



STATE OF NORTH CAROLINA

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

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State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
Board of Trustees, University of North Carolina School of the Arts

We have completed a financial statement audit of the University of North Carolina School of the Arts for the year ended June 30, 2009, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

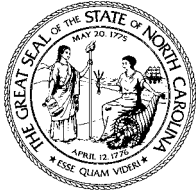
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
University of North Carolina School of the Arts
Winston-Salem, North Carolina

We have audited the accompanying financial statements of the University of North Carolina School of the Arts, 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, 2009, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University'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 NCSA Housing Corporation, which represent 5 percent, and 2 percent, respectively, of the assets, and revenues of the University; nor the financial statements of the University of North Carolina School of the Arts Foundation, Inc., the University's discretely presented component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of North Carolina School of the Arts and its discretely presented component unit as of June 30, 2009, and the respective changes in financial position and cash flows, where

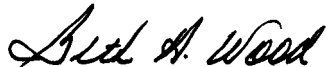
INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, during the year ended June 30, 2009.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 17, 2010 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, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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



Beth A. Wood, CPA
State Auditor

March 17, 2010

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS MANAGEMENT'S DISCUSSION AND ANALYSIS



Introduction

This section of the University of North Carolina School of the Arts financial report provides an overview of the financial position and activities for the year ended June 30, 2009. This discussion has been prepared by management along with the financial statements and related notes to the financial statements and should be read in conjunction with the financial statements and the notes thereto, which follow this section. This discussion and analysis is designed to focus on current activities, resulting change, and current known facts.

Using the Financial Statements

This annual report consists of a series of financial statements, prepared in accordance with standards issued by the Governmental Accounting Standards Board. These financial statements focus on the financial condition of the University, the results of operations, and cash flows of the University as a whole. The three financial statements presented include: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. For the purpose of this discussion, we will address the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. The Statement of Net Assets is a point of time financial statement. The purpose of the Statement of Net Assets is to present the readers of the financial statements a fiscal snapshot of the University of North Carolina School of the Arts. The Statement of Net Assets presents end-of-year data concerning assets (current and noncurrent), liabilities (current and noncurrent), and net assets (assets minus liabilities).

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

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the University's equity in property, plant and equipment

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

owned by the University. The next net assets category is restricted net assets, which is divided into two categories, nonexpendable and expendable. Nonexpendable restricted net assets include endowment investments, which are only available for investment purposes, and student loan funds. Expendable restricted net assets are available for expenditure by the University but must be spent for purposes as determined by donors and/or external entities that have placed certain restrictions on the use of the assets. This category includes restricted funds for endowment investments, capital projects, debt service reserves, and other expendable restricted resources. The final category is unrestricted net assets, which are available to the University for any lawful purpose of the University. The University uses available resources to acquire and improve all areas of the University to better serve the instructional and public service missions of the University. Please refer to the financial statements and notes to the financial statements for more detail.

Condensed Statement of Net Assets

	Year Ended June 30,		
	2009	2008	Change
Assets			
Current Assets	\$ 12,310,877.42	\$ 10,638,991.60	\$ 1,671,885.82
Capital Assets, Net	94,191,045.06	95,897,095.68	(1,706,050.62)
Other Noncurrent Assets	12,345,379.58	16,592,927.00	(4,247,547.42)
Total Assets	118,847,302.06	123,129,014.28	(4,281,712.22)
Liabilities			
Current Liabilities	2,903,088.91	3,202,362.79	(299,273.88)
Noncurrent Liabilities	11,629,762.99	11,777,373.24	(147,610.25)
Total Liabilities	14,532,851.90	14,979,736.03	(446,884.13)
Net Assets			
Invested in Capital Assets, Net of Related Debt	84,487,827.28	85,750,634.62	(1,262,807.34)
Restricted:			
Nonexpendable	7,823,451.70	8,152,738.05	(329,286.35)
Expendable	4,902,821.71	8,073,147.37	(3,170,325.66)
Unrestricted	7,100,349.47	6,172,758.21	927,591.26
Total Net Assets	\$ 104,314,450.16	\$ 108,149,278.25	\$ (3,834,828.09)

The total assets of the University decreased by \$4,281,712.22 for the year, with an increase of \$1,671,885.82 in current assets and a decrease in capital assets and other noncurrent assets of \$1,706,050.62 and \$4,247,547.42, respectively. The decrease in net capital assets of \$1,706,050.62 resulted mainly from an increase of \$1,065,512.95 in new capital assets offset against depreciation expense of \$2,788,610.70. Other noncurrent assets decreased mainly due to a decrease in noncurrent cash of \$2,816,856.42 and a decrease in endowment investments of \$1,268,625.64. The \$2,816,856.42 decrease in cash is partly due to reversions of prior years' capital appropriations totaling \$699,853.97 and increased capital project expenditures in excess of \$2,000,000.00. The \$1,268,625.64 decrease in endowment investments is mainly

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

due to an increase in endowments of approximately \$1,000,000.00 resulting from new additions to endowments for the year and endowment cash received in the prior year that was invested in the current year. This increase is offset against a net loss on investments of \$2,481,060.35. The net loss is a result of the downward trend in the economy and its associated impact on the investment markets.

The total liabilities of the University decreased \$446,884.13 for the year, which included a decrease of \$299,273.88 in current liabilities and a decrease of \$147,610.25 in noncurrent liabilities. The decrease in current liabilities was primarily the result of a decrease of \$258,633.42 in current payables and payroll, also due to a downturn in the economy that resulted in spending restrictions near the end of the year. The \$147,610.25 decrease in noncurrent liabilities is mainly due to the retirement of capital debt of \$443,243.28 offset against a \$275,214.32 increase in compensated absences.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets reports the University's results of operation for the fiscal year. Changes in total net assets presented on the Statement of Net Assets are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of this statement is to present the revenues received by the University and expenses paid by the University, both operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by the University.

Generally speaking, operating revenues are received for providing instruction, goods, or services to the various customers of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided. For example, the State appropriations are nonoperating because they are provided by the State legislature which receives no goods or services in return for those revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	Year Ended June 30,		
	2009	2008 (as Restated)	Change
Operating Revenues			
Student Tuition and Fees, Net	\$ 9,584,115.17	\$ 9,739,970.07	\$ (155,854.90)
Federal Grants and Contracts	73,836.72	19,012.58	54,824.14
Sales and Services, Net	5,829,242.10	5,085,947.42	743,294.68
Interest Earnings on Loans	1,247.74	1,334.79	(87.05)
Other Operating Revenues	636,582.93	718,310.71	(81,727.78)
Total Operating Revenues	16,125,024.66	15,564,575.57	560,449.09
Operating Expenses:			
Salaries and Benefits	30,696,992.92	28,769,372.26	1,927,620.66
Supplies and Materials	3,578,441.33	6,386,899.95	(2,808,458.62)
Services	7,379,012.63	8,911,868.68	(1,532,856.05)
Scholarships and Fellowships	741,777.20	869,091.07	(127,313.87)
Utilities	2,103,438.93	2,071,689.85	31,749.08
Depreciation	2,788,610.70	2,699,428.69	89,182.01
Total Operating Expenses	47,288,273.71	49,708,350.50	(2,420,076.79)
Operating Loss	(31,163,249.05)	(34,143,774.93)	2,980,525.88
Nonoperating Revenues (Expenses)			
State Appropriations	24,214,751.23	26,937,054.44	(2,722,303.21)
State Aid - Federal Recovery Funds	865,557.00		865,557.00
Noncapital Grants - Federal Student Financial Aid	772,333.73	739,113.05	33,220.68
Other Noncapital Grants	17,889.00	338,321.00	(320,432.00)
Noncapital Gifts	3,309,184.07	3,255,982.97	53,201.10
Investment Income (Loss)	(1,761,609.70)	200,703.29	(1,962,312.99)
Interest and Fees on Debt	(451,369.85)	(479,129.69)	27,759.84
Other Nonoperating Revenues (Expenses)	(60,557.33)	12,549.48	(73,106.81)
Net Nonoperating Revenues	26,906,178.15	31,004,594.54	(4,098,416.39)
Loss Before Other Revenues and Expenses	(4,257,070.90)	(3,139,180.39)	(1,117,890.51)
Capital Appropriations		1,606,000.00	(1,606,000.00)
Refund of Prior Years Capital Appropriations	(699,853.97)	(1,000,000.00)	300,146.03
Capital Grants	95,036.20	1,407,973.00	(1,312,936.80)
Capital Gifts	509,401.53		509,401.53
Additions to Endowments	519,818.58	1,000,025.00	(480,206.42)
Net Other Revenues	424,402.34	3,013,998.00	(2,589,595.66)
Decrease in Net Assets	(3,832,668.56)	(125,182.39)	(3,707,486.17)
Beginning Net Assets	108,149,278.25	107,393,000.68	756,277.57
Restatement of Net Assets (Note 16)	(2,159.53)	881,459.96	(883,619.49)
Ending Net Assets	\$ 104,314,450.16	\$ 108,149,278.25	\$ (3,834,828.09)

The Statement of Revenues, Expenses, and Changes in Net Assets reported a decrease in the net assets at the end of the year. Total net revenues were \$43,455,605.15 for 2009 and \$49,583,168.11 for 2008. The decrease in total net revenues of \$6,127,562.96 is primarily the result of a decrease in investment income of \$1,962,312.99, and a decrease in state

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

appropriations, of \$2,722,303.21. Some of the highlights of the revenue accounts presented on the Statement of Revenues, Expenses, and Changes in Net Assets are as follows:

- Student tuition and fees decreased \$155,854.90 mainly due to a reduction in the number of high school out-of-state students enrolled for the 2008-2009 fiscal year.
- Sales and services revenue increased \$743,294.68 mainly due to increases in fees charged to students and an increase in revenue associated with the University's Nutcracker production.
- The University received \$865,557.00 of Federal American Recovery and Reinvestment Act (ARRA) - Fiscal Stabilization funds, which supported state appropriations for operations. This amount was recorded as state aid since the funds were federal pass-through funds and was used to cover academic salaries and benefits.
- Investment income decreased \$1,962,312.99 as a result of the downward trend in the economy and its associated impact on the investment markets.
- The University was required to revert \$541,728.97 of unexpended cash previously included in capital appropriations. Additionally, the University transferred \$158,125.00 of prior years capital appropriations to Winston-Salem State University for the operation of the Center for Design Innovation, an institute of the University of North Carolina System. The University has administrative oversight for the institute.
- State appropriations' decrease of \$2,722,303.21 (10.1% from 2007-2008) is due to the worsening national and state economic conditions, credit crunch and overall volatility in the financial markets. These factors led to a downturn in the revenues collected and, therefore, a reduction in the available funds for use by state agencies and universities.

Operating expenses totaled \$47,288,273.71 for the year compared to \$49,708,350.50 from the previous year, a decrease of \$2,420,076.79. The most significant decreases in expenses occurred in supplies and materials, with a decrease of \$2,808,458.62, and services with a decrease of \$1,532,856.05. These decreases were primarily due to spending restrictions imposed by the North Carolina Office of State Budget and Management. Salaries and benefits increased \$1,927,620.66 primarily due to legislative salary increases.

Capital Asset and Debt Administration

The University's capital assets, net of accumulated depreciation at June 30, 2009, were \$94,191,045.06. For more information about the University's asset holdings, refer to Note 5 of the Notes to the Financial Statements.

The University had \$11,673,475.39 in outstanding long-term debt at June 30, 2009, and continues to make all of its debt payments in a timely manner. No new debt was issued

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

during the 2008-2009 fiscal year. Refer to Note 7 of the Notes to the Financial Statements for more detailed information about the University's debt obligations.

Economic Outlook

The University of North Carolina School of the Arts experienced a budget reduction in 2008-2009 due to the poor cash position and economy of the State. We were instructed by the North Carolina Office of State Budget and Management (OSBM) to withhold two percent from our quarterly allotment requests early in the Fall term. By the Spring term, the revenues for the State did not increase as originally predicted and OSBM issued a restriction on spending. All requests for non-classroom expenditures were directed to OSBM for preapproval. By June 30th, the University had suffered a 12.3% budget reversion to the State's General Fund as well as an approximate \$625,000 reduction in previous repair and renovation funding.

In the 2009-2010 certified budget, the University will experience a \$1,352,276 budget reversion and a \$740,587 permanent budget reduction. The Legislature did not approve items requested through the continuation budget process for inflationary funding, equipment/vehicle replacement funding, personnel-related benefit funding, and operating funds for the new library. The Legislature passed a bill that transferred the University's appropriated funding for the Manteo Summer Program to the North Carolina Department of Cultural Resources. Lastly, the Center for Design Innovation's budget was reduced \$100,000 as part of the NC Centers and Institutes Reduction initiative. These Legislative changes total an additional loss of \$2,402,318 to the 2009-2010 budget. The North Carolina Legislature passed an additional \$27,000,000 in reductions for the University System for 2010-2011. Therefore, UNC School of the Arts will definitely face additional reductions next fiscal year.

The University did receive \$1,000,000 in Special Needs funding, as well as \$500,000 in non-recurring funding and \$500,000 in recurring funding for the School of Filmmaking for 2009-2010. In capital improvements for 2009-2010, the University received \$744,000 in repair and renovation funding for projects such as roof replacements for the School of Filmmaking and the School of Design and Production, exterior waterproofing for the School of Filmmaking buildings, structural repairs to breezeways and stairwells in the Gray Building, and other various projects. The revised campus master plan is expected to be complete in the Spring of 2010.

In 2008-2009, the University was allocated \$11,100,000 for the Central Storage and Campus Police Operations Facility; \$24,920,000 for the Library; and \$12,900,000 for the School of Filmmaking Production Facility. These amounts were reduced in the 2009-2011 budget to reflect new amounts of \$10,237,116 for the Central Storage and Campus Police Operations Facility; \$23,043,890 for the Library; and \$11,543,828 for the School of Filmmaking Production Facility. These projects will be funded by Certificates of Participation (COPS) and the receipt of the funds will depend upon the sale of these certificates by the State.

University of North Carolina School of the Arts
Statement of Net Assets
June 30, 2009

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 9,804,935.63
Restricted Cash and Cash Equivalents	1,975,656.87
Receivables, Net (Note 4)	160,189.60
Due from University Component Unit	15,497.20
Inventories	240,593.29
Notes Receivable, Net (Note 4)	114,004.83

Total Current Assets	12,310,877.42
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Noncurrent Assets:

Restricted Cash and Cash Equivalents	3,521,507.58
Restricted Due from Primary Government	104,806.63
Endowment Investments	7,185,184.07
Restricted Investments	550,535.77
Other Investments	52,463.34
Notes Receivable, Net (Note 4)	376,684.19
Bond Issuance Costs, Net of Amortization of \$102,601	554,198.00
Capital Assets - Nondepreciable (Note 5)	6,365,135.85
Capital Assets - Depreciable, Net (Note 5)	87,825,909.21

Total Noncurrent Assets	106,536,424.64
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Total Assets	118,847,302.06
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	664,806.60
Due to Primary Government	82,868.78
Unearned Revenue	1,540,991.16
Interest Payable	55,264.67
Long-Term Liabilities - Current Portion (Note 7)	559,157.70

Total Current Liabilities	2,903,088.91
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Noncurrent Liabilities:

Deposits Payable	54,292.81
Funds Held for Others	18,513.20
U. S. Government Grants Refundable	442,639.29
Long-Term Liabilities (Note 7)	11,114,317.69

Total Noncurrent Liabilities	11,629,762.99
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Total Liabilities	14,532,851.90
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University of North Carolina School of the Arts
Statement of Net Assets
June 30, 2009

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	84,487,827.28
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	322,503.20
Endowed Professorships	3,905,709.06
Departmental Uses	3,517,025.00
Loans	78,214.44
Expendable:	
Scholarships and Fellowships	1,069,732.33
Departmental Uses	52,095.50
Capital Projects	3,230,458.11
Debt Service	550,535.77
Unrestricted	<u>7,100,349.47</u>
Total Net Assets	<u><u>\$ 104,314,450.16</u></u>

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

University of North Carolina School of the Arts
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2009

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 9,584,115.17
Federal Grants and Contracts	73,836.72
Sales and Services, Net (Note 9)	5,829,242.10
Interest Earnings on Loans	1,247.74
Other Operating Revenues	636,582.93

Total Operating Revenues 16,125,024.66

EXPENSES

Operating Expenses:

Salaries and Benefits	30,696,992.92
Supplies and Materials	3,578,441.33
Services	7,379,012.63
Scholarships and Fellowships	741,777.20
Utilities	2,103,438.93
Depreciation	2,788,610.70

Total Operating Expenses 47,288,273.71

Operating Loss (31,163,249.05)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	24,214,751.23
State Aid - Federal Recovery Funds	865,557.00
Noncapital Grants - Federal Student Financial Aid	772,333.73
Other Noncapital Grants	17,889.00
Noncapital Gifts	3,309,184.07
Investment Loss	(1,761,609.70)
Interest and Fees on Debt	(451,369.85)
Other Nonoperating Expenses	(60,557.33)

Net Nonoperating Revenues 26,906,178.15

Loss Before Other Revenues and Expenses (4,257,070.90)

Refund of Prior Years Capital Appropriations	(699,853.97)
Capital Grants	95,036.20
Capital Gifts	509,401.53
Additions to Endowments	519,818.58

Decrease in Net Assets (3,832,668.56)

NET ASSETS

Net Assets - July 1, 2008, as Restated (Note 16) 108,147,118.72

Net Assets - June 30, 2009 \$ 104,314,450.16

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

University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 16,036,461.73
Payments to Employees and Fringe Benefits	(30,445,170.77)
Payments to Vendors and Suppliers	(13,239,265.56)
Payments for Scholarships and Fellowships	(741,777.20)
Loans Issued	(51,384.00)
Collection of Loans	68,494.71
Interest Earned on Loans	1,247.74
Interest and Earnings on Perkins Loans	8,025.88
Student Deposits Received	168,000.00
Student Deposits Returned	(168,600.00)
	<hr/>
Net Cash Used by Operating Activities	(28,363,967.47)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	24,214,751.23
State Aid - Federal Recovery Funds	865,557.00
Noncapital Grants - Federal Student Financial Aid	772,333.73
Other Noncapital Grants	17,889.00
Noncapital Gifts	3,309,184.07
Additions to Endowments	519,818.58
William D. Ford Direct Lending Receipts	5,325,506.00
William D. Ford Direct Lending Disbursements	(5,325,506.00)
Related Activity Agency Receipts	18,513.20
Other Payments	(60,557.33)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	29,657,489.48

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Refund of Prior Years Capital Appropriations	(699,853.97)
Capital Grants	233,224.97
Proceeds from Sale of Capital Assets	10,772.93
Acquisition and Construction of Capital Assets	(487,672.72)
Principal Paid on Capital Debt and Leases	(443,243.28)
Interest and Fees Paid on Capital Debt and Leases	(409,939.76)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(1,796,711.83)

CASH FLOWS FROM INVESTING ACTIVITIES

Investment Income	671,654.14
Purchase of Investments and Related Fees	(1,245,354.84)
	<hr/>
Net Cash Used by Investing Activities	(573,700.70)
	<hr/>
Net Decrease in Cash and Cash Equivalents	(1,076,890.52)
	<hr/>
Cash and Cash Equivalents - July 1, 2008	16,378,990.60
	<hr/>
Cash and Cash Equivalents - June 30, 2009	\$ 15,302,100.08

University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3

Page 2

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

Operating Loss	\$ (31,163,249.05)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	2,788,610.70
Allowances, Write-Offs, and Amortizations	2,142.84
Changes in Assets and Liabilities:	
Receivables (Net)	1,170.48
Due from University Component Unit	1,460.80
Inventories	42,337.63
Accounts Payable and Accrued Liabilities	(310,426.18)
Due to Primary Government	82,868.78
Unearned Revenue	(115,620.38)
U S Government Grants Refundable	15,011.88
Compensated Absences	275,214.32
Deposits Payable	(600.00)
Notes Receivable, Students	17,110.71
	<hr/>
Net Cash Used by Operating Activities	<u><u>\$ (28,363,967.47)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 9,804,935.63
Restricted Cash and Cash Equivalents	1,975,656.87
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	3,521,507.58
	<hr/>
Total Cash and Cash Equivalents - June 30, 2009	<u><u>\$ 15,302,100.08</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	509,401.53
Change in Fair Value of Investments	(2,481,060.35)
Reinvested Distributions	387,401.18

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Financial Position
June 30, 2009

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$ 2,543,222
Investments	13,131,825
Annuity Investments	681,147
Beneficial Interest in Perpetual Trusts	563,259
Beneficial Interest in Charitable Remainder Trusts	153,314
Pledges Receivable, Net of Allowance and Discount Amortization of \$672,779	2,024,511
Accounts Receivable	8,850
Prepaid Expenses	18,591
Staff, Faculty, and Student Loans Receivable	10,509
Property, Plant and Equipment, Net of Accumulated Depreciation and Amortization of \$284,204	<u>1,474,316</u>
Total Assets	<u>20,609,544</u>

LIABILITIES

Accounts Payable and Accrued Expenses	37,068
Annuity Payment Liability	437,271
Notes Payable	<u>45,563</u>
Total Liabilities	<u>519,902</u>

NET ASSETS

Unrestricted	(1,489,895)
Temporarily Restricted	3,213,588
Permanently Restricted	<u>18,365,949</u>
Total Net Assets	<u>20,089,642</u>
Total Liabilities and Net Assets	<u><u>\$ 20,609,544</u></u>

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2009

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Gifts and Grants	\$ 441,774	\$ 1,350,701	\$ 387,530	\$ 2,180,005
Gifts In-Kind		782,820		782,820
Interest and Dividend Income	18,914	210,967		229,881
Realized and Unrealized Losses	(1,865,908)	(1,640,207)		(3,506,115)
Change in Fair Value of Split-Interest Agreements			(106,296)	(106,296)
Change in Fair Value of Beneficial Interest in Perpetual Trusts		15,428	(232,581)	(217,153)
Other Income	100,767	35,298		136,065
Net Assets Released from Restrictions	2,424,701	(2,424,701)		
Total Revenues	1,120,248	(1,669,694)	48,653	(500,793)
EXPENSES				
Program Services:				
Scholarships and Awards	844,503			844,503
School Programs	1,406,941			1,406,941
Total Program Services	2,251,444			2,251,444
Supporting Services:				
Administrative Costs	242,727			242,727
Investment Management Fees	37,564			37,564
Development Costs	334,157			334,157
Depreciation and Amortization Expense	107,493			107,493
Miscellaneous Expense	59,600			59,600
Total Supporting Services	781,541			781,541
Total Expenses	3,032,985			3,032,985
Change in Net Assets Before Transfers	(1,912,737)	(1,669,694)	48,653	(3,533,778)
Transfers of Property to the University	(519,401)	(43,759)		(563,160)
Transfers Between Funds	(150,000)	125,000	25,000	
Change in Net Assets	(2,582,138)	(1,588,453)	73,653	(4,096,938)
NET ASSETS				
Net Assets - Beginning of Year	1,092,243	4,802,041	18,292,296	24,186,580
Net Assets - End of Year	<u>\$ (1,489,895)</u>	<u>\$ 3,213,588</u>	<u>\$ 18,365,949</u>	<u>\$ 20,089,642</u>

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

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UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009

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 (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina School of the Arts is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

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

Blended Component Unit - Although legally separate, the NCSA Housing Corporation, a component unit of the University, is reported as if it was part of the University.

The NCSA Housing Corporation is governed by a five-member board. Its purpose is to aid, support, and promote the University, specifically by the ownership of the Center Stage apartment complex at 900 Center Stage Court, Winston-Salem, NC 27127. Because the directors are appointed by the Chancellor and its primary purpose is to benefit the University of North Carolina School of the Arts, its financial statements have been blended with those of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Separate financial statements for the NCSA Housing Corporation may be obtained from the University Controller's Office, PO Box 12189, Winston-Salem, NC 27107, or by calling (336) 770-3304. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

Discretely Presented Component Unit - The University of North Carolina School of the Arts Foundation, Inc. (Foundation) is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University.

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 12, nor more than 21 members. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be 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 University of North Carolina School of the Arts Foundation, Inc. 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, 2009, the Foundation distributed \$2,814,604.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University of North Carolina School of the Arts Foundation, Inc., PO Box 12189, Winston-Salem, NC 27107.

- 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).

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

- E. Investments** - Investments are reported at fair value, as determined by quoted market prices. The net decrease in the fair value of investments is recognized as a component of investment income.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

amounts internally designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** - Inventories, consisting of expendable supplies, are valued at cost using the last invoice cost method. Merchandise for resale is valued using the retail inventory method.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs.

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 50 years for general infrastructure and buildings, and 5 to 15 years for equipment, except for specialized filmmaking equipment (20 years) and specialized musical instruments (15 to 50 years).

The Regis Film 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, certificates of participation,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

capital lease obligations, and compensated absences that will not be paid within the next fiscal year.

Premiums, discounts, and issuance costs for the University are expensed for bonds. Issuance costs for the blended housing corporation were capitalized and amortized over the life of the certificates of participation using the straight-line method.

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

- O. Internal Sales Activities** - The University has 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 agency funds held directly by the University.

At June 30, 2009, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$14,358,414.91 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.8 years as of June 30, 2009. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2009 was \$4,930.00. The carrying amount of the University's deposits not with the State Treasurer was \$938,755.17 and the bank balance was \$1,094,848.57. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2009, \$616,209.22 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

B. Investments

University - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

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

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

UNC Investment Fund, LLC – At June 30, 2009, the University's investments include \$7,185,184.07 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 of 12.70 years as of June 30, 2009. 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 Chapel Hill Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2009, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years) <u>Less</u> Than 1
Debt Securities		
Money Market Mutual Funds	<u>\$ 602,999.11</u>	<u>\$ 602,999.11</u>

At June 30, 2009, the Money Market Mutual Funds, with a fair value of \$602,999.11, were rated AAAM by Standard and Poors.

Total Investments - The following table presents the fair value of the total investments at June 30, 2009:

Investment Type	Fair Value
Debt Securities	
Money Market Mutual Funds	\$ 602,999.11
Other Securities	
UNC Investment Fund, LLC	7,185,184.07
Total Investments	\$ 7,788,183.18

Component Unit - Investments of the University's discretely presented component unit, the Foundation, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) 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:

Investment Type	Fair Value
ACM Financial Trust	\$ 647,125.00
UNC Investment Fund II, LLC	12,483,930.00
Short-Term Investments	770.00
Total Investments	\$ 13,131,825.00

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, State law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may also appropriate expenditures from eligible nonexpendable balances if deemed prudent and necessary to meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. However, a majority of the University's endowment donor agreements prohibit spending of nonexpendable balances and therefore the related nonexpendable balances are not eligible for expenditure. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). 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.

During the current year, the university incurred investment losses that exceeded the related endowment's available accumulated income and net appreciation. These losses resulted in a reduction to the specific nonexpendable endowment balance. At June 30, 2009 the amount of investment losses reported against the nonexpendable endowment balances were \$1,394,330.65.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2009, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 25,456.17	\$ 11,043.84	\$ 14,412.33
Accounts	79,212.41		79,212.41
Intergovernmental	31,709.09		31,709.09
Interest on Loans	34,855.77		34,855.77
Total Current Receivables	\$ 171,233.44	\$ 11,043.84	\$ 160,189.60
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 139,601.11	\$ 26,734.53	\$ 112,866.58
Institutional Student Loan Programs	7,677.45	6,539.20	1,138.25
Total Notes Receivable - Current	\$ 147,278.56	\$ 33,273.73	\$ 114,004.83
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 527,302.69	\$ 150,618.50	\$ 376,684.19

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2009, is presented as follows:

	Balance July 1, 2008	Increases	Decreases	Balance June 30, 2009
Capital Assets, Nondepreciable:				
Land	\$ 3,939,216.51	\$ 72,635.23	\$ 0.00	\$ 4,011,851.74
Art, Literature, and Artifacts	1,395,364.44	509,401.53		1,904,765.97
Construction in Progress	189,189.86	259,328.28		448,518.14
Total Capital Assets, Nondepreciable	5,523,770.81	841,365.04		6,365,135.85
Capital Assets, Depreciable:				
Buildings	106,384,720.40		17,559.75	106,367,160.65
Machinery and Equipment	9,014,470.38	224,147.91	178,966.99	9,059,651.30
General Infrastructure	5,107,656.50			5,107,656.50
Total Capital Assets, Depreciable	120,506,847.28	224,147.91	196,526.74	120,534,468.45
Less Accumulated Depreciation for:				
Buildings	24,069,173.85	2,127,349.39	15,390.40	26,181,132.84
Machinery and Equipment	5,372,010.34	559,108.18	178,966.99	5,752,151.53
General Infrastructure	673,121.74	102,153.13		775,274.87
Total Accumulated Depreciation	30,114,305.93	2,788,610.70	194,357.39	32,708,559.24
Total Capital Assets, Depreciable, Net	90,392,541.35	(2,564,462.79)	2,169.35	87,825,909.21
Capital Assets, Net	\$ 95,916,312.16	\$ (1,723,097.75)	\$ 2,169.35	\$ 94,191,045.06

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2009, were as follows:

	Amount
Accounts Payable	\$ 456,365.14
Accrued Payroll	192,394.25
Contract Retainage	16,047.21
Total Accounts Payable and Accrued Liabilities	\$ 664,806.60

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2009, is presented as follows:

	Balance July 1, 2008	Additions	Reductions	Balance June 30, 2009	Current Portion
Revenue Bonds Payable	\$ 3,175,000.00	\$ 0.00	\$ 290,000.00	\$ 2,885,000.00	\$ 295,000.00
Certificates of Participation	6,910,000.00		140,000.00	6,770,000.00	145,000.00
Total Bonds and Certificates of Participation Payable	10,085,000.00		430,000.00	9,655,000.00	440,000.00
Capital Leases Payable	61,461.06		13,243.28	48,217.78	14,054.50
Compensated Absences	1,695,043.29	1,073,516.52	798,302.20	1,970,257.61	105,103.20
Total Long-Term Liabilities	\$ 11,841,504.35	\$ 1,073,516.52	\$ 1,241,545.48	\$ 11,673,475.39	\$ 559,157.70

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2009	Principal Outstanding June 30, 2009	See Table Below
<u>Revenue Bonds Payable</u>							
<u>The University of North Carolina System Pool Revenue Bonds</u>							
Fitness and Student Center Project	A	3.25%-5.25%	10/01/2018	2,650,000.00	1,035,000.00	1,615,000.00	(1)
Refunding 1998B and 2000 UNC System Pool Revenue Bonds	B	3.00%-4.25%	04/01/2019	1,900,000.00	630,000.00	1,270,000.00	
Total UNC System Pool Revenue Bonds				<u>4,550,000.00</u>	<u>1,665,000.00</u>	<u>2,885,000.00</u>	
<u>Certificates of Participation</u>							
Student Housing Project	C	3.50%-4.50%	06/01/2036	7,200,000.00	430,000.00	6,770,000.00	(2)
Total Bonds Payable and Certificates of Participation				<u>\$ 11,750,000.00</u>	<u>\$ 2,095,000.00</u>	<u>\$ 9,655,000.00</u>	

(A) The University of North Carolina System Pool Revenue Bonds, Series 1998B

(B) The University of North Carolina System Pool Revenue Bonds, Series 2005B

(C) University of North Carolina School of the Arts Student Housing Project, Series 2005

Fund reservations in the amount of \$433,325.00 required by the Series 2005 Certificates of Participation Indenture for the Student Housing Project were established and recorded in a Reserve Fund with the fiscal agent. At June 30, 2009, the balance in the Reserve Fund was \$485,788.34. In addition, the University contributes to a Maintenance and Equipment Reserve Fund also required by the indenture. At June 30, 2009, the balance in this reserve was \$117,210.77.

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year Revenues Net of Expenses	Current Year Principal & Interest	Estimate of % of Revenues Pledged
(1)	Facility Debt Fee Revenues	2,018,478.14	252,245.80	203,993.76	80%
(2)	Housing Revenues	11,624,243.88	600,036.06	430,675.00	72%

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, 2009, are as follows:

<u>Fiscal Year</u>	Annual Requirements			
	Revenue Bonds Payable		Certificates of Participation	
	Principal	Interest	Principal	Interest
2010	\$ 295,000.00	\$ 122,531.26	\$ 145,000.00	\$ 285,775.00
2011	310,000.00	109,728.13	150,000.00	280,700.00
2012	325,000.00	96,975.00	155,000.00	275,450.00
2013	335,000.00	82,887.50	160,000.00	270,025.00
2014	355,000.00	67,481.25	165,000.00	264,425.00
2015-2019	1,265,000.00	151,037.50	930,000.00	1,222,168.80
2020-2024			1,135,000.00	1,020,212.54
2025-2029			1,395,000.00	758,937.54
2030-2034			1,730,000.00	421,875.00
2035-2036			805,000.00	54,675.00
Total Requirements	\$ 2,885,000.00	\$ 630,640.64	\$ 6,770,000.00	\$ 4,854,243.88

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to a bus 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, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 16,548.48
2011	16,548.48
2012	19,515.50
Total Minimum Lease Payments	52,612.46
Amount Representing Interest (5.96% Rate of Interest)	4,394.68
Present Value of Future Lease Payments	\$ 48,217.78

Machinery and equipment acquired under capital lease amounted to \$83,787.00 at June 30, 2009.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Operating Lease Obligations - The University entered into operating leases for copiers and land. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 83,205.06
2011	62,039.70
2012	31,667.76
2013	15,661.84
Total Minimum Lease Payments	<u>\$ 192,574.36</u>

Rental expense for all operating leases during the year was \$69,257.74.

NOTE 9 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Change in Allowance for Uncollectibles</u>	<u>Net Revenues</u>
Operating Revenues:					
Student Tuition and Fees	<u>\$ 12,640,491.25</u>	<u>\$ 0.00</u>	<u>\$ 3,057,981.87</u>	<u>\$ 1,605.79</u>	<u>\$ 9,584,115.17</u>
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 3,495,272.77	\$ 0.00	\$ 829,351.26	\$ 0.00	\$ 2,665,921.51
Dining	2,223,814.27		517,654.33		1,706,159.94
Health, Physical Education, and Recreation Services	153,116.69				153,116.69
Bookstore	278,128.10				278,128.10
Parking	58,225.20				58,225.20
Other	6,562.25				6,562.25
Sales and Services of Education and Related Activities:					
School Production Revenues	770,078.40				770,078.40
Other	240,062.58	49,012.57			191,050.01
Total Sales and Services	<u>\$ 7,225,260.26</u>	<u>\$ 49,012.57</u>	<u>\$ 1,347,005.59</u>	<u>\$ 0.00</u>	<u>\$ 5,829,242.10</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	\$ 12,907,379.35	\$ 423,901.25	\$ 755,418.75	\$ 0.00	\$ 668.73	\$ 0.00	\$ 14,087,368.08
Public Service	554,621.29	57,152.59	787,049.52				1,398,823.40
Academic Support	3,693,031.10	261,672.82	364,668.53		109.76		4,319,482.21
Student Services	961,837.18	18,647.66	89,620.45				1,070,105.29
Institutional Support	5,735,728.10	163,759.83	2,388,214.40		7,498.63		8,295,200.96
Operations and Maintenance of Plant	3,894,295.20	2,061,403.14	603,168.87		1,541,605.49		8,100,472.70
Student Financial Aid				741,777.20			741,777.20
Auxiliary Enterprises	2,950,100.70	591,904.04	2,390,872.11		553,556.32		6,486,433.17
Depreciation						2,788,610.70	2,788,610.70
Total Operating Expenses	<u>\$ 30,696,992.92</u>	<u>\$ 3,578,441.33</u>	<u>\$ 7,379,012.63</u>	<u>\$ 741,777.20</u>	<u>\$ 2,103,438.93</u>	<u>\$ 2,788,610.70</u>	<u>\$ 47,288,273.71</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, 2009, these rates were set at 3.36% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$24,919,047.77, of which \$12,352,993.12 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 \$415,060.57 and \$741,179.59, respectively.

Required employer contribution rates for the years ended June 30, 2008, and 2007, were 3.05% and 2.66%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2009, 2008, and 2007, which were \$415,060.57, \$344,977.74, and \$278,587.53, 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 "Proceed directly to OSC's index page," then "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, 2009, 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 \$24,919,047.77, of which \$9,391,542.58 was covered under the Optional Retirement Program. Total employer and employee contributions for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

pension benefits for the year were \$642,381.51 and \$563,492.55, 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 \$47,243.00 for the year ended June 30, 2009.

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, 2009, were \$97,403.56. The voluntary contributions by employees amounted to \$162,395.98 for the year ended June 30, 2009.

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 \$149,841.54 for the year ended June 30, 2009.

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 *North Carolina General Statute 135-7* and Chapter 135, Article 3A, 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, 2008, and 2007, were 4.1% and 3.8%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2009, 2008, and 2007, which were \$891,525.96, \$826,083.63, and \$711,237.90, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Proceed directly to OSC's index page," then "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, 2009, 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, 2008, and 2007, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2009, 2008, and 2007, which were \$113,071.59, \$104,771.58, and \$97,327.29, 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 retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. The University also purchased through the Fund extended coverage for fire, sprinkler leakage, business interruption, vandalism, theft, and "all risks" for buildings and contents. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

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 \$10,000,000 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. The private insurance company pays 90% of each loss less a \$75,000 deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. The insurance purchased included general and professional liability insurance for the School of Filmmaking student interns, student accident and health insurance, and accident and health insurance for students who study abroad.

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 retains the risk for workers' compensation.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$242,758.88 and on other purchases were \$105,385.65 at June 30, 2009.
- B. Pending Litigation and Claims** - The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

NOTE 15 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2009, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*.

GASB Statement No. 49, requires reporting pollution remediation obligations, including reporting pollution remediation obligations that previously may not have been reported.

GASB Statement No. 52, requires reporting land and other real estate held as investments at fair value. This statement amends GASB Statement No. 31 which required endowments to report land and other real estate investments at historical cost.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

In addition, beginning with the year ended June 30, 2009, the University reports federal student aid as nonoperating revenue instead of operating revenue. This change was the result of a clarification in the GASB *Comprehensive Implementation Guide*.

NOTE 16 - NET ASSET RESTATEMENT

As of July 1, 2008, net assets as previously reported were restated as follows:

	<u>Amount</u>
July 1, 2008 Net Assets as Previously Reported	\$ 108,149,278.25
Restatement: Adjustment to Cash for Interest Not Reversed in Prior Years	<u>(2,159.53)</u>
July 1, 2008 Net Assets as Restated	<u><u>\$ 108,147,118.72</u></u>

STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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

Board of Trustees
University of North Carolina School of the Arts
Winston-Salem, North Carolina

We have audited the financial statements of the University of North Carolina School of the Arts, 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, 2009, which collectively comprise the University's basic financial statements and have issued our report thereon dated March 17, 2010. 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. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, during the year ended June 30, 2009.

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 NCSA Housing Corporation and the discretely presented component unit, the University of North Carolina School of the Arts Foundation, Inc., as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. 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.

**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)**

Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

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

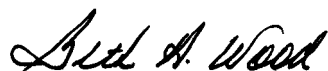
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

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

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*.

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



Beth A. Wood, CPA
State Auditor

March 17, 2010

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State of North Carolina
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