	9,519.00			2,886,462.17
Academic Support	8,480,979.37	4,158,351.33	2,039,885.46	8,721.00			14,687,937.16
Student Services	5,367,536.25	826,055.09	2,208,584.36	5,908.41			8,408,084.11
Institutional Support	15,332,828.38	1,446,680.19	3,386,958.58		26.80		20,166,493.95
Operations and Maintenance of Plant	10,928,238.21	5,141,799.28	4,721,566.10		5,156,487.43		25,948,091.02
Student Financial Aid	(7,283.58)	8.12	78,592.27	6,893,703.45			6,965,020.26
Auxiliary Enterprises	11,135,780.73	5,131,291.44	17,478,994.27	16,596.48	1,748,682.03		35,511,344.95
Depreciation						9,655,486.17	9,655,486.17
Total Operating Expenses	\$ 124,872,738.40	\$ 21,630,086.40	\$ 40,307,237.91	\$ 7,141,196.38	\$ 6,923,660.70	\$ 9,655,486.17	\$ 210,530,405.96

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - 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 \$102,738,721.17, of which \$49,144,505.38 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$2,948,670.32 and \$1,307,243.84, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2007, 2006, and 2005, which were \$1,307,243.84, \$1,015,928.25, and \$894,368.00, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 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 \$102,738,721.17, of which \$40,350,938.90 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$2,421,056.33 and \$2,760,004.00, respectively.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$333,694.18 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 \$63,364.63. The voluntary contributions by employees amounted to \$604,152.53 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 \$1,574,595.84 for the year ended June 30, 2007.

NOTE 12 - 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$3,399,457.94. 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 \$465,188.98. 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 13 - RISK MANAGEMENT

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible.

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

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence with a \$75,000 deductible and a 10% participation in each loss above the deductible. The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

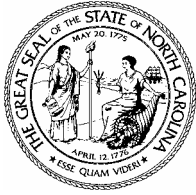
NOTE 14 - COMMITMENTS

The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$39,417,774.11 at June 30, 2007.

NOTE 15 - RELATED PARTIES

Foundations - There are three separately incorporated nonprofit foundations associated with the University. These foundations are the University of North Carolina at Wilmington Alumni Association, Inc., The Foundation of the University of North Carolina at Wilmington, Inc., and the University of North Carolina at Wilmington Student Aid Association, Inc.

These organizations serve 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 University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundations, except for support from each organization to the University. This support approximated \$755,294 for the year ended June 30, 2007.



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

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

Board of Trustees
University of North Carolina Wilmington
Wilmington, North Carolina

We have audited the financial statements of University of North Carolina Wilmington, 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 unit, 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 January 7, 2008. Our report was modified to include a reference to the other auditor.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component unit, as described in our report on the University's financial statements. The financial statements of the discretely presented component unit 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 opinion 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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GOVERNMENT AUDITING STANDARDS (CONTINUED)**

weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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. We consider the deficiencies described in findings 3 and 4 in the Audit Findings and Responses section of this report to be significant deficiencies in the internal control over financial reporting.

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 the 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 the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

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*.

The University's responses to the findings identified in our audit are described in the Audit Findings and Responses section of this report. We did not audit the University's response and, accordingly, we express no opinion on it.

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

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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

January 7, 2008

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting or Federal Compliance Objectives

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements or other matters.

1. TIME AND EFFORT CERTIFICATIONS NOT COMPLETED TIMELY

The University did not have controls in place to ensure that time and effort certifications were completed within the required time frames. Time and effort certifications are used to confirm that the percentage of salary charged to a grant matches the percentage of time that the employee actually expended on that grant. The risk that grants will not be properly charged increases when time and effort certifications are not completed timely.

At the beginning of our audit in August 2007, we learned that the time and effort reports had not been completed for the 2006-2007 year. After our inquiry, the certifications were sent out for both semesters of the year. Salary costs charged to the Research and Development Cluster approximated \$3 million for the fiscal year ending June 30, 2007.

The federal cost principle (OMB Circular A-21 Section J.10) requires institutions to develop a mechanism to determine or confirm how individuals actually expend effort during a specified time period. These effort reports must be performed on a regular schedule and must be certified by individuals who have first-hand knowledge of 100 percent of the employee's compensated activities. These reports are to be prepared at least every six months. In addition, the University's policy states "To meet audit standards, the certificate (time and effort form) must account for 100 percent of the employee's work and be submitted each semester.

Recommendation: We recommend the University strengthen controls to ensure compliance with federal cost principles and with its policy concerning time and effort reporting.

University Response: The University of North Carolina Wilmington Office of Sponsored Program will strengthen controls to ensure compliance with federal cost principles and with its policy concerning time and effort reporting.

2. CONTROLS OVER FEDERAL DEBARMENT VERIFICATION NEED IMPROVEMENT

The University did not have controls in place to ensure that covered transactions (contracts and procurements in excess of \$25,000) were made only to vendors that were eligible to participate in federal programs. Our tests of 17 vendor payments over \$30,000 in the Research and Development Cluster (ES-14882-05-55, award period

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

July 1, 2006 – June 30, 2007) disclosed that the University had not verified the federal debarment status for any of the vendors tested. None of the vendors involved were currently debarred and there were no questioned costs. Inadequate controls increase the risk that contracts could be made with debarred or suspended parties resulting in questioned costs.

Title 2 CFR sections 180.220 and .300 require verification for procurement transactions, expected to equal or exceed \$25,000, to ensure that the recipients of federal funds are not suspended or debarred. This verification may be accomplished by checking the Excluded Parties List System maintained by the General Services Administration, collecting a certification from the entity, or adding a clause or condition to the covered transaction with that entity.

Recommendation: The University should establish and implement procedures to ensure compliance with federal suspension and debarment regulations.

University Response: The University has established and implemented procedures between the Purchasing Department and the Office of Sponsored Programs to ensure compliance with federal suspension and debarment regulations.

3. ESTIMATED USEFUL LIFE OF CAPITAL ASSETS NEEDS TO BE RE-EVALUATED

The University did not fully re-evaluate its machinery and equipment capital assets that were fully depreciated or were approaching the end of their useful lives. Because depreciation is a method of allocating an asset's cost over its useful life, a periodic review of the useful life is necessary for depreciation to reflect that allocation. The University reported total Machinery and Equipment of \$29.9 million at June 30, 2007, and \$11 million of this total was fully depreciated.

We examined a sample of fully depreciated capital assets with cost of \$4 million and found that \$2.1 million were still in service, functioning as designed, and expected to remain in service for an unknown period of time. Extending the useful lives of the fully depreciated assets by 2 – 10 years based on the asset classification, we estimated that the accumulated depreciation was overstated by approximately \$3.3 million.

Recommendation: The University should implement additional procedures to ensure that the useful lives of capital assets are periodically re-evaluated and to ensure that assets still in service are not fully depreciated.

University Response: The University of North Carolina Wilmington will continue to strengthen procedures to ensure that the useful lives of capital assets are periodically re-evaluated and to ensure that assets still in service are not fully depreciated.

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

4. FINANCIAL STATEMENTS NOT PREPARED TIMELY

The University did not have adequate controls in place to ensure its financial statements were completed and submitted within required time frames as prescribed by the Office of State Controller. The completion of financial statements in a timely manner will ensure compliance with representations made to the Office of State Controller and prevent delays in the audit process.

Per the Office of State Controller's Memorandum SAD 04-22, all component units of the State of North Carolina that are audited by the State Auditor will disclose in their letter of representation that the formal financial statements, the formal notes to the financial statements, the management's discussion and analysis, and required supplementary information (if applicable) prepared in accordance with GAAP will be made available to the State Auditor by September 30 of each year. The University, in its letter dated August 31, 2007, represented to the Office of State Controller that the financial statements would be completed and available for audit on or before September 30, 2007. However, on October 24, 2007, the University had not submitted the management discussion and analysis component and statement of cash flows component of the University's financial statements. Other required components were completed timely.

Recommendation: The University should establish and implement procedures to ensure that completed financial statements are available for audit by September 30 of each year.

University Response: The University met all deadlines for timely completion for the formal financial statements, formal notes and supplementary information to the Office of State Controller. Upon completion of our final entries and affirmation from the Office of State Controller that our financial statements were completed, we promptly sent our transaction file to the State Auditor's prior to receiving a formal request. We also made available a preliminary copy of our financial statements to the state auditors for their review to determine materiality thresholds in early September. This prompt action on the University's part was to aid the state auditors to be able to proceed with their audit as they were currently on campus and in the middle of their audit. Although our letter of representation does indicate that we will make available to the state auditors our formal financial statements, it has been our practice with the state auditors to provide the Management Discussion and Analysis and the Statement of Cash Flows as needed in their audit review. This repetitive common practice became the accepted deadline with the state auditors. Although the formal Management Discussion and Analysis was not provided to the state auditors by September 30, the management discussion and analysis worksheet had been completed and sent to the Office of State Controller by August 31.

The University will change its practice in the future to provide the formal financial statements by the established deadlines to the Office of State Auditors.

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