



STATE OF NORTH CAROLINA

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2010

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2010

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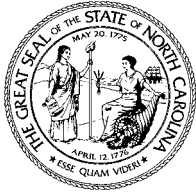
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State Auditor

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of the University of North Carolina School of the Arts for the year ended June 30, 2010, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

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

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the University of North Carolina School of the Arts, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2010, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the NCSA Housing Corporation, which represent 5 percent, and 2 percent, respectively, of the assets and revenues of the University; nor the financial statements of the University of North Carolina School of the Arts Foundation, Inc., the University's discretely presented component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

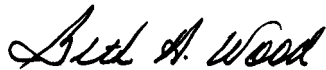
In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of North Carolina School of the Arts and its discretely presented component unit as of June 30,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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 18, 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.

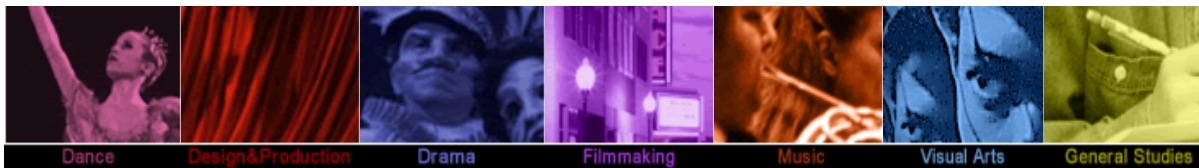
The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which 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

April 18, 2011

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



Introduction

This section of the University of North Carolina School of the Arts financial report provides an overview of the financial position and activities for the year ended June 30, 2010. This discussion has been prepared by management along with the financial statements and related notes to the financial statements and should be read in conjunction with the financial statements and the notes thereto, which follow this section. This discussion and analysis is designed to focus on current activities, resulting change, and current known facts.

Using the Financial Statements

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

The Statement of Cash Flows provides information relative to the University's sources and uses of cash for operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The statement provides a reconciliation of beginning cash balances to ending cash balances and is representative of the activity reported on the Statement of Revenues, Expenses, and Changes in Net Assets as adjusted for changes in the beginning and ending balances of noncash accounts on the Statement of Net Assets. For the purpose of this discussion, we will address the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Net Assets

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

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

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

Condensed Statement of Net Assets

	Year Ended June 30,		
	2010	2009 (restated)	Change
Assets			
Current Assets	\$ 13,520,344.55	\$ 12,310,877.42	\$ 1,209,467.13
Capital Assets, Net	94,131,371.59	95,703,519.79	(1,572,148.20)
Other Noncurrent Assets	12,966,607.77	12,345,379.58	621,228.19
Total Assets	<u>120,618,323.91</u>	<u>120,359,776.79</u>	<u>258,547.12</u>
Liabilities			
Current Liabilities	3,535,749.53	2,903,088.91	632,660.62
Noncurrent Liabilities	10,554,196.14	11,629,762.99	(1,075,566.85)
Total Liabilities	<u>14,089,945.67</u>	<u>14,532,851.90</u>	<u>(442,906.23)</u>
Net Assets			
Invested in Capital Assets, Net of Related Debt	84,882,208.31	86,000,302.01	(1,118,093.70)
Restricted:			
Nonexpendable	9,059,570.75	7,823,451.70	1,236,119.05
Expendable	4,564,045.54	4,902,821.71	(338,776.17)
Unrestricted	8,022,553.64	7,100,349.47	922,204.17
Total Net Assets	<u>\$ 106,528,378.24</u>	<u>\$ 105,826,924.89</u>	<u>\$ 701,453.35</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The total assets of the University increased by \$258,547.12 for the year, with a decrease in capital assets of \$1,572,148.20 and an increase in current assets and other noncurrent assets of \$1,209,467.13 and \$621,228.19, respectively. The decrease in net capital assets of \$1,572,148.20 resulted mainly from an increase of \$1,323,734.94 for new capital asset acquisitions and additions during the year, offset against current year's depreciation of \$2,761,411.98. Other noncurrent assets increased mainly due to an increase in endowment investments of \$1,216,894.56 and a decrease in noncurrent cash of \$478,844.50. The \$1,216,894.56 increase in endowment investments is primarily due to the investment of new endowments of approximately \$750,000.00 during the year and gains on investments of approximately \$517,000.00, offset against investment expenses of approximately \$46,000.00. The decrease in noncurrent cash is primarily due to decreases in cash of approximately \$693,000 for continued expenditures from appropriated capital projects with no new funding, offset against the receipt of a \$250,000 endowment that had not been invested at year end. The decrease in net assets for invested in capital assets of \$1,118,093.70 resulted mainly from a beginning balance restatement of \$1,512,474.73 to correct errors in establishing useful lives of capital assets. See Net Asset Restatement per Note 16.

The total liabilities of the University decreased \$442,906.23 for the year, which included an increase of \$632,660.02 in current liabilities and a decrease of \$1,075,566.85 in noncurrent liabilities. The increase in current liabilities was primarily the result of an increase of \$773,826.33 in current accounts payable resulting from increased accruals for the current year end compared to the prior year due to a more stringent spending restriction in place for the prior year. The \$1,075,566.85 decrease in noncurrent liabilities is mainly due to the retirement of capital debt of \$454,054.50 and a net decrease of \$390,552.03 in compensated absences.

Statement of Revenues, Expenses, and Changes in Net Assets

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	Year Ended June 30,		
	2010	2009 (restated)	Change
Operating Revenues			
Student Tuition and Fees, Net	\$ 10,007,019.82	\$ 9,545,161.66	\$ 461,858.16
Federal Grants and Contracts	57,579.33	73,836.72	(16,257.39)
Sales and Services, Net	5,583,500.81	5,812,083.53	(228,582.72)
Interest Earnings on Loans	1,548.47	1,247.74	300.73
Other Operating Revenues	579,239.06	636,582.93	(57,343.87)
Total Operating Revenues	16,228,887.49	16,068,912.58	159,974.91
Operating Expenses:			
Salaries and Benefits	29,692,580.25	30,696,992.92	(1,004,412.67)
Supplies and Materials	5,308,144.84	3,578,441.33	1,729,703.51
Services	7,646,234.68	7,379,012.63	267,222.05
Scholarships and Fellowships	1,239,386.17	1,162,576.12	76,810.05
Utilities	1,901,581.87	2,103,438.93	(201,857.06)
Depreciation	2,761,411.98	2,788,610.70	(27,198.72)
Total Operating Expenses	48,549,339.79	47,709,072.63	840,267.16
Operating Loss	(32,320,452.30)	(31,640,160.05)	(680,292.25)
Nonoperating Revenues (Expenses)			
State Appropriations	26,119,639.00	24,214,751.23	1,904,887.77
State Aid - Federal Recovery Funds	1,290,919.00	865,557.00	425,362.00
Noncapital Grants - Federal Student Financial Aid	898,335.34	772,333.73	126,001.61
Other Noncapital Grants	530,250.05	494,800.00	35,450.05
Noncapital Gifts	2,866,662.63	3,309,184.07	(442,521.44)
Investment Income (Loss)	699,260.32	(1,761,609.70)	2,460,870.02
Interest and Fees on Debt	(433,977.98)	(451,369.85)	17,391.87
Other Nonoperating Expenses	(557,681.01)	(60,557.33)	(497,123.68)
Net Nonoperating Revenues	31,413,407.35	27,383,089.15	4,030,318.20
Loss Before Other Revenues and Expenses	(907,044.95)	(4,257,070.90)	3,350,025.95
Refund of Prior Years Capital Appropriations	(54,994.00)	(699,853.97)	644,859.97
Capital Grants	569,819.00	95,036.20	474,782.80
Capital Gifts	87,500.00	509,401.53	(421,901.53)
Additions to Endowments	1,006,173.30	519,818.58	486,354.72
Net Other Revenues	1,608,498.30	424,402.34	1,184,095.96
Increase (Decrease) in Net Assets	701,453.35	(3,832,668.56)	4,534,121.91
Beginning Net Assets	105,826,924.89	109,659,593.45	(3,832,668.56)
Ending Net Assets	\$ 106,528,378.24	\$ 105,826,924.89	\$ 701,453.35

The Statement of Revenues, Expenses, and Changes in Net Assets reported an increase in the net assets at the end of the year. Total net revenues were \$49,250,793.14 for 2010 and \$43,876,404.07 for 2009. The increase in total net revenues of \$5,374,389.07 is primarily the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

result of an increase in investment income of \$2,460,870.02, and an increase in state appropriations of \$1,904,887.77. The University restated the June 30, 2009 balances related to student tuition and fees, sales and services, other noncapital grants, and scholarships and fellowships expense to reflect the proper reporting of state student aid as nonoperating revenue due to a clarification in the GASB *Comprehensive Implementation Guide* in the prior year. In addition, the June 30, 2009 net assets for invested in capital assets were restated to correct errors in establishing useful lives of capital assets as previously mentioned in the Statement of Net Assets section. Some of the highlights of the revenue accounts presented on the Statement of Revenues, Expenses, and Changes in Net Assets are as follows:

- Student tuition and fees increased \$461,858.16 mainly due to an increase in tuition and fee rates for the 2009-2010 fiscal year.
- The University received increased funding of \$425,362.00 from the Federal American Recovery and Reinvestment Act (ARRA) - Fiscal Stabilization funds, which supports state appropriations for operations. This amount was recorded as state aid since the funds were federal pass-through funds and was used to cover academic salaries and benefits.
- Investment income increased \$2,460,870.02 as a result of the improvement in the economy from the prior year which resulted in gains on investments.
- The refund of prior years' capital appropriations decreased \$644,859.97 mainly due to the University's required reversion of only \$54,994.00 for the 2010 fiscal year compared to a \$541,728.97 capital appropriations reversion in the prior year. In addition, the University transferred \$158,125.00 of capital appropriations in the prior year to another University that was not required in the 2010 fiscal year.
- Capital grants increased \$474,782.80 mainly due to increased funding for certificates of participation and higher education bond funds for capital projects. Capital gifts decreased \$421,901.53 due to the University receiving fewer donated capital gifts in the 2009-2010 fiscal year.
- State appropriations' increase of \$1,904,887.77 is mainly due to an increase of approximately \$2 million in special needs funding and expansion funding designated for the Film School.

Operating expenses totaled \$48,549,339.79 for the year compared to \$47,709,072.63 from the previous year, an increase of \$840,267.16. The most significant increase in expenses occurred in supplies and materials, with an increase of \$1,729,703.51. This increase is attributed to approximately \$1,304,000 more of computer and equipment purchases in the current year compared to the prior year due to 2010 being the year to replenish old computer purchases. In addition, there was a \$364,000 increase in general construction costs related to expensed repair and renovation projects. Salaries and benefits decreased \$1,004,412.67 primarily due to permanent budget reductions totaling \$740,587.00 from the North Carolina Office of State Budget Management (OSBM).

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Capital Asset and Debt Administration

The University's capital assets, net of accumulated depreciation at June 30, 2010, were \$94,131,371.59. For more information about the University's asset holdings, refer to Note 5 of the Notes to the Financial Statements.

The University had \$10,828,868.86 in outstanding long-term debt at June 30, 2010, and continues to make all of its debt payments in a timely manner. No new debt was issued during the 2009-2010 fiscal year. Refer to Note 7 of the Notes to the Financial Statements for more detailed information about the University's debt obligations.

Economic Outlook

The University of North Carolina School of the Arts experienced a record breaking reduction in its operating budget during the 2009-2010 fiscal year due to the distressed economic conditions of the State. The North Carolina Legislature reduced the operating budget by \$1,840,672 and the Center for Design Innovation budget by \$100,000. In addition to this permanent cut, UNC General Administration mandated a permanent flexibility reduction of \$740,587. The Office of State Budget and Management also implemented a non-recurring 5% budget reversion of \$1,352,276. In order for UNCSA to sustain its mission, a reduction in force was applied to 8.6 full-time equivalents.

The federal government's 2009 American Recovery and Reinvestment Act (ARRA) made funds available to the State of North Carolina to assist in stabilizing education budgets. The General Assembly used \$137 million of federal ARRA funds to offset the University System's regular state appropriation in the 2009-2010 fiscal year. UNCSA's share of stimulus funding was \$1,290,919. This funding had zero effect on UNCSA's budget.

Cuts assigned to the University System for 2010-2011 total another \$142 million. The 2010 legislative session cut the University System by \$91.5 million on top of the \$50.6 million in cuts for the 2010-2011 fiscal year as assigned to the University System during the 2009 legislative session. In an effort to help protect the quality of education, the General Assembly authorized all of the UNC Schools to increase their tuition up to \$750 per student. This was done for the specific purpose of reducing the impact of the reductions and to protect the universities' academic core. Twenty percent of this tuition increase was mandated to be set aside for need-based financial aid. The gross base budget reductions allocated to UNCSA as a result of legislative action and the UNC General Administration allocation was \$725,000. However, after factoring in the net impact of the tuition increase resulting in increased revenue of \$581,400, the UNCSA net permanent base budget reduction was \$143,600. In addition to the permanent budget reductions, the Office of State Budget and Management mandated a 1% reversion in the amount of \$293,881 and an advertisement budget reduction of \$63,977. The State revenue projections for the next biannual budget continue to indicate a very challenging time for the State. Additional budget reductions are anticipated in the next biannual budget cycle.

As part of the enacted 2010-2011 budget, the Legislature did provide \$201,165 permanently to help cover the costs of in-state high school students so they can continue attending the school at no cost to the student. The University also received \$500,000 in non-recurring

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

funding for the School of Filmmaking for 2010-2011. Another infusion of funds from the ARRA is anticipated in the 2010-2011 fiscal year. The North Carolina General Assembly will use \$144 million to offset the University System's state appropriation. As last year, this will result in a zero effect on UNCOSA's budget.

Also included in the 2010-2011 budget allocation, the recurring funds appropriated to UNCOSA for the Summer Institute on Roanoke Island was permanently transferred to the Department of Cultural Resources and allocated to the Roanoke Island Commission. The University transferred approximately \$438,000 to the Department of Cultural Resources in the 2009-2010 fiscal year.

In capital improvements for 2010-2011, the University received \$1,440,000 in repair and renovation funding for projects such as improvements to electrical, plumbing, and heating, ventilating, and air conditioning systems in the Stevens Center and Academic Facilities; improvements to utility infrastructure for the Campus High Voltage and Information Technologies; interior renovations in Workplace, Gray Building and Academic Facilities; improvements to campus security systems campus wide; roof replacements, structural repairs and water proofing in Workplace West and Academic Facilities. These projects are expected to be completed in the summer of 2011.

The Office of State Budget and Management released UNCOSA's Repair and Renovation funding of \$600,000 late last fiscal year. The projects related to those funds were originally planned for completion over the summer 2010. Due to the funds being released in April 2010, the projects new completion schedule is set for late fall 2010. Some of these projects include a roof and exterior building repair to the Design and Production building, a chiller replacement in Design and Production, repairs to the skywalk and stairs between the Gray building and Workplace, and a roof replacement on the Film school's building #3.

The design phase on all of the new buildings will take place over the 2010-2011 fiscal year. This is the new Library, Campus Police Operation Center, Central Storage Facility and the Film School Production Design facility. Ground breaking for all of the new facilities is scheduled for Spring 2012.

University of North Carolina School of the Arts
Statement of Net Assets
June 30, 2010

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 11,024,247.69
Restricted Cash and Cash Equivalents	1,931,897.47
Receivables, Net (Note 4)	138,803.79
Due from University Component Unit	70,521.00
Inventories	262,549.42
Notes Receivable, Net (Note 4)	92,325.18
	<hr/>
Total Current Assets	13,520,344.55

Noncurrent Assets:

Restricted Cash and Cash Equivalents	3,042,663.08
Restricted Due from Primary Government	36,498.45
Endowment Investments	8,402,078.63
Restricted Investments	581,736.93
Other Investments	52,517.37
Notes Receivable, Net (Note 4)	317,507.31
Bond Issuance Costs, Net of Amortization of \$123,190	533,606.00
Capital Assets - Nondepreciable (Note 5)	6,574,195.98
Capital Assets - Depreciable, Net (Note 5)	87,557,175.61
	<hr/>
Total Noncurrent Assets	107,097,979.36

Total Assets	<hr/> <hr/> 120,618,323.91
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	1,526,322.30
Due to Primary Government	22,395.65
Unearned Revenue	1,194,723.93
Interest Payable	51,566.67
Long-Term Liabilities - Current Portion (Note 7)	740,740.98
	<hr/>
Total Current Liabilities	3,535,749.53

Noncurrent Liabilities:

Deposits Payable	58,192.81
Funds Held for Others	11,916.91
U. S. Government Grants Refundable	395,958.54
Long-Term Liabilities (Note 7)	10,088,127.88
	<hr/>

Total Noncurrent Liabilities	10,554,196.14
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Total Liabilities	<hr/> <hr/> 14,089,945.67
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University of North Carolina School of the Arts
Statement of Net Assets
June 30, 2010

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	84,882,208.31
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	322,503.20
Endowed Professorships	5,142,908.37
Departmental Uses	3,520,550.00
Loans	73,609.18
Expendable:	
Scholarships and Fellowships	1,065,707.62
Departmental Uses	180,211.49
Capital Projects	2,387,935.13
Debt Service	930,191.30
Unrestricted	<u>8,022,553.64</u>
Total Net Assets	<u><u>\$ 106,528,378.24</u></u>

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

University of North Carolina School of the Arts
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2010

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 10,007,019.82
Federal Grants and Contracts	57,579.33
Sales and Services, Net (Note 9)	5,583,500.81
Interest Earnings on Loans	1,548.47
Other Operating Revenues	579,239.06
	<hr/>
Total Operating Revenues	16,228,887.49
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	29,692,580.25
Supplies and Materials	5,308,144.84
Services	7,646,234.68
Scholarships and Fellowships	1,239,386.17
Utilities	1,901,581.87
Depreciation	2,761,411.98
	<hr/>
Total Operating Expenses	48,549,339.79
	<hr/>
Operating Loss	(32,320,452.30)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	26,119,639.00
State Aid - Federal Recovery Funds	1,290,919.00
Noncapital Grants - Federal Student Financial Aid	898,335.34
Other Noncapital Grants	530,250.05
Noncapital Gifts	2,866,662.63
Investment Income (Net of Investment Expense of \$46,629.79)	699,260.32
Interest and Fees on Debt	(433,977.98)
Other Nonoperating Expenses	(557,681.01)
	<hr/>
Net Nonoperating Revenues	31,413,407.35
	<hr/>
Loss Before Other Revenues and Expenses	(907,044.95)
	<hr/>
Refund of Prior Years Capital Appropriations	(54,994.00)
Capital Grants	569,819.00
Capital Gifts	87,500.00
Additions to Endowments	1,006,173.30
	<hr/>
Increase in Net Assets	701,453.35
	<hr/>

NET ASSETS

Net Assets - July 1, 2009, as Restated (Note 16)	105,826,924.89
	<hr/>
Net Assets - June 30, 2010	\$ 106,528,378.24
	<hr/> <hr/>

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

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

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 15,851,820.73
Payments to Employees and Fringe Benefits	(29,994,889.75)
Payments to Vendors and Suppliers	(14,151,542.05)
Payments for Scholarships and Fellowships	(1,239,386.17)
Loans Issued	(70,860.00)
Collection of Loans	81,516.96
Interest Earned on Loans	1,548.47
Student Deposits Received	60,300.00
Student Deposits Returned	(57,300.00)
	<hr/>
Net Cash Used by Operating Activities	(29,518,791.81)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	26,119,639.00
State Aid - Federal Recovery Funds	1,290,919.00
Noncapital Grants - Federal Student Financial Aid	898,335.34
Other Noncapital Grants	530,250.05
Noncapital Gifts	2,866,662.63
Additions to Endowments	1,006,173.30
William D. Ford Direct Lending Receipts	6,390,706.00
William D. Ford Direct Lending Disbursements	(6,390,706.00)
Related Activity Agency Disbursements	(6,596.29)
Other Payments	(438,564.00)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	32,266,819.03

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Refund of Prior Years Capital Appropriations	(54,994.00)
Capital Grants	638,127.18
Proceeds from Sale of Capital Assets	15,354.15
Acquisition and Construction of Capital Assets	(1,243,380.94)
Principal Paid on Capital Debt and Leases	(454,054.50)
Interest and Fees Paid on Capital Debt and Leases	(417,083.98)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(1,516,032.09)

CASH FLOWS FROM INVESTING ACTIVITIES

Investment Income	262,457.91
Purchase of Investments and Related Fees	(797,744.88)
	<hr/>
Net Cash Used by Investing Activities	(535,286.97)
	<hr/>
Net Increase in Cash and Cash Equivalents	696,708.16
Cash and Cash Equivalents - July 1, 2009	15,302,100.08
	<hr/>
Cash and Cash Equivalents - June 30, 2010	\$ 15,998,808.24

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

Exhibit A-3

Page 2

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

Operating Loss	\$ (32,320,452.30)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	2,761,411.98
Allowances, Write-Offs, and Amortizations	137,253.66
Changes in Assets and Liabilities:	
Receivables (Net)	27,878.00
Due from University Component Unit	(55,023.80)
Inventories	(21,956.13)
Notes Receivable (Net)	10,656.96
Accounts Payable and Accrued Liabilities	781,161.70
Due to Primary Government	(60,473.13)
Unearned Revenue	(346,267.23)
US Government Grants Refundable	(46,329.49)
Compensated Absences	(390,552.03)
Deposits Payable	3,900.00
	<hr/>
Net Cash Used by Operating Activities	<u><u>\$ (29,518,791.81)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 11,024,247.69
Restricted Cash and Cash Equivalents	1,931,897.47
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	3,042,663.08
	<hr/>
Total Cash and Cash Equivalents - June 30, 2010	<u><u>\$ 15,998,808.24</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 87,500.00
Change in Fair Value of Investments	517,712.27
Loss on Disposal of Capital Assets	134,471.16

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Financial Position
June 30, 2010

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$ 2,941,637
Investments	13,743,368
Annuity Investments	720,989
Prepaid Expenses and Other Current Assets	46,771
Pledges Receivable, Net	1,828,677
Beneficial Interest in Perpetual Trusts	723,256
Beneficial Interest in Charitable Remainder Trusts	162,585
Property, Plant and Equipment, Net	<u>1,384,767</u>
Total Assets	<u><u>\$ 21,552,050</u></u>

LIABILITIES AND NET ASSETS

Liabilities:

Accounts Payable and Accrued Expenses	\$ 109,629
Annuity Obligations	<u>435,992</u>
Total Liabilities	<u>545,621</u>

NET ASSETS

Unrestricted	(1,519,568)
Temporarily Restricted	3,615,288
Permanently Restricted	<u>18,910,709</u>
Total Net Assets	<u>21,006,429</u>
Total Liabilities and Net Assets	<u><u>\$ 21,552,050</u></u>

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2010

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES				
Gifts and Grants	\$ 390,260	\$ 1,045,370	\$ 290,957	\$ 1,726,587
Interest and Dividend Income	75,738	1,250		76,988
Net Gain on Investments	647,279	260,528	30,676	938,483
Change in Fair Value of Split-Interest Agreements			50,392	50,392
Change in Fair Value of Beneficial Interest in Perpetual Trusts			138,580	138,580
Other Income	110,313	294,930	588	405,831
Net Assets Released from Restrictions	<u>1,631,341</u>	<u>(1,631,341)</u>		
Total Revenues and Support	2,854,931	(29,263)	511,193	3,336,861
EXPENSES				
Program Services:				
Scholarships and Awards	842,785			842,785
School Programs	<u>750,239</u>			<u>750,239</u>
Total Program Services	1,593,024			1,593,024
Supporting Services:				
Administrative Costs	258,313			258,313
Investment Management Fees	68,733			68,733
Development Costs	322,381			322,381
Depreciation and Amortization Expense	<u>92,271</u>			<u>92,271</u>
Total Supporting Services	741,698			741,698
Total Expenses	<u>2,334,722</u>			<u>2,334,722</u>
Change in Net Assets Before Transfers	520,209	(29,263)	511,193	1,002,139
Transfers of Property to the University		(85,352)		(85,352)
Transfers Between Funds	<u>(549,882)</u>	<u>516,315</u>	<u>33,567</u>	
Change in Net Assets	(29,673)	401,700	544,760	916,787
NET ASSETS				
Net Assets - Beginning of Year	<u>(1,489,895)</u>	<u>3,213,588</u>	<u>18,365,949</u>	<u>20,089,642</u>
Net Assets - End of Year	<u>\$ (1,519,568)</u>	<u>\$ 3,615,288</u>	<u>\$ 18,910,709</u>	<u>\$ 21,006,429</u>

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

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2010

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina School of the Arts is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of not less than 12, nor more than 21 members. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University and is reported in separate financial statements because of the difference in its reporting model, as described below.

The University of North Carolina School of the Arts Foundation, Inc. reports its financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2010, the Foundation distributed \$1,593,024.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University of North Carolina School of the Arts Foundation, Inc., PO Box 12189, Winston-Salem, NC 27107.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts.

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

The University capitalizes assets that have a value or cost of \$5,000 or greater at the date of acquisition and an estimated useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 50 years for general infrastructure and buildings, and 7 to 15 years for equipment, except for specialized filmmaking equipment (20 years) and specialized musical instruments (25 to 50 years).

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

either investing, capital, or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

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

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2010, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$15,520,708.26 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Cash on hand at June 30, 2010 was \$4,930.00. The carrying amount of the University's deposits not with the State Treasurer was \$473,169.98 and the bank balance was \$987,733.44. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2010, \$350,337.28 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

B. Investments

University - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina to invest its special funds 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Institutional Funds Act” (UPMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

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

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

UNC Investment Fund, LLC - At June 30, 2010, the University’s investments include \$8,402,078.63 which represents the University’s equity position in the UNC Investment Fund, LLC (System Fund). The System Fund is an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating. Asset and ownership interests of the System Fund are determined on a market unit valuation basis each month. Investment risks associated with the System Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from the UNC CH Controller’s Office, Campus Box 1270, Chapel Hill, NC 27599-1270.

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

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years) <u>Less</u> Than 1
Debt Securities		
Money Market Mutual Funds	\$ 634,254.30	\$ 634,254.30

At June 30, 2010, the Money Market Mutual Funds, with a fair value of \$634,254.30, were rated AAAM by Standard and Poor’s.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Investment Type	Fair Value
Debt Securities	
Money Market Mutual Funds	\$ 634,254.30
Other Securities	
UNC Investment Fund, LLC	8,402,078.63
Total Investments	\$ 9,036,332.93

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

Investment Type	Fair Value
UNC Investment Fund II, LLC	\$ 13,743,368.00

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University’s endowment funds is predicated on the total return concept (yield plus appreciation). To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference.

During the current year, the University incurred investment losses that exceeded the related endowment's available accumulated income and net appreciation. These losses resulted in a reduction to the specific nonexpendable endowment balance. At June 30, 2010 the amount of investment losses reported against the nonexpendable endowment balances were \$944,165.90.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2010, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 24,054.99	\$ 6,338.58	\$ 17,716.41
Accounts	70,604.10		70,604.10
Intergovernmental	13,840.58		13,840.58
Interest on Loans	36,642.70		36,642.70
Total Current Receivables	<u>\$ 145,142.37</u>	<u>\$ 6,338.58</u>	<u>\$ 138,803.79</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 117,366.05	\$ 27,129.12	\$ 90,236.93
Institutional Student Loan Programs	8,477.45	6,389.20	2,088.25
Total Notes Receivable - Current	<u>\$ 125,843.50</u>	<u>\$ 33,518.32</u>	<u>\$ 92,325.18</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 538,080.79</u>	<u>\$ 220,573.48</u>	<u>\$ 317,507.31</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 (as restated)	Increases	Decreases	Balance June 30, 2010
Capital Assets, Nondepreciable:				
Land	\$ 4,011,851.74	\$ 64,588.59	\$ 0.00	\$ 4,076,440.33
Art, Literature, and Artifacts	1,904,765.97			1,904,765.97
Construction in Progress	448,518.14	144,471.54		592,989.68
Total Capital Assets, Nondepreciable	<u>6,365,135.85</u>	<u>209,060.13</u>		<u>6,574,195.98</u>
Capital Assets, Depreciable:				
Buildings	106,367,160.65	167,900.00	140,153.00	106,394,907.65
Machinery and Equipment	9,059,651.30	946,774.81	327,730.01	9,678,696.10
General Infrastructure	5,107,656.50			5,107,656.50
Total Capital Assets, Depreciable	<u>120,534,468.45</u>	<u>1,114,674.81</u>	<u>467,883.01</u>	<u>121,181,260.25</u>
Less Accumulated Depreciation for:				
Buildings	26,304,286.00	2,126,499.00	14,752.54	28,416,032.46
Machinery and Equipment	4,094,108.28	532,759.85	318,659.31	4,308,208.82
General Infrastructure	797,690.23	102,153.13		899,843.36
Total Accumulated Depreciation	<u>31,196,084.51</u>	<u>2,761,411.98</u>	<u>333,411.85</u>	<u>33,624,084.64</u>
Total Capital Assets, Depreciable, Net	<u>89,338,383.94</u>	<u>(1,646,737.17)</u>	<u>134,471.16</u>	<u>87,557,175.61</u>
Capital Assets, Net	<u>\$ 95,703,519.79</u>	<u>\$ (1,437,677.04)</u>	<u>\$ 134,471.16</u>	<u>\$ 94,131,371.59</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 1,230,191.47
Accrued Payroll	280,636.78
Contract Retainage	15,494.05
Total Accounts Payable and Accrued Liabilities	<u>\$ 1,526,322.30</u>

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	\$ 2,885,000.00	\$ 0.00	\$ 295,000.00	\$ 2,590,000.00	\$ 310,000.00
Certificates of Participation	6,770,000.00		145,000.00	6,625,000.00	150,000.00
Total Revenue Bonds and Certificates of Participation Payable	9,655,000.00		440,000.00	9,215,000.00	460,000.00
Capital Leases Payable	48,217.78		14,054.50	34,163.28	14,915.41
Compensated Absences	1,970,257.61	1,093,277.26	1,483,829.29	1,579,705.58	265,825.57
Total Long-Term Liabilities	\$ 11,673,475.39	\$ 1,093,277.26	\$ 1,937,883.79	\$ 10,828,868.86	\$ 740,740.98

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

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2010	Principal Outstanding June 30, 2010	See Table Below
Revenue Bonds Payable							
The University of North Carolina System Pool Revenue Bonds							
Fitness and Student Center Project	A	3.25%-5.25%	10/01/2018	\$ 2,650,000.00	\$ 1,165,000.00	\$ 1,485,000.00	(1)
Refunding 1998B and 2000 UNC System Pool Revenue Bonds	B	3.00%-4.25%	04/01/2019	1,900,000.00	795,000.00	1,105,000.00	
Total UNC System Pool Revenue Bonds				4,550,000.00	1,960,000.00	2,590,000.00	
Certificates of Participation							
Student Housing Project	C	3.50%-4.50%	06/01/2036	7,200,000.00	575,000.00	6,625,000.00	(2)
Total Revenue Bonds Payable and Certificates of Participation				\$ 11,750,000.00	\$ 2,535,000.00	\$ 9,215,000.00	

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

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

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

Fund reservations in the amount of \$433,325.00 required by the Series 2005 Certificates of Participation Indenture for the Student Housing Project were established and recorded in a Reserve Fund with the fiscal agent. At June 30, 2010, the balance in the Reserve Fund was \$485,842.37. In addition, the University contributes to a Maintenance and Equipment Reserve Fund also required by the indenture. At June 30, 2010, the balance in this reserve was \$148,411.93.

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year			Estimate of % of Revenues Pledged
			Revenues Net of Expenses	Principal	Interest	
(1)	Facility Debt Fee Revenues	\$ 1,815,234.38	\$ 267,252.60	\$ 130,000.00	\$ 73,243.76	75%
(2)	Housing Revenues	11,193,468.88	546,634.07	145,000.00	285,775.00	79%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Certificates of Participation	
	Principal	Interest	Principal	Interest
2011	\$ 310,000.00	\$ 109,728.13	\$ 150,000.00	\$ 280,700.00
2012	325,000.00	96,975.00	155,000.00	275,450.00
2013	335,000.00	82,887.50	160,000.00	270,025.00
2014	355,000.00	67,481.25	165,000.00	264,425.00
2015	230,000.00	51,700.00	170,000.00	258,443.76
2016-2020	1,035,000.00	99,337.50	970,000.00	1,185,418.80
2021-2025			1,180,000.00	973,625.04
2026-2030			1,455,000.00	697,906.28
2031-2035			1,810,000.00	344,025.00
2036			410,000.00	18,450.00
Total Requirements	<u>\$ 2,590,000.00</u>	<u>\$ 508,109.38</u>	<u>\$ 6,625,000.00</u>	<u>\$ 4,568,468.88</u>

NOTE 8 - LEASE OBLIGATIONS

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

Fiscal Year	Amount
2011	\$ 16,548.48
2012	19,515.50
Total Minimum Lease Payments	36,063.98
Amount Representing Interest (5.96% Rate of Interest)	1,900.70
Present Value of Future Lease Payments	<u>\$ 34,163.28</u>

Machinery and equipment acquired under capital lease amounted to \$83,787.00 at June 30, 2010. Depreciation on this asset at June 30, 2010 totaled \$21,877.72.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

<u>Fiscal Year</u>	<u>Amount</u>
2011	\$ 62,039.70
2012	31,667.76
2013	15,661.84
Total Minimum Lease Payments	<u>\$ 109,369.30</u>

Rental expense for all operating leases during the year was \$83,205.06.

NOTE 9 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Change in Allowance for Uncollectibles</u>	<u>Net Revenues</u>
Operating Revenues:					
Student Tuition and Fees	\$ 13,321,859.93	\$ 0.00	\$ 3,321,587.47	\$ 6,747.36	\$ 10,007,019.82
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 3,237,981.43	\$ 0.00	\$ 851,037.50	\$ 1,204.86	\$ 2,385,739.07
Dining	2,105,817.67		541,646.67	827.68	1,563,343.32
Health, Physical Education, and Recreation Services	117,688.94				117,688.94
Bookstore	273,344.74				273,344.74
Parking	56,958.25				56,958.25
Other	24,088.96			0.10	24,088.86
Sales and Services of Education and Related Activities:					
University Production Revenues	734,168.88			9.46	734,159.42
Other	456,581.31	28,403.10			428,178.21
Total Sales and Services	<u>\$ 7,006,630.18</u>	<u>\$ 28,403.10</u>	<u>\$ 1,392,684.17</u>	<u>\$ 2,042.10</u>	<u>\$ 5,583,500.81</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 12,697,524.79	\$ 1,665,822.18	\$ 751,005.22	\$ 0.00	\$ 0.00	\$ 0.00	\$ 15,114,352.19
Public Service	408,555.43	46,707.34	620,017.35				1,075,280.12
Academic Support	3,591,256.56	311,179.65	307,203.69				4,209,639.90
Student Services	919,458.74	20,562.61	184,024.09				1,124,045.44
Institutional Support	5,364,604.54	675,320.59	2,903,387.74		4,185.04		8,947,497.91
Operations and Maintenance of Plant	3,863,980.58	1,987,950.93	618,875.46		1,519,015.22		7,989,822.19
Student Financial Aid				1,239,386.17			1,239,386.17
Auxiliary Enterprises	2,847,199.61	600,601.54	2,261,721.13		378,381.61		6,087,903.89
Depreciation						2,761,411.98	2,761,411.98
Total Operating Expenses	<u>\$ 29,692,580.25</u>	<u>\$ 5,308,144.84</u>	<u>\$ 7,646,234.68</u>	<u>\$ 1,239,386.17</u>	<u>\$ 1,901,581.87</u>	<u>\$ 2,761,411.98</u>	<u>\$ 48,549,339.79</u>

NOTE 11 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 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 \$24,195,546.23, of which \$11,747,553.49 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$419,387.66 and \$704,853.21, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$419,387.66, \$415,060.57, and \$344,977.74, respectively.

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

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

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

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 \$24,195,546.23, of which \$9,531,915.60 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$651,983.03 and \$571,914.94, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$33,774.66 for the year ended June 30, 2010.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2010, were \$97,723.62. The voluntary contributions by employees amounted to \$152,357.00 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 \$122,578.18 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

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

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly.

For the current fiscal year the University contributed 4.5% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. The required contribution rate for the years ended June 30, 2009 and 2008 was 4.1% for both years. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2010, 2009, and 2008, which were \$957,576.11, \$891,525.96, and \$826,083.63, 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. The required contribution rate for the years ended June 30, 2009 and 2008 was 52% for both years. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2010, 2009, and 2008, which were \$110,653.24, \$113,071.59, and \$104,771.58, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 13 - RISK MANAGEMENT

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

Tort claims of up to \$1,000,000 are retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Other operations not supported by the State's General Fund are charged for the coverage. The University also purchased through the Fund extended coverage for fire, sprinkler leakage, business interruption, vandalism, theft, and "all risks" for buildings and contents. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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 \$443,361.83 and on other purchases were \$1,553,614.82 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.

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.

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

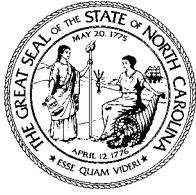
GASB Statement No. 51, requires reporting certain intangible assets as capital assets.

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

NOTE 16 - NET ASSET RESTATEMENT

As of July 1, 2009, net assets as previously reported were restated as follows:

	<u>Amount</u>
July 1, 2009 Net Assets as Previously Reported	\$ 104,314,450.16
Restatement: Correct Errors in Establishing Useful Lives of Capital Assets	<u>1,512,474.73</u>
July 1, 2009 Net Assets as Restated	<u><u>\$ 105,826,924.89</u></u>



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

We have audited the financial statements of the University of North Carolina School of the Arts, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2010, which collectively comprise the University's basic financial statements and have issued our report thereon dated April 18, 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 the NCSA Housing Corporation and the discretely presented component unit, the University of North Carolina School of the Arts Foundation, Inc., as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

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

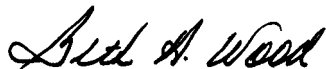
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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



Beth A. Wood, CPA
State Auditor

April 18, 2011

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