



STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2011

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2011

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THE UNIVERSITY OF NORTH CAROLINA

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Beth A. Wood, CPA
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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of The University of North Carolina at Chapel Hill for the year ended June 30, 2011, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

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

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2011, 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 UNC Investment Fund, LLC, which represent 41 percent, 45 percent, and 7 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units as of June 30, 2011, 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.

As discussed in Note 19 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 59, *Financial Instruments Omnibus*, during the year ended June 30, 2011.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 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

November 2, 2011

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

Introduction

Management's Discussion and Analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year that ended June 30, 2011, with comparative information for the fiscal year ended June 30, 2010. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying notes to the financial statements.

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

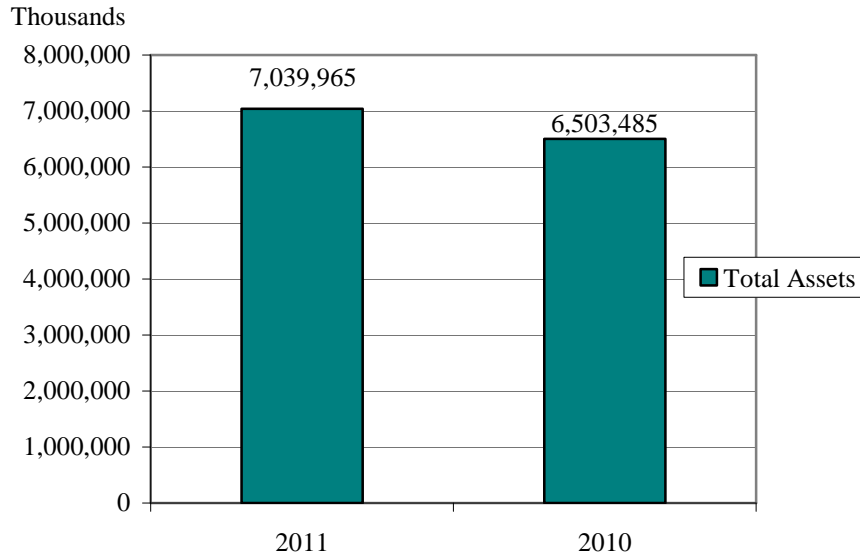
Financial Highlights

The University's financial position at June 30, 2011 improved over the prior year but continued to be impacted by State and national economic conditions. Operating revenues recorded increases, although state appropriations and aid declined from the prior year. The financial markets recorded very strong returns for fiscal year 2010-2011, which helped the University's financial condition. The University implemented appropriate and necessary spending reductions and other measures to address shortfalls in resources. The University's proactive decisions helped mitigate the impacts of the financial shortfalls.

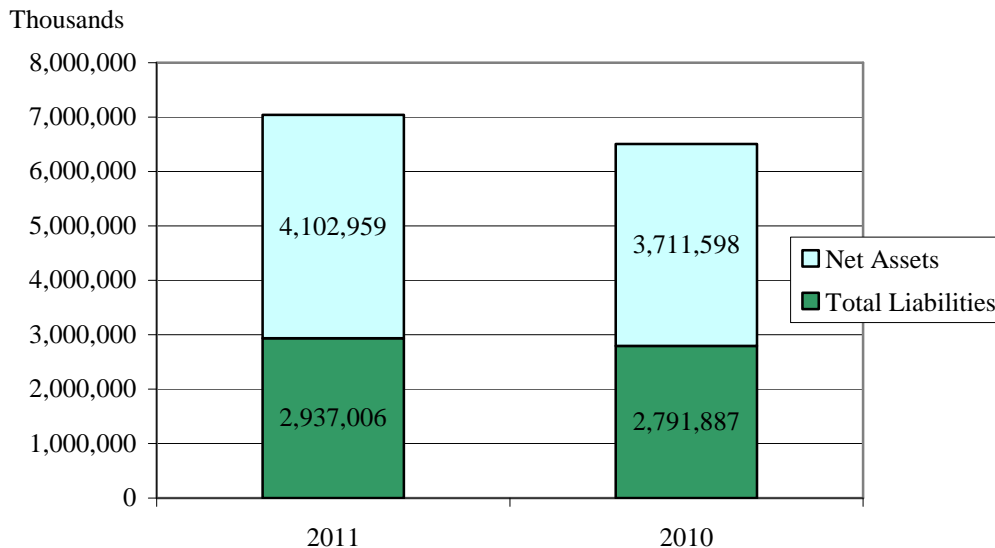
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University's total assets were \$7 billion at June 30, 2011. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were \$4.1 billion at June 30, 2011. The University's net assets increased by \$391.4 million in fiscal year 2010-2011 as a result of operating, nonoperating, and other changes in net assets. A comparison of the total assets, liabilities, and net assets at June 30, 2011 and June 30, 2010, and a comparison of the major components of the changes in net assets for the two fiscal years are presented below:

STATEMENT OF NET ASSETS

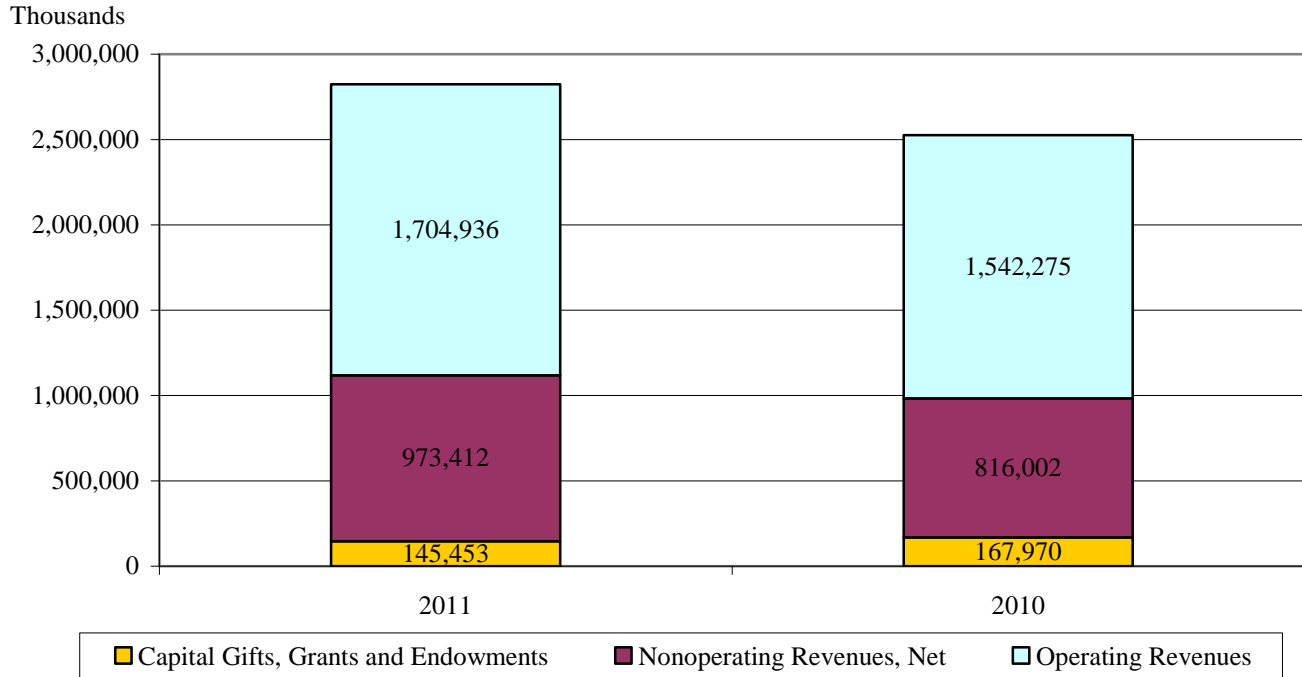


STATEMENT OF NET ASSETS

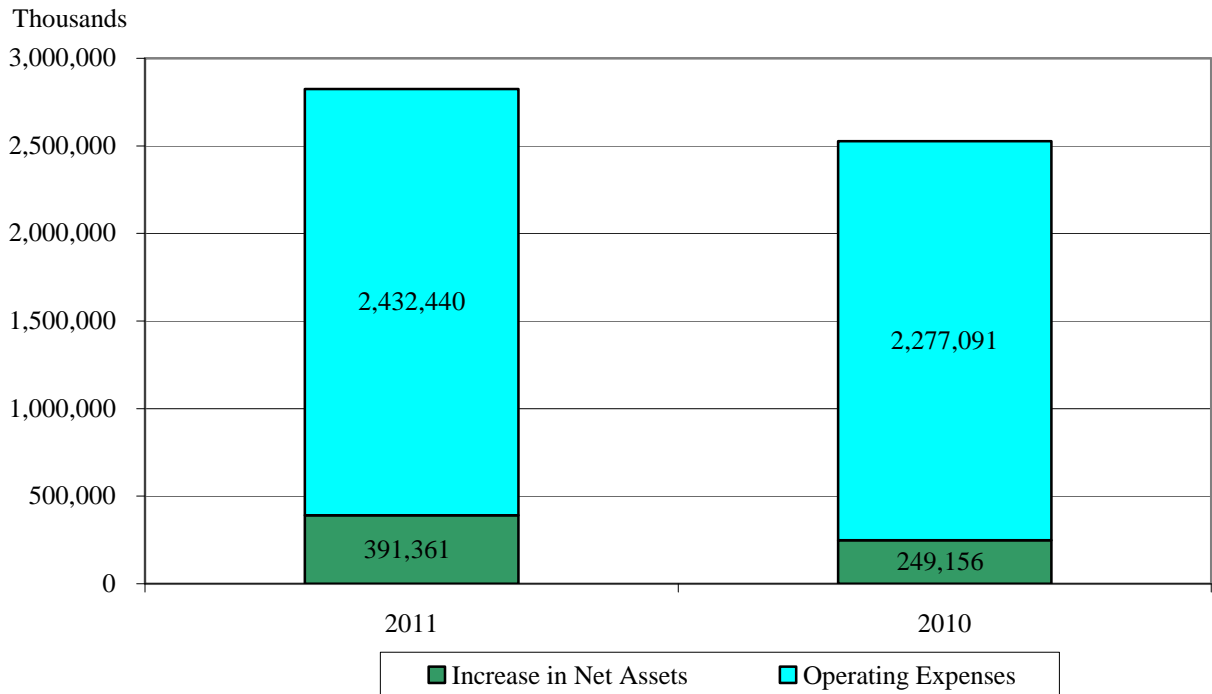


MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS



STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net assets increased 10.5% at June 30, 2011 over the prior year. Total assets increased 8.2% from the prior year and total liabilities rose 5.2% for the same period. Operating revenues increased at a greater rate than operating expenses in fiscal year 2010-2011 over the prior year, 10.5% and 6.8%, respectively. Net nonoperating revenues and expenses increased 19.3% in fiscal year 2010-2011 over the prior year, due primarily to the substantial increase in investment income from \$103.6 million in fiscal year 2009-2010 to \$208.2 million in 2010-2011. As a major research university, funding from contracts and grants remained a major revenue source. Fund raising for operational and capital needs, state appropriations, and tuition and fees continued to provide important resources for the University.

Using the Financial Statements

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

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

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

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

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and noncurrent components. Net assets represent the difference between total assets and total liabilities and are one indicator of the University's current financial condition. The following table summarizes the University's assets, liabilities, and net assets on June 30, 2011 and June 30, 2010.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	2011	2010	Percent Change
Assets:			
Current Assets	\$ 1,400,132	\$ 1,253,869	11.7
Noncurrent Assets:			
Endowment, Restricted and Other Investments	2,552,449	2,268,098	12.5
Capital Assets, Net	2,931,679	2,782,886	5.3
Other Noncurrent Assets	<u>155,705</u>	<u>198,632</u>	(21.6)
Total Assets	<u>7,039,965</u>	<u>6,503,485</u>	8.2
Liabilities:			
Current Liabilities	404,803	338,285	19.7
Noncurrent Liabilities:			
Funds Held in Trust for Pool Participants	1,179,704	1,071,561	10.1
Long-Term Liabilities	1,305,982	1,330,159	(1.8)
Other Noncurrent Liabilities	<u>46,517</u>	<u>51,882</u>	(10.3)
Total Liabilities	<u>2,937,006</u>	<u>2,791,887</u>	5.2
Net Assets:			
Invested in Capital Assets, Net of Related Debt	1,587,446	1,420,104	11.8
Restricted	1,664,259	1,513,055	10.0
Unrestricted	<u>851,254</u>	<u>778,439</u>	9.4
Total Net Assets	<u>\$ 4,102,959</u>	<u>\$ 3,711,598</u>	10.5

Current Assets and Liabilities

The Statement of Net Assets shows that working capital, which is current assets less current liabilities, was \$995.3 million at June 30, 2011, an increase of 8.7%, or \$79.7 million, over the previous year. The working capital increase results from many factors. The largest changes were increases in restricted cash and cash equivalents and in net receivables for \$47.5 and \$37 million, respectively. The Statement of Net Assets details the current asset and current liability categories.

Endowment, Restricted and Other Investments

Endowment investments increased 15.5% during 2010-2011 and were \$1.37 billion at June 30, 2011 and \$1.19 billion at June 30, 2010, and include permanent endowments, funds internally designated as endowments and similar funds such as gift annuities and charitable trusts.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

Most of the University's endowment investments are currently managed within the UNC Investment Fund, a pooled investment fund vehicle. The UNC Investment Fund is designed to provide long-term, stable rates of return on the invested assets through the use of a diversified portfolio strategy. The investment objective is to earn an average real total return of at least 5.5% per year, net of all fees, over rolling five- and ten-year periods. The earnings distribution policy is to provide a stable source of spending support that is sustainable over the long term while preserving the purchasing power of the endowment investments. The earnings distribution rate was established at 5% of the previous year's market value, with annual increases based on inflationary factors. Each year's distribution is subject to a 4% floor and a 7% cap based on estimated fiscal year-end market value.

Restricted investments of \$1.15 billion at June 30, 2011 include funds of affiliated entities that are neither part of the University's reporting entity nor reported discretely but invested through the UNC Investment Fund. Other investments include bond reserves and related funds of \$25.4 million.

As reported by UNC Management Company, Inc. (the Management Company), the manager of the UNC Investment Fund, the investment return on the endowment assets invested in the UNC Investment Fund for fiscal year 2010-2011 was 15.3%. The respective returns for fiscal years 2009-2010 and 2008-2009 were 6.8% and (19.6%). The 15.3% return in fiscal year 2010-2011 trailed the 20.2% Strategic Investment Policy Portfolio (SIPP) benchmark by 4.9 percentage points. The SIPP is a blended portfolio benchmark that represents a weighted average of the appropriate market benchmarks for the UNC Investment Fund's strategic asset classes. The 70/30 "traditional" domestic benchmark is comprised of 70% invested in the S&P 500 equity index and 30% in the Barclay's Capital US Aggregate Index, and the UNC Investment Fund lagged the 70/30 index return by 7.0 percentage points in fiscal year 2010-2011.

The investment performance resulted in the UNC Investment Fund earning a three-year annualized return of (0.4%) at June 30, 2011. This three-year return measure compares with the corresponding annualized SIPP return of 3.4% for the period. For the five years ended June 30, 2011, the UNC Investment Fund earned a 5.7% annualized return compared to the 5.9% for the SIPP benchmark and outperformed the 4.4% return on the traditional 70/30 stock/bond index for the corresponding period.

A policy for the University Statutory Endowment was approved during fiscal year 2008-2009 to address the provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), which was adopted by the State of North Carolina in March 2009. Consistent with the procedures for implementing UPMIFA, the recommended distribution of earnings excluded any invasion of principal. Therefore, the distribution for fiscal year 2010-2011 was reduced by a total of \$1.5 million, or 2.8%, from the calculated distribution of earnings. This was an improvement over fiscal year 2009-2010, for which the annual earnings distribution from the University Statutory Endowment was reduced by \$4.3 million, 8.5%, from the calculated earnings distribution to avoid any principal invasion.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

Capital Assets and Debt Management

Even with the completion of the Higher Education Bond program, the University continues an active construction program. In fiscal year 2010-2011, notable projects completed include the hangar at RDU International Airport for Med Air Operations, the renovation of Bynum Hall Basement for the Office of University Counsel, and additions to the Smith Center and Fetzer Gymnasium for the Athletics Department.

Construction on three significant projects is still underway. Construction on the \$104 million Dental Sciences Building began in 2008 and will be completed in January 2012. This 216,000 square foot building will provide teaching and research facilities to support enrollment growth in the School of Dentistry. Also scheduled for completion in early 2012 is the Genome Sciences Building. This research and teaching building includes a 400 seat and 250 seat auditoria, classrooms and wet and dry lab research facilities. The \$245 million Biomedical Research Imaging Building which began construction in 2009 will house research labs and a consortium to support and advance the science of biomedical imaging.

Building from the successes of the 2001 Campus Master Plan, the University completed a master plan for Carolina North approved by the University's Board of Trustees in 2007. The Carolina North Master Plan envisions a campus that is a model of sustainability to support the University's mission of teaching, research, service, outreach, and economic development. The University and Town of Chapel Hill signed a 20 year Development Agreement in 2009 that entitles the University to construct 3,000,000 square feet of development. Design is currently underway on the infrastructure to support the first research building, funded by the University, to house units currently in lease space.

A summary of changes in capital assets is disclosed in Note 5. Capital assets, net of accumulated depreciation and amortization, at June 30, 2011 and June 30, 2010, were as follows:

Capital Assets (dollars in thousand)

	2011	2010	Percent Change
Capital Assets:			
Construction in Progress	\$ 316,011	\$ 346,226	(8.7)
Land and Other Nondepreciable Assets	156,431	194,064	(19.4)
Buildings	1,645,672	1,605,894	2.5
General Infrastructure	582,516	470,698	23.8
Machinery, Equipment, and Computer Software	231,049	166,004	39.2
Total	\$ 2,931,679	\$ 2,782,886	5.3

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Computer software in development is categorized as a nondepreciable asset. Once the system is implemented, it is then categorized as computer software, a depreciable asset. The 19.4% decrease in land and other nondepreciable assets category and the 39.2% increase in the machinery, equipment, and computer software category were due primarily to a transfer of \$44.1 million of computer software in development to computer software.

The University continues to use its commercial paper program to provide low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was \$73.7 million at June 30, 2011 and \$59.8 million at June 30, 2010. The Board of Governors of the University of North Carolina System intends on issuing General Revenue Bonds later in fiscal year 2011-2012 for the University. The anticipated amount is between \$150 million and \$175 million, and the bonds will refund approximately \$83 million of commercial paper that is included in the total issue estimate.

A University component unit is seeking to refinance \$36.5 million of a total outstanding debt of \$45.75 million during fiscal year 2011-2012. The debt refinancing is expected to be closed by the end of December 2011. The remaining balance of \$9.25 million after the closing will mature on July 1, 2012. The component unit is negotiating for an extension of the loan by two to three year terms from the current date of maturity.

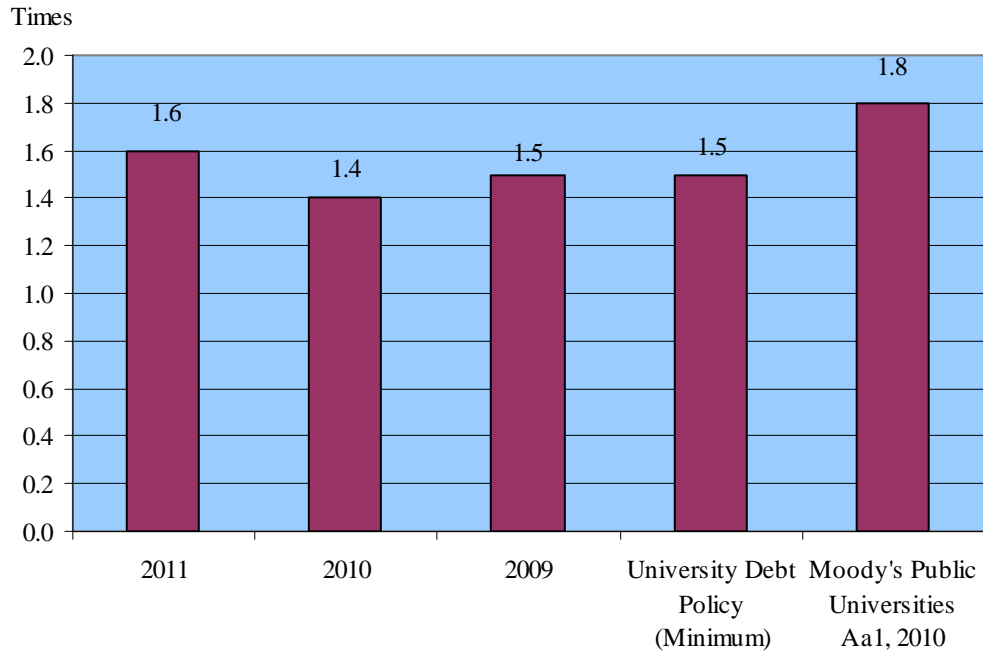
The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The interest rate on the commercial paper program for fiscal year 2010-2011 was 0.25% and for 2009-2010 was 0.32%. Interest rates on the University's variable rate, long-term bonds were 0.20% for fiscal year 2010-2011 and 0.19% for fiscal year 2009-2010. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements. These rates reflect direct interest rates and do not reflect any impact from the interest rate swaps as referenced in Note 9.

The University's debt policy uses two key ratios to measure debt capacity, financial health, and credit quality. The *expendable resources to debt ratio* measures unrestricted, expendable restricted, and temporarily restricted net assets to funded debt and serves as a relative indicator of financial health or cushion. The *debt service to operations ratio* provides an indicator of the University's ability to repay annual principal and interest relative to its overall operating expenses. Each ratio is compared to the University's debt policy standard and the appropriate peer group comparison for fiscal year 2009-2010 (the latest available numbers). At June 30, 2011, the *expendable resources to debt ratio* was 1.6 times, and the *debt service to operations ratio* was 3.4%.

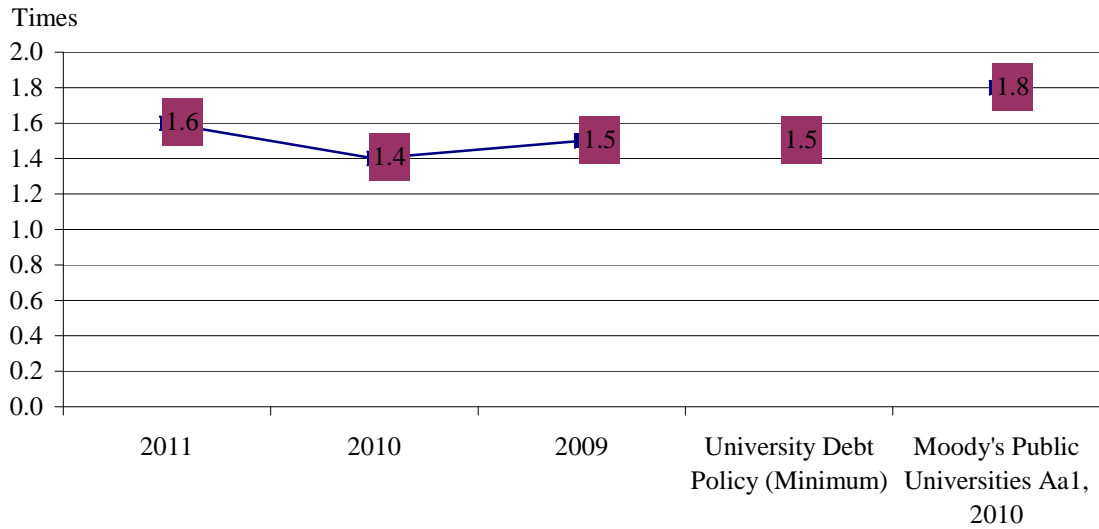
During fiscal year 2010-2011, Fitch Ratings upgraded its long-term rating of the University's long-term bond indebtedness to AAA from AA+. The University continues to maintain its long-term bond ratings of Aaa/AA+ from Moody's Investor Services and Standard & Poor's, respectively.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

EXPENDABLE RESOURCES TO DEBT

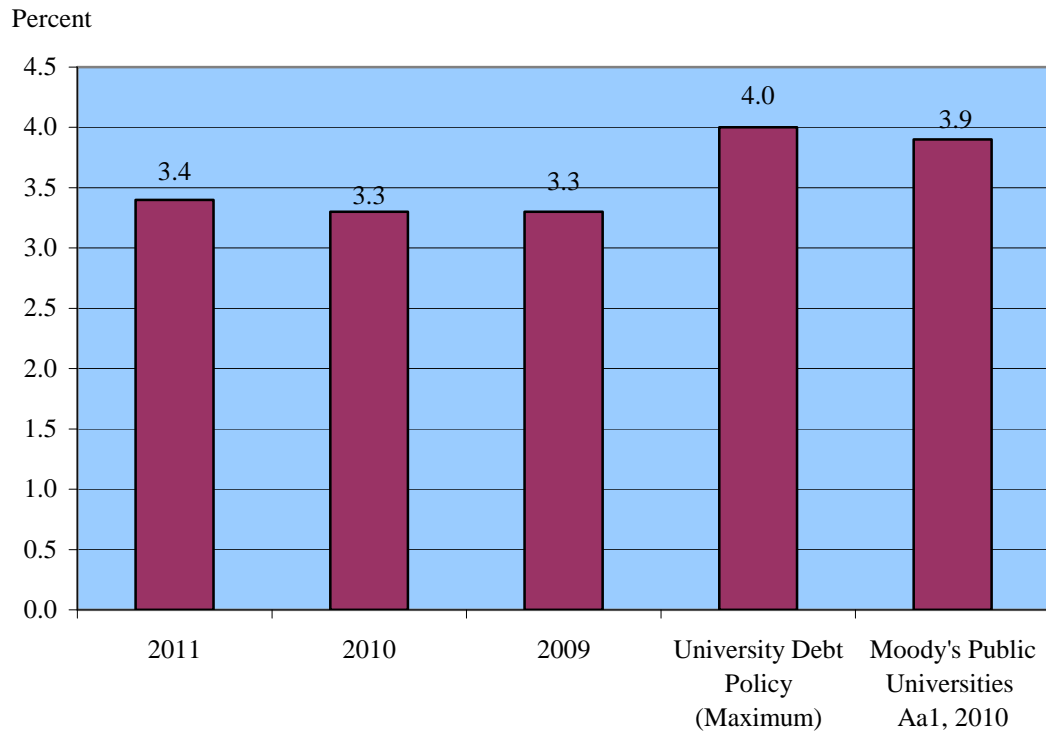


EXPENDABLE RESOURCES TO DEBT

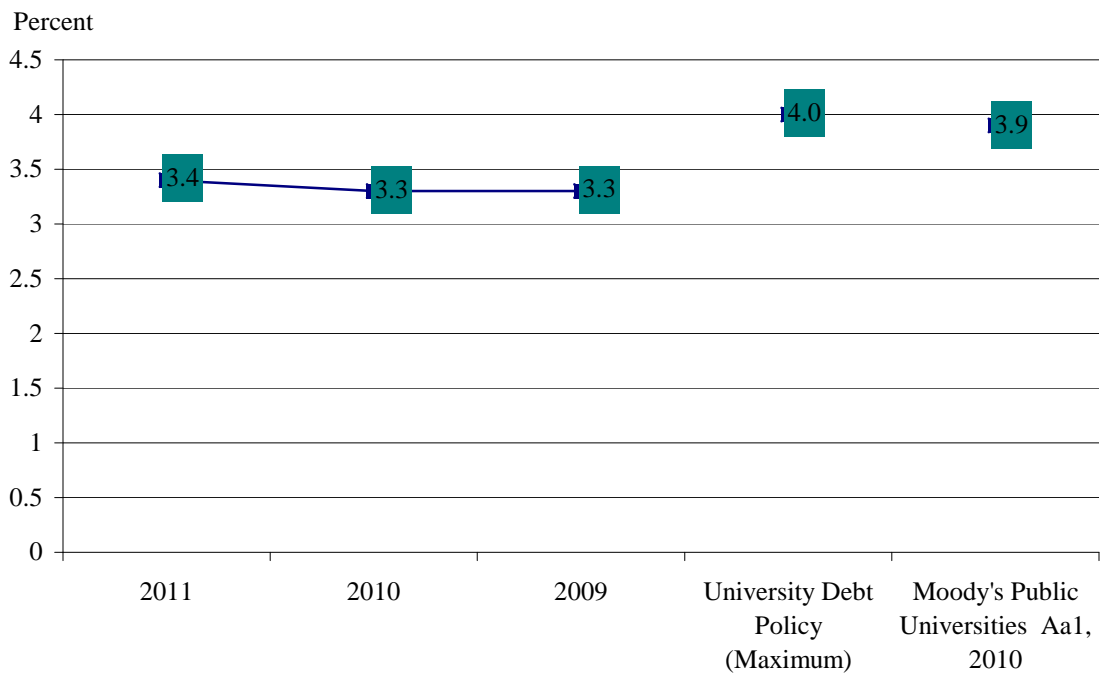


MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

DEBT SERVICES TO OPERATIONS



DEBT SERVICES TO OPERATIONS



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

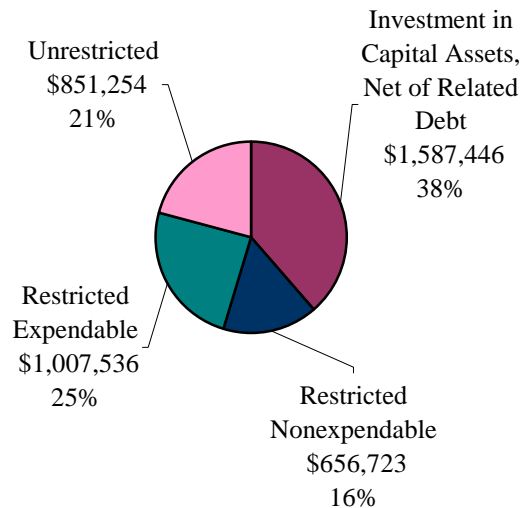
Other Noncurrent Assets and Liabilities

Other noncurrent assets were \$155.7 million at June 30, 2011 and \$198.6 million at June 30, 2010, a 21.6% decrease. Noncurrent liabilities were \$2.5 billion at June 30, 2011 and 2010, and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of \$1.2 billion and \$1.1 billion, respectively. These entities are not part of the University's financial reporting entity and are not discretely presented, but the entities do invest through the UNC Investment Fund. The increase in funds held in trust of 10.1% over the prior year resulted from additional participant contributions, new participants in the UNC Investment Fund, and net investment gains.

Net Assets

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were \$4.1 billion at June 30, 2011, an increase of \$391.4 million over the prior year. Net assets invested in capital assets, net of related debt, represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included. Nonexpendable restricted net assets include endowment and similar assets whose use is limited by donors or other outside sources and as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net assets include resources in which the University is legally obligated to spend the resources in accordance with restrictions provided by external parties. Unrestricted net assets are not subject to externally imposed stipulations; however, most of these resources have been designated for particular academic, research, or other programs, as well as capital projects.

2011 NET ASSETS: \$4,102,959 (IN THOUSANDS)



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2011 and the prior year are summarized as follows:

University Operations (dollars in thousands)

	2011	2010	Percent Change
Operating Revenues:			
Student Tuition and Fees, Net	\$ 289,897	\$ 249,083	16.4
Grants and Contracts	755,620	688,721	9.7
Sales and Services, Net	653,741	597,196	9.5
Other	5,678	7,275	(22.0)
Total Operating Revenues	1,704,936	1,542,275	10.5
Operating Expenses	2,432,440	2,277,091	6.8
Operating Loss	(727,504)	(734,816)	(1.0)
Nonoperating Revenues (Expenses):			
State Appropriations and State Aid	534,678	541,753	(1.3)
Noncapital Gifts and Grants	287,712	247,994	16.0
Investment Income	208,184	103,605	100.9
Interest and Fees on Debt	(56,765)	(64,261)	(11.7)
Federal Interest Subsidy on Debt	2,273	1,130	101.2
Other Net Nonoperating Expenses	(2,670)	(14,219)	(81.2)
Income Before Other Changes	245,908	81,186	202.9
Refund of Prior Years Capital Appropriations	(81)	(444)	(81.8)
Capital Grants	91,864	86,117	6.7
Capital Gifts	9,149	50,688	(82.0)
Additions to Permanent Endowments	44,521	31,609	40.8
Increase in Net Assets	391,361	249,156	57.1
Net Assets – July 1	3,711,598	3,462,442	7.2
Net Assets – June 30	\$ 4,102,959	\$ 3,711,598	10.5

Fiscal year 2010-2011 revenues and other changes total \$2,883,317 and expenses total \$2,163,317. Fiscal year 2009-2010 revenues and other changes total \$2,605,171 and expenses total \$2,338,171.

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was \$72.7 million for fiscal year 2010-2011 and \$68.7 million for the prior year. Net revenues from student tuition and fees increased 16.4% over the prior year. Tuition rates increased for fiscal year 2010-11 by 24.6% for undergraduate residents, 7.7% for undergraduate nonresidents, 17.6% for graduate residents, and 6.5% for graduate nonresidents.

Revenues from noncapital grants and contracts increased 10.4% over the prior year when operating and nonoperating sources are combined. Discussion of grants and contracts in terms of awards provides another useful perspective. The University is among the nation's

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

leading public research universities, with a diversified portfolio of research that attracted \$788 million in sponsored program funding during fiscal year 2010-2011. The fiscal year 2009-2010 of \$803 million was the largest amount in campus history. If excluding federal stimulus funding from 2009-2010, the 2010-2011 sponsored program funding amount was higher than the prior year. The contracts and grants come primarily from the federal government, especially the National Institutes of Health (NIH) and the National Science Foundation. The NIH is traditionally the University's largest source of research funding. The high quality of faculty research resulted in continued success in attracting outside contract and grant support.

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

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

Operating Expenses

The University's operating expenses were \$2.4 billion for the fiscal year ended June 30, 2011, an increase of 6.8% over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in Note 12. The following table illustrates the University's operating expenses by functional classification and by natural classification.

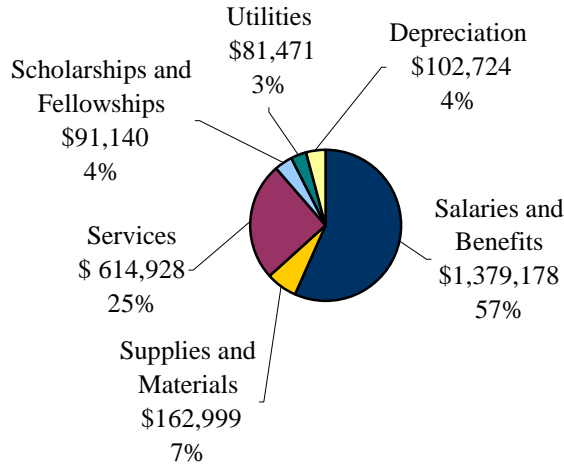
Operating Expenses by Nature (dollars in thousands)			
	2011	2010	Percent Change
Salaries and Benefits	\$ 1,379,178	\$ 1,340,749	2.9
Supplies and Materials	162,999	156,404	4.2
Services	614,928	538,784	14.1
Scholarships and Fellowships	91,140	69,083	31.9
Utilities	81,471	81,210	0.3
Depreciation and Amortization	102,724	90,861	13.1
Total Operating Expenses	\$ 2,432,440	\$ 2,277,091	6.8

Operating Expenses by Function (dollars in thousands)			
	2011	2010	Percent Change
Instruction	\$ 698,770	\$ 684,836	2.0
Research	468,685	431,317	8.7
Public Service	137,279	138,044	(0.6)
Academic Support	105,883	107,806	(1.8)
Student Services	28,320	26,961	5.0
Institutional Support	91,558	83,962	9.0
Operations and Maintenance of Plant	145,270	136,008	6.8
Student Financial Aid	91,140	69,083	31.9
Auxiliary Enterprises	562,811	508,213	10.7
Depreciation and Amortization	102,724	90,861	13.1
Total Operating Expenses	\$ 2,432,440	\$ 2,277,091	6.8

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

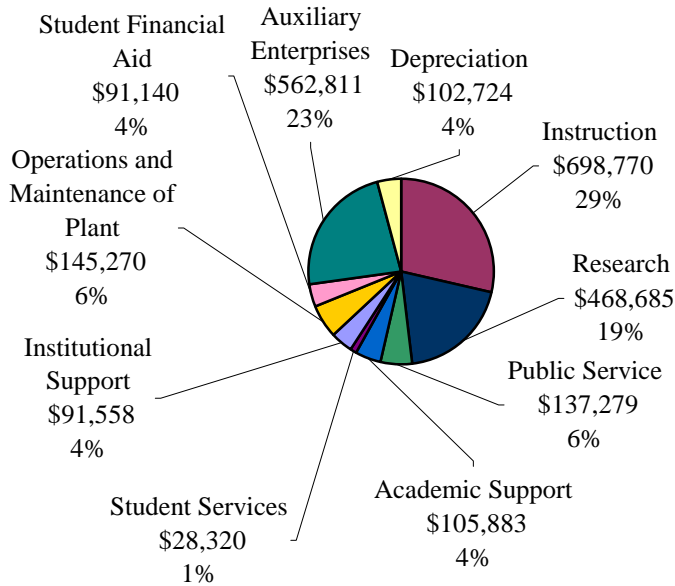
The following graph illustrates the University's operating expenses by the natural classification.

**2011 OPERATING EXPENSES BY NATURE: \$2,432,440
(IN THOUSANDS)**



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

**2011 OPERATING EXPENSES BY FUNCTION: \$2,432,440
(IN THOUSANDS)**



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating expense categories changed at varying rates, although the overall rate of increase was 6.8%. Depreciation increased 13.1% as capital construction projects are completed and placed into service. Student financial aid awards increased 31.9%. Student financial aid awards are made on an annual basis and are determined primarily from income data of the prior year. Awards made for 2010-2011 were based on 2009 personal incomes. Decreased personal incomes in 2009 caused an influx of financial aid applications and an increased level of need for those students. Fiscal year 2010-2011 was the first year awards were significantly impacted by the economic downturn, causing a dramatic increase in student financial aid awards. Various sources funded the additional financial aid, including revenues from the tuition increases which had accompanying set asides for need-based student financial aid. Research expenses increased 8.7% in keeping with the growth in sponsored awards.

Nonoperating Revenues and Expenses

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

State appropriations received, when including state aid of \$14.5 million, totaled \$534.7 million for fiscal year 2010-2011, a decrease of 1.3% from the state appropriations and state aid of \$541.8 million received during the prior year. The University's initial budget for state appropriations for fiscal year 2010-2011 was \$571.9 million, and increases in the budget for state appropriations totaled \$17.4 million to fund student enrollment growth, operating costs for new buildings, tuition waivers, and other operating costs. Subsequent reductions in budgeted state appropriations for fiscal year 2010-2011 totaled \$54.6 million for state budget reductions including restrictions on the cash allotted to the University by the State of North Carolina and loss of funds unspent at year-end. The reduced state appropriations required a significant decrease in spending. The University endeavored to protect the academic core and instructional programs and continued its review of campus operations to identify additional efficiencies to generate savings.

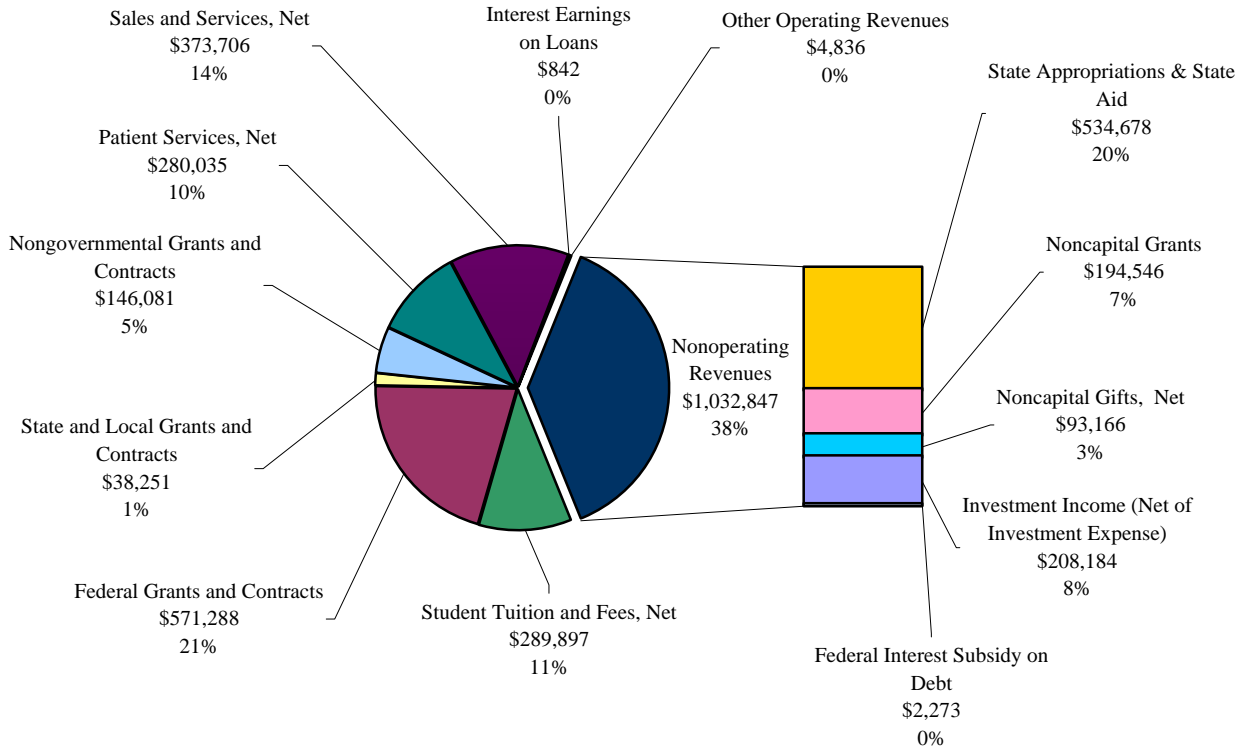
Noncapital gifts and grants increased 16.0% to \$287.7 million and include expendable gifts and federal awards that are not considered to be operating revenues. Net investment income from fiscal year 2010-2011 of \$208.2 million, represents a 100.9% increase from 2009-2010, and includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For additional discussion, the reader may refer to the Endowment and Other Investments section of Management's Discussion and Analysis.

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as state appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and nonoperating revenues, which total \$2.7 billion for fiscal year 2010-2011.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

2011 TOTAL REVENUES BY SOURCE; \$2,737,783



Other Changes in Net Assets

Capital grants of \$91.9 million for fiscal year 2010-2011 and \$86.1 million for fiscal year 2009-2010 are for capital construction projects. Capital gifts of \$9.1 million for fiscal year 2010-2011 and \$50.7 million for the prior year resulted from fund-raising efforts and also provided funding for construction projects. Nonexpendable gifts and funds from the state's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of \$44.5 million during fiscal year 2010-2011 and \$31.6 million during fiscal year 2009-2010.

Economic Outlook

The national and state economic conditions will impact University resources for fiscal year 2011-2012. The University's fiscal state improved during fiscal year 2010-2011 when compared to the prior year, and its overall financial condition remained stable. The University will continue to maintain and generate sufficient resources to successfully fulfill its teaching, research, and service missions. Decisions to curtail or eliminate administrative expenses have protected the academic core from significant resource limitations, although the fiscal year 2011-2012 reductions in state appropriations will cause losses in instruction due to the cumulative impact of repeated reductions in state funding. Despite the state's economic hardships, the University is committed to providing a high quality education to our students and maintaining our national prominence as a top-tier public research-intensive university.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University maintains low tuition levels in relative terms that provide important resources. Support from the state was impacted due to economic conditions. Growth in sponsored awards is a proven and reliable source in support of the University's research mission. Philanthropic efforts continue to demonstrate success in a challenging environment. Invested funds provide an important distribution of earnings and continued to rebound from previous declines in the global financial markets. The University's strong debt credit ratings of Aaa, AAA, and AA+ allow it to obtain competitive financing for capital construction.

Tuition rates increased for fiscal year 2011-2012 by 6.5% for undergraduate residents, undergraduate nonresidents, graduate residents, and also for graduate nonresidents. The University's academic standing allows it to continuously attract top students.

The state appropriations budget for fiscal year 2011-2012 is reflective of the state's economic challenges and includes \$100.7 million in budget reductions. The 2011-2012 budgeted state appropriated funds include commitments of \$15.8 million for growth in student enrollment and operating costs for new buildings. In total, the 2011-2012 state appropriations budget is \$478 million and is substantially less than the actual state appropriations and state aid of \$534.7 in fiscal year 2010-2011.

External awarded funding from contracts and grants was \$788 million during fiscal year 2010-2011, the second largest amount in campus history. The largest level of contracts and grants funding was the \$803 million in fiscal year 2009-2010, of which \$126 million came from the American Recovery and Reinvestment Act (ARRA), also known as the stimulus bill.

Fund-raising has been a cornerstone resource for the University, and in a down economy becomes even more vital. The University's fund-raising efforts brought in \$277 million in gifts in fiscal year 2010-2011, the second highest total for a fiscal year. The University secured \$305.6 million in commitments, which includes pledges as well as gifts, for the fiscal year. The commitments total was up from the prior fiscal year total of \$292 million.

The University's investment management operation is separately organized as the UNC Management Company, Inc. (UNCMC), the nonprofit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated nonprofit foundations as appropriate. As of June 30, 2011, the UNCMC managed invested assets of \$2.9 billion.

The University will continue to provide excellent teaching, research, and public service endeavors for students, citizens, and other constituents. Management has taken action to restructure and reduce the operating budget while protecting the academic foundation as much as possible. Carolina Counts is a program initiated by the Chancellor to carry out key recommendations from a significant review of the campus operating structure and to address ways to make the University more efficient.

The mission of the Carolina Counts initiative is to make The University of North Carolina at Chapel Hill the most collaborative, well-managed university in the country. The objectives of the initiative are to streamline campus operations and provide more funding for academics

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

and University's core missions; to implement simpler, more responsive systems and processes that enable informed decision-making while complying with policies and laws; and to reduce bureaucracy and create a more satisfying work environment for faculty and staff.

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

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2011

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 381,042,368
Restricted Cash and Cash Equivalents	447,227,467
Short-Term Investments	223,274,352
Restricted Short-Term Investments	107,826,046
Receivables, Net (Note 4)	201,839,669
Due from State of North Carolina Component Units	17,750,005
Inventories	20,820,840
Notes Receivable, Net (Note 4)	111,078
Other Assets	239,994
	<hr/>
Total Current Assets	1,400,131,819

Noncurrent Assets:

Restricted Cash and Cash Equivalents	59,430,837
Receivables, Net (Note 4)	31,766,870
Restricted Due from Primary Government	2,095,435
Endowment Investments	1,373,642,498
Restricted Investments	1,153,371,434
Other Investments	25,434,631
Deferred Outflow of Resources	15,532,144
Notes Receivable, Net (Note 4)	38,561,098
Investment in Joint Venture (Note 18)	8,318,917
Capital Assets - Nondepreciable (Note 5)	472,442,249
Capital Assets - Depreciable, Net (Note 5)	2,459,236,452
	<hr/>
Total Noncurrent Assets	5,639,832,565

Total Assets	<hr/> 7,039,964,384 <hr/>
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	147,538,736
Due to Primary Government	9,553,256
Due to State of North Carolina Component Units	6,778,159
Deposits Payable	1,929,420
Funds Held for Others	418,561
Unearned Revenue	52,532,558
Interest Payable	9,584,072
Short-Term Debt (Note 7)	73,650,000
Long-Term Liabilities - Current Portion (Note 8)	102,817,910
	<hr/>
Total Current Liabilities	404,802,672

Noncurrent Liabilities:

U. S. Government Grants Refundable	30,985,525
Funds Held in Trust for Pool Participants	1,179,703,848
Hedging Derivative Liability (Note 9)	15,532,144
Long-Term Liabilities (Note 8)	1,305,981,663
	<hr/>
Total Noncurrent Liabilities	2,532,203,180

Total Liabilities	<hr/> 2,937,005,852 <hr/>
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The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2011

Exhibit A-1
Page 2 of 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	1,587,445,408
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	134,643,074
Research	18,215,151
Library Acquisitions	29,098,098
Endowed Professorships	309,823,658
Departmental Uses	116,864,685
Loans	18,085,328
Other	29,993,087
Expendable:	
Scholarships and Fellowships	189,088,288
Research	18,936,450
Library Acquisitions	49,468,662
Endowed Professorships	320,887,737
Departmental Uses	343,482,118
Instruction and Educational Agreements	14,742,477
Plant Improvements	19,120,456
Capital Projects	42,957,442
Debt Service	8,852,500
Unrestricted	851,253,913
Total Net Assets	<u>\$ 4,102,958,532</u>

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

***The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2011***

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 11)	\$ 289,896,547
Patient Services, Net (Note 11)	280,034,935
Federal Grants and Contracts	571,287,523
State and Local Grants and Contracts	38,251,452
Nongovernmental Grants and Contracts	146,081,345
Sales and Services, Net (Note 11)	373,705,560
Interest Earnings on Loans	842,582
Other Operating Revenues	4,835,763
	<hr/>
Total Operating Revenues	1,704,935,707
	<hr/>

EXPENSES

Operating Expenses:

Salaries and Benefits	1,379,177,952
Supplies and Materials	162,998,866
Services	614,928,151
Scholarships and Fellowships	91,139,491
Utilities	81,471,033
Depreciation/Amortization	102,724,282
	<hr/>
Total Operating Expenses	2,432,439,775
	<hr/>
Operating Loss	(727,504,068)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	520,198,494
State Aid - Federal Recovery Funds	14,479,411
Noncapital Grants - Student Financial Aid	18,945,583
Other Noncapital Grants	175,600,458
Noncapital Gifts, Net (Note 11)	93,166,398
Investment Income (Net of Investment Expense of \$4,317,745)	208,184,198
Interest and Fees on Debt	(56,764,609)
Federal Interest Subsidy on Debt	2,272,964
Other Nonoperating Expenses	(2,670,423)
	<hr/>
Net Nonoperating Revenues	973,412,474
	<hr/>
Income Before Other Revenues, Expenses, Gains, or Losses	245,908,406
Refund of Prior Years Capital Appropriations	(81,256)
Capital Grants	91,864,121
Capital Gifts	9,149,274
Additions to Endowments	44,520,293
	<hr/>
Increase in Net Assets	391,360,838

NET ASSETS

Net Assets - July 1, 2010	<hr/> 3,711,597,694
Net Assets - June 30, 2011	<hr/> <hr/> \$ 4,102,958,532

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

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2011

Exhibit A-3

Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 1,694,480,846
Payments to Employees and Fringe Benefits	(1,362,150,952)
Payments to Vendors and Suppliers	(820,616,277)
Payments for Scholarships and Fellowships	(91,139,491)
Loans Issued	(5,813,188)
Collection of Loans	5,817,894
Interest Earned on Loans	753,438
Other Payments	(19,443,099)
	<hr/>
Net Cash Used by Operating Activities	(598,110,829)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	520,198,494
State Aid - Federal Recover Funds	14,479,411
Noncapital Grants - Student Financial Aid	18,926,841
Other Noncapital Grants	172,162,494
Noncapital Gifts	89,525,767
Additions to Endowments	44,520,293
William D. Ford Direct Lending Receipts	140,781,241
William D. Ford Direct Lending Disbursements	(143,097,845)
Related Activity Agency Receipts	238,037,223
Related Activity Agency Disbursements	(223,748,793)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	871,785,126

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	30,000,000
Refund of Prior Years Capital Appropriations	(81,256)
Capital Grants	92,241,684
Capital Gifts	806,064
Acquisition and Construction of Capital Assets	(262,312,125)
Principal Paid on Capital Debt and Leases	(37,264,352)
Interest and Fees Paid on Capital Debt and Leases	(55,698,993)
Federal Interest Subsidy on Debt Received	2,272,964
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(230,036,014)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	2,345,320,795
Investment Income	76,531,307
Purchase of Investments and Related Fees	(2,444,615,721)
	<hr/>
Net Cash Used by Investing Activities	(22,763,619)
	<hr/>
Net Increase in Cash and Cash Equivalents	20,874,664
Cash and Cash Equivalents - July 1, 2010	866,826,008
	<hr/>
Cash and Cash Equivalents - June 30, 2011	\$ 887,700,672

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2011

Exhibit A-3
Page 2 of 2

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

Operating Loss	\$ (727,504,068)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation/Amortization Expense	102,724,282
Allowances and Write-Offs	19,607,849
Changes in Assets and Liabilities:	
Receivables (Net)	(36,741,997)
Inventories	(68,104)
Notes Receivable (Net)	7,534
Other Assets	45,010
Accounts Payable and Accrued Liabilities	22,968,756
Due to Primary Government	9,130,130
U.S. Government Grants Refundable	(352,549)
Unearned Revenue	7,947,196
Compensated Absences	4,125,132
	<hr/>
Net Cash Used by Operating Activities	<u><u>\$ (598,110,829)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 381,042,368
Restricted Cash and Cash Equivalents	447,227,467
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	59,430,837
	<hr/>
Total Cash and Cash Equivalents - June 30, 2011	<u><u>\$ 887,700,672</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 8,343,210
Change in Fair Value of Investments	132,838,615
Loss on Disposal of Capital Assets	(19,182,376)

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

The University of North Carolina at Chapel Hill Foundations
Statement of Financial Position
June 30, 2011

Exhibit B-1

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 12,105,809	\$ 10,367,899	\$ 48,970,317
Investments		171,754,991	85,368,444
Unconditional Promises to Give, Net	7,673,152	4,037,288	2,523,747
Contributions Receivable from Split-Interest Agreements		2,941,573	
Funds Held in Trust	1,202,255		
Interest Receivable			29,511
Prepaid Expenses			264,385
Miscellaneous Receivables			303,024
Total Current Assets	<u>20,981,216</u>	<u>189,101,751</u>	<u>137,459,428</u>
Property and Equipment:			
Building			560,020
Furniture and Equipment	595,729		512,741
Leasehold Interest - Building	3,750,483		
Vehicle	26,422		
Total Property and Equipment	<u>3,400,640</u>		<u>605,870</u>
Other Assets:			
Investments	142,411,950		69,702,773
Unconditional Promises to Give, Net	6,199,633		3,608,559
Restricted Cash			528,996
Split-Interest Agreements	2,401,300		3,801,930
Cash Surrender Value of Life Insurance		1,963,801	205,898
Total Other Assets	<u>151,012,883</u>	<u>1,963,801</u>	<u>77,848,156</u>
Total Assets	<u>\$ 175,394,739</u>	<u>\$ 191,065,552</u>	<u>\$ 215,913,454</u>
LIABILITIES			
Current Liabilities:			
Accounts Payable	\$ 17,211	\$ 0	\$ 227,800
Annuities Payable		92,798	
Accrued Expenses	173,705		288,608
Total Current Liabilities	<u>190,916</u>	<u>92,798</u>	<u>516,408</u>
Long-Term Debt	850,000		
Total Liabilities	<u>1,040,916</u>	<u>92,798</u>	<u>516,408</u>
NET ASSETS			
Unrestricted	27,185,956		10,662,038
Temporarily Restricted	62,413,223	85,851,647	130,475,516
Permanently Restricted	84,754,644	105,121,107	74,259,492
Total Net Assets	<u>174,353,823</u>	<u>190,972,754</u>	<u>215,397,046</u>
Total Liabilities and Net Assets	<u>\$ 175,394,739</u>	<u>\$ 191,065,552</u>	<u>\$ 215,913,454</u>

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

The University of North Carolina at Chapel Hill Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2011

Exhibit B-2

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
REVENUES			
Support:			
Contributions	\$ 11,470,178	\$ 2,059,092	\$ 13,998,744
Development Assessment Fee Income	2,029,119		
Change in Value of Split-Interest Agreements	859,800		297,903
Donated Facilities	82,675		
Actuarial Adjustment of Annuities Payable		3,017	
Endowment Investment Return Designated for Current Operations		8,499,270	
Total Support	14,441,772	10,561,379	14,296,647
Revenue:			
Interest and Dividend Income			2,662,512
Net Unrealized and Realized Gains on Investments	17,287,453		20,550,733
Investment Income	1,870,048		
Other Income	39,853		902,321
Total Revenues	19,197,354		24,115,566
Total Support and Revenue	33,639,126	10,561,379	38,412,213
EXPENSES			
Program Services:			
Grants	8,015,017		21,452,099
Scholarship Expense Distribution		8,492,313	
Annuity Payments		6,957	
Other Expenses		466,900	
Total Program Services	8,015,017	8,966,170	21,452,099
Supporting Services:			
Fundraising Expenses	2,434,114		1,463,215
Management and General	957,745		1,527,862
Total Supporting Services	3,391,859		2,991,077
Total Expenses	11,406,876	8,966,170	24,443,176
Loss on Lease			
Loss from Bad Debt	(34,229)		1,203,234
Lease Guarantee			(653,093)
Total Expenses and Bad Debt	11,372,647	8,966,170	24,993,317
Changes in Net Assets from Operations	22,266,479	1,595,209	13,418,896
OTHER CHANGES			
Investment Return in Excess of Amounts Designated for Current Operations		14,846,158	
CHANGES IN NET ASSETS			
Unrestricted	8,904,547		(1,211,570)
Temporarily Restricted	7,520,615	14,849,175	11,261,496
Permanently Restricted	5,841,317	1,592,192	3,368,970
Total Changes in Net Assets	22,266,479	16,441,367	13,418,896
NET ASSETS			
Net Assets at Beginning of Year	152,087,344	174,531,387	201,978,150
Net Assets at End of Year	\$ 174,353,823	\$ 190,972,754	\$ 215,397,046

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

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THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2011

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The UNC Investment Fund was organized by the Chapel Hill Investment Fund to allow the University, other constituent institutions of the University of North Carolina System (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured, and managed by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Chapel Hill Investment Fund contributed and assigned all of its assets to the UNC Investment Fund effective January 1, 2003, in exchange for its membership interest in the UNC Investment Fund. Upon such contribution and assignment, and in consideration thereof, the UNC Investment Fund has assumed all liabilities and obligations of the Chapel Hill Investment Fund in respect of such contributed assets. At June 30, 2011, the Chapel Hill Investment Fund membership interest was approximately 76.4% of the UNC Investment Fund total membership interests. Because the Chapel Hill Investment Fund is the organizer and controlling member of the UNC Investment Fund, the financial statements of the UNC Investment Fund have been blended with those of the University.

The Management Company is a North Carolina nonprofit corporation organized and operated exclusively to support the educational mission of the University. The Management Company provides investment management and administrative services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and performs other functions for and generally carries out the purposes of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests is restricted to the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

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

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

The Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust are private nonprofit organizations that report their financial results under Financial Accounting Standards Board

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(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 financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2011, the Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total \$37,959,429 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

includes State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

- D. Cash and Cash Equivalents** - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the Short-Term Investment Fund. The Short-Term Investment Fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - Investments generally are reported at fair value. The fair values of all debt and equity securities with readily determinable fair market values are based on quoted market prices. Investments for which a readily determinable fair value does not exist include investments in certain commingled funds and limited partnerships. These investments are carried at estimated fair values as provided by the respective fund managers of these investments or third party administrators. The Management Company reviews and evaluates the values provided by the fund managers as well as the valuation methods and assumptions used in determining the fair value of such investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed. The net increase or decrease in the fair value of investments is recognized as a component of investment income.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 50 years for general infrastructure, 12 to 75 years for buildings, and 3 to 30 years for equipment. Amortization is computed using the straight-line method over the estimated useful lives of the assets, generally from 3 to 20 years for computer software.

The University's historic property, artworks, and literary collections are capitalized at cost or fair value at the date of donation. These properties and collections are considered inexhaustible and are therefore not depreciated.

- I. Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

resources restricted for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants or as internally designated.

- J. Funds Held in Trust for Pool Participants** - Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2. The assets associated with this liability are included in restricted investments, cash, and other similar asset accounts.
- K. Funds Held in Trust by Others** - Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2011 is approximately \$31,538,495.
- L. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, annuity and life income payable, and compensated absences that will not be paid within the next fiscal year.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

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

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

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

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - Unless specifically exempt, the University is required by *North Carolina General Statute 147-77* to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Governors, pursuant to G.S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2011, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$804,221,716 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 1.9 years as of June 30, 2011. 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 "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2011 was \$141,590. The carrying amount of the University's deposits not with the State Treasurer, including certificates of deposit, was \$83,337,366 and the bank balance was \$39,572,239. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2011, \$8,931,653 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

Investments of the University's component units, UNC-Chapel Hill Foundation, Management Company, Chapel Hill Investment Fund, UNC Investment Fund, Business School Foundation, Law Foundation, School of Education Foundation, the Medical Foundation, the Arts and Sciences Foundation, and Educational Foundation Trust, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements. The Management Company does not hold endowment funds.

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

Investments are subject to the following risks.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

The Bank of New York Mellon is the custodian for the Temporary Pool and provides the University with monthly statements defining income and market value information. Investments of the Temporary Pool are generally highly liquid and include U.S. government securities, collateralized mortgage obligations, asset-backed securities, corporate bonds, and mutual funds. The University has elected to invest a portion of the Temporary Pool assets in the Chapel Hill Investment Fund.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2011.

Temporary Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 35,363,298	\$ 21,066,860	\$ 14,296,438	\$ 0	\$ 0
U.S. Agencies	98,596,023	5,774,150	19,126,907	1,841,113	71,853,853
Mortgage Pass Throughs	50,440				50,440
Collateralized Mortgage Obligations	50,419,716	3,441,209	86,721	727,173	46,164,613
Asset-Backed Securities	1,131,424	267,572			863,852
Debt Mutual Funds	3,126,640			3,126,640	
Money Market Mutual Funds	107,743,379	107,743,379			
Domestic Corporate Bonds	11,406,328	8,433,213	2,203,330	288,145	481,640
Total Debt Securities	307,837,248	\$ 146,726,383	\$ 35,713,396	\$ 5,983,071	\$ 119,414,398
<i>Other Securities</i>					
Domestic Stocks	30,000				
Total Temporary Pool Investments	\$ 307,867,248				

The University has elected to invest \$42,106,658 of the Temporary Pool assets in the Chapel Hill Investment Fund. The disclosures for these investments are not included here. The disclosures for this portion of the Temporary Pool can be found under the heading Chapel Hill Investment Fund, Inc.

At June 30, 2011, investments in the Temporary Investment Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB, Ba and Below	Unrated
U.S. Agencies	\$ 98,596,023	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 98,596,023
Mortgage Pass Throughs	50,440	50,440					
Collateralized Mortgage Obligations	50,419,716	63,351	67,435	1,903,378	51,609	10,753,781	37,580,162
Asset-backed Securities	1,131,424		57,102			1,074,322	
Debt Mutual Funds	3,126,640			3,126,640			
Money Market Mutual Funds	107,743,379	107,743,379					
Domestic Corporate Bonds	11,406,328			10,636,543	769,785		
Total	\$ 272,473,950	\$ 107,857,170	\$ 124,537	\$ 15,666,561	\$ 821,394	\$ 11,828,103	\$ 136,176,185

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2011, are as follows:

Temporary Investment Pool
Statement of Net Assets
June 30, 2011

	Amount
<i>Assets:</i>	
Cash in Bank	\$ 3,745,107
State Treasurer Investment Fund	100,000,000
Accounts Receivable	17
Accrued Investment Income	952,951
Deferred Loss	247,902
Chapel Hill Investment Fund	42,106,658
Investments	307,867,248
Total Assets	454,919,883
<i>Liabilities:</i>	
Accounts Payable	3,876,125
Total Liabilities	3,876,125
<i>Net Assets Held in Trust for All Pool Participants:</i>	
Internal Portion	283,800,962
External Portion	167,242,796
Total Net Assets	\$ 451,043,758

Temporary Investment Pool
Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2011

	Amount
<i>Increase in Net Assets from Operations:</i>	
<i>Revenues:</i>	
Investment Income	\$ 6,906,034
<i>Expenses:</i>	
Investment Management	(1,143,038)
Net Increase in Net Assets Resulting from Operations	5,762,996
<i>Distributions to Participants:</i>	
Distributions Paid and Payable	(5,762,996)
<i>Share Transactions:</i>	
Net Share Liquidations	(63,658,155)
Total Decrease in Net Assets	(63,658,155)
<i>Net Assets:</i>	
Beginning of Year	514,701,913
End of Year	\$ 451,043,758

Intermediate Investment Pool - Established in October 2007, this is a portfolio managed by the UNC Management Company, Inc.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2011.

Intermediate Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
Debt Mutual Funds	\$ 8,155,114	\$ 0	\$ 8,155,114	\$ 0	\$ 0
Money Market Mutual Funds	7,851,336	7,851,336			
Total Intermediate Pool Investments	\$ 16,006,450	\$ 7,851,336	\$ 8,155,114	\$ 0	\$ 0

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2011, investments in the Intermediate Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A
Debt Mutual Funds	\$ 8,155,114	\$ 0	\$ 8,155,114	\$ 0
Money Market Mutual Funds	7,851,336	1,193,791		6,657,545
Total	<u>\$ 16,006,450</u>	<u>\$ 1,193,791</u>	<u>\$ 8,155,114</u>	<u>\$ 6,657,545</u>

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

At June 30, 2011, the Intermediate Investment Pool had investments of \$22,599,362 in the Chapel Hill Investment Fund. The disclosures for these investments are not included here. The disclosures for this portion of the Intermediate Investment Pool can be found under the heading Chapel Hill Investment Fund, Inc.

UNC-Chapel Hill Foundation Investment Fund, Inc. (Chapel Hill Investment Fund) - This is a North Carolina nonprofit corporation exempt from income tax pursuant to Section 501(c)(3). It was established in January 1997 and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The University's Endowment, UNC-Chapel Hill Foundation, Business School Foundation, School of Education Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust are participants in the Chapel Hill Investment Fund and are included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Chapel Hill Investment Fund are not included in the University's reporting entity. Fund ownership of the Chapel Hill Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Chapel Hill Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants.

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

The Chapel Hill Investment Fund is the primary participant of UNC Investment Fund, LLC (UNC Investment Fund) and on a monthly basis receives a unitization report from the Management Company defining change in book and market value, applicable realized gains and losses and expenses. The Chapel Hill Investment Fund uses a unit basis to determine each participant's market value and to distribute the fund's earnings

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

according to the fund's spending policy. There are no involuntary participants in the Chapel Hill Investment Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the Chapel Hill Investment Fund. The audited financial statements for the Chapel Hill Investment Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Chapel Hill Investment Fund consists of an approximately 76.4% membership in the UNC Investment Fund categorized below.

UNC Investment Fund, LLC (UNC Investment Fund) - This is a nonprofit limited liability company exempt from income tax pursuant to Section 501(c)(3) organized under the laws of the State of North Carolina. It was established in December 2002 by the Chapel Hill Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Chapel Hill Investment Fund, with an approximately 76.4% membership interest as of June 30, 2011, is the predominant member of the UNC Investment Fund. The University's reporting entity portion of the Chapel Hill Investment Fund and the Management Company's portion of the UNC Investment Fund is characterized as the internal portion. Other affiliated organizations in the Chapel Hill Investment Fund in addition to other members of the UNC Investment Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the UNC Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the UNC Investment Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

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

The Bank of New York Mellon is the custodian for the UNC Investment Fund and provides the University with monthly statements defining income and market value information. The UNC Investment Fund uses a unit basis to determine each member's market value and to distribute the fund's earnings. The University has not provided or obtained any legally

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

binding guarantees during the period to support the value for the UNC Investment Fund investments. The audited financial statements for the UNC Investment Fund may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

The following table presents the fair value of the UNC Investment Fund investments by type and investments subject to interest rate risk at June 30, 2011.

UNC Investment Fund Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 34,385,815	\$ 0	\$ 24,800,645	\$ 6,036,250	\$ 3,548,920
U.S. Agencies	7,533,783	31,269		1,148,720	6,353,794
Collateralized Mortgage Obligations	7,920,504	6,250,049			1,670,455
Asset-Backed Securities	2,938,288	2,938,288			
Debt Mutual Funds	27,009,346			25,852,981	1,156,365
Money Market Mutual Funds	86,168,885	86,168,885			
Domestic Corporate Bonds	4,058,105		1,147,780	1,666,740	1,243,585
Total Debt Securities	170,014,726	\$ 95,388,491	\$ 25,948,425	\$ 34,704,691	\$ 13,973,119
<i>Other Securities</i>					
International Equity Index Funds	51,287,935				
Equity Index Funds	57,538,972				
Real Estate Investment Trust	646,956				
Other Hedge Funds	926,675,281				
Long Only Hedge Funds	460,436,492				
Private Equity Limited Partnerships	667,970,386				
Real Assets Limited Partnerships	433,525,614				
Domestic Stocks	127,191,853				
Foreign Stocks	173,474				
Other	1,055				
Total UNC Investment Fund Pool Investments	\$ 2,895,462,744				

At June 30, 2011, investments in the UNC Investment Fund Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB, Ba & Below	Unrated
U.S. Agencies	\$ 7,533,783	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 7,533,783
Collateralized Mortgage Obligations	7,920,504					7,920,504	
Asset-Backed Securities	2,938,288					2,938,288	
Debt Mutual Funds	27,009,346			25,852,981	1,156,365		
Money Market Mutual Funds	86,168,885	86,168,885					
Domestic Corporate Bonds	4,058,105	690,240	1,120,605	1,701,125	546,135		
Total	\$ 135,628,911	\$ 86,859,125	\$ 1,120,605	\$ 27,554,106	\$ 1,702,500	\$ 10,858,792	\$ 7,533,783

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Foreign Currency Risk: At June 30, 2011, the UNC Investment Fund Pool's exposure to foreign currency risk is as follows:

	Currency	Fair Value (U.S. Dollars)
Private Equity Limited Partnerships	Euro	\$ 69,049,582
Real Assets Limited Partnerships	Euro	29,055,019
Other Hedge Funds	Euro	8,730,999
Private Equity Limited Partnerships	British Pound Sterling	8,996,560
Real Assets Limited Partnerships	British Pound Sterling	4,209,980
Private Equity Limited Partnerships	Australian Dollar	3,166,317
Real Assets Limited Partnerships	Canadian Dollar	2,601,916
Foreign Stock	Canadian Dollar	173,474
Total		\$ 125,983,847

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2011.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 269,830	\$ 20,301	\$ 154,096	\$ 50,296	\$ 45,137
U.S. Agencies	193,521	35,687	157,834		
Mortgage Pass Throughs	120,361				120,361
Collateralized Mortgage Obligations	35,146				35,146
State and Local Government	111,858				111,858
Asset-Backed Securities	5,802				5,802
Debt Mutual Funds	5,993,545		161,127	4,637,505	1,194,913
Money Market Mutual Funds	48,158,848	48,158,848			
Domestic Corporate Bonds	20,550			20,550	
Foreign Government Bonds	33,124				33,124
Total Debt Securities	54,942,585	\$ 48,214,836	\$ 473,057	\$ 4,708,351	\$ 1,546,341
<i>Other Securities</i>					
International Equity Index Funds	5,018,878				
Equity Index Funds	5,311,408				
Investments in Real Estate	2,303,303				
Private Equity Limited Partnerships	1,717,584				
Real Assets Limited Partnerships	1,601,344				
Domestic Stocks	14,001,413				
Foreign Stocks	390,983				
Other	8,845,397				
Total Non-Pooled Investments	\$ 94,132,895				

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2011, the University's non-pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below	Unrated
U.S. Agencies	\$ 193,521	\$ 193,521	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Mortgage Pass Throughs	120,361	100,891		3,428		16,042	
Collateralized Mortgage Obligations	35,146	14,069				21,077	
State and Local Government	111,858				74,623	37,235	
Asset-backed Securities	5,802			5,802			
Debt Mutual Funds	5,993,545	301,274	993,912	3,049,859	1,140,997	504,072	3,431
Money Market Mutual Funds	48,158,848	333,145		47,825,703			
Domestic Corporate Bonds	20,550					20,550	
Foreign Government Bonds	33,124			33,124			
Total	\$ 54,672,755	\$ 942,900	\$ 993,912	\$ 50,917,916	\$ 1,215,620	\$ 598,976	\$ 3,431

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

Foreign Currency Risk: At June 30, 2011, the Non-Pooled Investments exposure to foreign currency risk is as follows:

Investment	Currency	Fair Value (U.S. Dollars)
Foreign Stock	Euro	\$ 90,007
Foreign Stock	Hong Kong Dollar	25,908
Foreign Stock	British Pound Sterling	19,356
Foreign Stock	Australian Dollar	14,071
Foreign Stock	Japanese Yen	46,442
Foreign Stock	Mexican Peso	15,756
Total		\$ 211,540

Total Investments - The following table presents the fair value of the total investments at June 30, 2011:

Investment Type	Fair Value
<i>Debt Securities</i>	
U.S. Treasuries	\$ 70,018,943
U.S. Agencies	106,323,327
Mortgage Pass Throughs	170,801
Collateralized Mortgage Obligations	58,375,366
State and Local Government	111,858
Asset-Backed Securities	4,075,514
Debt Mutual Funds	44,284,645
Money Market Mutual Funds	249,922,448
Domestic Corporate Bonds	15,484,983
Foreign Government Bonds	33,124
Total Debt Securities	548,801,009
<i>Other Securities</i>	
International Equity Index Funds	56,306,813
Equity Index Funds	62,850,380
Investments in Real Estate	2,303,303
Real Estate Investment Trust	646,956
Other Hedge Funds	926,675,281
Long Only Hedge Funds	460,436,492
Private Equity Limited Partnerships	669,687,970
Real Assets Limited Partnerships	435,126,958
Domestic Stocks	141,223,266
Foreign Stocks	564,457
Other	8,846,452
Total Investments	\$ 3,313,469,337

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total investments include \$429,920,376 held in the UNC Investment Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 63.3% of the UNC Investment Fund.

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

<u>Investment Type</u>	<u>Carrying Value</u>
Mutual Funds	\$ 31,989,203
Equities	6,773,752
Certificates of Deposit	<u>257,766</u>
Total Investments	<u>\$ 39,020,721</u>

NOTE 3 - ENDOWMENT INVESTMENTS

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

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2011, accumulated income

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and appreciation of \$512,925,486 was available in the University's pooled endowment funds of which \$462,215,048 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2011, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 8,308,062	\$ 0	\$ 8,308,062
Patients	110,871,771	78,561,523	32,310,248
Accounts	60,443,485		60,443,485
Intergovernmental	79,409,715		79,409,715
Pledges	19,272,098	481,802	18,790,296
Investment Earnings	1,710,261		1,710,261
Interest on Loans	826,544		826,544
Other	41,058		41,058
Total Current Receivables	<u>\$ 280,882,994</u>	<u>\$ 79,043,325</u>	<u>\$ 201,839,669</u>
Noncurrent Receivables:			
Pledges	<u>\$ 32,581,405</u>	<u>\$ 814,535</u>	<u>\$ 31,766,870</u>
Notes Receivable:			
Notes Receivable - Current:			
Institutional Student Loan Programs	<u>\$ 122,429</u>	<u>\$ 11,351</u>	<u>\$ 111,078</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 33,498,690	\$ 2,202,874	\$ 31,295,816
Institutional Student Loan Programs	<u>7,632,570</u>	<u>367,288</u>	<u>7,265,282</u>
Total Notes Receivable - Noncurrent	<u>\$ 41,131,260</u>	<u>\$ 2,570,162</u>	<u>\$ 38,561,098</u>

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of .69% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Amount
2012	\$ 19,272,098
2013	15,769,760
2014	8,544,125
2015	4,766,007
2016	1,642,923
2017-2021	2,513,259
Total Pledge Receipts Expected	52,508,172
Less Discount Amount Representing Interest (0.69% Rate of Interest)	654,668
Present Value of Pledge Receipts Expected	51,853,504
Less Allowance for Uncollectible	1,296,338
Pledges Receivable	\$ 50,557,166

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2011, is presented as follows:

	Balance July 1, 2010	Increases	Decreases	Balance June 30, 2011
Capital Assets, Nondepreciable:				
Land	\$ 62,119,658	\$ 193,112	\$ 0	\$ 62,312,770
Art, Literature, and Artifacts	80,322,785	1,555,095	337	81,877,543
Construction in Progress	346,226,327	107,843,194	138,058,503	316,011,018
Computer Software in Development	50,621,598	4,674,180	44,054,860	11,240,918
Other Intangible Assets	1,000,000			1,000,000
Total Capital Assets, Nondepreciable	540,290,368	114,265,581	182,113,700	472,442,249
Capital Assets, Depreciable:				
Buildings	2,253,759,781	90,996,210	775,472	2,343,980,519
Machinery and Equipment	333,153,040	51,260,899	21,657,973	362,755,966
General Infrastructure	700,521,139	147,093,469		847,614,608
Computer Software	-	49,196,387		49,196,387
Total Capital Assets, Depreciable	3,287,433,960	338,546,965	22,433,445	3,603,547,480
Less Accumulated Depreciation/Amortization for:				
Buildings	647,865,912	50,490,350	47,540	698,308,722
Machinery and Equipment	167,149,140	14,193,086	3,203,866	178,138,360
General Infrastructure	229,823,100	35,276,141		265,099,241
Computer Software	-	2,764,705		2,764,705
Total Accumulated Depreciation	1,044,838,152	102,724,282	3,251,406	1,144,311,028
Total Capital Assets, Depreciable, Net	2,242,595,808	235,822,683	19,182,039	2,459,236,452
Capital Assets, Net	\$ 2,782,886,176	\$ 350,088,264	\$ 201,295,739	\$ 2,931,678,701

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2011, were as follows:

	Amount
Accounts Payable	\$ 76,066,263
Accrued Payroll	60,874,630
Contract Retainage	10,431,536
Intergovernmental Payables	166,307
Total Accounts Payable and Accrued Liabilities	\$ 147,538,736

NOTE 7 - SHORT-TERM DEBT

Short-term debt activity for the year ended June 30, 2011, was as follows:

	Balance July 1, 2010	Draws	Repayments	Balance June 30, 2011
Commercial Paper Program (2002A Bonds)	\$ 59,784,000	\$ 30,000,000	\$ 16,134,000	\$ 73,650,000

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

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2011, is presented as follows:

	Balance July 1, 2010	Additions	Reductions	Balance June 30, 2011	Current Portion
Revenue Bonds Payable	\$ 1,242,850,000	\$ 0	\$ 28,515,000	\$ 1,214,335,000	\$ 92,372,022
Add/Deduct Premium/Discount	13,219,175		1,303,791	11,915,384	
Deduct Deferred Charge on Refunding	(2,632,571)		(401,922)	(2,230,649)	
Total Revenue Bonds Payable	1,253,436,604	0	29,416,869	1,224,019,735	92,372,022
Notes Payable	46,100,000		350,000	45,750,000	
Capital Leases Payable	3,461,811		2,648,254	813,557	759,183
Compensated Absences	122,736,494	70,082,057	65,956,925	126,861,626	8,228,583
Annuity and Life Income Payable	10,576,389	778,266		11,354,655	1,458,122
Total Long-Term Liabilities	\$ 1,436,311,298	\$ 70,860,323	\$ 98,372,048	\$ 1,408,799,573	\$ 102,817,910

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue plus Capital Appreciation	Principal Paid Through June 30, 2011	Discount on Capital Appreciation Bonds	Principal Outstanding June 30, 2011	See Table Below
General Revenue								
	2001A	5.000% - 5.375%	12/01/2025	\$ 89,930,000	\$ 56,790,000	\$ 0	\$ 33,140,000	
	2001B	4.345% *	12/01/2025	54,970,000	20,360,000		34,610,000	
	2001C	3.25% *	12/01/2025	54,970,000	20,360,000		34,610,000	
	2002B	5.00%	12/01/2011	66,555,000	57,770,000		8,785,000	
	2003	4.625% - 5.000%	12/01/2033	107,960,000	13,440,000		94,520,000	
	2005A	4.250% - 5.000%	12/01/2034	404,960,000	3,550,000		401,410,000	
	2007	4.450% - 5.000%	12/01/2036	298,475,000			298,475,000	
	2009A	3.000% - 5.000%	12/01/2028	97,735,000	3,610,000		94,125,000	
	2009B	5.757% **	12/01/2039	112,805,000			112,805,000	
Total General Revenue				<u>1,288,360,000</u>	<u>175,880,000</u>		<u>1,112,480,000</u>	
Housing System	1997B	5.00%	11/01/2011	7,210,000	6,335,000		875,000	(1)
Utility System	1997	5.250% - 5.500%	08/01/2021	84,135,000		(21,081,645)	63,053,355	(2)
Student Recreation Center	1997	5.00%	06/01/2011	3,545,000	3,545,000			
U.S. EPA Project	1991	9.05%	02/15/2015	58,125,000	41,280,000	(2,871,020)	13,973,980	
Total Revenue Bonds Payable (Principal Only)				<u>\$ 153,015,000</u>	<u>\$ 51,160,000</u>	<u>\$ (23,952,665)</u>	<u>1,190,382,335</u>	
Less: Unamortized Loss on Refunding								(2,230,649)
Less: Unamortized Discount								35,868,049
Total Revenue Bonds Payable								<u>\$ 1,224,019,735</u>

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

* For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

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

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year			Estimate of % of Revenues Pledged
			Revenues Net of Expenses	Principal	Interest	
(1)	Housing Revenues	\$ 896,875	\$ 23,543,908	\$ 825,000	\$ 63,859	2%
(2)	Utilities Revenue	84,135,000	42,906,799	3,279,945	0	6%

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The University entered into a line of credit agreement in the amount of \$300,000,000 with Wachovia Bank (or Bank) on September 21, 2006. Under the line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal and accrued interest on Variable Rate Demand Bonds (or Commercial Paper Bonds) delivered for purchase. Under the line of credit agreement, the University may request that the Bank increase the commitment by increments of \$25,000,000 for a total commitment of up to \$400,000,000. A request for increase is subject to the Bank's sole discretion, and the University cannot be in default under the agreement at the time of the request. During fiscal year 2009, Wells Fargo purchased Wachovia Bank, but the line of credit agreement remains in place under original terms and conditions.

The University is required to pay a quarterly facility fee for the line of credit in the amount of 0.08% per annum based on the size of the commitment. If a long-term debt rating assigned by S&P, Moody's, or Fitch is lowered, the facility fee assigned to the lowest rating in the below table shall apply:

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

In the event that the Bank increases the available commitment prior to the due date for payment of a facility fee, upon request by the University as referenced in the prior paragraph, the University must pay a supplemental fee based on the facility fee applied to the amount of the increase at the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

time of commitment to increase. The University will also pay an accrued interest fee equal to the amount of accrued interest, at the time of purchase of the bonds, multiplied by the prime rate multiplied by the ratio of the number of days from the date of purchase of the bonds until the date of payment of the accrued interest to 365 days.

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

The line of credit agreement expires on September 21, 2014 and is subject to covenants customary to this type of transaction, including a default provision in the event that the University's long-term bond ratings were lowered to below a BBB- for S&P, BBB- for Fitch, and Baa3 for Moody's. At June 30, 2011, no purchase drawings had been made under the letter of credit.

- D. Capital Appreciation Bonds** - The University's Series 1997 Utility System and the Series 1991 U.S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of \$30,379,142 and \$3,828,921, respectively. These bonds are recorded in the amounts of \$63,053,355 (\$84,135,000 ultimate maturity less \$21,081,645 discount) and \$13,973,980 (\$25,275,000 ultimate maturity less \$2,871,020 accreted principal less \$8,430,000 principal paid), respectively, which is the accreted value at June 30, 2011. These bonds mature in the years from 2012 to 2021.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

E. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2011, are as follows:

Fiscal Year	Annual Requirements				
	Revenue Bonds Payable			Notes Payable	
	Principal	Interest	Interest Rate Swaps, Net *	Principal	Interest
2012	\$ 29,250,000	\$ 51,388,169	\$ 2,522,391	\$ 0	\$ 590,633
2013	29,690,000	50,676,991	2,355,540	45,750,000	1,588
2014	28,695,000	50,145,680	2,151,745		
2015	29,405,000	49,585,731	1,994,298		
2016	25,915,000	49,019,150	1,831,638		
2017-2021	135,090,000	235,631,698	6,572,310		
2022-2026	150,240,000	214,228,756	2,425,324		
2027-2031	135,715,000	176,548,420			
2032-2036	493,555,000	91,949,915			
2037-2041	156,780,000	6,719,051			
Total Requirements	\$ 1,214,335,000	\$ 975,893,561	\$ 19,853,246	\$ 45,750,000	\$ 592,221

Interest on the variable rate General Revenue Bonds 2001B is calculated at 0.04% at June 30, 2011.

Interest on the variable rate General Revenue Bonds 2001C is calculated at 0.06% at June 30, 2011.

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

This schedule also includes the debt service requirements for debt associated with interest rate swaps. More detailed information about interest rate swaps is presented in Note 9.

**Computed using $(5.24\% - 0.09) \times (\$22,000,000 - \text{annual swap reduction})$ and $(3.314 - 0.19) \times \$49,535,000$ notional amount.*

The fiscal year 2012 principal requirements includes demand bonds principal payments due for 2012 only.

This differs from the amount disclosed as current in Note 8A Changes in Long-Term Liabilities as the current portion of bonds payable includes all outstanding principal for the demand bonds.

See Note 8C Demand Bonds.

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

General Revenue Bonds, Series 2001A: On August 30, 2005, the University defeased \$33,310,000 of outstanding General Revenue Bonds, Series 2001A. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Statement of Net Assets. At June 30, 2011, the outstanding balance of the defeased General Revenue Bonds, Series 2001A bonds was \$0.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Beginning Balance July 1, 2010	Draws	Repayments	Principal Outstanding June 30, 2011
Real Property Purchases	Bank of America	1.581%	06/30/2011	\$ 350,000	\$ 0	\$ 350,000	\$ 0
Real Property Purchases	Bank of America	1.454%	07/01/2012	45,750,000			45,750,000
Total Notes Payable				<u>\$ 46,100,000</u>	<u>\$ 0</u>	<u>\$ 350,000</u>	<u>\$ 45,750,000</u>

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, originally in the aggregate principal amount up to \$10,000,000, and later reduced to \$6,000,000 upon the request of the Foundation, to finance the costs of projects benefiting the Foundation and/or the University. The line of credit had a maturity date of June 30, 2011. Prior to stated maturity, Bank of America extended the maturity date to September 30, 2011 to allow for documents to be restated and amended and to reduce the commitment amount, at the request of the Foundation, from \$6,000,000 to \$3,000,000. The Foundation has since executed the renewal of the line of credit in the amount of \$3,000,000 that carries the new maturity date to June 30, 2013. Under the new commitment, advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 1.15%. An unused commitment fee is due each quarter calculated as 0.24% of the difference between the commitment amount and the average balance outstanding for the quarter and paid in arrears on a quarterly basis. If the Foundation utilizes the line of credit to purchase an asset on behalf of the University, and later sells such asset to the University, the University reimburses the Foundation the principal amount of the draw and all accrued interest and associated transaction expenses.

On July 1, 2009, the UNC Chapel Hill Foundation, Inc. and Chapel Hill Foundation Real Estate Holdings Inc., (collectively, the Borrowers), entered into a loan agreement with the Bank of America, N.A. for \$45,750,000 to fund the acquisition of student housing and rental real property. Interest payments are made quarterly at the variable rate of the BBA LIBOR Daily Floating Rate plus 1.10%. The principal balance of the loan is due at maturity. A one-time loan fee of 0.25% of the commitment was paid on the effective date of the agreement. The loan is unsecured, but is governed by a loan agreement with financial and other covenants on the Borrowers. The loan matures on July 1, 2012.

H. Annuities Payable - The University participates in split-interest agreements with donors that require benefits payments for a specified period to a designated beneficiary out of assets held in trust for this

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

purpose. At the end of the predetermined period (e.g., the lifetime of the beneficiary specified by the donor), the remaining assets of the trust revert to the University for its use or for a purpose specified by the donor. At the end of each fiscal year, annuities and life income payable to the beneficiaries is calculated using IRS issued 90CM table, taking into consideration beneficiary's age and the amount of the gift, and using IRS issued Life Table 90CM.

NOTE 9 - DERIVATIVE INSTRUMENTS

Derivative instruments held at June 30, 2011 are as follows:

Type	Notional Amount	Change in Fair Value		Fair Value at June 30, 2011	
		Classification	Increase (Decrease)	Classification	Asset (Liability)
<i>Hedging Derivative Instruments</i>					
<i>Cash Flow Hedges</i>					
Pay-Fixed Interest Rate Swap 2001B Bonds (Lehman Brothers)	\$ 19,685,000	Deferred Outflow of Resources	\$ 389,012	Hedging Derivative Liability	\$ (4,081,211)
Pay-Fixed Interest Rate Swap 2001B&C and 2002A Bonds (Wachovia)	100,000,000	Deferred Outflow of Resources	4,622,586	Hedging Derivative Liability	(11,450,933)
			<u>\$ 5,011,598</u>		<u>\$ (15,532,144)</u>

Hedging derivative instruments held at June 30, 2011 are as follows:

Type	Objective	Notional Amount	Effective Date	Maturity Date	Terms
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash Flows on General Revenue 2001B Series Bonds	\$ 19,685,000	10/03/00	11/01/25	Pay 5.24%, Receive SIFMA
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash Flows on General Revenue 2001B&C and 2002A Series Bonds	100,000,000	12/01/07	12/01/36	Pay 3.314%, Receive 67% 1 Mo. LIBOR

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

The fair value for the Wachovia Bank, N.A. interest rate swap was provided by Wachovia. Their method calculates the present value of all expected future

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

payments on the swap based on forward curves discounted at current market rates.

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

Risk

Interest Rate Risk: The University is exposed to interest rate risk on its interest rate swaps. The fair values of these instruments are highly sensitive to interest rate changes. Because rates have changed since the effective dates of the swaps, both of the swaps have a negative fair value as of June 30, 2011. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the calculated values as of June 30, 2011. As the yield curve rises, the value of the swaps will increase and as rates fall, the value of the swaps decrease.

Credit Risk: As of June 30, 2011, the University was not exposed to credit risk because the swaps had a negative fair value.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

to rollover risk for the Wachovia swap based upon the maturity date of the underlying debt and due to the form of the debt as variable rate demand bonds.

Future Swaps

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

NOTE 10 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations for machinery and equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2011:

<u>Fiscal Year</u>	<u>Amount</u>
2012	\$ 777,641
2013	55,911
Total Minimum Lease Payments	833,552
Amount Representing Interest (0% - 13.066% Rate of Interest)	19,995
Present Value of Future Lease Payments	<u>\$ 813,557</u>

Machinery and equipment acquired under capital lease amounted to \$2,874,429 at June 30, 2011. Depreciation for the capital assets associated with capital leases is included in depreciation expense.

- B. Operating Lease Obligations** - Future minimum lease payments under noncancelable operating leases for buildings and land consist of the following at June 30, 2011:

<u>Fiscal Year</u>	<u>Amount</u>
2012	\$ 6,417,323
2013	3,591,375
2014	768,055
2015	329,727
2016	56,574
2017-2021	72,475
2022-2026	42,240
2027-2031	40,128
Total Minimum Lease Payments	<u>\$ 11,317,897</u>

Rental expense for all operating leases during the year was \$24,946.158.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Less Indigent Care and Contractual Adjustments	Net Revenues
Operating Revenues:						
Student Tuition and Fees	\$ 362,637,149	\$ 0	\$ 72,740,602	\$ 0	\$ 0	\$ 289,896,547
Patient Services	\$ 689,236,056	\$ 0	\$ 0	\$ (493,080)	\$ 409,694,201	\$ 280,034,935
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Professional Income	\$ 98,867,454	\$ 6,325,138	\$ 0	\$ 0	\$ 0	\$ 92,542,316
Residential Life	62,154,724	79,961	9,729,411			52,345,352
Athletic	47,930,957					47,930,957
Utilities	131,781,470	99,278,763				32,502,707
Dining	30,843,903					30,843,903
Other	90,858,087	65,717,803				25,140,284
Parking	22,856,999	1,199				22,855,800
Bookstore	22,290,785		812,150			21,478,635
Health, Physical Education and Recreation Services	7,784,912		301,330			7,483,582
UNC Management Company	7,106,313					7,106,313
Rental Property	5,691,729	193,015				5,498,714
School of Government	4,500,444					4,500,444
Trademark License Program	4,071,291					4,071,291
Telecommunications	17,452,414	13,736,575				3,715,839
Doubletree Carolina Inn	3,171,690					3,171,690
Printing/Carolina Copy	6,786,384	4,041,832				2,744,552
KFBS Center	2,693,824					2,693,824
Carolina Living & Learning Center and Recreation Services	2,077,820					2,077,820
Repairs & Maintenance	1,735,382					1,735,382
ERP Student Fees	1,687,229					1,687,229
ERP Student Fees	1,424,750					1,424,750
Student Union Services	7,619,585	7,511,574				108,011
Material Management and Disbursements	46,165					46,165
Total Sales and Services	<u>\$ 581,434,311</u>	<u>\$ 196,885,860</u>	<u>\$ 10,842,891</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 373,705,560</u>
Nonoperating - Noncapital Gifts	<u>\$ 93,369,786</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 203,388</u>	<u>\$ 0</u>	<u>\$ 93,166,398</u>

NOTE 12 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation and Amortization	Total
Instruction	\$ 530,494,189	\$ 25,197,166	\$ 142,812,939	\$ 0	\$ 265,674	\$ 0	\$ 698,769,968
Research	280,296,165	54,072,693	134,080,599		235,652		468,685,109
Public Service	63,613,622	7,653,252	65,883,148		128,895		137,278,917
Academic Support	74,687,092	11,824,994	19,232,341		138,465		105,882,892
Student Services	15,215,692	843,714	12,260,209		729		28,320,344
Institutional Support	63,148,973	5,001,786	23,363,972		43,511		91,558,242
Operations and Maintenance of Plant	45,243,144	6,934,563	21,918,287		71,173,610		145,269,604
Student Financial Aid				91,139,491			91,139,491
Auxiliary Enterprises	306,479,075	51,470,698	195,376,656		9,484,497		562,810,926
Depreciation/Amortization						102,724,282	102,724,282
Total Operating Expenses	<u>\$ 1,379,177,952</u>	<u>\$ 162,998,866</u>	<u>\$ 614,928,151</u>	<u>\$ 91,139,491</u>	<u>\$ 81,471,033</u>	<u>\$ 102,724,282</u>	<u>\$ 2,432,439,775</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 13 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2011, these rates were set at 4.93% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$1,159,144,403, of which \$472,793,699 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$23,308,729 and \$28,367,622, respectively.

Required employer contribution rates for the years ended June 30, 2010, and 2009, were 3.57% and 3.36%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2011, 2010, and 2009, which were \$23,308,729, \$16,632,618, and \$15,756,451, 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 "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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2011, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$1,159,144,403, of which \$476,742,643 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$32,609,197 and \$28,604,559, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. The plan administrator is Prudential Financial Inc. No costs are incurred by the University. The voluntary contributions by employees amounted to \$8,726,184 for the year ended June 30, 2011.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2011, were \$122,616. The voluntary contributions by employees amounted to \$3,820,813 for the year ended June 30, 2011.

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. The plan administrators are Fidelity Investments and TIAA-CREF. No costs are incurred by the University. The voluntary contributions by employees amounted to \$24,388,624 for the year ended June 30, 2011.

NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS

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

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

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 4.9% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. Required contribution rates for the years ended June 30, 2010, and 2009, were 4.5% and 4.1%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2011, 2010, and 2009, which were \$46,527,281, \$41,953,228, and \$37,956,143, 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.ncosc.net/> and clicking on "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

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

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2011, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2010, and 2009, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2011, 2010, and 2009, which were \$4,937,589, \$4,847,929, and \$4,813,950, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 15 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. Settled claims have not exceeded coverage in any of the past three fiscal years.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

Comprehensive Major Medical Plan - University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a discretely presented component unit of the State of North Carolina. The Plan has contracted with third parties to process claims.

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

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

The Trust Fund is an unincorporated entity created by Chapter 116, Article 26, of the *North Carolina General Statutes* and The University of North Carolina Board of Governors Resolution of June 9, 1978. The Trust Fund is a self-insurance program established to provide professional medical malpractice liability covering The University of North Carolina Hospitals at Chapel Hill (UNC Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (UNC P&A), the program participants. The Trust Fund provides coverage for program participants and individual health care practitioners working as employees, agents, or officers of program participants. The Trust Fund is exempt from federal and state income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

For the period July 1, 2010 through June 30, 2011, the Trust Fund provided coverage on an occurrence basis of \$3,000,000 per individual and \$7,000,000 in the aggregate per claim. Effective July 1, 2006, in lieu of purchasing commercial reinsurance, participants contributed approximately \$10,000,000 to a reimbursement fund for future losses. Prior to July 1, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer.

For the fiscal year ending June 30, 2011, the Trust Fund purchased a direct insurance policy to cover the first \$1,000,000 per occurrence and \$3,000,000 in the aggregate for dental residents. *North Carolina General Statutes* Chapter 116 was amended during 1987 to authorize the Trust Fund to borrow necessary amounts up to \$30,000,000, in the event that the Trust Fund may have insufficient funds to pay existing and future claims. Any such borrowing would be repaid from the assets and revenues of program participants. No line of credit or borrowing has been established pursuant to this authorization. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

At June 30, 2011, University assets in the Trust Fund totaled \$30,494,589 while University liabilities totaled \$26,180,389 resulting in net assets of \$4,314,200.

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

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

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

NOTE 16 - COMMITMENTS AND CONTINGENCIES

A. Commitments - The University has commitments of \$108,810,858 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

The UNC Investment Fund, LLC (UNC Investment Fund) has entered into agreements with limited partnerships to invest capital. These agreements represent the funding of capital over a designated period of time and are subject to adjustments. As of June 30, 2011, the UNC Investment Fund had approximately \$526,206,956 unfunded committed capital.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

Purpose	Amount
Pledges to Permanent Endowments	<u>\$ 15,273,852</u>

NOTE 17 - RELATED PARTIES

There are 14 separately incorporated nonprofit foundations associated with the University. These foundations are the Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The School of Government Foundation, Inc., The Morehead-Cain Scholarship Fund, The Pharmacy Foundation of North Carolina, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc., The School of Social Work Foundation, Inc., James B. Hunt, Jr. Institute for Educational Leadership and Policy Foundation, Inc., and Carolina for Kibera, Inc. Some of these organizations serve, in conjunction with the University's component units (See Note 1A), as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support totaled \$19,235,361 for the year ended June 30, 2011.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 18 - INVESTMENT IN JOINT VENTURE

The University is a member of the Southern Observatory for Astronomical Research Consortium (SOAR), a joint venture accounted for under the equity method. The University is partners with Michigan State University, the Association of Universities for Research in Astronomy, and the Ministry of Science and Technology of the Federal Republic of Brazil. SOAR designed, constructed, and now operates a 4.0-meter telescope with instrumentation and related support buildings located at Cerro Pachon, a mountain in central Chile. The SOAR agreement allocates the University 16.7% of observing time until 2023. The audited financial statements for SOAR may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

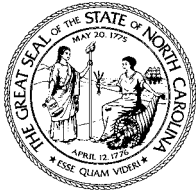
NOTE 19 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2011, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 59, *Financial Instruments Omnibus*.

GASB Statement No. 59, updates the disclosure and reporting requirements for certain financial instruments and external investment pools.

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Beth A. Wood, CPA
State Auditor

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

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2011, which collectively comprise the University's basic financial statements and have issued our report thereon dated November 2, 2011. Our report includes a reference to other auditors.

As discussed in Note 19 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 59, *Financial Instruments Omnibus*, during the year ended June 30, 2011.

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 UNC Investment Fund, LLC and the discretely presented component units, as described in our report on the University's financial statements. The financial statements of the UNC Investment Fund, LLC and the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

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

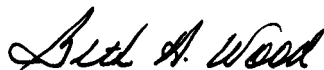
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination 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

November 2, 2011

ORDERING INFORMATION

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

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