



STATE OF NORTH CAROLINA

WINSTON-SALEM STATE UNIVERSITY

WINSTON-SALEM, 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

WINSTON-SALEM STATE UNIVERSITY

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2007

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THE UNIVERSITY OF NORTH CAROLINA

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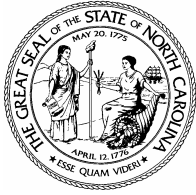
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STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of Winston-Salem State University for the year ended June 30, 2007, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements and our consideration of the University's administration of federal programs in accordance with applicable laws, regulations, contracts and grants 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.

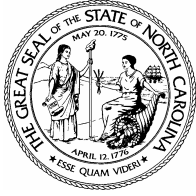
Leslie W. Merritt, Jr.

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

March 31, 2008

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

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Winston-Salem State University
Winston-Salem, North Carolina

We have audited the accompanying financial statements of Winston-Salem State University, 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 Winston-Salem State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Winston-Salem State University Foundation, Inc., and Subsidiary, the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the discretely presented component unit, is based on the report of the other auditors.

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

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Winston-Salem State University 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 February 27, 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.

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

February 27, 2008

WINSTON-SALEM STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Winston-Salem State University (the "University") annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2007. This discussion has been prepared by University management along with the financial statements and notes to the financial statements and should be read in conjunction with, and is qualified in its entirety by, the financial statements and notes. The Management's Discussion and Analysis has comparative data for the applicable years (past and current) with emphasis on the current year. The financial statements, notes, and this discussion are the responsibility of University management.

Using the Annual Report

This annual report consists of a series of financial statements, prepared in accordance with the Governmental Accounting Standards Board (GASB). GASB statements establish standards for external financial reporting for public colleges and universities and require that financial statements be presented on a consolidated basis for the University as a whole, with resources classified for accounting and reporting purposes into four net asset categories. One of the most important questions asked is whether the University as a whole is better or worse off as a result of the year's activities. The key to understanding this question is the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets. These statements present financial information in a form similar to that used by corporations. It is prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged.

The Statement of Net Assets includes all assets and liabilities. The University's net assets (the difference between assets and liabilities) are an indicator of the University's financial health. Over time, increases or decreases in net assets is one indicator of the improvement or erosion of the University's financial health when considered with nonfinancial facts such as enrollment levels and the condition of the facilities.

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. All things being equal, a public University's dependency on State appropriations and gifts will result in operating deficits, because GASB Statement No. 35 classifies State appropriations and gifts as nonoperating revenues.

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used by private-sector companies. The University's supporting organization, the Winston-Salem State University Foundation, Inc., (the "Foundation") is an independent nonprofit corporation formed for the exclusive benefit of the University.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

According to Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units*, the Foundation meets the requirements to be reported discretely in these financial statements.

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2007. Its combined net assets increased \$6,352,088.44 from the previous year, which is an increase of approximately 5.7 percent.

Condensed Financial Information

Statement of Net Assets

The Statement of Net Assets presents the assets (current and noncurrent), liabilities (current and noncurrent), and the net assets (total assets less total liabilities) of the University. This financial statement provides a comparative University fiscal snapshot as of June 30, 2007, and June 30, 2006. This provides the readers of this statement with information on assets available to continue operations.

Condensed Statement of Net Assets June 30, 2007

	2007		2006	
Assets				
Current Assets	\$ 21,120,587.92	11.5%	\$ 19,597,040.65	11.7%
Noncurrent Assets:				
Capital	128,164,170.57	70.0%	125,473,793.05	74.9%
Other	33,897,375.22	18.5%	22,454,163.50	13.4%
Total Assets	183,182,133.71	100.0%	167,524,997.20	100.0%
Liabilities				
Current Liabilities	6,774,093.34	10.8%	5,879,406.91	10.6%
Noncurrent Liabilities	55,976,605.30	89.2%	49,379,189.13	89.4%
Total Liabilities	62,750,698.64	100.0%	55,258,596.04	100.0%
Net Assets*				
Invested in Capital Assets, Net of Related Debt	75,329,589.04	62.5%	78,350,067.57	69.8%
Restricted:				
Nonexpendable	11,849,416.53	9.8%	11,423,994.91	10.2%
Expendable	25,584,961.36	21.2%	14,588,537.23	13.0%
Unrestricted	7,667,468.14	6.4%	7,903,801.45	7.0%
Total Net Assets	\$ 120,431,435.07	100.0%	\$ 112,266,401.16	100.0%

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

As of June 30, 2007, total University assets were \$183,182,133.71. The University's largest asset is investment in capital assets of \$128,164,170.57 at June 30, 2007. Cash and investments increased by \$14,444,011.29 primarily due to note proceeds received net of capital expenditures for the Brown Hall renovations and the Civitan Park athletic upgrade of \$6,998,281.94, and increased revenues of \$2,018,861.41 from providing student services to a growing student enrollment. The cash balance related to capital grants and appropriations designated for capital projects increased \$2,738,294.61, and net realized and unrealized gains on endowments increased \$2,688,573.33.

The \$21,120,587.92 in current assets covered the current liabilities of \$6,774,093.34, as the current ratio was \$3.12 in current assets to every \$1.00 in current liabilities.

University liabilities totaled \$62,750,698.64 at June 30, 2007. Bonds payable of \$11,244,581.53, a note payable of \$7,170,000.00, and a capital lease of \$34,420,000.00 were the largest liabilities, representing 84.2% of the total University liabilities. The University had outstanding bonds of \$6,075,000.00, \$2,419,581.53, and \$2,750,000.00 from 1998, 2002, and 2004 bond issues, respectively.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the activity that shows the changes in net assets. The activity is represented by the revenues received by the University, both operating and nonoperating, and the expenses paid by the University, operating and nonoperating, as well as any other revenues, expenses, gains and losses received or expended by the University.

Operating revenues are received for providing goods and services to the various customers of the University. Operating expenses are used to acquire goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating and other revenues are revenues received for nonexchange transactions, i.e., State appropriations and investment income. Nonoperating expenses are expenses other than those involved in the normal operation of the University and can include interest expense.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Revenues, Expenses, and Changes in Net Assets For the Year Ended June 30, 2007

	2007		2006	
Operating Revenues:				
Student Tuition and Fees, Net	\$ 15,591,533.29	39.0%	\$ 13,532,921.93	39.4%
Grants and Contracts	10,215,958.47	25.6%	9,172,378.33	26.7%
Sales and Services, Net	13,129,066.99	32.9%	10,810,869.09	31.4%
Other	999,947.43	2.5%	874,565.26	2.5%
Total Operating Revenues	39,936,506.18	100.0%	34,390,734.61	100.0%
Operating Expenses:				
Salaries and Benefits	64,105,442.57	54.4%	52,588,327.34	54.6%
Supplies, Materials, and Services	39,339,445.34	33.4%	31,792,274.23	33.0%
Scholarships and Fellowships	6,902,467.55	5.9%	5,213,096.08	5.4%
Utilities	2,650,639.28	2.3%	2,795,242.32	2.9%
Depreciation	4,720,677.65	4.0%	3,958,479.79	4.1%
Total Operating Expenses	117,718,672.39	100.0%	96,347,419.76	100.0%
Operating Loss	(77,782,166.21)		(61,956,685.15)	
Revenues (Expenses) and Other Changes				
State Appropriations	65,842,692.35	78.1%	50,573,984.87	71.1%
Capital Grants	1,867,207.00	2.2%	6,210,146.00	8.7%
Capital Appropriations	3,161,753.83	3.8%	2,125,800.00	3.0%
Noncapital Grants	10,842,913.52	12.9%	11,367,035.75	16.0%
Noncapital Gifts	183,803.97	0.2%	378,499.78	0.5%
Additions to Endowments	1,055,355.00	1.3%	1,193,504.56	1.7%
Other	1,180,528.98	1.4%	(742,951.89)	-1.0%
Net Nonoperating Revenues and Other Changes	84,134,254.65	100.0%	71,106,019.07	100.0%
Increase in Net Assets	6,352,088.44		9,149,333.92	
Net Assets:				
Beginning of Year	112,266,401.16		103,117,067.24	
Restatement of Net Assets (Note 15)	1,812,945.47			
End of Year	\$ 120,431,435.07		\$ 112,266,401.16	

Total operating loss for fiscal year 2007 was \$77,782,166.21. Since the State of North Carolina appropriation is not included within operating revenue per GASB Statement No. 35, the University will show a significant operating loss on a continuing basis.

The sources of operating revenue for the University are tuition and fees, grants and contracts, auxiliary services, and other educational activities.

The University strives to provide students with the opportunity to obtain a quality education. Future University enrollments may be affected by a number of factors, including any material

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

increase in tuition and other mandatory charges, stemming from any material decrease in appropriation funding from the State of North Carolina.

The following table details the University's grants and contracts revenue for the fiscal year ended June 30, 2007.

	<u>Amount</u>
Federal:	
Department of Education	\$ 14,903,366.72
Department of Health and Human Services	2,627,975.89
National Science Foundation	630,085.46
Department of Housing and Urban Development	493,653.67
Department of Justice	43,419.00
Department of Transportation	<u>22,231.41</u>
Total Federal	18,720,732.15
Private, State, and Local	<u>2,338,139.84</u>
Total All Sources	<u>\$ 21,058,871.99</u>

Operating expenses, including depreciation of \$4,720,677.65, totaled \$117,718,672.39. Of this total, \$58,739,653.97 or 49.9 percent was used for instruction and student support.

Salaries and benefits expenses increased by \$11,517,115.23 for the fiscal year ended June 30, 2007, due to legislative salary increases and increases in staffing due to enrollment growth. Supplies, materials, and services expenses increased by \$7,547,171.11 for the fiscal year ended June 30, 2007, due to enrollment growth and spending on capital improvement projects.

The University's largest source of nonoperating revenue is the State of North Carolina appropriation. This is received in monthly payments, beginning in July of each year, since the State's fiscal year begins on July 1. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year ended June 30, 2007, the State of North Carolina appropriated to the University \$65,842,692.35 for operations. The State of North Carolina provided \$5,028,960.83 in capital grants and capital appropriations during the fiscal year.

Total net revenues were \$124,070,760.83 for fiscal year 2007, compared to \$105,496,753.68 for fiscal year 2006, resulting in a net increase of \$18,574,007.15, which is primarily contributed to the following:

- Student tuition and fees reflect a \$2,058,611.36 increase due to increases in tuition and fee rates.
- Sales and services reflect a \$2,318,197.90 increase due to increases in housing and dining rates.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

- State appropriations reflect a \$15,268,707.48 increase due to increased funding from the State of North Carolina.
- Investment income reflects a \$1,861,114.50 increase due to the increase in realized and unrealized gains on Endowment investments.
- Capital appropriations reflect a \$1,035,953.83 increase due to increased funding from the State of North Carolina.
- Capital grants reflect a \$4,342,939.00 decrease due to the completion of construction projects funded under the University Improvement General Obligation Bonds.

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

Capital Assets

With the passage of the University Improvement General Obligation Bonds in 2000, the University has been allotted a total of \$46,880,581.00 for capital improvements through June 30, 2007. Major capital expenditures for the year ended June 30, 2007, include the Anderson Center Renovations of \$218,456.92; Athletic and Student Recreation Facilities of \$186,195.86; Joint Center for Design Innovation of \$226,083.10; and the Brown Hall Renovation of \$251,710.12.

Factors Impacting Future Periods

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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

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

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

Winston-Salem State University
Statement of Net Assets
June 30, 2007

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 12,701,747.74
Restricted Cash and Cash Equivalents	5,163,931.33
Restricted Short-Term Investments	624,739.06
Receivables, Net (Note 4)	2,262,990.99
Inventories	222,229.16
Notes Receivable, Net (Note 4)	144,949.64

Total Current Assets	21,120,587.92
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Noncurrent Assets:

Restricted Cash and Cash Equivalents	14,703,752.24
Restricted Due from Primary Government	742,878.65
Endowment Investments	17,284,783.38
Other Investments	524,034.24
Notes Receivable, Net (Note 4)	641,926.71
Capital Assets - Nondepreciable (Note 5)	6,318,844.17
Capital Assets - Depreciable, Net (Note 5)	121,845,326.40

Total Noncurrent Assets	162,061,545.79
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Total Assets	183,182,133.71
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	2,960,480.98
Due to Primary Government	75,116.80
Unearned Revenue	1,527,756.18
Interest Payable	241,383.38
Long-Term Liabilities - Current Portion (Note 7)	1,969,356.00

Total Current Liabilities	6,774,093.34
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Noncurrent Liabilities:

Deposits Payable	133,439.75
Funds Held for Others	326,295.19
U. S. Government Grants Refundable	807,626.83
Long-Term Liabilities (Note 7)	54,709,243.53

Total Noncurrent Liabilities	55,976,605.30
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Total Liabilities	62,750,698.64
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Winston-Salem State University
Statement of Net Assets
June 30, 2007

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	75,329,589.04
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,309,151.03
Endowed Professorships	6,030,500.00
Departmental Uses	2,422,511.72
Loans	87,253.78
Expendable:	
Scholarships and Fellowships	1,328,361.56
Professorships	3,037,745.50
Departmental Uses	5,123,509.37
Loans	191,382.67
Capital Projects	14,960,184.59
Debt Service	943,777.67
Unrestricted	<u>7,667,468.14</u>
Total Net Assets	<u>\$ 120,431,435.07</u>

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

Winston-Salem State University
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)	\$ 15,591,533.29
Federal Grants and Contracts	10,215,958.47
Sales and Services, Net (Note 9)	13,129,066.99
Interest Earnings on Loans	4,086.56
Other Operating Revenues	995,860.87
	<hr/>
Total Operating Revenues	39,936,506.18
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	64,105,442.57
Supplies and Materials	12,421,350.32
Services	26,918,095.02
Scholarships and Fellowships	6,902,467.55
Utilities	2,650,639.28
Depreciation	4,720,677.65
	<hr/>
Total Operating Expenses	117,718,672.39
	<hr/>
Operating Loss	(77,782,166.21)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	65,842,692.35
Noncapital Grants	10,842,913.52
Noncapital Gifts	183,803.97
Investment Income (Net of Investment Expense of \$67,765.16)	3,253,932.88
Interest and Fees on Debt	(2,073,403.90)
	<hr/>
Net Nonoperating Revenues	78,049,938.82
	<hr/>
Income Before Other Revenues	267,772.61
	<hr/>
Capital Appropriations	3,161,753.83
Capital Grants	1,867,207.00
Additions to Endowments	1,055,355.00
	<hr/>
Increase in Net Assets	6,352,088.44
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NET ASSETS

Net Assets - July 1, 2006, as Restated (Note 15)	114,079,346.63
	<hr/>
Net Assets - June 30, 2007	\$ 120,431,435.07
	<hr/> <hr/>

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

Winston-Salem State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2007

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 39,560,743.78
Payments to Employees and Fringe Benefits	(62,408,958.38)
Payments to Vendors and Suppliers	(41,416,796.65)
Payments for Scholarships and Fellowships	(6,902,467.55)
Loans Issued	(170,000.00)
Collection of Loans	203,108.80
Interest Earned on Loans	(7,566.51)
Student Deposits Received	133,439.75
Student Deposits Returned	(252,103.16)
	<hr/>
Net Cash Used by Operating Activities	(71,260,599.92)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	65,842,692.35
Noncapital Grants	11,465,759.06
Noncapital Gifts	183,803.97
Additions to Endowments	1,055,355.00
Other Receipts	55,995.81
	<hr/>
Cash Provided by Noncapital Financing Activities	78,603,606.19

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	7,170,000.00
State Capital Appropriations	3,161,753.83
Capital Grants	2,865,719.48
Acquisition and Construction of Capital Assets	(5,798,648.54)
Principal Paid on Capital Debt and Leases	(1,450,000.00)
Interest and Fees Paid on Capital Debt and Leases	(2,059,103.85)
	<hr/>
Net Cash Provided by Capital Financing and Related Financing Activities	3,889,720.92

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	3,121,251.42
Investment Income	1,226,647.93
Purchase of Investments and Related Fees	(3,858,109.41)
	<hr/>
Net Cash Provided by Investing Activities	489,789.94

Net Increase in Cash and Cash Equivalents	11,722,517.13
Cash and Cash Equivalents - July 1, 2006	20,846,914.18
	<hr/>
Cash and Cash Equivalents - June 30, 2007	\$ 32,569,431.31

Winston-Salem State University
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 USED BY OPERATING ACTIVITIES**

Operating Loss	\$ (77,782,166.21)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	4,720,677.65
Allowances, Write-Offs, and Amortizations	13,685.21
Changes in Assets and Liabilities:	
Receivables (Net)	(831,259.20)
Inventories	(13,098.29)
Accounts Payable and Accrued Liabilities	890,228.24
Due to Primary Government	(3,215.00)
Unearned Revenue	447,930.29
Compensated Absences	1,382,172.00
Deposits Payable	(118,663.41)
Student Loans Issued	(170,000.00)
Student Loan Principal Repayments	203,108.80
	<u>203,108.80</u>
Net Cash Used by Operating Activities	<u>\$ (71,260,599.92)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 12,701,747.74
Restricted Cash and Cash Equivalents	5,163,931.33
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>14,703,752.24</u>
Total Cash and Cash Equivalents - June 30, 2007	<u>\$ 32,569,431.31</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Change in Fair Value of Investments	\$ 1,356,577.34
Loss on Disposal of Capital Assets	13,685.21

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

**Winston-Salem State University Foundation, Inc.,
and Subsidiary**
Consolidated Statement of Financial Position
June 30, 2007

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$ 5,584,460
Restricted Cash	14,083,802
Accounts Receivable	57,075
Lease Obligation Receivable, Net	28,811,605
Pledges Receivable, Net	2,806,211
Investment Securities	4,474,486
Property and Equipment, Net	1,845,656
Construction in Progress	8,936,880
Deferred Financing Costs, Net	2,317,530
Other	2,269
	<hr/>
Total Assets	68,919,974

LIABILITIES

Due to Board of Trustees of the Endowment	750,000
Accounts Payable and Other Accruals	2,707,704
Bonds Payable	53,255,000
	<hr/>
Total Liabilities	56,712,704

NET ASSETS

Unrestricted	1,863,445
Temporarily Restricted	4,671,971
Permanently Restricted	5,671,854
	<hr/>
Total Net Assets	\$ 12,207,270

See Note 1 in the Notes to the Financial Statements

**Winston-Salem State University Foundation, Inc.,
and Subsidiary**
Consolidated Statement of Activities
For the Year Ended June 30, 2007

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE				
Lease Income	\$ 1,760,860	\$ 0	\$ 0	\$ 1,760,860
Gifts and Grants	179,828	1,132,652	217,181	1,529,661
Investment Income	780,352	72,083		852,435
Administrative Fees	119,164			119,164
Unrealized Gain on Investment Activities		491,066		491,066
Passport Income	93,610			93,610
Other	55,570			55,570
	<u>2,989,384</u>	<u>1,695,801</u>	<u>217,181</u>	<u>4,902,366</u>
Net Assets Released from Restrictions	<u>1,342,883</u>	<u>(1,342,883)</u>		
Total Support and Revenue	<u>4,332,267</u>	<u>352,918</u>	<u>217,181</u>	<u>4,902,366</u>
EXPENSES				
Depreciation and Amortization	80,343			80,343
Interest	2,049,890			2,049,890
Scholarships	624,174			624,174
Special Programs	718,709			718,709
Management and General	618,091			618,091
Unrelated Business Income Tax	11,024			11,024
Fundraising Expense	80,509			80,509
Total Expenses	<u>4,182,740</u>			<u>4,182,740</u>
Change in Net Assets Before Transfers	149,527	352,918	217,181	719,626
Transfer of Endowed Funds		<u>(750,000)</u>		<u>(750,000)</u>
Change in Net Assets	149,527	(397,082)	217,181	(30,374)
NET ASSETS				
Net Assets, Beginning	<u>1,713,918</u>	<u>5,069,053</u>	<u>5,454,673</u>	<u>12,237,644</u>
Net Assets, Ending	<u>\$ 1,863,445</u>	<u>\$ 4,671,971</u>	<u>\$ 5,671,854</u>	<u>\$ 12,207,270</u>

See Note 1 in the Notes to the Financial Statements

WINSTON-SALEM STATE UNIVERSITY
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. Winston-Salem State University is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

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

Discretely Presented Component Unit – The Winston-Salem State University Foundation, 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 Winston-Salem State University Housing Foundation, LLC, is the wholly owned subsidiary of the Winston-Salem State University Foundation, Inc.

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation is governed by a 34-member board with two emeritus directors, six ex-officio directors, and 26 elected members. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The Winston-Salem State University Foundation, Inc., is a private not-for-profit organization that reports its financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2007, the Foundation distributed \$1,258,234.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Winston-Salem State University Foundation, Inc., S.G. Atkins House, Winston-Salem, NC 27110, or by calling (336) 750-3005.

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

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

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

- C. Basis of Accounting** – The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are

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 deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** – This classification includes mutual funds, money market mutual funds, and limited partnerships. Except for money market mutual funds, 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 in the fair value of investments is recognized as a component of investment income.

Money market mutual funds 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, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of fuel oil held for consumption, are valued at cost using the last invoice cost. Inventories of postage are valued at the retail cost.
- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 40 years for general infrastructure, 12 to 50 years for buildings, and 5 to 20 years for equipment.

The Diggs Gallery 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. The University amortizes bond premiums over the life of the bonds using the straight-line method. Issuance costs are expensed.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, and debt service funds 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 \$32,569,431.31 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.

B. Investments

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

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

specified institutions; prime quality commercial paper, and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

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

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

Investments of the University's component unit, the Foundation, is 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.

Long-Term Investment Pool – This is an internal investment pool that is utilized for the investment of the endowment funds. Endowment funds of the University and its discretely presented component unit represent the pool's internal participants. Fund ownership and allocation of investment income are based on the equity interest that each fund holds in the internal investment pool. The investment strategy, including the selection of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

investment managers, is based on the directives of the University's Endowment Board.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 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	\$ 4,552,109.90	\$ 0.00	\$ 558,614.12	\$ 3,993,495.78
Money Market Mutual Funds	200,531.75	200,531.75		
		<u>\$ 200,531.75</u>	<u>\$ 558,614.12</u>	<u>\$ 3,993,495.78</u>
Other Securities				
International Mutual Funds	2,723,685.32			
Other Mutual Funds	7,406,515.36			
Limited Partnerships	2,401,941.05			
Total Long-Term Investment Pool	<u>\$ 17,284,783.38</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
Mutual Bond Funds	\$ 4,552,109.90	\$ 3,979,832.79	\$ 572,277.11
Money Market Mutual Funds	200,531.75	200,531.75	
Total	<u>\$ 4,752,641.65</u>	<u>\$ 4,180,364.54</u>	<u>\$ 572,277.11</u>

Rating Agency: Standard and Poors

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	<u>Fair Value</u>	<u>Investment Maturities (in Years) Less Than 1</u>
Debt Securities		
Money Market Mutual Funds	<u>\$ 1,148,773.30</u>	<u>\$ 1,148,773.30</u>

At June 30, 2007, the Money Market Mutual Funds, with a fair value of \$1,148,773.30, were rated AAA by Standard and Poors.

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

Investment Type	<u>Fair Value</u>
Debt Securities	
Mutual Bond Funds	\$ 4,552,109.90
Money Market Mutual Funds	1,349,305.05
Other Securities	
International Mutual Funds	2,723,685.32
Other Mutual Funds	7,406,515.36
Limited Partnerships	<u>2,401,941.05</u>
Total Investments	<u>\$ 18,433,556.68</u>

Component Unit – Investments of the University’s discretely presented component unit, 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. Because the Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

	Fair Value
Investment Type	
Equity Investments	\$ 3,044,178.00
Collective Fixed Income	1,378,305.00
Money Market Funds	52,003.00
	<hr/>
Total Investments	\$ 4,474,486.00
	<hr/> <hr/>

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled. 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). The total spending rate is calculated annually by taking the sum of the market value of the endowment investments for the preceding twelve quarters, and dividing the result by twelve. Spending from the average value shall be at a rate of five percent, paid out proportionately on a quarterly basis. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference. At June 30, 2007, net appreciation of \$5,522,620.63 was available to be spent for restricted purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2007, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 1,289,082.81	\$ 380,525.30	\$ 908,557.51
Accounts	45,163.97		45,163.97
Intergovernmental	1,044,712.08		1,044,712.08
Investment Earnings	92,507.11		92,507.11
Interest on Loans	156,146.44		156,146.44
Other	15,903.88		15,903.88
Total Current Receivables	\$ 2,643,516.29	\$ 380,525.30	\$ 2,262,990.99
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 230,165.11	\$ 100,414.83	\$ 129,750.28
Institutional Student Loan Programs	20,321.30	5,121.94	15,199.36
Total Notes Receivable - Current	\$ 250,486.41	\$ 105,536.77	\$ 144,949.64
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 1,022,305.40	\$ 449,919.65	\$ 572,385.75
Institutional Student Loan Programs	108,110.45	38,569.49	69,540.96
Total Notes Receivable - Noncurrent	\$ 1,130,415.85	\$ 488,489.14	\$ 641,926.71

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 (as restated)	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable:				
Land	\$ 3,968,242.04	\$ 0.00	\$ 0.00	\$ 3,968,242.04
Art, Literature, and Artifacts	625,772.00			625,772.00
Construction in Progress	1,024,792.39	943,815.69	243,777.95	1,724,830.13
Total Capital Assets, Nondepreciable	5,618,806.43	943,815.69	243,777.95	6,318,844.17
Capital Assets, Depreciable:				
Buildings	146,050,339.55	243,777.95		146,294,117.50
Machinery and Equipment	6,781,323.68	4,145,689.22	238,750.38	10,688,262.52
General Infrastructure	6,021,126.29			6,021,126.29
Total Capital Assets, Depreciable	158,852,789.52	4,389,467.17	238,750.38	163,003,506.31
Less Accumulated Depreciation for:				
Buildings	30,950,986.49	3,600,143.67		34,551,130.16
Machinery and Equipment	4,133,695.53	874,448.84	225,065.17	4,783,079.20
General Infrastructure	1,577,885.41	246,085.14		1,823,970.55
Total Accumulated Depreciation	36,662,567.43	4,720,677.65	225,065.17	41,158,179.91
Total Capital Assets, Depreciable, Net	122,190,222.09	(331,210.48)	13,685.21	121,845,326.40
Capital Assets, Net	\$ 127,809,028.52	\$ 612,605.21	\$ 257,463.16	\$ 128,164,170.57

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 1,729,094.27
Accrued Payroll	1,217,120.71
Contract Retainage	14,266.00
Total Accounts Payable and Accrued Liabilities	\$ 2,960,480.98

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
Revenue Bonds Payable	\$ 11,935,000.00	\$ 0.00	\$ 775,000.00	\$ 11,160,000.00	\$ 805,000.00
Add Premium	93,725.48		9,143.95	84,581.53	
Total Bonds Payable	12,028,725.48		784,143.95	11,244,581.53	805,000.00
Notes Payable		7,170,000.00		7,170,000.00	
Capital Leases Payable	35,095,000.00		675,000.00	34,420,000.00	695,000.00
Compensated Absences	2,461,846.00	3,895,276.00	2,513,104.00	3,844,018.00	469,356.00
Total Long-Term Liabilities	\$ 49,585,571.48	\$ 11,065,276.00	\$ 3,972,247.95	\$ 56,678,599.53	\$ 1,969,356.00

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
Housing and Dining System						
UNC System Pool Revenue Bonds	2002B	3.50% - 5.37%	04/01/2017	\$ 3,090,000.00	\$ 755,000.00	\$ 2,335,000.00
Revenue Refunding bonds	1998B	3.70% - 5.00%	01/01/2017	8,430,000.00	2,355,000.00	6,075,000.00
Total Housing and Dining System				11,520,000.00	3,110,000.00	8,410,000.00
Student Services System						
UNC System Pool Revenue Bonds	2004B	3.00% - 5.00%	04/01/2022	2,925,000.00	175,000.00	2,750,000.00
Total Bonds Payable (principal only)				\$ 14,445,000.00	\$ 3,285,000.00	11,160,000.00
Plus: Unamortized Premium						84,581.53
Total Bonds Payable						\$ 11,244,581.53

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:

Fiscal Year	Annual Requirements Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2008	\$ 805,000.00	\$ 512,645.00	\$ 0.00	\$ 193,259.38
2009	835,000.00	479,132.50	7,170,000.00	139,483.59
2010	875,000.00	443,163.75		
2011	925,000.00	401,186.25		
2012	960,000.00	356,567.50		
2013-2017	5,635,000.00	1,021,945.02		
2018-2022	1,125,000.00	141,050.00		
Total Requirements	<u>\$ 11,160,000.00</u>	<u>\$ 3,355,690.02</u>	<u>\$ 7,170,000.00</u>	<u>\$ 332,742.97</u>

D. Notes Payable – The University was indebted for notes payable for the purpose shown in the following table:

Purpose	Financial Institution	Interest Rate/Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2007	Principal Outstanding June 30, 2007
Housing Bond Anticipation Note	Bank of America, N.A.	2.70%	09/30/2008	<u>\$ 7,170,000.00</u>	<u>\$ 0.00</u>	<u>\$ 7,170,000.00</u>

The University plans to refinance the notes maturing on September 30, 2008, with other long-term financing.

E. Component Unit

Bonds Payable – Three student housing facilities have been financed through the issuance of bonds. In December 2001, \$17,665,000.00 of Series 2001 bonds were issued by the North Carolina Facilities Finance Agency to fund the construction of Rams Commons. The bonds were scheduled to mature at various intervals through 2031.

In September 2004, \$35,900,000.00 of Series 2004 bonds were issued. The proceeds of this issuance were used to retire the Series 2001 bonds, and to finance the construction of Gleason-Hairston Terrace. These bonds mature at various intervals through 2036, and bear interest at fixed rates ranging from 3% to 5%.

In October 2006, \$18,835,000.00 of Series 2006 bonds were issued. The proceeds of this issuance were used to finance the construction of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Foundation Heights. These bonds mature at various intervals through 2038, and bear interest at fixed rates ranging from 3% to 5%.

<u>Fiscal Year</u>	<u>Bonds Payable</u>
2008	\$ 895,000.00
2009	1,015,000.00
2010	1,035,000.00
2011	1,170,000.00
2012	1,210,000.00
Thereafter	<u>47,930,000.00</u>
Total Requirements	<u>\$ 53,255,000.00</u>

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations – Capital lease obligations relating to University student housing 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	\$ 2,228,532.52
2009	2,227,682.52
2010	2,226,232.52
2011	2,225,507.52
2012	2,226,757.50
2013-2017	11,137,400.06
2018-2022	11,145,430.04
2023-2027	11,127,712.52
2028-2032	11,135,947.50
2033-2036	<u>6,642,762.50</u>
Total Minimum Lease Payments	62,323,965.20
Amount Representing Interest (3.00% - 5.00% Interest Rate/Range)	<u>27,903,965.20</u>
Present Value of Future Lease Payments	<u>\$ 34,420,000.00</u>

Buildings acquired under capital lease amounted to \$35,900,000.00 at June 30, 2007.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Amount
2008	\$ 37,102.96
2009	5,516.68
2010	5,682.18
2011	5,852.65
2012	6,028.23
2013-2017	32,964.84
2018-2022	38,215.26
2023-2027	44,301.90
2028-2032	51,358.05
2033-2037	59,538.09
2038-2042	26,390.83
Total Minimum Lease Payments	\$ 312,951.67

Rental expense for all operating leases during the year was \$728,427.73.

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	Change in Allowance for Doubtful Accounts	Net Revenues	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	\$ 19,851,354.97	\$ 0.00	\$ 4,397,402.43	\$ 137,580.75	\$ 15,591,533.29	\$ 755,030.80 (B)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 8,264,041.35	\$ 0.00	\$ 1,725,109.15	\$ 82,475.07	\$ 6,621,407.27	\$ 6,621,407.27 (A)
Dining	4,701,426.52		937,867.06	47,882.68	3,811,442.14	3,811,442.14 (A)
Student Union Services	824,447.98			15,607.27	840,055.25	840,055.25 (B)
Health, Physical Education, and Recreation Services	8,803.00			11,273.16	20,076.16	
Parking	446,711.10			1,415.29	448,126.39	
Athletic	590,381.88			23,285.97	613,667.85	
Other	2,221,416.04	1,458,233.42		11,109.31	774,291.93	
Total Sales and Services	\$ 17,057,227.87	\$ 1,458,233.42	\$ 2,662,976.21	\$ 193,048.75	\$ 13,129,066.99	\$ 11,272,904.66

Revenue Bonds Secured by Pledged Revenues:

(A) Housing and Dining System

(B) Student Services System

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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	\$ 35,902,138.34	\$ 4,553,163.55	\$ 3,609,957.44	\$ 439,619.14	\$ 0.00	\$ 0.00	\$ 44,504,878.47
Research	776,641.05	227,146.38	198,830.89				1,202,618.32
Public Service	1,191,166.18	74,847.05	1,191,025.14	40,785.48			2,497,823.85
Academic Support	5,774,699.45	3,124,699.99	1,553,342.84	3,450.00			10,456,192.28
Student Services	2,996,648.21	151,537.20	611,997.81	18,400.00			3,778,583.22
Institutional Support	7,556,940.54	2,345,235.33	5,837,008.04				15,739,183.91
Operations and Maintenance of Plant	5,324,732.06	814,602.89	4,566,909.26		1,782,007.86		12,488,252.07
Student Financial Aid	299,898.75	2,103.68	33,445.68	6,391,332.93			6,726,781.04
Auxiliary Enterprises	4,282,577.99	1,128,014.25	9,315,577.92	8,880.00	868,631.42		15,603,681.58
Depreciation						4,720,677.65	4,720,677.65
Total Operating Expenses	<u>\$ 64,105,442.57</u>	<u>\$ 12,421,350.32</u>	<u>\$ 26,918,095.02</u>	<u>\$ 6,902,467.55</u>	<u>\$ 2,650,639.28</u>	<u>\$ 4,720,677.65</u>	<u>\$ 117,718,672.39</u>

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 \$51,293,969.80, of which \$28,923,116.58 was covered under the Teachers' and State Employees' Retirement System. Total employee and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

employer contributions for pension benefits for the year were \$1,735,386.99 and \$769,354.90, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2007, 2006, and 2005, which were \$769,354.90, \$581,475.67, and \$480,205.92, respectively.

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

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2007, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2007, the University had a total payroll of \$51,293,969.80, of which \$15,262,233.56 was covered under the Optional Retirement Program. Total employee and employer contributions for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

pension benefits for the year were \$915,734.01 and \$1,043,936.78, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans** – IRC Section 457 Plan – The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$151,159.82 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 \$36,744.14. The voluntary contributions by employees amounted to \$190,279.00 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 \$554,974.08 for the year ended June 30, 2007.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$1,679,043.31. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. 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 \$229,763.82. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

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

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible except theft losses, which carry a \$1,000 per occurrence deductible. The University also purchased through the Fund extended coverage against losses caused by windstorm or hail, explosion, smoke, aircraft or vehicles, and riot or civil commotion on certain buildings and contents. In addition, the University purchased "all risk" coverage through the Fund for a particular tower and adjacent building.

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.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

work related injury. The University is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The University is self-insured for workers' compensation.

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

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. **Commitments** – The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$908,027.16 and on other purchases were \$6,000,182.30 at June 30, 2007.
- B. **Pending Litigation and Claims** – The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.
- C. **Capital Lease Commitments** – The University entered into a twenty-nine year lease agreement with the Winston-Salem State University Housing Foundation, LLC, on October 1, 2006. Under the agreement, the Housing Foundation will construct and lease a student housing facility (Foundation Heights) to the University. The total principal and interest payments for the term of the lease are \$33,331,606.00, and began on December 1, 2007.

The University also entered into a twenty-four year lease agreement with the City of Winston-Salem on August 31, 2006. Under the agreement, the City will construct and lease an athletic field house at Bowman Gray Stadium to the University. The total principal and interest payments for

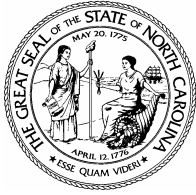
NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

the term of the lease are \$5,556,130.50, and payment is expected to begin on May 25, 2008.

NOTE 15 - NET ASSET RESTATEMENTS

As of July 1, 2006, net assets as previously reported were restated as follows:

	<u>Amount</u>
July 1, 2006, Net Assets as Previously Reported	\$ 112,266,401.16
Restatement: Error in Endowment Revenue Recognition	(522,290.00)
Error in Establishing Useful Lives of Capital Assets	<u>2,335,235.47</u>
July 1, 2006, Net Assets as Restated	<u><u>\$ 114,079,346.63</u></u>



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

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

Board of Trustees
Winston-Salem State University
Winston-Salem, North Carolina

We have audited the financial statements of Winston-Salem State University, 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 February 27, 2008. Our report was modified to include a reference to other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component 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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

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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AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
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 1 through 6 in the Audit Findings and Responses section of this report to be significant deficiencies in 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, of the significant deficiencies described above, we consider Finding 6 to be 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in findings 1 through 4 in the Audit Findings and Responses section of this report.

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.

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

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

Leslie W. Merritt, Jr.

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

February 27, 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. INAPPROPRIATE STUDENT FINANCIAL AID AWARDED TO EMPLOYEES

The University awarded questionable federal and non-federal financial aid funds to its employees by disregarding its own policies and procedures, overriding system-generated award calculations, and not abiding by federal regulations. As result, we are questioning cost of \$40,119, of which \$39,723 is federal cost.

We tested eligibility for 24 University employees who were awarded student financial aid during the 2006-2007 academic year and determined the following:

- a. Four University employees who were enrolled as less than half-time students received federal loans totaling \$26,615. Federal regulations require that students be enrolled at least half-time to be eligible for these loans.
- b. Four University employees received over-awards totaling \$4,105 because the University did not include the employees' tuition and fee waivers (a benefit available to certain University employees that eliminates costs associated with taking classes at the University) as one of the employees' financial resources when calculating their need for financial aid.
- c. Three University employees received over-awards totaling \$5,400 because the University increased these employees' calculations of financial aid need for reasons that were not documented.
- d. One financial aid employee received a \$3,999 Federal Supplemental Educational Opportunity Grant (the maximum award for this grant is \$4,000) even though federal regulations require that these grants be awarded to students with the greatest need. Students with greater calculated need were awarded less than \$3,999.

We also noted other deficiencies in awarding student financial aid to employees. Financial aid employees calculated their own financial aid awards and disbursed the funds to their own accounts. According to financial aid office management, there is an unwritten policy requiring that employees' receiving financial aid have their application reviewed by a management team member, which includes the Director, Associate Director, or the Assistant Director of Student Financial Aid. However, this was not done in numerous cases.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Further, non-federal aid was disproportionately awarded to two financial aid employees and an employee managing student accounts, as compared to other University employees included in our audit. Out of \$41,821 in non-federal aid awarded to 24 employees, two financial aid employees received \$21,764 or 52% of the aid and one employee who manages student accounts received \$6,341 or 15% of the aid.

Finally, we found that 16 University employees received \$13,430 in tuition and fee waivers for which they were not eligible. According to University policy, employees receiving non-repayable financial aid such as grants and scholarships are not eligible for tuition or fee waivers, and tuition may be waived for no more than one course per semester. The University granted waivers to employees in violation of both of these requirements.

Recommendation: The University should improve internal control to ensure that student financial aid is awarded in accordance with federal regulations and University policy. Additional internal control is required when awards are made to employees. Financial aid employees should not have the system access rights to award and distribute funds to their own accounts or accounts of their co-workers. In addition, University employees should not be given special consideration for financial aid awards.

(Award #s P063P061969, P007A063195, and Federal Family Education Loans - Award year – 7/1/06 to 6/30/07)

University Response: Concurs with finding.

Corrective Action: Effective August 2007, all University employee aid packages are reviewed for compliance with the University's official tuition waiver policy. At the end of the fourth week of each semester, Financial Aid will request from the Director of Billings & Receivables, a list of all employees who have had tuition waivers applied to their accounts. The Assistant Director or Senior Counselor in Financial Aid will review the list of employee-students receiving non-repayable aid. Billings and Receivables will be responsible for removing the ineligible waiver and notifying the student.

The process adopted by Financial Aid for awarding eligible students has been revised in the Banner Information System used to process and disburse student aid awards. Furthermore, Financial Aid will review all student refunds prior to release to ensure eligibility. System security has been revised to restrict staff edit capabilities to budget assignment screens. Budget changes must be documented and approved by the Director, Associate Director or Assistant Director. Finally, the employee responsible for the report system abuses has been terminated.

Financial Aid packaging guidelines have been established to ensure equitable distribution of available funds to eligible student applicants only. Any increase above initial award limit must be documented and approved by the Financial Aid Director, Associate Director or Assistant Director. The Financial Aid Office has established a

AUDIT FINDINGS AND RESPONSES (CONTINUED)

written policy regarding employee awards. FA employees are not allowed to process aid or loan requests for family members or close associates at any time. Any effected student's application must be processed by the Director, Associate Director or the Assistant Director. Employees who violate this policy are subject to disciplinary action.

2. STUDENT FINANCIAL AID OVER-AWARDED

The University over-awarded financial aid to several students, two of whom were relatives of a financial aid employee. As a result, we are questioning \$8,983 in federal costs.

We tested eligibility for 41 students who were awarded financial aid during the 2006-2007 academic year and identified four students who were over-awarded financial aid. The excess awards resulted from the financial aid office increasing the students' cost of attendance budget without documented justification. Students are assigned a cost of attendance budget by the University based on a variety of factors including enrollment status, living arrangements, etc. to ensure that students are treated equitably in their consideration for financial aid. Modifications to the budgets can be made at the University's discretion for students with specific needs, but all changes should be documented and placed in the students' files.

Federal regulations require that when a University establishes standard costs of attendance for different categories of students, the University must apply the cost allowances uniformly to all students within its established categories

Recommendation: The University should improve internal control to ensure that student financial aid is awarded in accordance with federal regulations and University policy. The University should maintain documentation for all changes to its standard cost of attendance calculations that determine students' need for financial aid. Special consideration should not be given to family members of University employees awarding financial aid, nor should financial aid employees be involved in the processing of financial aid for a relative.

(Federal Family Education Loans - Award year – 7/1/06 to 6/30/07)

University Response: Concur with finding.

Corrective Action: Costs of attendance budgets have been established and standardized for similar student groups. Students may request in writing that the cost of attendance be increased due to documented expenses, not considered in the initial budget, required to continue their educations. Revisions to these established costs of attendance must be documented and approved by the Director, Associate Director or Assistant Director. Furthermore, system security has been revised to restrict staff edit capabilities. Employees are expressly forbidden from processing family and close associates' aid

AUDIT FINDINGS AND RESPONSES (CONTINUED)

applications or loan requests. Those must be reviewed and processed by a senior management team member.

3. STUDENT FINANCIAL AID FUNDS NOT RETURNED TO PROVIDERS AS REQUIRED

The University did not properly return student financial aid funds to the federal government or appropriate lenders as required when students who received aid withdraw from classes. We identified \$15,036 that was not returned at all and \$7,433 that was returned late.

The University is required to calculate and return to the applicable party in a timely manner the amount of federal financial aid that is unearned by a student who withdraws from the University. We tested 25 students who withdrew from the University during the 2006-2007 academic year. In two cases, no calculation was performed to determine if there were funds subject to return. We performed the calculation and determined that \$290 should have been returned. In eight cases, the calculation was performed; however, the University failed to return \$14,746 of the calculated amount. In three cases, the calculation was performed and funds totaling \$7,433 were returned; however, they were returned between 86 to 250 days late.

Federal regulations require that when a student withdraws from the University, the University must calculate the amount of federal financial aid that was not earned by the student and return those funds to the federal government or appropriate lender. The funds must be returned within 45 days of the date that the University determined that a student withdrew.

Recommendation: The University should comply with federal regulations by ensuring that federal funds that are unearned by students who withdraw from the University are returned to the federal government or appropriate lender within the required timeframe.

(Award #s P063P061969 and Federal Family Education Loans; Award year – 7/1/06 to 6/30/07)

University Response: Concur with finding.

Corrective Action: The return to Title IV calculations are in progress from academic years 2004 to the current year based on both the State and Federal program reviews. New procedures have been established in Financial Aid to ascertain if unofficial withdrawals have occurred. Financial Aid will review any students receiving all W, I or F grades at mid-term and finals to identify potential unofficial withdrawals. Any students deemed to have withdrawn unofficially from the University are reported to Billings and Receivables. This Department has the responsibility of returning the funds, as appropriate.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

4. FINANCIAL AID AWARDED TO STUDENTS WHO DID NOT MEET ACADEMIC STANDARDS

The University awarded student financial aid to students who were not in compliance with the University's satisfactory academic progress policy, which is not allowed by federal regulations. As a result, we are questioning \$46,271 of federal costs.

We tested eligibility for 41 students who received federal student financial aid and found that four did not meet the University's satisfactory academic progress financial aid policy. The Code of Federal Regulations, Title 34, Part 668.16(e), Standards of Administrative Capability, states that students must maintain satisfactory academic progress in their courses of study according to the institution's published standards of satisfactory academic progress.

The University's satisfactory academic progress policy that determines financial aid eligibility can differ from its satisfactory academic progress policy that determines academic eligibility, but it cannot be less strict. We reviewed the portion of both policies that indicate what the University considers successful progression toward a degree; however, based on the manner in which the policies were written, we were unable to determine whether the financial aid policy was less strict than the overall policy.

Recommendation: The University should improve internal control to ensure that student financial aid is awarded in accordance with federal regulations. The satisfactory academic progress policy for student financial aid should clearly be at least as strict as the satisfactory academic progress policy for students overall.

(Award #s – P063P061969, P007A063195, and Federal Family Education Loans, and Federal Perkins Loan Program; Award year – 7/1/06 to 6/30/07)

University Response: Concurs with finding.

Corrective Action: Financial Aid guidelines for determining satisfactory academic progress (SAP) have been updated and brought into compliance with federal aid regulations. Students not maintaining SAP are ineligible for student aid unless granted an appeal and placed on financial aid probation. Appeal forms are available to effected students online and in office. Appeals are considered and decided by the Appeals Committee or the Director of Financial Aid.

5. INAPPROPRIATE INFORMATION SYSTEM ACCESS

The University allowed information system access rights inconsistent with adequate internal controls to prevent error or misappropriation. We identified four employees who continued to have system access rights after their termination from the University and three employees who had system access rights inconsistent with their job duties.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

Prudent internal control principles require that users be given access to the specific computer resources needed for their job duties, and upon termination, such access be revoked to prevent unauthorized access to University data.

Recommendation: The University should improve internal control over computer system access to ensure only authorized personnel are granted the necessary system access to perform their job duties, and such access is revoked in a timely manner upon employee termination.

University Response: Concurs with finding.

Corrective Action. The University's policy as related to staff separations and terminations will be revised. The revised policy will reflect the hiring supervisor's responsibility to notify Human Resources, as appropriate, for any staff separations, terminations and/or transfers. Human Resources will notify Information Technology to terminate all system access. The revised policy will also include consequences for non-compliance up to and including disciplinary action.

Electronic processes will be developed to notify other parties of personnel movements as appropriate.

The University will be educated of the revisions to these policies and procedures through the use of various forums such as the Ask HR quarterly meetings, and the monthly Budget Managers' Meetings.

6. DEFICIENCIES IN BANK RECONCILIATIONS

The University did not accurately reconcile its Short Term Investment Fund account and has not kept the reconciliations current. This increases the risk that an error or misappropriation could occur and not be detected in a timely manner.

The June 30, 2007, reconciliation for the University's Short Term Investment Fund account contained several errors:

- a. The account was reconciled to the wrong general ledger balance. The balance used on the reconciliation was \$22,644,013, while the balance per the University's accrual basis general ledger was \$23,258,317, a difference of \$614,304.
- b. The true difference between the adjusted bank balance and the general ledger balance was \$882,452; however, the University could only explain \$160,234 of the difference.
- c. Items totaling \$737,212 and identified as deposits in transit per the University's reconciliation could not be verified as being deposited per review of subsequent months' bank statements for the account.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

As of December 27, 2007, the Short Term Investment Fund reconciliations for the months of July 2007 through November 2007 had not been completed.

Recommendation: The University should improve internal control to ensure that all its bank accounts are reconciled completely, accurately and timely.

University Response: Concurs with finding.

The following steps have been performed:

- a. We have reconciled the bank statement balance to the Banner Bank Fund balance. Any postings to the actual Banner Fund (primarily Billings & Receivables feeds) were not always posting properly to the associated Bank Fund Account Code. This is due primarily to the implementation of the Banner Student Accounts Receivable module in July 2006 and staffing issues (proper training) in the Billings & Receivables area. Most of the problems were in the first four months of implementation and have declined tremendously since the implementation. We have currently reconciled the differences between the Banner Bank Funds and the individual Banner Funds. These adjustments are reflected on the updated Bank Reconciliation.
- b. We have identified all differences between the adjusted Bank Balance and the General Ledger. As we have noted above, some of the differences are due to improper postings to the Bank Fund balance and also to human error with regards to improperly recording deposits to the correct bank account.
- c. We have assigned our Trust Fund Accountant to work with Billings & Receivables to identify all deposit discrepancies. Through June 30, 2007, all deposit discrepancies have been identified and reflected on the updated Bank Reconciliation.

Additionally, we are working on the current year reconciliation and plan to be up to date by April 30, 2008. From the analysis that we have completed, we now have a better understanding of how Banner Student interacts with Banner Finance. Also, we have approached assistance from UNC Greensboro, since they have the most experience with Banner Student in the University System and on the interfaces with Banner Finance. We are currently implementing UNCG's reconciliation methodology since it is more streamlined and automated. Implementation is targeted for July 1, 2008.

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