



STATE OF NORTH CAROLINA

APPALACHIAN STATE UNIVERSITY

BOONE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2008

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

APPALACHIAN STATE UNIVERSITY

BOONE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2008

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THE UNIVERSITY OF NORTH CAROLINA

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STATE OF NORTH CAROLINA
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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of Appalachian State University 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.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements disclosed a deficiency that is detailed in the Audit Findings and Responses section of this report. The University's response is included following our audit finding.

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

Leslie W. Merritt, Jr.

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

December 19, 2008

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Appalachian State University
Boone, North Carolina

We have audited the accompanying financial statements of Appalachian State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component 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 Appalachian State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Appalachian State University Foundation, Inc., or the Appalachian Student Housing Corporation, 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 Appalachian State University Foundation, Inc. and the Appalachian Student Housing Corporation 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 Appalachian State University and its discretely presented component units 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.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 15 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 November 20, 2008, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



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

November 20, 2008

**APPALACHIAN STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Overview of the Financial Statement Information

Appalachian State University is pleased to present its financial statements for fiscal year 2008. These statements are prepared in accordance with Governmental Accounting Standard's Board (GASB). GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, was implemented in fiscal year 2007-2008 and those requirements are disclosed in Note 7B within the Notes to the Financial Statements.

Statement of Net Assets

The Statement of Net Assets (condensed, comparative table presented within this discussion and analysis) presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. It provides readers with information on the assets available to continue operations, and the amounts owed to vendors, investors, and lending institutions. The change in net assets (assets minus liabilities) from year to year is an indicator of the financial condition of the institution. Restricted nonexpendable net assets consist of loan funds and endowment gifts with specific restrictions on spending the principal. Restricted expendable net assets consist of income from endowment funds, gifts and pledges with specific restrictions, unexpended bond proceeds and grants from third party agencies with expenditure restrictions.

Prominent changes in the Statement of Net Assets include an increase of \$52,937,901.42 of Total Assets. This is primarily due to an increase of \$33,321,929.25 in Capital Assets - Nondepreciable and an increase of \$10,099,602.97 in Capital Assets-Depreciable. The increase in nondepreciable capital assets was primarily due to the increase of \$27,226,313.43 in construction in progress for athletic facilities, the new dining facility, renovations to residence facilities, and upgrades to the steam distribution system. Land acquisitions for the future College of Education, the First Presbyterian Church property, and Hickory Technology Center totaling \$5,748,853.57 also contributed to the increase in nondepreciable capital assets. The increase in depreciable capital assets was a result of construction projects placed into service and acquisitions of assets. The most notable being capitalized costs related to the renovation to Hoey Residence Hall for \$7,056,505.76, significant parking area improvements for \$3,057,867.37, the completion of a pedestrian bridge for \$1,598,856.08, and the purchase of the First Presbyterian Church building for \$3,303,466.96.

The decrease in Restricted Due from Primary Government is due to the decreased receivable as of June 30, 2008, in the University's share of the North Carolina General Obligation Bonds of \$966,059.00 and a decrease in receivables for Repairs and Renovations appropriation totaling \$280,263.11.

The net increase of \$38,038,809.30 in Total Liabilities was due primarily to the issuance of \$32,470,000.00 in new bonds for construction projects, a new note payable of \$4,750,000.00

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

for purchase of property and increases in current accounts payable of \$4,978,989.15, less the current year debt service \$6,045,000.00 (See the Capital Asset and Debt Administration discussion below).

Invested in Capital Assets - Net of Related Debt increased \$18,827,971.56 which represents the actual increase in net capital assets of \$45,829,880.18 less the increase in related debt.

The increase in restricted nonexpendable net assets of \$1,126,168.90 was due primarily to the addition of the Roy Carroll Endowed Professorship of \$1,000,000.00 and the addition of the James Neal Endowed Scholarship of \$100,000.00. The decrease in restricted expendable net assets of \$2,197,036.29 was primarily due to a decrease in the expendable capital projects. Overall, Appalachian had an increase of \$14,899,092.12 in Total Net Assets.

Condensed Statement of Net Assets

	<u>Fiscal Year 2008</u>	<u>Fiscal Year 2007</u>	<u>\$ Change</u>	<u>% Change</u>
Assets				
Current Assets	\$ 93,055,795.37	\$ 89,174,089.42	\$ 3,881,705.95	4.4
Noncurrent Assets				
Restricted Cash and Cash Equivalents	31,406,423.41	24,487,944.63	6,918,478.78	28.3
Restricted Due From Primary Government	301,523.35	1,547,845.46	(1,246,322.11)	(80.5)
Capital Assets - Nondepreciable	83,591,262.17	50,269,332.92	33,321,929.25	66.3
Capital Assets - Depreciable	323,376,069.74	313,276,466.77	10,099,602.97	3.2
Other	19,632,663.44	19,670,156.86	(37,493.42)	(0.2)
Total Assets	<u>551,363,737.48</u>	<u>498,425,836.06</u>	<u>52,937,901.42</u>	<u>10.6</u>
Liabilities				
Current Liabilities	37,605,982.88	29,023,178.53	8,582,804.35	29.6
Funds Held Others	161,231.32	177,618.79	(16,387.47)	(9.2)
Long-Term Liabilities	182,591,745.00	153,088,322.48	29,503,422.52	19.3
Other Noncurrent Liabilities	4,076,669.71	4,107,699.81	(31,030.10)	(0.8)
Total Liabilities	<u>224,435,628.91</u>	<u>186,396,819.61</u>	<u>38,038,809.30</u>	<u>20.4</u>
Net Assets				
Invested in Capital Assets - Net of Related Debt	257,064,965.73	238,236,994.17	18,827,971.56	7.9
Restricted				
Nonexpendable	7,912,805.52	6,786,636.62	1,126,168.90	16.6
Expendable	14,002,519.89	16,199,556.18	(2,197,036.29)	(13.6)
Unrestricted	47,947,817.43	50,805,829.48	(2,858,012.05)	(5.6)
Total Net Assets	<u>\$ 326,928,108.57</u>	<u>\$ 312,029,016.45</u>	<u>\$ 14,899,092.12</u>	<u>4.8</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets (condensed, comparative table presented on the next page) depicts operating and nonoperating revenues and expenses. Note that State appropriations are considered nonoperating revenues.

In Operating Revenues, Grants and Contracts increased 128.5% due primarily to the addition of the UNC Need Based Grant, the NC Student Incentive Grant, and the Education Lottery Grant totaling \$9,604,245.00, an increase in Pell Grants of \$1,095,712.00 and an increase of nongovernmental grants totaling \$1,748,320.62. Sales and Services increased \$1,428,239.79 or 2.2% due to rate and population increases.

In total, Operating Expenses grew by \$32,293,678.44 representing a 12.1% overall increase. Salaries and Benefits increased from \$163,414,766.63 to \$182,300,477.92 or 11.6%. The increase is primarily due to State employees receiving an overall 4% pay increase this year, adjustments for Career Banding, and the addition of new positions. Supplies and Materials were \$41,135,065.99 this year as compared to \$35,563,080.18 for last year, an increase of 15.7%. Services increased 3.0%, to \$32,140,442.50 as opposed to \$31,180,223.16 last year. Scholarships and Fellowships increased 46% due primarily to the addition of the UNC Need Based Scholarship, the NC Student Incentive Grant, and the Education Lottery Scholarship. Utilities increased 8.0% from \$13,977,195.21 to \$15,093,426.10. Finally, Depreciation increased 8% from \$13,674,991.00 to \$14,764,893.92. These changes and subsequent trends are primarily due to the increase in student population, expansion of services, and other business increases for a continually growing University.

In Nonoperating Revenues, Appalachian State experienced an increase in State Appropriations of \$16,139,059.07 for a 14.1% change. This increase is due to enrollment growth and additional funding for labor. Other Nonoperating Revenues decreased \$5,820,441.60 or 27%. Investment Income decreased \$2,362,984.09 due to an unfavorable economic climate and Interest and Fees on Debt increased \$1,362,929.11 due to additional borrowing. (See the Capital Asset and Debt Administration discussion below).

The Other Revenues section consists of Capital Grants, Capital Appropriations, and Capital Gifts. Other Revenues decreased by a total of \$7,994,977.25 or 40.7%. Capital Grants derived from the 2000 North Carolina General Obligation Bonds issue decreased by \$6,484,382.90, as related projects are nearing completion.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	Fiscal Year 2008	Fiscal Year 2007	\$ Change	% Change
Operating Revenues				
Tuition and Fees	\$ 68,610,406.18	\$ 67,341,829.49	\$ 1,268,576.69	1.9
Grants and Contracts	22,238,054.36	9,731,653.45	12,506,400.91	128.5
Sales and Services, Net	64,961,211.93	63,532,972.14	1,428,239.79	2.2
Interest Earnings on Loans	13,238.56	21,031.58	(7,793.02)	(37.1)
Other Operating Revenues	1,410,165.23	890,758.53	519,406.70	58.3
Total Operating Revenues	157,233,076.26	141,518,245.19	15,714,831.07	11.1
Salaries and Benefits	182,300,447.92	163,414,766.63	18,885,681.29	11.6
Supplies and Materials	41,135,065.99	35,563,080.18	5,571,985.81	15.7
Services	32,140,442.50	31,180,223.16	960,219.34	3.1
Scholarships and Fellowships	14,832,203.35	10,162,545.16	4,669,658.19	45.9
Utilities	15,093,426.10	13,977,195.21	1,116,230.89	8.0
Depreciation	14,764,893.92	13,674,991.00	1,089,902.92	8.0
Operating Expenses	300,266,479.78	267,972,801.34	32,293,678.44	12.1
Operating Loss	(143,033,403.52)	(126,454,556.15)	(16,578,847.37)	(13.1)
Nonoperating Revenues				
State Appropriations	130,572,749.07	114,433,690.00	16,139,059.07	14.1
Other Nonoperating Revenues	15,734,471.04	21,554,912.64	(5,820,441.60)	(27.0)
Net Nonoperating Revenues	146,307,220.11	135,988,602.64	10,318,617.47	7.6
Income Before Other Revenues	3,273,816.59	9,534,046.49	(6,260,229.90)	65.7
Capital Grants	419,203.42	6,903,586.32	(6,484,382.90)	(93.9)
Capital Appropriations	7,596,700.00	6,727,000.00	869,700.00	12.9
Capital Gifts	2,509,372.11	5,989,666.46	(3,480,294.35)	(58.1)
Additions to Endowments	1,100,000.00	1,100,000.00	1,100,000.00	100.0
Total Other Revenues	11,625,275.53	19,620,252.78	(7,994,977.25)	(40.7)
Total Increase in Net Assets	14,899,092.12	29,154,299.27	(14,255,207.15)	(48.9)
Net Assets				
Net Assets at Beginning of Year, as Restated	312,029,016.45	282,874,717.18	29,154,299.27	10.3
Net Assets at End of Year	\$ 326,928,108.57	\$ 312,029,016.45	\$ 14,899,092.12	4.8

Economic Outlook

The University experienced a growth in net assets of \$14,899,092.12 for the year. This increase was mainly due to the \$16,139,059.07 increase in State appropriations. Consistent

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

with the trend throughout most of the country, North Carolina's revenue collections slowed considerably in 2007-08. Total General Fund revenue collections totaled \$19,825.7 million in 2007-08, only 1.9% above 2006-07. This modest growth was anticipated by the 2007-08 revenue forecast as revenue collections exceeded expectations by \$70.0 million (0.3%).

Capital Asset and Debt Administration

On April 2, 2008, the University participated in the UNC System Pool Revenue Bonds, (2008A Pool General Trust Indenture) Series 2008A issue totaling \$51,700,000.00. Debt proceeds of \$32,225,000.00 were deposited for the following: \$8,520,000.00 for the renovation of Cannon Residence Hall, \$3,350,000.00 for stadium parking lot improvements, and \$20,600,000.00 for improvements to athletic facilities. The proceeds also provided \$19,230,000.00 for an advanced refunding which is discussed in the Notes to the Financial Statements Note 7D. The refunding was undertaken to reduce total debt service payments by \$1,526,937.47 over the next fifteen years and resulted in an economic gain of \$684,606.74.

Capitalized assets placed into service consisted of further capitalized costs of \$3,057,867.37 for stadium parking facilities improvements and \$7,056,505.76 for the renovation of residence facilities.

Other major capital projects (not funded through the University-wide bond issue) to be completed in the near future:

- The new Owens Field House (Athletic Facility at Kidd Brewer Stadium) currently under construction and scheduled to be completed in Fall 2009. This total project includes an indoor practice facility, a baseball facility, a women's softball field and improvements to Varsity Gymnasium. The expansion of the East Stands in Kidd Brewer Stadium is also nearing completion. The total Athletic Facilities project has an estimated cost of \$59,563,000.00.
- The Wellborn Dining Hall replacement is expected to be completed in December 2008. The estimated cost for this project is \$30,951,440.00.
- The \$8,400,000.00 renovation of Cannon residence hall is nearing completion. Frank residence hall will begin renovation in fiscal year 2008-2009 for approximately \$8,000,000.00. The funding for additional residence hall renovation projects will require external financing of approximately \$25,600,000.00 over the next three years.

The new Student Residential, Learning, and Activity Development Center is currently in the advanced planning stage. This project is not funded through the University-wide bond issue. The project will renovate the existing 58,800 square foot Cone residence hall, construct a new 110,000 square foot, 350 bed residence hall and expand the adjacent Student Union by adding a 61,000 square-foot addition. The new residence hall will provide a living-learning environment that enhances the student learning experience by co-mingling classrooms, faculty offices, and a computer lab within the traditional residence hall setting. The new Student Union will provide additional student activity and academic space to support the new complex and the campus. This project is estimated to cost \$63,726,000.00, including

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

\$7,360,000.00 for the Academic portion. Advance Planning authorization of \$6,400,000.00, to be funded from housing receipts, will be requested during the 2008 session.

Total annual debt service payments were \$14,811,183.74 in 2008 compared to \$12,428,450.61 last year. There were increases in payments on bonds and interest and fees on debt.

Appalachian State University
Statement of Net Assets
June 30, 2008

Exhibit A-1

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 65,301,207.14
Restricted Cash and Cash Equivalents	8,610,755.90
Receivables, Net (Note 4)	9,210,395.32
Due from State of North Carolina Component Units	974,673.00
Due from University Component Units	154,986.40
Inventories	8,048,559.96
Notes Receivable (Note 4)	755,217.65
	<hr/>
Total Current Assets	93,055,795.37
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	31,406,423.41
Restricted Due from Primary Government	301,523.35
Endowment Investments	7,448,158.07
Other Investments	8,893,242.42
Notes Receivable, Net (Note 4)	3,291,262.95
Capital Assets - Nondepreciable (Note 5)	83,591,262.17
Capital Assets - Depreciable, Net (Note 5)	323,376,069.74
	<hr/>
Total Noncurrent Assets	458,307,942.11
	<hr/>
Total Assets	551,363,737.48

LIABILITIES

Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	16,885,170.47
Due to Primary Government	106,259.62
Unearned Revenue	8,777,584.11
Interest Payable	2,562,920.79
Long-Term Liabilities - Current Portion (Note 7)	9,274,047.89
	<hr/>
Total Current Liabilities	37,605,982.88
Noncurrent Liabilities:	
Deposits Payable	251,205.49
Funds Held for Others	161,231.32
U. S. Government Grants Refundable	3,825,464.22
Long-Term Liabilities (Note 7)	182,591,745.00
	<hr/>
Total Noncurrent Liabilities	186,829,646.03
	<hr/>
Total Liabilities	224,435,628.91

Appalachian State University
Statement of Net Assets
June 30, 2008

Exhibit A-1

Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	257,064,965.73
Restricted for:	
Nonexpendable:	
Research	20,000.00
Endowed Professorships	7,428,158.07
Loans	464,647.45
Expendable:	
Scholarships and Fellowships	270,646.35
Research	15,002.63
Endowed Professorships	2,076,150.39
Departmental Uses	2,503,142.21
Debt Service	9,137,578.31
Unrestricted	47,947,817.43
Total Net Assets	<u>\$ 326,928,108.57</u>

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

***Appalachian State University
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 9)	\$ 68,610,406.18
Federal Grants and Contracts	8,698,946.64
State and Local Grants and Contracts	10,882,671.20
Nongovernmental Grants and Contracts	2,656,436.52
Sales and Services, Net (Note 9)	64,961,211.93
Interest Earnings on Loans	13,238.56
Other Operating Revenues	1,410,165.23

Total Operating Revenues	157,233,076.26
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EXPENSES

Operating Expenses:

Salaries and Benefits	182,300,447.92
Supplies and Materials	41,135,065.99
Services	32,140,442.50
Scholarships and Fellowships	14,832,203.35
Utilities	15,093,426.10
Depreciation	14,764,893.92

Total Operating Expenses	300,266,479.78
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Operating Loss	(143,033,403.52)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	130,572,749.07
Noncapital Grants	12,644,538.52
Noncapital Gifts	6,165,137.81
Investment Income	4,032,668.44
Interest and Fees on Debt	(8,249,872.34)
Other Nonoperating Revenues	1,141,998.61

Net Nonoperating Revenues	146,307,220.11
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Income Before Other Revenues, Expenses, Gains, or Losses	3,273,816.59
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Capital Appropriations	7,596,700.00
Capital Grants	419,203.42
Capital Gifts	2,509,372.11
Additions to Endowments	1,100,000.00

Increase in Net Assets	14,899,092.12
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NET ASSETS

Net Assets - July 1, 2007, as Restated (Note 16)	312,029,016.45
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Net Assets - June 30, 2008	\$ 326,928,108.57
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The accompanying notes to the financial statements are an integral part of this statement.

Appalachian State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 155,126,977.98
Payments to Employees and Fringe Benefits	(181,018,875.56)
Payments to Vendors and Suppliers	(87,838,512.11)
Payments for Scholarships and Fellowships	(14,832,203.35)
Loans Issued	(637,383.00)
Collection of Loans	627,197.32
Interest Earned on Loans	3,732.98
Other Receipts	1,410,165.23
	<hr/>
Net Cash Used by Operating Activities	(127,158,900.51)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	130,572,749.07
Noncapital Grants	12,661,904.39
Noncapital Gifts	5,580,621.22
Additions to Endowments	1,100,000.00
Related Activity Agency Receipts	17,012,484.87
Related Activity Agency Disbursements	(17,028,872.34)
Other Payments	(287,258.62)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	149,611,628.59

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	52,581,965.25
State Capital Appropriations	7,596,700.00
Capital Grants	1,665,525.53
Capital Gifts	1,708,005.64
Proceeds from Sale of Capital Assets	47,541.72
Acquisition and Construction of Capital Assets	(50,424,918.09)
Principal Paid on Capital Debt and Leases	(25,651,311.40)
Interest and Fees Paid on Capital Debt and Leases	(7,591,877.17)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(20,068,368.52)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	259,000.00
Investment Income	4,974,062.05
Purchase of Investments and Related Fees	(1,100,000.00)
	<hr/>
Net Cash Provided by Investing Activities	4,133,062.05
	<hr/>
Net Increase in Cash and Cash Equivalents	6,517,421.61
Cash and Cash Equivalents - July 1, 2007	98,800,964.84
	<hr/>
Cash and Cash Equivalents - June 30, 2008	\$ 105,318,386.45

Appalachian State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008

Exhibit A-3

Page 2

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

Operating Loss	\$ (143,033,403.52)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	14,764,893.92
Allowances, Write-Offs, and Amortizations	239,282.33
Nonoperating Other Income	584,516.59
Changes in Assets and Liabilities:	
Receivables (Net)	(2,021,968.21)
Due from State of North Carolina Component Units	(139,688.40)
Inventories	(135,401.77)
Accounts Payable and Accrued Liabilities	603,366.90
Due to Primary Government	(101,870.73)
Unearned Revenue	1,318,982.46
Arbitrage Rebate Payable	6,501.37
Compensated Absences	854,882.48
Deposits Payable	(2,354.99)
Note Principal Repayments	540,744.06
Notes Issued	(637,383.00)
	<u>(637,383.00)</u>
Net Cash Used by Operating Activities	<u>\$ (127,158,900.51)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 65,301,207.14
Restricted Cash and Cash Equivalents	8,610,755.90
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>31,406,423.41</u>
Total Cash and Cash Equivalents - June 30, 2008	<u>\$ 105,318,386.45</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired Through a Gift	\$ 954,436.57
Change in Fair Value of Investments	(1,343,097.87)
Reinvested Distributions	738,662.68
Loss on Disposal of Capital Assets	351,876.25
Bond Issuance Cost Withheld	921,740.25

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

Appalachian State University Foundation, Inc.
Statement of Financial Position
June 30, 2008

Exhibit B-1

ASSETS	
Cash and Cash Equivalents	\$ 511,702
Contributions Receivable	7,242,082
Other Receivables	154,101
Prepaid Expenses	20,576
Investments	71,858,101
Real Estate Held for Investment	10,154,146
Contributions Receivable from Trusts	1,596,573
Contributions Receivable from Irrevocable Bequests	278,308
Cash Surrender Value of Life Insurance	166,881
In-Kind Gifts	25,053
Property and Equipment, Net	4,432,780
	<hr/>
Total Assets	96,440,303
	<hr/>
LIABILITIES	
Accounts Payable and Accrued Expenses	20,483
Deferred Revenue - Advance Royalties	524,481
Deposits Payable	9,613
Notes Payable to University	5,838,655
Grants Payable to University	154,986
Split Interest Agreement Obligations	2,515,148
	<hr/>
Total Liabilities	9,063,366
	<hr/>
NET ASSETS	
Unrestricted	7,960,763
Temporarily Restricted	27,326,107
Permanently Restricted	52,090,067
	<hr/>
Total Net Assets	\$ 87,376,937
	<hr/> <hr/>

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

Appalachian State University Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2008

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, LOSSES AND OTHER SUPPORT				
Contributions	\$ 621,027	\$ 10,469,579	\$ 8,384,579	\$ 19,475,185
Investment Income	1,069,851	656,153	(4,296)	1,721,708
Auxiliary Income	153,634	126,843		280,477
Net Unrealized and Realized Losses on Investments	(232,293)	(3,181,691)	(129,372)	(3,543,356)
Net Change in Split Interest Agreement Obligations		(97,509)	(54,291)	(151,800)
Other Income	9,515	(3,874)		5,641
Subtotal	1,621,734	7,969,501	8,196,620	17,787,855
Net Assets Released from Restrictions	8,514,608	(8,514,608)		
Total Revenues, Gains, Losses, and Other Support	10,136,342	(545,107)	8,196,620	17,787,855
EXPENSES				
Program Services:				
General University Support	6,904,113			6,904,113
Student Financial Aid	1,904,794			1,904,794
Alumni Affairs	195,576			195,576
Other	495,149			495,149
Total Program Services	9,499,632			9,499,632
Supporting Services:				
General and Administrative	97,604			97,604
Fund Raising	615,407			615,407
Total Supporting Services	713,011			713,011
Total Expenses	10,212,643			10,212,643
Net (Increase) Decrease in Allowance for Doubtful Contributions Receivable		(283,728)	22,963	(260,765)
Increase (Decrease) in Net Assets	(76,301)	(828,835)	8,219,583	7,314,447
NET ASSETS				
Net Assets, Beginning	8,037,064	28,154,942	43,870,484	80,062,490
Net Assets, Ending	<u>\$ 7,960,763</u>	<u>\$ 27,326,107</u>	<u>\$ 52,090,067</u>	<u>\$ 87,376,937</u>

Appalachian Student Housing Corporation
Statement of Financial Position
June 30, 2008

Exhibit B-3

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 2,186,377
Accounts Receivable, Net of allowances for doubtful accounts of \$13,609	9,520
Sales Tax Refund Receivable	9,089
Prepaid expenses	86,830
	<hr/>
Total Current Assets	2,291,816
Property and Equipment, Net	<hr/> 19,901,869
Other Assets:	
Deferred Financing Cost, Net	185,473
Assets limited as to Use by Bond Order	4,427,994
	<hr/>
Total Other Assets	4,613,467
	<hr/>
Total Assets	<u>\$ 26,807,152</u>

LIABILITIES

Current:	
Current Portion of Long-Term Debt	\$ 470,000
Accounts Payable	311,100
Accrued Expenses	59,636
Accrued Interest	26,784
Deferred Income	46,775
	<hr/>
Total Current Liabilities	914,295
	<hr/>
Long-Term Debt, Less Current Portion	19,780,000
	<hr/>
Total Liabilities	<hr/> 20,694,295

NET ASSETS

Unrestricted	<hr/> 6,112,857
Total Liabilities and Net Assets	<u>\$ 26,807,152</u>

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

Appalachian Student Housing Corporation
Statement of Activities
For the Fiscal Year Ended June 30, 2008

Exhibit B-4

REVENUES AND OTHER SUPPORT

Net Rental Income	\$ 4,064,132
Other Operating Revenues	98,988
	<hr/>
Total Revenues and Other Support	4,163,120
	<hr/>

EXPENSES

Salaries and Benefits	343,378
Purchased Services	75,650
Communications and Service Contacts	62,019
Professional Fees	19,241
Building	73,630
Utilities	498,993
Letter of Credit	195,398
Licenses and Fees	8,100
Insurance	73,495
Renovation	92,704
Depreciation	588,937
Amortization	61,886
Interest	599,849
Bond Remarketing Fees	17,323
Taxes	134,870
Advertising	17,624
Other	167,493
	<hr/>

Total Expenses	3,030,590
	<hr/>

Other Interest Income	229,267
	<hr/>

Increase (Decrease) in Unrestricted Net Assets	1,361,797
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NET ASSETS

Beginning of Year	4,751,060
	<hr/>
End of Year	\$ 6,112,857
	<hr/> <hr/>

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APPALACHIAN STATE UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2008

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

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are discretely presented in the University's financial statements. 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.

Discretely Presented Component Units – The Appalachian State University Foundation, Inc. and the Appalachian Student Housing Corporation are legally separate not-for-profit corporations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Appalachian State University Foundation, Inc. is a legally separate, tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 26 self-perpetuating members of which four members are administrative officers of the University. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The Appalachian Student Housing Corporation is a legally separate, tax-exempt component unit of the University. The Corporation's primary function is to develop, finance, prepare, provide, and supervise residential housing facilities for college and University students and employees of Appalachian State University. The Corporation's board consists of six members of which two members are administrative officers of the University. Because the Corporation's sole purpose is to benefit the University, it is considered a component unit of the University and is reported in separate financial statements due to the difference in its reporting model, as described below.

The Appalachian State University Foundation, Inc. and the Appalachian Student Housing Corporation are private not-for-profit 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 the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the component units' financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2008, the Foundation distributed \$8,808,907.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Vice Chancellor for University Advancement or the ASU Foundation President. The financial statements of the Corporation may be obtained from the Vice Chancellor for Student Development. The address is: Dougherty Administration Building, 438 Academy Street, Boone, NC 28608.

- 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 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** - Investments generally are reported at fair value, as determined by quoted market prices or an estimated amount determined by management if quoted market prices are not available. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Real estate investment and other asset holdings are reported at cost, if purchased or at fair value or appraised value at date of gift, if donated.

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

or for a specified period of time, 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 for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** – Inventories, consisting of expendable supplies, are valued at cost using first-in, first-out method. Merchandise for resale is valued using the retail inventory method. Rental textbooks are recorded at cost using first-in, first-out method.
- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 25 years for general infrastructure, 10 to 50 years for buildings, and 5 to 25 years for equipment.

The scientific, art and historical collections are capitalized at cost or fair value at the date of donation. These collections are depreciated over the life of the collection using the straight-line method. The estimated useful lives for the collections are 20 years.

- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Bonds payable are reported net of deferred losses on refunds. The deferred losses on refunds are amortized over the life of the new debt using the straight-line method. Issuance costs are expensed.

- K. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.

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

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

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2008, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$102,795,586.48 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$462,308.87. The carrying amount of the University's deposits not with the State Treasurer was \$2,060,491.10 and the bank balance was \$2,244,989.15. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2008, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	<u>\$ 1,984,397.70</u>
--------------------------------	------------------------

B. Investments

University - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

Investments are subject to the following risks.

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

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

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

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the percentage method. Under this method, each participating fund's investment balance is determined on percentage of original investment. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)	
		1 to 5	6 to 10
Debt Securities			
Mutual Bond Funds	\$ 5,251,163.84	<u>\$ 3,161,261.24</u>	<u>\$ 2,089,902.60</u>
Other Securities			
International Mutual Funds	1,462,000.76		
Other Mutual Funds	<u>7,068,604.21</u>		
Total Long-Term Investment Pool	<u>\$ 13,781,768.81</u>		

At June 30, 2008, investments in the Long-Term Investment Pool included \$5,251,163.84 in Mutual Bond Funds with credit exposure for which Standard and Poors' credit quality distribution was AA.

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, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturity
		(in Years) Less Than 1
Debt Securities		
Money Market Mutual Funds	\$ 2,460,443.96	<u>\$ 2,460,443.96</u>
Other Securities		
Other Mutual Funds	16,917.95	
Real Estate Investment Trust	5,069.40	
Domestic Stocks	76,200.37	
Other	<u>1,000.00</u>	
Total Non-Pooled Investments	<u>\$ 2,559,631.68</u>	

At June 30, 2008, the University's non-pooled investments included \$2,460,443.96 in money market mutual funds with credit exposure for which Standard and Poors' credit quality distribution was AAAM.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2008, the University's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty's Trust Dept or Agent not in University's Name
Closed-End Mutual Funds	\$ 16,917.95
Domestic Stocks	76,200.37
Total	\$ 93,118.32

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

Investment Type	Fair Value
Debt Securities	
Mutual Bond Funds	\$ 5,251,163.84
Money Market Funds	2,460,443.96
Other Securities	
International Mutual Funds	1,462,000.76
Other Mutual Funds	7,085,522.16
Real Estate Investment Trust	5,069.40
Domestic Stocks Held by Counterparty	76,200.37
Other	1,000.00
Total Investments	\$ 16,341,400.49

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Short-Term Investment Fund	\$ 15,323,288.00
Money Market Funds	701,717.00
Equity Investments	27,955,273.00
Fixed Income Investments	11,093,021.00
Alternative Investments	<u>16,784,802.00</u>
	71,858,101.00
Real Estate Held for Resale	<u>10,154,146.00</u>
Total Investments	<u><u>\$ 82,012,247.00</u></u>

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which limits spending to 5% of an individual endowment account's net asset value at the end of the previous year. An earnings reserve must be held in each endowment account in an amount equal to 5% of the original contribution. Earnings in excess of the reserve amount as calculated at the end of each fiscal year are eligible for pay out. Realized and unrealized net capital losses that invade the corpus amounts are recovered from accumulated income before any spending budgets are calculated. Subject to these limitations, the budgeted spending amount will be based on the net asset value of each individual endowment fund. At June 30, 2008, net appreciation \$1,738,581.32 of which \$400,847.30 was available to be spent and was restricted to specific purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2008, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 2,867,588.19	\$ 617,809.10	\$ 2,249,779.09
Accounts	5,034,468.90	34,644.99	4,999,823.91
Intergovernmental	1,876,241.30		1,876,241.30
Interest on Loans	84,551.02		84,551.02
Total Current Receivables	<u>\$ 9,862,849.41</u>	<u>\$ 652,454.09</u>	<u>\$ 9,210,395.32</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 752,866.65	\$ 0.00	\$ 752,866.65
Institutional Student Loan Programs	2,351.00		2,351.00
Total Notes Receivable - Current	<u>\$ 755,217.65</u>	<u>\$ 0.00</u>	<u>\$ 755,217.65</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 3,561,125.67</u>	<u>\$ 269,862.72</u>	<u>\$ 3,291,262.95</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2007 (as restated)	Increases	Decreases	Balance June 30, 2008
Capital Assets, Nondepreciable:				
Land	\$ 15,106,111.31	\$ 5,748,853.57	\$ 0.00	\$ 20,854,964.88
Construction in Progress	35,163,221.61	41,241,417.16	13,668,341.48	62,736,297.29
Total Capital Assets, Nondepreciable	<u>50,269,332.92</u>	<u>46,990,270.73</u>	<u>13,668,341.48</u>	<u>83,591,262.17</u>
Capital Assets, Depreciable:				
Buildings	383,102,491.65	13,414,896.12	122,907.72	396,394,480.05
Machinery and Equipment	38,337,463.62	5,481,894.62	2,418,074.31	41,401,283.93
Art, Literature, and Artifacts	1,777,428.57	302,601.75		2,080,030.32
General Infrastructure	47,772,159.86	8,472,870.33	159,490.88	56,085,539.31
Total Capital Assets, Depreciable	<u>470,989,543.70</u>	<u>27,672,262.82</u>	<u>2,700,472.91</u>	<u>495,961,333.61</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	122,557,036.38	10,270,747.31	122,907.72	132,704,875.97
Machinery and Equipment	26,126,802.36	2,833,858.39	2,125,640.59	26,835,020.16
Art, Literature, and Artifacts	969,867.61	137,696.68		1,107,564.29
General Infrastructure	10,467,718.54	1,522,591.54	52,506.63	11,937,803.45
Total Accumulated Depreciation	<u>160,121,424.89</u>	<u>14,764,893.92</u>	<u>2,301,054.94</u>	<u>172,585,263.87</u>
Total Capital Assets, Depreciable, Net	<u>310,868,118.81</u>	<u>12,907,368.90</u>	<u>399,417.97</u>	<u>323,376,069.74</u>
Capital Assets, Net	<u>\$ 361,137,451.73</u>	<u>\$ 59,897,639.63</u>	<u>\$ 14,067,759.45</u>	<u>\$ 406,967,331.91</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 11,570,896.65
Accrued Payroll	2,757,903.95
Contract Retainage	2,511,929.75
Intergovernmental Payables	44,440.12
Total Accounts Payable and Accrued Liabilities	<u>\$ 16,885,170.47</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2008, is presented as follows:

	Balance July 1, 2007	Additions	Reductions	Balance June 30, 2008	Current Portion
Revenue Bonds Payable	\$ 151,550,000.00	\$ 51,700,000.00	\$ 25,135,000.00	\$ 178,115,000.00	\$ 6,045,000.00
Deduct Deferred Charge on Refunding	(2,348,479.79)	(345,225.00)	(162,428.67)	(2,531,276.12)	
Total Bonds Payable	149,201,520.21	51,354,775.00	24,972,571.33	175,583,723.88	6,045,000.00
Notes Payable	2,198,153.68	4,750,000.00	516,311.40	6,431,842.28	2,198,508.28
Arbitrage Rebate Payable		6,501.37		6,501.37	
Compensated Absences	8,988,842.88	6,144,729.01	5,289,846.53	9,843,725.36	1,030,539.61
Total Long-Term Liabilities	\$ 160,388,516.77	\$ 62,256,005.38	\$ 30,778,729.26	\$ 191,865,792.89	\$ 9,274,047.89

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2008	Principal Outstanding June 30, 2008	See Table Below
Revenue Bonds Payable							
Housing and Student Center System							
ASU Housing and Student Center System Revenue Bonds	2001	5.23%	07/15/2027	\$ 6,680,000.00	\$ 945,000.00	\$ 5,735,000.00	3
ASU Housing and Student Center System Revenue Refunding Bonds	2002	4.30%	07/15/2015	13,240,000.00	3,985,000.00	9,255,000.00	3
Total Housing and Student Center System				<u>19,920,000.00</u>	<u>4,930,000.00</u>	<u>14,990,000.00</u>	
Student Union System							
ASU Student Fee Revenue Refunding Bonds Student Union Building	1998	4.87%	05/15/2012	8,050,000.00	5,145,000.00	2,905,000.00	1
Utility System							
ASU Utility System Revenue Refunding Bonds	1998	5.29%	05/15/2024	27,535,000.00	23,320,000.00	4,215,000.00	2
The University of North Carolina System Pool Revenue Bonds							
Doughton Renovation	(A)	5.02%	04/01/2027	4,940,000.00	4,340,000.00	600,000.00	
Broyhill Inn	(B)	3.82%	10/01/2015	990,000.00	95,000.00	895,000.00	
Doughton Renovation	(B)	4.27%	10/01/2026	3,755,000.00	5,000.00	3,750,000.00	
Dining Hall	(B)	4.38%	05/01/2031	23,330,000.00	515,000.00	22,815,000.00	
Hoey Hall Renovation	(B)	4.25%	10/01/2026	6,980,000.00	220,000.00	6,760,000.00	
Student Recreation Center	(B)	4.13%	10/01/2021	7,680,000.00		7,680,000.00	
Utility System	(C)	4.28%	10/01/2023	19,230,000.00		19,230,000.00	
Cannon Hall	(C)	4.69%	10/01/2033	8,520,000.00		8,520,000.00	
Parking-Stadium	(C)	4.69%	10/01/2033	3,350,000.00		3,350,000.00	
New Field House Complex	(C)	4.69%	10/01/2033	20,600,000.00		20,600,000.00	
Total The University of North Carolina System Pool Revenue Bonds				<u>99,375,000.00</u>	<u>5,175,000.00</u>	<u>94,200,000.00</u>	
ASU General Revenue Bonds							
ASU General Revenue Bonds Student Recreation Center	2003A	4.48%	05/01/2028	25,635,000.00	11,055,000.00	14,580,000.00	
ASU General Revenue Bonds Housing, Athletics, Parking	2005	4.54%	07/15/2030	50,915,000.00	3,690,000.00	47,225,000.00	
Total General Revenue Bonds				<u>76,550,000.00</u>	<u>14,745,000.00</u>	<u>61,805,000.00</u>	
Total Bonds Payable (principal only)				<u>\$ 231,430,000.00</u>	<u>\$ 53,315,000.00</u>	178,115,000.00	
Less: Unamortized Loss on Refunding						<u>2,531,276.12</u>	
Total Bonds Payable						<u>\$ 175,583,723.88</u>	

(A) The University of North Carolina System Pool Revenue Bonds, Series 2002A

(B) The University of North Carolina System Pool Revenue Bonds, Series 2006A

(C) The University of North Carolina System Pool Revenue Bonds, Series 2008A

* For variable rate debt, interest rates in effect at June 30, 2006 are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year Revenues Net of Expenses	Current Year Principal & Interest
(1)	Indebtedness Fee	\$ 3,278,500.00	\$ 1,236,692.41	\$ 809,460.00
(2)	Steam Plant	4,754,000.00	3,711,215.88	2,143,260.00
(3)	Housing Revenues	20,170,128.00	5,287,440.08	1,835,155.00

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

<u>Fiscal Year</u>	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2009	\$ 6,045,000.00	\$ 8,145,771.24	\$ 2,198,508.28	\$ 73,481.58
2010	7,005,000.00	7,886,241.28	1,866,666.00	48,280.35
2011	7,330,000.00	7,596,096.28	1,616,668.00	39,372.56
2012	7,635,000.00	7,295,078.78	200,000.00	30,527.25
2013	7,165,000.00	6,956,530.04	200,000.00	21,557.00
2014-2018	37,600,000.00	29,856,178.32	350,000.00	31,944.98
2019-2023	42,390,000.00	20,560,143.91		
2024-2028	40,210,000.00	10,319,212.57		
2029-2033	20,555,000.00	2,770,312.50		
2034-2038	2,180,000.00	54,500.00		
Total Requirements	<u>\$ 178,115,000.00</u>	<u>\$ 101,440,064.92</u>	<u>\$ 6,431,842.28</u>	<u>\$ 245,163.72</u>

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

On April 2, 2008, the University issued \$19,230,000.00 in UNC System Pool Revenue Bonds, Series 2008A with an average interest rate of 4.41%. The bonds were issued for a current refunding of \$19,090,000.00 of outstanding Appalachian State University Utility System Revenue Refunding Bonds, Series 1998 with an average interest rate of 5%. The refunding was undertaken to reduce total debt service payments by \$1,526,937.47 over the next fifteen years and resulted in an economic gain of \$684,606.74.

Prior Year Defeasances – During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

bonds are not included in the University's financial statements. At June 30, 2008, the outstanding balance of prior year defeased bonds was \$32,410,000.00.

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2008	Principal Outstanding June 30, 2008
Visual Arts Center	J P Morgan Chase	4.91%	08/01/2008	\$ 2,700,000.00	\$ 2,368,157.72	\$ 331,842.28
Electric Utility	RBC Centura	4.30%	03/15/2013	1,000,000.00	500,000.00	500,000.00
Electric Utility	BB & T	4.56%	10/12/2016	1,000,000.00	150,000.00	850,000.00
Presbyterian Church Property	Presbyterian Church	0.00%	06/30/2011	4,750,000.00		4,750,000.00
Total Notes Payable				<u>\$ 9,450,000.00</u>	<u>\$ 3,018,157.72</u>	<u>\$ 6,431,842.28</u>

F. Component Units

ASU Foundation

On January 5, 2007, the Foundation entered into a revolving line of credit agreement with RBC Bank for up to \$3.5 million. The agreement was amended on August 8, 2007 to increase the line of credit to \$5.0 million. The purpose of the agreement is to assist with costs related to the Athletics facilities enhancement project. The outstanding balance as of June 30, 2008 was \$3,311,000.00. The line of credit is collateralized by outstanding pledge commitments and the amount borrowed may not exceed 95% of the total unpaid pledges. The line of credit is due on January 5, 2012. The interest rate is equal to the 30-day LIBOR plus .49% (2.95% at June 30, 2008).

The Foundation entered into a loan agreement with RBC Bank for \$6,241,500.00 on April 14, 2008. The purpose of the loan is to assist with costs related to the athletics facilities east stands project. The outstanding balance as of June 30, 2008, was \$2,527,655.00. The loan is due on October 14, 2009. The Foundation assigned the rights to marketing revenues to RBC Bank as security for the loan. The interest rate is equal to the 30-day LIBOR plus .57%.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

ASU Student Housing Corporation

Long-Term debt at June 30, 2008, consists of the following:

Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$9,935,000; interest at variable rate calculated weekly due serially from July 1, 2003 to July 1, 2031.	\$ 7,640,000.00
Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$10,000,000; interest at variable rate calculated weekly due serially from July 1, 2002 to July 1, 2031.	7,415,000.00
Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$7,000,000; interest at variable rate calculated weekly due serially from July 1, 2003 to July 1, 2031.	<u>5,195,000.00</u>
Total Long-Term Debt	20,250,000.00
Less Current Portion	<u>470,000.00</u>
Long-Term Debt, Less Current Portions	<u><u>\$ 19,780,000.00</u></u>

Principal Maturities over the term of the debt are as follows:

2009	\$ 470,000.00
2010	505,000.00
2011	540,000.00
2012	580,000.00
2013	615,000.00
Thereafter	<u>17,540,000.00</u>
	<u><u>\$ 20,250,000.00</u></u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - LEASE OBLIGATIONS

The University entered into operating leases for equipment, office space, and parking facilities. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2008:

<u>Fiscal Year</u>	<u>Amount</u>
2009	\$ 385,155.06
2010	189,449.44
2011	45,901.94
2012	11,121.24
2013	930.92
Total Minimum Lease Payments	<u>\$ 632,558.60</u>

Rental expense for all operating leases during the year was \$2,616,758.37.

NOTE 9 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Less Change in Allowance for Uncollectibles</u>	<u>Net Revenues</u>
Operating Revenues:					
Student Tuition and Fees	<u>\$ 78,928,722.75</u>	<u>\$ 0.00</u>	<u>\$ 10,254,365.27</u>	<u>\$ 63,951.30</u>	<u>\$ 68,610,406.18</u>
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 19,176,923.06	\$ 801,897.74	\$ 2,343,059.01	\$ 69,901.12	\$ 15,962,065.19
Dining	17,577,635.37	3,617,993.13	1,384,211.07	37,481.40	12,537,949.77
Student Union Services	154,454.70	56,225.78		11,363.14	86,865.78
Health, Physical Education, and Recreation Services	1,403,897.78	46,822.94		15,574.36	1,341,500.48
Bookstore	11,533,725.39	941,289.95	324,843.68	18,489.06	10,249,102.70
Parking	2,961,756.40	27,183.37		15,874.21	2,918,698.82
Camp Programs	1,575,517.01	22,699.12			1,552,817.89
Steam Utility System	8,646,685.73	8,646,685.73			0.00
Athletic	4,289,683.00	73,076.87		9,212.83	4,207,393.30
Other	8,102,874.13	3,911,444.74	293,853.07	3,460.06	3,894,116.26
Sales and Services of Education and Related Activities	1,933,358.21	1,156,777.82			776,580.39
New River Light and Power	<u>15,829,643.58</u>	<u>4,396,632.22</u>		<u>(1,109.99)</u>	<u>11,434,121.35</u>
Total Sales and Services	<u>\$ 93,186,154.36</u>	<u>\$ 23,698,729.41</u>	<u>\$ 4,345,966.83</u>	<u>\$ 180,246.19</u>	<u>\$ 64,961,211.93</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - OPERATING EXPENSES BY FUNCTION

The University's operating expenses by functional classification are presented as follows:

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 89,466,415.68	\$ 4,361,784.10	\$ 4,521,774.07	\$ 63,306.64	\$ 894.61	\$ 0.00	\$ 98,414,175.10
Research	1,285,891.51	588,549.69	883,729.21	38,106.45			2,796,276.86
Public Service	5,919,943.20	575,591.31	1,611,352.13	1,184,937.00	10,412.72		9,302,236.36
Academic Support	22,712,004.14	10,096,401.90	5,813,909.53	274,434.08	362.32		38,897,111.97
Student Services	5,812,806.49	452,787.81	965,151.30	78,145.00			7,308,890.60
Institutional Support	14,369,403.69	1,005,522.42	3,378,106.92		4,148.71		18,757,181.74
Operations and Maintenance of Plant	12,262,554.09	849,741.15	7,872,746.09		6,750,982.12		27,736,023.45
Student Financial Aid	52,239.79			11,937,336.73			11,989,576.52
Auxiliary Enterprises	29,326,718.94	16,783,643.57	6,018,002.31	1,255,937.45	8,326,625.62		61,710,927.89
New River Light and Power	1,092,470.39	6,421,044.04	1,075,670.94				8,589,185.37
Depreciation						14,764,893.92	14,764,893.92
Total Operating Expenses	<u>\$ 182,300,447.92</u>	<u>\$ 41,135,065.99</u>	<u>\$ 32,140,442.50</u>	<u>\$ 14,832,203.35</u>	<u>\$ 15,093,426.10</u>	<u>\$ 14,764,893.92</u>	<u>\$ 300,266,479.78</u>

NOTE 11 - PENSION PLANS

A. Retirement Plans - Each permanent full-time employee, as a condition of employment, is a member of either the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Eligible employees can elect to participate in the Optional Retirement Program at the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 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 \$150,089,548.28, of which \$70,718,283.89 was covered under the Teachers' and State Employees' Retirement System. Total employer and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

employee contributions for pension benefits for the year were \$4,243,097.03 and \$2,163,331.14, 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 \$2,163,331.14, \$1,707,518.20, and \$1,352,980.32, 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 \$150,089,548.28, of which \$58,968,047.66 was covered under the Optional Retirement Program. Total employer and employee

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

contributions for pension benefits for the year were \$3,538,082.86 and \$4,033,414.46, 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 \$161,537.48 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 \$50,546.85. The voluntary contributions by employees amounted to \$868,847.26 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 \$1,968,874.37 for the year ended June 30, 2008.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - 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 provide 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 of the 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 \$5,322,128.91, \$4,498,407.96, and \$4,027,668.31, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$674,421.86, \$615,571.62, and \$551,154.61, 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 13 - RISK MANAGEMENT

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

Tort claims of up to \$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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible, except theft losses are subject to a \$1,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium. The University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, flood, and "all risks" for buildings and contents.

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

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

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. Health care coverage is provided to participants in international educational programs through the Preferred Health Plan for the University of North Carolina System for participants engaged in international educational activities. All exchange students and visitors are required to have medical insurance in effect for themselves and any accompanying spouse and dependents. The maximum coverage for sickness or injury is \$100,000 for participants and dependents with no medical deductible per injury or sickness.

The University also purchased health care and life insurance for participants in the University camp programs with coverages of \$5,000 for accidental death and dismemberment and \$500 for sickness medical expense benefit. These plans are funded by individual contributions and the coverages were effected and placed by the North Carolina Department of Insurance through the State's agent of record.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$38,426,128.14 and on other purchases were \$3,134,811.01 at June 30, 2008.
- B. Pending Litigation and Claims** - The North Carolina School Boards Association, et al., filed a civil action against 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. In part, this civil action included a determination of whether monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations and library fines were "civil penalties," which the State Constitution requires to be paid to the school fund in the county where they are collected. On July 1, 2005, the North Carolina Supreme Court held in favor of the school boards with regard to parking fines and held in favor of the University with regards to library fines. The matter was remanded back to trial court for disposition in accordance with the Supreme Court's decision. On August 8, 2008, the trial court entered a judgment against

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the defendants. The manner and means by which the judgment is satisfied will be determined by the General Assembly. At issue are transportation fines in the amount of \$4,307,434.00 for the period of January 1, 1996 to June 30, 2005.

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 is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

NOTE 15 - 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 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.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 16 - NET ASSET RESTATEMENTS

As of July 1, 2007, net assets as previously reported was restated as follows:

	<u>Amount</u>
July 1, 2007 Net Assets as Previously Reported	\$ 310,382,866.25
Restatements:	
Corrections to Accumulated Depreciation	(381,098.88)
Corrections to Rental Book Inventory-Bookstore	<u>2,027,249.08</u>
July 1, 2007 Net Assets as Restated	<u>\$ 312,029,016.45</u>

NOTE 17 - SUBSEQUENT EVENTS

A. Bond Issuance - The University is planning to issue bonds in spring 2009 for construction projects. Subject to approval by the University of North Carolina Board of Governors, ASU General Revenue Bonds will be issued for approximately \$16,300,000 to provide funds for new athletic facilities (\$8,300,000) and renovation of Frank residence hall (\$8,000,000).

B. Fair Value of Investments

- 1) University - The fair market value of the University's endowment investments in the long-term investment pool decreased 17.4 percent over the four-month period ending October 31, 2008. The market values for the investment pool were \$13,781,768.81 at June 30, 2008 and declined to \$11,390,261.64.
- 2) Component Unit - The University foundation's endowment investments decreased 16.7 percent over the four-month period ending October 31, 2008. The market values at June 30, 2008, were \$56,534,813 (total investments per Note 2B - Component Units, less real estate held for resale of \$10,154,146 and short-term investment fund of \$15,323,288) and declined to \$47,079,064.

These changes are primarily due to unrealized losses on investments as a result of the current economic and financial market conditions. University and Foundation management, along with their investment management advisors, will continue to monitor investments for the purpose of managing investment risks and to maximize investment returns.

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Leslie W. Merritt, Jr., CPA, CFP
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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
Appalachian State University
Boone, North Carolina

We have audited the financial statements of Appalachian State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component 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 November 20, 2008. Our report was modified to include a reference to other auditors.

As discussed in Note 15 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

**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 (CONTINUED)**

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above are a material weakness.

Compliance and Other Matters

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

**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)**

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

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

Leslie W. Merritt, Jr.

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

November 20, 2008

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

The following finding was identified during the current audit and describes conditions that represent deficiencies in internal control.

DEFICIENCIES IN FINANCIAL REPORTING

The financial statements and notes to the financial statements contained several misstatements that were corrected as a result of our audit. Without these corrections, the financial statements could have been misleading to readers. Misstatements noted in our audit included:

- The University duplicated the reporting of a \$15.3 million deposit in the State Treasurer's Short-Term Investment Fund. The amount was reported on both the University's Statement of Net Assets and the Statement of Net Assets for one of its component units. It should not have been reported on the University's statement. Although the funds may be reported in the University's internal accounting records during the fiscal year, they should be eliminated for the University's financial statement presentation.
- A \$1 million endowment gift was reported as other operating revenues and noncapital gifts rather than additions to endowments. Although \$333,000 was properly reported in the University's internal accounting records for the Statewide Comprehensive Financial Report, the \$1 million should have been reported as additions to endowments on the University's financial statements.
- The University reported deficit net assets restricted for capital projects of \$4.8 million. Restricted net assets should not have been reduced below zero, with the negative difference used to reduce unrestricted net assets.
- The liability for accrued salaries and benefits was overstated by \$2.4 million.

Recommendation: The University should place greater emphasis on the year-end financial reporting process and implement effective internal controls to ensure the accuracy of the financial statements and related notes.

University's Response: We recently implemented new processes for reviewing financial statement classification to ensure the accuracy of the University's financial statements. One of the processes includes the involvement of an additional accountant in reviewing and checking ASU classification decisions against *Governmental Accounting Standards Board* pronouncements. Also, two accountants will review reports generated to calculate accrued salaries and benefits to make sure that year-end accrual calculations are accurate.

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