



STATE OF NORTH CAROLINA

WINSTON-SALEM STATE UNIVERSITY

WINSTON-SALEM, 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

WINSTON-SALEM STATE UNIVERSITY

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2008

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

ERSKINE B. BOWLES, PRESIDENT

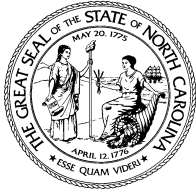
BOARD OF TRUSTEES

NIGEL D. ALSTON, CHAIRMAN

ADMINISTRATIVE OFFICERS

DR. DONALD JULIAN REAVES, CHANCELLOR

GERALD E. HUNTER, VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of Winston-Salem 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 certain deficiencies that are detailed in the Audit Findings and Responses section of this report. The University's response is included following each finding.

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

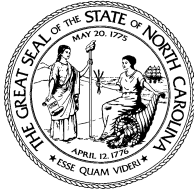
Leslie W. Merritt, Jr.

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

December 19, 2008

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR’S REPORT	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
BASIC FINANCIAL STATEMENTS	
University Exhibits	
A-1 Statement of Net Assets	10
A-2 Statement of Revenues, Expenses, and Changes in Net Assets	12
A-3 Statement of Cash Flows	13
Component Unit Exhibits	
B-1 Consolidated Statement of Financial Position	15
B-2 Consolidated Statement of Activities.....	16
Notes to the Financial Statements	17
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 <i>GOVERNMENT</i> <i>AUDITING STANDARDS</i>	43
AUDIT FINDINGS AND RESPONSES	47
ORDERING INFORMATION	51



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of Winston-Salem State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2008, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Winston-Salem State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Winston-Salem State University Foundation, Inc. and Subsidiary, the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinions, insofar as they relate to the amounts included for the discretely presented component unit, are based on the report of the other auditors.

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

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Winston-Salem State University and its discretely presented component unit as of June 30, 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

WINSTON-SALEM STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Winston-Salem State University (the “University”) annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2008. This discussion has been prepared by University management along with the financial statements and notes to the financial statements and should be read in conjunction with, and is qualified in its entirety by, the financial statements and notes. The Management’s Discussion and Analysis has comparative data for the applicable years (past and current) with emphasis on the current year. The financial statements, notes, and this discussion are the responsibility of University management.

Using the Annual Report

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

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

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

Reporting Entity

The financial statements report information about the University as a whole using accounting methods similar to those used by private-sector companies. The University’s supporting organization, the Winston-Salem State University Foundation, Inc. (the “Foundation”), is an independent nonprofit corporation formed for the exclusive benefit of the University. According to Governmental Accounting Standards Board Statement No. 39, *Determining*

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Whether Certain Organizations are Component Units, the Foundation meets the requirements to be reported discretely in these financial statements.

Financial Highlights

The University's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2008. Its combined net assets increased \$8,114,164.87 from the previous year, which is an increase of approximately 6.7 percent.

Condensed Financial Information

Statement of Net Assets

The Statement of Net Assets presents the assets (current and noncurrent), liabilities (current and noncurrent), and the net assets (total assets less total liabilities) of the University. This financial statement provides a comparative University fiscal snapshot as of June 30, 2008, and June 30, 2007. This provides the readers of this statement with information on assets available to continue operations.

Condensed Statements of Net Assets June 30, 2008

	2008		2007	
Assets				
Current Assets	\$ 25,071,586.10	11.7%	\$ 21,120,587.92	11.5%
Noncurrent Assets				
Capital	155,320,439.56	72.3%	128,164,170.57	70.0%
Other	34,312,926.43	16.0%	33,897,375.22	18.5%
Total Assets	214,704,952.09	100.0%	183,182,133.71	100.0%
Liabilities				
Current Liabilities	9,097,504.85	10.6%	6,774,093.34	10.8%
Noncurrent Liabilities	77,061,847.30	89.4%	55,976,605.30	89.2%
Total Liabilities	86,159,352.15	100.0%	62,750,698.64	100.0%
Net Assets*				
Invested in Capital Assets, Net of Related Debt	81,279,146.98	63.2%	75,329,589.04	62.5%
Restricted:				
Nonexpendable	13,954,280.02	10.9%	11,849,416.53	9.9%
Expendable	24,478,677.78	19.0%	25,584,961.36	21.2%
Unrestricted	8,833,495.16	6.9%	7,667,468.14	6.4%
Total Net Assets	\$ 128,545,599.94	100.0%	\$ 120,431,435.07	100.0%

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

As of June 30, 2008, total University assets were \$214,704,952.09. The University's largest asset is investment in capital assets of \$155,320,439.56 at June 30, 2008, of which

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

depreciable capital assets of \$143,046,197.66 increased \$21,200,871.26 compared to the prior year amount of \$121,845,326.40. The University acquired the Foundation Heights Residence Hall for \$18,835,000.00 and the Bowman Gray Field House for \$3,300,000.00 under capital leases with the Winston-Salem State University Foundation, Inc. and the City of Winston-Salem, respectively, which resulted in the significant increase to depreciable capital assets. Cash and investments increased by \$2,935,686.38 due to increased revenues of \$1,550,868.77 from providing student services to a growing student enrollment. The cash balance related to capital grants and appropriations designated for capital projects decreased \$797,602.06, and endowment investments increased \$2,182,419.67 primarily due to gifts received.

The \$25,071,586.10 in current assets covered the current liabilities of \$9,097,504.85, as the current ratio was \$2.76 in current assets to every \$1.00 in current liabilities.

University liabilities totaled \$86,159,352.15 at June 30, 2008, of which noncurrent long-term liabilities of \$75,709,064.96 increased \$20,999,821.43 compared to the prior year amount of \$54,709,243.53. This increase is primarily due to the Foundation Heights Residence Hall and Bowman Gray Field House capital lease acquisitions discussed earlier. Bonds payable of \$17,745,437.58 and capital leases of \$55,585,000.00 were the largest liabilities, representing 85.1% of the total University liabilities. The University had outstanding bonds of \$5,600,000.00, \$2,220,437.58, \$2,610,000.00, and \$7,315,000.00 from 1998, 2002, 2004, and 2008 bond issues, respectively.

Statement of Revenues, Expenses, and Changes in Net Assets

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

Operating revenues are received for providing goods and services to the various customers of the University. Operating expenses are used to acquire goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating 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 activities since these are either investing, capital, or noncapital financing activities. Nonoperating expenses are expenses other than those involved in the normal operation of the University that can include interest expense.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Revenues, Expenses, and Changes in Net Assets For the Year Ended June 30, 2008

	2008		2007	
Operating Revenues:				
Student Tuition and Fees, Net	\$ 17,323,885.12	40.9%	\$ 15,591,533.29	39.0%
Grants and Contracts	10,430,746.34	24.6%	10,215,958.47	25.6%
Sales and Services, Net	13,393,075.00	31.7%	13,129,066.99	32.9%
Other	1,165,221.77	2.8%	999,947.43	2.5%
Total Operating Revenues	42,312,928.23	100.0%	39,936,506.18	100.0%
Operating Expenses:				
Salaries and Benefits	73,464,311.69	60.0%	64,105,442.57	54.4%
Supplies, Materials, and Services	34,616,791.85	28.3%	39,339,445.34	33.4%
Scholarships and Fellowships	6,157,466.80	5.0%	6,902,467.55	5.9%
Utilities	2,884,888.38	2.4%	2,650,639.28	2.3%
Depreciation	5,298,035.44	4.3%	4,720,677.65	4.0%
Total Operating Expenses	122,421,494.16	100.0%	117,718,672.39	100.0%
Operating Loss	(80,108,565.93)		(77,782,166.21)	
Nonoperating Revenues (Expenses):				
State Appropriations	69,647,121.08	87.3%	65,842,692.35	84.4%
Noncapital Grants	11,739,400.83	14.7%	10,842,913.52	13.9%
Noncapital Gifts	219,000.65	0.3%	183,803.97	0.2%
Other	(1,816,667.92)	-2.3%	1,180,528.98	1.5%
Net Nonoperating Revenues	79,788,854.64	100.0%	78,049,938.82	100.0%
Income (Loss) Before Contributions	(319,711.29)		267,772.61	
Capital Appropriations and Grants	6,347,152.71	75.3%	5,028,960.83	82.7%
Additions to Endowments	2,086,723.45	24.7%	1,055,355.00	17.3%
Total Other Revenues	8,433,876.16	100.0%	6,084,315.83	100%
Increase in Net Assets	8,114,164.87		6,352,088.44	
Net Assets:				
Beginning of Year	120,431,435.07		112,266,401.16	
Restatement of Net Assets			1,812,945.47	
End of Year	\$ 128,545,599.94		\$ 120,431,435.07	

Total operating loss for fiscal year 2008 was \$80,108,565.93. Since the State of North Carolina appropriation is not included within operating revenue per GASB Statement No. 35, the University will show a significant operating loss on a continuing basis.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

The following table details the University's grants and contracts revenue for the fiscal year ended June 30, 2008.

	Amount
Federal:	
Department of Education	\$ 15,748,803.30
Department of Health and Human Services	2,947,817.30
National Science Foundation	449,055.95
Department of Housing and Urban Development	319,214.86
Department of Justice	104,311.89
Department of Transportation	13,200.38
Total Federal	19,582,403.68
Private, State, and Local	2,587,743.49
Total All Sources	\$ 22,170,147.17

Operating expenses, including depreciation of \$5,298,035.44, totaled \$122,421,494.16. Of this total, \$62,011,541.13 or 50.7 percent was used for instruction and student support.

Salaries and Benefits increased by \$9,358,869.12 due to legislative salary increases and increases in staffing due to enrollment growth. Supplies, Materials, and Services had a net decrease of \$4,722,653.49 consisting of a slight increase in Services of \$149,412.30 and a decrease in Supplies and Materials of \$4,872,065.79. The decrease in Supplies and Materials was primarily due to the completion of several capital repair and renovation projects in the prior year, as well as increased equipment purchases in the prior year.

The University's largest source of nonoperating revenue is the State of North Carolina appropriation. This is received in monthly payments, beginning in July of each year, since the State's fiscal year begins on July 1. There is no direct connection between the amount of tuition revenues collected by the University and the amount of State funds appropriated in any given year. For the fiscal year ended June 30, 2008, the State of North Carolina appropriated to the University \$69,647,121.08 for operations. The State of North Carolina provided \$6,347,152.71 in capital grants and capital appropriations during the fiscal year.

Total net revenues were \$130,535,659.03 for fiscal year 2008, compared to \$124,070,760.83 for fiscal year 2007, resulting in a net increase of \$6,464,898.20, which is primarily contributed to the following:

- Student tuition and fees reflect a \$1,732,351.83 increase due to increases in student enrollment and in tuition and fee rates, including the implementation of a new student health insurance fee of \$224.00 per semester.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

- State appropriations reflect a \$3,804,428.73 increase due to increased funding from the State of North Carolina.
- Investment income reflects a \$950,507.42 decrease due to the decrease in realized and unrealized gains on Endowment investments because of recent volatility in the stock market.
- State capital appropriations reflect a \$2,756,246.17 increase due to increased funding from the State of North Carolina.
- Capital grants reflect a \$1,438,054.29 decrease due to the completion of construction projects funded under the University Improvement General Obligation Bonds.
- Additions to Endowments reflect a \$1,031,368.45 increase due to matching gifts given by UNC General Administration.

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

Capital Assets

With the passage of the University Improvement General Obligation Bonds in 2000, the University has been allotted a total of \$47,156,581.00 for capital improvements as of June 30, 2008. Major capital expenditures for the year ended June 30, 2008, include the Athletic and Student Recreation Facilities of \$3,158,494.47; the Brown Hall Renovation of \$3,655,940.59; and the Whitaker Basketball Courts of \$327,884.75.

Factors Impacting Future Periods

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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

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

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

Winston-Salem State University
Statement of Net Assets
June 30, 2008

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 12,942,852.09
Restricted Cash and Cash Equivalents	7,346,479.68
Restricted Short-Term Investments	638,077.38
Receivables, Net (Note 4)	3,826,281.38
Inventories	216,669.79
Notes Receivable, Net (Note 4)	101,225.78
Total Current Assets	<u>25,071,586.10</u>

Noncurrent Assets:

Restricted Cash and Cash Equivalents	13,004,127.91
Restricted Due from Primary Government	566,535.04
Endowment Investments	19,467,203.05
Other Investments	539,934.26
Notes Receivable, Net (Note 4)	735,126.17
Capital Assets - Nondepreciable (Note 5)	12,274,241.90
Capital Assets - Depreciable, Net (Note 5)	143,046,197.66
Total Noncurrent Assets	<u>189,633,365.99</u>
Total Assets	<u>214,704,952.09</u>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	4,775,141.34
Due to Primary Government	91,296.89
Unearned Revenue	1,376,604.38
Interest Payable	339,233.62
Long-Term Liabilities - Current Portion (Note 7)	2,515,228.62
Total Current Liabilities	<u>9,097,504.85</u>

Noncurrent Liabilities:

Deposits Payable	216,381.55
Funds Held for Others	241,886.78
U. S. Government Grants Refundable	894,514.01
Long-Term Liabilities (Note 7)	75,709,064.96
Total Noncurrent Liabilities	<u>77,061,847.30</u>
Total Liabilities	<u>86,159,352.15</u>

Winston-Salem State University
Statement of Net Assets
June 30, 2008

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	81,279,146.98
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,372,240.61
Endowed Professorships	8,130,500.00
Departmental Uses	2,355,069.13
Loans	96,470.28
Expendable:	
Scholarships and Fellowships	2,242,726.91
Professorships	4,627,047.17
Departmental Uses	3,839,947.01
Loans	193,227.01
Capital Projects	12,672,542.80
Debt Service	903,186.88
Unrestricted	8,833,495.16
Total Net Assets	<u><u>\$ 128,545,599.94</u></u>

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

Winston-Salem State University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2008

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 17,323,885.12
Federal Grants and Contracts	10,430,746.34
Sales and Services, Net (Note 9)	13,393,075.00
Interest Earnings on Loans	3,723.08
Other Operating Revenues	1,161,498.69
	<hr/>
Total Operating Revenues	42,312,928.23
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	73,464,311.69
Supplies and Materials	7,549,284.53
Services	27,067,507.32
Scholarships and Fellowships	6,157,466.80
Utilities	2,884,888.38
Depreciation	5,298,035.44
	<hr/>
Total Operating Expenses	122,421,494.16
	<hr/>
Operating Loss	(80,108,565.93)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	69,647,121.08
Noncapital Grants	11,739,400.83
Noncapital Gifts	219,000.65
Investment Income (Net of Investment Expense of \$71,976.35)	2,303,425.46
Interest and Fees on Debt	(2,971,337.38)
Refunds to Grantors and Lenders (Note 16B)	(1,148,756.00)
	<hr/>
Net Nonoperating Revenues	79,788,854.64
	<hr/>
Loss Before Other Revenues	(319,711.29)
	<hr/>
Capital Appropriations	5,918,000.00
Capital Grants	429,152.71
Additions to Endowments	2,086,723.45
	<hr/>
Increase in Net Assets	8,114,164.87

NET ASSETS

Net Assets - July 1, 2007	<hr/> 120,431,435.07
Net Assets - June 30, 2008	<hr/> <hr/> \$ 128,545,599.94

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

Winston-Salem State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 42,387,661.77
Payments to Employees and Fringe Benefits	(72,938,122.42)
Payments to Vendors and Suppliers	(37,643,690.30)
Payments for Scholarships and Fellowships	(6,157,466.80)
Loans Issued	(140,100.00)
Collection of Loans	177,511.58
Interest Earned on Loans	(3,096.26)
Student Deposits Received	216,381.55
Student Deposits Returned	(133,439.75)
	<hr/>
Net Cash Used by Operating Activities	(74,234,360.63)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	69,647,121.08
Noncapital Grants	9,938,356.57
Noncapital Gifts	11,000.65
Additions to Endowments	2,086,723.45
Other Payments	(84,408.41)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	81,598,793.34

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	7,315,000.00
State Capital Appropriations	5,918,000.00
Capital Grants	605,496.32
Acquisition and Construction of Capital Assets	(8,758,001.81)
Principal Paid on Capital Debt and Leases	(8,945,000.00)
Interest and Fees Paid on Capital Debt and Leases	(2,882,631.09)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(6,747,136.58)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	20,056,865.57
Investment Income	1,455,166.72
Purchase of Investments and Related Fees	(21,405,300.05)
	<hr/>
Net Cash Provided by Investing Activities	106,732.24
	<hr/>
Net Increase in Cash and Cash Equivalents	724,028.37
Cash and Cash Equivalents - July 1, 2007	32,569,431.31
	<hr/>
Cash and Cash Equivalents - June 30, 2008	\$ 33,293,459.68

Winston-Salem State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2008

Exhibit A-3

Page 2

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

Operating Loss	\$ (80,108,565.93)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	5,298,035.44
Allowances, Write-Offs, and Amortizations	(3,218.75)
Changes in Assets and Liabilities:	
Receivables (Net)	9,391.94
Inventories	5,559.37
Accounts Payable and Accrued Liabilities	26,675.49
Due to Primary Government	16,180.09
Unearned Revenue	62,245.34
Compensated Absences	338,983.00
Deposits Payable	82,941.80
Student Loans Issued	(140,100.00)
Student Loan Principal Repayments	177,511.58
Net Cash Used by Operating Activities	<u><u>\$ (74,234,360.63)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 12,942,852.09
Restricted Cash and Cash Equivalents	7,346,479.68
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	13,004,127.91
Total Cash and Cash Equivalents - June 30, 2008	<u><u>\$ 33,293,459.68</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired Through the Assumption of a Liability	\$ 22,135,000.00
Assets Acquired through a Gift	208,000.00
Change in Fair Value of Investments	(2,307,345.50)

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

***Winston-Salem State University Foundation, Inc.
and Subsidiary
Consolidated Statement of Financial Position
June 30, 2008***

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	5,298,604
Restricted Cash		3,778,561
Accounts Receivable		311,249
Lease Obligation Receivable, Net		44,207,773
Pledges Receivable, Net		1,960,852
Investment Securities		5,296,138
Property and Equipment, Net		1,850,993
Deferred Financing Costs, Net		2,233,681
Other		2,269
		<hr/>
Total Assets		64,940,120
		<hr/>

LIABILITIES

Accounts Payable and Other Accruals		253,513
Bonds Payable		52,360,000
		<hr/>
Total Liabilities		52,613,513
		<hr/>

NET ASSETS

Unrestricted		1,791,528
Temporarily Restricted		4,576,858
Permanently Restricted		5,958,221
		<hr/>
Total Net Assets		12,326,607
		<hr/>
Total Liabilities and Net Assets	\$	64,940,120
		<hr/>

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

***Winston-Salem State University Foundation, Inc.
and Subsidiary
Consolidated Statement of Activities
For the Year Ended June 30, 2008***

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
SUPPORT AND REVENUE				
Gifts and Grants	\$ 293,989	\$ 734,008	\$ 286,367	\$ 1,314,364
Investment Income	466,785	26,164		492,949
Unrealized Gain on Investment Activities		253,617		253,617
Administrative Fees	117,159			117,159
Passport Income	74,206			74,206
Lease Income	2,364,859			2,364,859
Other	282,099	309,496		591,595
	3,599,097	1,323,285	286,367	5,208,749
Net Assets Released from Restrictions	1,418,398	(1,418,398)		
Total Support and Revenue	5,017,495	(95,113)	286,367	5,208,749
EXPENSES				
Scholarships	379,376			379,376
Special Programs	1,039,022			1,039,022
Housing Expenses	413,034			413,034
Management and General	763,186			763,186
Depreciation and Amortization	95,493			95,493
Interest	2,313,439			2,313,439
Unrelated Business Income Tax	7,037			7,037
Fundraising Expense	78,825			78,825
Total Expenses	5,089,412			5,089,412
Change in Net Assets	(71,917)	(95,113)	286,367	119,337
NET ASSETS				
Net Assets, Beginning	1,863,445	4,671,971	5,671,854	12,207,270
Net Assets, Ending	<u>\$ 1,791,528</u>	<u>\$ 4,576,858</u>	<u>\$ 5,958,221</u>	<u>\$ 12,326,607</u>

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

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

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

Discretely Presented Component Unit – The Winston-Salem State University Foundation, Inc. is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. The Winston-Salem State University Housing Foundation, LLC, is the wholly owned subsidiary of the Winston-Salem State University Foundation, Inc.

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of not less than five and not more than twenty-seven elected directors, with the number at any given time being set by the Board of Directors. In addition to the elected directors, the Chancellor and the Vice Chancellor for University Advancement of Winston-Salem State University shall be full voting members of the Board of Directors. Although the University does not control the timing or amount of receipts from the Foundation, the majority

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

During the year ended June 30, 2008, the Foundation distributed \$703,974.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Winston-Salem State University Foundation, Inc., S.G. Atkins House, Winston-Salem, NC 27110, or by calling (336) 750-3005.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

recognized when earned, and expenses are recorded when an obligation has been incurred, regardless of the timing of the cash flows.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

G. Inventories – Inventories of fuel oil held for consumption are valued at cost using the last invoice cost method. Inventories of postage are valued at the retail cost.

H. Capital Assets – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. 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 40 years for general infrastructure, 12 to 50 years for buildings, and 5 to 20 years for equipment.

The Diggs Gallery collection is capitalized at cost or fair value at the date of donation. This collection is considered inexhaustible and is therefore not depreciated.

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

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

Bonds payable are reported net of unamortized premiums. The University amortizes bond premiums over the life of the bonds using the straight-line method. Issuance costs are expensed.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

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

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

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

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

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

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

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

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

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

O. Internal Sales Activities – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

as copy centers, motor pool, postal services, telecommunications, and facilities rentals. 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 \$33,293,459.68 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 2.9 years as of June 30, 2008. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

B. Investments

University - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

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

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

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

Investments are subject to the following risks.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

UNC Investment Fund, LLC - At June 30, 2008, the University's endowment investments include \$19,467,203.05 which represents the University's equity position in the UNC Investment Fund, LLC (System Fund). The System Fund, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating, had a weighted average maturity of 12.96 years as of June 30, 2008. Asset and ownership interests of the System Fund are determined on a market unit valuation basis each month. Investment risks associated with the System Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from the UNC CH Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270.

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

Non-Pooled Investments

	Fair Value	Investment Maturities (in Years)
		Less Than 1
Investment Type		
Debt Securities		
Money Market Mutual Funds	\$ 1,178,011.64	\$ 1,178,011.64

At June 30, 2008, the Money Market Mutual Funds, with a fair value of \$1,178,011.64, were rated AAAM by Standard and Poors.

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

	Fair Value
Investment Type	
Debt Securities	
Money Market Mutual Funds	\$ 1,178,011.64
Other Securities	
UNC Investment Fund, LLC	19,467,203.05
Total Investments	\$ 20,645,214.69

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

	Fair Value
Investment Type	
Equity Investments	\$ 2,542,146
Collective Fixed Income	974,489
Money Market Funds	1,779,503
Total Investments	<u>\$ 5,296,138</u>

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). The total spending rate is calculated annually by taking the sum of the market value of the endowment investments for the preceding twelve quarters, and dividing the result by twelve. Spending from the average value shall be at a rate of five percent, paid out proportionately on a quarterly basis. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference. At June 30, 2008, net appreciation of \$5,609,393.31 was available to be spent for restricted purposes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2008, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 1,303,272.48	\$ 302,269.66	\$ 1,001,002.82
Accounts	460,405.08		460,405.08
Intergovernmental	2,070,465.88		2,070,465.88
Investment Earnings	77,542.32		77,542.32
Interest on Loans	162,965.78		162,965.78
Other	53,899.50		53,899.50
Total Current Receivables	<u>\$ 4,128,551.04</u>	<u>\$ 302,269.66</u>	<u>\$ 3,826,281.38</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 150,402.78	\$ 59,046.04	\$ 91,356.74
Institutional Student Loan Programs	13,224.96	3,355.92	9,869.04
Total Notes Receivable - Current	<u>\$ 163,627.74</u>	<u>\$ 62,401.96</u>	<u>\$ 101,225.78</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 1,096,963.97	\$ 434,871.62	\$ 662,092.35
Institutional Student Loan Programs	113,909.90	40,876.08	73,033.82
Total Notes Receivable - Noncurrent	<u>\$ 1,210,873.87</u>	<u>\$ 475,747.70</u>	<u>\$ 735,126.17</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	Increases	Decreases	Balance June 30, 2008
Capital Assets, Nondepreciable:				
Land	\$ 3,968,242.04	\$ 0.00	\$ 0.00	\$ 3,968,242.04
Art, Literature, and Artifacts	625,772.00	208,000.00		833,772.00
Construction in Progress	1,724,830.13	7,934,889.29	2,187,491.56	7,472,227.86
Total Capital Assets, Nondepreciable	6,318,844.17	8,142,889.29	2,187,491.56	12,274,241.90
Capital Assets, Depreciable:				
Buildings	146,294,117.50	22,884,289.24		169,178,406.74
Machinery and Equipment	10,688,262.52	1,608,367.39	247,486.73	12,049,143.18
General Infrastructure	6,021,126.29	2,003,031.32	64,968.00	7,959,189.61
Total Capital Assets, Depreciable	163,003,506.31	26,495,687.95	312,454.73	189,186,739.53
Less Accumulated Depreciation for:				
Buildings	34,551,130.16	4,006,342.05		38,557,472.21
Machinery and Equipment	4,783,079.20	1,000,286.52	250,705.48	5,532,660.24
General Infrastructure	1,823,970.55	291,406.87	64,968.00	2,050,409.42
Total Accumulated Depreciation	41,158,179.91	5,298,035.44	315,673.48	46,140,541.87
Total Capital Assets, Depreciable, Net	121,845,326.40	21,197,652.51	(3,218.75)	143,046,197.66
Capital Assets, Net	\$ 128,164,170.57	\$ 29,340,541.80	\$ 2,184,272.81	\$ 155,320,439.56

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 2,675,535.98
Accrued Payroll	1,404,326.98
Contract Retainage	257,377.38
Due to Lenders	437,901.00
Total Accounts Payable and Accrued Liabilities	\$ 4,775,141.34

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

UNIVERSITY

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	\$ 11,160,000.00	\$ 7,315,000.00	\$ 805,000.00	\$ 17,670,000.00	\$ 835,000.00
Add Premium	84,581.53		9,143.95	75,437.58	
Total Bonds Payable	11,244,581.53	7,315,000.00	814,143.95	17,745,437.58	835,000.00
Notes Payable	7,170,000.00	710,855.00	7,170,000.00	710,855.00	233,437.62
Capital Leases Payable	34,420,000.00	22,135,000.00	970,000.00	55,585,000.00	1,095,000.00
Compensated Absences	3,844,018.00	4,592,409.00	4,253,426.00	4,183,001.00	351,791.00
Total Long-Term Liabilities	\$ 56,678,599.53	\$ 34,753,264.00	\$ 13,207,569.95	\$ 78,224,293.58	\$ 2,515,228.62

Additional information regarding capital lease obligations is included in Note 8.

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2008	Principal Outstanding June 30, 2008	See Table Below
Housing and Dining System							
UNC System Pool Revenue Bonds	2008A	3.00%-5.00%	10/01/2033	\$ 4,591,004.21	\$ 0.00	\$ 4,591,004.21	(1)
UNC System Pool Revenue Bonds	2002B	3.50%-5.37%	04/01/2017	3,090,000.00	945,000.00	2,145,000.00	(1)
Revenue Refunding Bonds	1998B	3.70%-5.00%	01/01/2017	8,430,000.00	2,830,000.00	5,600,000.00	(1)
Total Housing and Dining System				16,111,004.21	3,775,000.00	12,336,004.21	
Student Services System							
UNC System Pool Revenue Bonds	2008A	3.00%-5.00%	10/01/2033	2,723,995.79		2,723,995.79	(2)
UNC System Pool Revenue Bonds	2004B	3.00%-5.00%	04/01/2022	2,925,000.00	315,000.00	2,610,000.00	(2)
Student Services System				5,648,995.79	315,000.00	5,333,995.79	
Total Bonds Payable (principal only)				\$ 21,760,000.00	\$ 4,090,000.00	17,670,000.00	
Plus: Unamortized Premium						75,437.58	
Total Bonds Payable						\$ 17,745,437.58	

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	Estimate of % of Revenues Pledged
(1)	Housing and Dining Revenues	\$ 17,748,099.21	\$ 1,572,075.99	\$ 1,065,520.00	24%
(2)	Student Services Revenues	8,293,653.15	721,422.25	252,125.00	36%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2009	\$ 835,000.00	\$ 815,333.51	\$ 233,437.62	\$ 7,961.50
2010	1,040,000.00	777,001.25	186,686.77	11,769.47
2011	1,100,000.00	729,098.75	192,365.02	6,091.22
2012	1,135,000.00	679,230.00	98,365.59	862.48
2013	1,200,000.00	626,332.50		
2014-2018	5,870,000.00	2,216,950.02		
2019-2023	2,235,000.00	1,278,696.90		
2024-2028	1,665,000.00	842,584.43		
2029-2034	2,590,000.00	406,525.00		
Total Requirements	<u>\$ 17,670,000.00</u>	<u>\$ 8,371,752.36</u>	<u>\$ 710,855.00</u>	<u>\$ 26,684.67</u>

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

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2008	Principal Outstanding June 30, 2008
	United States					
Final Program Review Determination	Department of Education	3.00%	12/01/2011	<u>\$ 710,855.00</u>	<u>\$ 0.00</u>	<u>\$ 710,855.00</u>

COMPONENT UNIT

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

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

In October 2006, \$18,835,000.00 of Series 2006 bonds were issued. The proceeds of this issuance were used to finance the construction of Foundation Heights. These bonds mature at various intervals through 2038 and bear interest at fixed rates from 3% to 5%.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

<u>Fiscal Year</u>	<u>Bonds Payable</u>
2009	\$ 1,015,000.00
2010	1,035,000.00
2011	1,170,000.00
2012	1,210,000.00
2013	1,250,000.00
Thereafter	<u>46,680,000.00</u>
Total Requirements	<u>\$ 52,360,000.00</u>

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to University student housing and athletic facilities are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2008:

<u>Fiscal Year</u>	<u>Amount</u>
2009	\$ 3,535,711.28
2010	3,524,913.28
2011	3,624,599.78
2012	3,622,170.76
2013	3,626,473.02
2014-2018	18,119,112.58
2019-2023	18,127,547.54
2024-2028	18,112,444.06
2029-2033	17,660,519.76
2034-2036	<u>7,895,406.26</u>
Total Minimum Lease Payments	97,848,898.32
Amount Representing Interest (3.00% - 5.00% Interest Rate/Range)	<u>42,263,898.32</u>
Present Value of Future Lease Payments	<u>\$ 55,585,000.00</u>

Buildings acquired under capital lease amounted to \$58,035,000.00 at June 30, 2008.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Operating Lease Obligations – The University entered into operating leases for athletic fields and office space. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2008:

Fiscal Year	Amount
2009	\$ 686,091.07
2010	681,710.53
2011	395,699.27
2012	403,282.36
2013	340,824.77
2014-2018	287,859.42
2019-2023	39,361.71
2024-2028	45,630.95
2029-2033	52,898.80
2034-2038	61,324.23
2039-2043	13,390.42
Total Minimum Lease Payments	<u><u>\$ 3,008,073.53</u></u>

Rental expense for all operating leases during the year was \$1,433,979.65.

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees	\$ 22,295,751.83	\$ 0.00	\$ 4,890,903.08	\$ 80,963.63	\$ 17,323,885.12
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 8,926,732.12	\$ 0.00	\$ 1,948,083.01	\$ 42,126.01	\$ 6,936,523.10
Dining	4,323,744.76		913,528.40	14,924.18	3,395,292.18
Student Union Services	968,714.65			9,152.86	959,561.79
Health, Physical Education, and Recreation Services	9,055.10				9,055.10
Parking	545,566.36			590.24	544,976.12
Athletic	702,125.25			15,322.63	686,802.62
Other	2,528,432.55	1,663,573.45		3,995.01	860,864.09
Total Sales and Services	<u><u>\$ 18,004,370.79</u></u>	<u><u>\$ 1,663,573.45</u></u>	<u><u>\$ 2,861,611.41</u></u>	<u><u>\$ 86,110.93</u></u>	<u><u>\$ 13,393,075.00</u></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	\$ 41,405,158.87	\$ 1,847,443.39	\$ 4,240,174.10	\$ 258,392.25	\$ 0.00	\$ 0.00	\$ 47,751,168.61
Research	790,609.34	182,739.39	182,464.60	13,212.80			1,169,026.13
Public Service	1,145,607.64	76,491.83	638,348.23	67,067.00			1,927,514.70
Academic Support	5,698,654.76	2,719,853.48	1,520,688.17	4,930.00			9,944,126.41
Student Services	3,348,279.67	189,576.31	768,390.13	10,000.00			4,316,246.11
Institutional Support	8,991,723.81	672,707.98	5,413,036.38				15,077,468.17
Operations and Maintenance of Plant	6,450,948.11	549,207.05	3,038,569.93		2,139,031.32		12,177,756.41
Student Financial Aid	619,709.33	14,811.13	27,876.18	5,785,429.59			6,447,826.23
Auxiliary Enterprises	5,013,620.16	1,296,453.97	11,237,959.60	18,435.16	745,857.06		18,312,325.95
Depreciation						5,298,035.44	5,298,035.44
Total Operating Expenses	<u>\$ 73,464,311.69</u>	<u>\$ 7,549,284.53</u>	<u>\$ 27,067,507.32</u>	<u>\$ 6,157,466.80</u>	<u>\$ 2,884,888.38</u>	<u>\$ 5,298,035.44</u>	<u>\$ 122,421,494.16</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 \$59,835,208.91, of which \$32,758,907.80 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 \$999,146.69 and \$1,965,534.47, 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 \$999,146.69, \$769,354.90, and \$581,475.67, 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 \$59,835,208.91, of which \$19,209,017.26 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$1,313,896.78 and \$1,152,541.04, 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 \$170,643.44 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 \$42,135.55. The voluntary contributions by employees amounted to \$218,855.00 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 \$692,983.38 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 \$2,130,684.93, \$1,679,043.31, and \$1,391,157.25, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

<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 \$270,233.21, \$229,763.82, and \$190,368.88, 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 insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 against losses caused by windstorm or hail, explosion, smoke, aircraft or vehicles, and riot or civil commotion on certain buildings and contents. In addition, the University purchased "all risk" coverage through the Fund for a particular tower and various buildings.

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.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$2,407,888.93 and on other purchases were \$1,826,346.47 at June 30, 2008.
- B. Pending Litigation and Claims** – The NC 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 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 NC 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 the trial court for disposition in accordance with the Supreme Court’s decision. On August 8, 2008, the trial court entered a judgment against the defendants. The manner and means by which the judgment is satisfied will be determined by the General Assembly. Approximately \$852,423 represent transportation fines collected by the University for the period of January 1, 1996 to June 30, 2005, and of this amount 10% or \$85,242 may be retained by the University to fund related operating expenses. Therefore, \$767,181 may be payable by 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*.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

NOTE 16 - SUBSEQUENT EVENTS

UNIVERSITY

- A. Fair Value of Endowment Investments** – The fair market value of the University's endowment investments with the UNC Investment Fund, LLC decreased from \$19,467,203.05 at June 30, 2008, to \$16,626,681.79 at October 31, 2008. This represents a \$2,840,521.26 or 14.6 percent decrease in endowment investments for the four-month period. The change is primarily due to the unrealized loss on these investments as a result of the volatile and unstable world-wide financial market. It is expected that this downward trend will continue into the foreseeable future. University management, along with their investment management advisors, plan to continue their efforts of monitoring these investments to minimize any significant losses.
- B. Final Determination of Title IV Program Review** – The University received a final determination letter, dated September 5, 2008, from the United States Department of Education (Department) notifying them of a

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

\$1,151,446.00 liability that has been assessed to the University due to outstanding findings from a December 11, 2006, Title IV Program Review. Of the \$1,151,446.00 liability, \$710,855.00 is payable to the Department, \$437,901.00 is payable to the lenders, and \$2,690.00 is payable to institutional accounts. The University concurs with the \$1,151,446.00 liability assessment and entered into a note agreement with the Department on November 20, 2008, regarding repayment of the \$710,855.00 owed to the Department. The total payments on principal and interest for the term of the note will be \$737,539.67, of which \$142,171.00 is due upon signing of the note agreement, and the remaining balance of \$595,368.67 is to be paid in 36 monthly installments commencing January 1, 2009. The remaining liability of \$440,591.00 is expected to be paid in full to the applicable parties in the 2008-2009 fiscal year.

The liability to the Department of \$710,855.00, as well as the liability to the lenders of \$437,901.00, for a total of \$1,148,756.00, has been reported on the Statement of Net Assets, with the offset reported on the Statement of Revenues, Expenses, and Changes in Net Assets as "Refunds to Grantors and Lenders."

COMPONENT UNIT

- C. Fair Value of Endowment Investments** – The fair market value of the component unit's endowment investments with the UNC Investment Fund, LLC decreased from \$5,296,138.00 at June 30, 2008, to \$4,633,741.28 at October 31, 2008. This represents a \$662,396.72 or 12.5 percent decrease in endowment investments for the four-month period. The change is primarily due to the unrealized loss on these investments as a result of the volatile and unstable world-wide financial market. It is expected that this downward trend will continue into the foreseeable future. Foundation management, along with their investment management advisors, plan to continue their efforts of monitoring these investments to minimize any significant losses.

[This Page Left Blank Intentionally]



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

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

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

We have audited the financial statements of Winston-Salem State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 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 unit, as described in our report on the University's financial statements. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

**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 findings 1 and 2 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 is 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 findings identified in our audit are described in the Audit Findings and Responses section of this report. We did not audit the University's response and, accordingly, we express no opinion on it.

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

[This Page Left Blank Intentionally]

AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control.

1. INCORRECT PAYROLL DISBURSEMENTS

The University paid several employees incorrectly during the year. We identified \$50,800 in salary overpayments and \$22,913 in salary underpayments.

We examined a sample of 69 employees paid during the year and found one employee who was overpaid \$436 and seven employees who were underpaid a total of \$11,235. We also examined a sample of 46 terminated employees who were exempt from the state personnel act and found six employees who were overpaid a total of \$50,364 and one who was underpaid \$11,678. For four of the six overpayments made to terminated employees, the University had already detected the errors and was in the process of recovering the funds. As of the time of our testing, \$9,164 had been refunded to the University, leaving unreimbursed salary overpayments of \$41,200.

One reason for the errors was the late submission of personnel action forms to the payroll office. This lead to payroll changes (salary increases, employee terminations, etc.) not being processed timely and erroneous payments made in the meantime. Errors also resulted from the University's method of paying nine-month employees over a 12-month period. These employees can receive one or two months of pay prior to beginning work in the new period. If the employee does not notify the University of his or her resignation timely, unearned payments may be made to the employee. A proper system of internal control requires that payroll changes be documented and processed timely.

Recommendation: The University should improve internal control by developing procedures to ensure that all salary payments are made correctly and timely. The University should reconsider its methodology for paying its nine-month employees over a 12-month period to determine whether there is an alternative payment method which precludes payment of employees in advance for work not yet performed. In addition, the University should rectify the noted salary underpayments and continue its efforts to recover the noted salary overpayments.

University's Response: Concur with finding.

Corrective Action: In order to improve upon the current accounting for non-returning faculty employed annually for nine months yet paid over a twelve month period, and to alleviate faculty overpayments, academic administration is considering modifying the current pay year from July 1 - June 30 to September 1 to August 31. Given the new payment method, non-returning faculty would be paid through August only and by that time Academic Affairs would have a greater likelihood of knowing whether a faculty

AUDIT FINDINGS AND RESPONSES (CONTINUED)

member is returning or not. In addition to this step, Human Resources and Academic Affairs will conduct refresher training for all hiring officials in both administrative and academic departments to reiterate the need for timely processing of payroll information when any changes occur. Finally, Human Resources will track instances where hiring officials fail to report changes in a timely fashion and the University will take appropriate personnel action to prevent repeat errors. All overpayment and underpayment amounts have been collected/paid out except for \$38,370. All outstanding payments have been sent a second notice for repayment.

Along with nine other UNC institutions, WSSU will be implementing the Banner Human Resource/Payroll module with a scheduled “Go-Live” date of January 1, 2010. As one of the initial tasks of this project, the Human Resource and Payroll units will be identifying and documenting all personnel related processes from initial employment through actual payment for services rendered. We will continue to make training and follow-up of errors a part of any new Banner processes implemented.

2. QUESTIONABLE PAYMENTS TO FOUNDATION

During the 2007-08 fiscal year, the University paid \$294,742 to the Winston-Salem State University Foundation, Inc. (Foundation) without any apparent justification. The payments represented a four percent fee assessed on the prior year’s gross revenues collected by the University on two student housing facilities. These facilities were constructed by the Foundation and are being leased to the University; however, the fee is not required by the lease agreement.

Subsequent to the 2007-08 fiscal year, an agreement dated July 15, 2008, between the University and the Foundation was developed in an effort to clarify the fee. The agreement stipulates that the University shall pay four percent of its annual net project revenues for administrative and managerial services provided by the Foundation in connection with the use and operation of the student housing facilities. However, the University is responsible for operating and managing the student housing facilities, assessing charges and collecting fees and rents on these facilities, and making the debt service payments on the facilities. As a result, the four percent fee paid by the University to the Foundation appears questionable.

The agreement does not clearly define what administrative and managerial services are being performed by the Foundation to warrant a four percent fee. Furthermore, the agreement requires that the University pay the Foundation based on four percent of its annual net project revenues, which is defined as project revenues less operating expenses. However, the 2007-08 payments to the Foundation were applied to the gross revenues.

Sound accounting practices and prudent management of University funds require that adequate documentation defining the purpose of expenditures be in place prior to the disbursement of University funds.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Recommendation: The University should ensure that adequate documentation that clearly defines the purpose of expenditures be in place prior to the disbursement of funds. In addition, the University should reconsider its agreement with the Foundation and ensure that legitimate administrative and management services are being performed by the Foundation that warrant payment of the fee. If the payment of a fee can not be clearly defined and documented, the University should seek reimbursement from the Foundation for these expenditures and discontinue any future payments to the Foundation.

University's Response: Concur with finding.

Corrective Action: University and Foundation leadership will examine the contractual relationship regarding all aspects of our privatized housing arrangement and will take appropriate action to clarify the contract. The expected result of this examination will be to determine the propriety of the payments in question and to ensure that any future payments to the Foundation will be appropriate based on the circumstances, fully documented in execution, and specifically authorized by the contract. If it is determined that the payments in question were in error, the University will seek reimbursement from the Foundation for any and all payments deemed not to be appropriate based on actual contractual responsibilities and obligations.

[This Page Left Blank Intentionally]

ORDERING INFORMATION

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

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919/807-7500

Facsimile: 919/807-7647