



STATE OF NORTH CAROLINA

NORTH CAROLINA STATE UNIVERSITY
RALEIGH, NORTH CAROLINA
FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

NORTH CAROLINA STATE UNIVERSITY

RALEIGH, 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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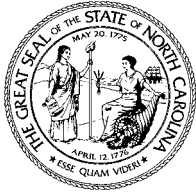
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Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

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

AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of North Carolina State University 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*.

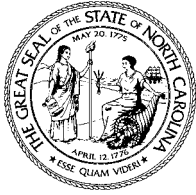
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

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
North Carolina State University
Raleigh, North Carolina

We have audited the accompanying financial statements of North Carolina State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 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 NC State Investment Fund, Inc., which represent 14 percent, 21 percent, and 6 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of the North Carolina State University Foundation, Inc. and the NC State Student Aid Association, 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 North Carolina State University Foundation, Inc. and the NC State Student Aid Association, 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 North Carolina State University and its discretely presented component units as of June 30, 2010, and the respective changes in financial position and cash flows, where

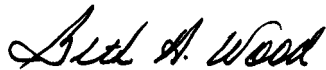
INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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

As discussed in Note 18 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 December 7, 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

December 7, 2010

NORTH CAROLINA STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Management's Discussion and Analysis of the financial report provides an overview of the accompanying basic financial statements. It includes comparative financial analysis with discussion of significant changes from the prior year. The overview also includes information on currently known facts, decisions, or conditions affecting the financial affairs of the University.

Financial Highlights

NC State University's net assets increased by 6.0% to \$1.51 billion in fiscal year 2010. Net assets represent the University's equity, the assets less the liabilities. The primary causes of this increase included the acquisition of capital assets net of related debt of \$52.9 million, a \$9.8 million rise in endowed professorship balances as a result of market value improvement in investments, and an increase of \$18.9 million in unrestricted balances.

Revenues increased by 7.5% to \$1.18 billion in fiscal year 2010. Revenues represent amounts received or accrued that are either operating or nonoperating on the accompanying financial statements. This change was primarily due to improvement in the market value of investments and efforts to address the recession. Investment income rose \$38.2 million and state appropriations increased \$23.3 million. Federal grants and contracts increased during the year by \$11.5 million, federal economic recovery funds increased by \$5.6 million, and federal student financial aid increased by \$8.0 million. Tuition and fees increased by \$8.7 million due to increased enrollment and billing rates. The recession caused some revenue items to fall, including noncapital gifts by \$10.7 million and state and local grants and contracts by \$3.4 million.

Operating expenses in fiscal year 2010 were consistent with 2009 at \$1.13 billion. Operating expenses represent amounts paid or accrued for operating purposes. By function, Instruction, Institutional Support and Student Financial Aid showed the largest increases, primarily caused by replacement of supplies and materials depleted in the prior year and increased federal financial aid. Research and Public Service expenses were down, driven by lower spending on salaries and benefits and services.

Using the Financial Statements

The University's financial statements are used to evaluate financial position as of June 30th and the results of operations for the fiscal year then ended. The *Statement of Net Assets* provides information relative to the evaluation of financial position. The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information relative to the evaluation of the results of operations. Its ending net assets agree to the total net assets on the *Statement of Net Assets*.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The financial statements also include a *Statement of Cash Flows*. This statement is used to identify the University's sources and uses of cash. The ending cash on the *Statement of Cash Flows* agrees to the total cash reported on the *Statement of Net Assets*. Also, this statement reconciles the net operating loss reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* to the net cash used by operating activities.

In using the financial statements, the *Notes to the Financial Statements* accompanying the financial statements should be read in conjunction with the financial statements. The notes provide information regarding the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on long-term liabilities, detailed information on accounts receivable, accounts payable, revenues and expenses, required information on pension plans and other post employment benefits, insurance against losses, commitments and contingencies, and accounting changes. If necessary, the disclosures include a discussion of adjustments to prior periods and events subsequent to the University's financial statement period. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Comparative Condensed Financial Statement Information

Statement of Net Assets

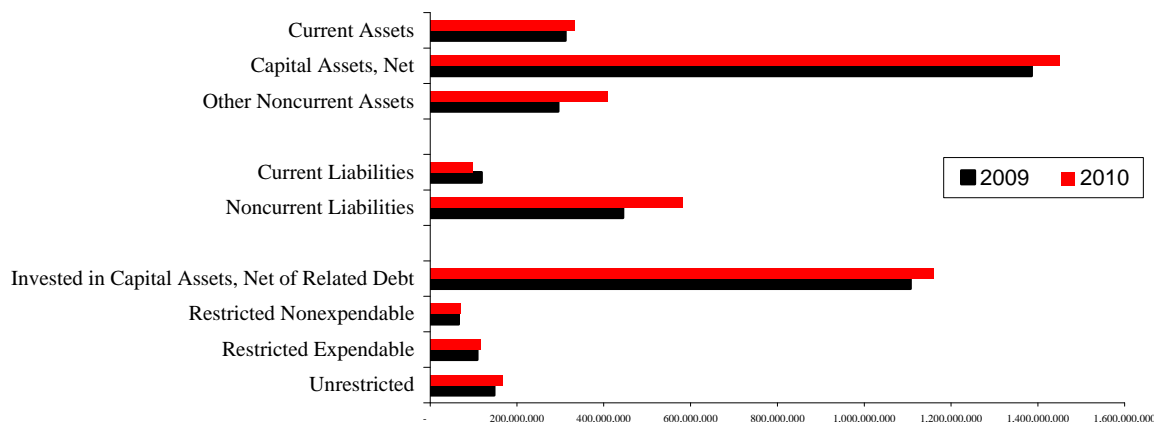
The *Statement of Net Assets* provides information regarding the University's assets, liabilities, and net assets as of June 30, 2010. Asset and liability balances are classified as either current or noncurrent. Assets classified as current are those that are available to pay for current liabilities or current year expenditures. Liabilities classified as current are those that are due and payable in the next fiscal year. The net asset balances are classified as either invested in capital assets (net of related debt), restricted or unrestricted. In addition, net assets classified as restricted are classified as either nonexpendable or expendable. Overall, the *Statement of Net Assets* provides information to evaluate the financial strength of the University and its ability to meet current and long-term obligations.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Following is a comparative analysis on the condensed balances reported in the *Statement of Net Assets* as of June 30, 2010 and 2009.

	2010	2009	Increase/ (Decrease)
Assets			
Current Assets	\$ 333,598,950	\$ 311,348,243	\$ 22,250,707
Capital Assets, Net	1,451,692,968	1,385,631,913	66,061,055
Other Noncurrent Assets	409,366,770	295,007,971	114,358,799
Total Assets	2,194,658,688	1,991,988,127	202,670,561
Liabilities			
Current Liabilities	98,270,439	118,501,555	(20,231,116)
Noncurrent Liabilities	582,135,211	444,524,372	137,610,839
Total Liabilities	680,405,650	563,025,927	117,379,723
Net Assets			
Invested in Capital Assets, Net of Related Debt	1,159,910,462	1,106,986,595	52,923,867
Restricted			
Nonexpendable	71,087,600	66,033,683	5,053,917
Expendable	116,907,131	108,456,576	8,450,555
Unrestricted	166,347,845	147,485,346	18,862,499
Total Net Assets	\$ 1,514,253,038	\$ 1,428,962,200	\$ 85,290,838

The following graph illustrates the assets, liabilities and net assets of the University as of June 30, 2010, as compared to June 30, 2009.



Assets totaled \$2.19 billion, an increase of \$202.7 million over the prior year. This change in assets includes an increase in other noncurrent assets of \$114.4 million, capital asset growth of \$66.1 million, and an increase in current assets of \$22.2 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The increase in other noncurrent assets is primarily due to an increase in noncurrent restricted cash of \$70.4 million, consisting primarily of proceeds of the new 2010 bonds and Energy Conservation Loan and increases in foundations deposits. In addition, endowment and other long-term investments increased by a combined total of \$36.5 million, primarily because of improvements in market values. Also, the new accounting standards for derivatives resulted in a \$10.4 million noncurrent asset for deferred outflow of resources related to the University's hedging derivative liability.

The capital asset growth of \$66.1 million is due to construction funding from capital grants and gifts, new capital financing and spending of prior year capital improvement monies. NC State received \$37.6 million in capital grants in 2010, primarily from the state's higher education bond/certificates of participation (COPs) program, \$68.7 million in capital financing, and \$5.3 million in capital gifts.

Current assets increased by \$22.2 million in fiscal year 2010. This increase was primarily the result of an increase in unrestricted cash of \$26.8 million, offset by a reduction in restricted cash of \$6.8 million. Unrestricted cash growth, including increases in auxiliaries and overhead cash, resulted from reduced spending in response to the economic environment. Changes in restricted cash, classified as current assets, primarily results from the movement of noncurrent cash to cover current liabilities for capital and debt purposes. Current capital and debt liabilities were lower in 2010 and less cash was moved to current restricted cash. Current receivables also increased by \$7.8 million, mainly in intergovernmental (federal) receivables.

Liabilities totaled \$680.4 million, an increase of \$117.4 million over the prior year. The increase in liabilities is attributable to an increase in noncurrent liabilities of \$137.6 million and a decrease in current liabilities of \$20.2 million.

Current liabilities totaled \$98.3 million. These liabilities include accounts payable and accrued liabilities, due to other entities, deferred revenue, and the current portion of University debt. Current liabilities decreased \$20.2 million, primarily because \$20.0 million of short-term debt was changed to long-term debt financing.

Noncurrent liabilities totaled \$582.1 million, and include deposits payable, funds held for other entities, funds held in trust in the investment pool, long-term debt, compensated absences and the hedging derivative liability. Noncurrent liabilities increased \$137.6 million as a result of multiple factors. New long-term bonded debt totaling \$77.6 million was issued in fiscal year 2010. After considering the effect of regular bond principal payments, the net noncurrent part of bonds payable increased was \$70.2 million. Notes payable increased by \$18.7 million due to the new energy conservation loan. The liability for funds held in trust for pool participants increased by \$23.9 million due to increases in market value of investments held. Also, the funds held for others liability increased by \$15.8 million primarily due to affiliated foundation deposits in the University's cash accounts with the State Treasurer. Because of new accounting standards for derivative instruments, the University recorded a \$10.4 million hedging derivative liability.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net assets totaled \$1.51 billion, an increase of \$85.3 million over the prior year. Invested in plant, net of related debt, grew by \$52.9 million as the University obtained new capital resources, including debt financing and capital grants and gifts, and spent capital reserves. Unrestricted net assets rose by \$18.9 million, as departments were conservative in spending during the economic crisis. Restricted expendable net assets rose \$8.5 million, including a \$5.1 million increase in endowed professorships. Restricted nonexpendable net assets also went up by \$5.1 million, including a \$4.7 million increase in endowed professorships. The growth in endowment professorship net assets was primarily attributable to improvement in market values of related investments.

The University's current assets are more than sufficient to cover current liabilities, with a ratio of 3.4 times compared to 2.6 times in the prior year. The University's total assets are significantly more than the University's liabilities with a ratio of 3.2 times as compared to 3.5 times in the prior year. These financial ratios are indicators of NC State's financial strength and its ability to meet current and long-term obligations.

Statement of Revenues, Expenses, and Changes in Net Assets

The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information regarding the University's activities for the year ending June 30, 2010. The activity balances are classified as operating, nonoperating, or other. Activities classified as operating include all revenues of the University except those considered nonoperating or those associated with funds received to enhance capital assets or permanent endowments, and all expenses except those related to interest expense on financing activities, loss on disposal of capital assets, and investment expenses (shown as net against investment income). Activities classified as nonoperating include state appropriations, state aid - federal economic recovery funds, noncapital gifts and grants revenue, investment income (net of investment expenses), interest and fees on debt, and gains or losses on disposal of capital assets. Activities classified as other include capital gifts or grants, additions to permanent endowments, and return of prior year capital appropriations. Overall, the *Statement of Revenues, Expenses, and Changes in Net Assets* provides information to evaluate the University's management of operations and maintenance of financial strength.

Following is a comparative analysis on the condensed balances reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* for the fiscal years ended June 30, 2010 and 2009. The 2009 balances were restated to be consistent with the current year presentation of moving certain scholarship grants from Agency funds to other noncapital grants and subjecting the related tuition and fees to discounting.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

	<u>2010</u>	<u>Restated 2009</u>	<u>Increase/ (Decrease)</u>
Operating Revenues			
Student Tuition and Fees, Net	\$ 170,813,363	\$ 162,119,262	\$ 8,694,101
Federal Appropriations	18,480,582	23,156,605	(4,676,023)
Grants and Contracts	199,584,152	188,199,311	11,384,841
Sales and Services, Net	168,927,911	168,977,142	(49,231)
Other	<u>15,935,453</u>	<u>14,359,951</u>	<u>1,575,502</u>
Total Operating Revenues	<u>573,741,461</u>	<u>556,812,271</u>	<u>16,929,190</u>
Operating Expenses			
Salaries and Benefits	712,602,591	720,572,163	(7,969,572)
Supplies and Materials	111,260,760	100,692,620	10,568,140
Services	170,470,891	176,252,400	(5,781,509)
Scholarships and Fellowships	40,609,010	36,142,936	4,466,074
Utilities	36,023,202	36,009,011	14,191
Depreciation	<u>54,464,008</u>	<u>56,485,824</u>	<u>(2,021,816)</u>
Total Operating Expenses	<u>1,125,430,462</u>	<u>1,126,154,954</u>	<u>(724,492)</u>
Net Operating Loss	<u>(551,689,001)</u>	<u>(569,342,683)</u>	<u>17,653,682</u>
Nonoperating Revenues (Expenses)			
State Appropriations	472,039,507	448,754,067	23,285,440
State Aid - Federal Recovery Funds	19,891,167	14,252,039	5,639,128
Noncapital Grants - Federal Student Financial Aid	24,581,555	16,594,802	7,986,753
Other Noncapital Grants and Gifts	68,201,515	78,341,949	(10,140,434)
Investment Income (Loss)	17,101,221	(21,063,730)	38,164,951
Other	<u>(11,978,920)</u>	<u>(13,841,437)</u>	<u>1,862,517</u>
Net Nonoperating Revenues	<u>589,836,045</u>	<u>523,037,690</u>	<u>66,798,355</u>
Gain (Loss) Before Other Revenue	38,147,044	(46,304,993)	84,452,037
Gifts, Grants, and Refund of Prior Year Capital			
Appropriations	42,680,320	30,907,374	11,772,946
Additions to Permanent Endowments	<u>4,463,474</u>	<u>4,916,348</u>	<u>(452,874)</u>
Increase (Decrease) in Net Assets	<u>\$ 85,290,838</u>	<u>\$ (10,481,271)</u>	<u>\$ 95,772,109</u>

Operating and Nonoperating Activities

The following illustrates the relationships of operating and nonoperating revenue sources and expense functions to total revenue/expenses for the fiscal year 2010 and 2009, and the consistency of relationships between the two years.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating and Nonoperating Revenues

Title	% to Total 2010	% to Total 2009
State Appropriations	40 %	41 %
State Aid - Federal Recovery Funds	2 %	1 %
Research Contracts and Grants	17 %	17 %
Student Tuition and Fees	14 %	15 %
Sales and Services	14 %	16 %
Noncapital Grants and Gifts	8 %	9 %
Federal Appropriations	2 %	2 %
Other	3 %	(1) %
Total	100 %	100 %

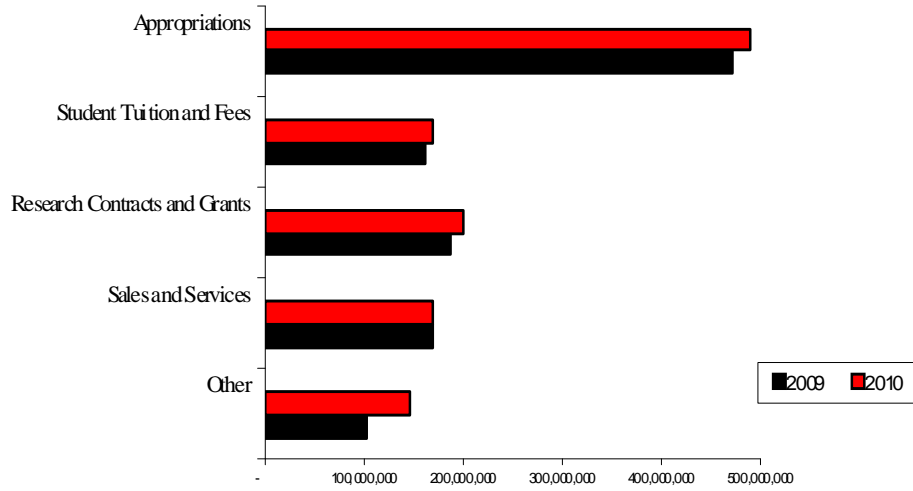
Operating and Nonoperating Expenses

Title	% to Total 2010	% to Total 2009
Instruction	30 %	29 %
Research	19 %	19 %
Public Service	10 %	11 %
Auxiliary Enterprises	10 %	11 %
Operations & Maintenance of Plant	7 %	7 %
Academic Support	6 %	6 %
Institutional Support	6 %	6 %
Depreciation	5 %	5 %
Student Financial Aid	4 %	3 %
Student Services	2 %	2 %
Other	1 %	1 %
Total	100 %	100 %

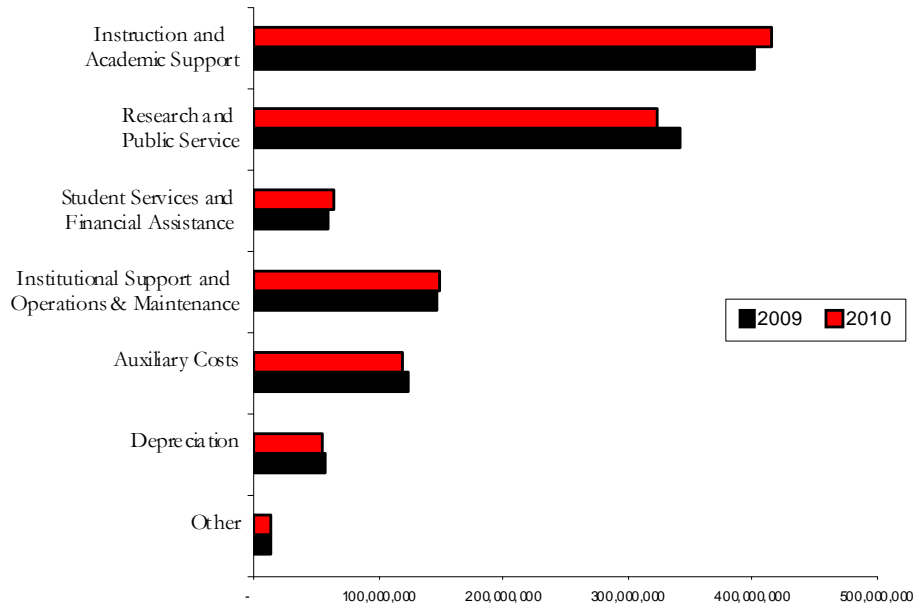
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graphs illustrate the University's operating and nonoperating revenues/expenses by source/function.

Operating and Nonoperating Revenues



Operating and Nonoperating Expenses



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total revenues (operating and nonoperating) increased \$81.9 million or 7.5% compared to the prior year. Investment income grew \$38.1 million as market values of investments improved. State appropriations rose by \$23.3 million or 5.2% from the prior year, but were still some \$15.7 million below the 2008 level. The University continued to expand its research mission, with research contracts and grants increasing \$11.4 million or 6.0%. Student tuition and fees increased \$8.7 million or 5.4% as enrollment and rates increased. The economic recession was still a major factor in the University's revenues. The University received \$19.9 million in federal economic recovery funds from the State, up \$5.6 million from 2009. Also federal student financial aid was up \$8.0 million and noncapital gifts were down \$10.7 million as foundations were still recovering from investment losses in the prior year.

Total expenses (operating and nonoperating) were relatively flat, decreasing \$2.6 million or 0.2% compared to the prior year, primarily as a result of responses to the continuing recession. Decreases in salaries and benefits of \$8.0 million and services of \$5.8 million were offset by a \$10.6 million increase in spending for supplies and a \$4.5 increase in scholarships and fellowships. The salaries and benefits decrease was due to a hiring freeze in response to the budget. Factors affecting the services decrease included a one-time \$2.6 million expense in 2009 for cleaning up an oil spill on campus. As departments could not hire new employees, they used available monies to replenish supplies and materials depleted in 2009. The supplies expense is still some \$12 million below the 2008 total.

Other Activity

Other activity totaled \$47.1 million, up \$11.3 million from the prior year. Capital grants increased by \$9.6 million, primarily in state bond/COPs aid. Because of budget limitations, the University had no new capital appropriations. Capital gifts grew \$0.5 million but additions to permanent endowments declined by \$0.5 million, reflecting the difficult economic environment.

Capital Assets and Long-Term Debt Activities

Capital Assets

The University capitalizes assets that have a value or cost equal to or greater than \$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. Repairs and renovations that do not extend the life of the building beyond the expected useful life at acquisition, nor increase the future service potential of the building are expensed and not capitalized.

Machinery and Equipment are depreciated over their estimated useful lives, generally 4 to 22 years beginning in the year of acquisition. Buildings and General Infrastructure are depreciated over their estimated useful lives, generally 10 to 50 years for buildings and 15 to 75 years for general infrastructure beginning in the year that the construction is completed or, if purchased after construction, when acquired. Computer software are depreciated over their

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

estimated useful lives, generally 2 to 15 years beginning in the year that the development is completed or, if purchased after development, when acquired. Land, Construction in Progress, and Computer Software in Development are nondepreciable capital assets. When a construction project is completed, the capital project costs are moved from the Construction in Progress account to either Buildings or General Infrastructure as appropriate. When computer software is completed, the project costs are moved from the Computer Software in Development account to Computer Software.

As shown in the following table, the University increased its net capital assets by \$66.1 million during fiscal year 2010.

	<u>2010</u>	<u>2009</u>	<u>Increase/ (Decrease)</u>
Land	\$ 38,285,610	\$ 26,914,428	\$ 11,371,182
Construction in Progress	162,025,112	145,513,373	16,511,739
Computer Software in Development	2,385,000		2,385,000
Buildings	1,426,874,142	1,385,945,616	40,928,526
Machinery and Equipment	262,528,573	249,036,940	13,491,633
General Infrastructure	160,499,489	140,311,584	20,187,905
Computer Software	<u>2,166,073</u>		<u>2,166,073</u>
Total Capital Assets	2,054,763,999	1,947,721,941	107,042,058
Accumulated Depreciation	<u>(603,071,031)</u>	<u>(562,090,028)</u>	<u>(40,981,003)</u>
Net Capital Assets	<u>\$ 1,451,692,968</u>	<u>\$ 1,385,631,913</u>	<u>\$ 66,061,055</u>

With the implementation of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, the University added computer software and computer software in development to the capital assets. In addition to costs incurred, the University had \$69.7 million in outstanding commitments for construction projects as of June 30, 2010.

During fiscal year 2010, NC State continued to build new facilities and work on renovations to modernize campus. Funding for these improvements came from funds provided by NC bonds and certificates of participation, prior year state capital appropriations, and University debt financing.

Following are some of the major construction projects that were completed or were in progress as of June 30, 2010.

Work neared completion on the new Engineering Building III on Centennial Campus during fiscal year 2010. The new building is the home of the Department of Mechanical and Aerospace Engineering and the Joint NC State/UNC-Chapel Hill Department of Biomedical Engineering. The 248,291 square-foot building will include approximately 80 laboratories, a wind tunnel facility, eight classrooms, and offices for faculty and graduate students. Once EBIII is occupied, two-thirds of the University's College of Engineering program will be located on Centennial Campus.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University completed two major new parking decks to address the needs of a growing campus. A four level parking deck was added to Centennial Campus connecting Partners Way drive with Partners III building. This addition adds over 400 parking spaces. Adding over 500 spaces, the Centennial Biomedical Campus Parking Deck just off of Hillsborough Street opened in anticipation of the new Terry Companion Veterinarian Medical Center opening in 2011.

Built in 1897 and last renovated in 1959, Winslow Hall underwent major renovations to over 12,000 square feet of its interior. These renovations updated the interior for egress code deficiencies and asbestos abatement and added a new elevator, restrooms, sprinkler systems, and heating, ventilating and air conditioning system. The improvements also included more efficient office layouts leading to more office square footage for the building.

Avent Ferry Technology Center had significant renovations completed in 2010 that provides additional office space, training rooms, and warehouse space for the departments of Enterprise Applications & Database Services (EADS) and Communications Technology (ComTech). Renovations also addressed deficiencies in the building code and circulation issues. Electrical and mechanical systems were also upgraded, as well as aesthetic improvements to the building's exterior.

More information about the University's long-range capital plan is located at http://www.ncsu.edu/facilities/construction_info/index.htm.

Long-Term Debt Activities

The University incurs long-term debt to finance construction projects, to purchase equipment using lease arrangements and to provide for accumulated unused vacation benefits for employees. As shown in the following chart, the University increased its long-term debt by \$87.8 million during fiscal year 2010.

	<u>2010</u>	<u>2009</u>	<u>Increase/ (Decrease)</u>
Bonds Payable	\$ 323,109,579	\$ 253,137,535	\$ 69,972,044
Capital Leases Payable	388,055	513,688	(125,633)
Notes Payable	23,650,703	4,994,095	18,656,608
Compensated Absences	<u>55,817,030</u>	<u>56,515,793</u>	<u>(698,763)</u>
Total Long-Term Liabilities	<u>\$ 402,965,367</u>	<u>\$ 315,161,111</u>	<u>\$ 87,804,256</u>

NC State issued \$77.6 million in new bonds in fiscal year 2010. However, with the effect of premiums and discounts and \$9.1 million in regular principal payments, the increase at June 30 was \$70.0 million. Notes payable rose \$18.7 million because of a new \$19.7 million loan for energy conservation projects. Compensated absences showed a small decrease.

Economic Factors That Will Affect the Future

As a state supported institution, NC State recognizes the importance and challenges faced by the State of North Carolina in achieving economic balance. In association with effects of the global economic collapse in 2009 and its significant impact on unemployment rates, state revenues have been negatively affected. During the recent legislative session, state budget cuts were again considered necessary to balance the budget for fiscal year 2011. To reduce the effect of the budget cuts on the University System, the legislature approved institutional based tuition increases. In addition, the legislature approved new state appropriations to fund enrollment increases. As a result of these state legislative actions, NC State was able to avoid major budget cuts to its operations and services for fiscal year 2011.

As to future state appropriations, significant questions still abound as to the strength of the economic recovery and its effect on job growth. Adding to this, the next state legislative session awaits the sunset of tax increases passed to temporarily help with the effects of the economic recession as well as the expiration of the federal stimulus package passed to stimulate economic recovery. The State Office of Budget and Management has reported that these conditions will leave a shortfall of approximately \$3.3 billion in the state's budget for the coming legislative session. Concern and uncertainty exist in regards to this shortfall and to what legislative actions will occur to balance the state budget and to what, if any, action the congress may give to further stimulate the economy.

As a result, reductions to the University's operating state appropriation of up to 10% are currently being evaluated by the State. Such reductions if made would be significant to University operations. To meet this challenge, the Chancellor and his executive management team continue to use a collective strategy to assist program and fiscal managers with directing budget decisions and at the same time ensuring the achievement of core mission services. Attention to removing redundancies and underperforming programs, as well as reducing spending and improving revenue streams where available, will be evaluated during the budget decision process.

NC State has a history of strong leadership and fiscal management. With the exceptional quality of our faculty and staff, our location and the extent of campus operations, the affordability offered to our students, as well as the research and extension opportunities afforded as a Federal Land Grant Institution and by our public-private partnerships at Centennial Campus, NC State is uniquely qualified to excel in a highly competitive market. As a doctoral/research-extensive, land-grant public university, NC State is committed to excellence and service to its students and the people of North Carolina.

North Carolina State University
Statement of Net Assets
June 30, 2010

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 192,685,881
Restricted Cash and Cash Equivalents	78,173,597
Short-Term Investments	1,860
Receivables, Net (Note 5)	45,311,179
Due from Primary Government	7,255,862
Due from State of North Carolina Component Units	2,043,961
Due from University Component Units	428,434
Inventories	4,775,658
Notes Receivable, Net (Note 5)	2,922,518
	<hr/>
Total Current Assets	333,598,950
	<hr/>

Noncurrent Assets:

Restricted Cash and Cash Equivalents	116,468,181
Restricted Due from Primary Government	3,880
Endowment Investments	143,111,925
Other Investments	130,365,431
Deferred Outflow of Resources (Note 4)	10,395,528
Notes Receivable, Net (Note 5)	9,021,825
Capital Assets - Nondepreciable (Note 6)	202,695,722
Capital Assets - Depreciable, Net (Note 6)	1,248,997,246
	<hr/>
Total Noncurrent Assets	1,861,059,738
	<hr/>

Total Assets	2,194,658,688
	<hr/>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 7)	41,871,890
Due to Primary Government	5,437,280
Due to University Component Units	5,000
Unearned Revenue	36,289,449
Interest Payable	2,654,743
Long-Term Liabilities - Current Portion (Note 9)	12,012,077
	<hr/>
Total Current Liabilities	98,270,439
	<hr/>

Noncurrent Liabilities:

Deposits Payable	650,873
Funds Held for Others	32,924,632
U. S. Government Grants Refundable	5,960,632
Funds Held in Trust for Pool Participants	141,250,256
Hedging Derivative Liability (Note 4)	10,395,528
Long-Term Liabilities (Note 9)	390,953,290
	<hr/>
Total Noncurrent Liabilities	582,135,211
	<hr/>

Total Liabilities	680,405,650
	<hr/>

North Carolina State University
Statement of Net Assets
June 30, 2010

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	1,159,910,462
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	8,423,037
Endowed Professorships	48,044,704
Departmental Uses	6,496,196
Loans	6,918,085
Other	1,205,578
Expendable:	
Scholarships and Fellowships	19,408,956
Research	15,598,603
Endowed Professorships	32,339,825
Departmental Uses	26,106,088
Loans	1,486,014
Capital Projects	8,408,785
Debt Service	5,745,091
Other	7,813,769
Unrestricted	166,347,845
Total Net Assets	<u>\$ 1,514,253,038</u>

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

North Carolina State University
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)	\$ 170,813,363
Federal Appropriations	18,480,582
Federal Grants and Contracts	115,038,412
State and Local Grants and Contracts	32,613,219
Nongovernmental Grants and Contracts	51,932,521
Sales and Services, Net (Note 11)	168,927,911
Interest Earnings on Loans	424,276
Other Operating Revenues, Net (Note 11)	15,511,177

Total Operating Revenues	573,741,461
--------------------------	-------------

EXPENSES

Operating Expenses:

Salaries and Benefits	712,602,591
Supplies and Materials	111,260,760
Services	170,470,891
Scholarships and Fellowships	40,609,010
Utilities	36,023,202
Depreciation/ Amortization	54,464,008

Total Operating Expenses	1,125,430,462
--------------------------	---------------

Operating Loss	(551,689,001)
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	472,039,507
State Aid - Federal Economic Recovery Funds	19,891,167
Noncapital Grants - Federal Student Financial Aid	24,581,555
Other Noncapital Grants	24,096,141
Noncapital Gifts	44,105,374
Investment Income (Net of Investment Expense of \$610,322)	17,101,221
Interest and Fees on Debt	(10,761,843)
Other Nonoperating Expenses	(1,217,077)

Net Nonoperating Revenues	589,836,045
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Income Before Other Revenues and Expenses	38,147,044
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Refund of Prior Years Capital Appropriations	(209,557)
Capital Grants	37,597,562
Capital Gifts	5,292,315
Additions to Endowments	4,463,474

Increase in Net Assets	85,290,838
------------------------	------------

NET ASSETS

Net Assets - July 1, 2009	1,428,962,200
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Net Assets - June 30, 2010	\$ 1,514,253,038
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The accompanying notes to the financial statements are an integral part of this statement

North Carolina State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2010

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 550,561,451
Payments to Employees and Fringe Benefits	(712,460,829)
Payments to Vendors and Suppliers	(311,165,935)
Payments for Scholarships and Fellowships	(40,609,010)
Loans Issued	(1,063,735)
Collection of Loans	1,553,021
Interest Earned on Loans	206,042
Other Receipts	15,511,177
	<hr/>
Net Cash Used by Operating Activities	(497,467,818)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	472,039,507
State Aid - Federal Economic Recovery Funds	19,891,167
Noncapital Grants - Federal Student Financial Aid	24,581,555
Other Noncapital Grants	26,837,071
Noncapital Gifts	43,461,779
Additions to Endowments	4,463,474
Federal Family Education Loan Receipts	89,714,528
Federal Family Education Loan Disbursements	(91,379,202)
William D. Ford Direct Lending Receipts	13,944,799
William D. Ford Direct Lending Disbursements	(14,010,432)
Related Activity Agency Receipts	45,892,450
Related Activity Agency Disbursements	(28,390,616)
External Participation in Investment Fund Receipts	17,767,362
External Participation in Investment Fund Disbursements	(5,045,482)
Other Receipts	76,147
	<hr/>
Net Cash Provided by Noncapital Financing Activities	619,844,107

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	108,946,106
Refund of Prior Years Capital Appropriations	(209,557)
Capital Grants	40,766,412
Capital Gifts	2,888,605
Proceeds from Sale of Capital Assets	377,977
Acquisition and Construction of Capital Assets	(126,474,891)
Principal Paid on Capital Debt and Leases	(40,249,729)
Interest and Fees Paid on Capital Debt and Leases	(9,047,762)
Other Payments	(878,762)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(23,881,601)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	59,250,206
Investment Income	3,748,802
Purchase of Investments and Related Fees	(71,113,580)
	<hr/>
Net Cash Used by Investing Activities	(8,114,572)
	<hr/>
Net Increase in Cash and Cash Equivalents	90,380,116
Cash and Cash Equivalents - July 1, 2009	296,947,543
	<hr/>
Cash and Cash Equivalents - June 30, 2010	\$ 387,327,659

North Carolina State University
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 PROVIDED (USED) BY OPERATING ACTIVITIES**

Operating Loss	\$ (551,689,001)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation/ Amortization Expense	54,464,008
Allowances, Write-Offs, and Amortizations	1,294,642
Changes in Assets and Liabilities:	
Receivables (Net)	(6,429,659)
Due from Primary Government	138,349
Inventories	(44,670)
Accounts Payable and Accrued Liabilities	7,070,382
Due to Primary Government	(1,756,630)
Unearned Revenue	498,800
Compensated Absences	(698,762)
Deposits Payable	(315,277)
	<hr/>
Net Cash Used by Operating Activities	<u>\$ (497,467,818)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 192,685,881
Restricted Cash and Cash Equivalents	78,173,597
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	116,468,181
	<hr/>
Total Cash and Cash Equivalents - June 30, 2010	<u>\$ 387,327,659</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 2,623,871
Change in Fair Value of Investments	28,858,582
Loss on Disposal of Capital Assets	(1,625,041)
Amortization of Bond Premiums/Discounts	(655,600)
Bond Issuance Cost Withheld	(462,241)

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

***North Carolina State University Foundations
Statement of Financial Position
June 30, 2010***

Exhibit B-1

	North Carolina State University Foundation, Inc.	NC State Student Aid Association, Inc.
ASSETS		
Cash and Cash Equivalents	\$ 5,924,699	\$ 17,087,037
Investments	7,838,284	26,816,717
Investments with University Investment Pool	55,652,218	
Cash Surrender Value of Life Insurance	202,474	181,246
Real Estate Held for Resale	2,982,613	7,807,679
Receivables, Net	136,610	244,906
Pledges Receivable/Promises	12,482,756	31,223,735
Prepaid Expenses		40,602
Notes/Loans Receivable, Net		46,350
Deferred Charges		256,178
Property and Equipment, Net	3,732,620	52,625,826
Total Assets	<u>88,952,274</u>	<u>136,330,276</u>
LIABILITIES		
Accounts Payable and Accrued Expenses	862,081	711,466
Due to University and Other Foundations	428,434	
Deferred Revenue	12,429	3,300,845
Interest Payable		153,320
Deposits Payable		3,715
Funds Held for Others	73,772	
Interest Rate Swap Fair Value Liability		3,369,351
Split Interest Agreement Obligations	4,174,820	
Notes Payable		1,531,436
Bonds Payable		47,655,000
Total Liabilities	<u>5,551,536</u>	<u>56,725,133</u>
NET ASSETS		
Unrestricted	4,046,947	15,083,499
Temporarily Restricted	41,084,389	31,224,369
Permanently Restricted	38,269,402	33,297,275
Total Net Assets	<u>\$ 83,400,738</u>	<u>\$ 79,605,143</u>

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

North Carolina State University Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2010

Exhibit B-2

	North Carolina State University Foundation, Inc.	NC State Student Aid Association, Inc.
CHANGES IN UNRESTRICTED NET ASSETS		
Revenues, Gains and Losses:		
Contributions	\$ 3,245	\$ 7,925,866
Change in Pledges Receivable	249,330	
Donated Services and Noncash Contributions	389,200	1,863,444
Student Housing Rents		2,691,121
Investment Income	69,176	1,730,310
Net Unrealized and Realized Gains on Long-Term Investments	2,855,003	541,137
Unrealized Loss on Swap Contracts		(1,204,319)
Net Asset Reclassification - Underwater Endowments	2,364,701	
Other	3,902,393	1,648,586
Total Unrestricted Revenues, Gains and Losses	9,833,048	15,196,145
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	5,133,654	
Facility Improvements		6,539,552
Total Net Assets Released from Restrictions	5,133,654	6,539,552
Total Unrestricted Revenues, Gains, Losses and Other Support	14,966,702	21,735,697
Expenses:		
University Support	5,956,880	6,216,506
University Facilities Support	1,933,723	6,539,552
Student Housing		3,046,223
Management and General	333,946	586,326
Fund Raising	537,067	2,730,096
Total Expenses	8,761,616	19,118,703
Increase in Unrestricted Net Assets	6,205,086	2,616,994
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS		
Contributions	7,030,423	3,818,190
Change in Pledges Receivable	(942,172)	
Donated Services and Noncash Contributions	189,977	4,375
Investment Income	11,386	119,808
Net Unrealized and Realized Gains on Long-Term Investments	2,831,932	121,011
Unrealized Loss on Swap Contracts		(30,644)
Net Asset Reclassification - Underwater Endowments	(2,364,701)	
Vaughn Towers Revenue		4,232,391
Other	890,522	
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	(5,133,654)	
Facility Improvements		(6,539,552)
Increase in Temporarily Restricted Net Assets	2,513,713	1,725,579
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS		
Contributions	2,085,221	738,646
Change in Pledges Receivable	(3,768,430)	
Donated Services and Noncash Contributions		9,000
Investment Income	170,813	
Net Unrealized and Realized Gains on Long-Term Investments	460,319	
Change in Value of Split Interest Agreements	(863,366)	
Other	450,613	
Increase (Decrease) in Permanently Restricted Net Assets	(1,464,830)	747,646
Increase in Net Assets	7,253,969	5,090,219
Net Assets at Beginning of Year	76,146,769	74,514,924
Net Assets at End of Year	\$ 83,400,738	\$ 79,605,143

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

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

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are 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 NC State Investment Fund, Inc. (Investment Fund) and the NC State University Partnership Corporation (Corporation), component units of the University, are reported as if they were part of the University.

The Investment Fund is governed by a Members Board consisting of six ex officio directors and five elected directors. The Investment Fund's purpose is to support 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Investment Fund is a governmental external investment pool. Because the majority of the Members Board of the Investment Fund consists of University administrators and board members and the Investment Fund's primary purpose is to benefit North Carolina State University, its financial statements have been blended with those of the University.

The Corporation is governed by a Board of Directors appointed by the Chancellor of the University. The Corporation's purpose is to support and benefit the University with the aims of creating new knowledge and improving the lives of the people of North Carolina. The Corporation formed NC State University Centennial Development, LLC on January 25, 2002 to develop, construct, own, finance, manage and otherwise deal with a nonprofit hotel, golf course, conference center and related meeting facilities on Centennial Campus as outlined in the Campus Master Plan. In addition, the Corporation formed NC State Upfit, LLC on October 27, 2006 to develop, construct, own, finance, manage and otherwise upfit facilities and other infrastructure on Centennial Campus, and it formed NC State Residence, LLC on October 27, 2006 to develop, construct, own, finance, manage and otherwise deal with a nonprofit chancellor's residence on Centennial Campus. Also, the Corporation formed NC State CBC Land I, LLC on June 1, 2007 to acquire, develop, own, lease, hold, manage, sell, and otherwise exercise all right of ownership of land and flex lab facilities on Centennial Biomedical Campus. Additionally, the Corporation formed NC State American Home, LLC on August 8, 2007 and changed its name to Bell Tower Holdings LLC on December 14, 2009. The purposes of Bell Tower Holdings LLC are to acquire, develop, own, lease, hold, manage, sell and otherwise exercise all right of ownership of real property and enter into any related agreements for assisting with the acquisition, development, financing, construction, management and operation of real property. On March 31, 2008 the Corporation formed NC State CC Holding I, LLC to acquire, develop, own, lease, hold, manage, sell and otherwise exercise all right of ownership of land and facilities on Centennial Campus. Because the Corporation's Board is appointed by the Chancellor and its sole purpose is to support and benefit the University, the Corporation and the LLCs are considered part of the University for financial reporting purposes.

Separate financial statements for the Investment Fund and for the Corporation and the LLCs may be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Discretely Presented Component Units - The North Carolina State University Foundation, Inc. (Foundation) and NC State Student Aid Association, Inc. (Athletic Club) are legally separate not-for-profit corporations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Foundation and Athletic Club are legally separate, tax-exempt component units of the University. These entities act primarily as fund-raising organizations to supplement the resources that are available to the University in support of its programs. Separate Boards of Directors govern these entities independent of the University's Board of Trustees. Although the University does not control the timing or amount of receipts from these entities, the majority of resources, or income thereon, that these entities hold and invest is restricted to the activities of the University by the donors. Because these restricted resources held by these entities can only be used by, or for the benefit of the University, these entities are considered component units of the University and are reported in separate financial statements because of the difference in their reporting model, as described below.

The Foundation and Athletic Club are private not-for-profit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to their financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2010, the Foundation distributed \$8,391,018 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149.

During the year ended June 30, 2010, the Athletic Club distributed \$5,642,350 to the University for both restricted and unrestricted purposes. Complete financial statements for the Athletic Club can be obtained from the NC State Student Aid Association, PO Box 37100, Raleigh, NC 27627, or by calling (919) 865-1500.

- 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 GASB.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. Private equity funds consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are valued utilizing the most current information provided by the general partner.

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity or for a specified period of time, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts. Land and other real estate held as investments by endowments are reported at fair value, consistent with how investments are generally reported. However, real estate held as quasi-endowments or principally for other than investment purposes is reported at cost.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, state and local governments, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are valued at cost using the first-in, first-out method. Exceptions are the bookstore, which uses the retail inventory method, and physical plant, which uses the moving weighted average method.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost of \$5,000 or greater at the date of acquisition and an estimated 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 75 years for general infrastructure, 10 to 50 years for buildings, 4 to 22 years for equipment, and 2 to 15 years for computer software.

The University does not capitalize its collections. These collections adhere to the University's policy to maintain for public exhibition, education, or research; protect, keep unencumbered, care for, and preserve; and requires proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized.

- I. Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants.
- J. Funds Held in Trust for Pool Participants** - Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.
- K. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. Losses on refunding and issuance costs on bonds payable are not material to the accompanying financial statements and are expensed in the year incurred.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

N. 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.

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

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

P. Internal Sales Activities - Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as Central Stores, the Creamery, Telecommunications, Physical Plant, and Motor Pool. In addition, the University has other miscellaneous sales and service units that operate 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$368,496,463 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 \$219,284. The carrying amount of the University's deposits not with the State Treasurer was \$18,611,912 and the bank balance was \$18,723,626. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University follows the Cash Management Plan (Plan) approved by the North Carolina Office of the State Controller. As provided by the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Plan, all funds belonging to the University are deposited with the State Treasurer pursuant to G.S. 147-77 and G.S. 147-69.1. As provided by the Plan, imprest checking accounts are established with outside banks when considered effective in meeting management objectives. All imprest checking accounts are authorized by the University Treasurer and are limited to the minimum amount needed for sanctioned purposes. In addition, pursuant to G.S. 116-36(e), the University invests certain endowment funds with outside bank accounts. The University does not have a deposit policy for custodial credit risk. As of June 30, 2010, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	\$	211,307
Uninsured and Collateral Held by Pledging Bank's Trust Department not in University's Name		<u>17,532,635</u>
Total	\$	<u>17,743,942</u>

- 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the investment of funds by fiduciaries but in compliance with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the endowment funds including those invested in the Investment Fund, a University component unit, are subject to and restricted by G.S. 36E “Uniform Prudent Management of Institutional Funds Act” (UPMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool

(Excludes Amounts Reported in the Investment Fund)

	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
Money Market Mutual Funds	\$ 208	\$ 208	\$ 0	\$ 0	\$ 0
Other Securities					
Pooled Investments	<u>282,865</u>				
Total Long-Term Investment Pool	<u>\$ 283,073</u>				

At June 30, 2010, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure (based on Moody's and/or S&P ratings):

	Fair Value	AAA Aaa
Money Market Mutual Funds	<u>\$ 208</u>	<u>\$ 208</u>

Investment Fund - The Investment Fund began operations in April 1999 and is classified as a non-rated 2a7-like governmental external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940. The Investment Fund is utilized as one of the investment managers for the Long-Term Investment Pool and the North Carolina State University Foundation, Inc., a discretely presented component unit in the accompanying financial statements (the Investment Fund's internal participants). Other affiliated organizations not included in the University's reporting entity represent the pool's external participants. The external portion of the pool is presented in the accompanying financial statements as "Funds Held in Trust for Pool Participants."

The Investment Fund is not subject to any formal oversight other than that provided by the Investment Fund Members Board or its Board of Directors. The Members Board is responsible for adopting investment objectives and policies and for monitoring policy implementation and investment performance. The Members Board has chosen not to make individual security selection decisions. The Board of Directors has the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

responsibility to oversee the allocation of the Investment Fund's portfolio among the asset classes, investment vehicles, and investment managers.

BNY Mellon is the custodian for the pool and provides the University with quarterly statements defining income and fair value information, which is then allocated among the fund's participants. Each participant holds Master Trust Units of the Fund. The unit price fluctuates based on the investment experience of the investment pool. There are no involuntary participants in the pool. The University has not provided or obtained any legally binding guarantees during the period to support the value for the pool's investments. The annual financial report for the external investment pool may be obtained from the Foundations Accounting and Investment Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149, or at http://www.fis.ncsu.edu/foundations_accounting/investment-fund/.

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

		Investment Maturities (in Years)			
		Fair Value	Less Than 1	1 to 5	6 to 10
Investment Type					
Debt Securities					
Money Market Mutual Funds	\$ 3,739,588	\$ 3,739,588	\$ 0	\$ 0	\$ 0
Other Securities					
UNC Investment Fund	278,949,072				
Limited Partnerships	20,227,327				
Total Investment Fund	\$ 302,915,987				

At June 30, 2010, investments in the External Investment Pool had the following credit quality distribution for securities with credit exposure (based on Moody's and/or S&P ratings):

	Fair Value	AAA Aaa
Money Market Mutual Funds	\$ 3,739,588	\$ 3,739,588

UNC Investment Fund, LLC - At June 30, 2010, the University's investments include \$278,949,072 which represents the University's

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

equity position in the UNC Investment Fund, LLC (System Fund). The System Fund is an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating. Asset and ownership interests of the System Fund are determined on a market unit valuation basis each month. Investment risks associated with the System Fund are included in the audited financial statements of the UNC Investment Fund, LLC which may be obtained from the UNC CH Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270.

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2010, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
Money Market Mutual Funds	\$ 1,860	<u>\$ 1,860</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>
Other Securities					
Investments in Real Estate	23,670,492				
Domestic Stocks	2,200,420				
Collections and Mineral Rights	<u>59,602</u>				
Total Non-Pooled Investments	<u>\$ 25,932,374</u>				

At June 30, 2010, the University's non-pooled investments had the following credit quality distribution for securities with credit exposure (based on Moody's and/or S&P ratings):

	Fair Value	AAA Aaa
Money Market Mutual Funds	<u>\$ 1,860</u>	<u>\$ 1,860</u>

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	<u>Fair Value</u>
Debt Securities	
Money Market Mutual Funds	\$ 3,741,656
Other Securities	
UNC Investment Fund	278,949,072
Investments in Real Estate	23,670,492
Limited Partnerships	20,227,327
Pooled Investments	282,865
Domestic Stocks	2,200,420
Other	59,602
Total Investments	<u>\$ 329,131,434</u>

Total investments include \$55,652,218 held in the “Investment Fund” for the North Carolina State University Foundation, Inc. This amount is excluded from the University prepared financial statements and included in the accompanying component unit financial statements.

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University’s endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University pooled endowment funds are determined by applying 4% (the Board approved spending rate) to the average market value of the long term investment pool (for a 20 quarter period), divided by the number of investment units in the pool to determine the “average spending amount” per unit of investment. The individual endowment fund payout or spending budget is then

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

determined by applying the “average spending amount” to the number of investment units held by the individual endowment fund. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference. At June 30, 2010, endowment net assets of \$88,962,646 were available to be spent, of which \$73,139,841 was restricted to specific purposes.

During the current fiscal year, the University experienced positive investment gains, but not sufficient to recoup prior year losses. As a result, at June 30, 2010, \$2,862,123 of eroded corpus has been reported against the nonexpendable endowment as compared to \$4,740,395 at the prior fiscal year end.

NOTE 4 - DERIVATIVE INSTRUMENTS

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

Type	Notional Amount	Change in Fair Value		Fair Value at June 30, 2010	
		Classification	Decrease	Classification	Liability
<i>Hedging Derivative Instruments</i>					
<i>Cash Flow Hedges</i>					
Pay-Fixed Interest Rate Swap		Deferred Outflow of		Hedging	
2003B Bonds	\$ 24,655,000	Resources	\$ (1,436,201)	Derivative	
				Liability	\$ (3,218,489)
Pay-Fixed Interest Rate Swap		Deferred Outflow of		Hedging	
2008A Bonds	\$ 50,000,000	Resources	(2,871,047)	Derivative	
				Liability	(7,177,039)
			<u>\$ (4,307,248)</u>		<u>\$ (10,395,528)</u>

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

Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms
Pay-Fixed Interest Rate Swap	Hedge changes in cash flows on General Revenue 2003B Series Bonds	\$ 24,655,000	06/20/03	10/01/27	Pay 3.54%, Receive 75% LIBOR
Pay-Fixed Interest Rate Swap	Hedge changes in cash flows on General Revenue 2008A Series Bonds	\$ 50,000,000	09/01/08	10/01/26	Pay 3.862%, Receive SIFMA

As of June 30, 2010, the synthetic interest rates on the swapped portion of the 2003B and 2008A bonds were 3.48% and 3.84%, respectively. The fair value

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

of the pay-fixed interest rate swaps was estimated using the market value method. This method calculates the market price of traded instruments.

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, created 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 market values as of June 30, 2010. Both of the swaps outstanding have termination dates greater than 15 years. As the yield curve rises, the value of the swaps will increase and as rates fall, the value of the swaps decreases.

Credit Risk: As of June 30, 2010, the University was not exposed to credit risk related to positively valued swaps. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. The swap agreements require termination should the University's or the counterparty's credit rating fall below either Baa2 as issued by Moody's or BBB as issued by S&P or Fitch. Also, under the terms of the swap agreements, should one party become insolvent or otherwise default on its obligations, provisions permit the nondefaulting party to accelerate and terminate all outstanding transactions. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A3 as determined by Moody's or A- as determined by S&P, the swap will be collateralized by the counterparty with cash, U.S. government or agency securities. If the counterparty is required to collateralize, then the collateral will be posted with a third party custodian or secured party. The swap agreements entered into by the University are held with separate counterparties. All the counterparties are rated A or better.

Basis Risk: The University is exposed to basis risk on the swaps when the variable payment received is based on an index other than Securities Industry on Financial Markets Association (SIFMA). Should the relationship between London Interbank Offering Rate (LIBOR) and SIFMA move to convergence, the expected cost savings may not be realized. The current outstanding swaps and the related bonds reset rates

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

weekly and pay monthly. As of June 30, 2010, the SIFMA rate was 0.25%, whereas 75% of LIBOR was 0.26%.

Termination Risk: The University or the counterparty may terminate any of the swaps if the other party fails to perform under the terms of the contract. If any of the swaps are terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the University would be liable to the counterparty for that amount.

Rollover Risk: By definition, the University is exposed to rollover risk because the swap related to the 2008A bonds terminates October 1, 2026, two years before the related bonds mature on October 1, 2028. It is not the intent of the University, at this time, to re-hedge the bonds.

Future Swaps: The University has also entered into a future dated interest rate swap agreement for \$22,382,500 to be effective March 1, 2017, on the General Revenue Series 2008A bonds.

NOTE 5 - RECEIVABLES

Receivables at June 30, 2010 were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 5,613,997	\$ 3,661,825	\$ 1,952,172
Accounts	24,270,097	2,654,648	21,615,449
Intergovernmental	21,065,586		21,065,586
Interest on Loans	949,370	271,398	677,972
	<u>51,899,050</u>	<u>6,587,871</u>	<u>45,311,179</u>
Total Current Receivables	\$ 51,899,050	\$ 6,587,871	\$ 45,311,179
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 2,634,050	\$ 12,641	\$ 2,621,409
Institutional Student Loan Programs	301,934	825	301,109
Non-Student	1,769,762	1,769,762	
	<u>4,705,746</u>	<u>1,783,228</u>	<u>2,922,518</u>
Total Notes Receivable - Current	\$ 4,705,746	\$ 1,783,228	\$ 2,922,518
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 9,483,621	\$ 599,087	\$ 8,884,534
Institutional Student Loan Programs	258,792	133,104	125,688
Non-Student	491,841	480,238	11,603
	<u>10,234,254</u>	<u>1,212,429</u>	<u>9,021,825</u>
Total Notes Receivable - Noncurrent	\$ 10,234,254	\$ 1,212,429	\$ 9,021,825

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 and Permanent Easements	\$ 26,914,428	\$ 11,371,182	\$ 0	\$ 38,285,610
Construction in Progress	145,513,373	58,635,114	42,123,375	162,025,112
Computer Software in Development		2,385,000		2,385,000
Total Capital Assets, Nondepreciable	<u>172,427,801</u>	<u>72,391,296</u>	<u>42,123,375</u>	<u>202,695,722</u>
Capital Assets, Depreciable:				
Buildings	1,385,945,616	41,896,797	968,271	1,426,874,142
Machinery and Equipment	249,036,940	27,631,407	14,139,774	262,528,573
General Infrastructure	140,311,584	20,187,905		160,499,489
Computer Software		2,166,073		2,166,073
Total Capital Assets, Depreciable	<u>1,775,294,140</u>	<u>91,882,182</u>	<u>15,108,045</u>	<u>1,852,068,277</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	356,091,124	32,999,182	14,949	389,075,357
Machinery and Equipment	174,766,587	16,881,942	13,468,056	178,180,473
General Infrastructure	31,232,317	3,659,529		34,891,846
Computer Software		923,355		923,355
Total Accumulated Depreciation	<u>562,090,028</u>	<u>54,464,008</u>	<u>13,483,005</u>	<u>603,071,031</u>
Total Capital Assets, Depreciable, Net	<u>1,213,204,112</u>	<u>37,418,174</u>	<u>1,625,040</u>	<u>1,248,997,246</u>
Capital Assets, Net	<u>\$ 1,385,631,913</u>	<u>\$ 109,809,470</u>	<u>\$ 43,748,415</u>	<u>\$ 1,451,692,968</u>

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 28,015,762
Accrued Payroll	9,495,114
Contract Retainage	3,882,779
Intergovernmental Payables	13,282
Other	464,953
Total Accounts Payable and Accrued Liabilities	<u>\$ 41,871,890</u>

NOTE 8 - SHORT-TERM DEBT - COMMERCIAL PAPER PROGRAM

The University has available Commercial Paper Program financing for short-term credit up to \$100,000,000 to finance capital construction projects. The University's available funds are pledged to the Commercial Paper Program financing with the anticipation of converting to general revenue bond

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

financing in the future. As of June 30, 2010, no commercial paper was outstanding.

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	\$ 20,000,000	\$ 10,000,000	\$ 30,000,000	\$ 0

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	\$ 246,300,000	\$ 77,630,000	\$ 9,080,000	\$ 314,850,000	\$ 8,855,000
Add/Deduct Premium/Discount	6,837,535	2,077,644	655,600	8,259,579	
Total Revenue Bonds Payable	253,137,535	79,707,644	9,735,600	323,109,579	8,855,000
Notes Payable	4,994,095	19,700,703	1,044,095	23,650,703	
Capital Leases Payable	513,688		125,633	388,055	163,368
Compensated Absences	56,515,793	35,225,744	35,924,507	55,817,030	2,993,709
Total Long-Term Liabilities	\$ 315,161,111	\$ 134,634,091	\$ 46,829,835	\$ 402,965,367	\$ 12,012,077

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	Principal Paid Through June 30, 2010	Principal Outstanding June 30, 2010	See Table Below
CENTENNIAL CAMPUS SYSTEM							
Centennial Campus Projects	1997A	6.55-7.04%	12/15/2010	\$ 7,765,000	\$ 7,465,000	\$ 300,000	1
GENERAL REVENUE							
Refund Housing System Series L & M	2002B	2-5%	10/01/2014	8,800,000	4,670,000	4,130,000	
Centennial Campus Projects	2002C	2.75-6.45%	10/01/2013	7,160,000	4,235,000	2,925,000	
Housing System Projects/Doak Field Projects	2003A	2-5%	10/01/2018	26,735,000	715,000	26,020,000	
Housing System Projects/Doak Field Projects	2003B	3.54% * swap	10/01/2027	45,660,000	1,935,000	43,725,000	
Various Construction Projects	2005A	3-5%	10/01/2025	81,615,000	11,300,000	70,315,000	
Various Construction Projects	2008A	3.86% * swap	10/01/2028	66,605,000		66,605,000	
Various Construction Projects	2008B	3-5%	10/01/2020	26,955,000	3,755,000	23,200,000	
Various Construction Projects	2010A	3-5%	10/01/2022	18,065,000		18,065,000	
Various Construction Projects	2010B	5.08-6.03% **	10/01/2035	59,565,000		59,565,000	
Total General Revenue				341,160,000	26,610,000	314,550,000	
Total Revenue Bonds Payable (principal only)				\$ 348,925,000	\$ 34,075,000	314,850,000	
Less: Unamortized Discount						9,074	
Plus: Unamortized Premium						8,268,653	
Total Revenue Bonds Payable						\$ 323,109,579	

* 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 in Note 4.

** 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	Interest	
1	Centennial Campus Revenues	\$ 310,560	\$ 5,261,323	\$ 845,000	\$ 50,864	5%

- 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 agent.

With regard to the following demand bonds, the issuer has entered into take-out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

North Carolina State University at Raleigh Variable Rate General Revenue Bonds, Series 2003B: On June 20, 2003 the University issued tax-exempt variable rate revenue demand bonds in the amount of \$45,660,000 that have a final maturity date of October 1, 2027. The bonds are subject to mandatory sinking fund redemption that began on October 1, 2004. The University’s proceeds of this issuance were used to pay a portion of the costs of certain improvements on the campus of the University, to refund certain debt previously incurred for that purpose, and to pay the costs incurred in connection with the issuance of the 2003B bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days’ notice and delivery to the paying agent, The Bank of New York Mellon. Upon notice from the paying agent, the remarketing agent, Wachovia Bank, N.A., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Bayerische Landesbank, a Liquidity Facility has been established for the Trustee (The Bank of New York Mellon) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.13% of the available commitment, payable quarterly in arrears, beginning on July 1, 2003 and on each

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

October 1, January 1, April 1, and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider rate (the greater of the bank prime commercial lending rate and federal funds rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2010, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility expiration date has been extended and is scheduled to expire on November 30, 2015, unless otherwise extended based on the terms of the Agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 12 quarterly installments, beginning the first business day of January, April, July, or October, whichever first occurs on or following the Purchase Date along with accrued interest at the Liquidity Provider rate. In the event the entire issue of \$43,725,000 of demand bonds was “put” and not resold, the University would be required to pay \$15 million a year for three years under this agreement assuming a 3.25% interest rate.

North Carolina State University at Raleigh Variable Rate General Revenue Bonds, Series 2008A: On July 10, 2008 the University issued tax-exempt variable rate revenue demand bonds in the amount of \$66,605,000 that have a final maturity date of October 1, 2028. The bonds are subject to mandatory sinking fund redemption that begins on October 1, 2014. The University’s proceeds of this issuance were used to pay a portion of the costs of certain improvements on the campus of the University, to refund certain debt previously incurred for that purpose, and to pay the costs incurred in connection with the issuance of the 2008A bonds.

While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days’ notice and delivery to the paying agent, The Bank of New York Mellon. Upon notice from the paying agent, the remarketing agent, Citigroup Global Markets, Inc., has agreed to exercise its best efforts to remarket the bonds for which a notice of purchase has been received.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Under a Standby Bond Purchase Agreement (Agreement) between the Board of Governors of the University of North Carolina and Bank of America, N.A., a Liquidity Facility has been established for the Trustee (The Bank of New York Mellon) to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. This Agreement requires a commitment fee equal to 0.20% of the available commitment, payable quarterly in arrears, beginning on October 1, 2008 and on each October 1, January 1, April 1 and July 1 thereafter until the expiration date or the termination date of the Agreement.

Under the Agreement, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Base Rate (the greater of the bank prime commercial lending rate and federal funds rate plus 3.0%) for 30 days. For the period of 31 through 60 days after purchase, the Bank Bonds bear interest at the Base Rate plus 1%. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is due the first business day of each month in which Bank Bonds are outstanding. At June 30, 2010, there were no Bank Bonds held by the Liquidity Facility. The Liquidity Facility is scheduled to expire on July 10, 2011, unless otherwise extended based on the terms of the Agreement.

After the purchase of the Bank Bonds, or expiration or termination of the Agreement, the University is required to redeem (purchase) the Bank Bonds held by the Liquidity Facility in six semi-annual installments, beginning the first business day of the month which next occurs on or following 61 days after the Purchase Date along with accrued interest at the Bank Bond rate plus 2%. In the event the entire issue of \$66,605,000 of demand bonds was "put" and not resold, the University would be required to pay \$24 million a year for three years under this agreement assuming a 5.25% interest rate.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

D. 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	\$ 8,855,000	\$ 9,948,348	\$ 2,614,437	\$ 0	\$ 33,575
2012	13,170,000	9,784,807	2,614,437	3,950,000	2,264,368
2013	13,935,000	9,225,601	2,614,437	485,877	1,005,324
2014	14,630,000	8,629,367	2,614,437	540,405	980,170
2015	13,470,000	8,010,945	2,614,437	598,270	952,244
2016-2020	69,670,000	32,215,523	11,416,808	3,989,177	4,232,973
2021-2025	81,755,000	22,459,812	7,114,571	6,051,038	3,010,357
2026-2030	57,185,000	14,718,044	792,826	8,035,936	1,199,752
2031-2035	38,865,000	4,006,446			
2036-2040	3,315,000	99,897			
Total Requirements	\$ 314,850,000	\$ 119,098,790	\$ 32,396,390	\$ 23,650,703	\$ 13,678,763

Interest on the variable rate 2003B general revenue bonds is calculated at 0.20% at June 30, 2010.

Interest on the variable rate 2008A general revenue bonds is calculated at 0.23% at June 30, 2010.

Interest rates are reset each week by the remarketing agent based upon University credit ratings 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.

E. Prior Year Defeasances - During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2010, the outstanding balance of prior year defeased bonds was \$2,645,000.

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

Purpose	Financial Institution	Interest Rate/Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2010	Principal Outstanding June 30, 2010
Energy Conservation Loan	BB&T	4.97%	06/01/2030	\$ 19,700,703	\$ 0	\$ 19,700,703
Lonnie Poole Golf Course	SunTrust	Variable	12/31/2011	5,000,000	1,050,000	3,950,000
Total Notes Payable				\$ 24,700,703	\$ 1,050,000	\$ 23,650,703

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to 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:

Fiscal Year	<u>Amount</u>
2011	\$ 163,368
2012	147,745
2013	83,819
2014	68,734
2015	<u>938</u>
Total Minimum Lease Payments	464,604
Amount Representing Interest (0.0917% Rate of Interest)	<u>76,549</u>
Present Value of Future Lease Payments	<u><u>\$ 388,055</u></u>

Machinery and equipment acquired under capital lease amounted to \$930,533 at June 30, 2010.

- B. Operating Lease Obligations** - The University entered into operating leases for equipment and property rental. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2010:

Fiscal Year	<u>Amount</u>
2011	\$ 6,291,250
2012	5,043,861
2013	4,256,464
2014	3,758,049
2015	<u>228,404</u>
Total Minimum Lease Payments	<u><u>\$ 19,578,028</u></u>

Rental expense for all operating leases during the year was \$6,030,820.

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	Net Revenues
Operating Revenues:					
Student Tuition and Fees	\$ 225,147,308	\$ 530,502	\$ 53,342,725	\$ 460,718	\$ 170,813,363
Other Revenues	\$ 20,444,313	\$ 4,532,497	\$ 0	\$ 400,639	\$ 15,511,177
Sales and Services	\$ 229,296,320	\$ 47,398,964	\$ 12,536,160	\$ 433,285	\$ 168,927,911

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	\$ 289,565,192	\$ 28,064,747	\$ 26,073,565	\$ 0	\$ 2,914	\$ 0	\$ 343,706,418
Research	150,444,953	16,281,891	42,528,344		812,843		210,068,031
Public Service	83,684,206	9,189,636	20,978,546		329,242		114,181,630
Academic Support	38,479,310	14,902,339	17,666,629		17,780		71,066,058
Student Services	14,214,185	2,144,095	5,576,338		94,173		22,028,791
Institutional Support	52,438,717	3,465,911	15,741,341		86,393		71,732,362
Operations and Maintenance of Plant	33,601,733	6,296,352	8,058,199		29,226,126		77,182,410
Student Financial Aid	1,053,561	356,490	387,024	40,609,010	1,867		42,407,952
Auxiliary Enterprises	49,120,734	30,559,299	33,460,905		5,451,864		118,592,802
Depreciation						54,464,008	54,464,008
Total Operating Expenses	\$ 712,602,591	\$ 111,260,760	\$ 170,470,891	\$ 40,609,010	\$ 36,023,202	\$ 54,464,008	\$ 1,125,430,462

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$620,929,300, of which \$300,872,483 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$10,741,148 and \$18,052,349, 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 \$10,741,148, \$10,536,565 and \$9,039,835, 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.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$620,929,300, of which \$215,799,081 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$14,760,657 and \$12,947,945, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$2,753,633 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 \$127,926. The voluntary contributions by employees amounted to \$4,655,914 for the year ended June 30, 2010.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$10,672,568 for the year ended June 30, 2010.

- C. Federal Employment Retirement** - The Federal Retirement System is a multiple-employer retirement system and is composed of three retirement programs: the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1987, the Federal Employees Retirement System (FERS) for participants employed after January 1, 1987, and the Civil Service Retirement Offset System for reemployed CSRS employees.

North Carolina Cooperative Extension employees with federal appointments prior to January 1, 1987 participate in the Civil Service Retirement System. Currently, 69 employees participate in CSRS. Participating employees and the University are required by federal statute to contribute 7% of salary to CSRS. In addition, the CSRS employees may contribute to the Thrift Savings Plan (a defined contribution plan managed by the Federal Retirement Thrift Investment Board) up to the IRS annual elective limits with no agency matching contributions. Total employee and employer contributions for CSRS for the year ended June 30, 2010, was \$507,590 and \$543,579 respectively. Employees covered under CSRS contributed \$39,617 to the Thrift Savings Plan.

Under the Federal Employees Retirement System (FERS), employees are required to contribute 0.8% of salary and the University 11.2%. Currently, six employees participate in FERS. In addition, the FERS employees may contribute to the Thrift Savings Plan up to the IRS annual elective limits with an agency matching contribution of up to 5% depending upon the employee's contribution. Total employee and employer contributions for the year ended June 30, 2010 were \$5,379 and \$75,304, respectively. For employees covered under FERS, the total employee and employer contributions to the Thrift Savings Plan for the year ended June 30, 2010 were \$66,205 and \$33,230, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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 \$23,250,220, \$21,576,756, and \$20,320,873, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

<http://www.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 0.52% of covered payroll under the Teachers’ and State Employees’ Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2009, and 2008, were 0.52% and 0.52%, 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 \$2,686,692, \$2,736,564, and \$2,577,281, 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. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to \$1,000,000 per claimant 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 per occurrence, via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. University departments, as an individual business decision, may also purchase through the Fund primary extended coverage for buildings and contents. Coverage may also be purchased through the Fund for theft, vandalism, sprinkler leakage, or all-risk perils. University departments also have the option to purchase all-risk coverage for computers and "miscellaneous equipment" on a scheduled basis. Flood insurance may also be purchased through the Fund for qualifying assets. Receipts-supported auxiliary units insure assets for additional perils coverage, as per the options noted above, in addition to the fire and lightning perils. General-funded departments and units insure for the perils of fire and lightning with the exception of certain coastal properties which are also insured for extended coverage perils and the peril of flood.

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

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is procured through the State's Agent of Record and approved by the North Carolina Department of Insurance. The University is charged a premium by the private insurance company. Coverage limit is \$1,000,000 per occurrence. The applicable deductible is \$25,000 per occurrence.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance and the State's Agent of Record. The types of insurance policies purchased include: medical professional liability, veterinary professional liability, fine arts property, master crime, inland marine property for musical instruments, campers accident and sickness, athletic accident, boiler and machinery, watercraft, oceanographic equipment, and nuclear energy liability.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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 0.16% for the current fiscal year.

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

NOTE 16 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$69,748,871 at June 30, 2010.

The University has amended the Use Agreement for the RBC Center with the Centennial Authority (a related party) and therein agreed to make scheduled capital contributions totaling \$6,000,000 to the Authority's Building Enhancement Fund over a 15 year period. The total outstanding commitment on this agreement was \$5,250,000 as of June 30, 2010.

- B. Pending Litigation and Claims** - As previously reported, the Environmental Protection Agency (EPA) filed a civil action against the University pursuant to the Comprehensive Environmental Response, Compensation and Liability Act. The complaint sought relief that would cause the University to enter into remediation of a hazardous waste site known as "Lot 86." The University is involved in ongoing discussions and negotiations with the EPA concerning the appropriate means for addressing the remediation. A Consent Decree executed by North Carolina State University and the EPA has been approved by the Court. Remedial clean-up pursuant to the Consent Decree continues. The remediation costs remaining are estimated to be around \$1,400,000 to \$1,800,000.

As previously reported, the NC School Boards Association, et. al. filed a civil action against various state officials in their official capacity seeking

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. On July 1, 2005, the NC Supreme Court held in favor of the school boards with regard to parking fines. The matter was remanded back to the trial court for disposition in accordance with the Superior Court's decision. On August 8, 2008, the Wake County Superior Court issued judgment that the estimated amounts collected from January 1, 1996, to June 30, 2005, by UNC Campuses belong and should have been paid to the public schools of the State by payment to the State's Civil Penalty and Forfeiture Fund. The manner in which the judgment will be settled is uncertain and is to be determined by the North Carolina General Assembly. At issue for NC State University is approximately \$6,074,286 in transportation fines collected since January 1, 1996, to June 30, 2005. Of this amount, the University has transferred \$2,048,739 to the Office of State Budget and Management leaving approximately \$4,025,547 still outstanding. Since July 2005, the University has been forwarding transportation fine collections, less collection costs, to the Office of State Budget and Management on a monthly basis.

As previously reported, on September 16, 2005, Ward Transformer Company, Inc. and related entities (collectively the "Ward Performing Parties") entered into a Settlement Agreement with the United States Environmental Protection Agency ("EPA"). In the Agreement, the Ward Performing Parties agreed to fund and carry out a removal action to address PCB contamination at and in the vicinity of the 11 acre Ward Transformer facility on Mount Herman Road near the Raleigh-Durham International Airport. It is currently estimated that the removal action will involve the excavation and onsite treatment or offsite disposal of approximately 60,000 cubic yards, or about 220,000 tons, of PCB contaminated soils. The removal action will also address the PCB contaminated transformer repair building, oil storage tank farm, and water treatment building. Current estimates indicate that the costs may be in the range upwards of \$20 million. The Ward Performing Parties have notified NC State that they believe that the University is responsible for some of the PCB contamination because NC State allegedly had Ward repair and refurbish transformers during the 1960's through the 1990's. On March 24, 2010, the Court granted the University's Motion to Dismiss based on the 11th Amendment sovereign immunity. However, this case is still open pending an appeal by the plaintiffs.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 17 - RELATED PARTIES

Foundations - There are 11 separately incorporated nonprofit foundations associated with the University. These foundations are the North Carolina Agricultural Foundation, Inc., North Carolina State University Foundation, Inc., North Carolina Tobacco Foundation, Inc., North Carolina State University Physical and Mathematical Sciences Foundation, Inc., North Carolina Engineering Foundation, Inc., North Carolina Veterinary Medical Foundation, Inc., NC State Natural Resources Foundation, Inc., North Carolina Textile Foundation, Inc., NC State Student Aid Association, Inc., Friends of NC State Baseball, LLC, and the North Carolina State University Alumni Association, Inc.

These organizations serve 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. As described in Note 1 to the financial statements, the North Carolina State University Foundation, Inc. and the NC State Student Aid Association, Inc. are considered component units of the University for reporting purposes and their financial statements are presented separately as part of the University's financial statements. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the other foundations, except for support from each organization to the University. This support of the foundations, excluding amounts from the North Carolina State University Foundation, Inc. and the NC State Student Aid Association, Inc. approximated \$22,550,817 for the year ended June 30, 2010.

Nonprofit Corporation - The Centennial Authority (Authority) was created by the 1995 General Assembly (Senate Bill 606) for the purpose of studying, designing, planning, constructing, owning, promoting, financing, and operating a regional facility on land owned by the State. Prior to this act, the General Assembly authorized the construction by the University of a facility to be known as the "Entertainment and Sports Arena" (ESA). This facility serves as a regional sports entertainment center and is available for cultural performances, sporting events, and other activities of the University or of other entities (the Centennial Center project). With the 1995 legislation, the Centennial Center project was transferred to the Authority.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Authority entered into a Ground Lease with the State of North Carolina to lease land for the ESA for a period of 99 years at an annual rent of \$1. The University entered into a Use Agreement with the Authority. Both parties agreed that the University shall be the primary and preferred user of all areas of the ESA. The University is required to pay the greater of 10% of gross ticket revenues or \$47,077 for each men's and \$20,591 for each women's basketball game to compensate the Authority for facility rental and operating expenses. Rent and expense payments for miscellaneous events will be negotiated on an event by event basis based on the availability of the ESA and the anticipated attendance.

In fiscal year 2003, a naming rights agreement was executed to change the name of the ESA to the "RBC Center". As a result of this agreement, the University will receive \$13,184,000 over a ten-year period beginning in fiscal year 2003.

In fiscal year 2008, the University entered a Capital Improvement Plan Agreement with the Authority to pay \$6,000,000 in quarterly installments over the next 15 years.

NOTE 18 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2010, the University implemented the following pronouncements issued by GASB:

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 19 - SUBSEQUENT EVENTS

On October 21, 2010, the NC State Residence LLC, part of the reporting entity of the NC State University Partnership Corporation, a blended component unit of North Carolina State University, entered into a construction loan for the chancellor's residence. The loan terms provide for up to \$3 million in cash draws for construction purposes and is secured by a Leasehold Deed of Trust

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

on the property. The loan's interest rate is LIBOR plus .75% with interest payable monthly. The principal loan amount is due the earlier of when the property is transferred to the University or November 30, 2011.

NOTE 20 - DISCRETELY PRESENTED COMPONENT UNITS

The University's discretely presented component units use the accounting and reporting standards promulgated by FASB. Selected disclosures from the discretely presented component units' audited financial statements follow:

NORTH CAROLINA STATE UNIVERSITY FOUNDATION, INC.

ENDOWMENT

The Foundation's endowment consists of approximately 470 individual funds established for a variety of purposes related to the mission of the University. The endowment includes both donor-restricted endowments and funds designated by the Foundation Board to function as endowments. As required by generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. The majority of the Foundation's signed endowment gift agreements with donors have donor-imposed restrictions which stipulate that principal shall not be used to fund spending.

Interpretation of Relevant Law:

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) was adopted in North Carolina as NC General Statute 36E effective March 17, 2009. UPMIFA defines a prudence standard for management and investment of institutional funds. As a result of the Foundation's interpretation of UPMIFA and the signed endowment agreements with donors, the Foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment that are required by the applicable donor gift instrument. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the Foundation's endowment spending policy.

Funds with Deficiencies:

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor requires the Foundation to retain as a fund of perpetual duration. In accordance with generally accepted accounting principles, deficiencies of this nature are

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

reported in unrestricted net assets, and were \$2,416,896 as of June 30, 2010. These deficiencies resulted from unfavorable market fluctuations.

Investment Return Objectives and Risk Parameters:

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a stable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for donor-specified periods as well as board-designated funds. The endowment assets are invested through the NC State Investment Fund, Inc. (NCSIF) in a manner that is intended to produce results that exceed a 70% S&P 500 Index/30% Barclays Aggregate Bond Index benchmark over rolling five and ten year periods while assuming a moderate level of investment risk.

Spending Policy:

The Foundation has a policy of appropriating for distribution each year 4% of its endowment fund's average market value over the prior 20 quarters through the fiscal year-end preceding the fiscal year in which the distribution is planned. This is consistent with the Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return. However, in declining market conditions many endowments are not able to fund spending at the 4% level. In this situation, as prescribed by the donor endowment agreements, the Foundation does not initiate or renew spending for the individual endowments affected by declining market conditions until their market value has been recovered and exceeds their original gift value. In establishing the spending policy, the Foundation considered the long-term expected return on its endowment. Spending budgets for fiscal year 2010 were calculated at \$869,575 and \$746,605 for fiscal year 2011.

Strategies Employed for Achieving Investment Objectives:

For the long term, the primary investment objective for the NCSIF is to earn a total return (net of investment and custodial fees), within prudent levels of risk, which is sufficient to maintain in real terms the purchasing power of the NCSIF and to meet the spending needs of the University. To meet this investment objective, the NCSIF invests in various asset classes to offer diversification. The purpose of diversification is to provide reasonable assurance that no single security or class of securities or manager will have a disproportionate impact on the performance of the total fund.

The NCSIF's investments are diversified both by asset class (e.g. common stocks and fixed income securities) and within asset classes (e.g. within

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

common stocks by economic sector, geographic area, industry, quality, and size). In general, the Investment Manager seeks to diversify exposure to all asset classes by hiring multiple managers that use a variety of investment approaches.

The following represents changes in endowment net assets for the fiscal year ended June 30, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, Beginning of Year	\$ (4,399,862)	\$ 20,005,323	\$ 39,734,232	\$ 55,339,693
Net Asset Reclassification - Underwater Endowments	2,364,701	(2,364,701)		
Endowment Net Assets After Reclassification	<u>(2,035,161)</u>	<u>17,640,622</u>	<u>39,734,232</u>	<u>55,339,693</u>
Investment Return: Investment Income	(34,362)	(144,872)	170,813	(8,421)
Net Appreciation (Realized and Unrealized)	1,099,832	8,749,088	460,319	10,309,239
Total Investment Return	<u>1,065,470</u>	<u>8,604,216</u>	<u>631,132</u>	<u>10,300,818</u>
Contributions, Net of Change in Accrued Pledges			(1,683,209)	(1,683,209)
Appropriations of Endowment Assets for Expenditure	(130,766)	(921,821)		(1,052,587)
Change in Value of Split Interest Agreements			(863,366)	(863,366)
Other Changes:				
Transfers to Endow			450,613	450,613
Endowment Net Assets, End of Year	<u>\$ (1,100,457)</u>	<u>\$ 25,323,017</u>	<u>\$ 38,269,402</u>	<u>\$ 62,491,962</u>

The following represents endowment net asset composition by type of fund, as of June 30, 2010:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Undesignated - Underwater Endowments	\$ (2,416,896)	\$ 0	\$ 0	\$ (2,416,896)
Donor Restricted Endowment Funds	2,627,345	25,323,017	38,269,402	66,219,764
Board-Designated Endowment Funds	<u>(1,310,906)</u>			<u>(1,310,906)</u>
Total Funds	<u>\$ (1,100,457)</u>	<u>\$ 25,323,017</u>	<u>\$ 38,269,402</u>	<u>\$ 62,491,962</u>

MARKETABLE SECURITIES

Marketable securities at June 30, 2010 consisted of:

	Cost	Fair Value
NC State Investment Fund, Inc. (NCSIF)	\$ 61,824,607	\$ 55,652,218
BNY Mellon - Life Income Funds	5,358,892	5,801,074
Citicorp Trust Bank	<u>425,299</u>	<u>404,453</u>
Total	<u>\$ 67,608,798</u>	<u>\$ 61,857,745</u>

Marketable securities held by the NCSIF at June 30, 2010 were made up of limited partnerships with a cost of \$61,824,607 and a fair value of \$55,652,218. As of June 30, 2010, approximately 89% of these limited

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

partnerships were with the UNC Management Company (UNCMC), and 11% were in other private equity investments with JP Morgan, Blackrock, and SEI.

The Foundation's investment in the NCSIF represents approximately 17.73% of the member equity of the NCSIF at June 30, 2010. NCSIF's net assets were primarily invested with UNCMC at of June 30, 2010, and were valued at approximately \$313,828,000.

Academy Centennial Fund, LLC (ACF), a venture capital investment held outside of the NC State Investment Fund, was legally dissolved in fiscal year 2010. The Foundation's net investment in ACF of \$1,037,900 had been written down in a prior fiscal year to \$30,608 in recognition of a permanent decline in value. Upon dissolution, the Foundation received cash in the amount of \$62,108 in addition to various securities. From initial investment to the time of dissolution the total loss recognized was \$972,792. To cover anticipated final accounting expenses, a minimal amount of approximately \$1,980 was held back from the proceeds. In addition to cash, common and preferred stock for start-up companies in which ACF had invested were distributed. These securities, though not currently marketable and valued at \$0 for financial reporting purposes, will be held and the companies monitored for future redemption opportunities.

The Foundation's investments held by BNY Mellon - Life Income Funds primarily consist of bond mutual funds and equity mutual funds.

The Foundation's investments held by Citicorp Trust Bank primarily consist of common equity securities.

The Foundation invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of financial position.

FAIR VALUE MEASUREMENT

The Fair Value Measurements and Disclosures Topic of FASB Accounting Standards Codification (ASC), ASC 820 (formerly Statement of Financial Standards No. 157, Fair Value Measurements), provides a framework for measuring fair value under generally accepted accounting principles. ACS 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ACS 820 requires that valuation techniques maximize the use of observable inputs and minimize the use of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

unobservable inputs. ACS 820 also establishes a fair value hierarchy, which prioritizes the valuation inputs into three broad levels.

The three-tier hierarchy of inputs is summarized in the three broad levels listed below:

Level 1 - quoted prices in active markets for identical investments

Level 2 - other significant observable inputs (including quoted prices for similar investments, interest rates, credit risks, etc.)

Level 3 - significant unobservable inputs (including the fund's own assumptions in determining the fair value of investments)

To measure fair value, there are three general valuation techniques that may be used, as described below:

- A. Market approach - Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. Prices may be indicated by pricing guides, sale transactions, market trades, or other sources;
- B. Cost approach - Based on the amount that currently would be required to replace the service capacity of an asset (replacement cost); and
- C. Income approach - Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about the future amounts (includes present value techniques and option-pricing models). Net present value is an income approach where a stream of expected cash flows is discounted at an appropriate market interest rate.

Assets itemized below were measured at fair value during the year using market and income approaches. The market approach was used for level 2 and the income approach was used for level 3.

	Level 1	Level 2	Level 3	Total Fair Value
NC State Investment Fund, Inc.	\$ 0	\$ 0	\$ 55,652,218	\$ 55,652,218
BNY Mellon - Life Income Funds		5,801,074		5,801,074
Citicorp Trust Bank		404,453		404,453
Total	<u>\$ 0</u>	<u>\$ 6,205,527</u>	<u>\$ 55,652,218</u>	<u>\$ 61,857,745</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following is a reconciliation of the investments in which significant unobservable inputs (Level 3) were used in determining value:

	NC State Investment Fund, Inc.
Beginning Balance	\$ 48,061,096
Unrealized Gain (Loss) on Investments	5,098,965
Realized Gain (Loss) on Investments	569,799
Net investment	<u>1,922,358</u>
Ending Balance	<u>\$ 55,652,218</u>

PLEDGES RECEIVABLE

Pledges receivable are stated at their present value, estimated by discounting the future cash flows using Federal Reserve rates of return, and are as follows:

	Amount
Receivable in Less Than One Year	\$ 4,922,665
Receivable in One to Five Years	8,692,033
Receivable in More Than Five Years	<u>110,220</u>
Total Gross Pledges Receivable	13,724,918
Less: Allowance for Uncollectible Pledges	937,572
Less: Unamortized Discount	<u>304,590</u>
Net Pledges Receivable	<u>\$ 12,482,756</u>

NC STATE STUDENT AID ASSOCIATION, INC.

CONCENTRATION OF CREDIT RISK

The Association maintains cash balances at several financial institutions located in Raleigh, North Carolina, and in several brokerage accounts located in North Carolina. The balances in the financial institution are insured by the Federal Deposit Insurance Corporation up to \$250,000 at June 30, 2010. The balances in the brokerage accounts are insured at varying amounts. The Association's uninsured cash balances totaled \$13,652,624 at June 30, 2010.

PLEDGES RECEIVABLE

The Association carries its pledges receivable at cost less a discount for pledges receivable due in more than a year and less an allowance for doubtful accounts. On a periodic basis, the Association evaluates its receivables and establishes an allowance for doubtful accounts based on history of past write-offs and current credit conditions.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Pledges receivable at June 30, 2010 are as follows:

	Amount
Pledges Receivable	\$ 40,685,352
Less: Allowance for Uncollectible Pledges	2,027,917
Less: Discount on Pledges	7,433,700
	31,223,735
Less: Current Portion	7,410,067
Pledges Due After One Year	\$ 23,813,668

Pledges receivable due in more than one year are reflected at the present value of estimated future cash flows using a discount rate of 6%.

	Amount
Receivable in Less Than One Year	\$ 7,793,386
Receivable in One to Five Years	22,972,417
Receivable in More Than Five Years	9,919,549
	40,685,352
Less: Allowance for Uncollectible Pledges	2,027,917
Less: Discount on Pledges	7,433,700
Net Pledges Receivable	\$ 31,223,735

At June 30, 2010, Goal Line Drive pledges totaling \$11,188,435 and Wolfpack Pride pledges totaling \$1,504,819 were pledged as collateral for the Goal Line Drive bond payable and the Vaughn Towers bond payable. These pledge totals are reflected at the present value of estimated future cash flows less an allowance for uncollectible pledges.

INVESTMENTS

The Association held the following investments at June 30, 2010:

	Historical Cost	Market Value
U.S. Government Obligations	\$ 4,033,358	\$ 4,171,997
Marketable Equity Securities	13,073,251	12,071,416
Other Marketable Debt Securities	2,879,277	3,022,701
Partnership Interests	4,243,430	4,387,345
Mutual Funds	3,289,405	3,163,258
Total	\$ 27,518,721	\$ 26,816,717

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investment income consists of the following:

	Amount
Interest	\$ 351,444
Dividends	373,707
Realized Loss on Sale of Investments	(76,105)
Unrealized Gain on Investments	2,084,740
Investment Expenses	(221,520)
Total	<u>\$ 2,512,266</u>

LONG-TERM DEBT

BOND INDENTURE--GOAL LINE DRIVE

The Association, through the North Carolina Capital Facilities Finance Agency issued \$40,000,000 of bonds during 2002. The bonds are secured by the Goal Line Drive pledges, Wolfpack Pride Campaign pledges, and the Medlin property. The bonds are also secured by approximately \$2,000,000 in scoreboard revenues to be received from NCSU through 2012. The proceeds from these bonds were used for the Carter-Finley Stadium expansion and improvements. The bonds pay interest monthly at a variable rate equal to 0.35% plus the higher of the federal funds rate plus ½% or Bank of America's publicly announced prime rate.

The Association also must pay Bank of America a letter of credit fee. This fee, paid quarterly, is 1.75% of the outstanding debt balance. The Association must also pay annually \$17,000 of agency and \$5,000 of trustee fees. The Association pays a remarketing fee annually to Bank of America. This fee is 0.1% of the outstanding debt balance. The bond matures in 2012.

BOND INDENTURES--WOLFPACK CLUB STUDENT HOUSING FOUNDATION

The Housing Foundation, through the North Carolina Capital Facilities Finance Agency issued a \$23,710,000 Series 2003A bond and a \$1,235,000 Series 2003B bond in June 2003. The proceeds from these bonds were used to construct a residence hall for NCSU students and student athletes. The bonds paid interest monthly at variable rates. The Series 2003A bonds paid interest based on a variable rate established weekly by Wachovia Bank, remarketing agent. The Series 2003B bonds paid interest based on a variable rate established monthly by the remarketing agent. The Housing Foundation paid a letter of credit fee quarterly to Wachovia Bank. The fee, paid quarterly, is 1.50% of the outstanding balance. The Housing Foundation paid a remarketing fee semi-annually to Wachovia Bank. This fee is 0.125% of the outstanding balance. The Series 2003A bonds mature in July 2035. The Series 2003B bonds matured in July 2009.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

In November 2009, the Series 2003A bond was refinanced with Branch Banking & Trust (BB&T) through a \$22,780,000 Series 2009 bond, issued through the North Carolina Capital Facilities Finance Agency. The bond pays interest monthly at a variable rate based on the monthly LIBOR rate. The variable rate at June 30, 2010 was 1.86%.

The Housing Foundation has entered into a swap contract for a majority of this debt to hedge against interest rate fluctuations. The swap was issued at market terms so that it had no value at its inception. The carrying amount of the swap has been adjusted to its fair value at June 30, 2010, which, because of changes in forecasted levels of interest rates, resulted in reporting a liability of \$1,710,175 at June 30, 2010, for the fair value of the net payments forecasted under the swap. The swap liability is classified as noncurrent since the Association does not intend to settle it within the next twelve months.

BOND INDENTURES--VAUGHN TOWERS

The Association, through the North Carolina Capital Facilities Finance Agency issued a \$15,855,000 Series 2004A bond and a \$17,685,000 Series 2004B bond in November 2004. The proceeds from these bonds were used to construct Vaughn Towers at Carter-Finley Stadium. The bonds pay interest monthly at variable rates. The Series 2004A bond pays interest based on a variable rate established weekly by Wachovia Bank, remarketing agent. The Series 2004B bond pays interest based on a variable rate established weekly by Banc of America Securities, LLC, remarketing agent. The Association must pay a 1.85% quarterly letter of credit fee. The Association pays an annual remarketing fee of 0.10% of the outstanding bonds to the remarketing agents. The Series 2004A bond matures in September 2024. The Series 2004B bond matures in September 2018.

The Association has entered into swap contracts for a majority of this debt to hedge against interest rate fluctuations. The swaps were issued at market terms so that they had no value at their inception. The carrying amount of the swaps have been adjusted to their fair value at June 30, 2010, which, because of changes in forecasted levels of interest rates, resulted in reporting a liability of \$1,417,640 at June 30, 2010, for the fair value of the net payments forecasted under the swap. The swap liability is classified as noncurrent since the Association does not intend to settle it within the next twelve months.

NOTES PAYABLE--NORTH END ZONE

During the year ended June 30, 2008, the Association converted the bank lines of credit with Wachovia Bank and Bank of America into notes payable. Certain endowment investment accounts serve as collateral on these notes. The note payable to Wachovia Bank has an annual principal payment requirement of \$120,960 plus interest at LIBOR (1.118% at June 30, 2010)

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

plus 1.5% through November 2012, at which time the remaining principal is due. The note payable to Bank of America has an annual principal payment requirement of \$130,786 plus interest at LIBOR (1.118% at June 30, 2010) plus 1.5% through November 2012, at which time the remaining principal is due.

The Association has entered into swap contracts for a majority of this debt to hedge against interest rate fluctuations. The swaps were issued at market terms so that they had no value at their inception. The carrying amount of the swaps have been adjusted to their fair market value at June 30, 2010, which because of changes in forecasted levels of interest rates, resulted in reporting a liability of \$241,536 at June 30, 2010, for the fair value of the net payments forecasted under the swap. The swap liability is classified as noncurrent since the Association does not intend to settle it within the next twelve months.

The adjustments on the value of the swap contracts resulted in an unrealized loss of \$1,234,963 which is reported in the Statements of Activities for the year ended June 30, 2010.

Long-term debt consists of the following at June 30, 2010:

	Amount
Goal Line Drive Bond Indenture	\$ 4,060,000
Wolfpack Club Student Housing Foundation--Series 2009	22,780,000
Vaughn Towers Project--Series 2004A	15,855,000
Vaughn Towers Project--Series 2004B	4,960,000
Note Payable--Wachovia Bank	847,727
Note Payable--Bank of America	683,709
	49,186,436
Less: Amount Classified as Current Liability	1,816,746
Amount Due After One Year	\$ 47,369,690

Maturities of long-term debt are as follows:

	Amount
2011	\$ 1,816,746
2012	5,976,746
2013	2,792,944
2014	1,595,000
2015	470,000
Thereafter	36,535,000
Total	\$ 49,186,436

LETTERS OF CREDIT

Pursuant to the issuance of the Goal Line Drive bonds payable, the Association obtained an irrevocable letter of credit in the amount of \$40,460,274. The

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

original letter of credit expired March 15, 2010, and was extended until April 15, 2012.

Pursuant to the issuance of the Wolfpack Club Student Housing Foundation Series 2003A and 2003B bonds payable, the Association obtained an irrevocable letter of credit. The original letter of credit expired June 9, 2006, and was extended until October 9, 2009. The Series 2009 bonds payable did not require any letters of credit.

Pursuant to the issuance of the Wolfpack Towers bonds payable, the Association obtained two irrevocable letters of credit in the total amount of \$33,976,814. The original letters of credit expired March 15, 2010, and was extended until March 15, 2013.

CASH REQUIRED FOR GOAL LINE DRIVE BOND MATURITIES AND FEES

The administrative agent requires that contributions and revenues received after March 2002 for the Goal Line Drive Campaign and the Pride Campaign be placed in separate bank accounts. These monies can only be used for principal payments, interest payments, and loan fees. At June 30, 2010, cash held for bond obligations totaled \$5,317,725. The administrative expenses for the Goal Line Drive Campaign are being paid for by the Pride Campaign and the Association's operating fund. These expenses will be reimbursed once the debt has been retired. At June 30, 2010, the amount due to Wolfpack Pride from Goal Line Drive was \$9,119,750 and the amount due to the Association's operating fund from Goal Line Drive was \$12,451,635.

FAIR VALUE MEASUREMENTS

The following table provides information by level for assets and liabilities that are measured at fair value on a recurring basis:

	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Assets			
Investments	\$ 26,816,717	\$ 22,429,372	\$ 4,387,345
Liabilities			
Swap Contract			
Wolfpack Club Student Housing	\$ 1,710,175	\$ 0	\$ 1,710,175
Vaughn Towers	1,417,640		1,417,640
North End Zone	241,536		241,536
Total Liabilities	\$ 3,369,351	\$ 0	\$ 3,369,351

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

ENDOWMENT FUND

The Association's endowment fund provides long-term scholarship support through annual earnings. As required by U.S. generally accepted accounting principles, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The State of North Carolina enacted the North Carolina (NC) Uniform Prudent Management of Institutional Funds Act (UPMIFA), the provisions of which apply to endowment funds existing on or established after that date. Absent donor stipulations to the contrary, the provisions of this state law do not impose either a permanent or temporary restriction on the income or capital appreciation derived from the original gifts.

For the year ended June 30, 2010, the Association has classified as permanently restricted net assets the original value of gifts donated to the permanent endowment. Gains and losses will be classified as unrestricted net assets until those amounts are appropriated for expenditure by the Association in a manner consistent with the standard of prudence described in UPMIFA.

Changes in endowment assets for the year ended June 30, 2010 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets - Beginning of Year	\$ (9,422,567)	\$ 59,237	\$ 32,549,629	\$ 23,186,299
Investment Return:				
Investment Income	247,997	52,341		300,338
Realized Loss on Sale of Investments	(50,614)			(50,614)
Net Appreciation on Investments	1,397,101			1,397,101
Total Investment Return	1,594,484	52,341		1,646,825
Contributions			747,646	747,646
Decrease in CSV of Life Insurance Policies	493			493
Appropriation of Endowment Assets for Expenditure	(180,265)	(59,237)		(239,502)
Endowment Net Assets - End of Year	<u>\$ (8,007,855)</u>	<u>\$ 52,341</u>	<u>\$ 33,297,275</u>	<u>\$ 25,341,761</u>

Funds with Deficiencies

From time to time, the fair value of assets associated with donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Association to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets were \$7,955,514 as of June 30, 2010. These deficiencies resulted from unfavorable market fluctuations.

Investment Return Objectives and Strategies

The Association's investment policies include several investment objectives relative to its long-term investments, including permanent endowment funds. These objectives include (1) preservation of capital, (2) prudent investment of capital, (3) production of reasonable earnings and (4) low-risk growth in

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

principal of invested capital. To achieve these objectives, the Association has employed the investment strategy of diversifying amongst various fund managers. The investment composition at any given time is dependent upon a number of factors, including the amount available for investment and current market conditions.

Spending Policy and How the Investment Objectives Relate to Spending Policy
The Association has a policy of appropriating for distribution each year the net earnings from investments. In establishing this policy, the Association considered the long-term expected return on its endowment. Accordingly, the Association expects the current spending policy to sustain its endowment and investment return objectives.

LOAN COVENANT

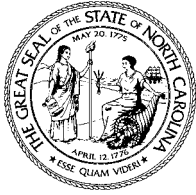
The Housing Foundation is required to maintain a debt service ratio of at least 1.00 to 1.00 in order to be in compliance with the terms of the Series 2009 bond agreement. The Foundation is in compliance with this covenant at June 30, 2010.

The Housing Foundation was required to maintain a debt service ratio of at least 1.20 to 1.00 in order to be in compliance with the terms of the Series 2003A and B bond agreements. At June 30, 2009, the Housing Foundation was in default in regards to this covenant. The Housing Foundation received a waiver from Wachovia Bank in regards to this loan covenant default for the year ended June 30, 2009.

RESTATEMENT DUE TO RECENT PRONOUNCEMENT

The Financial Accounting Standards Board issued a new standard, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhancement Disclosures for All Endowment Funds*. This standard provides guidance on the net asset classification of donor-restricted endowment funds for a non-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act of 2006 (UPMIFA) and requires additional disclosures about an organization's endowment funds (both donor-restricted endowment funds and board-designated endowment funds) whether or not the organization is subject to UPMIFA. As a result of the new pronouncement and change in North Carolina state law, the net assets of the NC State Student Aid Association were restated as of July 1, 2008. Unrestricted net assets were decreased by \$5,566,664 and permanently restricted net assets were increased by \$5,566,664.

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Beth A. Wood, CPA
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

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

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

Board of Trustees
North Carolina State University
Raleigh, North Carolina

We have audited the financial statements of North Carolina State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2010, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 7, 2010. Our report includes a reference to other auditors.

As discussed in Note 18 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 NC State Investment Fund and the discretely presented component units, as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the discretely presented component 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.

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

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

December 7, 2010

ORDERING INFORMATION

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

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

Telephone: 919/807-7500

Facsimile: 919/807-7647