STATE OF
NORTH CAROLINA

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, 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

FAYETTEVILLE STATE UNIVERSITY

FAYETTEVILLE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

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Office of the State Auditor

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

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of Fayetteville 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

May 29, 2008

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the accompanying financial statements of Fayetteville State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2007, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Fayetteville State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Fayetteville State University's Foundation, Inc., and Subsidiary, the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the report of the other auditors.

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated April 24, 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

April 24, 2008

Introduction

Fayetteville State University (University) provides this overview and management discussion and analysis to assist in understanding the statements and notes to the financial statements presented herewith for the year ended June 30, 2007, and includes comparative data for the year ended June 30, 2006. The discussion describes important trends and events that have impacted the fiscal health of the University and that may continue to exert influence in future years. This discussion has been prepared by and is the responsibility of the University management along with the financial statements and notes. The report should be read and considered in its entirety.

Using the Annual Report

This annual report consists of a series of financial statements, notes and other information prepared in accordance with the Governmental Accounting Standards Board (GASB). The GASB establishes standards for external financial reporting for public colleges and universities and requires that financial statements be presented on a consolidated basis for the University as a whole. These standards were used in the preparation of this document. They are prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. Comparative information for the prior fiscal year is also presented in the condensed financial statements.

The Notes to the Financial Statements should be read in conjunction with the financial statements. The Notes to the Financial Statements provide detailed information about the University regarding significant accounting principles, deposits and investments, endowment investments, receivables, capital assets, accounts payable and accrued liabilities, long-term liabilities, lease obligations, revenues, operating expenses by function, pension plans, other post employment benefits, risk management, commitments and contingencies, and if necessary, information regarding accounting changes, adjustments to prior periods, and events subsequent to the University's financial statement period. Overall, these disclosures provide information to better understand details, risks, and uncertainty associated with amounts reported in the financial statements.

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used in the private-sector. The University's supporting organization, the Fayetteville State University Foundation, Inc. (Foundation) is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. Therefore, the results of its operations are not blended with the University's financial statements, but are discretely presented, and are not included in this Management's Discussion and Analysis. The Foundation includes as a subsidiary, the University Place Apartments (UPA). These apartments were leased 50% in fiscal year 2007 and are being leased in their entirety beginning with fiscal year 2008.

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2007. The combined net assets for the University increased $8.44 million in the current year, which is an increase of 8.98 percent.

Summary of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The Statement of Net Assets is a point-in-time financial statement. The purpose of the Statement of Net Assets is to present to the readers of the financial statements a fiscal snapshot of Fayetteville State University. The Statement of Net Assets presents end-of-year data showing assets (property that we own and what we are owed by others); liabilities (what we owe to others and have collected from others in advance of providing the service); and net assets (assets minus liabilities). It is prepared using the accrual basis of accounting, where revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service to us, regardless of when cash is exchanged.

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

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

Condensed Summary of Net Assets (in millions)

	2007	2006	Increase/ (Decrease)	Percent Change
Assets:				
Current Assets	$ 14.44	$ 16.02	$ (1.58)	-9.86%
Noncurrent Assets:				
Capital	91.87	85.46	6.41	7.50%
Other	14.30	10.90	3.40	31.19%
Total Assets	120.61	112.38	8.23	7.32%
Liabilities:				
Current Liabilities	6.71	6.52	0.19	2.91%
Noncurrent Liabilities	11.49	11.89	(0.40)	-3.36%
Total Liabilities	18.20	18.41	(0.21)	-1.14%
Net Assets:				
Invested in Capital Assets, Net of Related Debt	86.35	79.39	6.96	8.77%
Restricted:				
Nonexpendable	3.00	5.95	(2.95)	-49.58%
Expendable	6.55	4.72	1.83	38.77%
Unrestricted	6.51	3.91	2.60	66.50%
Total Net Assets	$ 102.41	$ 93.97	$ 8.44	8.98%

Net Assets categories are defined in Note 1.L of the Notes to the Financial Statements. Net assets, invested in capital assets, net of related debt, was restated for fiscal year 2006 due to the asset life being re-calculated. The total restatement, increasing the asset value and net assets, is $25,194,486.37.

As of June 30, 2007, total University assets were $120.61 million, which is an increase of $8.23 million. The University's largest assets are its capital assets of $91.87 million, representing 76.17 percent of total assets. Current assets decreased by $1.58 million primarily due to a decrease in receivables of $1.87 million. Most of the decrease was due to a change from the Direct Leading (drawdown) program to FFELP (direct pay) for student loans. Other programs had better collections in the current year, which also reduced receivables.

Noncurrent capital assets increased by $6.41 million primarily due to construction relating to capital expenditures funded by proceeds from the sale of North Carolina general obligation bonds. Noncurrent other assets increased by $3.40 million primarily due to an increase in due from primary government of $76 million and an increase in endowment investments of $.66 million.

The University's liabilities totaled $18.20 million at June 30, 2007, which is a decrease of $.21 million. Noncurrent liabilities of $11.49 million consist mainly of $4.96 million bonds payable and $2.82 million compensated absences. Other liabilities include contracts and accounts payable, U. S. government grants refundable, and funds held for others. Details of both current and noncurrent liabilities are shown on the Statement of Net Assets and in notes 6 and 7.

The University's current assets of $14.44 million covered the current liabilities of $6.71 million, at a ratio of 2.15 ($2.15 in current assets for every $1.00 in current liabilities).

At June 30, 2007, the University had outstanding bonds of $5.53 million. Bonds payable is the University's largest liability, representing 30 percent of total University liabilities.

The $8.44 million overall increase in net assets was largely attributable to the increase in invested in capital assets, net of related debt, of $6.96 million.

Summary of Revenues, Expenses, and Changes in Net Assets

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

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

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

Condensed Summary of Revenues, Expenses, and Changes in Net Assets (in millions)

	2007	2006	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees, Net	$ 14.14	$ 14.12	$ 0.02	0.14%
Grants and Contracts	12.65	12.31	0.34	2.76%
Auxiliary Activities	6.32	5.34	0.98	18.35%
Other Educational Activities	0.30	0.13	0.17	130.77%
Total Operating Revenues	33.41	31.90	1.51	4.73%
Total Operating Expenses	95.16	86.33	8.83	10.23%
Operating Loss	(61.75)	(54.43)	(7.32)	13.45%
Nonoperating Revenues:				
State Appropriations	49.20	44.36	4.84	10.91%
Other Nonoperating Revenue	7.83	7.54	0.29	3.85%
Net Nonoperating Revenues	57.03	51.90	5.13	9.88%
Loss Before Other Revenues	(4.72)	(2.53)	(2.19)	86.56%
Capital Contributions	12.93	14.42	(1.49)	-10.33%
Permanent Endowment Additions	0.23	0.06	0.17	283.33%
Increase in Net Assets	8.44	11.95	(3.51)	-29.37%
Net Assets:				
Beginning of Year	93.97	82.02	11.95	14.57%
End of Year	$ 102.41	$ 93.97	$ 8.44	8.98%

The Condensed Summary of Revenues, Expenses, and Changes in Net Assets shows an increase in net assets of $8.4 million at the end of the year.

The total operating loss for fiscal year 2007 was $61.75 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB, the University shows a significant operating loss.

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

The University strives to provide students with the opportunity to obtain a quality education. Future University enrollments may be affected by a number of factors, including any material increase in tuition and other mandatory charges. Changes in appropriation funding from the State of North Carolina may influence costs to students and the ability to continue normal operations. The State appropriations are a critical source of funding for the University.

The State appropriations are received through an allotment and requisition system through the North Carolina Office of State Budget and Management and the North Carolina Office of State Controller. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year beginning July 1, 2006, and ending June 30, 2007, the appropriations from the State for the University were $49.2 million for operations and $3.4 million for capital projects. These appropriations were recorded by the University during the fiscal year.

Operating expenses, including depreciation of $1.79 million, totaled $95.16 million. Of this total, $42.94 million, or 45.12 percent, was used for instruction and student support; $10.17 million, or 10.69 percent, was used for institutional support; $13.37 million, or 14.05 percent, was used for operations and maintenance of plant; and $10.87 million, or 11.42 percent, was used for auxiliary enterprises. The largest increase in operating expenses was for salaries and benefits which increased $5.9 million. This increase is mainly due to State legislative increases.

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

Capital Assets

With the successful passage of the higher education bond referendum in November 2000 the University received a $46 million allocation to enhance campus facilities. Major capital expenditures provided through the year ended June 30, 2007, include, the Residence Hall ($6.52 million), Seabrook Renovation ($8.01 million), Lyons Renovation and Additions ($12.41 million), Cook Dining Conversion ($2.44 million), Taylor Gymnasium Conversion ($4.93 million), and Spaulding Renovation Conversion ($1.45 million).

Other capital projects for the fiscal year 2007 include repair and renovation expenditures of $3.1 million. Planning continues on the Nursing Education and Research Center, a $10 million project. The total capital assets, net of accumulated depreciation, at June 30, 2007, were $91,868,231.69. For more detailed information about asset holdings, see Note 5 of the Notes to the Financial Statements.

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. The University has undergone recent changes in management around the end of the 2007 fiscal year. These changes are not considered to have a significant affect on the continued operations and financial position of the University.

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

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

Private gifts are an important supplement to the fundamental support from the State, student tuition and fees, and other revenue sources. Gifts are a significant factor in the growth and support of academic units and support for student scholarships. Economic pressures affecting donors may affect the future level of support the University receives from corporate and individual giving, including the support received through the Fayetteville State University Foundation, Inc.

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

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

Fayetteville State University
Statement of Net Assets
June 30, 2007 ***Exhibit A-1***

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	7,365,022.30
Restricted Cash and Cash Equivalents		3,285,221.92
Receivables, Net (Note 4)		2,924,990.03
Inventories		249,644.53
Notes Receivable (Note 4)		614,903.33
Total Current Assets		14,439,782.11
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		5,187,385.48
Restricted Due from Primary Government		1,394,944.21
Endowment Investments		5,585,292.97
Other Investments		441,061.88
Notes Receivable, Net (Note 4)		1,688,030.83
Capital Assets - Nondepreciable (Note 5)		21,480,991.05
Capital Assets - Depreciable, Net (Note 5)		70,387,240.64
Total Noncurrent Assets		106,164,947.06
Total Assets		120,604,729.17
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 6)		4,460,665.03
Due to Primary Government		32,647.27
Unearned Revenue		1,184,711.95
Interest Payable		64,006.88
Long-Term Liabilities - Current Portion (Note 7)		971,369.00
Total Current Liabilities		6,713,400.13
Noncurrent Liabilities:		
Funds Held for Others		1,817,888.55
U. S. Government Grants Refundable		1,897,464.82
Long-Term Liabilities (Note 7)		7,769,704.00
Total Noncurrent Liabilities		11,485,057.37
Total Liabilities		18,198,457.50
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		86,343,231.69
Restricted for:		
Nonexpendable:		
Scholarships and Fellowships		737,714.12
Endowed Professorships		1,686,042.00
Loans		580,600.70
Expendable:		
Scholarships and Fellowships		139,306.83
Endowed Professorships		1,097,255.87
Departmental Uses		603,066.05
Capital Projects		3,469,962.68
Debt Service		1,239,347.84
Unrestricted		6,509,743.89
Total Net Assets	$	102,406,271.67

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

Fayetteville State University
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2007

Exhibit A-2

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 9)	$	14,135,061.61
Federal Grants and Contracts		12,652,911.95
Sales and Services, Net (Note 9)		6,317,983.26
Interest Earnings on Loans		3,757.91
Other Operating Revenues		296,134.46
Total Operating Revenues		33,405,849.19
EXPENSES		
Operating Expenses:		
Salaries and Benefits		54,511,690.76
Supplies and Materials		11,567,697.33
Services		15,325,968.75
Scholarships and Fellowships		9,521,294.06
Utilities		2,447,323.13
Depreciation		1,785,604.25
Total Operating Expenses		95,159,578.28
Operating Loss		(61,753,729.09)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		49,198,094.49
Noncapital Grants		6,088,596.06
Noncapital Gifts		752,912.42
Investment Income (Net of Investment Expense of $19,503.86)		1,245,532.57
Interest and Fees on Debt		(275,959.05)
Other Nonoperating Revenues		18,417.73
Net Nonoperating Revenues		57,027,594.22
Loss Before Other Revenues		(4,726,134.87)
Capital Appropriations		3,394,300.00
Capital Grants		9,532,961.46
Additions to Endowments		232,143.89
Increase in Net Assets		8,433,270.48
NET ASSETS		
Net Assets - July 1, 2006, as Restated (Note 15)		93,973,001.19
Net Assets - June 30, 2007	$	102,406,271.67

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

Fayetteville State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2007 — *Exhibit A-3*

CASH FLOWS FROM OPERATING ACTIVITIES	
Received from Customers	$ 34,968,062.34
Payments to Employees and Fringe Benefits	(54,148,618.94)
Payments to Vendors and Suppliers	(30,419,546.98)
Payments for Scholarships and Fellowships	(9,521,294.06)
Loans Issued	(599,697.19)
Collection of Loans	535,001.60
Interest Earned on Loans	3,184.42
Other Receipts	63,197.45
Net Cash Used by Operating Activities	(59,119,711.36)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State Appropriations	49,198,094.49
Noncapital Grants	6,088,596.06
Noncapital Gifts	752,912.42
Additions to Endowments	232,143.89
Federal Family Education Loan Receipts	25,138,869.30
Federal Family Education Loan Disbursements	(24,036,467.00)
Related Activity Agency Receipts	253,532.21
Net Cash Provided by Noncapital Financing Activities	57,627,681.37
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES	
State Capital Appropriations	3,394,300.00
Capital Grants	8,770,121.30
Proceeds from Sale of Capital Assets	18,417.73
Acquisition and Construction of Capital Assets	(8,228,594.81)
Principal Paid on Capital Debt	(550,000.00)
Interest and Fees Paid on Capital Debt	(281,861.54)
Net Cash Provided by Capital Financing and Related Financing Activities	3,122,382.68
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales and Maturities of Investments	868,000.00
Investment Income	573,020.92
Purchase of Investments and Related Fees	(874,769.67)
Net Cash Provided by Investing Activities	566,251.25
Net Increase in Cash and Cash Equivalents	2,196,603.94
Cash and Cash Equivalents - July 1, 2006	13,641,025.76
Cash and Cash Equivalents - June 30, 2007	$ 15,837,629.70

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

Operating Loss	$	(61,753,729.09)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		1,785,604.25
Allowances, Write-Offs, and Amortizations		61,169.36
Changes in Assets and Liabilities:		
Receivables (Net)		1,018,818.69
Inventories		(57,711.88)
Accounts Payable and Accrued Liabilities		(737,199.97)
Due to Primary Government		(6,460.05)
U. S. Government Grants Refundable		63,197.45
Unearned Revenue		673,708.75
Compensated Absences		(102,413.28)
Student Loan Principal Repayments		535,001.60
Student Loans Issued		(599,697.19)
Net Cash Used by Operating Activities	$	(59,119,711.36)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	7,365,022.30
Restricted Cash and Cash Equivalents		3,285,221.92
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		5,187,385.48
Total Cash and Cash Equivalents - June 30, 2007	$	15,837,629.70

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Change in Fair Value of Investments	$	656,342.76
Reinvested Distributions		160.29
Loss on Disposal of Capital Assets		5,070.22

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

Fayetteville State University Foundation, Inc., and Subsidiary
Consolidated Statement of Financial Position
June 30, 2007 *Exhibit B-1*

ASSETS		
Current Assets:		
Cash in Bank	$	2,165,082
Cash in Bank - Housing Foundation		837,319
Accrued Interest Receivable		6,209
Accounts Receivable		72,479
Due from FSU		16,742
Investments - Land for Sale		764,221
Investments		2,485,242
Total Current Assets		6,347,294
Property, Plant and Equipment:		
Furniture and Equipment		1,100,733
Land and Buildings		12,424,385
		13,525,118
Less: Accumulated Depreciation		2,269,653
Net Property and Equipment		11,255,465
Total Assets	$	17,602,759
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Accounts Payable	$	190,836
Current Maturities of Long-Term Debt		220,000
Security Deposits		39,327
Total Current Liabilities		450,163
Long-Term Debt		14,035,000
Net Assets:		
Unrestricted:		
Subsidiary - FSU Housing Foundation		(2,479,964)
Fayetteville State University Foundation		882,447
Temporarily Restricted:		
Subsidiary - FSU Housing Foundation		837,319
Fayetteville State University Foundation		1,571,873
Permanently Restricted		2,305,921
Total Net Assets		3,117,596
Total Liabilities and Net Assets	$	17,602,759

See Note 1 in the Notes to the Financial Statements.

Fayetteville 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				
Gifts and Donations	$ 88,143	$ 135,876	$ 87,560	$ 311,579
Total Support	88,143	135,876	87,560	311,579
REVENUE				
Interest and Dividend Income	47,884	117,912		165,796
Unrealized Gain on Investments		318,364		318,364
Gain on Sale of Land	55,487			55,487
Rental Income	1,331,780			1,331,780
Net Assets Released from Restrictions	474,404	(474,404)		
Total Revenue	1,909,555	(38,128)		1,871,427
Total Support and Revenue	1,997,698	97,748	87,560	2,183,006
OPERATING EXPENSES				
Program Services	2,120,028			2,120,028
Management and General	28,640			28,640
Fund Raising Expenses	2,462			2,462
Total Operating Expenses	2,151,130			2,151,130
Increase (Decrease) in Net Assets	(153,432)	97,748	87,560	31,876
NET ASSETS				
Beginning of Year	(1,444,085)	2,311,444	2,218,361	3,085,720
End of Year	$ (1,597,517)	$ 2,409,192	$ 2,305,921	$ 3,117,596

See Note 1 in the Notes to the Financial Statements.

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NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity – The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. Fayetteville State University is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report.*

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

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

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 35 directors. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income theron, that the Foundation holds and invests, are restricted to the activities of the University by the donors. Because these restricted resources held by the

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

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

During the year ended June 30, 2007, the Foundation distributed $222,446.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Fayetteville State University Foundation Inc., and Subsidiary at (910) 672-1151.

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

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

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

C. **Basis of Accounting** – The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred, regardless of the timing of the cash flows.

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange includes State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

D. Cash and Cash Equivalents – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

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

F. Receivables – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.

G. Inventories – Inventories, consisting of expendable supplies and merchandise for resale, are valued at the lower of cost or market value using the first-in, first-out method.

H. Capital Assets – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost in excess of $5,000 at the date of acquisition and an estimated useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 74 years for general infrastructure, 30 to 100 years for buildings, and 3 to 20 years for equipment.

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

I. **Restricted Assets –** Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations. Certain other assets are classified as restricted because their use is limited by external parties or statute.

J. **Noncurrent Long-Term Liabilities –** Noncurrent long-term liabilities include principal amounts of bonds payable and compensated absences that will not be paid within the next fiscal year.

The University's bond premiums/discounts are considered immaterial and are expensed.

K. **Compensated Absences –** The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. 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.

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

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

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

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

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

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

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

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

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

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

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

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2007, the amount shown on the Statement of Net Assets as cash and cash equivalents includes $15,662,366.43 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2007. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.ncosc.net/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2007, was $11,700.00. The carrying amount of the University's deposits not with the State Treasurer was $163,563.27 and the bank balance was $163,130.27. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2007, $59,300.49 of the University's bank balance was exposed to custodial credit risk and held as uninsured and uncollateralized by the bank per bond covenants.

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

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper, and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

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

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

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

Investments are subject to the following risks.

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

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

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

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

		Investment Maturities (in Years)			
	Fair Value	Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
U.S. Treasuries	$ 441,061.88	$ 441,061.88	$ 0.00	$ 0.00	$ 0.00
Mutual Bond Funds	1,757,283.41			1,757,283.41	
		$ 441,061.88	$ 0.00	$ 1,757,283.41	$ 0.00
Other Securities					
Other Mutual Funds	3,828,009.56				
Total Long-Term Investment Pool	$ 6,026,354.85				

The University's mutual bond funds held at June 30, 2007, were unrated.

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 report is under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type:

Fayetteville State University Foundation, Inc., and Subsidiary

Investments are presented in the financial statements at fair market value. Investments earned $58,113.00 during the year ended June 30, 2007, and incurred management fees of $8,845.00. Investments within the account are composed of the following:

	Cost	Market	Unrealized Appreciation
Common Fund:			
Multi Strategy Equity Fund	$ 960,000.00	$ 1,816,057.00	$ 856,057.00
Multi Strategy Bond Fund	640,000.00	668,135.00	28,135.00
Equity Securities	3,500.00	1,050.00	(2,450.00)
	$ 1,603,500.00	$ 2,485,242.00	$ 881,742.00

Investments also include donated land which is available for sale. At June 30, 2007, land value totaled $764,221.00.

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated under classical trust doctrines. Unless the donor has stipulated otherwise, capital gains and losses are accounted for as part of the endowment principal and are not available for expenditure. The University's endowment spending policy governs the rate at which funds are released to the operating budget from the endowment. The University uses a disciplined spending rate with a long-term spending rule. The target rate for spending is set between 4% and 6% of the endowment's three-year average year end market value. In order to preserve the purchasing power of the endowment, the portfolio is invested with the expectation of generating a long-term rate of return at least equal to the payout plus the rate of inflation. At June 30, 2007, net appreciation of $2,179,222.96 was available to be spent, of which $1,301,524.10 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2007, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 2,719,968.77	$ 1,907,125.03	$ 812,843.74
Accounts	137,561.22		137,561.22
Intergovernmental	1,886,865.17		1,886,865.17
Investment Earnings	40,051.01		40,051.01
Interest on Loans	46,660.00		46,660.00
Other	1,008.89		1,008.89
Total Current Receivables	$ 4,832,115.06	$ 1,907,125.03	$ 2,924,990.03
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	$ 584,969.89	$ 0.00	$ 584,969.89
Institutional Student Loan Programs	29,933.44		29,933.44
Total Notes Receivable - Current	$ 614,903.33	$ 0.00	$ 614,903.33
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 2,105,458.50	$ 417,427.67	$ 1,688,030.83

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	$ 963,243.22	$ 0.00	$ 0.00	$ 963,243.22
Construction in Progress	16,175,415.83	7,127,738.45	2,785,406.45	20,517,747.83
Total Capital Assets, Nondepreciable	17,138,659.05	7,127,738.45	2,785,406.45	21,480,991.05
Capital Assets, Depreciable:				
Buildings	82,767,567.68	2,785,406.45		85,552,974.13
Machinery and Equipment	5,984,775.71	1,073,469.59	284,774.47	6,773,470.83
General Infrastructure	2,786,625.27			2,786,625.27
Total Capital Assets, Depreciable	91,538,968.66	3,858,876.04	284,774.47	95,113,070.23
Less Accumulated Depreciation/Amortization for:				
Buildings	19,096,291.28	1,043,173.84		20,139,465.12
Machinery and Equipment	2,733,582.60	680,605.09	270,064.62	3,144,123.07
General Infrastructure	1,380,416.08	61,825.32		1,442,241.40
Total Accumulated Depreciation	23,210,289.96	1,785,604.25	270,064.62	24,725,829.59
Total Capital Assets, Depreciable, Net	68,328,678.70	2,073,271.79	14,709.85	70,387,240.64
Capital Assets, Net	$ 85,467,337.75	$ 9,201,010.24	$ 2,800,116.30	$ 91,868,231.69

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	$ 2,372,704.77
Accrued Payroll	1,074,376.56
Contract Retainage	705,911.68
Intergovernmental Payables	307,597.34
Other	74.68
Total Accounts Payable and Accrued Liabilities	$ 4,460,665.03

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	$ 6,075,000.00	$ 0.00	$ 550,000.00	$ 5,525,000.00	$ 570,000.00
Compensated Absences	3,318,486.28	1,968,038.00	2,070,451.28	3,216,073.00	401,369.00
Total Long-Term Liabilities	$ 9,393,486.28	$ 1,968,038.00	$ 2,620,451.28	$ 8,741,073.00	$ 971,369.00

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
Dormitory System						
Dormitory System Revenue Bond	B	8.0%-10.0%	10/01/2009	$ 1,750,000.00	$ 1,390,000.00	$ 360,000.00
The University of North Carolina System Pool Revenue Bonds						
Refunding of U.S. Department of Education Notes Payable	2002B	3.5%-5.375%	04/01/2022	1,245,000.00	200,000.00	1,045,000.00
Stadium Renovation	2002B	3.5%-5.0%	04/01/2012	2,735,000.00	1,155,000.00	1,580,000.00
Dining	2005B	3.5%-4.5%	04/01/2023	2,770,000.00	230,000.00	2,540,000.00
Total The University of North Carolina System Pool Revenue Bonds				6,750,000.00	1,585,000.00	5,165,000.00
Total Bonds Payable (principal only)				$ 8,500,000.00	$ 2,975,000.00	$ 5,525,000.00

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

	Annual Requirements Bonds Payable	
Fiscal Year	Principal	Interest
2008	$ 570,000.00	$ 251,517.50
2009	590,000.00	225,737.50
2010	625,000.00	197,887.50
2011	515,000.00	169,057.50
2012	545,000.00	145,257.50
2013-2017	1,095,000.00	510,826.26
2018-2022	1,375,000.00	241,068.78
2023	210,000.00	9,187.50
Total Requirements	$ 5,525,000.00	$ 1,750,540.04

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

During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2007, the outstanding balance of prior year defeased bonds was $2,355,000.00.

E. Component Unit - Long-Term Debt

Fayetteville State University Foundation, Inc., and Subsidiary

Long-term debt at June 30, 2007, consisted of a North Carolina Student Housing Facilities Revenue Bond with a balance of $14,255,000.00, secured by real property. The Foundation has entered into an interest rate swap arrangement to lock in the interest rate on 75% of the bond at 3.09%. The remainder of the bond is at a variable interest rate based on the BMA index. The buildings are used as housing for students of Fayetteville State University.

Maturities of long-term debt are as follows:

Year ending June 30, 2008		
(included in current maturities)	$	220,000.00
2009		235,000.00
2010		245,000.00
2011		260,000.00
2012		275,000.00
2013 and thereafter		13,020,000.00
	$	14,255,000.00

NOTE 8 - LEASE OBLIGATIONS

Operating Lease Obligations – The University entered into an operating lease for 190 beds at University Place Apartments. Future minimum lease payments under the noncancelable operating lease consist of the following at June 30, 2007:

Fiscal Year	Amount
2008	$ 604,200.00
2009	604,200.00
2010	604,200.00
2011	604,200.00
Total Minimum Lease Payments	$ 2,416,800.00

Rental expense for all operating leases during the year was $554,622.56.

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	
Operating Revenues:						
Student Tuition and Fees	$ 19,756,377.99	$ 0.00	$ 5,128,304.26	$ 493,012.12	$ 14,135,061.61	
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	$ 4,085,427.71	$ 0.00	$ 967,127.19	$ 170,832.62	$ 2,947,467.90	(A)
Dining	2,795,146.52		718,014.43	118,714.19	1,958,417.90	(B)
Bookstore	167,893.49				167,893.49	
Other	1,637,466.67	832,314.26			805,152.41	
Sales and Services of Education and Related Activities	439,051.56				439,051.56	
Total Sales and Services	$ 9,124,985.95	$ 832,314.26	$ 1,685,141.62	$ 289,546.81	$ 6,317,983.26	

Revenue Bonds Secured by Pledged Revenues:
(A) Dormitory System Revenue Bonds
(B) Dining System Facility Fee Revenue Bonds

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	$ 29,823,817.66	$ 804,218.22	$ 1,117,384.18	$ 0.00	$ 0.00	$ 0.00	$ 31,745,420.06
Research	600,833.32	268,197.49	182,881.52				1,051,912.33
Public Service	1,520,383.50	63,387.89	527,681.51				2,111,452.90
Academic Support	5,544,270.06	2,764,968.82	1,829,778.48				10,139,017.36
Student Services	3,022,000.15	148,577.74	822,608.31				3,993,186.20
Institutional Support	5,438,962.31	518,442.74	4,207,707.38				10,165,112.43
Operations and Maintenance of Plant	4,661,538.79	5,607,204.25	1,315,995.81		1,783,243.61		13,367,982.46
Student Financial Aid	387,857.82	1,071.27	18,036.71	9,521,294.06			9,928,259.86
Auxiliary Enterprises	3,512,027.15	1,391,628.91	5,303,894.85		664,079.52		10,871,630.43
Depreciation						1,785,604.25	1,785,604.25
Total Operating Expenses	$ 54,511,690.76	$ 11,567,697.33	$ 15,325,968.75	$ 9,521,294.06	$ 2,447,323.13	$ 1,785,604.25	$ 95,159,578.28

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 $45,034,186.19, of which $26,801,260.42 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were

$1,608,075.63 and $712,913.53, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2007, 2006, and 2005, which were $712,913.53, $568,392.83, and $512,004.87, 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 $45,034,186.19, of which $13,003,328.57 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were $780,199.71 and $889,427.67, 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 $134,472.98 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 $33,789.89. The voluntary contributions by employees amounted to $166,721.00 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 $626,115.28 for the year ended June 30, 2007.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees – The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.8% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2007, the University's total contribution to the Plan was $1,512,574.38. 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 $206,983.86. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

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

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

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a $500 per occurrence deductible. The University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, and "all risks" for all buildings and contents.

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

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

The University purchased Intercollegiate Sports Accident Insurance from a private insurance company through the North Carolina Department of Insurance. This policy covers medical expenses incurred for the treatment of injury to covered persons.

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

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

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

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

NOTE 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 $4,091,003.68 and on other purchases were $1,269,534.52 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.

NOTE 15 - NET ASSETS RESTATEMENT

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

	Amount
July 1, 2006, Net Assets as Previously Reported	$ 68,778,514.82
Restatement: Errors in depreciation and in establishing useful lives of capital assets.	25,194,486.37
July 1, 2006, Net Assets as Restated	$ 93,973,001.19

NOTE 16 - SUBSEQUENT EVENTS

On September 4, 2007, the University amended the five-year operating lease agreement with the Fayetteville State University Housing Foundation, LLC. The lease was amended for an additional 151 beds. The University is obligated to pay $1,590 per bed, per semester.

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

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Office of the State Auditor

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

Board of Trustees
Fayetteville State University
Fayetteville, North Carolina

We have audited the financial statements of Fayetteville State University, a constituent institution of the 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 April 24, 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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material 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, 12 and 14 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 Findings 1 and 6 to be material weaknesses.

Compliance and Other Matters

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

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

This report is intended solely for the information and use of management of the University, the Board of Governors, the Board of Trustees, the Audit Committee, the Governor, the

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)

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

April 24, 2008

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Matters Related to Financial Reporting or Federal Compliance Objectives

The following audit findings were identified during the audit ending June 30, 2007, and describe conditions that represent significant deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements or other matters. Finding numbers 1 through 5, 7 through 10, and 14 were also reported in the prior year.

1. INFORMATION SYSTEM ACCESS RIGHTS INCONSISTENT WITH JOB DUTIES

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

   Inappropriate access rights included the following:

   a. The University's Vice Chancellor for Business and Finance, Associate Vice Chancellor for Business and Finance, and Controller are responsible for approving system transactions that have been entered by their subordinates. When employees in these positions have the access rights to create and approve transactions, there is no control in place to prevent fraud. These employees had unlimited system access rights to the entire purchasing and payment process. They could create vendors, create requisitions, create and modify purchase orders, indicate the receipt of purchased goods, create returns of goods, enter invoices, and print checks. In addition, they could add and delete assets from the equipment inventory. They could change departmental budgets. They could enter and update grant information. They could enter charges and payments on students' accounts. These employees were also allowed to create journal entries and approve them.

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

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

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

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

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

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

Segregation of duties is a basic internal control that requires assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. This would reduce the opportunities for any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties.

Recommendation: The University should limit system access rights to ensure that employees are assigned the least amount of system access necessary to perform their jobs and that adequate segregation of duties is maintained in employees' access to the system. System access rights should be reviewed on a regular basis.

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

2. UNAUTHORIZED PURCHASES OF SERVICES

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

We reviewed 28 payments for services. In five instances, or 17.9% of the payments reviewed, purchase orders were created after services were provided. Authorization of transactions is a basic internal control that reduces the potential for misappropriation of assets and budget overruns.

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

University Response: FSU agrees with the recommendation to follow the written guidelines for purchase of goods and services. Currently, those guidelines have been reviewed and changed. While FSU will continue to abide by State Guidelines, our threshold for creating an official purchase order has been raised to a more appropriate level.

3. UNIVERSITY FAILS TO FOLLOW COLLECTION PROCEDURES ON STUDENT ACCOUNTS

As previously reported, the University did not diligently bill and collect student charges. During the fiscal year ended June 30, 2007, the University did not follow its established collection procedures on unpaid charges. Specifically, the University did not send the accounts to a State contracted collection agency. As a result, the University continues to have over $2 million in unpaid student charges that at this point, are considered to be approximately 70 percent uncollectible.

The University's cash management policies over accounts receivable states that for accounts that cannot be collected by the State Attorney General's Office, the University must refer the accounts to a State contracted collection agency.

Recommendation: University management should enforce their cash management policies.

University Response: FSU agrees that cash management procedures need to be followed. Due diligence in collecting outstanding balances is underway as described in the University Cash Management Plan. However, completing the due diligence procedures and working with the collection agencies takes time to complete. New employees are learning the cash management procedures. All employees are working to complete collections timely.

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

As previously reported, cash collected outside of the University's main cashiering office was not adequately monitored. Management did not ensure that cash collected was submitted to the University's main cashiers in a timely manner or that all of the cash collected was turned in. As a result, the University significantly increased its risk for error or fraud.

The University's student purchasing cards are called Bronco One cards. Students pay for a variety of services on campus using their Bronco One cards. University employees in the Bronco One Card Office collect cash from students on a daily basis and are responsible for updating students' Bronco One accounts for the funds collected. In the 2007 fiscal year, Bronco One Card Office employees randomly submitted cash collections to the University's main cashier's office for deposit in the University's account. No reconciliation was prepared between the amount of cash collected and credited to students' Bronco One accounts and the amount of cash submitted by the Bronco One Card Office for deposit.

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

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

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

5. INADEQUATE MANAGEMENT RESPONSE TO AUDIT FINDINGS

The University repeatedly has audit findings in the areas of cash disbursements and information system access rights. The University has had an information system access rights finding reported for four consecutive years and a cash disbursements finding reported for three consecutive years. The University has had repeat audit findings for two consecutive years regarding the University's management of student accounts and the University's monitoring of cash collected outside of the main cashiering office.

Sound internal controls require that management provide prompt resolution to problems identified in audits and other reviews.

Recommendation: Current University management is working to resolve the repeat audit findings by reevaluating employee information system access rights and by updating and enforcing University policies and procedures. We recommend that management continue these efforts to ensure that the issues are resolved. In the future, University management should promptly evaluate, respond, and take corrective action to resolve audit findings.

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

6. ESTIMATED USEFUL LIVES OF CAPITAL ASSETS NOT RE-EVALUATED

The University has not periodically evaluated the appropriateness of the estimated useful lives of its capital assets. After we requested that the University perform such an evaluation, staff identified an overstatement of accumulated depreciation of $26,328,564.78.

With the implementation of Governmental Accounting Standards Board 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,* universities had to start recording depreciation for capital assets. The University used the suggested Office of the State Controller useful lives of assets but has not adjusted those suggested guidelines based on actual experience. A periodic review of useful lives is necessary to ensure that costs are allocated based on actual use of the assets.

Recommendation: The University should monitor the useful lives of its depreciable assets on a regular basis. Management should make changes to the useful lives when necessary in order to ensure that depreciation expense is recognized over the entire useful lives of the assets.

University Response: FSU agrees that useful lives of depreciable assets should be monitored on a regular basis. Staff will monitor the assets and the useful lives on a regular basis going forward.

7. ERRORS IN THE STUDENT FINANCIAL AID APPLICATION VERIFICATION PROCESS

University employees did not properly verify and correct some students' financial aid application data that were used to determine the students' eligibility for financial aid awards. As a result, errors were made in financial aid awards.

We reviewed the University's verification and correction of financial aid application data for 41 students. We found seven errors in the students' files. In six instances the University correctly documented their verification of the students' application data but failed to correct the students' application data for differences noted through the verification process. Known questioned costs from these errors total $200 for the Pell Grant Program. The other error represents an instance where the University did not properly perform the verification process by not resolving questionable information in student's file. It is likely that questioned costs exceed $10,000 in the population.

Title 34CFR, Part 668.56(a) lists the information that institutions must verify and update for students selected for verification. Title 34CFR, Part 668.54(a)(3) indicates that institutions must resolve information in students' financial aid files that they have reason to believe is incorrect. The Federal Student Aid Handbook, Chapter 4, Verification, describes the types of questionable information that must be resolved by institutions including conflicting information concerning the number of household members, adjusted gross income and the number of household members in college. The Student Financial Aid Handbook states that institutions must document their resolution of discrepancies in students' files.

Recommendation: The University should correct students' financial aid application data for all differences identified through the verification process in order to ensure that awards are accurate. The University should properly review students' federal financial aid applications and document their resolution of discrepancies found while performing the verification process of students' financial aid application data.

(Award #s P063P060322 and P375A060322 – Award year 7/1/2006 – 6/30/2007)

University Response: The University uses the federal verification worksheet and the individual's income tax return form as acceptable forms of documentation per the US Department of Education to use in the verification process for information on the FAFSA and ISIR for all differences identified through the verification process. The verification form is used to verify the information submitted on the FAFSA. The procedure the university uses is in accordance with the verification regulation. Additionally, for the 2007-2008 academic year the Office of Financial Aid is re-verifying students who were selected for verification by the Central Processing System and received federal assistance to ensure accuracy of awards. Also, effective 2008-2009, the university is requesting a letter of clarification for figures listed on worksheets A, B and C of the FAFSA and not reported on the Federal Verification Worksheet and/or Federal Tax Return. Additionally, ongoing verification training is underway to ensure the verification process is being carried out per the US Department of Education guidelines.

8. ERRORS IN FINANCIAL AID AWARDS

The University made errors in awarding several students' financial aid. As a result, some students received the wrong award amounts and some students received the wrong type of federal loan.

We reviewed the awards of 74 federal financial aid recipients in order to determine whether students' awards were calculated correctly. One student received a $650 Pell grant when the student should have received a $2,025 Pell grant. Nine students received a total of $15,051 in unsubsidized federal loans when the students should have received the $15,051 in subsidized federal loans. Unsubsidized loans result in more interest expense to students.

Pell grant award amounts are established by Congress. Title 34CFR, Part 682.201(a)(2) indicates that institutions must determine students subsidized loan eligibility prior to awarding unsubsidized loans.

Recommendation: The University should ensure that students are awarded the correct amount and type of financial aid.

(Award #s P063P060322 – Award year 7/1/2006 – 6/30/2007)

University Response: The Financial Aid Counselors employed by the University during the State Auditor's audit period for the year ended June 30, 2007 had not received the training necessary to correctly calculate student's financial aid awards. However, current Financial Aid Counselors have received and continue to receive extensive training on calculating and adjusting student's financial aid awards. The Financial Aid Policy and Procedures Manual require counselors to receive at least 50 hours of Financial Aid Professional Development Training annually.

The errors noted by the State Auditor's finding have been corrected. The Pell Grant award amount was corrected and the nine unsubsidized student loans were changed to subsidized student loans and the accrued interest was credited back to the student.

9. ERRORS IN CALCULATION OF STUDENTS' COST OF ATTENDANCE IN DETERMINING STUDENT FINANCIAL AID AWARDS

The University incorrectly determined a number of students' cost of attendance when awarding student financial aid. As a result, the amount that students were allowed to borrow from loan programs was also incorrect.

Cost of attendance represents the University's estimate of expenses that are incurred by its students and is one of the factors that determines students' eligibility for financial aid awards. The University establishes different cost of attendance budgets for categories of similar students.

We reviewed the cost of attendance calculated by the University for 74 students who were awarded financial aid and found that in 44 instances the incorrect cost of attendance budget was used. All of these students except one were assigned a lower cost of attendance budget than the University designated as appropriate for the applicable category of student. As a result, the University underestimated the students' cost of attendance and reduced the students' eligibility to borrow financial aid in the form of federal loans.

The Federal Student Aid Handbook, Volume 3, Chapter 2, Page 17 states that when a University establishes standard cost of attendance budgets for different categories of students, the University must apply the cost allowances uniformly to all students within the categories.

Recommendation: The University should apply the same cost of attendance budget to similar groups of students.

(Award year 7/1/2006 – 6/30/2007)

University Response: The University ran a program in Banner for the 2006-2007 academic year to correct the cost of attendance budgets used for year ended June 30, 2006. However, the program did not fix all of the cost of attendance budgets used for the 06-07 academic year, but no over awards occurred from using the incorrect cost of attendance budgets. The University has established standard cost of attendance budgets for the 07-08 school year and these costs were applied uniformly to all students. The cost of attendance budgets are reviewed and adjusted annually and a student's financial aid eligibility is based on the standard budget allowances.

10. STUDENTS WHO RECEIVED STUDENT FINANCIAL AID NOT MONITORED FOR SATISFACTORY ACADEMIC PROGRESS

The University did not consistently review students' academic progress in order to determine financial aid eligibility. As a result, some students who did not meet the University's satisfactory academic progress standards received financial aid awards. Known questioned costs that result from these errors include $42,007 for the Pell Grant Program, $2,000 for the Supplemental Educational Opportunity Grant, and $119,000 for the Federal Family Education Loan Program.

Satisfactory academic progress standards are designed to prevent students from continuing to receive federal financial aid awards if students are not making progress towards earning a degree. It is the University's policy to review students' academic progress at the end of each spring semester in order to determine financial aid eligibility for the next fiscal year. However, the University did not have procedures in place to review the academic progress of students who miss one or more semesters and then decide to reenroll at the University. This allowed students who did not meet the University's satisfactory academic progress standards to reenroll at the University and receive financial aid awards.

We examined the academic progress of 40 students who received federal financial aid awards to verify that the students met the University's satisfactory academic progress standards. We noted two students who did not meet the standards, both of whom had reenrolled at the University in the academic year we audited without having their academic progress reviewed. With the assistance of University management, we obtained a report that identified 16 additional students who reenrolled at the University in the academic year we audited who did not meet the University's satisfactory academic progress standards and received financial aid.

Title 34CFR, Part 668.16(e) states that institutions must establish, publish, and apply reasonable standards for measuring whether an otherwise eligible student is maintaining satisfactory progress in his or her educational program.

Recommendation: The University should monitor the academic progress of students who maintain continuous enrollment at the University as well as students who reenroll after missing a semester.

(Award #s P063P060322 and P007A063097 – Award year 7/1/2006 – 6/30/2007)

University Response: Under the current policy, the University adequately monitors all students who maintain continuous enrollment for satisfactory academic progress at the end of each academic year. Students who have not been enrolled for one or more semesters must apply for readmission to the University. These students are monitored for satisfactory academic progress as part of the application for readmission process. Currently, students with one suspension are permitted to re-enroll without submitting an appeal letter. However, students with more than one suspension are required to submit an appeal letter and go through the appeals process.

The Academic Appeals Committee is currently revising the satisfactory academic progress and appeals policy to strengthen the monitoring procedures for student's who re-enroll after missing a semester. The policy will be effective in fall 2008.

11. UNTIMELY RETURN OF FEDERAL FUNDS

The University was late in returning funds that were owed to the federal government for students who were awarded federal financial aid and later withdrew from the University. As a result, the University did not comply with federal regulations.

When a student withdraws from the University prior to a specified date within the semester, the University is required to return a portion of the students' financial aid award to the federal government. We tested 17 students who were awarded financial aid and then withdrew from the University. In ten cases the University returned the unearned award funds to the federal government five to 90 days late, with an average of 28 days late.

Title 34CFR, Part 668.22(j) requires 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 ensure that federal funds that are unearned by students who withdraw from the University are returned to the federal government within the required timeframe.

(Award #s P063P060322 and P375A060322 – Award year 7/1/2006 – 6/30/2007)

University Response: Prior to the fall of 2006, the Financial Aid Office did not receive timely notification that a student had withdrawn from the University. In the fall semester of 2006, the University implemented a No Show policy. The policy requires instructors to submit an interim grade of "X" for students who do not attend class the first week of the semester or term. The Registrars Office runs a report of all students in this category and submits it to the Business office and Financial Aid Office for review. After the review, students that are identified as no shows in at least 75 percent of their classes are dropped. However, instances have occurred where instructors didn't identify students through this process but identified them later in the semester via email. This resulted in the untimely return of federal funds. The No Show policy is discussed at Pre-School Conferences and a greater emphasis will be placed on this policy in the future. Also, the Registrars Office is developing a report that will identify those individuals that are continually in non compliance with this policy.

In addition, the Registrars Office discontinued the process that allowed students to withdraw from the University online. The Registrars Office found that this process didn't meet the needs of several offices including Financial Aid. The online process was terminated in the spring 2008 and the manual withdrawal process was reinstated. The manual process ensures that Financial Aid is notified of the withdrawal allowing the Office to take the actions needed to ensure that unearned federal funds are returned within the required timeframe.

12. INADEQUATE RECONCILIATION OF STUDENT FINANCIAL AID AWARDS

The University did not reconcile students' financial aid awards calculated by the financial aid department to students' awards paid by the business and finance department or to the funds that the University received from the federal government in order to pay students' financial aid. As a result, there was an increased risk of error in payments, receipts, and/or financial aid records and reports. The Federal Family Education Loan awards amount that the University reported to the Office of the State Controller for the year ended June 30, 2007, was overstated by $2,294,241.

Chapter 12 of the federal Blue Book states that at a minimum, a school's financial management system including its accounting system must provide monthly reconciliation of individual federal student aid awards as recorded in the financial aid, business office, student account, and federal systems.

Recommendation: Each month the University should perform a reconciliation of student awards calculated by the financial aid department to student awards paid by the business and finance department to the funds received from the federal government.

(Award #s P063P060322, P007A063097, P375A060322, P376S060322, P033A063097 – Award year 7/1/2006 – 6/30/2007)

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

13. EXCESS FEDERAL LOAN FUNDS NOT RETURNED TIMELY

The University did not return excess federal loan funds to lenders on a timely basis. As a result, the University was not in compliance with federal regulations.

The University received $117,909 of Federal Family Education Loan Program funds in June 2007 that were not disbursed to students. The University returned the funds to the lender on July 19, 2007, which was past the time frame allowed by federal regulations.

Title 34CFR, Part 668.167(b) states that institutions must return loan program funds to a lender if the institution does not disburse those funds to a student or parent for a payment period within three business days following the date the institution receives the funds.

Recommendation: The University should return any excess financial aid funds within the required time frame. To help ensure that this happens, the University should reconcile student financial aid funds received to student financial aid funds disbursed.

(Award year 7/1/2006 – 6/30/2007)

University Response: FSU agrees excess federal funds should be returned timely. The federal program changed prior to the audit year from the Federal Direct Loan Program to the FFELP program and the cash reconciliation procedures were not adjusted to reflect the differences in these programs. Procedures have now been revised to ensure funds are reviewed and reconciled and any excess federal funds are returned within the required timeframe.

14. INAPPROPRIATE SYSTEM ACCESS RIGHTS TO FINANCIAL AID DATA

As previously reported, the University assigned information system access rights to University employees inconsistent with adequate security over financial aid data. This could allow employees to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties.

All employees in the University's financial aid department had the same information system access rights to financial aid data as the Director of Financial Aid. Also, two employees in positions outside of the financial aid department, one consultant, and some user ID's that were not assigned to specific employees had access to financial aid data. Lastly, employees who no longer worked in the University's financial aid department still had access rights to financial aid data.

Sound internal controls require that University employees are assigned the least level of information system access necessary to perform their jobs and that adequate segregation of duties is maintained in employees' access to the system.

This finding is resolved. The University reviewed access rights to financial aid data and made appropriate revisions as of June 30, 2007.

(Award #s P063P060322, P007A063097, P375A060322, P376S060322, P033A063097 – Award year 7/1/2006 – 6/30/2007)

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