STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2008

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

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FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2008

STATE OF NORTH CAROLINA
Office of the State Auditor

Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Board of Trustees, The University of North Carolina at Chapel Hill

We have completed a financial statement audit of The University of North Carolina at Chapel Hill for the year ended June 30, 2008, 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.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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.

Beth A. Wood

Beth A. Wood, CPA
State Auditor

February 4, 2009

TABLE OF CONTENTS

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2008, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of The University of North Carolina at Chapel Hill's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

as of June 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, Statement 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, and Statement 50, *Pension Disclosures*, during the year ended June 30, 2008.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 8, 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.

Beth A. Wood

Beth A. Wood, CPA
State Auditor

December 8, 2008

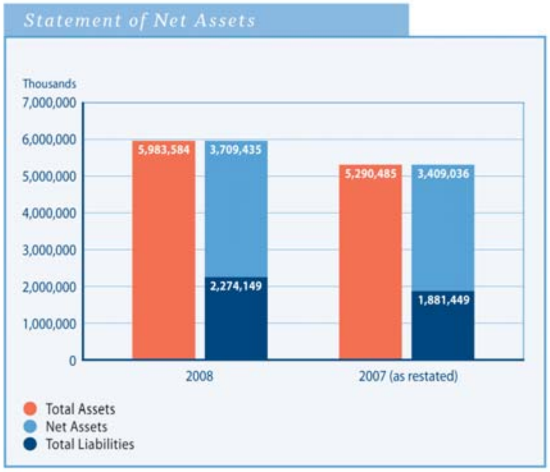
Introduction

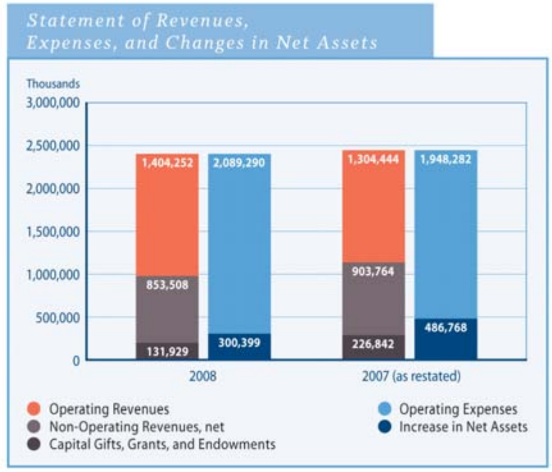
Management's Discussion and Analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year that ended June 30, 2008, with comparative information for the fiscal year ended June 30, 2007. Due to a change in the bylaws of the School of Social Work Foundation, Inc. previously reported as a component unit, the entity is no longer reported as if it were part of the University. Therefore, certain prior year amounts have been restated to conform to current year presentations. The reader may refer to Note 18 for additional information. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying Notes to the Financial Statements.

The University is a constituent institution of the multi-campus University of North Carolina System (UNC System), a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report (CAFR)*. The financial reporting entity for the financial statements is comprised of the University and 10 component units. Seven component units are reported as if they were part of the University, and three are reported as discretely presented component units based on the nature and significance of their relationship to the University. The reader may refer to Note 1A for detail information on the financial reporting entity.

Financial Highlights

The University's financial position at June 30, 2008, remains strong with total assets of $6 billion. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were $3.7 billion at June 30, 2008. The University's net assets increased by $300.4 million in fiscal 2007-2008 as a result of operating and nonoperating revenues, and other changes in net assets. A comparison of the total assets, liabilities, and net assets at June 30, 2008, and June 30, 2007, and a comparison of the major components of the changes in net assets for the two fiscal years are presented below:





Net assets increased 8.8% on June 30, 2008, over the prior year. Total assets increased 13.1% and total liabilities rose 20.9% for the same period. Operating revenues increased at a lower rate than operating expenses in 2007-2008 over the prior year, 7.7% and 7.2%, respectively. Net nonoperating revenues and expenses decreased 5.6% in 2007-2008 over the prior year. The growth in State appropriations - 10.3% - was significant; however, investment income had a substantial decrease of 53.8% in 2007-2008 from the prior year. Research funding, fund raising for operational and capital needs, and construction funding through the North Carolina Higher Education Bond Referendum of 2000 continued to be positive factors in the sustained financial well-being of the University.

Using the Financial Statements

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the University as a whole. The full scope of the University's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

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

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

Management's Discussion and Analysis provides information regarding the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and noncurrent components. Net assets represent the difference between total assets and total liabilities and are one indicator of the University's current financial condition. The following table summarizes the University's assets, liabilities, and net assets on June 30, 2008, and June 30, 2007.

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

	2008	2007 (as restated)	% Change
Assets:			
Current Assets	$ 1,200,432	$ 1,005,433	19.4
Noncurrent Assets:			
Endowment and Other Investments	2,277,442	1,996,987	14.0
Capital Assets, Net	2,289,015	2,082,829	9.9
Other Noncurrent Assets	216,695	205,236	5.6
Total Assets	5,983,584	5,290,485	13.1
Liabilities:			
Current Liabilities	372,616	471,718	(21.0)
Noncurrent liabilities:			
Funds Held in Trust for Pool Participants	781,049	588,099	32.8
Long-Term Liabilities	1,088,637	789,568	37.9
Other Noncurrent Liabilities	31,847	32,064	(0.7)
Total Liabilities	2,274,149	1,881,449	20.9
Net Assets:			
Invested in Capital Assets, Net of Related Debt	1,290,034	1,211,805	6.5
Restricted	1,747,431	1,579,658	10.6
Unrestricted	671,970	617,573	8.8
Total Net Assets	$ 3,709,435	$ 3,409,036	8.8

Current Assets and Liabilities

The Statement of Net Assets shows that working capital, which is current assets less current liabilities, was $827.8 million at June 30, 2008, an increase of 55.1%, or $294.1 million, over the previous year. Funds in the State Treasurer's short-term investment fund are categorized as cash equivalents and increased by $155 million over the prior year. Short-term debt decreased by $91.3 million as a long-term general revenue bond issue refunded commercial paper borrowings. The Statement of Net Assets details the current asset and current liability categories.

Endowment and Other Investments

Endowment investments increased 6.7% during 2007-2008 and were $1.485 billion at June 30, 2008, and $1.392 billion at June 30, 2007, and include permanent endowments, funds internally designated as endowments and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were $1.46 billion at June 30, 2008, and $1.37 billion for the prior year.

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

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

Other investments of $792 million at June 30, 2008, include funds of $744.8 million of affiliated entities that are neither part of the University's reporting entity nor reported discretely but do invest through the System Fund. The remaining component is bond reserves and related funds of $47.2 million.

Most of the University's endowment investments are currently managed within the System Fund, a pooled investment fund vehicle. The System Fund is designed to provide long-term, stable rates of return on the invested assets through the use of a highly diversified portfolio strategy. As reported by UNC Management Company, Inc., the investment return on the endowment assets invested in the System Fund for fiscal 2007-2008 was 8%. The investment return for fiscal 2006-2007 was 23.4%. Although the System Fund's return of 8% lagged the returns of the four prior fiscal years, the investment performance for fiscal 2007-2008 was very strong relative to benchmarks and other endowment funds. The System Fund return of 8% for 2007-2008 significantly outperformed the Strategic Investment Policy Portfolio ("SIPP") return of 3.3%. The System Fund's return also exceeded the 70% S&P 500/30% Lehman Brothers Bond Index ("70/30") return of -7.2% for the year.

The investment performance enabled the System Fund to earn a three-year annualized return of 16.7% at June 30, 2008. This three-year return measure compares well with the corresponding measure of 11.2% for the SIPP and 4.4% for the 70/30. For the five years ended June 30, 2008, the System Fund earned a 16.4% annualized return compared to 12.6% for the SIPP and 6.6% for the 70/30.

The System Fund has also outperformed its long-term objective of real return, after inflation, of 5.5% for each of the periods noted above as well as for longer time periods. For the 10-, 15-, and 20-year time periods ended June 30, 2008, the System Fund returned 11.1%, 12%, and 12.4% respectively. Comparatively, the CPI plus 5.5% has been 8.6%, 8.4%, and 8.7% respectively for the corresponding time periods. This primary objective of earning the inflation rate plus 5.5% reflects the need to preserve the purchasing power of the System Fund actor factoring in inflation and spending.

The return of 8% for fiscal 2007-2008 ended four consecutive years in which the System Fund was able to produce a return in excess of 15%. More important then the absolute return; however, was the ability to protect and enhance the value of the portfolio in a year in which most financial markets generated losses. The System Fund remains invested according to an investment policy that is designed to capture a significant portion of the upside returns during bull markets while protecting the down side during bear markets.

Capital Assets and Debt Management

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

A summary of changes in capital assets is disclosed in Note 5. Capital assets, net of accumulated depreciation, at June 30, 2008, and June 30, 2007, were as follows:

Capital Assets
(Dollars in Thousands)

	2008	2007	% Change
Construction in Progress	$ 665,936	$ 535,332	24.4
Land and Other Nondepreciable Assets	115,155	97,030	18.7
Buildings	1,184,264	1,129,399	4.9
General Infrastructure	212,514	218,431	(2.7)
Machinery and Equipment	111,146	102,637	8.3
Total	$ 2,289,015	$ 2,082,829	9.9

The University is engaged in a $2.1 billion capital construction program that began in 2000 and will continue through the next few years. The 151 projects in the capital program include major capital renewal of existing buildings and infrastructure to address both deferred maintenance and programmatic needs. The 76 completed projects total $856 million, or 41%

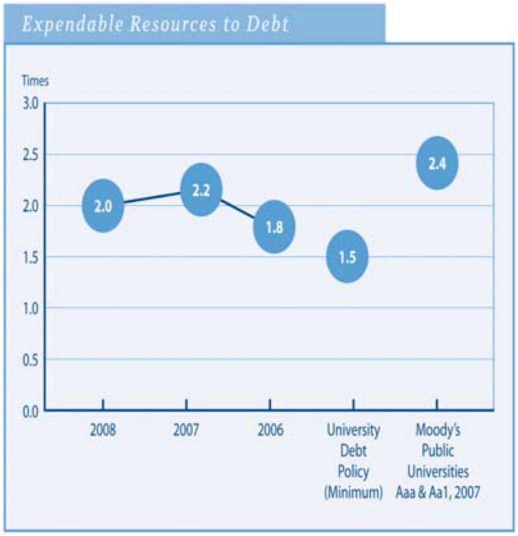
of the $2.1 billion capital construction program. The 29 projects under construction total $511 million or 24%, and the 46 projects under design represent $733 million or 35%. Capital funds resulting from North Carolina Higher Education Bonds continue to provide essential resources for construction. The University is directly investing in its capital construction program using a variety of other funding sources including general revenue bonds, cost reimbursements from research grants, internal reserves, and private gifts.

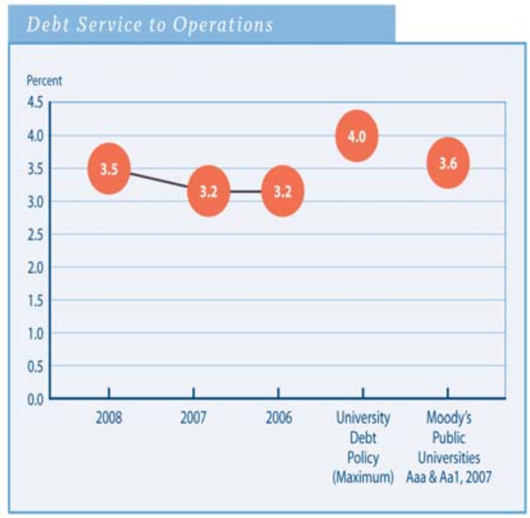
The University continues to use its commercial paper program to provide low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was $101.2 million at June 30, 2008 and $192.4 million at June 30, 2007. The University currently plans to issue a long-term bond in fiscal year 2009-2010 to refund a significant portion of outstanding commercial paper and to provide additional funds for capital projects.

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

The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The effective, combined interest rate for variable and fixed rate debt was 4.65% for fiscal year 2007-2008 and 4.72% for fiscal year 2006-2007. The interest rate on the commercial paper program for fiscal year 2007-2008 was 3.19% and for 2006-2007 was 3.6%. Interest rates on the University's variable rate, long-term bonds were 2.84% for fiscal year 2007-2008 and 3.59% for fiscal year 2006-2007. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements. The University's financial strength allowed it to achieve ratings of AA+/Aa1 by the national rating agencies.

The University's debt policy uses two key ratios to measure debt capacity, financial health, and credit quality. The expendable resources to debt ratio measures the availability of expendable assets to cover long-term obligations should the University be required to repay all of its obligations immediately. The debt service to operations ratio measures the University's ability to repay annual principal and interest associated with all outstanding debt and its impact on the overall budget. Each ratio is compared to the University's debt policy standard and the appropriate peer group comparison for fiscal 2006-2007 (the latest available numbers). The debt policy floor for expendable resources to debt is 1.5 times, and the metrics indicate the University has sufficient expendable resources to pay its long-term debt obligations. The debt policy ceiling for debt service to operations is 4%, and the metrics indicate the University's annual debt service requirements are a reasonable proportion of the operating budget.





Other Noncurrent Assets and Liabilities

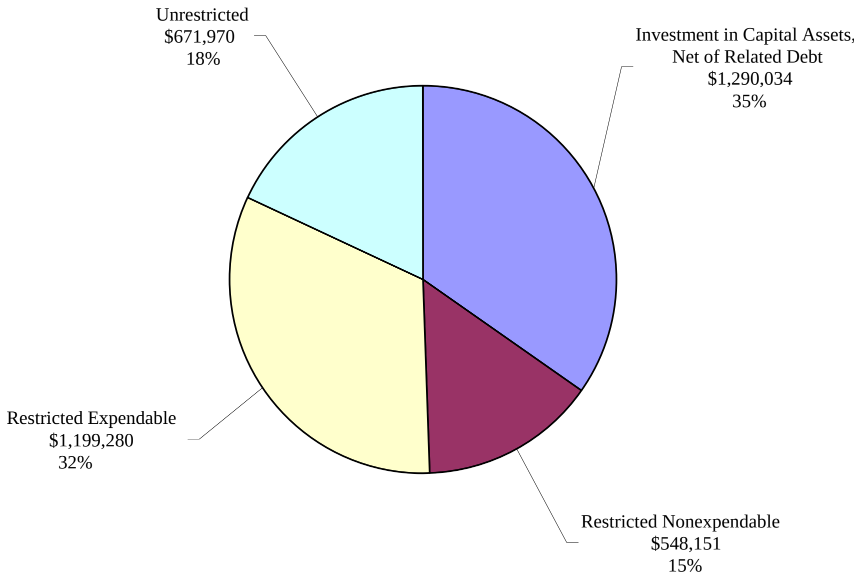
Other noncurrent assets were $216.7 million at June 30, 2008, and $205.2 million at June 30, 2007, a 5.6% increase. Noncurrent liabilities were $1.9 billion at June 30, 2008, and $1.4 billion at June 30, 2007, and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of $781 million and $588.1 million, respectively. These entities are not part of the University's financial reporting entity and are not discretely presented, but the entities do invest through the System Fund. The increase in funds held in trust of 32.8% over the prior year resulted from solid investment performance, participant contributions, and new participants in the System Fund.

Net Assets

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were $3.7 billion at June 30, 2008, an increase of $300.4 million over the prior year. Net assets invested in capital assets, net of related debt, represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included. Nonexpendable restricted net assets include endowment and similar assets whose use is limited by donors or other outside sources and as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net assets include resources in which the University is legally obligated to spend the resources in accordance with restrictions provided by external parties. Unrestricted net assets are not subject to externally imposed stipulations; however, most of these resources have been designated for particular academic, research, or other programs, as well as capital projects.

2008 NET ASSESTS: $3,709,435

(IN THOUSANDS)



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

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2008, and the prior year are summarized as follows:

University Operations
(Dollars in Thousands)

	2008	2007 (as restated)	% Change
Operating Revenues:			
Student Tuition and Fees, Net	$ 218,763	$ 210,651	3.9
Grants and Contracts	614,513	566,887	8.4
Sales and Services, Net	564,078	521,653	8.1
Other	6,898	5,253	31.3
Total Operating Revenues	1,404,252	1,304,444	7.7
Operating Expenses	2,089,290	1,948,282	7.2
Operating Loss	(685,038)	(643,838)	6.4
Nonoperating Revenues (Expenses):			
State Appropriations	543,292	492,471	10.3
Noncapital Gifts and Grants	216,026	136,306	58.5
Investment Income	146,650	317,767	(53.8)
Interest and Fees on Debt	(53,311)	(42,926)	24.2
Other Net Nonoperating Revenues	851	146	482.9
Income Before Other Changes	168,470	259,926	(35.2)
Capital Grants and Appropriations	60,091	171,738	(65.0)
Capital Gifts	11,596	15,662	(26.0)
Additions to Permanent Endowments	60,242	39,442	52.7
Increase in Net Assets	300,399	486,768	(38.3)
Net Assets – July 1	3,409,036	2,922,268	16.7
Net Assets – June 30	$ 3,709,435	$ 3,409,036	8.8

Fiscal year 2007-2008 revenues and other changes total $2,443,000 and expenses total $2,142,601.
Fiscal year 2006-2007 revenues and other changes total $2,477,976 and expenses total $1,991,208.

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was $57.1 million for fiscal 2007-2008 and $51.1 million for the prior year. Net revenues from student tuition and fees increased 3.9% over the prior year. The 2007-2008 tuition rates increased 7.2% for undergraduate resident students, 6.9% for undergraduate nonresidents, 12.2% for graduate residents, and 2.8% for graduate nonresidents.

Operating revenues from grants and contracts increased 8.4% over the prior year as reflected in the financial statements. Discussion of grants and contracts in terms of awards provides another useful perspective. The University is among the nation's leading public research universities, with a diversified portfolio of research that attracted $678.2 million in sponsored program funding during fiscal 2007-2008, an 11.1% increase over the previous year. As federal funding for research stalls and competition for investment from other sources increases, the University was able to sustain growth in awards.

While competition for funding from the National Institutes of Health (NIH) funding has increased significantly, the University share of those funds improved 13% to $356 million. Health-related research funded from NIH and other sources continues to receive the bulk of research dollars, with the medical school bringing in $356.8 million in 2007-2008. The College of Arts and Sciences received $68.6 million, the School of Pharmacy received $16.5 million, and the School of Social Work $12 million.

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

Operating Expenses

The University's operating expenses were $2.1 billion for the fiscal year ended June 30, 2008, an increase of 7.2% over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in the notes to the financial statements (Note 11). The following table illustrates the University's operating expenses by functional classification and by natural classification:

Operating Expenses by Function
(Dollars in Thousands)

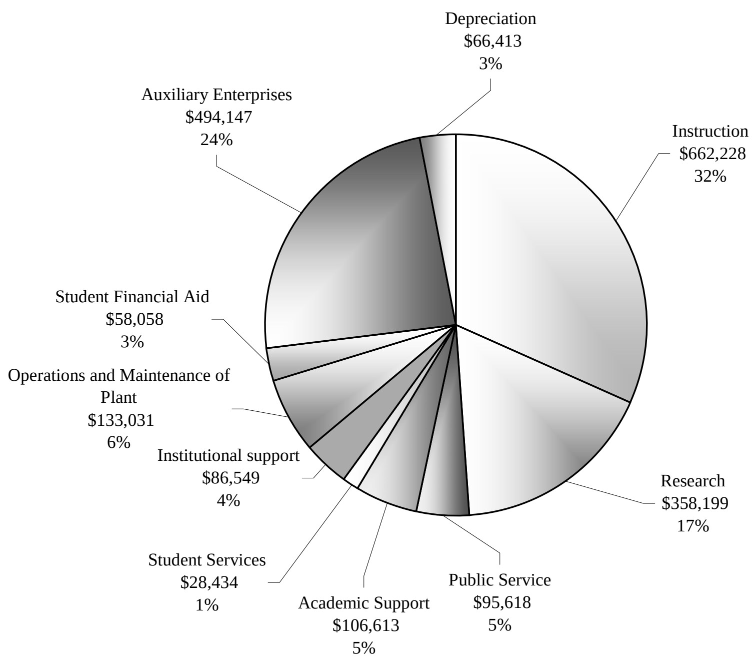
	2008	2007	% Change
Instruction	$ 662,228	$ 624,128	6.1
Research	358,199	312,160	14.7
Public Service	95,618	90,025	6.2
Academic Support	106,613	97,776	9.0
Student Services	28,434	25,865	9.9
Institutional Support	86,549	76,188	13.6
Operations and Maintenance of Plant	133,031	124,991	6.4
Student Financial Aid	58,058	56,662	2.5
Auxiliary Enterprises	494,147	459,660	7.5
Depreciation	66,413	80,827	(17.8)
Total Operating Expenses	$ 2,089,290	$ 1,948,282	7.2

Operating Expenses by Nature
(Dollars in Thousands)

	2008	2007	% Change
Salaries and Benefits	$ 1,210,757	$ 1,122,269	7.9
Supplies and Materials	161,219	165,704	(2.7)
Services	526,646	462,093	14.0
Scholarships and Fellowships	58,058	56,662	2.5
Utilities	66,197	60,727	9.0
Depreciation	66,413	80,827	(17.8)
Total Operating Expenses	$ 2,089,290	$ 1,948,282	7.2

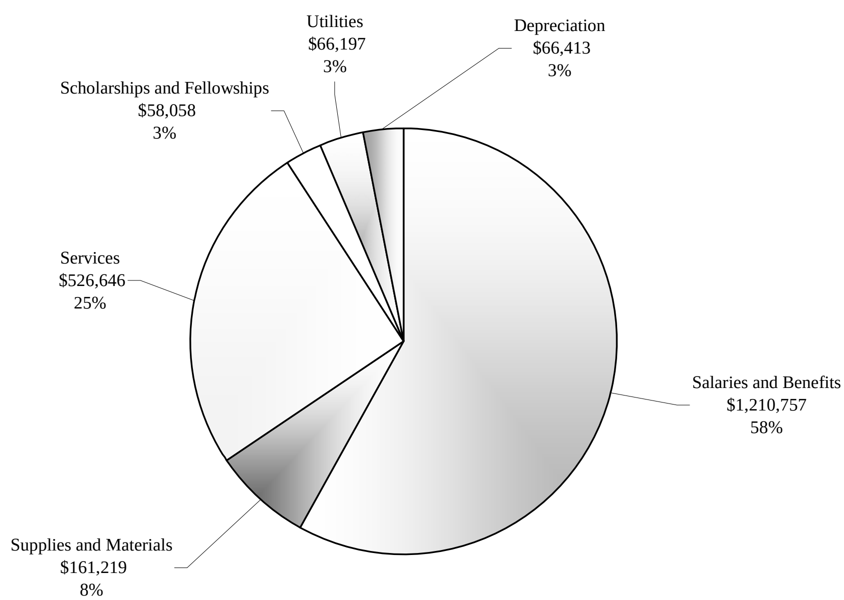
The following graph illustrates the University's operating expenses by function.

2008 OPERATING EXPENSES BY FUNCTION: $2,089,290 (IN THOUSANDS)



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

2008 OPERATING EXPENSES BY NATURE: $2,089,290
(IN THOUSANDS)



Operating expense categories changed at varying rates. The 14% increase in Services resulted in part from additional contractual service agreements related to professional health care services. The 17.8% decrease in depreciation expenses in 2007-2008 over the prior year resulted from increases in the estimated useful life used for buildings. The useful life for certain segments of componentized buildings was increased from 50 to 75 years, and the useful life for non-componentized buildings was increased from 40 to 75 years. The reader may refer to note disclosure 1H for additional information. The $2.1 billion capital construction that began in 2000 has resulted in an increased depreciable capital asset base of $2.4 billion at June 30, 2008, an increase of 67.1% from five years earlier. Research expenses increased 14.7% in keeping with the growth in sponsored awards. Institutional support increased 13.6% in part from noncapitalized expenses for the Enterprise Resource Planning project implementation, other technology needs, and administrative expenses of a component unit.

Nonoperating Revenues and Expenses

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

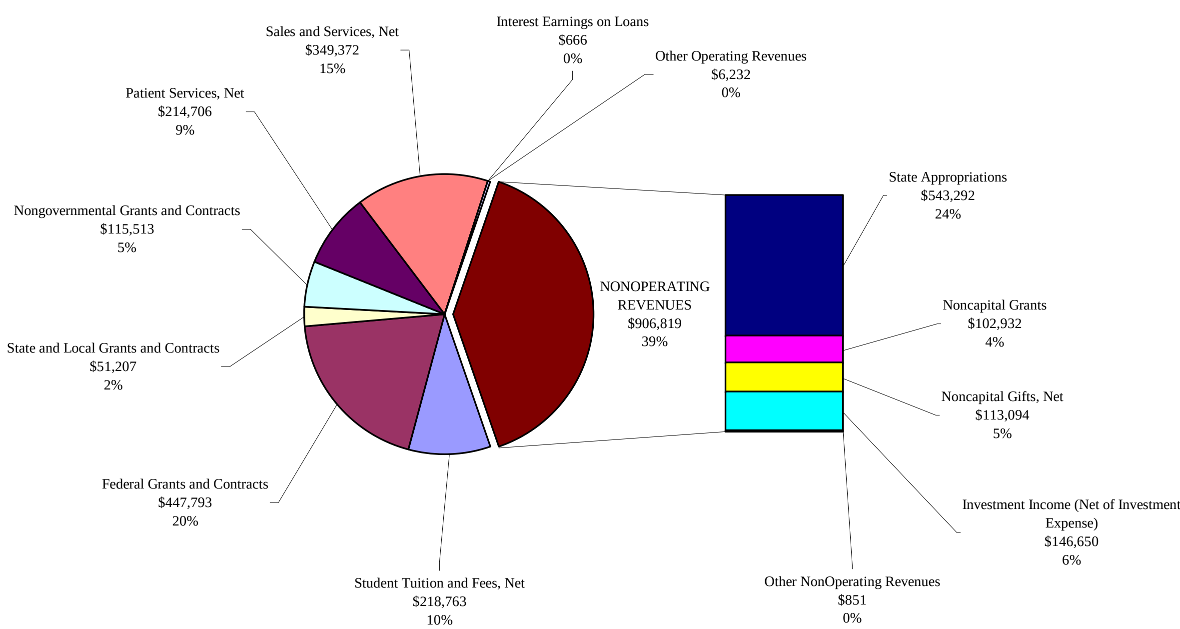
State appropriations were $543.3 million for fiscal 2007-2008, a 10.3% increase. The University received budget increases totaling $26.4 million to fund salary and benefit enhancements, $20.9 million for additional enrollment and program enhancements, and $9.7 million for operating costs for new facilities. The expiration of nonrecurring budget allocations and other net budget reductions were $6.2 million.

Noncapital gifts and grants increased $79.7 million and include expendable gifts and federal awards that are not considered to be operating revenues. The increase resulted in large part from the increase in expendable gifts as part of the University's fundraising efforts. Net investment income of $146.7 million, a decrease of 53.8% over 2006-2007, includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For additional discussion, the reader may refer to the Endowment and Other Investments section of the Management's Discussion and Analysis.

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as State appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and nonoperating revenues, which total $2.3 billion for fiscal year 2007-2008.

2008 TOTAL REVENUES BY SOURCE: $2,311,071



Other Changes in Net Assets

Capital grants and appropriations of $60.1 million for fiscal 2007-2008 and $171.7 million for fiscal 2006-2007 are from Statewide higher education bond proceeds and State appropriations for capital construction projects. These resources decreased as other resources are used and the pace of new constructions lessens. Capital gifts of $11.6 million for fiscal 2007-2008 and $15.7 million for the prior year resulted from fund-raising efforts and also provided funding for construction projects. Nonexpendable gifts and funds from the State's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of $60.2 million during fiscal 2007-2008 and $39.4 million during fiscal 2006-2007.

Economic Outlook

The University is financially well-positioned and will continue to maintain and generate sufficient resources to successfully fulfill its teaching, research, and service missions. The fiscal improvement during 2007-2008 enhanced the University's solid financial foundation. The University maintains low tuition levels in relative terms that provide important resources for key University priorities. Support from the State remains solid despite a national economic downturn, sponsored awards are a proven and reliable source in support of the University's research mission, philanthropic efforts have demonstrated outstanding success, and investment returns provide a stable stream of earnings. The University's strong debt credit ratings of Aa1 and AA+ allow it to obtain competitive financing for capital construction.

Tuition rates increased for fiscal 2008-2009 by 6.5% for undergraduate nonresidents, 8.7% for graduate residents, and 4.3% for graduate nonresidents. Tuition rates for undergraduate residents did not change. The University's academic standing allows it to continuously attract top students. The University's CAFR Statistical Section includes historical data for important metrics including the ratio of accepted applications as a percentage of total applications and the ratio of enrolled students as a percentage of accepted applications.

The Governor and the General Assembly of North Carolina have continued to demonstrate strong financial support for higher education. The budgeted funding level for State appropriations for fiscal 2008-2009 totals $573.6 million, which represents an increase of 5.6% over fiscal 2007-2008 actual State appropriations. This level of State appropriation funding includes faculty and staff pay and benefit increases of $17.1 million. The fiscal 2008-2009 pay increase of 3% for faculty and 2.75% for staff is the fifth consecutive year of base salary increases for all employees. Other budget changes included $15.8 million for enrollment increases and program enhancements, $2.8 million for operating costs for new facilities, and $5.4 million in net budget decreases. Because of a slowing national economy, the Governor recommended lowering revenue expectations for fiscal 2008-2009 to help manage a revenue shortfall should it arise. The impact on the University will be a requirement to reserve nonrecurring budget of 4% for fiscal 2008-2009 should a budget reduction become necessary.

External funding from contracts and grants increased to $678.2 million in fiscal 2007-2008. In many cases researchers from multiple University schools, departments, and units collaborate on research grants, contracts, and studies. The approach reflects the University's emphasis on interdisciplinary teaching and scholarship between and among the health, natural and social sciences, as well as the liberal arts and the humanities. The level of awards exceeded expectations and demonstrates strong potential for future growth as the University continues to expand its research facilities as part of the University's capital construction program.

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

The University's fund-raising efforts brought in more than $300 million in gifts for fiscal year 2007-2008, surpassing the $300 million mark for the first time and setting a new record for the fifth consecutive year. These latest milestones occurred in a year that the University concluded the Carolina First Campaign on a historic note. The campaign ended December 31, 2007, with $2.38 billion in commitments, which include pledges as well as gifts. The campaign marked the fifth largest total among completed campaigns at that time in the history of U.S. higher education and the largest in the South.

Carolina First, which supports the University's vision to be the nation's leading public university, began July 1, 1999. Its public launch came in October 2002 with a $1.8 billion goal. That goal was raised to $2 billion in October 2005. Not only did Carolina surpass its overall goal, but each professional school and unit exceeded individual goals as well. The final amount raised was $2.38 billion.

The University's academic standing augments its financial future. In the fall semester of 2007, the University enrolled its most academically prepared first-year class in its history, with 3,893 students enrolled from a record 20,090 applications. Applications for the fall semester of 2008 surpassed the prior year by 7%. Total student enrollment for fall semester 2007 exceeded 28,000 students for the first time. The first full class of Carolina Scholars graduated in May 2008. The Carolina Covenant, which provides a debt-free education to qualified low-income students from North Carolina and beyond, is a national model for making a college degree possible for qualified low-income students. The University's polices protect affordability and offer an outstanding education.

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

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2008

Exhibit A-1

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	306,241,864
Restricted Cash and Cash Equivalents		364,417,260
Short-Term Investments		195,957,967
Restricted Short-Term Investments		103,208,331
Receivables, Net (Note 4)		185,105,754
Due from State of North Carolina Component Units		19,295,769
Inventories		23,389,483
Notes Receivable, Net (Note 4)		2,621,117
Other Assets		193,915
Total Current Assets		1,200,431,460
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		119,085,895
Receivables, Net (Note 4)		35,859,181
Restricted Due from Primary Government		18,264,453
Endowment Investments		1,485,398,669
Other Investments		792,043,416
Notes Receivable, Net (Note 4)		35,166,168
Investment In Joint Venture		8,318,917
Capital Assets - Nondepreciable (Note 5)		781,091,310
Capital Assets - Depreciable, Net (Note 5)		1,507,924,143
Total Noncurrent Assets		4,783,152,152
Total Assets		5,983,583,612
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 6)		91,947,105
Due to Primary Government		7,273,721
Due to State of North Carolina Component Units		5,784,042
Deposits Payable		1,742,516
Funds Held for Others		3,876,485
Unearned Revenue		42,379,319
Interest Payable		4,862,588
Short-Term Debt (Note 7)		101,157,000
Long-Term Liabilities - Current Portion (Note 8)		113,592,746
Total Current Liabilities		372,615,522
Noncurrent Liabilities:		
U. S. Government Grants Refundable		31,846,832
Funds Held in Trust for Pool Participants		781,049,014
Long-Term Liabilities (Note 8)		1,088,637,083
Total Noncurrent Liabilities		1,901,532,929
Total Liabilities		2,274,148,451

NET ASSETS		
Invested in Capital Assets, Net of Related Debt		1,290,033,696
Restricted for:		
Nonexpendable		
Scholarships and Fellowships		113,623,685
Research		17,069,199
Library Acquisitions		27,132,326
Endowed Professorships		240,569,934
Departmental Uses		103,360,727
Loans		16,431,800
Other		29,963,465
Total Nonexpendable		548,151,136
Expendable		
Scholarships and Fellowships		229,734,050
Research		28,351,226
Library Acquisitions		61,820,776
Endowed Professorships		396,506,546
Departmental Uses		365,358,550
Instruction and Educational Agreements		20,429,604
Plant Improvements		19,332,357
Capital Projects		68,981,470
Debt Service		8,765,000
Total Expendable		1,199,279,579
Unrestricted		671,970,750
Total Net Assets	$	3,709,435,161

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

The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2008 — *Exhibit A-2*

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 10)	$	218,763,485
Patient Services, Net (Note 10)		214,705,830
Federal Grants and Contracts		447,792,388
State and Local Grants and Contracts		51,207,123
Nongovernmental Grants and Contracts		115,513,098
Sales and Services, Net (Note 10)		349,372,187
Interest Earnings on Loans		665,619
Other Operating Revenues		6,232,215
Total Operating Revenues		1,404,251,945
EXPENSES		
Operating Expenses:		
Salaries and Benefits		1,210,757,446
Supplies and Materials		161,219,222
Services		526,645,768
Scholarships and Fellowships		58,058,259
Utilities		66,197,231
Depreciation		66,412,469
Total Operating Expenses		2,089,290,395
Operating Loss		(685,038,450)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		543,291,852
Noncapital Grants		102,932,492
Noncapital Gifts, Net (Note 10)		113,093,852
Investment Income (Net of Investment Expense of $6,416,039)		146,650,103
Interest and Fees on Debt		(53,311,210)
Other Nonoperating Revenues		851,693
Net Nonoperating Revenues		853,508,782
Income Before Other Revenues		168,470,332
Capital Appropriations		47,206,200
Capital Grants		12,884,378
Capital Gifts		11,596,369
Additions to Endowments		60,241,629
Increase in Net Assets		300,398,908
NET ASSETS		
Net Assets - July 1, 2007, as Restated (Note 18)		3,409,036,253
Net Assets - June 30, 2008	$	3,709,435,161

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

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008 ***Exhibit A-3***

CASH FLOWS FROM OPERATING ACTIVITIES	
Received from Customers	$ 1,381,267,969
Payments to Employees and Fringe Benefits	(1,193,733,438)
Payments to Vendors and Suppliers	(747,072,706)
Payments for Scholarships and Fellowships	(58,058,259)
Loans Issued	(7,952,158)
Collection of Loans	5,926,896
Other Payments	(21,512,209)
Net Cash Used by Operating Activities	(641,133,905)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State Appropriations	543,291,852
Noncapital Grants	88,851,058
Noncapital Gifts	96,958,135
Additions to Endowments	60,241,629
Related Activity Agency Receipts	191,708,958
Cash Provided by Noncapital Financing Activities	981,051,632
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES	
Proceeds from Capital Debt	426,478,562
State Capital Appropriations	47,206,200
Capital Grants	56,265,270
Capital Gifts	9,409,483
Acquisition and Construction of Capital Assets	(283,860,475)
Principal Paid on Capital Debt and Leases	(238,671,512)
Interest and Fees Paid on Capital Debt and Leases	(52,779,333)
Net Cash Used by Capital Financing and Related Financing Activities	(35,951,805)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from Sales and Maturities of Investments	1,306,318,418
Investment Income	56,598,516
Purchase of Investments and Related Fees	(1,522,635,524)
Net Cash Used by Investing Activities	(159,718,590)
Net Increase in Cash and Cash Equivalents	144,247,332
Cash and Cash Equivalents - July 1, 2007 (as Restated)	645,497,687
Cash and Cash Equivalents - June 30, 2008	$ 789,745,019

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

Operating Loss	$	(685,038,450)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		66,412,469
Allowances, Write-Offs, and Amortizations		204,424
Changes in Assets and Liabilities:		
Receivables, Net		(31,980,016)
Inventories		(3,883,607)
Notes Receivable, Net		(2,684,961)
Other Assets		(193,915)
Accounts Payable and Accrued Liabilities		10,862,763
Due to Primary Government		7,179,549
U.S. Government Grants Refundable		(217,247)
Unearned Revenue		(11,639,223)
Compensated Absences		9,844,309
Net Cash Used by Operating Activities	$	(641,133,905)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	306,241,864
Restricted Cash and Cash Equivalents		364,417,260
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		119,085,895
Total Cash and Cash Equivalents - June 30, 2008	$	789,745,019

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	$	2,147,681
Assets Acquired through a Gift		2,186,886
Change in Fair Value of Investments		23,565,632
Decrease in Receivables Related to Nonoperating Income		(6,957,789)
Loss on Disposal of Capital Assets		3,995,430

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

The University of North Carolina at Chapel Hill Foundations
Statement of Financial Position
June 30, 2008 ***Exhibit B-1***

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
ASSETS			
Current Assets:			
Cash and Cash Equivalents	$ 8,383,739	$ 15,652,749	$ 45,669,788
Investments		183,875,742	111,229,321
Unconditional Promises to Give	6,758,254	8,444,835	4,659,547
Contributions Receivable from Split-Interest Agreements		3,491,692	
Accounts Receivable	327,374		
Funds Held in Trust	498,823		
Accrued Income Receivable	21,906		139,212
Prepaid Expenses			68,298
Miscellaneous Receivables			152,306
Total Current Assets	15,990,096	211,465,018	161,918,472
Property and Equipment:			
Building			555,729
Furniture and Equipment	650,324		446,081
Leasehold Interest - Building	3,750,483		
Vehicle	26,422		
	4,427,229		1,001,810
Less: Allowance for Depreciation	(484,283)		(392,596)
Total Property and Equipment	3,942,946		609,214
Other Assets:			
Investments	138,393,715		60,820,662
Unconditional Promises to Give, Net	16,565,643		5,681,445
Restricted Cash	4,477,382		89,006
Split-Interest Agreements	2,284,358		4,807,143
Restricted Investments			473,532
Real Estate Interests Held for Investment	49,500		
Student Loans Receivable			36,198
Cash Surrender Value of Life Insurance		2,041,074	437,400
Total Other Assets	161,770,598	2,041,074	72,345,386
Total Assets	$ 181,703,640	$ 213,506,092	$ 234,873,072
LIABILITIES			
Current Liabilities:			
Accounts Payable	$ 64,901	$ 0	$ 160,446
Annuities Payable		117,159	
Accrued Expenses	160,985		211,541
Total Current Liabilities	225,886	117,159	371,987
Long-Term Debt	1,500,000		
Total Liabilities	1,725,886	117,159	371,987
NET ASSETS			
Unrestricted	17,501,214		11,395,790
Temporarily Restricted	86,874,251	114,643,701	162,284,633
Permanently Restricted	75,602,289	98,745,232	60,820,662
Total Net Assets	179,977,754	213,388,933	234,501,085
Total Liabilities and Net Assets	$ 181,703,640	$ 213,506,092	$ 234,873,072

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

The University of North Carolina at Chapel Hill Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2008 — *Exhibit B-2*

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
REVENUES			
Support:			
Contributions	$ 8,735,734	$ 7,207,726	$ 24,777,033
Development Assessment Fee	1,880,344		
Change in Value of Split-Interest Agreements	219,978		74,537
Donated Facilities	65,000		
Actuarial Adjustment of Annuities Payable		208	
Endowment Investment Return Designated for Current Operations		6,830,007	
Total Support	10,901,056	14,037,941	24,851,570
Revenue:			
Interest and Dividend Income			14,628,762
Net Unrealized and Realized Gains (Losses) on Investments	8,954,116		(16,167,753)
Investment Income	2,464,968		
Other Income	24,333		917,975
Total Revenues	11,443,417		(621,016)
Total Support and Revenue	22,344,473	14,037,941	24,230,554
EXPENSES			
Program Services:			
Grants	10,749,723		21,028,813
Scholarship Expense Distribution		6,815,685	
Annuity Payments		14,322	
Other Expenses		142,500	
Total Program Services	10,749,723	6,972,507	21,028,813
Supporting Services:			
Fundraising Expenses	2,300,126		1,258,197
Management and General	1,114,491		1,555,936
Total Supporting Services	3,414,617		2,814,133
Total Expenses	14,164,340	6,972,507	23,842,946
Changes in Net Assets from Operations	8,180,133	7,065,434	387,608
TRANSFERS:			
Transfers to UNC-CH	(50,302)		
OTHER CHANGES:			
Investment Return in Excess of Amounts Designated for Current Operations		6,621,787	
Changes in Net Assets	8,129,831	13,687,221	387,608
NET ASSETS			
Net Assets at Beginning of Year	171,847,923	199,701,712	234,113,477
Net Assets at End of Year	$ 179,977,754	$ 213,388,933	$ 234,501,085

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

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

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

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

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

The System Fund was organized by the Investment Fund to allow the University, the University of North Carolina and its other constituent institutions (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured and arranged by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Investment Fund contributed and assigned all of its assets to the System Fund effective January 1, 2003, in exchange for its membership interest in the System Fund. Upon such contribution and assignment, and in consideration thereof, the System Fund has assumed all liabilities and obligations of the Investment Fund in respect of such contributed assets. At June 30, 2008, the Investment Fund membership interest was approximately 88.1% of the System Fund total membership interests. Because the Investment Fund is the organizer and a predominant member of the System Fund, the financial statements of the System Fund have been blended with those of the University.

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

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

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

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

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

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

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

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

The Medical Foundation is governed by a board consisting of three ex-officio directors and 27 elected directors, which serve staggered terms. Its purpose is to support educational and research efforts of the University's Medical School and UNC Hospitals. Historically, the University's Medical School has been the major recipient of financial support from the Medical Foundation rather than UNC Hospitals. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests is restricted to the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

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

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

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

During the year ended June 30, 2008, the Medical Foundation, Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total $38,594,221 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

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

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

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

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

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

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

E. **Investments –** The fair values of all debt and equity securities with readily determinable fair market values are based on quoted market prices. Investments for which a readily determinable fair value does not exist include investments in certain commingled funds and limited partnerships. These investments are carried at estimated fair values as provided by the respective fund managers of these investments. The Management Company reviews and evaluates the values provided by the fund managers as well as the valuation methods and assumptions used in determining the fair value of such investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed. The net increase or decrease in the fair value of investments is recognized as a component of investment income.

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

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

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts.

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

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

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

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 30 years for general infrastructure, 12 to 75 years for buildings, and four to 10 years for equipment.

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

I. **Restricted Assets –** Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants.

J. **Funds Held in Trust for Pool Participants –** Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.

K. **Funds Held in Trust by Others –** Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2008, is approximately $29,939,739.

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

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

M. **Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method.

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

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

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

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

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

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

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

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

Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

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

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

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

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

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2008, the amount shown on the Statement of Net Assets as cash and cash equivalents includes $706,727,484, 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 2.9 years as of June 30, 2008. 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, 2008 was $202,611. The carrying amount of the University's deposits not with the State Treasurer was $82,814,924 and the bank balance was $37,442,238. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2008, $35,529,174 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

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

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

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

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

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

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

Investments are subject to the following risks.

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

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

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

Temporary Investment Pool (Temporary Pool) - This is a fixed income portfolio managed by the UNC Management Company, Inc. (Management Company) and Novant Asset Management, LLC (formerly Tanglewood). It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals, and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Fund ownership of the University's Temporary Pool is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The Temporary Pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the University's Board of Trustees. The University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

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

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

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2008.

Temporary Pool Investments

		Investment Maturities (in Years)			
	Fair Value	**Less Than 1**	**1 to 5**	**6 to 10**	**More than 10**
Investment Type					
Debt Securities					
U.S. Treasuries	$ 9,615,101	$ 0	$ 9,615,101	$ 0	$ 0
U.S. Agencies	3,011,341		2,986,443	24,898	
Mortgage Pass Throughs	44,634,666	973,751	2,036,202	982,724	40,641,989
Collateralized Mortgage Obligations	139,676,929	31,936	6,015,454	8,344,222	125,285,317
State and Local Government	3,073,519	748,519			2,325,000
Asset-Backed Securities	2,006,653				2,006,653
Mutual Bond Funds	4,128,480				4,128,480
Money Market Mutual Funds	85,971,576	85,971,576			
Domestic Corporate Bonds	1,868,347				1,868,347
Total Debt Securities	293,986,612	$ 87,725,782	$ 20,653,200	$ 9,351,844	$ 176,255,786
Other Securities					
Mutual Funds	4,879,257				
Domestic Stocks	30,000				
Total Temporary Pool Investments	$ 298,895,869				

At June 30, 2008, investments in the Temporary Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	$ 2,986,443	$ 0	$ 0	$ 0	$ 0	$ 0	$ 2,986,443
Mortgage Pass Throughs	44,634,666						44,634,666
Collateralized Mortgage Obligations	139,676,929	52,883,777	4,256,408	15,578,563		3,247,997	63,710,184
State and Local Government	3,073,519	748,519	2,325,000				
Asset-backed Securities	2,006,653	31,855	1,363,716		611,082		
Mutual Bond Funds	4,128,480		4,128,480				
Money Market Mutual Funds	85,971,576			85,971,576			
Domestic Corporate Bonds	1,868,347	1,354,367		513,980			
Total	$ 284,346,613	$ 55,018,518	$ 12,073,604	$ 102,064,119	$ 611,082	$ 3,247,997	$ 111,331,293

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

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

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2008, are as follows:

Statement of Net Assets
June 30, 2008

	Amount
Assets:	
State Treasurer Investment Fund	$ 43,000,000
Accounts Receivable	6,936,159
Accrued Investment Income	1,123,855
Investment Fund	50,400,252
Investments	298,895,869
Total Assets	$ 400,356,135
Liabilities:	
Deferred Income	$ 1,610,099
Accounts Payable	98,068
Total Liabilities	1,708,167
Net Assets:	
Internal Portion	233,448,250
External Portion	165,199,718
Total Net Assets	398,647,968
Total Liabilities and Net Assets	$ 400,356,135

Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2008

		Amount
Increase in Net Assets from Operations:		
Revenues:		
Investment Income	$	15,622,316
Expenses:		
Investment Management		(638,386)
Net Increase in Net Assets Resulting from Operations		14,983,930
Distributions to Participants:		
Distributions Paid and Payable		(14,983,930)
Share Transactions:		
Net Share Purchases		43,629,449
Total Increase in Net Assets		43,629,449
Net Assets:		
Beginning of Year		355,018,519
End of Year	$	398,647,968

Intermediate Investment Pool – Established in October 2007, this is a portfolio managed by the UNC Management Company, Inc. (Management Company), and is comprised of fixed income investments and investments with the University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. Participation in the Intermediate Pool is open to all participants that are eligible for the UNC Chapel Hill Temporary Investment Pool, however currently the University is the only member. Fund ownership of the University's Intermediate Pool is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The Intermediate Pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the University's Board of Trustees. The University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Intermediate Pool.

The Northern Trust Company is the custodian for the Intermediate Pool and provides the University with monthly statements defining income and market value information. Generally a minimum of 45% and a maximum of 65% of the market value of the Intermediate Pool will be invested in the University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund). The remaining assets of the Intermediate Pool will be invested primarily (at least 80%) in cash, money market instruments, high quality bonds, and other high quality fixed income instruments in accordance with the Investment Guidelines.

By written request to university accounting services, the purchase and sale of participation shares occur at the beginning of the month. As calculated by the Management Company, returns net of fees and expenses will be allocated 85% to the Intermediate Pool participants and 15% to the University. Statements are provided by the Management Company to each participant on a monthly basis reflecting the participants' balance and investment activity.

The following table presents the fair value of the fixed income segment of the Intermediate Pool investments by type and investments subject to interest rate risk at June 30, 2008.

Intermediate Pool Investments

		Investment Maturities (in Years)			
	Fair Value	**Less Than 1**	**1 to 5**	**6 to 10**	**More than 10**
Investment Type					
Debt Securities					
Mutual Bond Funds	$ 28,891,529	$ 14,322,862	$ 14,568,667	$ 0	$ 0
Money Market Mutual Funds	27,370	27,370			
Total Intermediate Pool Investments	$ 28,918,899	$ 14,350,232	$ 14,568,667	$ 0	$ 0

At June 30, 2008, investments in the Intermediate Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	**AAA Aaa**	**A**	**Unrated**
Mutual Bond Funds	$ 28,891,529	$ 14,322,862	$	$ 14,568,667
Money Market Mutual Funds	27,370		27,370	
Total	$ 28,918,899	$ 14,322,862	$ 27,370	$ 14,568,667

Rating Agency: Moody's/Standard & Poor's

At June 30, 2008, the Intermediate Investment Pool had investments of $42,946,665 in the Investment Fund.

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

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

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

The Investment Fund consists of an approximately 88.1% membership in the System Fund categorized below.

UNC Investment Fund, LLC (System Fund) - This is a limited liability company organized under the laws of the State of North Carolina. It was established in December 2002 by the Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Investment Fund, with an approximately 88.1% membership interest as of June 30, 2008, is the predominant member of the System Fund. The University's reporting entity portion of the Investment Fund is characterized as the internal portion. Other affiliated organizations in the Investment Fund in addition to other members of the System Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the System Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the System Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

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

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

The following table presents the fair value of the System Fund investments by type and investments subject to interest rate risk at June 30, 2008.

System Fund Pool Investments

		Investment Maturities (in Years)			
	Fair Value	Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
U.S. Treasuries	$ 23,941,000	$ 0	$ 0	$ 0	$ 23,941,000
U.S. Agencies	5,029,983			57,293	4,972,690
Mortgage Pass Throughs	5,569,790			2,620,425	2,949,365
Collateralized Mortgage Obligations	3,123,387				3,123,387
Mutual Bond Funds	4,676,618			3,743,651	932,967
Money Market Mutual Funds	33,014,358	33,014,358			
Domestic Corporate Bonds	14,932,700			1,521,678	13,411,022
Total Debt Securities	90,287,836	$ 33,014,358	$ 0	$ 7,943,047	$ 49,330,431
Other Securities					
International Mutual Funds	247,949,641				
Other Mutual Funds	150,072,544				
Hedge Funds	903,749,346				
Limited Partnerships	906,805,825				
Domestic Stocks	98,768,843				
Foreign Stocks	5,024,341				
Other	113,637,230				
Total System Fund Pool Investments	$ 2,516,295,606				

At June 30, 2008, investments in the System Fund Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	Unrated
U.S. Agencies	$ 4,972,690	$ 2,318,366	$ 0	$ 0	$ 0	$ 2,654,324
Mortgage Pass Throughs	5,569,790	2,949,365				2,620,425
Collateralized Mortgage Obligations	3,123,387					3,123,387
Mutual Bond Funds	4,676,618		773,760	1,341,725		2,561,133
Money Market Mutual Funds	33,014,358			33,014,358		
Domestic Corporate Bonds	14,932,700	453,134	1,017,224	6,973,866	6,488,476	
Total	$ 66,289,543	$ 5,720,865	$ 1,790,984	$ 41,329,949	$ 6,488,476	$ 10,959,269

Rating Agency: Moody's/Standard and Poor's/Fitch

Foreign Currency Risk: At June 30, 2008, the System Fund Pool's exposure to foreign currency risk is as follows:

Investment	Currency	Fair Value (U.S. Dollars)
Limited Partnerships	Euro	$ 51,146,119
Limited Partnerships	British Pound Sterling	5,393,647
Limited Partnerships	Australian Dollar	1,360,209
Foreign Stock	Canadian Dollar	1,308,363
Foreign Stock	Hong Kong Dollar	1,222,883
Hedge Funds	Euro	23,333,083
Total		$ 83,764,304

In addition to the foreign currency risk disclosed above, the System Fund invests in hedge funds containing securities that are highly sensitive to rate changes.

Non-pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2008.

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					
U.S. Treasuries	$ 279,235	$ 25,318	$ 93,172	$ 82,411	$ 78,334
U.S. Agencies	372,876	82,989	239,473	50,414	
Mortgage Pass Throughs	275,957				275,957
Collateralized Mortgage Obligations	95,322	8,864			86,458
State and Local Government	109,313				109,313
Asset-Backed Securities	35,000				35,000
Mutual Bond Funds	9,599,457		157,989	8,130,099	1,311,369
Money Market Mutual Funds	46,568,703	46,568,703			
Domestic Corporate Bonds	564,226	24,993	109,947	398,786	30,500
Foreign Corporate Bonds	140,361			69,409	70,952
Total Debt Securities	58,040,450	$ 46,710,867	$ 600,581	$ 8,731,119	$ 1,997,883
Other Securities					
International Mutual Funds	7,934,212				
Other Mutual Funds	10,929,293				
Investments in Real Estate	15,513,565				
Real Estate Investment Trust	201,042				
Limited Partnerships	1,706,885				
Domestic Stocks	12,371,359				
Foreign Stocks	411,752				
Other	11,659,548				
Total Non-Pooled Investments	$ 118,768,106				

At June 30, 2008, the University's Non-pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	$ 372,876	$ 367,789	$ 0	$ 0	$ 0	$ 0	$ 5,087
Mortgage Pass Throughs	275,957	250,396		25,561			
Collateralized Mortgage Obligations	95,322	65,891		29,431			
State and Local Government	109,313			73,697	35,616		
Asset-Backed Securities	35,000			35,000			
Mutual Bond Funds	9,599,457	217,938	8,000,973	771,842		608,704	
Money Market Mutual Funds	46,568,703	2,005,990		44,562,713			
Domestic Corporate Bonds	564,226		409,430	55,494		99,302	
Foreign Corporate Bonds	140,361	34,910	34,499			70,952	
Total	$ 57,761,215	$ 2,942,914	$ 8,444,902	$ 45,553,738	$ 35,616	$ 778,958	$ 5,087

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

Total Investments – The following table presents the fair value of the total investments at June 30, 2008:

	Fair Value
Investment Type	
Debt Securities	
U.S. Treasuries	$ 33,835,336
U.S. Agencies	8,414,200
Mortgage Pass Throughs	50,480,413
Collateralized Mortgage Obligations	142,895,638
State and Local Government	3,182,832
Asset-Backed Securities	2,041,653
Mutual Bond Funds	47,296,084
Money Market Mutual Funds	165,582,007
Domestic Corporate Bonds	17,365,273
Foreign Corporate Bonds	140,361
Total Debt Securities	471,233,797
Other Securities	
International Mutual Funds	$ 255,883,853
Other Mutual Funds	165,881,094
Investments in Real Estate	15,513,565
Real Estate Investment Trust	201,042
Hedge Funds	903,749,346
Limited Partnerships	908,512,710
Domestic Stocks	111,170,202
Foreign Stocks	5,436,093
Other	125,296,778
Total Investments	$ 2,962,878,480

Total investments include $386,270,097 held in the System Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 74.3% of the System Fund.

Component Units - Investments of the University's discretely presented component unit, the Medical Foundation of North Carolina, Inc., are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements. Because the Medical Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The carrying value of investments not held by the University is $106,732,907 in mutual funds.

NOTE 3 - ENDOWMENT INVESTMENTS

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

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2008, accumulated income and appreciation of $696,262,045 was available in the University's pooled endowment funds of which $628,860,866 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2008, were as follows:

	Gross Receivables	Less Allowance For Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 2,927,985	$ 0	$ 2,927,985
Patients	85,207,384	44,573,838	40,633,546
Accounts	69,216,700		69,216,700
Intergovernmental	45,992,906		45,992,906
Pledges	22,559,708	563,993	21,995,715
Investment Earnings	3,733,617		3,733,617
Interest on Loans	580,265		580,265
Other	25,020		25,020
Total Current Receivables	$ 230,243,585	$ 45,137,831	$ 185,105,754
Noncurrent Receivables:			
Pledges	$ 36,778,647	$ 919,466	$ 35,859,181
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	$ 2,158,031	$ 96,877	$ 2,061,154
Institutional Student Loan Programs	623,274	63,311	559,963
Total Notes Receivable - Current	$ 2,781,305	$ 160,188	$ 2,621,117
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 31,539,496	$ 1,287,080	$ 30,252,416
Institutional Student Loan Programs	5,052,795	139,043	4,913,752
Total Notes Receivable - Noncurrent	$ 36,592,291	$ 1,426,123	$ 35,166,168

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of 4.94% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

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

Fiscal Year	Amount
2009	$ 22,559,707
2010	16,039,146
2011	12,008,644
2012	9,140,628
2013	3,083,572
2014-2018	2,183,604
Total Pledge Receipts Expected	65,015,301
Discount Amount Representing Interest (4.94% Rate of Interest)	(5,676,946)
Present Value of Pledge Receipts Expected	59,338,355
Less Allowance for Uncollectible	(1,483,459)
Pledges Receivable	$ 57,854,896

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2008, is presented as follows:

	Balance July 1, 2007	Increases	Decreases	Balance June 30, 2008
Capital Assets, Nondepreciable:				
Land	$ 28,759,827	$ 1,061,068	$ 1,367,938	$ 28,452,957
Art, Literature, and Artifacts	67,269,935	2,825,038		70,094,973
Construction in Progress	535,331,669	194,385,291	63,780,866	665,936,094
Intangible	1,000,000	15,607,286		16,607,286
Total Capital Assets, Nondepreciable	632,361,431	213,878,683	65,148,804	781,091,310
Capital Assets, Depreciable:				
Buildings	1,643,244,541	90,668,827	4,489,643	1,729,423,725
Machinery and Equipment	247,266,162	31,001,797	12,241,053	266,026,906
General Infrastructure	409,962,110	6,193,929		416,156,039
Total Capital Assets, Depreciable	2,300,472,813	127,864,553	16,730,696	2,411,606,670
Less Accumulated Depreciation/Amortization for:				
Buildings	513,845,845	35,338,756	4,025,249	545,159,352
Machinery and Equipment	144,628,808	18,962,216	8,710,017	154,881,007
General Infrastructure	191,530,671	12,111,497		203,642,168
Total Accumulated Depreciation	850,005,324	66,412,469	12,735,266	903,682,527
Total Capital Assets, Depreciable, Net	1,450,467,489	61,452,084	3,995,430	1,507,924,143
Capital Assets, Net	$ 2,082,828,920	$ 275,330,767	$ 69,144,234	$ 2,289,015,453

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2008, were as follows:

	Amount
Accounts Payable	$ 45,097,135
Accrued Payroll	37,349,776
Contract Retainage	9,278,813
Intergovernmental Payables	221,381
Total Accounts Payable and Accrued Liabilities	$ 91,947,105

NOTE 7 - SHORT-TERM DEBT

Short-term debt activity for the year ended June 30, 2008, was as follows:

	Balance July 1, 2007	Draws	Redeemed	Balance June 30, 2008
Commercial Paper Program	$ 192,414,000	$ 122,719,000	$ 213,976,000	$ 101,157,000

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

Commercial paper was redeemed with proceeds from The University of North Carolina General Revenue Bonds, Series 2007 and payments from campus entities with outstanding commercial paper.

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, 2008, is presented as follows:

	Balance July 1, 2007	Additions	Reductions	Balance June 30, 2008	Current Portion
Bonds Payable	$ 804,875,000	$ 298,475,000	$ 22,515,000	$ 1,080,835,000	$ 102,072,546
Add/Deduct Premium/Discount	(15,729,857)	4,902,670	(4,317,485)	(6,509,702)	
Deduct Deferred Charge on Refunding	(3,838,338)		(401,923)	(3,436,415)	
Total Bonds Payable	785,306,805	303,377,670	17,795,592	1,070,888,883	102,072,546
Notes Payable	1,362,000	381,891	706,891	1,037,000	1,037,000
Arbitrage Rebate Payable	0	42,213		42,213	42,213
Capital Leases Payable	2,404,350	1,873,804	1,473,621	2,804,533	1,173,442
Compensated Absences	107,310,377	63,733,228	53,888,920	117,154,685	7,933,678
Annuity and Life Income Payable	5,999,428	7,147,445	2,844,358	10,302,515	1,333,867
Total Long-Term Liabilities	$ 902,382,960	$ 376,556,251	$ 76,709,382	$ 1,202,229,829	$ 113,592,746

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 plus Capital Appreciation	Principal Paid Through June 30, 2008	Discount on Capital Appreciation Bonds	Principal and Capital Appreciation Outstanding June 30, 2008	
Housing System								
	1997A	5.0%	11/01/17	$ 9,170,000	$ 9,170,000	$ 0	$ 0	(1)
	1997B	4.7% - 5.0%	11/01/11	7,210,000	3,985,000		3,225,000	(1)
Total Housing System				16,380,000	13,155,000		3,225,000	
Parking System								
	1997B	5.1%	05/15/09	8,245,000	7,330,000		915,000	(2)
General Revenue								
	2001A	5.000% -5.375%	12/01/25	89,930,000	48,440,000		41,490,000	
	2001B	variable	12/01/25	54,970,000	13,170,000		41,800,000	
	2001C	variable	12/01/25	54,970,000	13,170,000		41,800,000	
	2002B	5.0%	12/01/11	66,555,000	34,000,000		32,555,000	
	2003	2.5% - 5.0%	12/01/33	107,960,000	6,985,000		100,975,000	
	2005	3.25% - 5.00%	12/01/34	404,960,000	775,000		404,185,000	
	2007	4.45 - 5.00%	12/01/36	298,475,000			298,475,000	
Total General Revenue				1,077,820,000	116,540,000		961,280,000	
Utilities System	1997	5.25% - 5.50%	08/01/21	84,135,000		(30,418,396)	53,716,604	(4)
Student Union	2000	5.0%	06/01/10	12,465,000	11,490,000		975,000	(3)
Student Recreation Center	1997	4.7% - 5.0%	06/01/11	3,545,000	2,375,000		1,170,000	(3)
U.S. EPA Project	1991	9.05%	02/15/15	58,125,000	28,990,000	(7,656,627)	21,478,373	
Total Bonds Payable (principal only)				$ 1,260,715,000	$ 179,880,000	$ (38,075,023)	1,042,759,977	
Less: Unamortized Loss on Refunding							(3,436,415)	
Plus: Unamortized Discount							31,565,321	
Total Bonds Payable							$ 1,070,888,883	

The University has pledged future revenues, net of specific operating expenses, to repay revenue bonds and certificates of participation as shown in the table below:

Ref	Revenue Source	Total Future Revenues Pledged	Current Year Revenues Net of Expenses	Current Year Principal, Interest, and Accretion	Estimate of % of Revenues Pledged
(1)	Housing Revenues	$ 3,552,582	$ 21,984,760	$ 1,323,529	4%
(2)	Parking Revenues	961,665	9,598,309	950,525	10%
(3)	Student Fees	2,337,380	1,590,131	946,180	49%
(4)	Utilities	84,135,000	25,529,895	2,794,264	24%

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

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

General Revenue, Series 2001B and 2001C: In 2001 the University issued two series of variable rate demand bonds in the amount of $54,970,000 (2001B) and $54,970,000 (2001C) that each have a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agents, Lehman Brothers, Inc (2001B), UBS Financial Services, Inc. (2001C), and Bank of America Securities LLC (2001C). Effective June 25, 2008, the University changed remarketing agents for the 2001C bonds.

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

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

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

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

Under the line of credit agreement, draws to purchase bonds will accrue interest at the prime rate payable on the same interest date as provided in the trust agreement for the original bonds. The University is required to begin making a series of ten fully amortizing semi-annual principal payments on bonds held by the bank six months after the date of purchase. Commercial paper bonds held by the bank may be rolled over for a period of 180 days and must be reduced by 1/10th of the original amount of the commercial paper bonds for a period of up to ten rollovers. All outstanding principal and accrued but unpaid interest is due in full at the maturity of the line of credit. At June 30, 2008, no purchase draws had been made under the line of credit.

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

Interest Rate Swaps:

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

Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the Securities Industry and Financial Markets Association (SIFMA) index on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. The notional amount of the swap reduces annually in conjunction with the 2001B Bonds; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2008, rates were as follows:

Fixed Payment to Lehman	Fixed	5.24%
Variable Payment from Lehman	SIFMA	1.78%
Net Interest Rate Swap Payments		3.46%
Variable Rate Bond Coupon Payments		1.60%
Synthetic Interest Rate on Bonds		5.06%

As of June 30, 2008, the swap had a fair value of negative $3,559,488. The fair value was developed by Lehman Brothers. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for London Interbank Offered Rate (LIBOR) due on the date of each future net settlement on the swap.

As of June 30, 2008, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than $1,000,000, at that point Lehman would be required to collateralize 103% of their exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A2 by Moody's, A by S&P, and A+ by Fitch for unsecured long-term debt.

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

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

Wachovia: The University entered into an interest rate swap agreement with Wachovia on December 5, 2006, based on a notional amount of $100,000,000, effective December 1, 2007, maturing in December 1, 2036. The purpose of the transaction was to hedge the risk of rising interest rates for the University's planned issuance of long-term bonds in 2007 and 2009. Due to cash market fixed rates remaining at historically low levels at the time of the General Revenue 2007A issuance, the University decided to issue the bonds as traditional fixed-rate bonds. The University took delivery of the Wachovia swap beginning on December 1, 2007 and uses it as a portfolio hedge for its current variable rate debt, which includes General Revenue 2001 B&C bonds and the University's outstanding balance of Commercial Paper, and for a planned long-term bond issue in 2009.

Under the agreement, Wachovia pays the University 67% of the one-month LIBOR index times the notional amount, payable monthly. The University pays Wachovia a fixed rate of 3.314% on the notional amount, payable monthly. The effective date of this swap was December 1, 2007. As of June 30, 2008, rates were as follows:

Fixed Payment to Wachovia	Fixed	3.314%
Variable Payment from Wachovia	LIBOR	1.648%
Net Interest Rate Swap Payments		1.666%
Weighted Average Variable Rates		1.654%
Synthetic Interest Rate on Bonds		3.320%

As of June 30, 2008, the swap had a fair value of negative $1,124,708.25. The fair value was developed by Wachovia. Market value represents the amount that would be paid to (or received from) another swap dealer to assume the payments under the swap.

As of June 30, 2008, the University was not exposed to credit risk because the swap had a negative fair value. In the event that the swap carried a positive fair value for the University and in the event of a specified ratings downgrade of Wachovia's unsecured long-term debt, Wachovia would be required to post collateral in the amount of the difference between the positive fair value of the swap and the thresholds in the below tables. The University is also subject to the same provisions. Wachovia was rated A+ by S&P, A+ by Fitch and A1 by Moody's.

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

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

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

Future Swaps:

The University entered into an interest rate swap agreement with the Bank of New York for $150,000,000 to be effective December 1, 2009. The University has the option to (1) issue variable rate bonds in December 2009, thereby effectively creating synthetic fixed-rate debt, or (2) unwind the swap, capturing the value of the movement of interest rates from the issuance date and issuing traditional fixed rate bonds.

D. Capital Appreciation Bonds – The University's Series 1997 Utility System and the Series 1991 U. S. Environmental Protection Agency

Project bond issues include capital appreciation bonds with an original issue amount of $30,379,142 and $3,828,921, respectively. These bonds are recorded in the amounts of $53,716,604 ($84,135,000 ultimate maturity less $30,418,396 discount) and $17,618,373 ($25,275,000 ultimate maturity less $7,656,627 discount), respectively, which is the accreted value at June 30, 2008. These bonds mature in the years from 2015 to 2021.

E. **Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2008, are as follows:

	Annual Requirements				
	Bonds Payable			Notes Payable	
Fiscal Year	Principal	Interest	Interest Rate Swaps, Net*	Principal	Interest
2009	$ 24,055,000	$ 44,634,991	$ 706,446	$ 1,037,000	$ 28,362
2010	24,470,000	43,468,243	696,671		
2011	24,905,000	42,650,253	686,378		
2012	25,530,000	41,780,668	675,652		
2013	25,860,000	41,100,393	656,708		
2014-2018	115,725,000	198,398,962	2,835,816		
2019-2023	111,450,000	185,659,041	1,756,383		
2024-2028	129,695,000	163,865,533	316,331		
2029-2033	244,540,000	127,125,906			
2033-2038	354,605,000	28,736,500			
Total Requirements	$ 1,080,835,000	$ 917,420,490	$ 8,330,385	$ 1,037,000	$ 28,362

Interest on the variable rate General Revenue Bonds 2001 B is calculated at 1.60% at June 30, 2008.
Interest on the variable rate General Revenue Bonds 2001 C is calculated at 1.55% at June 30, 2008.

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

*Computed using (5.24% - 1.78%) X $22,000,000 - annual swap reduction)

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

Housing System: On August 30, 2005, the University defeased $6,250,000 of outstanding Housing System Revenue Bonds, Series 1997A. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2008, the outstanding balance of the defeased Housing System, Series 1997A bonds was $0.

Student Union: On August 30, 2005, the University defeased $8,750,000 of outstanding Student Fee Revenue Bonds, Series 2000. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2008, the outstanding balance of the defeased Student Fee Revenue Bonds, Series 2000 bonds was $8,750,000.

General Revenue Bonds, Series 2001A: On August 30, 2005, the University defeased $33,310,000 of outstanding General Revenue Bonds, Series 2001A. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2008, the outstanding balance of the defeased General Revenue Bonds, Series 2001A bonds was $33,310,000.

Student Union: On December 1, 1999, the University defeased $620,000 of outstanding Student Union Revenue Bonds, Series 1967. Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2008, the outstanding balance of the defeased Student Union bonds was $0.

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Beginning Balance 07/01/07	Draws	Repayments	Principal Outstanding 06/30/08
Real Property Purchases	Bank of America	2.74%	06/30/2009	$ 1,362,000	$ 381,891	$ 706,891	$ 1,037,000

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, originally in the aggregate principal amount up to $10,000,000 to finance the costs of projects benefiting the foundation or the University. The line of credit has a maturity date of June 30, 2009. The aggregate principal amount remained at $6,000,000. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 0.275%. An unused commitment fee is due each quarter calculated as 0.25% of the difference between the commitment amount and the average balance outstanding for the quarter through June 30, 2005, and 0.225% thereafter. The University repays draws on the note with capital improvement funds designated for land acquisition.

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

NOTE 9 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to medical and research equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2008:

Fiscal Year	Amount
2009	$ 1,316,499
2010	807,757
2011	496,149
2012	458,508
2013	23,651
Total Minimum Lease Payments	3,102,564
Amount Representing Interest (0.14% - 27.16% Rate of Interest)	298,031
Present Value of Future Lease Payments	$ 2,804,533

Machinery and equipment acquired under capital lease amounted to $3,863,154 at June 30, 2008.

B. Operating Lease Obligations – Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2008:

Fiscal Year		Amount
2009	$	7,030,452
2010		5,688,879
2011		3,964,195
2012		1,265,714
2013		702,100
2014-2018		95,714
Total Minimum Lease Payments	$	18,747,054

Rental expense for all operating leases during the year was $10,513,554.

C. Other Lease Obligations – The UNC-Chapel Hill Foundation issued certificates of participation to provide for construction of alumni facilities. The University constructed the facilities as an agent for the UNC-Chapel Hill Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-Chapel Hill Foundation and simultaneously entered into a sublease agreement with the General Alumni Association, an affiliated organization, for the same time period for the use of the alumni facilities. Legal interpretation of the sublease agreement assigned the debt obligation to the General Alumni Association.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2008, the aggregate principal amount of the certificates was $9,950,000.

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

NOTE 10 - REVENUES

A summary of eliminations and allowances by revenue classification is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Change In Allowance for Uncollectibles	Less Indigent Care and Contractual Adjustments	Net Revenues
Operating Revenues:						
Student Tuition and Fees	$ 275,866,434	$ 0	$ 57,102,949	$ 0	$ 0	$ 218,763,485
Patient Services	$ 562,669,940	$ 0	$ 0	$ (8,455,843)	$ 356,419,953	$ 214,705,830
Sales and Services:						
Residential Life	$ 43,191,328	$ 0	$ 8,417,095	$ 0	$ 0	$ 34,774,233
Dining	22,961,991					22,961,991
Student Union Services	475,039	473,531				1,508
Health, Physical Education, and Recreation Services	6,625,775		354,124			6,271,651
Bookstore	30,407,212	3,304,093	538,479			26,564,640
Parking	21,020,457	102				21,020,355
Athletic	40,465,192	23,382				40,441,810
Utilities	102,836,576	92,479,965	22,622			10,333,989
Telecommunications	17,447,017	13,779,003				3,668,014
Other Professional Income	86,255,397	354,145				85,901,252
Printing/Carolina Copy	6,170,360	5,594,610				575,750
Repairs & Maintenance	31,618,011	29,974,838				1,643,173
Materials Management and Disbursements	24,381,954	24,175,225				206,729
Other	134,777,998	39,770,906				95,007,092
Total Sales and Services	$ 568,634,307	$ 209,929,800	$ 9,332,320	$ 0	$ 0	$ 349,372,187
Nonoperating - Noncapital Gifts	$ 113,602,271	$ 0	$ 0	$ 508,419	$	$ 113,093,852

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	$ 513,701,961	$ 31,255,717	$ 117,099,043	$ 0	$ 171,591	$ 0	$ 662,228,312
Research	216,533,081	43,684,756	97,954,960		25,951		358,198,748
Public Service	37,561,388	3,872,691	54,056,212		128,135		95,618,426
Academic Support	70,426,147	15,417,231	20,660,950		108,865		106,613,193
Student Services	13,622,862	998,825	13,812,168		472		28,434,327
Institutional Support	54,543,782	5,744,288	26,218,500		42,279		86,548,849
Operations and Maintenance of Plant	42,541,068	16,297,464	16,788,498		57,403,626		133,030,656
Student Financial Aid				58,058,259			58,058,259
Auxiliary Enterprises	261,827,157	43,948,250	180,055,437		8,316,312		494,147,156
Depreciation						66,412,469	66,412,469
Total Operating Expenses	$ 1,210,757,446	$ 161,219,222	$ 526,645,768	$ 58,058,259	$ 66,197,231	$ 66,412,469	$ 2,089,290,395

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, 2008, these rates were set at 3.05% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of $1,042,581,959, of which $427,283,896 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were $13,032,159 and $25,637,034, respectively.

Required employer contribution rates for the years ended June 30, 2007, and 2006, were 2.66% and 2.34%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2008, 2007, and 2006, which were $13,032,159, $10,668,088, and $8,587,084, 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 or the trustee responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

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, 2008, 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 current fiscal year, the University had a total payroll of $1,042,581,959, of which $418,479,945 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were $28,624,028 and $25,108,797, 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 $6,413,466 for the year ended June 30, 2008.

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, 2008, were $167,585.32. The voluntary contributions by employees amounted to $3,752,722 for the year ended June 30, 2008.

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 $26,630,282 for the year ended June 30, 2008.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Benefits - The University participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides 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. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by Chapter 135-7, Article 1, and Chapter 135, Article 3, of the General Statutes and may be amended only by the North Carolina General Assembly. The Plan does not provided for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year the University contributed 4.1% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. Required contribution rates for the years ended June 30, 2007, and 2006, were 3.8% and 3.8%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2008, 2007, and 2006, which were $34,676,317, $29,918,690, and $27,155,790, respectively. 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*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.ncosc.net/ and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

B. **Disability Income** - The University participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program . Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2008, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional

Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2007, and 2006, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2008, 2007, and 2006, which were $4,397,972, $4,094,137, and $3,716,056, respectively. 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.

Public Officer's and Employee's Liability Insurance - Tort claims of up to $1,000,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to $5,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

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

Fire and Other Property Loss - The University is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Fire and lightning losses covered by the Fund are subject to a $500 per occurrence deductible, except theft losses are subject to a $1,000 per occurrence deductible. The University also purchases through the Fund extended coverage for all campus buildings and contents with a $500,000 per occurrence deductible. This extended coverage provides insurance against an additional set of perils, most notably for windstorms.

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

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

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

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

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

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

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

Participation in the Trust Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the UNC Hospitals, and any health-care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the UNC Hospitals. Only the UNC P&A and the UNC Hospitals have participated in the Trust Fund to date. Participants provide management and administrative services to the Trust Fund at no cost.

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

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

For the period July 1, 2007, through June 30, 2008, the Trust Fund provided coverage on an occurrence basis of $3,000,000 per individual and $7,000,000 in the aggregate per claim. Effective July 1, 2006, in lieu of purchasing commercial reinsurance, participants contributed approximately $10,000,000 to a reimbursement fund for future losses. Prior to July 1, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer.

For the fiscal year ending June 30, 2008, the Trust Fund purchased a direct insurance policy to cover the first $1,000,000 per occurrence and $3,000,000 in the aggregate for dental residents. *North Carolina General Statutes* Chapter 116 was amended during 1987 to authorize the Trust Fund to borrow necessary amounts up to $30,000,000, in the event that the Trust Fund may have insufficient funds to pay existing and future claims. Any such borrowing would be repaid from the assets and revenues of program participants. No line of credit or borrowing has been established pursuant to this authorization. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

The Trust Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs.

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

At June 30, 2008, University assets in the Trust Fund totaled $38,464,813 while University liabilities totaled $33,643,815 resulting in net assets of $4,820,998.

Additional disclosures about the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund for the years ended June 30, 2008 and 2007. Copies of this report may be obtained from the University of North Carolina Liability Insurance Trust Fund, 4030 Bondurant Hall, CB #7000, Chapel Hill, North Carolina 27599-7000, or by calling (919) 966-1712.

Term life insurance (death benefits) of $25,000 to $50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was .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 commitments of $79,569,212 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

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

On December 14, 2001, the Wake County Superior Court ruled in favor of the plaintiffs but stayed enforcement of the ruling, pending appeal. The defendants appealed this judgment. The Court of Appeals affirmed in part and reversed in part the order of summary judgment by the Superior Court. The North Carolina Supreme Court affirmed the Court of Appeals ruling that library fines are not civil penalties. The North Carolina Supreme Court reversed the ruling that fines for parking and traffic regulations are not civil penalties.

On August 8, 2008 a ruling was made by the Superior Court Division resulting in a judgment entered against the University of North Carolina System for $42,368,982 to be paid into the Civil Penalty and Forfeiture Fund for distribution to the public schools pursuant to G.S. 115C-457.1 and Article IX, Section 7 of the North Carolina Constitution. Settlement of the obligation is being facilitated by the General Assembly.

The University of North Carolina at Chapel Hill, a constituent university of the UNC System, has collected $10,097,719 representing net fines from the Department of Public Safety from January 1, 1996 through June 30, 2005. Of that amount 10% may be retained by the University to fund related operating expenses. Therefore, approximately $9,087,947 may be payable by the University. Collected fines of $3,587,768 remain unexpended. Annual fines are approximately $850,000. Fines net of approved operating expenses have been remitted to the State Treasurer on a monthly basis beginning July 1, 2005.

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

The University is a party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management believes that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

C. **Other Contingent Receivables –** The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied or, in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting principles generally accepted in the United States of America, these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year-end is as follows:

Purpose	Amount
Pledges to permanent endowments	$ 42,211,215

NOTE 16 - RELATED PARTIES

There are 14 separately incorporated nonprofit foundations associated with the University. These foundations are the Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The School of Government Foundation, Inc., The Law Alumni Association of N.C., Inc., The Morehead Scholarship Foundation, Inc., The Pharmacy Foundation of North Carolina, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc., The School of Social Work Foundation, Inc., and Carolina for Kibera, Inc. Some of these organizations serve, in conjunction with the University's component units (See Note 1A), as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support totaled $23,345,891 for the year ended June 30, 2008.

NOTE 17 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2008, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*.

GASB Statement No. 50, *Pension Disclosures*.

GASB Statement No. 45, requires cost-sharing employers to recognize OPEB expense for their contractually required contributions to the plan generally consistent with the approach adopted in GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers, with modifications to reflect differences between pension benefits and OPEB*.

GASB Statement No. 48, requires disclosures pertaining to future revenues that have been pledged in order to disclose information about which revenues will be unavailable for other purposes and how long they will continue to do so.

GASB Statement No. 50, aligns the financial reporting requirements for pensions with those of other postemployment benefits, to conform with GASB Statement No. 45. This Statement amends GASB Statement No. 27 to require note disclosure of the employer contribution rates and percentage of the amount contributed for the current and preceding two years and to disclose how the required contribution rates are established.

NOTE 18 - NET ASSET RESTATEMENT

As of July 1, 2007, net assets as previously reported were restated due to a change in the bylaws of the School of Social Work Foundation. The changed bylaws resulted in the University not appointing a voting majority of the foundation's board. Therefore, to comply with GASB Statement No. 14, *The Financial Reporting Entity*, the University removed the blended amount from the prior year.

	Amount
July 1, 2007 Net Assets as Previously Reported	$ 3,415,868,747
Restatement: Removed blending of the School of Social Work Foundation	(6,832,494)
July 1, 2007 Net Assets as Restated	$ 3,409,036,253

NOTE 19 - SUBSEQUENT EVENTS

On September 29, 2008, UNC Hospitals received approval from the North Carolina Department of Health and Human Services to transfer the completed Physician's Office Building (POB) to the University for use as an academic building. The cost of the POB totaled $28,936,312 and legal transfer of the building will take place during fiscal year 2009.

Effective September 23, 2008, J.P. Morgan Chase replaced Lehman Brothers, Inc. as the remarketing agent for the $54,970,000 General Revenue Series 2001B variable rate demand bonds. Also, any commercial paper outstanding that had been originally placed by Lehman Brothers will be remarketed by Banc of America Securities LLC when the maturities are due. The University is currently evaluating options for its floating-to-fixed rate swap with Lehman Brothers.

Subsequent to the end of the fiscal year, financial markets in the United States and around the world have deteriorated significantly. All of the assets of the Investment Fund are invested in the System Fund. Reflecting the weakness in global markets, the System Fund recorded a negative investment return in the three-month period ended September 30, 2008. Further declines in global financial markets could have a continued adverse impact on future System Fund returns.

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

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

We have audited the financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2008, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 8, 2008. Our report was modified to include a reference to other auditors.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, Statement 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, and Statement 50, *Pension Disclosures*, during the year ended June 30, 2008.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of the discretely presented component units, as described in our report on the University's financial statements. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

<u>Internal Control Over Financial Reporting</u>

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.

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)

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

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

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

<u>Compliance and Other Matters</u>

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

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

Beth A. Wood

Beth A. Wood, CPA
State Auditor

December 8, 2008

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