



STATE OF NORTH CAROLINA

ELIZABETH CITY STATE UNIVERSITY

ELIZABETH CITY, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

ELIZABETH CITY STATE UNIVERSITY

ELIZABETH CITY, 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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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of Elizabeth City 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.

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

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

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
Elizabeth City State University
Elizabeth City, North Carolina

We have audited the accompanying basic financial statements of Elizabeth City 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, as of and for the year ended June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of Elizabeth City State University Foundation, Inc. and Subsidiary, which represent 13 percent, 5 percent, and 3 percent, respectively, of the assets, net assets, and revenues of the University. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for Elizabeth City State University Foundation, Inc. and Subsidiary, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinion.

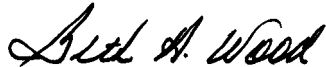
In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of Elizabeth City State University as of June 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 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.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In accordance with *Government Auditing Standards*, we have also issued our report dated February 24, 2011 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

February 24, 2011

ELIZABETH CITY STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Elizabeth City State University (the University) annual financial report presents our discussion and analysis of the financial performance of the University during the fiscal year ended June 30, 2010. This discussion has been prepared by University management along with the financial statements and notes to the financial statements and should be read in conjunction with, and is qualified in its entirety by, the financial statements and notes. The Management's Discussion and Analysis has comparative data for the applicable years (past and current) with emphasis on the current year. The financial statements, notes, and this discussion are the responsibility of University management.

Using the Annual Report

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

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

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

Reporting Entity

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

Financial Highlights

The University's financial position at June 30, 2010, remained strong with total current assets of \$20.8 million which is sufficient to cover liabilities of \$9.5 million by 2.20 times. This scenario indicates the University's ability to pay current liabilities as they become due. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were \$119.8 million at June 30, 2010. During the fiscal year, the University's net assets increased by \$17.1 million in this fiscal year. This is primarily attributable to university construction projects and increased revenues from tuition and fees, federal grants, state funding and other educational activities.

Condensed Financial Information

Statement of Net Assets

The Statement of Net Assets presents the assets (current and noncurrent), liabilities (current and noncurrent), and the net assets (total assets less total liabilities) of the University. This financial statement provides a comparative University fiscal snapshot as of June 30, 2010 and June 30, 2009. This provides the readers of this statement with information on assets available to continue operations.

Comparative Condensed Statements of Net Assets
June 30, 2010 and June 30, 2009

	2010	2009	Percentage Change
Assets			
Current Assets	\$ 20,752,022.98	\$ 12,412,979.00	67%
Noncurrent Assets			
Capital	118,935,856.48	102,550,983.85	16%
Other	9,109,425.94	13,347,341.74	-32%
Total Assets	<u>148,797,305.40</u>	<u>128,311,304.59</u>	16%
Liabilities			
Current Liabilities	9,457,505.37	4,958,837.47	91%
Noncurrent Liabilities	19,499,544.41	20,578,936.74	-5%
Total Liabilities	<u>28,957,049.78</u>	<u>25,537,774.21</u>	13%
Net Assets*			
Invested in Capital Assets, Net of Related Debt	102,990,569.46	86,011,365.12	20%
Restricted:			
Nonexpendable	5,758,937.84	5,231,397.97	10%
Expendable	6,535,344.94	9,259,286.80	-29%
Unrestricted	<u>4,555,403.38</u>	<u>2,271,480.49</u>	101%
Total Net Assets	<u>\$ 119,840,255.62</u>	<u>\$ 102,773,530.38</u>	17%

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

As of June 30, 2010, the University's total assets were \$148.8 million as compared to \$128.3 million in the prior year, an increase of \$20.5 million. This increase is attributable to the University's current construction projects of \$24.3 million, of which 88% represents the Pharmacy Building. In addition, current assets increased by 67% from \$12.4 million in 2009 to \$20.7 million in 2010. The \$8.3 million dollar increase is primarily due to cash collections by the University's auxiliaries services (such as Student Housing, Bookstores, Food Services, etc.) while controlling spending levels during 2010. Another factor contributing to the increase in current assets is the improved market values for the University's short term investments.

The University's liabilities totaled \$29.0 million at June 30, 2010 and \$25.5 million at June 30, 2009. Bonds payable of \$17.0 million was the largest liability, representing 59% of the total University's liabilities. The current liabilities increased by \$4.5 million as a result of construction payables due at June 30, 2010. The University incurs long-term debt to finance construction and renovation projects and to provide for accumulated unused vacation benefits for employees. The University decreased its long-term debt by \$.9 million during the fiscal year with the repayment of principal that was due on outstanding bonds. For detailed information about long-term debt see Note 7 of the Notes to the Financial Statements.

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were \$119.8 million at June 30, 2010, an increase of \$17.1 million over the prior year. The account net assets invested in capital assets, net of related debt, represents the University's total capital assets, net of outstanding debt obligations related to those capital assets and reflects an increase of \$17.0 million over last year due to construction projects underway. The increase of \$2.3 million in unrestricted net assets is primarily due to the increase in tuition and fees and reduced unrestricted expenditures.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets reports the revenues earned and expenses incurred during the fiscal year and a summarized comparison for the two fiscal years is presented below.

Comparative Condensed Statement of Revenues, Expenses, and Changes in Net Assets For the Year Ended June 30, 2010 and June 30, 2009

	2010	2009	Percent Change
Operating Revenues:			
Student Tuition and Fees, Net	\$ 8,342,781.11	\$ 6,489,254.60	29%
Grants and Contracts	5,029,604.88	4,007,514.77	26%
Sales and Services, Net	5,291,190.78	6,539,592.50	-19%
Other	387,177.80	144,960.31	167%
Total Operating Revenues	<u>19,050,754.57</u>	<u>17,181,322.18</u>	11%
Operating Expenses:			
Salaries and Benefits	43,069,995.85	44,414,258.78	-3%
Supplies and Materials	4,757,037.62	6,393,362.87	-26%
Services	15,735,668.73	14,449,874.69	9%
Scholarships and Fellowships	5,836,181.79	3,929,086.04	49%
Utilities	3,111,717.08	3,165,273.24	-2%
Depreciation	3,378,184.20	3,329,382.46	1%
Total Operating Expenses	<u>75,888,785.27</u>	<u>75,681,238.08</u>	0%
Operating Loss	(56,838,030.70)	(58,499,915.90)	-3%
Nonoperating Revenues and Expenses:			
State Appropriations	34,424,641.50	33,024,078.75	4%
State Aid - Federal Recovery Funds	1,611,443.00	1,024,952.00	57%
Noncapital Grants - Federal Student Financial Aid	11,894,900.46	8,657,847.78	37%
Other Noncapital Grants	12,022,835.36	11,480,739.81	5%
Noncapital Gifts	617,008.27	750,931.01	-18%
Investment Income (Net of Expense)	527,249.73	216,297.00	144%
Interest and Fees on Debt	(906,233.84)	(1,019,227.55)	-11%
Other Nonoperating Revenues and Expenses	(49,157.16)	(546,997.08)	-91%
Net Nonoperating Revenues	<u>60,142,687.32</u>	<u>53,588,621.72</u>	12%
Gain/(Loss) Before Other Revenues (Expenses)	3,304,656.62	(4,911,294.18)	
Capital Appropriations/ (Refund Prior Year)	(55,000.00)	(847,490.90)	-94%
Capital Grants	13,301,544.78	3,888,709.20	242%
Capital Gifts	304,355.00		100%
Additions to Permanent Endowment	211,168.84	267,479.85	-21%
Total Other Revenues	13,762,068.62	3,308,698.15	316%
Increase/(Decrease) in Net Assets	17,066,725.24	(1,602,596.03)	-1165%
Net Assets at the Beginning of the Year	<u>102,773,530.38</u>	<u>104,376,126.41</u>	-2%
Net Assets at the End of the Year	<u>\$ 119,840,255.62</u>	<u>\$ 102,773,530.38</u>	17%

The increase or decrease of revenues over expenses directly affects (increases/decreases) the total net assets reported on the Statement of Net Assets. These transactions are classified as

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

operating or nonoperating. Operating revenues primarily consist of student tuition and fees reported net of discounts and scholarships allowances, federal grants and contracts, and auxiliary sales and services revenues. Operating expenses primarily consist of salaries, supplies, services, scholarships, utilities and depreciation.

Operating revenues of \$19.1 million at June 30, 2010, increased by \$1.9 million when compared to 2009. The contributing factors to this increase are represented by a 26% increase in federal grant and contract revenues due to the University receiving additional funding from the U.S. Agency for International Development (USAID) grant of \$1.6 million and a 29% increase in student tuition and fees, which was related to a 6% student enrollment increase and an increase in tuition and fee rates for resident and non-resident students of 3.5% and 1.3%, respectively.

Overall, operating expenses at June 30, 2010 remained consistent with prior year expenditures. Scholarship and fellowships increased by \$1.9 million due to the increase in enrolment and student financial aid. Supplies and materials decreased by \$1.6 million due to completion of several repair and renovation projects in the prior year.

Nonoperating revenues and expenses stem from transactions that occur outside of the primary scope of the University's operations and for which no goods or services are provided. State appropriations, noncapital grants and gifts, investment income/expenses, and capital-related interest primarily represent the nonoperating revenues and expenses. Of the nonoperating revenues, there were significant changes in all accounts except State appropriations and other noncapital grants.

State appropriations increased by \$1.4 million as a result of funding for enrollment growth, the aviation science program and employee benefit inflationary adjustments. Noncapital grants - federal student financial aid increased by \$3.2 million as students received increased financial aid and enrollment increased. Investment income increased by approximately \$311,000 and is attributable to gains on investments from improved market conditions.

Again this year, the State of North Carolina received federal recovery funds to stabilize the State's budget. As a result, the University received \$1.6 million, which was recorded as a nonoperating revenue. The University did not receive any capital appropriations this year. However, the University received \$13.3 million in capital grants, which represents State aid received from the State and funded by State bond and debt sales.

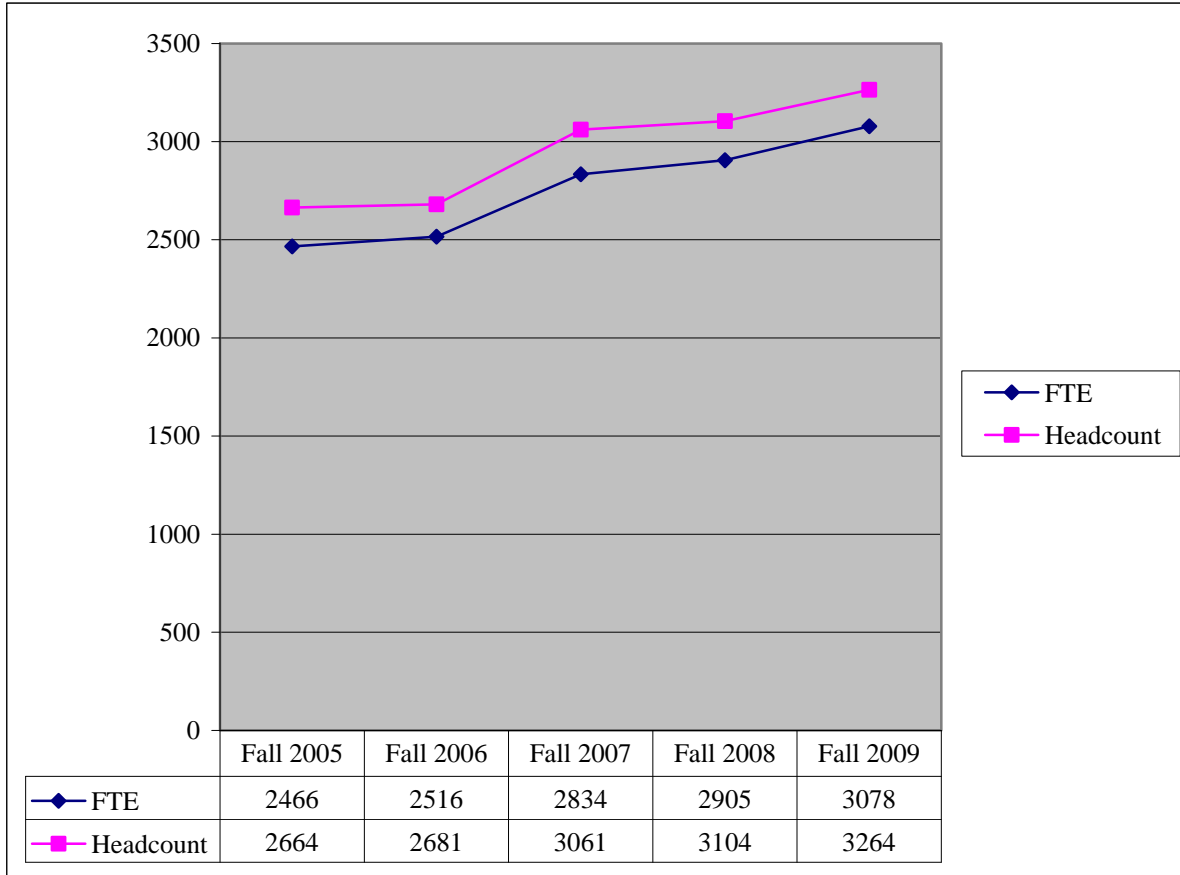
Capital Assets

The major projects remaining in construction in progress were the Pharmacy Building of \$21.3 million and the initial expenses for the Aviation Building and School of Education Building of \$2.3 million. With these construction projects, the amount committed to contractors at June 30th decreased a total of \$15.5 million, as reflected in the change in construction commitments from \$20.2 million in 2009 to \$4.8 million in 2010.

MANAGEMENT’S DISCUSSION AND ANALYSIS (CONTINUED)

Comparative Enrollment Data

The future years appear to be promising and the University expects enrollment to continue to increase; therefore, projected tuition and fee and sales and service revenues look favorable.



Factors Impacting Future Periods

Several factors impact a positive economic outlook for the University, such as campus expansion, research funding, private gifts and support from the State of North Carolina.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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

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

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

Elizabeth City State University
Statement of Net Assets
June 30, 2010

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 7,552,669.86
Restricted Cash and Cash Equivalents	4,936,628.71
Short-Term Investments	2,970,362.30
Receivables, Net (Note 4)	4,282,630.68
Inventories	987,696.35
Notes Receivable (Note 4)	15,332.58
Other Assets	6,702.50
	<hr/>
Total Current Assets	20,752,022.98
	<hr/>

Noncurrent Assets:

Restricted Cash and Cash Equivalents	2,472,627.36
Restricted Due from Primary Government	17,705.37
Endowment Investments	3,524,154.60
Other Investments	788,321.16
Notes Receivable, Net (Note 4)	1,213,412.37
Bond Issuance Costs	1,093,205.08
Capital Assets - Nondepreciable (Note 5)	26,495,792.39
Capital Assets - Depreciable, Net (Note 5)	92,440,064.09
	<hr/>
Total Noncurrent Assets	128,045,282.42
	<hr/>

Total Assets	148,797,305.40
	<hr/>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	6,944,098.46
Due to Primary Government	46,837.43
Unearned Revenue	1,472,229.19
Interest Payable	105,671.36
Long-Term Liabilities - Current Portion (Note 7)	888,668.93
	<hr/>
Total Current Liabilities	9,457,505.37
	<hr/>

Noncurrent Liabilities:

Deposits Payable	60,756.86
Funds Held for Others	201,696.35
U. S. Government Grants Refundable	676,292.73
Long-Term Liabilities (Note 7)	18,560,798.47
	<hr/>
Total Noncurrent Liabilities	19,499,544.41
	<hr/>

Total Liabilities	28,957,049.78
	<hr/>

Elizabeth City State University
Statement of Net Assets
June 30, 2010

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	102,990,569.46
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	3,587,898.03
Endowed Professorships	2,171,039.81
Expendable:	
Scholarships and Fellowships	2,604,712.74
Endowed Professorships	170,608.54
Loans	415,852.71
Debt Service	3,344,170.95
Unrestricted	4,555,403.38
Total Net Assets	<u>\$ 119,840,255.62</u>

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

Elizabeth City 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 9)	\$ 8,342,781.11
Federal Grants and Contracts	5,020,434.73
State and Local Grants and Contracts	1,901.96
Nongovernmental Grants and Contracts	7,268.19
Sales and Services, Net (Note 9)	5,291,190.78
Interest Earnings on Loans	23,080.64
Other Operating Revenues	364,097.16
	<hr/>
Total Operating Revenues	19,050,754.57
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	43,069,995.85
Supplies and Materials	4,757,037.62
Services	15,735,668.73
Scholarships and Fellowships	5,836,181.79
Utilities	3,111,717.08
Depreciation	3,378,184.20
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Total Operating Expenses	75,888,785.27
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Operating Loss	(56,838,030.70)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	34,424,641.50
State Aid - Federal Recovery Funds	1,611,443.00
Noncapital Grants - Federal Student Financial Aid	11,894,900.46
Other Noncapital Grants	12,022,835.36
Noncapital Gifts, Net (Note 9)	617,008.27
Investment Income (Net of Investment Expense of \$57,249.05)	527,249.73
Interest and Fees on Debt	(906,233.84)
Other Nonoperating Expenses	(49,157.16)
	<hr/>
Net Nonoperating Revenues	60,142,687.32
	<hr/>
Income Before Other Revenues and Expenses	3,304,656.62
	<hr/>
Refund of Prior Years Capital Appropriations	(55,000.00)
Capital Grants	13,301,544.78
Capital Gifts	304,355.00
Additions to Endowments	211,168.84
	<hr/>
Increase in Net Assets	17,066,725.24

NET ASSETS

Net Assets - July 1, 2009	102,773,530.38
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Net Assets - June 30, 2010	\$ 119,840,255.62
	<hr/> <hr/>

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

Elizabeth City 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	\$ 19,398,524.45
Payments to Employees and Fringe Benefits	(43,205,938.10)
Payments to Vendors and Suppliers	(23,308,053.26)
Payments for Scholarships and Fellowships	(5,836,181.79)
Loans Issued	(199,430.38)
Collection of Loans	75,493.05
Other Payments	(157,814.84)
	<hr/>
Net Cash Used by Operating Activities	(53,233,400.87)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	34,424,641.50
State Aid - Federal Recovery Funds	1,611,443.00
Noncapital Grants - Federal Student Financial Aid	11,894,900.46
Noncapital Grants	12,115,322.01
Noncapital Gifts	720,945.44
Additions to Endowments	198,784.32
William D. Ford Direct Lending Receipts	11,645,436.00
William D. Ford Direct Lending Disbursements	(11,645,436.00)
Federal Family Education Loan Receipts	2,770,294.00
Federal Family Education Loan Disbursements	(2,770,294.00)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	60,966,036.73

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Refund of Prior Years Capital Appropriations	(55,000.00)
Capital Grants	13,668,429.90
Capital Gifts	96,155.00
Proceeds from Sale of Capital Assets	67,230.94
Acquisition and Construction of Capital Assets	(16,247,615.14)
Principal Paid on Capital Debt and Leases	(650,000.00)
Interest and Fees Paid on Capital Debt and Leases	(909,723.70)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(4,030,523.00)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	10,779,957.37
Investment Income	347,142.10
Purchase of Investments and Related Fees	(11,796,677.66)
	<hr/>
Net Cash Used by Investing Activities	(669,578.19)
	<hr/>
Net Increase in Cash and Cash Equivalents	3,032,534.67
Cash and Cash Equivalents - July 1, 2009	11,929,391.26
	<hr/>
Cash and Cash Equivalents - June 30, 2010	\$ 14,961,925.93

Elizabeth City State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2010

Exhibit A-3
Page 2

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

Operating Loss	\$ (56,838,030.70)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	3,378,184.20
Allowances, Write-Offs, and Amortizations	55,430.77
Nonoperating Other Expenses	(1,292.43)
Changes in Assets and Liabilities:	
Receivables (Net)	(229,925.70)
Bond Issuance Costs	47,530.65
Funds Held for Others	(137,076.41)
Inventories	8,813.74
Notes Receivable (Net)	(123,937.33)
Accounts Payable and Accrued Liabilities	298,671.76
Due to Primary Government	13,220.90
Unearned Revenue	571,917.98
US Grants Refundable	(6,779.53)
Compensated Absences	(270,128.77)
	<hr/>
Net Cash Used by Operating Activities	<u>\$ (53,233,400.87)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 7,552,669.86
Restricted Cash and Cash Equivalents	4,936,628.71
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	2,472,627.36
	<hr/>
Total Cash and Cash Equivalents - June 30, 2010	<u>\$ 14,961,925.93</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 4,058,601.99
Assets Acquired through a Gift	220,584.52
Change in Fair Value of Investments	316,120.58
Increase in Receivables Related to Nonoperating Income	88,115.49
Loss on Disposal of Capital Assets	(47,864.73)

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

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

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

Blended Component Unit - Although legally separate, Elizabeth City State University Foundation, Inc and Subsidiary (Foundation), a component unit of the University, is reported as if it were part of the University.

The Foundation is governed by a 25-member board consisting of 14 ex officio directors and 11 elected directors. The Foundation's purpose is to aid, support, and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because the elected directors of the Foundation are appointed by the members of the Elizabeth City State University Board of Trustees and the Foundation's sole purpose is to benefit Elizabeth City State University, its financial statements have been blended with those of the University.

Separate financial statements for the Foundation may be obtained from the University Controller's Office, 1704 Weeksville Road, Elizabeth City,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NC 27909, or by calling 252-335-3211. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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 in the fair value of investments is recognized as a component of investment income.

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

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity or for a specified period of time, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** - Inventories, consisting of expendable supplies, are valued at cost using first-in, first-out method. Merchandise for resale is valued at the lower of cost or market using the retail inventory method. Textbooks for rental are valued at the lower of cost or market.
- 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 75 years for general infrastructure, 10 to 50 years for buildings, and 2 to 25 years for equipment.

- I. Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants.
- J. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refunds are amortized over the life of the new debt using the straight-line method. Issuance costs are expensed when not material. The issuance costs associated with the Elizabeth City State University Housing Foundation are capitalized and amortized using the straight-line method over the life of the bond which is 30 years.

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

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

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

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

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

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

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

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

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

M. Scholarship Discounts - Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$14,734,117.96 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 \$700.00. The carrying amount of the University's deposits not with the State Treasurer was \$227,107.97 and the bank balance was \$1,067,748.63. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2010, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	<u>\$ 814,470.10</u>
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NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

Investments are subject to the following risks.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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 on a market value basis. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

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.

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
Asset-Backed Securities	\$ 43,941.98	\$ 0.00	\$ 43,941.98	\$ 0.00	\$ 0.00
Mutual Bond Funds	1,641,074.27		263,867.87	1,329,956.40	47,250.00
Money Market Mutual Funds	324,836.42	324,836.42			
		<u>\$ 324,836.42</u>	<u>\$ 307,809.85</u>	<u>\$ 1,329,956.40</u>	<u>\$ 47,250.00</u>
Other Securities					
International Mutual Funds	101,980.47				
Other Mutual Funds	1,704,873.54				
Real Estate Investment Trust	565.25				
Domestic Stocks	17,468.38				
Total Long-Term Investment Pool	<u>\$ 3,834,740.31</u>				

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2010, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
Asset-Backed Securities	\$ 43,941.98	\$ 39,547.78	\$ 1,757.68	\$ 1,757.68	\$ 439.42	\$ 439.42	\$ 0.00
Mutual Bond Funds	1,641,074.27	775,905.80	113,720.50	190,190.65	173,638.67	363,505.96	24,112.69
Money Market Mutual Funds	324,836.42	321,280.61					3,555.81

Rating Agency: Standard & Poor's and Moody's

At June 30, 2010, investments in the Long-Term Investment Pool were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty
Asset-Backed Securities	\$ 43,941.98
Domestic Stock	17,468.38
Total	\$ 61,410.36

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 Less Than 1 Year
Debt Securities		
U.S. Treasuries	\$ 281,246.00	\$ 281,246.00
Money Market Mutual Funds	3,166,851.75	3,166,851.75
Total Non-Pooled Investments	\$ 3,448,097.75	\$ 3,448,097.75

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

	Fair Value	AAA Aaa
Money Market Mutual Funds	\$ 3,166,851.75	\$ 3,166,851.75

Rating Agency: Standard & Poor's and Moody's

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2010, the University's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty
U.S. Treasuries	\$ 281,246.00

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

Investment Type	Fair Value
Debt Securities	
U.S. Treasuries	\$ 281,246.00
Asset-Backed Securities	43,941.98
Mutual Bond Funds	1,641,074.27
Money Market Mutual Funds	3,491,688.17
Other Securities	
International Mutual Funds	101,980.47
Other Mutual Funds	1,704,873.54
Real Estate Investment Trust	565.25
Domestic Stocks	17,468.38
Total Investments	\$ 7,282,838.06

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). The non-mandatory spending

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

policy is to take annual withdrawals on August 1 of each year in the annual amount of 5% of a three-year rolling average of the market value of the endowment. The investment manager is expected to liquidate such investments as may be necessary to accomplish this objective, while still maintaining a balanced portfolio. At June 30, 2010, endowment net assets of \$1,686,260.83 were available to be spent, of which \$1,676,025.87 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2010, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 1,629,026.15	\$ 489,622.41	\$ 1,139,403.74
Accounts	194,752.57		194,752.57
Intergovernmental	1,802,841.27		1,802,841.27
Pledges	78,314.32	14,927.98	63,386.34
Investment Earnings	186.00		186.00
Interest on Loans	378,029.17		378,029.17
Other	704,031.59		704,031.59
Total Current Receivables	<u>\$ 4,787,181.07</u>	<u>\$ 504,550.39</u>	<u>\$ 4,282,630.68</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 11,530.16	\$ 0.00	\$ 11,530.16
Institutional Student Loan Programs	3,802.42		3,802.42
Total Notes Receivable - Current	<u>\$ 15,332.58</u>	<u>\$ 0.00</u>	<u>\$ 15,332.58</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 871,305.16	\$ 461,294.91	\$ 410,010.25
Institutional Student Loan Programs	853,533.53	50,131.41	803,402.12
Total Notes Receivable - Noncurrent	<u>\$ 1,724,838.69</u>	<u>\$ 511,426.32</u>	<u>\$ 1,213,412.37</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2009	Increases	Decreases	Balance June 30, 2010
Capital Assets, Nondepreciable:				
Land and Permanent Easements	\$ 1,987,911.32	\$ 208,200.00	\$ 0.00	\$ 2,196,111.32
Construction in Progress	6,040,201.24	18,259,479.83		24,299,681.07
Total Capital Assets, Nondepreciable	8,028,112.56	18,467,679.83		26,495,792.39
Capital Assets, Depreciable:				
Buildings	111,541,984.31	21,554.00	10,000.00	111,553,538.31
Machinery and Equipment	9,654,516.76	1,122,381.04	1,260,921.38	9,515,976.42
General Infrastructure	9,531,148.65	266,537.63		9,797,686.28
Total Capital Assets, Depreciable	130,727,649.72	1,410,472.67	1,270,921.38	130,867,201.01
Less Accumulated Depreciation/Amortization for:				
Buildings	28,078,791.98	2,242,531.10	10,000.00	30,311,323.08
Machinery and Equipment	5,591,435.96	653,932.25	1,145,825.71	5,099,542.50
General Infrastructure	2,534,550.49	481,720.85		3,016,271.34
Total Accumulated Depreciation	36,204,778.43	3,378,184.20	1,155,825.71	38,427,136.92
Total Capital Assets, Depreciable, Net	94,522,871.29	(1,967,711.53)	115,095.67	92,440,064.09
Capital Assets, Net	\$ 102,550,983.85	\$ 16,499,968.30	\$ 115,095.67	\$ 118,935,856.48

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 4,507,611.09
Accrued Payroll	1,651,645.42
Contract Retainage	784,841.95
Total Accounts Payable and Accrued Liabilities	\$ 6,944,098.46

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

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

	Balance July 1, 2009	Additions	Reductions	Balance June 30, 2010	Current Portion
Revenue Bonds Payable	\$ 17,745,000.00	\$ 0.00	\$ 650,000.00	\$ 17,095,000.00	\$ 685,000.00
Add/Deduct Premium/Discount	9,546.24		2,314.26	7,231.98	
Deduct Deferred Charge on Refunding	(67,489.28)		(3,749.40)	(63,739.88)	
Total Revenue Bonds Payable	17,687,056.96		648,564.86	17,038,492.10	685,000.00
Compensated Absences	2,681,104.07	1,107,307.57	1,377,436.34	2,410,975.30	203,668.93
Total Long-Term Liabilities	\$ 20,368,161.03	\$ 1,107,307.57	\$ 2,026,001.20	\$ 19,449,467.40	\$ 888,668.93

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
Revenue Bonds Payable							
Dormitory System Revenue Bonds of 1981							
Wamack Hall and Mitchell-Lewis Hall	A	3.00%	10/01/2017	\$ 675,000.00	\$ 485,000.00	\$ 190,000.00	(1)
Wamack Hall and Mitchell-Lewis Hall	B	3.00%	10/01/2020	1,680,000.00	1,000,000.00	680,000.00	(1)
Total Dormitory System Revenue Bonds of 1981				2,355,000.00	1,485,000.00	870,000.00	
Educational Facilities Revenue Bond							
Elizabeth City Housing Foundation	A	2.00% - 5.25%	06/01/2033	13,895,000.00	1,410,000.00	12,485,000.00	
Total Educational Facilities Revenue Bond				13,895,000.00	1,410,000.00	12,485,000.00	(2)
The University of North Carolina System Pool Revenue Bonds							
Refinance Dormitory 200 Bed (1992 Series C Bond)	(B)	3.50%-5.375%	04/01/2027	3,410,000.00	1,099,602.01	2,310,397.99	
Bedell Cafeteria Renovations	(B)	3.50%-5.375%	04/01/2027	1,225,000.00	395,017.68	829,982.32	
Dormitory Furniture	(B)	3.50%-5.375%	04/01/2027	885,000.00	285,380.31	599,619.69	
Total The University of North Carolina System Pool Revenue Bonds				5,520,000.00	1,780,000.00	3,740,000.00	
Total Revenue Bonds Payable (principal only)				\$ 21,770,000.00	\$ 4,675,000.00	17,095,000.00	
Less: Unamortized Loss on Refunding						(63,739.88)	
Less: Unamortized Discount						(123,090.07)	
Plus: Unamortized Premium						130,322.05	
Total Revenue Bonds Payable						\$ 17,038,492.10	

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

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)	Housing Revenue	\$ 1,011,300.00	\$ 258,123.40	\$ 70,000.00	\$ 27,150.00	16%
(2)	Housing Revenue	21,226,427.50	1,137,686.90	300,000.00	621,770.00	74%

C. 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	
	Principal	Interest
2011	\$ 685,000.00	\$ 828,873.76
2012	715,000.00	799,611.26
2013	745,000.00	768,536.26
2014	780,000.00	738,466.26
2015	815,000.00	702,322.50
2016-2020	4,100,000.00	2,868,360.02
2021-2025	3,120,000.00	2,006,550.00
2026-2030	3,620,000.00	1,176,500.00
2031-2033	2,515,000.00	255,500.00
Total Requirements	\$ 17,095,000.00	\$ 10,144,720.06

NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for equipment and temporary facilities. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2010:

Fiscal Year	Amount
2011	\$ 257,051.30
2012	48,552.00
Total Minimum Lease Payments	\$ 305,603.30

Rental expense for all operating leases during the year was \$1,076,508.14.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - REVENUES

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

	Gross Revenues	Sales Eliminations	Scholarship Discounts	Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees	\$ 15,577,733.68	\$ 0.00	\$ 6,960,536.63	\$ 274,415.94	\$ 8,342,781.11
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 6,090,373.99	\$ 0.00	\$ 3,491,368.00	\$ 65,454.17	\$ 2,533,551.82
Dining	3,361,862.95		1,770,869.98	63,817.54	1,527,175.43
Bookstore	1,350,707.03		548,248.33	34,333.69	768,125.01
Parking	1,211.17				1,211.17
Athletic	117,955.12			9,231.62	108,723.50
Vending Commission	91,787.78				91,787.78
Other	1,051,950.39	737,838.25		53,496.07	260,616.07
Total Sales and Services	\$ 12,065,848.43	\$ 737,838.25	\$ 5,810,486.31	\$ 226,333.09	\$ 5,291,190.78
Nonoperating - Noncapital Gifts	\$ 631,936.25	\$ 0.00	\$ 0.00	\$ 14,927.98	\$ 617,008.27

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 17,922,011.12	\$ 359,922.85	\$ 419,069.10	\$ 0.00	\$ 0.00	\$ 0.00	\$ 18,701,003.07
Research	1,155,032.10	271,170.47	2,965,589.88				4,391,792.45
Public Service	816,182.75	92,139.47	321,516.29				1,229,838.51
Academic Support	3,792,166.99	1,082,867.11	252,386.82				5,127,420.92
Student Services	4,880,022.71	1,304,992.19	1,903,877.81				8,088,892.71
Institutional Support	6,906,206.36	208,911.69	1,823,737.44				8,938,855.49
Operations and Maintenance of Plant	4,394,049.74	217,992.04	4,469.15		2,414,932.83		7,031,443.76
Student Financial Aid				5,836,181.79			5,836,181.79
Auxiliary Enterprises	3,204,324.08	1,219,041.80	8,045,022.24		696,784.25		13,165,172.37
Depreciation						3,378,184.20	3,378,184.20
Total Operating Expenses	\$ 43,069,995.85	\$ 4,757,037.62	\$ 15,735,668.73	\$ 5,836,181.79	\$ 3,111,717.08	\$ 3,378,184.20	\$ 75,888,785.27

NOTE 11 - PENSION PLANS

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2010, these rates were set at 3.57% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$34,997,280.42, of which \$24,545,594.69 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$876,277.73 and \$1,472,735.68 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 \$876,277.73, \$830,963.76, and \$725,282.28, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2010, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$34,997,280.42, of which \$6,044,614.61 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$413,451.64 and \$362,676.88 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 \$71,645.00 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$22,123.81. The voluntary contributions by employees amounted to \$282,615.80 for the year ended June 30, 2010.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$84,181.67 for the year ended June 30, 2010.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Benefits** - The University participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by *North Carolina General Statute 135-7* and Chapter 135, Article 3A, of the General Statutes and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$1,376,559.42, \$1,270,251.50, and \$1,201,604.76, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Disability Income** - The University participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2010, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2009, and 2008, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2010, 2009, and 2008, which were \$159,069.09, \$161,105.07, and \$152,398.65, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

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

Tort claims of up to \$1,000,000 are retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium. The University also purchased through the Fund, extended coverage for building and contents to cover windstorm, explosions, or damage caused by vehicle or aircraft impacts. The extended coverage applies to all campus buildings and contents with coverage amounts varying based on the value of each building and its contents.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the University's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The University is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The University 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 .16% for the current fiscal year.

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$4,750,647.87 and on other purchases were \$343,337.90 at June 30, 2010.
- B. Pending Litigation and Claims** - The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 15 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

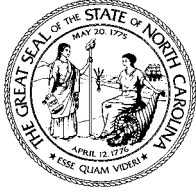
For the fiscal year ended June 30, 2010, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

- GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement requires reporting certain intangible assets as capital assets.
- GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. This statement requires reporting certain derivative instruments at fair value.

NOTE 16 - SUBSEQUENT EVENTS

On December 29, 2010 the University sold \$4,525,000 of Tax Exempt General Revenue Bonds, Series 2010A, \$14,720,000 of Taxable General Revenue Bonds (Build America Bonds), Series 2010B, and \$205,000 of Taxable General Revenue Bonds, Series 2010C for a total par value of \$19,450,000. Bond proceeds in the amount of \$15,388,660 will be used to pay cost of issuance, capitalized interest, and to construct, equip and furnish a new student housing facility on campus. Proceeds in the amount of \$4,061,340.00 will be used to prepay the Elizabeth City State University General Revenue Promissory Note dated November 14, 2002 in the outstanding principal amount of \$3,740,000.

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Beth A. Wood, CPA
State Auditor

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

Board of Trustees
Elizabeth City State University
Elizabeth City, North Carolina

We have audited the financial statements of Elizabeth City 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, as of and for the year ended June 30, 2010, and have issued our report thereon dated February 24, 2011. Our report includes a reference to other auditors.

As discussed in Note 15 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 Elizabeth City State University Foundation, Inc. and Subsidiary, 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.

Internal Control Over Financial Reporting

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

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

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

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.

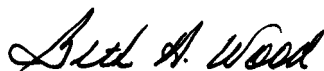
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we identified a deficiency in internal control over financial reporting that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the Audit Findings and Responses section of this report to be a significant deficiency.

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*.

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

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



Beth A. Wood, CPA
State Auditor

February 24, 2011

AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

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

INAPPROPRIATE INFORMATION SYSTEM ACCESS TO THE FINANCIAL ACCOUNTING SYSTEM

The University did not maintain adequate internal control over information system access to its financial accounting system. This increases the risk that misstatements in the financial records could occur due to error or fraud and not be detected.

We identified employees who had access rights that were incompatible with their job functions. Duties should be segregated so that employees, in the normal course of performing their assigned functions, can prevent or detect errors on a timely basis. We noted the following deficiencies:

- All employees in the Registrar's Office and eight employees in other departments, such as Business and Finance, Institutional Advancement, Procurement and Material Management, Auxiliary Services, Admissions and Recruitment, and Sponsored Programs, were assigned system access rights that allowed them to add and remove charges and payments on students' accounts. Such access should be limited to employees in the Student Accounts office as needed.
- All employees in the Registrar's Office and Student Accounts Office, and five employees in other departments, such as Business and Finance, Institutional Advancement, Procurement and Material Management, and Information Technology, had system access rights that allowed them to create and make adjustments to students' financial aid packages. Such access should be limited to employees in the Financial Aid Office as needed.
- Employees in the Student Accounts Office had inappropriate system access rights that allowed them to adjust students' eligibility status, such as satisfactory academic progress, which could result in students being eligible for more or less financial aid. Such access should be limited to employees in the Financial Aid office as needed.

The employees were granted these access rights by the University for a temporary need. However, periodic access reviews were not properly completed to sufficiently identify and adjust for such segregation of duty issues.

Recommendation: The University should establish appropriate controls over granting, managing, and monitoring access to its financial accounting system to ensure employees are assigned access privileges that are appropriate and necessary for their job duties.

University Response: We agree with the finding and recommendation noted in this report, and we have already taken immediate corrective action. On January 6th, Information Technology and Business & Finance assembled the module security administrator

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

team to 1) identify and correct any immediate information access security issues and 2) devise a comprehensive action plan to strengthen internal control over information security access going forward.

Regarding the immediate security issues, the module security team identified and corrected the deficiencies noted in this report. The results of the team's actions are as follows:

- Only employees within the Student Accounts Office have access to update charges and payments on student accounts.
- Only designated employees within the Financial Aid Office have access to create and make adjustments to a student's financial aid package.
- Employees in the Student Accounts Office have query access only to financial aid forms, which remains necessary to promote one-stop customer service as much as possible.

To maintain adequate internal control over information access to financial information going forward, we established and have implemented the following action plan:

- The Banner Security Coordinator and all Banner Module Security Administrators are now meeting monthly to review all banner user access (temporary and permanent) to ensure that appropriate security measures are obtained. The idea is to bring forth issues pertaining to access and any other issues and/or potential risks to proper cross-functional internal controls. The primary purpose of this meeting will be to address such cross-functional issues efficiently and effectively.
- All Banner Module Security Administrators are required to attend the monthly meetings unless a pre-approved absence is granted by the module security administrator's supervisor.
- Module Security Administrators will be required to thoroughly review the following three reports each month to ensure that appropriate information security access is maintained: 1) Security Class Reports; 2) Security User Reports and 3) Security Object Reports.
- The Banner Security Coordinator's role has been expanded by the Chancellor to include a stronger "gatekeeper" role. The coordinator is now empowered and is expected to notify the appropriate senior officer when a module security administrator misses a monthly security access meeting.
- Responsibility for indentifying potential cross-functional segregation of duties and system access issues and/or problems rests primarily with module security administrators. Once these issues are indentified, the Banner Security Coordinator will take the lead role in facilitating timely and effective resolutions by working collaboratively with module security administrators and other staff as needed. When a resolution cannot be reached, the Banner Security Coordinator is expected to escalate the issues and/or problems to the appropriate senior officer.

ORDERING INFORMATION

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