STATE OF NORTH CAROLINA

NORTH CAROLINA CENTRAL UNIVERSITY

DURHAM, 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

North Carolina Central University

Durham, North Carolina

Financial Statement Audit Report

For the Year Ended June 30, 2007

STATE OF NORTH CAROLINA
Office of the State Auditor

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

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement and compliance audit of North Carolina Central 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

July 10, 2008

TABLE OF CONTENTS

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
North Carolina Central University
Durham, North Carolina

We have audited the accompanying financial statements of North Carolina Central 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 North Carolina Central 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 NCCU Real Estate Foundation, Inc., which represent 7%, 0%, and 1%, respectively, of the assets, net assets and revenues of the University; or the financial statements of the NCCU Foundation, Inc., the University's discretely presented component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of North Carolina Central University and its discretely presented component unit as of June 30, 2007, and the respective changes in its 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 June 13, 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

June 13, 2008

Management's Discussion and Analysis is intended to give the reader an overview of factors that have affected operations and may affect operations in the future. The University is required by the Governmental Accounting Standards Board (GASB) to present three basic financial statements. Those statements are the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These statements provide both long-term and short-term financial information for North Carolina Central University (NCCU).

Brief Institutional Highlights

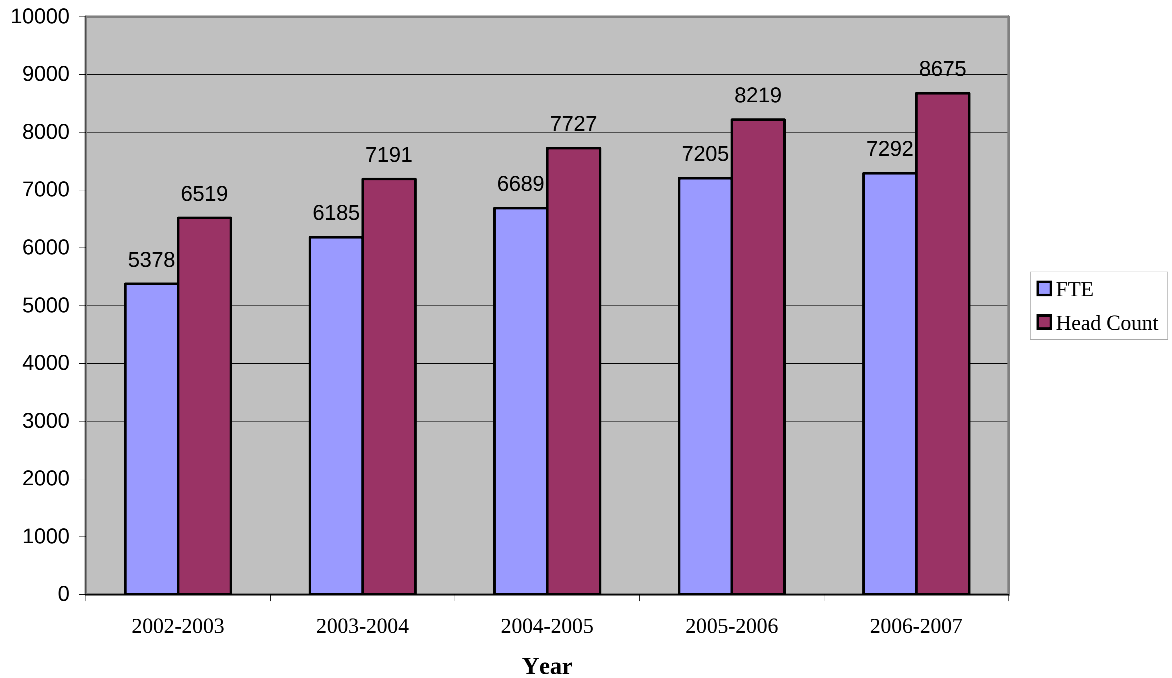
The 2006-2007 academic year was a good year for the Division of Academic Affairs. Black Enterprise magazine named the University as one of the "Top 50 Colleges" for African Americans in the nation. NCCU was ranked number 30. The students of the NCCU Law School passed the State Bar Examination at a rate of 86%; the highest of any other historically black school in the country. Lastly, the School of Business was accredited by the Assembly of American Colleges and Schools of Business International, the highest accrediting agency for a Business School.

Adjusted State appropriations were $74.6 million for fiscal year 2007, which is a 20% increase over fiscal year 2006. The total University budget, including receipts, for fiscal year 2007 was $107 million as compared to $94 million in 2006, a 14% increase. The increase in the University's budget is a result of having an increase in enrollment in academic year 2005-2006.

By the end of fiscal year 2007, the University's sponsored research and other grant awards were $61 million, which is a 10% decrease from fiscal year 2006. The decrease is due to reporting awards on an annual basis rather than a grant term. The Office of Institutional Advancement made strides in several areas for 2006-2007 such as the annual fundraiser, the faculty and staff leadership breakfast, major gifts, and planned giving, which generated $6.7 million in total fundraising.

Due to the University's continuing efforts in striving to recruit talented students, student enrollment increased 5.5% in fall 2006, totaling 8,675 in comparison to the 8,219 students enrolled in fall 2005. In the fall of 2006, the University enrolled five National Achievement Scholars, five National Achievement finalists, and eight semifinalists.

FTE and Head Count from 2002 to 2007



Financial Highlights

Condensed Statement of Net Assets

	2007	2006
Assets		
Current Assets	$ 31,142,182	$ 37,699,043
Capital Assets, Net	199,546,554	178,084,191
Other Assets	48,715,421	45,661,805
Total Assets	279,404,157	261,445,039
Liabilities		
Current Liabilities	15,262,790	31,596,479
Noncurrent Liabilities	36,996,874	17,037,562
Total Liabilities	52,259,664	48,634,041
Net Assets		
Invested in Capital Assets, Net of Related Debt	169,268,808	146,984,066
Restricted - Expendable	29,216,950	32,970,815
Restricted - Nonexpendable	10,535,606	10,583,933
Unrestricted	18,123,129	22,272,184
Total Net Assets	$ 227,144,493	$ 212,810,998

The Statement of Net Assets reports all assets and liabilities of the University; additionally, the Statement classifies those assets and liabilities as current and noncurrent depending on the availability of the assets or satisfaction of the obligation within 12 months (current) or longer. This Statement also reports the net assets, which is the difference between the total assets and total liabilities. The reader may use the net assets to gauge the financial position of the University as of June 30, 2007.

As of June 30, 2007, the University's total assets were $279.4 million as compared to $261.4 million in the prior year, an increase of $18 million. This increase is attributable to Construction in Progress.

The University's liabilities totaled $52.3 million in 2007 and $48.6 million in 2006 with the debt service on housing and stadium bonds comprising $29.8 million (current and noncurrent portions).

The total current liabilities of $15.3 million is covered 2.04 times by current assets of $31.1 million, which indicates the University's ability to pay current liabilities as they become due. Total net assets are $227 million, which is an increase of $14 million from the prior year.

For 2007, there was a significant change in the presentation of current and noncurrent liabilities. The change is due to demand bonds previously reported in the NCCU Real Estate Foundation, Inc. (Real Estate Foundation) as a current liability now being reported as a noncurrent liability. The University entered into an alternative financing arrangement that would convert any called bonds that are not successfully remarketed to another form of long-term debt.

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

	2007	2006
Operating Revenues		
Student Tuition and Fees, Net	$ 25,913,854	$ 25,060,122
Contracts and Grants	18,247,083	19,554,733
Sales and Services, Net	14,916,432	17,159,594
Other Operating Revenues	2,143,539	1,359,426
Total Operating Revenues	61,220,908	63,133,875
Operating Expenses	158,061,722	147,336,770
Operating Loss	(96,840,814)	(84,202,895)
Nonoperating Revenues and Expenses		
State Appropriations	74,595,799	62,010,445
Noncapital Grants	8,864,680	10,922,073
Noncapital Gifts	37,878	42,560
Investment Income	4,460,939	1,862,936
Other Nonoperating Expenses	(217,889)	(1,976,169)
Loss Before Other Revenues	(9,099,407)	(11,341,050)
Capital Appropriations	6,200,000	2,555,300
Capital Grants	17,191,002	22,544,780
Capital Gifts	41,900	116,400
Total Other Revenues	23,432,902	25,216,480
Increase in Net Assets	14,333,495	13,875,430
Net Assets- Beginning of the Year	212,810,998	198,935,568
Net Assets - End of Year	$ 227,144,493	$ 212,810,998

The Statement of Revenues, Expenses, and Changes in Net Assets reports the revenues earned and expenses incurred during the fiscal year. The increase or decrease of revenues over expenses directly affects (increases/decreases) the total net assets reported on the Statement of Net Assets. These transactions are classified as operating or nonoperating. Operating revenues primarily consist of student tuition and fees reported net of discounts and scholarship allowances, federal and State contracts and grants, and auxiliary sales and services revenues. Operating expenses primarily consist of salaries, supplies, services, scholarships, utilities, and depreciation.

Operating revenues decreased by $1.9 million when compared to 2006. The contributing factor to this decrease was that Sales and Services decreased by $2.2 million when compared to 2006. The majority of the decrease is due to Dining and Parking revenues. Dining decreased by $1.4 million as the result of three dorms being unoccupied during the year. NCCU placed students in off campus housing, where meal plans were not required.

Operating expenses increased by $10.7 million when compared to 2006. Salaries and benefits for University employees, services, and depreciation were the components of this increase. Contributing factors to the increase in salaries and benefits were legislative increases and new positions. Salaries and benefits increased by $9.7 million, services by $3.3 million and depreciation by approximately $500,000.

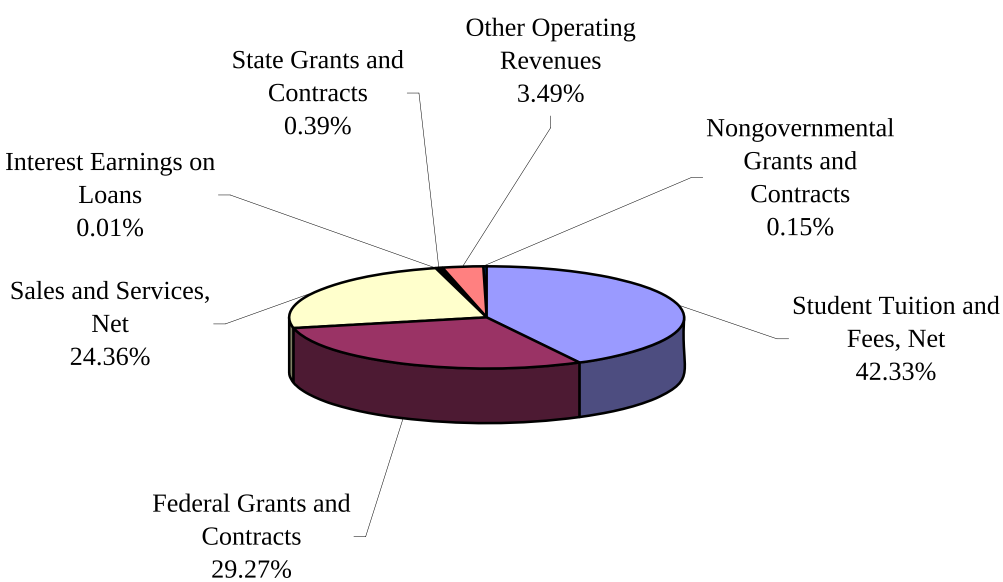
Overall, the University sustained a total operating loss of $96.8 million in the current fiscal year, which is $12.6 million more than the loss in fiscal year 2006. Operating losses are likely to continue due, in part, to the accounting requirement to categorize State appropriations (a major source of funding) as nonoperating revenues. In 2007, State appropriations were $74.6 million.

Nonoperating revenues and expenses stem from transactions that occur outside of the primary scope of the University's existence and for which no goods or services are provided. State appropriations, capital grants, noncapital grants and gifts, investment income/expenses, and capital-related interest primarily represent the nonoperating revenues and expenses.

Of the nonoperating revenues ($89.8 million), there were noticeable changes in the State appropriations and investment income. State appropriations increased by $12.6 million as a result of enrollment growth and special academic initiative funds. Investment income increased by $2.6 million and is attributable to the realized and unrealized gain on sale of Endowment Investments.

In addition, Capital Grants decreased by $5.4 million. The decrease is due to at or near completed projects at year end and having expended the majority of the Higher Education Bond funds in prior years.

Operating Revenues by Source



Capital Assets and Debt Administration

Major projects included in Construction in Progress are:

- $10.9 million for the Biomanufacturing Research Institute and Technology Enterprise buildings (BRITE),
- $9.5 million for the renovations of the Eagleson Residence Hall,
- $1.3 million for Pearson Cafeteria, and
- $1.1 million for renovations of the Shepard Library Building.

Outstanding commitments for ongoing construction projects were $18.2 million as of June 30, 2007.

For additional information concerning Capital Assets, see Notes 1(H), 5, and 15(A) in the Notes to the Financial Statements.

As of June 30, 2007, the University had $30.4 million in outstanding bonds, notes payable, and capital leases, of which $29.8 million is for outstanding bonds issued by the University and the Real Estate Foundation. The University reduced its outstanding debt by $1 million by redeeming the 1998 Stadium Revenue Bonds on April 1, 2008, as disclosed in Note 16 (Subsequent Event) of the financial statements.

There have been no significant changes in credit ratings or debt limitations that would affect future financing for the University.

For additional information concerning debt administration, see Note 8 in the Notes to the Financial Statements.

Economic Outlook

North Carolina Central University is the fastest growing institution in the University of North Carolina System. For fall 2006, the rate of growth in enrollment was 5.5%, which is greater than the UNC System's average growth rate of 3.1%. The outlying years appear to be promising and the University expects enrollment to maintain; therefore, projected tuition and fee revenues look favorable.

There are several factors that will impact a positive economic outlook for the University, increased support from the State, ability to attract top students, campus expansion, vibrant research funding, and private gifts.

North Carolina Central University's faculty is steadily writing, applying, and receiving research grant funds to augment State funding. Research is one of three components that faculty must strive to accomplish. The Sponsored Research Office works diligently with faculty to provide ongoing training and opportunities for research. Through our dedicated faculty and staff, we will continue to fulfill our mission of serving the State, nation, and the world through teaching, research, and service.

North Carolina Central University
Statement of Net Assets
June 30, 2007 — *Exhibit A-1*

ASSETS	
Current Assets:	
Cash and Cash Equivalents	$ 9,246,499
Restricted Cash and Cash Equivalents	8,808,240
Restricted Short-Term Investments	2,170,110
Receivables, Net (Note 4)	8,348,340
Due from University Component Units	1,713,539
Inventories	603,010
Notes Receivable, Net (Note 4)	252,444
Total Current Assets	31,142,182
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	11,005,679
Restricted Due from Primary Government	725,656
Restricted Due from State of North Carolina Component Units	18,211,751
Endowment Investments	15,669,491
Other Investments	10,036
Notes Receivable, Net (Note 4)	3,092,808
Capital Assets - Nondepreciable (Note 5)	31,354,609
Capital Assets - Depreciable, Net (Note 5)	168,191,945
Total Noncurrent Assets	248,261,975
Total Assets	279,404,157
LIABILITIES	
Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	11,196,028
Due to Primary Government	147,152
Funds Held for Others	1,713,539
Unearned Revenue	385,439
Interest Payable	315,559
Long-Term Liabilities - Current Portion (Note 8)	1,505,073
Total Current Liabilities	15,262,790
Noncurrent Liabilities:	
Deposits Payable	401
Funds Held for Others	68,970
U. S. Government Grants Refundable	2,747,930
Long-Term Liabilities (Note 8)	34,179,573
Total Noncurrent Liabilities	36,996,874
Total Liabilities	52,259,664

NET ASSETS

Invested in Capital Assets, Net of Related Debt	169,268,808
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	4,083,068
Endowed Professorships	5,693,355
Loans	759,183
Expendable:	
Scholarships and Fellowships	694,276
Research	240,768
Endowed Professorships	2,292,996
Departmental Uses	12,498,924
Capital Projects	13,476,908
Other	13,078
Unrestricted	18,123,129
Total Net Assets	$ 227,144,493

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

North Carolina Central 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 10)	$	25,913,854
Federal Grants and Contracts		17,916,573
State and Local Grants and Contracts		236,743
Nongovernmental Grants and Contracts		93,767
Sales and Services, Net (Note 10)		14,916,432
Interest Earnings on Loans		8,832
Other Operating Revenues		2,134,707
Total Operating Revenues		61,220,908
EXPENSES		
Operating Expenses:		
Salaries and Benefits		86,284,887
Supplies and Materials		23,391,811
Services		30,245,654
Scholarships and Fellowships		7,958,299
Utilities		4,160,415
Depreciation		6,020,656
Total Operating Expenses		158,061,722
Operating Loss		(96,840,814)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		74,595,799
Noncapital Grants		8,864,680
Noncapital Gifts		37,878
Investment Income		4,460,939
Interest and Fees on Debt		(2,048,428)
Other Nonoperating Revenues		1,830,539
Net Nonoperating Revenues		87,741,407
Loss Before Other Revenue		(9,099,407)
Capital Appropriations		6,200,000
Capital Grants		17,191,002
Capital Gifts		41,900
Increase in Net Assets		14,333,495
NET ASSETS		
Net Assets - July 1, 2006		212,810,998
Net Assets - June 30, 2007	$	227,144,493

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

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

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	63,918,216
Payments to Employees and Fringe Benefits		(85,582,722)
Payments to Vendors and Suppliers		(54,844,127)
Payments for Scholarships and Fellowships		(7,958,299)
Loans Issued		(531,559)
Collection of Loans		445,405
Other Receipts		2,125,094
Net Cash Used by Operating Activities		(82,427,992)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Appropriations		74,595,799
Noncapital Grants		8,919,072
William D. Ford Direct Lending Receipts		56,285,294
William D. Ford Direct Lending Disbursements		(56,285,294)
Proceeds from Noncapital Debt		100,000
Other Receipts		1,708,334
Net Cash Provided by Noncapital Financing Activities		85,323,205
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
State Capital Appropriations		6,200,000
Capital Grants		17,101,886
Proceeds from Sale of Capital Assets		353
Acquisition and Construction of Capital Assets		(27,091,800)
Principal Paid on Capital Debt and Leases		(887,361)
Interest and Fees Paid on Capital Debt and Leases		(1,990,765)
Net Cash Used by Capital Financing and Related Financing Activities		(6,667,687)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		18,218,239
Investment Income		235,828
Purchase of Investments and Related Fees		(16,743,775)
Net Cash Provided by Investing Activities		1,710,292
Net Decrease in Cash and Cash Equivalents		(2,062,182)
Cash and Cash Equivalents - July 1, 2006		31,122,600
Cash and Cash Equivalents - June 30, 2007	$	29,060,418

RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	$	(96,840,814)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		6,020,656
Allowances, Write-Offs, and Amortizations		225,064
Changes in Assets and Liabilities:		
Receivables (Net)		4,495,718
Inventories		(295,396)
Accounts Payable and Accrued Liabilities		3,727,968
Unearned Revenue		14,259
Other Assets		3,000
Compensated Absences		221,553
Net Cash Used by Operating Activities	$	(82,427,992)
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Current Assets:		
Cash and Cash Equivalents	$	9,246,499
Restricted Cash and Cash Equivalents		8,808,240
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		11,005,679
Total Cash and Cash Equivalents - June 30, 2007	$	29,060,418
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired Through a Gift	$	41,900
Change in Fair Value of Investments		2,933,409
Loss on Disposal of Capital Assets		(2,198,036)

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

North Carolina Central University Foundation, Inc.
Statement of Financial Position
June 30, 2007 — *Exhibit B-1*

ASSETS		
Cash and Cash Equivalents	$	1,810,672
Accounts Receivable, Related Party		184,209
Contributions Receivable, Net		510,936
Investments		10,928,126
Cash Surrender Value of Life Insurance		35,363
Total Assets		13,469,306
LIABILITIES		
Accounts Payable and Accrued Expenses		1,108
Funds Held on Behalf of Others		1,713,539
Total Liabilities		1,714,647
NET ASSETS		
Unrestricted		1,049,276
Temporarily Restricted		3,962,091
Permanently Restricted		6,743,292
Total Net Assets	$	11,754,659

See Note 1 in Notes to the Financial Statements

North Carolina Central University Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2007

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Revenues, Gains, and Other Support:				
Contributions	$ 38,422	$ 1,053,460	$ 598,920	$ 1,690,802
Interest and Dividends	78,567	160,348		238,915
Realized and Unrealized Gains on Investments	57,447	1,326,611		1,384,058
Other Income	142,453	53,163		195,616
Net Assets Released from Donor Restrictions	2,459,372	(2,459,372)		
Total Revenues, Gains, and Other Support	2,776,261	134,210	598,920	3,509,391
EXPENSES				
Program Services:				
Scholarships and Grants	762,866			762,866
University Support	454,780			454,780
Management and General	375,351			375,351
Bad Debts	31,445		213,940	245,385
Total Expenses	1,624,442		213,940	1,838,382
Release of Title III Funds		(672,807)	672,807	
Changes in Net Assets	1,151,819	(538,597)	1,057,787	1,671,009
NET ASSETS				
Net Assets - July 1, 2006	(102,543)	4,500,688	5,685,505	10,083,650
Net Assets - June 30, 2007	$ 1,049,276	$ 3,962,091	$ 6,743,292	$ 11,754,659

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

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

Blended Component Unit - Although legally separate, the Real Estate Foundation, a component unit of the University, is reported as if it were part of the University.

The Real Estate Foundation is governed by a three-member board. The Real Estate Foundation's purpose is to acquire property and to construct and own residential facilities for students. Because the directors of the Real Estate Foundation are appointed by the Chancellor and the Real Estate Foundation's sole purpose is to benefit North Carolina Central University, its financial statements have been blended with those of the University.

Separate financial statements for the Real Estate Foundation may be obtained from the University Controller's Office, 1801 Fayetteville Street, Durham, NC 27707, or by calling (919) 530-7432. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

Discretely Presented Component Unit - The NCCU Foundation, Inc. (NCCU 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.

The NCCU Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The NCCU Foundation board consists of 20 members. Although the University does not control the timing or amount of receipts from the NCCU Foundation, the majority of resources, or income thereon that the NCCU Foundation holds and invests, are restricted to the activities of the University by the donors. Because these restricted resources held by the NCCU Foundation can only be used by, or for the benefit of the University, the NCCU 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 NCCU 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 NCCU Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2007, the NCCU Foundation distributed $454,780 to the University for both restricted and unrestricted purposes. The University remitted $147,111 in payroll deducted employee contributions and $708,239 in other reimbursements to the NCCU Foundation. Complete financial statements for the Foundation can be obtained from the University Controller's Office, 1801 Fayetteville Street, Durham, NC 27707, or by calling (919)530-7432.

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

Money market funds are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

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

G. Inventories - Inventories, consisting of expendable supplies, are valued at cost using 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. Land is capitalized regardless of cost. 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 25 to 50 years for general infrastructure, 50 years for buildings, and 5 to 15 years for equipment.

Art collections are capitalized at cost or fair value at the date of donation. These collections are considered inexhaustible and are therefore not depreciated.

I. Restricted Assets - Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as 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, capital lease obligations, notes payable and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refunds are amortized over the life of the bond using the straight-line method. Issuance costs are expensed.

K. Compensated Absences - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 (for SPA employees) and July 1 (for EPA non-faculty employees) 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, copy centers, and postal services. In addition, the University has other miscellaneous sales and service units that operate 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 with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, and debt service funds with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2007, the amount shown on the Statement of Net Assets as cash and cash equivalents includes $27,307,333 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 $1,900. The carrying amount of the University's deposits not with the State Treasurer was $1,751,185 and the bank balance was $1,753,381. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2007, the University's uninsured and uncollateralized bank balance was $1,611,601.

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 in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

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

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

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The University utilizes investment pools to manage investments and distribute investment income. Purchases in the investment funds are allowed at the beginning of each month. Fund ownership is measured based on the participating funds purchases and accumulated gain/loss investment. This investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

Investments are subject to the following risks:

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

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

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

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

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. At June 30, 2007, investments in the Long-Term Investment Pool were $13,312,024. All investments in the Long-Term Investment Pool were in the UNC Investment Fund, LLC, a governmental external investment pool that is not registered with the SEC. The audited financial statements for the UNC Investment Fund, LLC may be obtained from the UNC-CH Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270.

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

Non-Pooled Investments

		Investment Maturities (in Years)			
	Fair Value	Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
Money Market Mutual Funds	$ 88,432	$ 88,432	$ 0	$ 0	$ 0
Other Securities					
International Mutual Funds	10,036				
Domestic Stocks	4,439,145				
Total Non-Pooled Investments	$ 4,537,613				

At June 30, 2007, the University's non-pooled investments included $88,432 in unrated Money Market Mutual Funds.

At June 30, 2007, the University did not have any investments requiring disclosure of custodial credit risk.

Component Unit - Investments of the University's discretely presented component unit, the NCCU Foundation, Inc., are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements. Because the NCCU Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type:

	Fair Value
Investment Type	
Cash and Cash Equivalents	$ 437,504
Mutual Funds	376,183
Equity Securities	7,820,028
Debt Securities	826,392
U.S. Government Obligations	1,446,885
Asset Backed Securities	21,134
Total Investments	$ 10,928,126

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are determined by 5.5% of the five year moving average of the fund's market value. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2007, net appreciation of $5,906,958 was available to be spent, of which $2,514,538 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	$ 6,689,959	$ 4,000,000	$ 2,689,959
Accounts	849,473		849,473
Intergovernmental	4,481,718		4,481,718
Pledges	32,750		32,750
Interest on Loans	108,561		108,561
Other	185,879		185,879
Total Current Receivables	$ 12,348,340	$ 4,000,000	$ 8,348,340
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	$ 531,560	$ 279,116	$ 252,444
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 6,318,370	$ 3,225,562	$ 3,092,808

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable:				
Land	$ 5,332,926	$ 800	$ 0	$ 5,333,726
Art, Literature, and Artifacts	623,940	41,900		665,840
Construction in Progress	1,159,702	24,195,341		25,355,043
Total Capital Assets, Nondepreciable	7,116,568	24,238,041		31,354,609
Capital Assets, Depreciable:				
Buildings	210,568,751		3,292,046	207,276,705
Machinery and Equipment	17,332,349	5,411,567		22,743,916
General Infrastructure	14,250,128	32,700		14,282,828
Total Capital Assets, Depreciable	242,151,228	5,444,267	3,292,046	244,303,449
Less Accumulated Depreciation/Amortization for:				
Buildings	55,139,169	3,793,812	1,092,757	57,840,224
Machinery and Equipment	8,379,688	1,627,993		10,007,681
General Infrastructure	7,664,748	598,851		8,263,599
Total Accumulated Depreciation	71,183,605	6,020,656	1,092,757	76,111,504
Total Capital Assets, Depreciable, Net	170,967,623	(576,389)	2,199,289	168,191,945
Capital Assets, Net	$ 178,084,191	$ 23,661,652	$ 2,199,289	$ 199,546,554

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	$ 7,069,681
Accrued Payroll	2,377,463
Contract Retainage	1,123,678
Intergovernmental Payables	608,543
Other	16,663
Total Accounts Payable and Accrued Liabilities	$ 11,196,028

NOTE 7 - TEMPORARY DEBT

The Real Estate Foundation has an outstanding note payable in the amount of $100,000. The note was issued in March 2007 with principal and interest originally due on August 15, 2007. However, the maturity date on the note has been extended until August 31, 2008. Consequently, the note is reported as part of long-term liabilities shown in Note 8. The interest rate on the note is the LIBOR plus two percent.

The proceeds from the note are to be used to pay for maintenance expenses at a residence hall. The note is secured by cash balances at the bank and the Real Estate Foundation's property.

NOTE 8 - LONG-TERM LIABILITIES

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

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Current Portion
Revenue Bonds Payable	$ 31,720,000	$ 0	$ 800,000	$ 30,920,000	$ 830,000
Add/Deduct Premium/Discount	(216,710)		(8,200)	(208,510)	
Deduct Deferred Charge on Refunding	(951,094)		(56,782)	(894,312)	
Total Bonds Payable	30,552,196		735,018	29,817,178	830,000
Capital Leases Payable	547,929		87,361	460,568	92,586
Notes Payable		100,000		100,000	
Compensated Absences	5,085,347	3,430,989	3,209,436	5,306,900	582,487
Total Long-Term Liabilities	$ 36,185,472	$ 3,430,989	$ 4,031,815	$ 35,684,646	$ 1,505,073

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

B. Bonds Payable - The University was indebted for 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
Stadium System Revenue Bonds	1998	4.4% to 5.0%	04/01/2023	$ 3,320,000	$ 1,045,000	$ 2,275,000
NCCU Real Estate Foundation, Inc. Housing System Student Housing Facilities Revenue Bonds	2003A *	Variable	10/01/2034	21,475,000	500,000	20,975,000
The University of North Carolina System Pool Revenue Bonds	2004B	3.0% to 5.0%	04/01/2023	8,670,000	1,000,000	7,670,000
Total Bonds Payable (principal only)				$ 33,465,000	$ 2,545,000	30,920,000
Less: Unamortized Loss on Refunding						(894,312)
Less: Unamortized Discount						(208,510)
Total Bonds Payable						$ 29,817,178

* For variable rate debt, interest rates in effect at June 30, 2007 are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

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

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

North Carolina Central University – Revenue Bond Series 2003A: In October of 2003, the North Carolina Capital Facilities Finance Agency issued Student Housing Facilities Revenue Demand Bonds ($21,475,000 Variable Rate Revenue Demand Bonds, Series 2003A) that have a maturity date of October 1, 2034. The issuer, the North Carolina Capital Facilities Finance Agency, loaned the proceeds of the Series 2003A Bonds to the NCCU Real Estate Foundation, Inc. (Foundation). The Foundation used the proceeds to finance the costs of building a student housing facility at North Carolina Central University, to fund a debt service reserve fund for the 2003A Bonds, to pay a portion of the interest on the bonds during construction of the project, and to pay certain costs of issuance of the bonds. The 2003A Bonds are subject to mandatory sinking fund redemption at the principal amount on the interest payment dates.

The Student Housing Facilities Revenue Demand Bonds (Series 2003A) has an Irrevocable Letter of Credit (LOC) for $21,212,718. The LOC is to secure the payment of the principal and purchase price of interest on the Series 2003A Bonds. The LOC was issued by Wachovia Bank, N.A., and expired on October 15, 2006. The LOC was subsequently extended until August 31, 2009, by request from the Foundation by delivering notice of extension to the Trustee. At June 30, 2007, the LOC rate for the bonds was 1.40% and the total amount drawn on it was $1,076,972.

The Foundation paid Wachovia Bank, N.A. a commitment fee of $109,098 for the LOC on the date the bonds were issued. Additionally, the Foundation paid credit facility fees in the amount of $278,083 during the fiscal year.

Under the LOC agreement, the proceeds of each drawing under the LOC to pay the portion of the purchase price of Series 2003A Bonds allocable to principal will constitute a tender advance and must be reimbursed as provided in the agreement. The Foundation is required to repay each tender advance to Wachovia Bank, N.A. plus an interest rate of Prime plus one percent. According to the Reimbursement Agreement Amendment dated May 2008, the amount of any tender advance made is repaid based on the earliest to occur of the date the credit provider bonds purchased pursuant to such tender advances are remarketed, the close of business on the date that is 366 days after the tender was made and/or the termination date.

The Student Housing Facilities Revenue Demand Bonds (Series 2003A) has remarketing fees. The remarketing fee is an upfront charge to reset the interest rates on a weekly basis. The remarketing agent is Wachovia Bank, N.A. for the Series 2003A Bonds. At June 30, 2007, the remarketing fee rate for the Bonds was 0.125%.

Interest Rate Swaps:

Objective: As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance in October 2003, effective April 1, 2004, the Foundation entered into two interest rate swaps with Wachovia Bank, N.A., in connection with its $21,475,000 Variable Rate Revenue Demand Bonds, Series 2003A. The intention of the swap agreements was to effectively change the interest rate on the bonds to a synthetic fixed rate of 3.515% (Swap 1) and 2.710% (Swap 2).

Terms: The bonds and the related swap agreements mature on October 1, 2024, (Swap 1) and April 1, 2009, (Swap 2) and the combined swaps' notional amount of $17,180,000 hedges 80% of the $21,475,000 variable-rate bonds. The combined notional value of the swaps and the combined principal amount of the associated debt is declining. Under the swaps, the Foundation pays Wachovia Bank, N.A., a fixed rate of 3.515% (Swap 1) and 2.710% (Swap 2) and receives a monthly variable rate at 70% and 100% of London Interbank Offered Rate (LIBOR) and Bond Market Association (BMA), respectively. The bonds' variable-rate coupons are closely associated with the BMA.

Fair Value: Because interest rates have risen since execution of the swaps, the swaps have positive fair values of $321,653 (Swap 1) and $134,361 (Swap 2) as of June 30, 2007. The swaps' positive fair value may be countered by an increase in total interest payments required under the variable rate bonds, creating a higher synthetic interest rate. Because the coupons on the Foundation's variable-rate bond are adjusted every seven days to changing interest rates, the bonds do not have a corresponding fair value increase. The market-to-market valuations were established by market quotations from Wachovia Bank, N.A., representing estimates of the amounts that would be paid upon terminating the transactions.

Credit Risk: As of June 30, 2007, the Foundation was exposed to credit risk because the swaps had a positive fair value in aggregate. The exposed credit risk is in the amount of the derivatives' aggregate fair value. Swap 1 and 2's counterparty (Wachovia Bank, N.A.) was rated Aa1 by Moody's Investors Service (Moody's), AA- by Standard and Poor's (S&P) and AA- by Fitch Ratings (Fitch).

Basis Risk and Termination Risk: Swap 1 exposes the Foundation to basis risk should the relationship between LIBOR and BMA converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 3.515% and the actual rate of 3.551% (Swap 1) at June 30, 2007. As of June 30, 2007, the rate on the Foundation's Bonds was 3.760% whereas 70% of LIBOR was 3.724%. Swap 2 exposes the Foundation to basis risk should the actual rate on the Foundation's Bond vary from the BMA. The effect of this difference in basis is indicated by the differences between the indicated synthetic rate of 2.710% and the actual rate of 2.740% (Swap 2) at June 30, 2007. As of June 30, 2007, the rate of the Foundation's Bonds was 3.760% whereas the BMA index was 3.730%. Termination could result in the Foundation being required to make an unanticipated termination payment. The swap agreements are terminated if the Foundation or Wachovia Bank, N.A., fails to perform under the terms of the contract.

Market-Access Risk/Rollover Risk: Swap 1 and Swap 2 expose the Foundation to market-access and rollover risk when the swaps mature on October 1, 2024, and April 1, 2009, respectively. When Swap 1 and Swap 2 mature, the interest rate on the underlying debt will return to a variable rate.

Swap Payments and Associated Debt: As rates vary, variable-rate debt and net swap payments will vary. As of June 30, 2007, debt service requirements of the University's outstanding variable-rate debt and net swap payments, assuming current interest rates remain the same, for their terms were as follows:

Fiscal Year Ending June 30	Swaps 1 & 2 Principal	Variable-Rate Bond Interest	Letter of Credit	Remarketing	Interest Rate Swaps, Net	Total
2008	$ 325,000	$ 783,257	$ 291,639	$ 26,073	$ (101,916)	$ 1,324,053
2009	345,000	768,316	286,075	25,579	(79,532)	1,345,438
2010	365,000	754,754	281,025	25,130	(16,746)	1,409,163
2011	385,000	740,438	275,695	24,655	(16,428)	1,409,360
2012	405,000	727,346	270,820	24,222	(16,094)	1,411,294
2013-2017	2,405,000	3,370,190	1,254,858	112,288	(74,735)	7,067,601
2018-2022	3,155,000	2,842,242	1,058,281	94,814	(63,025)	7,087,312
2023-2027	4,135,000	2,150,262	800,630	71,910	(23,673)	7,134,129
2028-2032	5,420,000	1,243,371	462,957	41,893		7,168,221
2033-2037	4,035,000	195,999	72,979	6,931		4,310,909
Total	$ 20,975,000	$ 13,576,175	$ 5,054,959	$ 453,495	$ (392,149)	$ 39,667,480

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

Fiscal Year	Annual Requirements Revenue Bonds Payable Principal	Interest	Interest Rate Swaps, Net
2008	$ 830,000	$ 1,524,207	$ (101,916)
2009	800,000	1,485,733	(79,532)
2010	835,000	1,451,597	(16,746)
2011	880,000	1,412,176	(16,428)
2012	915,000	1,373,346	(16,094)
2013-2017	5,340,000	6,148,699	(74,735)
2018-2022	6,880,000	4,666,937	(63,025)
2023-2027	4,985,000	3,058,802	(23,673)
2028-2032	5,420,000	1,748,221	
2033-2037	4,035,000	275,909	
Total Requirements	$ 30,920,000	$ 23,145,627	$ (392,149)

Interest on the variable rate University of North Carolina System Pool Revenue Bonds is calculated at 3% to 5% at June 30, 2007. Interest on the variable rate Stadium Revenue Bonds is calculated at 4.5% to 5% at June 30, 2007. Interest on the variable rate Student Housing Facilitates Revenue Bonds is calculated at 4.5% to 5% at June 30, 2007.

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

On March 31, 2004, the University defeased $7,690,000 of outstanding Housing Revenue Bonds, Series 1996 (original amount $8,890,000). Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2007, the outstanding balance of the defeased Housing Revenue Bonds, Series 1996 was $6,950,000.

NOTE 9 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to motor vehicles are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2007:

Fiscal Year	Amount
2008	$ 114,840
2009	381,056
Total Minimum Lease Payments	495,896
Amount Representing Interest (6% Rate of Interest)	35,328
Present Value of Future Lease Payments	$ 460,568

Machinery and equipment acquired under capital lease amounted to $695,486 at June 30, 2007.

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

Fiscal Year	Amount
2008	$ 14,458
2009	12,469
Total Minimum Lease Payments	$ 26,927

Rental expense for all operating leases during the year was $4,346,753.

NOTE 10 - 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	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	$ 33,861,841	$ 0	$ 7,843,759	$ 104,228	$ 25,913,854	$ 521,480 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	$ 9,707,219	$ 105,270	$ 1,702,241	$ (5,592)	$ 7,905,300	$ 0
Dining	3,690,616	13,430	806,433		2,870,753	
Student Union Services	1,279,412	7,430	275,504		996,478	
Health, Physical Education, and Recreation Services	421,256	2,450	91,229		327,577	
Bookstore	247,111				247,111	
Parking	701,307	565			700,742	
Athletic	340,639		73,771		266,868	
Other	1,104,075	503,545			600,530	
Sales and Services of Education and Related Activities	1,215,799	88,298		126,428	1,001,073	
Total Sales and Services	$ 18,707,434	$ 720,988	$ 2,949,178	$ 120,836	$ 14,916,432	$ 0

Revenue Bonds Secured by Pledged Revenues:
(A) Stadium System

NOTE 11 - 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	$ 49,380,307	$ 7,346,646	$ 5,515,120	$ 135,511	$ 198	$ 0	$ 62,377,782
Research	2,489,776	785,480	849,353				4,124,609
Public Service	1,064,886	115,830	722,623		40		1,903,379
Academic Support	7,774,305	4,164,440	1,591,860				13,530,605
Student Services	2,467,613	418,223	862,062		139,222	437,986	4,325,106
Institutional Support	10,724,348	3,400,445	5,449,488	12,420	37,153		19,623,854
Operations and Maintenance of Plant	4,120,640	4,126,375	2,933,769		3,372,306		14,553,090
Student Financial Aid	698,108		15,587	6,917,930			7,631,625
Auxiliary Enterprises	7,564,904	3,034,372	12,305,792	892,438	611,496		24,409,002
Depreciation						5,582,670	5,582,670
Total Operating Expenses	$ 86,284,887	$ 23,391,811	$ 30,245,654	$ 7,958,299	$ 4,160,415	$ 6,020,656	$ 158,061,722

NOTE 12 - 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 $72,311,657 of which $52,117,847 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $3,127,071 and $1,386,335, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2007, 2006, and 2005, which were $1,386,335, $1,060,207, and $878,108, 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 $72,311,657 of which $16,191,752 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were $971,505 and $1,107,516, 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 $137,182 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 $28,043. The voluntary contributions by employees amounted to $308,314 for the year ended June 30, 2007.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to $1,067,472 for the year ended June 30, 2007.

NOTE 13 - 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 $2,595,765. 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 $355,210. 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 14 - 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, vandalism and "all risk" for certain 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. The University is charged a premium by the private insurance company. Coverage limit is $5,000,000 per occurrence with a $75,000 deductible and a 10% participation in each loss above the deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance and the State's Agent of Record. Examples of insurance policies purchased include, but are not limited to fine arts, boiler and machinery, medical professional liability, athletic accident, excess liability, university internship and study abroad health insurance.

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

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

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

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

NOTE 15 - 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 $18,189,706 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 16 - SUBSEQUENT EVENT

Extinguishment of Stadium Debt – On April 1, 2008, the University retired the 1998 Stadium Revenue Bonds which are referenced in Note 8B. These were 25-year bonds issued for $3,320,000. Principal in the amount of $2,120,000 was redeemed early at a call premium of two percent.

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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
North Carolina Central University
Durham, North Carolina

We have audited the financial statements of North Carolina Central 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 June 13, 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 NCCU Real Estate Foundation, Inc. and the discretely presented component unit, as described in our report on the University's financial statements. The financial statements of the NCCU Real Estate Foundation, Inc. and 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 3 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 2 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 included in the Audit Findings and Responses section of this report. We did not audit the University's responses and, accordingly, we express no opinion on them.

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

June 13, 2008

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting or Federal Compliance Objectives

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

1. DEFICIENCIES IN FINANCIAL REPORTING

   The financial statements prepared by the University contained misstatements that were corrected as a result of our audit. Without these corrections, the financial statements could have been misleading to readers. We also noted that audited information from component units was not available on a timely basis. Misstatements included:

   a. There were misclassifications in the net asset account balances totaling $5.9 million.

   b. Current unrestricted cash was overstated by $7.4 million, current restricted cash was understated by $5.3 million, and noncurrent restricted cash was understated by $2.1 million.

   c. The University has not periodically evaluated the appropriateness of the estimated useful lives of its capital assets. A review of capital assets identified an estimated overstatement of accumulated depreciation of approximately $3.26 million.

   d. The Statement of Cash Flows contained several errors. Ten months after the year-end, University personnel prepared a revised statement.

   e. The investment note required significant revisions. For example, the University failed to report disclosures about material investments held by the discretely presented component unit. These investments had a market value of $10.9 million.

   f. The table in the changes in long-term liabilities note did not balance by $5.3 million. Several amounts were entered in the table as negatives and should not have been. In addition, the note included a table from the prior fiscal year that was not updated for fiscal year 2007.

   g. Various other misstatements were made in the financial statements and notes to the financial statements.

   The audit reports for the North Carolina Central University Foundation, Inc. and the NCCU Real Estate Foundation, Inc. (Real Estate Foundation) were not received until May 2008. The University did not hire an auditor for the Real Estate Foundation until we raised the issue at least six months after year end. The audits of these component units are needed prior to issuance of the University's audit report.

Recommendation: The University should place greater emphasis on and devote more resources to the year-end financial reporting process and implement effective internal controls to ensure complete and accurate financial statements. Furthermore, the University should ensure that foundation audits are performed timely.

Response: The University concurs. During the fiscal year, the University filled key vacancies, conducted additional staff training, and consulted with various technical experts in an effort to eliminate financial reporting deficiencies.

The NCCU Foundation and the Real Estate Foundation have engaged their respective auditors for fiscal year 2008. Those audits will be completed within the prescribed time frames outlined in the Memorandum of Understanding.

2. DEFICIENCIES IN BANK RECONCILIATIONS

The University did not prepare bank reconciliations accurately or timely during our audit year. This increases the risk that an error or misappropriation could occur and not be detected in a timely manner.

Our review of the monthly bank reconciliations for the State disbursing and Institutional Trust Fund (ITF) accounts disclosed the following weaknesses:

- The University did not complete reconciliations for the ITF account in a timely manner. Ten of the 12 monthly reconciliations examined were prepared from four to 80 days late, with an average of 39 days late. Consequently, the University has not complied with the State Treasurer's Internal Control Policies Manual, which requires that bank accounts be reconciled promptly after the end of each month. University policies require reconciliation within 15 days of receipt of the monthly State Treasurer's bank statement.

- The University had unreconciled differences between the bank balance and the book balance in both the State disbursing and the ITF accounts. The State disbursing account had six months with unreconciled differences up to $158,165 at June 30, 2007. The ITF account had unreconciled differences for the entire fiscal year up to $5,900,227 with an unreconciled balance of $374,919 at June 30, 2007. In addition, the ITF book balance per the bank reconciliation reflects $1,638.95 more that the general ledger at June 30, 2007.

- The State disbursing reconciliation contains old outstanding checks dating back to June 1996 that have not been cleared or escheated.

Recommendation: The University should improve internal control to ensure that all its bank accounts are reconciled completely, accurately and timely. Any variance with the general ledger should be investigated and reconciled. Outstanding items should be cleared or escheated in a timely manner.

Response: The University concurs. Prior to the implementation of Banner, the University reconciled all its bank accounts. During the year, the University created several web-focus reporting tools to assist with the reconciliations, enlisted the services of an external CPA firm, cleared reconciling items on the state disbursing account, and escheated old outstanding checks. The University will continue to review and refine the reconciliation process.

3. INFORMATION SYSTEM ACCESS AND SECURITY NEEDS TO BE STRENGTHENED

The University has weaknesses in assigning information system access rights and security classes, as well as the monitoring of information technology activity. These deficiencies could result in unauthorized or inappropriate transactions.

Weaknesses include the following:

- There are multiple employees in the Information Technology Systems unit who can login to the information system under a single user name. This single user name accesses the security form that creates/modifies user accounts, grants access to security classes, sets up passwords, and locks/unlocks user accounts. With multiple users having the ability to login using a single user name, there is no way to trace activity to the responsible employee.

- There are several individuals who have unnecessary access to forms and security classes. The individuals have no job responsibilities that require them to have access to some of the forms and/or classes to which they have been given access.

- One of the security classes in purchasing and receiving includes forms and responsibilities inconsistent with appropriate segregation of duties. Individuals assigned to this security class may create a requisition, process a purchase order, and verify the receipt of goods.

- The Information Technology Manager has unlimited access to all forms and security classes and the activity of this account is not monitored. The lack of monitoring decreases the ability to detect inappropriate activity at this security level.

Recommendation: The University should limit system access rights to ensure that employees are assigned the least amount of system access necessary to perform their job. Adequate segregation of duties should be maintained. System access rights should be reviewed on a regular basis and the Information Technology Manager's activity should be monitored.

Response: The University concurs. The University has implemented a process whereby monthly security reports of user access are provided to the functional areas for review. Additionally, the University underwent a security assessment by an external technology firm to identify areas for improvement. The University is also monitoring all Banner activity of the IT staff, including the Database Administrators via logs, which is accessible only to the IT Security Officer and the Chief Information Officer. The activity of the Information Technology Manager is being monitored.

4. UNTIMELY NOTICE TO LENDERS OF CHANGES IN STUDENTS' STATUS

The University did not provide student financial aid lenders with timely notice when students withdrew from the University. Title 34CFR, Part 635.309(b)(2) requires the University to notify the National Student Clearinghouse within 30 days of its discovery that a recipient of a Federal Direct Loan has ceased to be enrolled on at least a half-time basis, failed to enroll, or changed his or her permanent address.

The University failed to provide timely notice for all 25 of the student withdrawals we reviewed. Six were reported outside of the required timeframe. The remaining 19 were not reported until it was brought to the University's attention by the auditors. These were reported approximately two to 10 months late. The University had not adopted written procedures for providing the notice.

Recommendation: The University should develop written policies and procedures and implement controls to provide for timely notification of changes in student status.

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

Response: The University is in agreement with the audit finding and recognizes the urgent need to strengthen checks and balances when reporting withdrawn students to the National Student Clearinghouse. In this regard, a committee has been formed to review the current process. The committee has already identified ways to strengthen the process to eliminate further findings of this nature. For example, a withdrawal report will be submitted twice monthly to the Registrar's Office from the Dean of Students Office, and a complete review will be done by the Registrar's Office to make sure that withdrawn students have been reported accurately in Banner and the National Student Clearinghouse. Every effort will be made going forward to make absolutely sure that each student institutional withdrawal will be reported accurately to the National Student Clearinghouse to ensure that lenders are notified in a timely manner when a student status changes. It should also be noted that the Banner system is processing the withdrawals that are submitted to the National Student Clearinghouse file. The corrective action has been completed and the implementation date was February 2008.

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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