

STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2010

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THE UNIVERSITY OF NORTH CAROLINA

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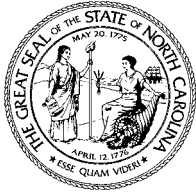
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Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of The University of North Carolina at Chapel Hill for the year ended June 30, 2010, 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
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2010, 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 Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

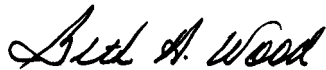
In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units as of June 30, 2010, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 19 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* and Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, during the year ended June 30, 2010.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 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

November 30, 2010

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Management's Discussion and Analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year that ended June 30, 2010, with comparative information for the fiscal year ended June 30, 2009. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying notes to the financial statements.

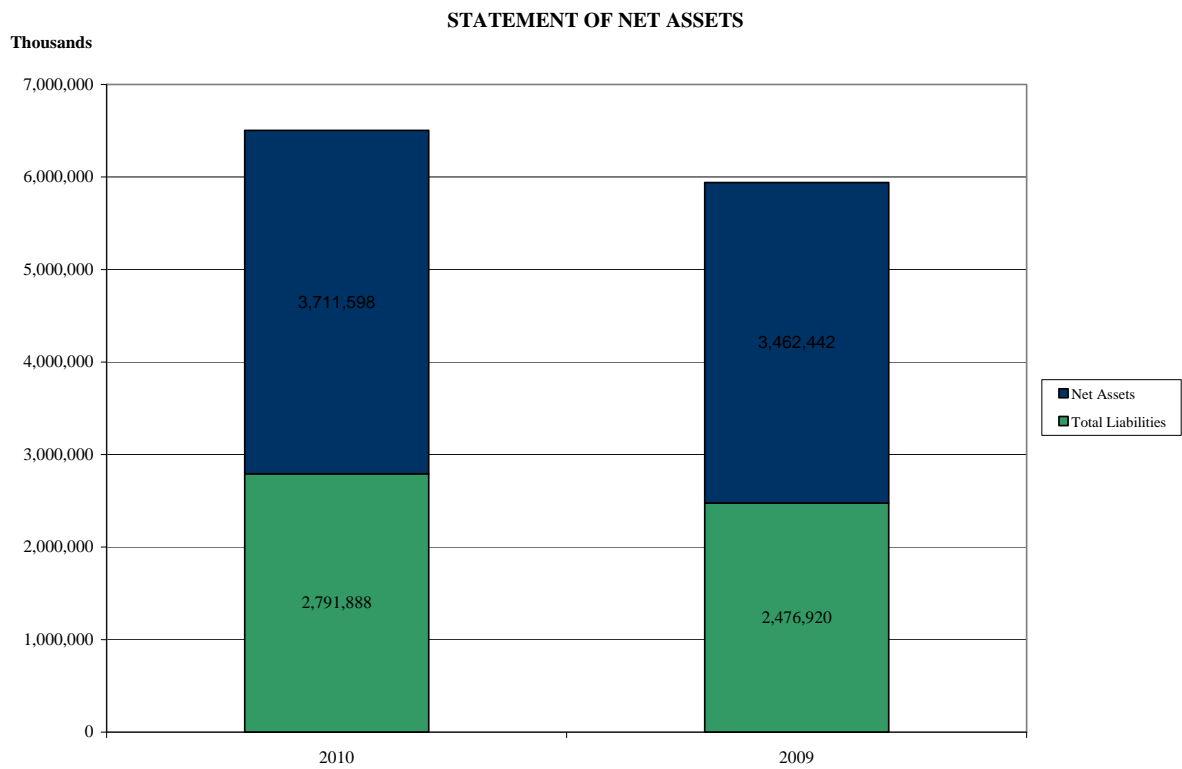
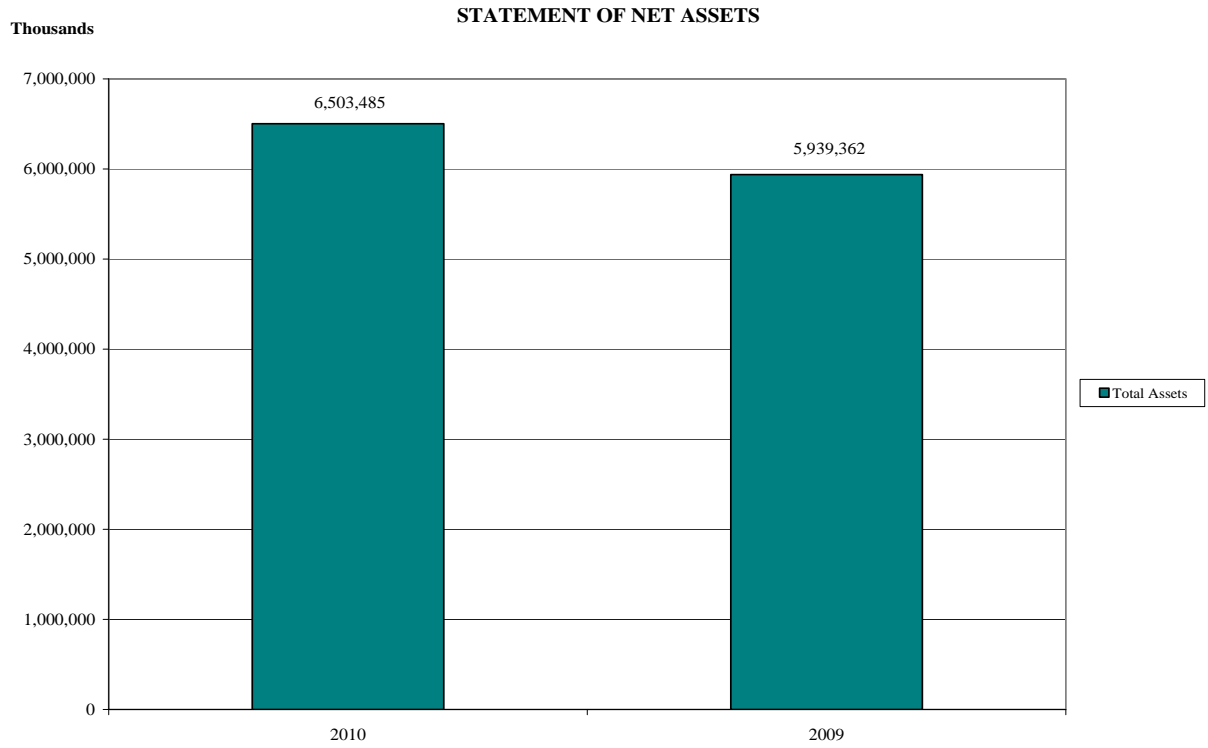
The University is a constituent institution of the multi-campus University of North Carolina System (UNC System), a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report (CAFR)*. The financial reporting entity for the financial statements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

Financial Highlights

The University's financial position at June 30, 2010 continued to be impacted by economic weaknesses as the State's revenues were below budgeted levels, although the global financial markets recorded gains and experienced a sharper recovery than economies around the world, which are improving at a more modest pace. The University implemented spending reductions and other measures to address shortfalls in resources. The University's proactive decisions helped mitigate the impacts of the financial shortfalls.

The University's total assets were \$6.5 billion at June 30, 2010. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were \$3.7 billion at June 30, 2010. The University's net assets increased by \$249 million in fiscal year 2009-2010 as a result of operating, nonoperating, and other changes in net assets. A comparison of the total assets, liabilities, and net assets at June 30, 2010 and June 30, 2009, and a comparison of the major components of the changes in net assets for the two fiscal years are presented below:

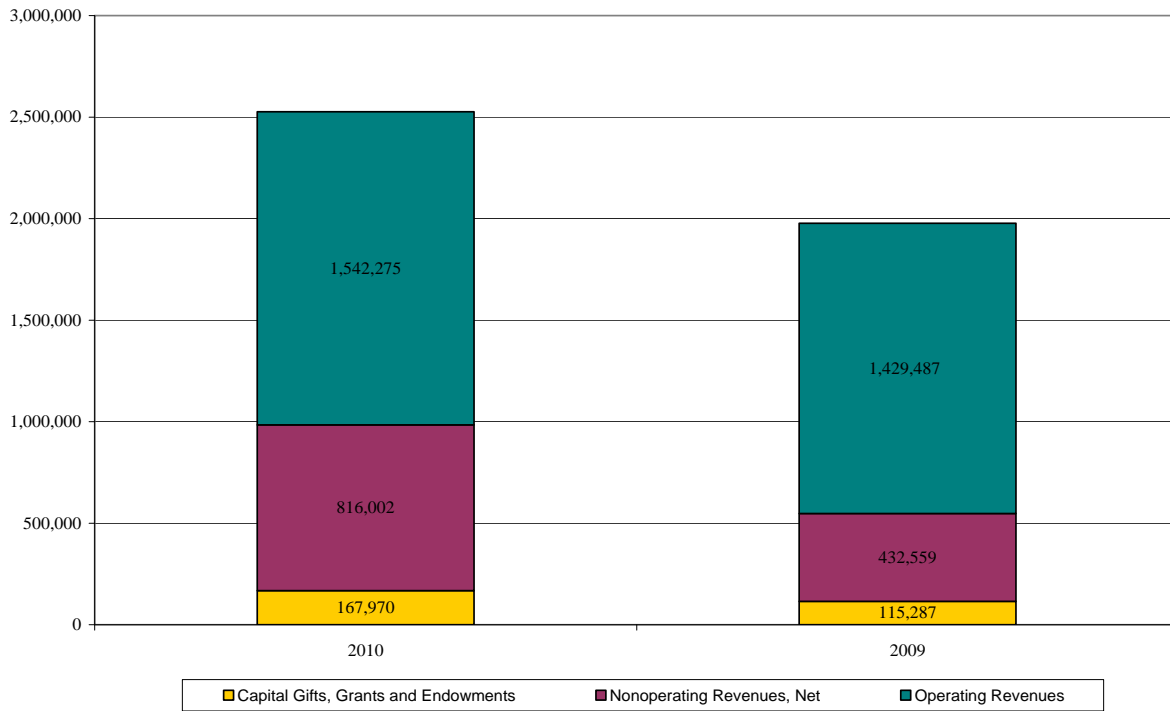
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

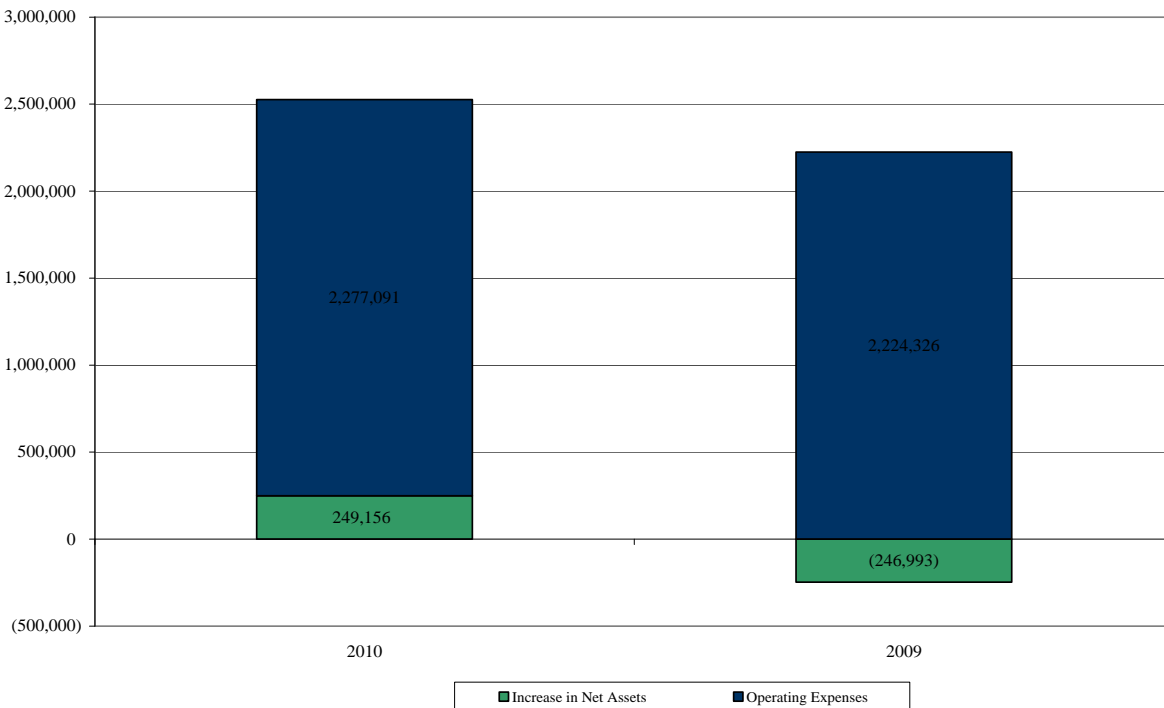
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STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS



Thousands

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net assets increased 7.2% at June 30, 2010 over the prior year. Total assets increased 9.5% from the prior year and total liabilities rose 12.7% for the same period. Operating revenues increased at a greater rate than operating expenses in fiscal year 2009-2010 over the prior year, 7.9% and 2.4%, respectively. Net nonoperating revenues and expenses increased 88.6% in fiscal year 2009-2010 over the prior year, due primarily to the substantial increase in investment income from a \$296.9 million loss in fiscal year 2008-2009 to a \$103.6 million gain in fiscal year 2009-2010. Research funding, fund raising for operational and capital needs, State appropriations, and tuition and fees continued to provide important resources to the University.

Using the Financial Statements

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

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

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

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

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and noncurrent components. Net assets represent the difference between total assets and total liabilities and are one indicator of the University's current financial condition. The following table summarizes the University's assets, liabilities, and net assets on June 30, 2010 and June 30, 2009.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Assets, Liabilities, and Net Assets (dollars in thousands)

	2010	2009	Percent Change
Assets:			
Current Assets	\$ 1,253,869	\$ 1,126,655	11.3
Noncurrent Assets:			
Endowment, Restricted and Other Investments	2,268,098	2,058,756	10.2
Capital Assets, Net	2,782,886	2,530,951	10.0
Other Noncurrent Assets	198,632	223,000	(10.9)
Total Assets	6,503,485	5,939,362	9.5
Liabilities:			
Current Liabilities	338,285	423,124	(20.1)
Noncurrent Liabilities:			
Funds Held in Trust for Pool Participants	1,071,561	940,560	13.9
Long-Term Liabilities	1,330,159	1,082,197	22.9
Other Noncurrent Liabilities	51,882	31,039	67.2
Total Liabilities	2,791,887	2,476,920	12.7
Net Assets:			
Invested in Capital Assets, Net of Related Debt	1,420,104	1,338,833	6.1
Restricted	1,513,055	1,423,329	6.3
Unrestricted	778,439	700,280	11.2
Total Net Assets	\$ 3,711,598	\$ 3,462,442	7.2

Current Assets and Liabilities

The Statement of Net Assets shows that working capital, which is current assets less current liabilities, was \$915.6 million at June 30, 2010, an increase of 30.1%, or \$212.1 million, over the previous year. While the working capital increase results from many factors, two significant changes were a decrease of \$88.5 million in short-term debt used as bridge financing for capital construction and an increase of \$101.1 million in short-term investments. The Statement of Net Assets details the current asset and current liability categories.

Endowment, Restricted and Other Investments

Endowment investments increased 3.2% during 2009-2010 and were \$1.19 billion at June 30, 2010 and \$1.15 billion at June 30, 2009, and include permanent endowments, funds internally designated as endowments and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were \$1.18 billion at June 30, 2010, and \$1.13 billion for the prior year.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

substantially all of the assets of the Investment Fund will be invested in the UNC Investment Fund, LLC (System Fund), which began functioning as a pooled investment fund effective January 1, 2003.

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

Restricted investments of \$1.01 billion at June 30, 2010 include funds of affiliated entities that are neither part of the University's reporting entity nor reported discretely but do invest through the System Fund. Other investments include bond reserves and related funds of \$67.5 million.

Most of the University's endowment investments are currently managed within the System Fund, a pooled investment fund vehicle. The System Fund is designed to provide long-term, stable rates of return (Consumer Price Index (CPI) plus 5.5%) on the invested assets through the use of a diversified portfolio strategy.

Fiscal year 2009-2010 represented a year of recovery from the period from late 2007 through the spring of 2009 that included the severe banking system and financial crisis and a significant weakening in most economies around the world. As reported by UNC Management Company, Inc., the manager of the System Fund, the investment return on the endowment assets invested in the Fund for fiscal year 2009-2010 was 6.8%. The respective returns for fiscal years 2008-2009 and 2007-2008 were (19.6)% and 8.0%.

The System Fund's 6.8% return for fiscal year 2009-2010 lagged the 10.9% return on the Strategic Investment Policy Portfolio (SIPP) benchmark by 4.1 percentage points. The SIPP is a blended portfolio benchmark that represents a weighted average of the appropriate market benchmarks for the Fund's strategic asset classes. The 70/30 "traditional" domestic benchmark is comprised of 70% invested in the S&P 500 equity index and 30% in the Barclay's Aggregate bond index, and the System Fund lagged the 70/30 index return by 6.5 percentage points in fiscal year 2009-2010.

The investment performance resulted in the System Fund earning a three-year annualized return of (2.5)% at June 30, 2010. This three-year return measure compares with the corresponding measure of (1.7)% for the SIPP and (4.5)% for the 70/30 benchmark. For the five years ended June 30, 2010, the System Fund earned 6.4% annualized return compared to 4.8% for the SIPP and the 1.4% for the 70/30 benchmark.

A policy for the University Statutory Endowment was approved during fiscal year 2008-2009 to address the provisions of the Uniform Prudent Management of Institutional Funds Act, which was adopted by the State of North Carolina in March 2009. For fiscal year 2009-2010,

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

the market values for 174 of the 1,069 endowments had fallen below book value; and the actual, annual earnings distribution from the University Statutory Endowment was subsequently reduced by 8.5%, or \$4.3 million, from the calculated earnings distribution to avoid any principal invasion.

The policy indicates that campus departments shall examine the endowment-supported activity for the upcoming fiscal year for possible deferment of program expenses, and then pursue alternative funding for essential activities, and finally shall consult with donors regarding other funding options for program support. Invasion of endowment principal is an option of last resort and will only be done consistent with approved limitations to preserve the endowment principal's value.

Capital Assets and Debt Management

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

A summary of changes in capital assets is disclosed in Note 6. Capital assets, net of accumulated depreciation, at June 30, 2010 and June 30, 2009, were as follows:

Capital Assets (dollars in thousand)

	2010	2009	Percent Change
Capital Assets:			
Construction in Progress	\$ 346,226	\$ 614,308	(43.6)
Land and Other Nondepreciable Assets	194,064	146,428	32.5
Buildings	1,605,894	1,425,456	12.7
General Infrastructure	470,698	207,171	127.2
Machinery and Equipment	166,004	137,588	20.7
Total	\$ 2,782,886	\$ 2,530,951	10.0

The University is engaged in a \$2.3 billion capital construction program that began in 2000 and will continue through the next few years. The 155 projects in the capital program include major capital renewal of existing buildings and infrastructure to address both deferred maintenance and programmatic needs. The 114 completed projects total \$1.3 billion, or 56% of the \$2.3 billion capital construction program. The 19 projects under construction total \$625 million or 27%, and the 22 projects under design represent \$409 million or 17%. Capital funds resulting from North Carolina Higher Education Bonds (HEB) provided

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

essential resources for construction, and the HEB program concluded in February 2010. The University is directly investing in its capital construction program using a variety of other funding sources including general revenue bonds, cost reimbursements from research grants, internal reserves, and private gifts.

The University continues to use its commercial paper program to provide low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was \$59.8 million at June 30, 2010 and \$148.3 million at June 30, 2009. The University currently plans to issue a long-term bond during fiscal year 2011-2012 to refund a significant portion of outstanding commercial paper and to provide additional funds for capital projects.

The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The interest rate on the commercial paper program for fiscal year 2009-2010 was .32% and for 2008-2009 was 1.20%. Interest rates on the University's variable rate, long-term bonds were 0.18% for fiscal year 2009-2010 and 1.2% for fiscal year 2008-2009. Interest rates on fixed rate, long-term bonds are disclosed in Note 9B of the financial statements. These rates reflect direct interest rates and do not reflect any impact from the interest rate swaps as referenced in Note 4.

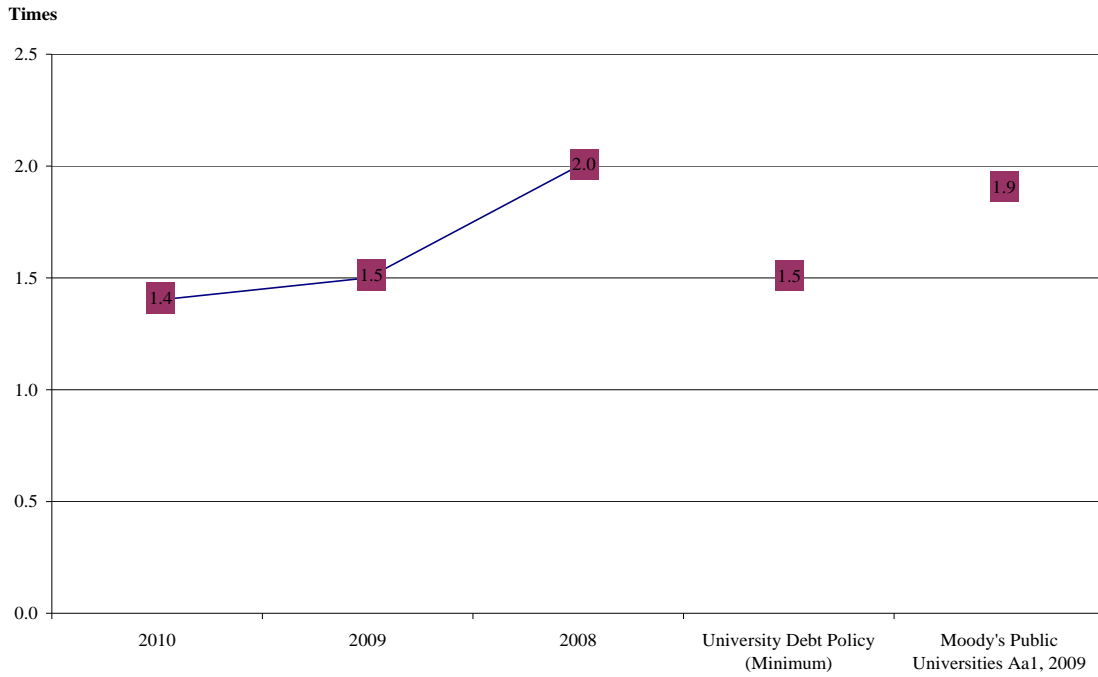
The University's debt policy uses two key ratios to measure debt capacity, financial health, and credit quality. The *expendable resources to debt ratio* measures unrestricted, expendable restricted, and temporarily restricted net assets to funded debt and serves as a relative indicator of financial health or cushion. The *debt service to operations ratio* provides an indicator of the University's ability to repay annual principal and interest relative to its overall operating expenses. Each ratio is compared to the University's debt policy standard and the appropriate peer group comparison for fiscal year 2008-2009 (the latest available numbers). At June 30, 2010, the *expendable resources to debt ratio* was 1.4 times, the *debt service to operations ratio* was 3.3%.

The fiscal year 2009-2010 measure for *expendable resources to debt* of 1.4 times is less than the floor of 1.5 times and reflects a strategic decision by management to finance mission-critical capital projects. *Expendable resources to debt* is a proxy indicator of financial cushion and is not a direct measurement of the primary source of repayment for debt. The University only debt finances projects for which an associated net revenue source has been identified for repayment of the obligation. The 1.5 times debt floor is a guideline, and the University's expendable resources increased 6.4% during fiscal year 2009-2010. Outstanding University debt at June 30, 2010 increased 13.5% due to the issuance of general revenue bonds and a promissory note by a University component unit.

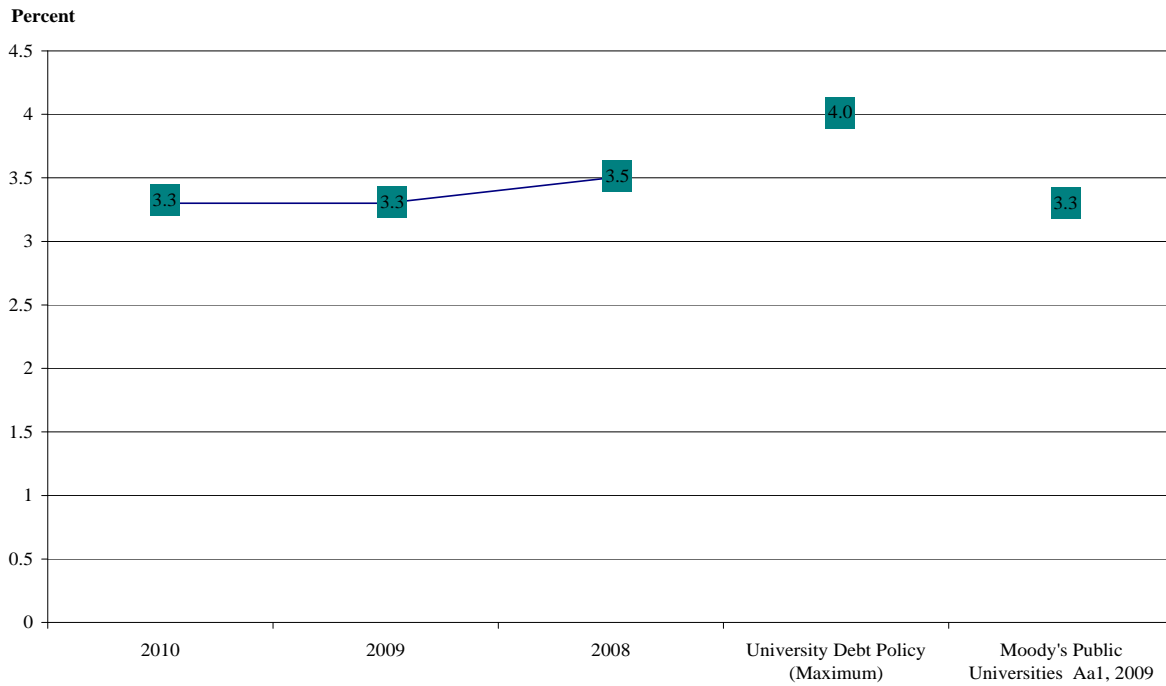
During fiscal year 2009-2010, Moody's Investor Services recalibrated its rating scale for public finance resulting in a recalibration of the University's long-term bond rating to Aaa from Aa1. The University continues to maintain its long-term bond ratings of AA+/AA+ from Standard & Poor's, and Fitch Ratings, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

EXPENDABLE RESOURCES TO DEBT



DEBT SERVICES TO OPERATIONS



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

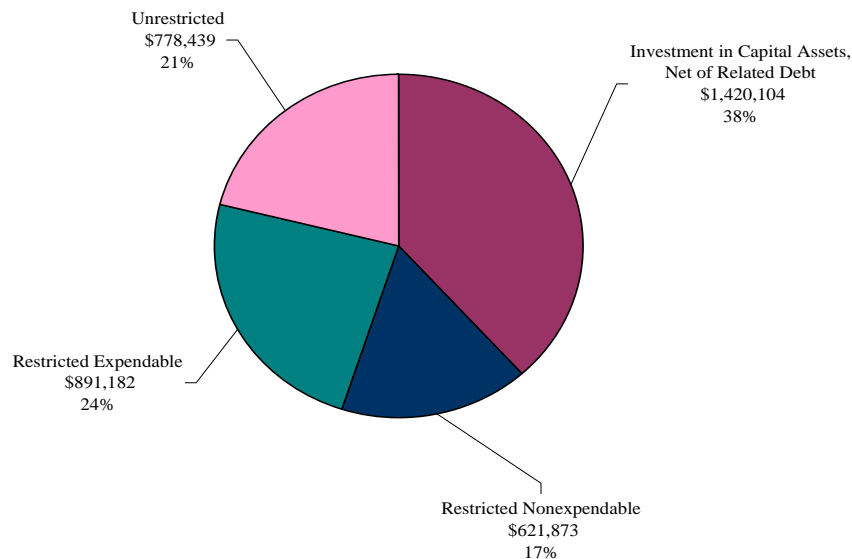
Other Noncurrent Assets and Liabilities

Other noncurrent assets were \$198.6 million at June 30, 2010 and \$223 million at June 30, 2009, a 10.9% decrease. Noncurrent liabilities were \$2.5 billion at June 30, 2010 and \$2.1 billion at June 30, 2009, and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of \$1.1 billion and \$940.6 million, respectively. These entities are not part of the University's financial reporting entity and are not discretely presented, but the entities do invest through the System Fund. The increase in funds held in trust of 13.9% over the prior year resulted from additional participant contributions, new participants in the System Fund, and net investment gains.

Net Assets

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were \$3.7 billion at June 30, 2010, an increase of \$249.2 million over the prior year. Net assets invested in capital assets, net of related debt, represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included. Nonexpendable restricted net assets include endowment and similar assets whose use is limited by donors or other outside sources and as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net assets include resources in which the University is legally obligated to spend the resources in accordance with restrictions provided by external parties. Unrestricted net assets are not subject to externally imposed stipulations; however, most of these resources have been designated for particular academic, research, or other programs, as well as capital projects.

2010 NET ASSETS: \$3,711,598
(IN THOUSANDS)



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2010 and the prior year are summarized as follows:

University Operations
(dollars in thousands)

	2010	2009	Percent Change
Operating Revenues:			
Student Tuition and Fees, Net	\$ 249,083	\$ 236,960	5.1
Grants and Contracts	688,721	624,420	10.3
Sales and Services, Net	597,196	559,471	6.7
Other	7,275	8,636	(15.8)
Total Operating Revenues	1,542,275	1,429,487	7.9
Operating Expenses	2,277,091	2,224,326	2.4
Operating Loss	(734,816)	(794,839)	(7.6)
Nonoperating Revenues (Expenses):			
State Appropriations and State Aid	541,753	538,327	0.6
Noncapital Gifts and Grants	247,994	241,242	2.8
Investment Income (Loss), Net	103,605	(296,904)	134.9
Interest and Fees on Debt	(64,261)	(52,465)	22.5
Federal Interest Subsidy on Debt	1,130		100.0
Other Net Nonoperating Revenues (Expenses)	(14,219)	2,359	(702.8)
Income Before Other Changes	81,186	(362,280)	122.4
Refund of Prior Years Capital Appropriations	(444)	(3,317)	(86.6)
Capital Grants and Appropriations	86,117	39,663	117.1
Capital Gifts	50,688	34,686	46.1
Additions to Permanent Endowments	31,609	44,255	(28.6)
Increase (Decrease) in Net Assets	249,156	(246,993)	200.9
Net Assets – July 1	3,462,442	3,709,435	(6.7)
Net Assets – June 30	\$ 3,711,598	\$ 3,462,442	7.2

Fiscal year 2009-2010 revenues and other changes total \$2,605,171 and expenses total \$2,356,015.

Fiscal year 2008-2009 revenues and other changes total \$2,330,019 and expenses total \$2,577,012.

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was \$68.7 million for fiscal year 2009-2010 and \$63.5 million for the prior year. Net revenues from student tuition and fees increased 5.1% over the prior year. Tuition rates increased for fiscal year 2009-2010 by 4.3% for

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

undergraduate residents, 5.6% for undergraduate nonresidents, 8% for graduate residents, and 2.1% for graduate nonresidents.

Revenues from noncapital grants and contracts increased 10.6% over the prior year when operating and nonoperating sources are combined. Discussion of grants and contracts in terms of awards provides another useful perspective. The University is among the nation's leading public research universities, with a diversified portfolio of research that attracted \$803 million in sponsored program funding during fiscal year 2009-2010, the largest amount in campus history and a 12.2% increase over the \$716 million received last fiscal year. The contracts and grants come primarily from the federal government, especially the National Institutes of Health (NIH) and the National Science Foundation. The NIH is traditionally the University's largest source of research funding.

In many cases, researchers from multiple University schools, departments and units collaborate on research grants, contracts and studies. That approach reflects the University's emphasis on interdisciplinary teaching and scholarship between and among the health, natural and social sciences, as well as the liberal arts and the humanities.

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

Operating Expenses

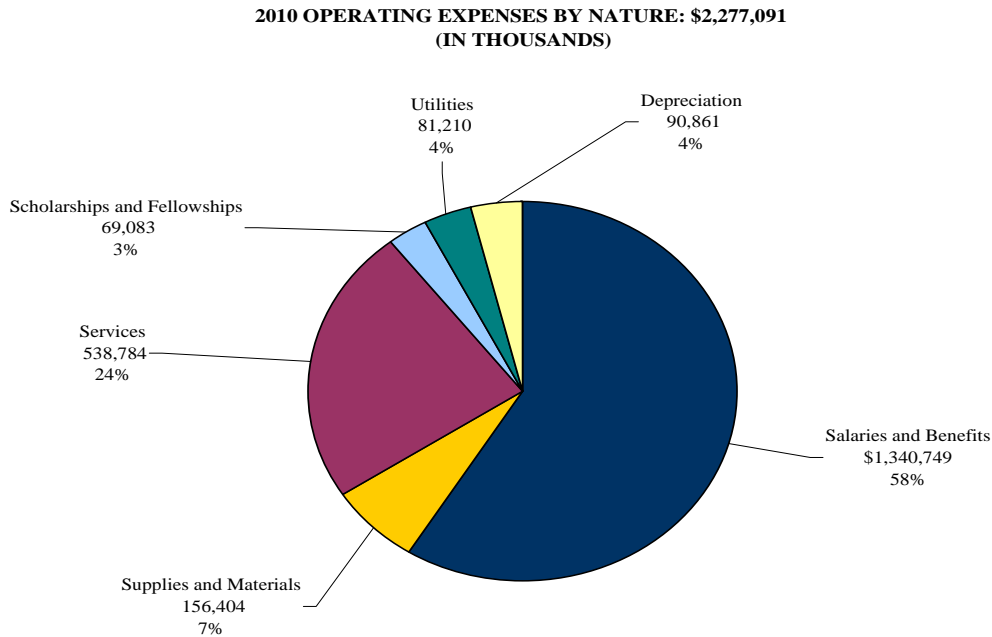
The University's operating expenses were \$2.3 billion for the fiscal year ended June 30, 2010, an increase of 2.4% over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in the notes to the financial statements (Note 12). The following table illustrates the University's operating expenses by functional classification and by natural classification.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating Expenses by Nature (dollars in thousands)	2010	2009	Percent Change
Salaries and Benefits	\$ 1,340,749	\$ 1,309,862	2.4
Supplies and Materials	156,404	174,501	(10.4)
Services	538,784	533,023	1.1
Scholarships and Fellowships	69,083	58,557	18.0
Utilities	81,210	77,636	4.6
Depreciation	90,861	70,747	28.4
Total Operating Expenses	\$ 2,277,091	\$ 2,224,326	2.4

Operating Expenses by Function (dollars in thousands)	2010	2009	Percent Change
Instruction	\$ 684,836	\$ 674,942	1.5
Research	431,317	398,754	8.2
Public Service	138,044	126,427	9.2
Academic Support	107,806	107,371	0.4
Student Services	26,961	27,967	(3.6)
Institutional Support	83,962	89,954	(6.7)
Operations and Maintenance of Plant	136,008	145,550	(6.6)
Student Financial Aid	69,083	58,557	18.0
Auxiliary Enterprises	508,213	524,057	(3.0)
Depreciation	90,861	70,747	28.4
Total Operating Expenses	\$ 2,277,091	\$ 2,224,326	2.4

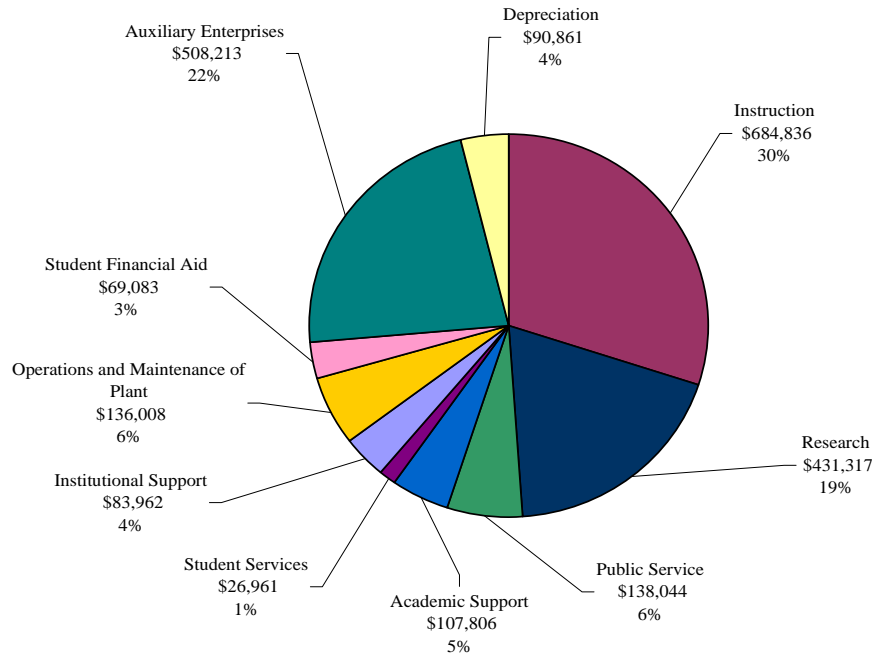
The following graph illustrates the University's operating expenses by the natural classification.



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

2010 OPERATING EXPENSES BY FUNCTION: \$2,277,091
(IN THOUSANDS)



Operating expense categories changed at varying rates. Reductions in institutional support and operation and maintenance of plant are consistent with the University's efforts to reduce administrative expenses and minimize impact on the academic core. Research expenses increased in keeping with the growth in sponsored awards. An objective of the University Cancer Research Fund is to accelerate progress in cancer prevention, early detection, and effective treatment; and community service efforts resulted in an increase in public service expenses.

Nonoperating Revenues and Expenses

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

State appropriations, when including State aid of \$32.1 million, totaled \$541.8 million for fiscal year 2009-2010, an increase of .6% from the prior year. The University received increases in State appropriations totaling \$6.4 million to fund faculty and staff benefit changes, \$5 million for additional student enrollment and program enhancements, and \$5 million for other operating costs. The reductions in State appropriations for fiscal year

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

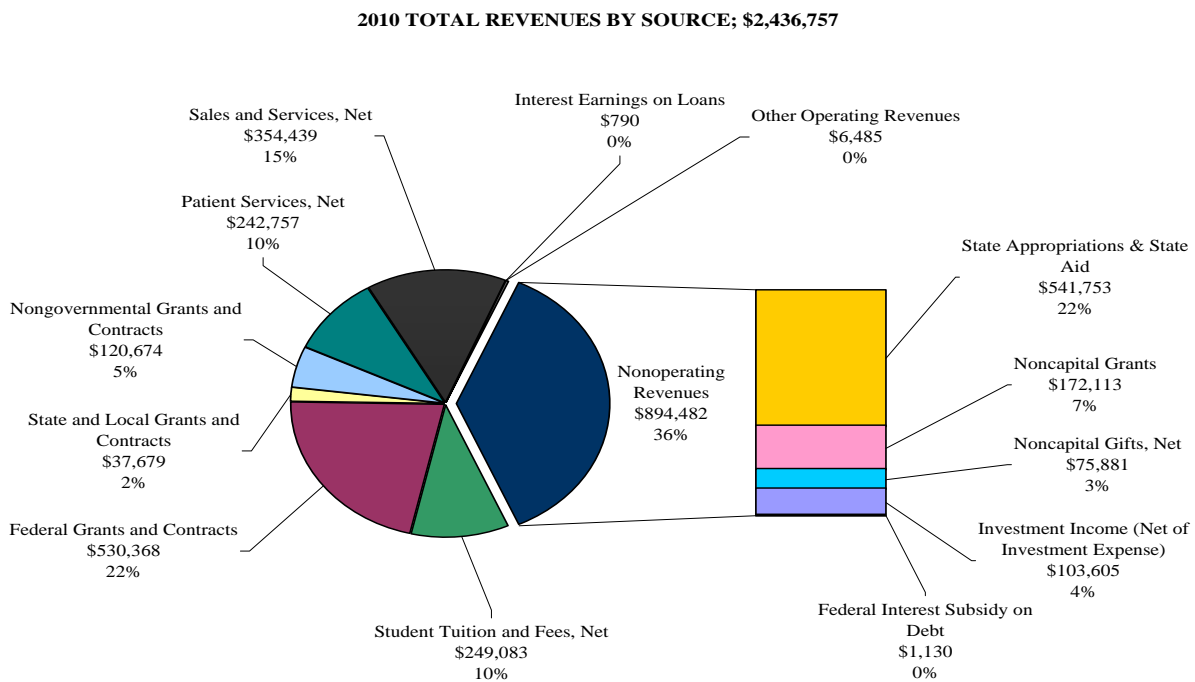
2009-2010 included \$48.2 million for state budget reductions of \$19.6 million and restrictions on the cash allotted to the University by the State of North Carolina of \$28.6 million. The reduced State appropriations required a significant decrease in spending.

The University endeavored to protect the academic core and instructional programs and reviewed campus operations to identify additional efficiencies to generate savings. General administrative support units on campus incurred reductions in budgeted State appropriations of 10% in order to minimize budget reductions for academic units. Academic support and related administrative areas incurred reductions of 6.7%, and instructional units incurred reductions of 5.2% on average. Significant reductions in budgeted State appropriations for centers and institutes were mandated by legislative action and resulted in a budget reduction of 17.6% for the research and economic development area.

Noncapital gifts and grants increased 2.8% to \$248 million and include expendable gifts and federal awards that are not considered to be operating revenues. Net investment income from fiscal year 2009-2010 of \$103.6 million, a significant increase of 134.9% from 2008-2009, includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For additional discussion, the reader may refer to the Endowment and Other Investments section of the Management's Discussion and Analysis.

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as State appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and nonoperating revenues, which total \$2.4 billion for fiscal year 2009-2010.



Other Changes in Net Assets

Capital grants and appropriations of \$85.7 million for fiscal year 2009-2010 and \$36.3 million for fiscal year 2008-2009 are from statewide higher education bond proceeds and State appropriations for capital construction projects. Capital gifts of \$50.7 million for fiscal year 2009-2010 and \$34.7 million for the prior year resulted from fund-raising efforts and also provided funding for construction projects. Nonexpendable gifts and funds from the State's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of \$31.6 million during fiscal year 2009-2010 and \$44.3 million during fiscal year 2008-2009.

Economic Outlook

The economic downturn that impacted fiscal year 2009-2010 will also impact University resources for fiscal year 2010-2011. The University's fiscal state improved during fiscal year 2009-2010 when compared to the prior year, and its overall financial condition remained solid. The University will continue to maintain and generate sufficient resources to successfully fulfill its teaching, research, and service missions. Decisions to curtail or eliminate administrative expenses have consistently protected the academic core from significant resource limitations.

The University maintains low tuition levels in relative terms that provide important resources. Support from the State was impacted due to the economic downturn, but in relative terms, higher education in North Carolina is soundly funded. Sponsored awards are a proven and reliable source in support of the University's research mission, philanthropic efforts continue to demonstrate success in a challenging environment, and invested funds provide an important distribution of earnings and rebounded from previous declines in the global financial markets. The University's strong debt credit ratings of Aaa and AA+ allow it to obtain competitive financing for capital construction.

Tuition rates increased for fiscal year 2010-2011 by 24.6% for undergraduate residents, 7.7% for undergraduate nonresidents, 17.6% for graduate residents, and 6.5% for graduate nonresidents. The University's academic standing allows it to continuously attract top students. For the first-year students enrolling for the Fall 2010 semester, 76.1% graduated in the top 10% of their class.

The University has benefited from the historically strong support that public higher education receives from the Governor and General Assembly. On a relative basis and considering the economic climate, there were positive aspects in the State appropriations budget for fiscal year 2010-2011. Funding commitments for need-based financial aid, for growth in student enrollment, and for operating costs for many new buildings were important aspects of the State appropriations budget. Authorized tuition increases helped offset reductions in State appropriations that would have necessitated offering fewer classes, increasing class sizes, and reducing library and other academic support services.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Despite the economic challenges, the projected funding level for State appropriations for fiscal year 2010-2011 totals \$552.1 million, which represents an increase of 1.9% over fiscal year 2009-2010 actual State appropriations. This projected level of State appropriations funding includes a \$21.7 million reduction, the impact of which was mitigated by a specified tuition increase generating \$15.9 million. Projected State appropriations also include \$7.3 million for additional student enrollment and program enhancements and are net of \$5.3 million held in reserve as cautionary action given the current economic environment. Additional reductions in State appropriations have not been identified, but the economic situation of the State continues to be monitored. There were no State appropriations provided for pay increases for fiscal year 2010-2011.

External awarded funding from contracts and grants increased to \$803 million during fiscal year 2009-2010, the largest amount in campus history. The awarded amount of \$126 million came from the American Recovery and Reinvestment Act (ARRA), also known as the stimulus bill. A total of 308 University projects were selected for ARRA funding, increasing the total number of ARRA-funded projects selected between the start of the federal initiative in February 2009 and the end of fiscal year 2009-2010 to 319. ARRA funding supports new and ongoing research at the University to help improve the state and national economies by creating jobs in addition to expanding our knowledge about diseases, human health and the environment.

The University's investment management operation is separately organized as the UNC Management Company, Inc. (UNCMC), the nonprofit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated nonprofit foundations as appropriate. This structure provides the ability to attract and retain investment professionals and increase the pool of funds and resulting investment returns. As of June 30, 2010, the UNCMC managed invested assets of \$2.5 billion. Although the course the financial markets will take this fiscal year and beyond is not known, UNCMC will manage the funds in a highly diversified manner to capture a fair share of the upside in asset classes that are strengthening while, more importantly, providing downside protection in periods of declining markets. The focus remains on the core mission of identifying the most attractive intermediate-to-long-term investment opportunities while also remaining highly aware of the elevated risks in the current financial environment.

Fundraising has been a cornerstone resource for the University, and in a down economy becomes even more vital. The University's fundraising efforts brought in \$268.1 million in gifts in fiscal year 2009-2010. The University secured \$292 million in commitments, which includes pledges as well as gifts, in fiscal year. The commitments total was up from the prior fiscal year total of \$290.4 million. Commitments in 2009-2010 helped the University create 17 endowed professorships, as well as a total of 98 undergraduate scholarships and graduate fellowships. The University had more than 73,500 donors for the fiscal year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

The University will continue to provide excellent teaching, research, and public service endeavors for students, citizens, and other constituents. Management has taken action to restructure and reduce the operating budget while protecting the academic foundation.

Carolina Counts is a program initiated by the Chancellor to carry out key recommendations from a significant review of the campus operating structure and to address ways to make the University more efficient. The mission of the Carolina Counts initiative is to make the University of North Carolina at Chapel Hill the most collaborative, well-managed university in the country. The objectives of the initiative are to streamline campus operations and provide more funding for academics and University's core missions; to implement simpler, more responsive systems and processes that enable informed decision-making while complying with policies and laws; and to reduce bureaucracy and create a more satisfying work environment for faculty and staff.

The University remains committed to sound financial and budgetary planning, protection and enhancement of its endowed and physical assets, as well as its observance of compliance and control standards.

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2010

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 359,711,419
Restricted Cash and Cash Equivalents	399,682,054
Short-Term Investments	208,767,663
Restricted Short-Term Investments	80,678,715
Receivables, Net (Note 5)	164,883,410
Due from State of North Carolina Component Units	14,907,143
Inventories	20,752,736
Notes Receivable, Net (Note 5)	4,200,541
Other Assets	285,004
	<hr/>
Total Current Assets	1,253,868,685

Noncurrent Assets:

Restricted Cash and Cash Equivalents	107,432,535
Receivables, Net (Note 5)	24,958,956
Restricted Due from Primary Government	2,472,998
Endowment Investments	1,189,678,865
Restricted Investments	1,010,891,779
Other Investments	67,527,992
Deferred Outflow of Resources (Note 4)	20,543,742
Notes Receivable, Net (Note 5)	34,904,642
Investment in Joint Venture	8,318,917
Capital Assets - Nondepreciable (Note 6)	540,290,368
Capital Assets - Depreciable, Net (Note 6)	2,242,595,808
	<hr/>
Total Noncurrent Assets	5,249,616,602

Total Assets

6,503,485,287

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 7)	114,144,816
Due to Primary Government	423,126
Due to State of North Carolina Component Units	4,745,100
Deposits Payable	2,589,538
Funds Held for Others	2,058,547
Unearned Revenue	41,072,161
Interest Payable	7,315,679
Short-Term Debt (Note 8)	59,784,000
Long-Term Liabilities - Current Portion (Note 9)	106,152,060
	<hr/>
Total Current Liabilities	338,285,027

Noncurrent Liabilities:

U. S. Government Grants Refundable	31,338,074
Funds Held in Trust for Pool Participants	1,071,561,512
Hedging Derivative Liability (Note 4)	20,543,742
Long-Term Liabilities (Note 9)	1,330,159,238
	<hr/>
Total Noncurrent Liabilities	2,453,602,566

Total Liabilities

2,791,887,593

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2010

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	1,420,103,761
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	125,489,074
Research	17,427,516
Library Acquisitions	28,229,821
Endowed Professorships	292,996,410
Departmental Uses	110,476,134
Loans	17,290,321
Other	29,963,465
Expendable:	
Scholarships and Fellowships	163,324,420
Research	18,390,007
Library Acquisitions	43,578,814
Endowed Professorships	260,619,237
Departmental Uses	263,113,979
Instruction and Educational Agreements	9,287,399
Plant Improvements	20,017,751
Capital Projects	104,023,300
Debt Service	8,827,500
Unrestricted	<u>778,438,785</u>
Total Net Assets	<u><u>\$ 3,711,597,694</u></u>

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

***The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2010***

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 11)	\$ 249,082,638
Patient Services, Net (Note 11)	242,757,083
Federal Grants and Contracts	530,368,427
State and Local Grants and Contracts	37,678,761
Nongovernmental Grants and Contracts	120,673,852
Sales and Services, Net (Note 11)	354,438,534
Interest Earnings on Loans	790,880
Other Operating Revenues	6,484,862
	<hr/>
Total Operating Revenues	<u>1,542,275,037</u>

EXPENSES

Operating Expenses:

Salaries and Benefits	1,340,748,680
Supplies and Materials	156,404,438
Services	538,783,972
Scholarships and Fellowships	69,082,962
Utilities	81,210,113
Depreciation	90,860,983
	<hr/>
Total Operating Expenses	<u>2,277,091,148</u>
Operating Loss	<u>(734,816,111)</u>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	509,690,868
State Aid - Federal Recovery Funds	32,062,595
Noncapital Grants - Student Financial Aid	17,098,881
Other Noncapital Grants	155,013,464
Noncapital Gifts, Net (Note 11)	75,881,170
Investment Income (Net of Investment Expense of \$4,233,708)	103,605,476
Interest and Fees on Debt	(64,261,203)
Federal Interest Subsidy on Debt	1,130,168
Other Nonoperating Expenses	(14,218,891)
	<hr/>
Net Nonoperating Revenues	<u>816,002,528</u>
Income Before Other Revenues, Expenses, Gains, or Losses	81,186,417
Refund of Prior Years Capital Appropriations	(443,816)
Capital Grants	86,116,493
Capital Gifts	50,688,450
Additions to Endowments	31,608,582
	<hr/>
Increase in Net Assets	249,156,126

NET ASSETS

Net Assets - July 1, 2009	<u>3,462,441,568</u>
Net Assets - June 30, 2010	<u>\$ 3,711,597,694</u>

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

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2010

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 1,561,263,167
Payments to Employees and Fringe Benefits	(1,336,405,091)
Payments to Vendors and Suppliers	(773,468,112)
Payments for Scholarships and Fellowships	(69,082,962)
Loans Issued	(5,544,386)
Collection of Loans	4,454,376
Interest Earned on Loans	708,418
Other Payments	(8,345,386)
	<hr/>
Net Cash Used by Operating Activities	(626,419,976)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	509,690,868
State Aid - Federal Recovery Funds	32,062,595
Noncapital Grants - Student Financial Aid	16,819,264
Other Noncapital Grants	128,188,888
Noncapital Gifts	83,565,747
Additions to Endowments	31,608,582
William D. Ford Direct Lending Receipts	110,950,873
William D. Ford Direct Lending Disbursements	(110,705,380)
Related Activity Agency Receipts	405,734,936
Related Activity Agency Disbursements	(294,845,117)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	913,071,256

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	298,801,728
Refund of Prior Years Capital Appropriations	(443,816)
Capital Grants	90,317,386
Capital Gifts	14,469,264
Acquisition and Construction of Capital Assets	(309,290,825)
Principal Paid on Capital Debt and Leases	(156,161,848)
Interest and Fees Paid on Capital Debt and Leases	(53,180,058)
Federal Interest Subsidy on Debt Received	1,130,168
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(114,358,001)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	2,061,160,614
Investment Income	61,553,471
Purchase of Investments and Related Fees	(2,289,519,217)
	<hr/>
Net Cash Used by Investing Activities	(166,805,132)
	<hr/>
Net Increase in Cash and Cash Equivalents	5,488,147
Cash and Cash Equivalents - July 1, 2009	861,337,861
	<hr/>
Cash and Cash Equivalents - June 30, 2010	\$ 866,826,008

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2010

Exhibit A-3

Page 2

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

Operating Loss	\$ (734,816,111)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	90,860,983
Allowances, Write-Offs, and Amortizations	5,943,921
Changes in Assets and Liabilities:	
Receivables (Net)	9,752,583
Inventories	2,228,131
Notes Receivable (Net)	(1,080,995)
Other Assets	(91,089)
Accounts Payable and Accrued Liabilities	5,285,458
Due to Primary Government	(3,486,800)
U.S. Government Grants Refundable	299,006
Unearned Revenue	1,290,558
Compensated Absences	(2,605,621)
	<u>(626,419,976)</u>
Net Cash Used by Operating Activities	<u>\$ (626,419,976)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 359,711,419
Restricted Cash and Cash Equivalents	399,682,054
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	107,432,535
	<u>866,826,008</u>
Total Cash and Cash Equivalents - June 30, 2010	<u>\$ 866,826,008</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Capital Lease	\$ 3,421,701
Assets Acquired through a Gift	36,219,186
Change in Fair Value of Investments	45,110,690
Loss on Disposal of Capital Assets	(6,135,758)

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

The University of North Carolina at Chapel Hill Foundations
Statement of Financial Position
June 30, 2010

Exhibit B-1

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 8,753,487	\$ 9,887,025	\$ 52,736,243
Investments		154,543,744	67,668,547
Unconditional Promises to Give, Net	9,518,364	5,656,452	2,379,407
Contributions Receivable from Split-Interest Agreements		2,602,232	
Accounts Receivable	50,600		
Funds Held in Trust	1,242,136		
Interest Receivable			30,826
Prepaid Expenses			39,403
Miscellaneous Receivables			269,437
Total Current Assets	<u>19,564,587</u>	<u>172,689,453</u>	<u>123,123,863</u>
Property and Equipment:			
Building			555,729
Furniture and Equipment	595,729		436,902
Leasehold Interest - Building	3,750,483		
Vehicle	26,422		
Less: Allowance for Depreciation	<u>(791,787)</u>		<u>(415,913)</u>
Total Property and Equipment	<u>3,580,847</u>		<u>576,718</u>
Other Assets:			
Investments	117,089,982		66,057,983
Unconditional Promises to Give, Net	6,110,050		4,772,549
Restricted Cash	5,232,263		3,608,984
Split-Interest Agreements	1,541,500		2,943,822
Restricted Investments			398,396
Cash Surrender Value of Life Insurance		1,937,749	230,757
Total Other Assets	<u>129,973,795</u>	<u>1,937,749</u>	<u>78,012,491</u>
Total Assets	<u>\$ 153,119,229</u>	<u>\$ 174,627,202</u>	<u>\$ 201,713,072</u>
LIABILITIES			
Current Liabilities:			
Accounts Payable	\$ 12,711	\$ 95,815	\$ 212,325
Annuities Payable			
Accrued Expenses	169,174		922,597
Total Current Liabilities	<u>181,885</u>	<u>95,815</u>	<u>1,134,922</u>
Long-Term Debt	<u>850,000</u>		
Total Liabilities	<u>1,031,885</u>	<u>95,815</u>	<u>1,134,922</u>
NET ASSETS			
Unrestricted	18,139,378		8,403,274
Temporarily Restricted	54,935,550	71,002,472	119,249,193
Permanently Restricted	79,012,416	103,528,915	72,925,683
Total Net Assets	<u>152,087,344</u>	<u>174,531,387</u>	<u>200,578,150</u>
Total Liabilities and Net Assets	<u>\$ 153,119,229</u>	<u>\$ 174,627,202</u>	<u>\$ 201,713,072</u>

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

The University of North Carolina at Chapel Hill Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2010

Exhibit B-2

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
REVENUES			
Support:			
Contributions	\$ 8,389,243	\$ 1,663,313	\$ 12,246,756
Development Assessment Fee Income	2,202,627		
Change in Value of Split-Interest Agreements	83,900		(385,179)
Donated Facilities	82,675		
Actuarial Adjustment of Annuities Payable		(692)	
Endowment Investment Return Designated for Current Operations		8,733,309	
Total Support	<u>10,758,445</u>	<u>10,395,930</u>	<u>11,861,577</u>
Revenue:			
Interest and Dividend Income			1,842,716
Net Unrealized and Realized Gains on Investments	6,897,861		11,680,214
Investment Income	993,898		
Other Income	41,956		1,363,938
Total Revenues	<u>7,933,715</u>	<u> </u>	<u>14,886,868</u>
Total Support and Revenue	<u>18,692,160</u>	<u>10,395,930</u>	<u>26,748,445</u>
EXPENSES			
Program Services:			
Grants	8,276,740		15,998,024
Scholarship Expense Distribution		8,724,663	
Annuity Payments		8,646	
Other Expenses		515,838	
Total Program Services	<u>8,276,740</u>	<u>9,249,147</u>	<u>15,998,024</u>
Supporting Services:			
Fundraising Expenses	2,435,560		1,266,366
Management and General	963,122		1,467,430
Total Supporting Services	<u>3,398,682</u>	<u> </u>	<u>2,733,796</u>
Total Expenses	<u>11,675,422</u>	<u>9,249,147</u>	<u>18,731,820</u>
Lease Guarantee			653,093
Loss from Bad Debt	934,153		225,331
Total Expense, Lease Guarantee, and Bad Debt	<u>12,609,575</u>	<u>9,249,147</u>	<u>19,610,244</u>
Changes in Net Assets from Operations	<u>6,082,585</u>	<u>1,146,783</u>	<u>7,138,201</u>
OTHER CHANGES			
Investment Return in Excess of Amounts Designated for Current Operations		944,575	
Changes in Net Assets	6,082,585	2,091,358	7,138,201
NET ASSETS			
Net Assets at Beginning of Year	<u>146,004,759</u>	<u>172,440,029</u>	<u>193,439,949</u>
Net Assets at End of Year	<u>\$ 152,087,344</u>	<u>\$ 174,531,387</u>	<u>\$ 200,578,150</u>

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

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THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2010

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The System Fund was organized by the Investment Fund to allow the University, other constituent institutions of the University of North Carolina System (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured, and managed by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Investment Fund contributed and assigned all of its assets to the System Fund effective January 1, 2003, in exchange for its membership interest in the System Fund. Upon such contribution and assignment, and in consideration thereof, the System Fund has assumed all liabilities and obligations of the Investment Fund in respect of such contributed assets. At June 30, 2010, the Investment Fund membership interest was approximately 76.5% of the System Fund total membership interests. Because the Investment Fund is the organizer and controlling member of the System Fund, the financial statements of the System Fund have been blended with those of the University.

The Management Company is a North Carolina nonprofit corporation organized and operated exclusively to support the educational mission of the University. The Management Company provides investment management and administrative services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and performs other functions for and generally carries out the purposes of the University. The Management Company is governed by five ex officio directors and one to three additional directors as fixed or changed from

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

time to time by the board, elected by the ex officio directors. The ex officio directors consist of the Chancellor, the Vice Chancellor for Finance and Administration, the Chairman of the University Board of Trustees, the Chairman of the Board of Directors of the Investment Fund, and the President of the Management Company. Because members of the Board of Directors of the Management Company are officials or appointed by officials of the University and the Management Company's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The School of Education Foundation is governed by a board consisting of seven ex officio directors and up to 15 elected directors. Ex officio directors include the Dean of the School of Education, as well as the school's Associate Dean for Academic Programs, Assistant Dean for External Relations, Assistant Dean for Administration and Finance, Director of Alumni Relations, President of the Alumni Council, and President-Elect of the Alumni Council. The remaining directors are elected to the School of Education Foundation Board of Directors by action of the ex officio directors. The School of Education Foundation aids, supports and promotes teaching, research, and service at the School of Education. Because members of the Board of Directors of the School of Education Foundation are officials or appointed by officials of the University, the financial statements of the School of Education Foundation have been blended with those of the University.

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

Discretely Presented Component Units - The Medical Foundation of North Carolina, Inc. (Medical Foundation), The Educational Foundation Scholarship Endowment Trust (Educational Foundation Trust), and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. (Arts and Sciences Foundation) are legally separate, not-for-profit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Medical Foundation is governed by a board consisting of three ex officio directors and up to 33 elected directors, which serve staggered terms. Its purpose is to support educational and research efforts of the University's Medical School and UNC Hospitals. Historically, the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University's Medical School has been the major recipient of financial support from the Medical Foundation rather than UNC Hospitals. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests is restricted to the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

During the year ended June 30, 2010, the Medical Foundation, Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total \$32,999,427 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts. Land and other real estate held as investments by endowments are reported at fair value, consistent with how investments are generally reported.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges to patients for services provided by the UNC Physicians & Associates and the Dental Faculty Practices. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied, and notes receivables from loans to students. Patients, pledges, and notes receivables are recorded net of the allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.
- G. Inventories** - Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost or market. Inventories consist of expendable supplies, postage, fuel held for consumption, textbooks, and other merchandise for resale.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year except for intangible assets which are capitalized when the value or cost is \$100,000 or greater and internally generated software which is capitalized when the value or cost is \$1,000,000 or greater. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 50 years for general infrastructure, 12 to 75 years for buildings, and 6 to 30 years for equipment.

The University's historic property, artworks, and literary collections are capitalized at cost or fair value at the date of donation. These properties

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and collections are considered inexhaustible and are therefore not depreciated.

- I. Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources segregated for the payment of principal and interest as required by debt covenants or as internally designated.
- J. Funds Held in Trust for Pool Participants** - Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2. The assets associated with this liability are included in restricted investments, cash, and other similar asset accounts.
- K. Funds Held in Trust by Others** - Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2010 is approximately \$24,653,187.
- L. Noncurrent Long-term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, annuity and life income payable, and compensated absences that are not scheduled to be paid within the next fiscal year.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- O. Scholarship Discounts** - Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.
- P. Revenue and Expense Recognition** - The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and 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 investing, capital or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

- Q. Internal Sales Activities** - Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as utility services, telecommunications, central stores, printing and copy centers, postal services, and repairs and maintenance services. In

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2010, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$823,889,372, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2010. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> 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, 2010 was \$153,546. The carrying amount of the University's deposits not with the State Treasurer was \$42,783,090 and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the bank balance was \$42,282,322. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2010, \$39,411,675 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

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

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

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

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

Investments of the University's component units, UNC-Chapel Hill Foundation, Management Company, Investment Fund, System Fund, Business School Foundation, Law Foundation, School of Education Foundation, Medical Foundation, Arts and Sciences Foundation, and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Educational Foundation Trust, 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. The Management Company does not hold endowment funds.

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

Investments are subject to the following risks.

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

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

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

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

The Bank of New York Mellon is the custodian for the Temporary Pool and provides the University with monthly statements defining income and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

market value information. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, asset-backed securities, corporate bonds, and mutual funds. The University has elected to invest a portion of the Temporary Pool assets in the Investment Fund.

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

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2010.

Temporary Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 48,170,389	\$ 13,035,410	\$ 35,134,979	\$ 0	\$ 0
U.S. Agencies	133,164,825	27,898,703	47,148,505	3,463,401	54,654,216
Collateralized Mortgage Obligations	55,064,831	13,577,784	548,065	2,098,225	38,840,757
Asset-backed Securities	3,563,393	3,563,393			
Mutual Bond Funds	4,225,770				4,225,770
Money Market Mutual Funds	41,412,513	41,412,513			
Domestic Corporate Bonds	19,214,570	5,967,552	12,319,567		927,451
Total Debt Securities	304,816,291	<u>\$ 105,455,355</u>	<u>\$ 95,151,116</u>	<u>\$ 5,561,626</u>	<u>\$ 98,648,194</u>
<i>Other Securities</i>					
Domestic Stocks	30,000				
Total Temporary Pool Investments	<u>\$ 304,846,291</u>				

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2010, investments in the Temporary Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	\$ 133,164,825	\$ 750,724	\$ 0	\$ 0	\$ 0	\$ 0	\$ 132,414,101
Collateralized Mortgage Obligations	55,064,831	6,217,079	1,818,670	7,131,665	1,076,449	17,137,657	21,683,311
Asset-Backed Securities	3,563,393		2,400,121			1,163,272	
Mutual Bond Funds	4,225,770			4,225,770			
Money Market Mutual Funds	41,412,513	41,412,513					
Domestic Corporate Bonds	19,214,570	2,102,392		15,427,957	756,769	927,452	
Total	<u>\$ 256,645,902</u>	<u>\$ 50,482,708</u>	<u>\$ 4,218,791</u>	<u>\$ 26,785,392</u>	<u>\$ 1,833,218</u>	<u>\$ 19,228,381</u>	<u>\$ 154,097,412</u>

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

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

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2010, are as follows:

Statement of Net Assets

June 30, 2010

	Amount
<i>Assets:</i>	
Cash in Bank	\$ 577,672
State Treasurer Investment Fund	167,500,000
Accounts Receivable	116,402
Accrued Investment Income	1,941,203
Deferred Loss	1,425,026
Investment Fund	38,469,590
Investments	304,846,291
Total Assets	<u>\$ 514,876,184</u>
<i>Liabilities:</i>	
Accounts Payable	\$ 174,271
Total Liabilities	<u>174,271</u>
<i>Net Assets:</i>	
Internal Portion	339,718,704
External Portion	174,983,209
Total Net Assets	<u>514,701,913</u>
Total Liabilities and Net Assets	<u>\$ 514,876,184</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Statement of Operations and Changes in Net Assets For the Fiscal Year Ended June 30, 2010

	Amount
<i>Increase in Net Assets from Operations:</i>	
Revenues:	
Investment Income	\$ 7,338,295
Expenses:	
Investment Management	(1,054,170)
Net Increase in Net Assets Resulting from Operations	6,284,125
<i>Distributions to Participants:</i>	
Distributions Paid and Payable	(6,284,125)
<i>Share Transactions:</i>	
Net Share Purchases	57,213,546
Total Increase in Net Assets	57,213,546
<i>Net Assets:</i>	
Beginning of Year	457,488,367
End of Year	\$ 514,701,913

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

bonds, and other high quality fixed income instruments in accordance with the Investment Guidelines.

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

The following table presents the fair value of the investments by type and investments subject to interest rate risk at June 30, 2010.

Intermediate Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
Mutual Bond Funds	\$ 7,942,629	\$ 0	\$ 7,942,629	\$ 0	\$ 0
Money Market Mutual Funds	7,767,264	7,767,264			
Total Intermediate Pool Investments	\$ 15,709,893	\$ 7,767,264	\$ 7,942,629	\$ 0	\$ 0

At June 30, 2010, investments in the Intermediate Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa
Mutual Bond Funds	\$ 7,942,629	\$ 7,942,629
Money Market Mutual Funds	7,767,264	7,767,264
Total	\$ 15,709,893	\$ 15,709,893

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

At June 30, 2010, the Intermediate Investment Pool had investments of \$19,547,949 in the Investment Fund.

UNC-Chapel Hill Foundation Investment Fund, Inc. (Investment Fund) - This is a North Carolina nonprofit corporation exempt from income tax pursuant to Section 501(c)(3). It was established in January 1997 and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The University's Endowment, UNC-Chapel Hill Foundation, Business School Foundation, School of Education Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust are participants in the Investment Fund and are included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in the accompanying financial statements as "Funds Held in Trust for Pool Participants."

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

The Investment Fund is the primary participant of UNC Investment Fund, LLC (System Fund) and on a monthly basis receives a unitization report from the Management Company defining change in book and market value, applicable realized gains and losses and expenses. The Investment Fund uses a unit basis to determine each participant's market value and to distribute the fund's earnings according to the fund's spending policy. There are no involuntary participants in the Investment Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the Investment Fund. The audited financial statements for the Investment Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Investment Fund consists of an approximately 76.5% membership in the System Fund categorized below.

UNC Investment Fund, LLC (System Fund) - This is a limited liability company organized under the laws of the State of North Carolina. It was established in December 2002 by the Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Investment Fund, with an approximately 76.5% membership interest as of June 30, 2010, is the predominant member of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the System Fund. The University's reporting entity portion of the Investment Fund and UNC Management Company's portion of the System Fund is characterized as the internal portion. Other affiliated organizations in the Investment Fund in addition to other members of the System Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the System Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the System Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following table presents the fair value of the System Fund investments by type and investments subject to interest rate risk at June 30, 2010.

System Fund Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 52,180,780	\$ 0	\$ 39,540,750	\$ 7,726,750	\$ 4,913,280
U.S. Agencies	11,083,618	39,651	3,057,711	1,207,315	6,778,941
Collateralized Mortgage Obligations	17,404,790		771,419		16,633,371
Asset-Backed Securities	7,602,984				7,602,984
Money Market Mutual Funds	25,106,137	25,106,137			
Domestic Corporate Bonds	5,252,940			3,361,115	1,891,825
Total Debt Securities	118,631,249	<u>\$ 25,145,788</u>	<u>\$ 43,369,880</u>	<u>\$ 12,295,180</u>	<u>\$ 37,820,401</u>
<i>Other Securities</i>					
International Mutual Funds	70,602,730				
Other Mutual Funds	43,471,403				
Real Estate Investment Trust	333,380				
Hedge Funds	1,207,430,424				
Limited Partnerships	961,267,494				
Domestic Stocks	91,868,262				
Foreign Stocks	6,321,869				
Other	1,791,084				
Total System Fund Pool Investments	<u>\$ 2,501,717,895</u>				

In addition to the interest rate risk disclosed above, the System Fund invests in hedge funds containing securities with fair values that are highly sensitive to interest rate changes. The System Fund includes \$257,028,161 in commingled securities and \$35,666,135 in high-yield bonds. The commingled securities are subject to additional risk since they hold domestic corporate bonds, bonds issued from abroad, or mortgage-backed securities. Bonds issued from overseas carry additional risk due to currency fluctuations, interest rates of foreign countries, or political risks. Corporate bonds are also subject to interest rate risk as well as the financial risk inherent in any company. Mortgage-backed bonds are subject to the interest rate risk within the pools of collateralized securities. All of these factors may impact interest rates and therefore have a higher risk. The high-yield bonds have both long and short positions. These strategies carry additional risk since high-yield securities often have a higher rate of default to accompany their higher interest rates. These factors make the investments more sensitive to interest rate movements than investment grade domestic bonds.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2010, investments in the System Fund Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/BA & Below	Unrated
U.S. Agencies	\$ 11,083,618	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 11,083,618
Collateralized Mortgage Obligations	17,404,790	928,391	253,658	461,370	1,256,846	14,504,525	
Asset-Backed Securities	7,602,984		292,874			7,310,110	
Domestic Corporate Bonds	5,252,940	713,760	1,120,590	2,901,235	517,355		
Money Market Mutual Funds	25,106,137	25,106,137					
Total	\$ 66,450,469	\$ 26,748,288	\$ 1,667,122	\$ 3,362,605	\$ 1,774,201	\$ 21,814,635	\$ 11,083,618

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

Foreign Currency Risk: At June 30, 2010, the System Fund Pool's exposure to foreign currency risk is as follows:

	Currency	Fair Value (U.S. Dollars)
Limited Partnerships	Euro	\$ 57,428,875
Hedge Funds	Euro	6,613,014
Limited Partnerships	British Pound Sterling	6,546,862
Limited Partnerships	Australian Dollar	2,230,224
Limited Partnerships	Canadian Dollar	1,553,763
Foreign Stock	Canadian Dollar	174,430
Total		\$ 74,547,168

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, 2010.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 334,220	\$ 0	\$ 174,563	\$ 112,702	\$ 46,955
U.S. Agencies	278,091	79,521	140,242	58,328	
Mortgage Pass Throughs	177,018			104,766	72,252
Collateralized Mortgage Obligations	68,574				68,574
State and Local Government	114,378				114,378
Asset-backed Securities	37,263				37,263
Mutual Bond Funds	5,539,769			4,497,348	1,042,421
Money Market Mutual Funds	56,869,462	56,869,462			
Domestic Corporate Bonds	313,028		23,408	289,620	
Foreign Corporate Bonds	117,786			55,618	62,168
Foreign Government Bonds	33,806				33,806
Total Debt Securities	63,883,395	\$ 56,948,983	\$ 338,213	\$ 5,118,382	\$ 1,477,817
<i>Other Securities</i>					
International Mutual Funds	3,630,367				
Other Mutual Funds	5,971,102				
Investments in Real Estate	2,303,303				
Real Estate Investment Trust	112,328				
Limited Partnerships	3,282,774				
Domestic Stocks	13,125,963				
Foreign Stocks	391,781				
Other	14,485,056				
Total Non-Pooled Investments	\$ 107,186,069				

At June 30, 2010, the University's Non-Pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	\$ 278,091	\$ 164,942	\$ 0	\$ 0	\$ 0	\$ 0	\$ 113,149
Mortgage Pass Throughs	177,018	154,277	19,263	3,478			
Collateralized Mortgage Obligations	68,574	49,264		19,310			
State and Local Government	114,378			77,199	37,179		
Asset-Backed Securities	37,263			37,263			
Mutual Bond Funds	5,539,769	1,364,076	3,138,524	386,608	272,238	378,323	
Money Market Mutual Funds	56,869,462	56,853,617		15,845			
Domestic Corporate Bonds	313,028		105,580	124,448		83,000	
Foreign Corporate Bonds	117,786	30,216	25,402		62,168		
Foreign Government Bonds	33,806			33,806			
Total	\$ 63,549,175	\$ 58,616,392	\$ 3,288,769	\$ 697,957	\$ 371,585	\$ 461,323	\$ 113,149

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments- The following table presents the fair value of the total investments at June 30, 2010.

Investment Type	Fair Value
<i>Debt Securities</i>	
U.S. Treasuries	\$ 100,685,389
U.S. Agencies	144,526,534
Mortgage Pass Throughs	177,018
Collateralized Mortgage Obligations	72,538,195
State and Local Government	114,378
Asset-Backed Securities	11,203,640
Mutual Bond Funds	17,708,168
Money Market Mutual Funds	131,155,376
Domestic Corporate Bonds	24,780,538
Foreign Corporate Bonds	117,786
Foreign Government Bonds	33,806
Total Debt Securities	503,040,828
<i>Other Securities</i>	
International Mutual Funds	74,233,097
Other Mutual Funds	49,442,505
Investments in Real Estate	2,303,303
Real Estate Investment Trust	445,708
Hedge Funds	1,207,430,424
Limited Partnerships	964,550,268
Domestic Stocks	105,024,225
Foreign Stocks	6,713,650
Other	16,276,140
Total Investments	\$ 2,929,460,148

Total investments include \$371,915,136 held in the System Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 62.9% of the System Fund.

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

Investment Type	Carrying Value
Certificates of Deposit	\$ 511,675
Equities	10,498,237
Mutual Funds	22,265,614
Total Investments	\$ 33,275,526

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - ENDOWMENT INVESTMENTS

Substantially all of the investments of the University's endowment funds are pooled in the Investment Fund. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may 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. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds. Investment return of the University's pooled endowment funds is predicated on the total return concept (yield plus appreciation). Annual distributions from the Investment Fund to the University's pooled endowment funds are generally based on an adopted distribution policy. Under this policy, the prior year distribution is increased by the rate of inflation as measured by the Consumer Price Index (CPI) unless the Board determines otherwise. Each year's distribution, however, is subject to a minimum of 4% and a maximum of 7% of the pooled endowment fund's average market value for the previous year.

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2010, accumulated income and appreciation of \$393,588,583 was available in the University's pooled endowment funds of which \$381,747,111 was restricted to specific purposes.

NOTE 4 - DERIVATIVE INSTRUMENTS

Derivative instruments held at June 30, 2010, are as follows:

Type	Notional Amount	Change in Fair Value		Fair Value	
		Classification	Increase (Decrease)	Classification	Asset (Liability)
<i>Hedging Derivative Instruments</i>					
<i>Cash Flow Hedges</i>					
Pay-Fixed Interest Rate Swap 2001B Bonds (Lehman Brothers)	\$ 19,990,000	Deferred Outflow of Resources	\$ (790,257)	Hedging Derivative Liability	\$ (4,470,223)
Pay-Fixed Interest Rate Swap 2001B&C and 2002A Bonds (Wachovia)	100,000,000	Deferred Outflow of Resources	(5,993,861)	Hedging Derivative Liability	(16,073,519)
			<u>\$ (6,784,118)</u>		<u>\$ (20,543,742)</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Hedging derivative instruments held at June 30, 2010 are as follows:

Type	Objective	Notional Amount	Effective Start Date	Termination End Date	Terms
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash Flows on General Revenue 2001B Series Bonds	\$ 19,990,000	10/03/00	11/01/25	Pay 5.24%, Receive SIFMA
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash Fows on General Revenue 2001B&C and 2002A Series Bonds	100,000,000	12/01/07	12/01/36	Pay 3.314%, Receive 67% 1 Mo. LIBOR

The fair value for the Lehman Brothers Special Financing, Inc. interest rate swap was provided by the University's financial advisor, Prager, Sealy, & Co. Their method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for LIBOR due on the date of each future net settlement on the swap.

The fair value for the Wachovia Bank, N.A. interest rate swap was provided by Wachovia. Their method calculates the present value of all expected future payments on the swap based on forward curves discounted at current market rates.

During fiscal year 2009, Lehman Brothers Special Financing, Inc., filed for bankruptcy and no longer disburses the variable payment scheduled under the agreement to the University. To account for this consideration and as allowed under the swap documents, the University nets its scheduled fix payment against that payment that should be received from Lehman Brothers Special Financing, Inc., based upon SIFMA.

Risks

Interest Rate Risk: The University is exposed to interest rate risk on its interest rate swaps. The fair values of these instruments are highly sensitive to interest rate changes. Because rates have changed since the effective dates of the swaps, both of the swaps have a negative fair value as of June 30, 2010. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the calculated values as of June 30, 2010. As

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the yield curve rises, the value of the swaps will increase and as rates fall, the value of the swaps decrease.

Credit Risk: As of June 30, 2010, the University was not exposed to credit risk because the swaps had a negative fair value. Wachovia was rated AA by S&P, AA- by Fitch and Aa2 by Moody's. The University does not have a formal policy regarding requiring collateral or other security to support hedging derivative instruments subject to credit risk. The University does not have a formal policy regarding entering into master netting arrangements.

Basis Risk: The University is exposed to basis risk on the swaps when its bonds begin to trade at a yield above the referenced index rate. For the Lehman Brothers swap, basis risk also exists since swap payments are received semi-annually while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a SIFMA swap to a percentage of LIBOR swap.

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

Rollover Risk: The University is not exposed to rollover risk for the Lehman Brothers swap based solely upon the maturity date of the bonds since the termination date of the swap, November 1, 2025, is prior to the maturity date of the hedged bonds, December 1, 2025. However, since the underlying hedged variable rate debt is in the form of variable rate demand bonds, the University is subject to rollover risk in the event that the bonds are tendered and cannot be remarketed by the remarketing agent. The University is exposed to rollover risk for the Wachovia swap based upon the maturity date of the underlying debt and due to the form of the debt as variable rate demand bonds.

Future Swaps - The University has also entered into a future dated interest rate swap agreement for \$150,000,000 to be effective December 1, 2011, on variable rate bonds.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - RECEIVABLES

Receivables at June 30, 2010, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 4,093,708	\$ 0	\$ 4,093,708
Patients	105,261,879	79,054,603	26,207,276
Accounts	41,352,935		41,352,935
Intergovernmental	72,148,824		72,148,824
Pledges	18,119,089	452,977	17,666,112
Investment Earnings	2,638,925		2,638,925
Interest on Loans	737,400		737,400
Other	38,230		38,230
Total Current Receivables	<u>\$ 244,390,990</u>	<u>\$ 79,507,580</u>	<u>\$ 164,883,410</u>
Noncurrent Receivables:			
Pledges	<u>\$ 25,598,929</u>	<u>\$ 639,973</u>	<u>\$ 24,958,956</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 3,551,173	\$ 183,341	\$ 3,367,832
Institutional Student Loan Programs	902,385	69,676	832,709
Total Notes Receivable - Current	<u>\$ 4,453,558</u>	<u>\$ 253,017</u>	<u>\$ 4,200,541</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 30,718,123	\$ 1,650,067	\$ 29,068,056
Institutional Student Loan Programs	6,089,542	252,956	5,836,586
Total Notes Receivable - Noncurrent	<u>\$ 36,807,665</u>	<u>\$ 1,903,023</u>	<u>\$ 34,904,642</u>

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of .93% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Amount
2011	\$ 18,119,089
2012	11,545,364
2013	8,777,023
2014	3,531,742
2015	609,424
2016-2020	1,835,252
Total Pledge Receipts Expected	44,417,894
Less Discount Amount Representing Interest (0.93% Rate of Interest)	699,876
Present Value of Pledge Receipts Expected	43,718,018
Less Allowance for Uncollectible	1,092,950
Pledges Receivable	\$ 42,625,068

NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2010, is presented as follows:

	Balance July 1, 2009	Increases	Decreases	Balance June 30, 2010
Capital Assets, Nondepreciable:				
Land	\$ 38,431,938	\$ 25,896,978	\$ 2,209,258	\$ 62,119,658
Art, Literature, and Artifacts	74,163,351	6,160,394	960	80,322,785
Construction in Progress	614,308,478	144,326,625	412,408,776	346,226,327
Computer Software in Development	32,823,163	17,798,435		50,621,598
Other Intangible Assets	1,009,000		9,000	1,000,000
Total Capital Assets, Nondepreciable	760,735,930	194,182,432	414,627,994	540,290,368
Capital Assets, Depreciable:				
Buildings	2,014,598,586	240,414,275	1,253,080	2,253,759,781
Machinery and Equipment	295,646,055	50,663,886	13,156,901	333,153,040
General Infrastructure	422,273,124	278,279,372	31,357	700,521,139
Total Capital Assets, Depreciable	2,732,517,765	569,357,533	14,441,338	3,287,433,960
Less Accumulated Depreciation for:				
Buildings	589,142,582	59,329,190	605,860	647,865,912
Machinery and Equipment	158,057,798	16,779,446	7,688,104	167,149,140
General Infrastructure	215,102,110	14,752,347	31,357	229,823,100
Total Accumulated Depreciation	962,302,490	90,860,983	8,325,321	1,044,838,152
Total Capital Assets, Depreciable, Net	1,770,215,275	478,496,550	6,116,017	2,242,595,808
Capital Assets, Net	\$ 2,530,951,205	\$ 672,678,982	\$ 420,744,011	\$ 2,782,886,176

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2010, were as follows:

	Amount
Accounts Payable	\$ 63,228,877
Accrued Payroll	47,972,762
Contract Retainage	2,819,132
Intergovernmental Payables	124,045
Total Accounts Payable and Accrued Liabilities	\$ 114,144,816

NOTE 8 - SHORT-TERM DEBT

Short-term debt activity for the year ended June 30, 2010, was as follows:

	Balance July 1, 2009	Draws	Repayments	Balance June 30, 2010
Commercial Paper Program	\$ 148,291,000	\$ 33,000,000	\$ 121,507,000	\$ 59,784,000
Line of Credit		665,000	665,000	
Total Short-Term Debt	\$ 148,291,000	\$ 33,665,000	\$ 122,172,000	\$ 59,784,000

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

Commercial paper was redeemed with proceeds from The University of North Carolina General Revenue Bonds, Series 2009A and payments from campus entities with outstanding commercial paper.

The University of North Carolina at Chapel Hill Foundation, Inc. (Foundation) and Chapel Hill Real Estate Holdings, Inc. entered into an interest rate swap agreement, in the form of an interest rate cap, with the Bank of New York Mellon on July 2, 2009. The Foundation used the Bank of America Line of Credit to fund the one-time, up-front payment to the Bank of New York Mellon under the agreement. The Foundation then paid in full the Line of Credit with cash reserves on July 13, 2009.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2010, is presented as follows:

	Balance July 1, 2009	Additions	Reductions	Balance June 30, 2010	Current Portion
Revenue Bonds Payable	\$ 1,056,780,000	\$ 210,540,000	\$ 24,470,000	\$ 1,242,850,000	\$ 96,424,207
Add/Deduct Premium/Discount	(3,309,104)	8,846,728	(7,681,551)	13,219,175	
Deduct Deferred Charge on Refunding	(3,034,493)		(401,922)	(2,632,571)	
Total Revenue Bonds Payable	1,050,436,403	219,386,728	16,386,527	1,253,436,604	96,424,207
Notes Payable	675,000	45,750,000	325,000	46,100,000	350,000
Capital Leases Payable	1,710,142	3,421,701	1,670,032	3,461,811	1,007,926
Compensated Absences	125,342,115	68,372,984	70,978,605	122,736,494	6,929,381
Annuity and Life Income Payable	11,555,016	83,458	1,062,085	10,576,389	1,440,546
Total Long-Term Liabilities	\$ 1,189,718,676	\$ 337,014,871	\$ 90,422,249	\$ 1,436,311,298	\$ 106,152,060

Additional information regarding capital lease obligations is included in Note 10.

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue plus Capital Appreciation	Principal Paid Through June 30, 2010	Discount on Capital Appreciation Bonds	Principal Outstanding plus Capital Appreciation June 30, 2010	See Table Below
General Revenue								
	2001A	5.000% - 5.375%	12/01/2025	\$ 89,930,000	\$ 53,865,000	\$ 0	\$ 36,065,000	
	2001B	0.180% - 5.170% *	12/01/2025	54,970,000	17,860,000		37,110,000	
	2001C	0.150% - 2.969% *	12/01/2025	54,970,000	17,860,000		37,110,000	
	2002B	5.00%	12/01/2011	66,555,000	49,420,000		17,135,000	
	2003	3.000% - 5.000%	12/01/2033	107,960,000	11,215,000		96,745,000	
	2005A	4.000% - 5.000%	12/01/2034	404,960,000	2,595,000		402,365,000	
	2007	4.450% - 5.000%	12/01/2036	298,475,000			298,475,000	
	2009A	3.000% - 5.000%	12/01/2039	97,735,000			97,735,000	
	2009B	5.757% **	12/01/2039	112,805,000			112,805,000	
Total General Revenue				1,288,360,000	152,815,000		1,135,545,000	
Housing System	1997B	4.875% - 5.000%	11/01/2011	7,210,000	5,510,000		1,700,000	(1)
Utility System	1997	5.250% - 5.500%	08/01/2021	84,135,000		(24,361,590)	59,773,410	(3)
Student Union	2000	5.00%	06/01/2010	12,465,000	12,465,000			(2)
Student Recreation Center	1997	5.00%	06/01/2011	3,545,000	3,135,000		410,000	(2)
U.S. EPA Project	1991	9.05%	02/15/2015	58,125,000	37,065,000		21,060,000	
Total Revenue Bonds Payable (Principal Only)				\$ 1,453,840,000	\$ 210,990,000	\$ (24,361,590)	1,218,488,410	
Less: Unamortized Loss on Refunding							(2,632,571)	
Plus: Unamortized Premium							37,580,765	
Total Revenue Bonds Payable							\$ 1,253,436,604	

General Revenue bonds were issued for various construction projects and refund of bonds and commercial paper.

* For variable rate debt, interest rates in effect at June 30, 2010 are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

** The University has elected to treat these bonds as federally taxable "Build America Bonds" for the purposes of the American Recovery and Reinvestment Act and to receive a cash subsidy from the U.S. Treasury equal to 35% of the interest payable on these bonds. For these bonds, the interest rate included is the taxable rate, which does not factor in the cash subsidy from the U.S. Treasury.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year			Estimate of % of Revenues Pledged
			Revenues Net of Expenses	Principal & Accretion	Interest	
(1)	Housing Revenues	\$ 1,785,734	\$ 25,015,789	\$ 785,000	\$ 102,809	4%
(2)	Student Fees	430,500	1,764,044	890,000	65,000	24%
(3)	Utilities Revenues	84,135,000	37,559,597	3,109,217		19%

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

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

General Revenue, Series 2001B and 2001C

In 2001, the University issued two series of variable rate demand bonds in the amount of \$54,970,000 (2001B) and \$54,970,000 (2001C) that each has a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; Housing System, Series 2000; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University’s remarketing agents J.P. Morgan Chase (2001B) and Bank of America, LLC (2001C). Effective September 23, 2008, J.P. Morgan Chase replaced Lehman Brothers, Inc.

The University entered into a line of credit agreement in the amount of \$300,000,000 with Wachovia Bank (or Bank) on September 21, 2006. Under the line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal and accrued interest on Variable Rate Demand Bonds (or Commercial Paper Bonds) delivered for purchase. Under the line of credit agreement, the University may request that the Bank increase the commitment by increments of \$25,000,000 for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

a total commitment of up to \$400,000,000. A request for increase is subject to the Bank's sole discretion, and the University cannot be in default under the agreement at the time of the request. During fiscal year 2009, Wells Fargo purchased Wachovia Bank, but the line of credit agreement remains in place under original terms and conditions.

The University is required to pay a quarterly facility fee for the line of credit in the amount of .08% per annum based on the size of the commitment. If a long-term debt rating assigned by S&P, Moody's, or Fitch is lowered, the facility fee assigned to the lowest rating in the below table shall apply:

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

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

Under the line of credit agreement, draws to purchase bonds will accrue interest at the prime rate payable on the same interest date as provided in the trust agreement for the original bonds. The University is required to begin making a series of 10 fully amortizing semi-annual principal payments on bonds held by the Bank six months after the date of purchase. Commercial paper bonds held by the Bank may be rolled over for a period of 180 days and must be reduced by 1/10th of the original amount of the commercial paper bonds for a period of up to 10 rollovers. All outstanding principal and accrued but unpaid interest is due in full at the maturity of the line of credit.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

D. Capital Appreciation Bonds - The University's Series 1997 Utility System and the Series 1991 U.S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of \$30,379,142 and \$3,828,921, respectively. These bonds are recorded in the amounts of \$59,773,410 (\$84,135,000 ultimate maturity less \$24,361,590 discount) and \$21,060,000 (\$25,275,000 ultimate maturity less \$4,215,000 accreted principal), respectively, which is the accreted value at June 30, 2010. These bonds mature in the years from 2010 to 2021.

E. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2010, are as follows:

Fiscal Year	Annual Requirements				
	Revenue Bonds Payable			Notes Payable	
	Principal	Interest	Interest Rate Swaps, Net *	Principal	Interest
2011	\$ 28,515,000	\$ 52,375,609	\$ 2,600,522	\$ 350,000	\$ 666,000
2012	29,250,000	51,465,024	2,445,612		665,471
2013	29,690,000	50,747,639	2,285,681	45,750,000	1,788
2014	28,695,000	50,210,269	2,090,008		
2015	29,405,000	49,645,054	1,938,274		
2016-2020	133,865,000	239,046,597	7,244,455		
2021-2025	144,710,000	219,750,357	3,178,587		
2026-2030	154,180,000	185,460,003	132,336		
2031-2035	497,560,000	116,319,897			
2036-2040	166,980,000	13,827,048			
Total Requirements	\$ 1,242,850,000	\$ 1,028,847,497	\$ 21,915,475	\$ 46,100,000	\$ 1,333,259

Interest on the variable rate General Revenue Bonds 2001B is calculated at 0.18% at June 30, 2010.

Interest on the variable rate General Revenue Bonds 2001C is calculated at 0.15% at June 30, 2010.

Interest rates are reset each week by the remarketing agent based upon a combination of the University's credit rating and market conditions.

This schedule also includes the debt service requirements for debt associated with interest rate swaps. More detailed information about interest rate swaps is presented in Note 4 Derivative Investments.

*Computed using $(5.24\% - 0.25\%) \times (\$22,000,000 - \text{annual swap reduction})$ and $(3.314\% - 0.348\%) \times \$54,230,000$ notional amount

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

Student Union: On August 30, 2005, the University defeased \$8,750,000 of outstanding Student Fee Revenue Bonds, Series 2000. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2010, the outstanding balance of the defeased Student Fee Revenue Bonds, Series 2000 bonds was \$0.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

General Revenue Bonds, Series 2001A: On August 30, 2005, the University defeased \$33,310,000 of outstanding General Revenue Bonds, Series 2001A. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2010, the outstanding balance of the defeased General Revenue Bonds, Series 2001A bonds was \$33,310,000.

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Beginning Balance July 1, 2009	Draws	Repayments	Principal Outstanding June 30, 2010
Real Property Purchases	Bank of America	1.597%	06/30/11	\$ 675,000	\$ 0	\$ 325,000	\$ 350,000
Real Property Purchases	Bank of America	1.454%	07/01/12		45,750,000		45,750,000
Total Notes Payable				<u>\$ 675,000</u>	<u>\$ 45,750,000</u>	<u>\$ 325,000</u>	<u>\$ 46,100,000</u>

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, originally in the aggregate principal amount up to \$10,000,000 to finance the costs of projects benefiting the foundation or the University. The line of credit had a maturity date of August 30, 2009 but was extended to June 30, 2011. The aggregate principal amount remained at \$6,000,000. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 1.25%. An unused commitment fee is due each quarter calculated as .25% of the difference between the commitment amount and the average balance outstanding for the quarter through June 30, 2005, and .215% thereafter. The University repays draws on the note with capital improvement funds designated for land acquisition.

On July 1, 2009, the UNC-Chapel Hill Foundation and Chapel Hill Foundation Real Estate Holdings Inc., (collectively, the Borrowers), entered into a loan agreement with the Bank of America, N.A. for \$45,750,000 to fund the acquisition of student housing and rental real property. Interest payments are made quarterly at the variable rate of the BBA LIBOR Daily Floating Rate plus 1.10%. The principal balance of the loan is due at maturity. A one-time loan fee of .25% of the Commitment was paid on the effective date of the agreement. The loan is unsecured, but is governed by a loan agreement with financial and other covenants on the Borrowers. The loan matures on July 1, 2012.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 10 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to medical and research equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2010:

<u>Fiscal Year</u>	<u>Amount</u>
2011	\$ 1,456,980
2012	1,403,000
2013	673,497
2014	608,415
2015	605,021
2016-2020	<u>149,558</u>
Total Minimum Lease Payments	4,896,471
Amount Representing Interest (0% - 24.1% Rate of Interest)	<u>1,434,660</u>
Present Value of Future Lease Payments	<u><u>\$ 3,461,811</u></u>

Machinery and equipment acquired under capital lease amounted to \$4,470,577 at June 30, 2010.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- B. Operating Lease Obligations** - Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2010:

<u>Fiscal Year</u>	<u>Amount</u>
2011	\$ 7,088,088
2012	3,790,201
2013	2,909,044
2014	351,736
2015	171,514
2016-2020	91,949
2021-2025	42,240
2026-2030	42,240
2031-2035	6,336
Total Minimum Lease Payments	\$ 14,493,348

Rental expense for all operating leases during the year was \$18,342,988.

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

Payments under the terms of the lease were a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the alumni facilities. The University had no other obligations for repayment of the certificates of participation; therefore, the certificates were not reported as a liability in prior year financial statements. The University paid the certificates' aggregate principal amount of \$9,950,000 in October 2009 and recorded the facilities as a capital asset at June 30, 2010.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Less Indigent Care and Contractual Adjustments	Net Revenues
Operating Revenues:						
Student Tuition and Fees	\$ 317,817,133	\$ 0	\$ 68,734,495	\$ 0	\$ 0	\$ 249,082,638
Patient Services	\$ 597,853,986	\$ 0	\$ 0	\$ (22,517,787)	\$ 377,614,690	\$ 242,757,083
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 59,898,831	\$ 48,890	\$ 10,150,791	\$ 0	\$ 0	\$ 49,699,150
Dining	29,378,488	1,278				29,377,210
Student Union Services	586,657	577,631				9,026
Health, Physical Education, and Recreation Services	6,809,684	2,000	360,902			6,446,782
Bookstore	26,749,546	1,152,106	809,955			24,787,485
Parking	22,263,282					22,263,282
Athletic	47,681,789	24,425				47,657,364
Utilities	125,446,425	95,809,611				29,636,814
Telecommunications	17,802,481	14,454,694				3,347,787
Other Professional Income	85,523,612	6,269,096				79,254,516
Printing/Carolina Copy	7,043,448	4,062,560				2,980,888
Repairs and Maintenance	28,175,286	27,079,270				1,096,016
Materials Management and Disbursements	3,144,772	3,094,573				50,199
Rental Property	5,679,842	111,455				5,568,387
Carolina Living and Learning Center	2,545,433					2,545,433
Performing Arts Series	1,520,160					1,520,160
KFBS Center	2,360,590					2,360,590
Trademark License Program	4,830,103					4,830,103
UNC Management Company	6,560,908					6,560,908
School of Government-Short Courses	4,604,382					4,604,382
Other	67,273,883	37,431,831				29,842,052
Total Sales and Services	\$ 555,879,602	\$ 190,119,420	\$ 11,321,648	\$ 0	\$ 0	\$ 354,438,534
Nonoperating - Noncapital Gifts	\$ 76,015,359	\$ 0	\$ 0	\$ 134,189	\$ 0	\$ 75,881,170

NOTE 12 - 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	\$ 524,684,780	\$ 25,167,214	\$ 134,817,384	\$ 0	\$ 166,244	\$ 0	\$ 684,835,622
Research	263,254,060	51,799,142	115,673,625		590,270		431,317,097
Public Service	64,854,224	12,129,018	60,947,215		113,341		138,043,798
Academic Support	76,500,833	13,446,204	17,723,357		135,616		107,806,010
Student Services	14,397,566	925,671	11,637,609		425		26,961,271
Institutional Support	58,773,567	3,052,868	22,091,314		44,126		83,961,875
Operations and Maintenance of Plant	45,282,795	3,587,669	16,999,380		70,138,695		136,008,539
Student Financial Aid				69,082,962			69,082,962
Auxiliary Enterprises	293,000,855	46,296,652	158,894,088		10,021,396		508,212,991
Depreciation						90,860,983	90,860,983
Total Operating Expenses	\$ 1,340,748,680	\$ 156,404,438	\$ 538,783,972	\$ 69,082,962	\$ 81,210,113	\$ 90,860,983	\$ 2,277,091,148

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 13 - 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, 2010, these rates were set at 3.57% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$1,144,377,392, of which \$465,899,657 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$16,632,618 and \$27,953,979, respectively.

Required employer contribution rates for the years ended June 30, 2009, and 2008, were 3.36% and 3.05%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2010, 2009, and 2008, which were \$16,632,618, \$15,756,451, and \$13,032,159, 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.osc.nc.gov/> 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2010, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$1,144,377,392, of which \$466,394,293 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$31,901,370 and \$27,983,658, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University. The voluntary contributions by employees amounted to \$7,984,418 for the year ended June 30, 2010.

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, 2010, were \$123,490. The voluntary contributions by employees amounted to \$3,638,752 for the year ended June 30, 2010.

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 \$24,036,209 for the year ended June 30, 2010.

NOTE 14 - 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

For the current fiscal year the University contributed 4.5% 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, 2009, and 2008, were 4.1% and 4.1%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2010, 2009, and 2008, which were \$41,953,228, \$37,956,143, and \$34,676,317, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> 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 by the General Assembly. For the fiscal year ended June 30, 2010, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees'

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2009, and 2008, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2010, 2009, and 2008, which were \$4,847,929, \$4,813,950, and \$4,397,972, 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 15 - 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. Settled claims have not exceeded coverage in any of the past three fiscal years.

Public Officer's and Employee's Liability Insurance - Tort claims of up to \$1,000,000 are 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 insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

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

Fire and Other Property Loss - The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. The University

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

reduced its property insurance from the previous year by eliminating campus-wide extended coverage purchased from the Fund.

Automobile Liability Insurance - All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are \$1,000,000 per claim and \$10,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

Employee and Computer Fraud - The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$75,000 deductible.

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

Comprehensive Major Medical Plan - University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a component unit 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.

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

The Trust Fund is an unincorporated entity created by Chapter 116, Article 26, of the *North Carolina General Statutes* and The University of North Carolina

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

For the period July 1, 2009 through June 30, 2010, the Trust Fund provided coverage on an occurrence basis of \$3,000,000 per individual and \$7,000,000 in the aggregate per claim. Effective July 1, 2006, in lieu of purchasing commercial reinsurance, participants contributed approximately \$10,000,000 to a reimbursement fund for future losses. Prior to July 1, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer. In addition during fiscal year 2010, the participants contributed an additional

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$1,006,106 to replenish the Reimbursement Fund to its original \$10,000,000 level.

For the fiscal year ending June 30, 2010, the Trust Fund purchased a direct insurance policy to cover the first \$1,000,000 per occurrence and \$3,000,000 in the aggregate for dental residents. *North Carolina General Statutes* Chapter 116 was amended during 1987 to authorize the Trust Fund to borrow necessary amounts up to \$30,000,000, in the event that the Trust Fund may have insufficient funds to pay existing and future claims. Any such borrowing would be repaid from the assets and revenues of program participants. No line of credit or borrowing has been established pursuant to this authorization. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

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

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

At June 30, 2010, University assets in the Trust Fund totaled \$36,165,415 while University liabilities totaled \$26,100,073 resulting in net assets of \$10,065,342.

Additional disclosures about the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund. Copies of this report may be obtained from The University of North Carolina Health Care System, 211 Friday Center Drive, Hedrick Building, Room 2029, Chapel Hill, NC 27517.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 16 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has commitments of \$149,104,017 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

The UNC Investment Fund, LLC (System Fund) has entered into agreements with limited partnerships to invest capital. These agreements represent the funding of capital over a designated period of time and are subject to adjustments. As of June 30, 2010, the System Fund had approximately \$509,898,500 unfunded committed capital.

- B. Pending Litigation and Claims** - The Supreme Court of North Carolina issued a ruling on July 1, 2005 regarding litigation between North Carolina School Boards Association, et. al. v. Richard H. Moore, State Treasurer, et. al. which involves various State officials in their official capacity seeking a judicial determination as to whether the State constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. The complaint alleged in part that the monetary payments collected pursuant to statutory authority by the University for violations of parking and traffic regulations and library fines are “civil penalties” which the State constitution requires to be paid to the school fund in the county where they are collected. The lawsuit sought declaratory judgment that the State Civil Penalty and Forfeiture Fund, the State School Technology Fund, and the Public Settlement Reserve Fund are unconstitutional. The North Carolina Supreme Court affirmed the Court of Appeals ruling that library fines are not civil penalties. The North Carolina Supreme Court reversed the ruling that fines for parking and traffic regulations are not civil penalties.

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

On August 8, 2008 a ruling was made by the Superior Court Division resulting in a judgment entered against the UNC System for \$42,368,982 to be paid into the Civil Penalty and Forfeiture Fund for distribution to the public schools pursuant to G.S. 115C-457.1 and Article IX, Section 7 of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the North Carolina Constitution. Settlement of the obligation is being facilitated by the General Assembly.

In January of 2009, the plaintiffs filed a Motion for Additional Relief with the court requesting that the plaintiffs be paid \$18,183,251 that the various University campuses have placed in escrow from 2001 through 2005. The University of North Carolina at Chapel Hill's share of that \$18,183,251 is \$3,907,525. The plaintiff's motion was heard and denied. The plaintiffs appealed the denial before the Court of Appeals.

On August 7, 2009, the General Assembly of North Carolina enacted Session Law 2009-451, Section 5.1.(b) requiring that all University of North Carolina campuses remit all parking fines held in escrow in the amount of \$18,183,251 to the Civil Penalty and Forfeiture Fund for appropriation. The University recorded a liability of \$3,907,525 at June 30, 2009 for its share of the escrow amount. The University remitted \$3,516,772 in November 2009 representing the amount of the recorded liability less 10% collection costs.

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

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

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

<u>Purpose</u>	<u>Amount</u>
Pledges to Permanent Endowments	<u>\$ 25,813,241</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 17 - RELATED PARTIES

There are 14 separately incorporated nonprofit foundations associated with the University. These foundations are the Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The School of Government Foundation, Inc., The Morehead-Cain Scholarship Fund, The Pharmacy Foundation of North Carolina, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc., The School of Social Work Foundation, Inc., James B. Hunt, Jr. Institute for Educational Leadership and Policy Foundation, Inc., and Carolina for Kibera, Inc. Some of these organizations serve, in conjunction with the University's component units (See Note 1A), as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support totaled \$11,878,662 for the year ended June 30, 2010.

NOTE 18 - INVESTMENT IN JOINT VENTURE

The University is a member of the Southern Observatory for Astronomical Research Consortium (SOAR), a joint venture accounted for under the equity method. The University is partners with Michigan State University, the Association of Universities for Research in Astronomy, and the Ministry of Science and Technology of the Federal Republic of Brazil. SOAR designed, constructed, and now operates a 4.0-meter telescope with instrumentation and related support buildings located at Cerro Pachon, a mountain in central Chile. The SOAR agreement allocates the University 15.6% of observing time until 2023. The audited financial statements for SOAR may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

NOTE 19 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2010, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*.

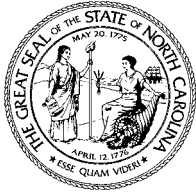
GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

GASB Statement No. 51, requires reporting certain intangible assets as capital assets.

GASB Statement No. 53, requires reporting certain derivative instruments at fair value.

NOTE 20 - SUBSEQUENT EVENTS

On September 14, 2010, the University purchased renovations to Kenan Stadium from the Educational Foundation, Inc. for \$24,995,000. On November 18, 2009, the State in care of the University entered into a ground lease with the Educational Foundation, Inc. The lease allowed the Educational Foundation, Inc. to add a fifth-floor on and renovate existing offices and team facilities in the Kenan Football Center.



Beth A. Wood, CPA
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
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2010, which collectively comprise the University's basic financial statements and have issued our report thereon dated November 30, 2010. Our report includes a reference to other auditors.

As discussed in Note 19 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* and Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, during the year ended June 30, 2010.

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

Internal Control Over Financial Reporting

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

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
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GOVERNMENT AUDITING STANDARDS (CONCLUDED)**


A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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

November 30, 2010

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