



# STATE OF NORTH CAROLINA

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

**FOR THE YEAR ENDED JUNE 30, 2011**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**NORTH CAROLINA STATE UNIVERSITY**

**RALEIGH, NORTH CAROLINA**

**FINANCIAL STATEMENT AUDIT REPORT**

**FOR THE YEAR ENDED JUNE 30, 2011**

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**THE UNIVERSITY OF NORTH CAROLINA**

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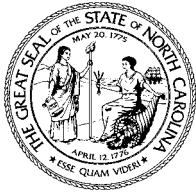
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**Beth A. Wood, CPA**  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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**AUDITOR'S TRANSMITTAL**

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

We have completed a financial statement audit of North Carolina State University for the year ended June 30, 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.

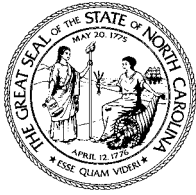
A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

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**Beth A. Wood, CPA**  
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**INDEPENDENT AUDITOR'S REPORT**

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Board of Trustees  
North Carolina State University  
Raleigh, North Carolina

We have audited the accompanying financial statements of North Carolina State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 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 NC State Investment Fund, Inc., which represent 16 percent, 23 percent, and 5 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of the North Carolina State University Foundation, Inc. and the NC State Student Aid Association, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

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

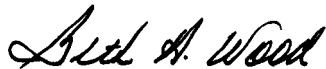
## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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As discussed in Note 18 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

## NORTH CAROLINA STATE UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

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### **Introduction**

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

### **Financial Highlights**

NC State University's net assets increased by 7.6% to \$1.63 billion in fiscal year 2011. Net assets represent the University's equity, the assets less the liabilities. The primary causes of this increase included the acquisition of capital assets net of related debt of \$73.2 million, a \$14.0 million rise in endowed professorship balances, and an increase of \$11.5 million in unrestricted balances.

Revenues increased by 6.8% to \$1.26 billion in fiscal year 2011. Revenues represent amounts received or accrued that are either operating or nonoperating on the accompanying financial statements. This change was primarily due to increases in tuition and fees, contracts and grants, and sales and services income. While state appropriations only increased by \$6.4 million, appropriations remain the largest factor in the University's revenues. Tuition and fees increased by \$26.3 million due to higher billing rates. These rate increases were also accompanied by higher levels of financial aid. Grants and contracts increased during the year by \$23.9 million, with federal, nongovernmental and state grants and contracts all showing growth. Sales and services income increased \$8.0 million across all types of sales activities, including dining, athletics, and other education related sales.

Operating expenses in fiscal year 2011 were up by \$63.7 million, a 5.7% increase compared to fiscal year 2010. Operating expenses represent amounts paid or accrued for operating purposes. By function, Instruction, Research, Public Service, and Financial Aid showed the largest increases, primarily caused by higher spending on salaries, supplies, and scholarships.

### **Using the Financial Statements**

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

The financial statements also include a *Statement of Cash Flows*. This statement is used to identify the University's sources and uses of cash. The ending cash on the *Statement of Cash Flows* agrees to the total cash reported on the *Statement of Net Assets*. Also, this statement

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

reconciles the net operating loss reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* to the net cash used by operating activities.

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

### Comparative Condensed Financial Statement Information

#### Statement of Net Assets

The *Statement of Net Assets* provides information regarding the University's assets, liabilities, and net assets as of June 30, 2011. Asset and liability balances are classified as either current or noncurrent. Assets classified as current are those that are available to pay for current liabilities or current year expenditures. Liabilities classified as current are those that are due and payable in the next fiscal year. The net asset balances are classified as either invested in capital assets (net of related debt), restricted or unrestricted. In addition, net assets classified as restricted are classified as either nonexpendable or expendable. Overall, the *Statement of Net Assets* provides information to evaluate the financial strength of the University and its ability to meet current and long-term obligations.

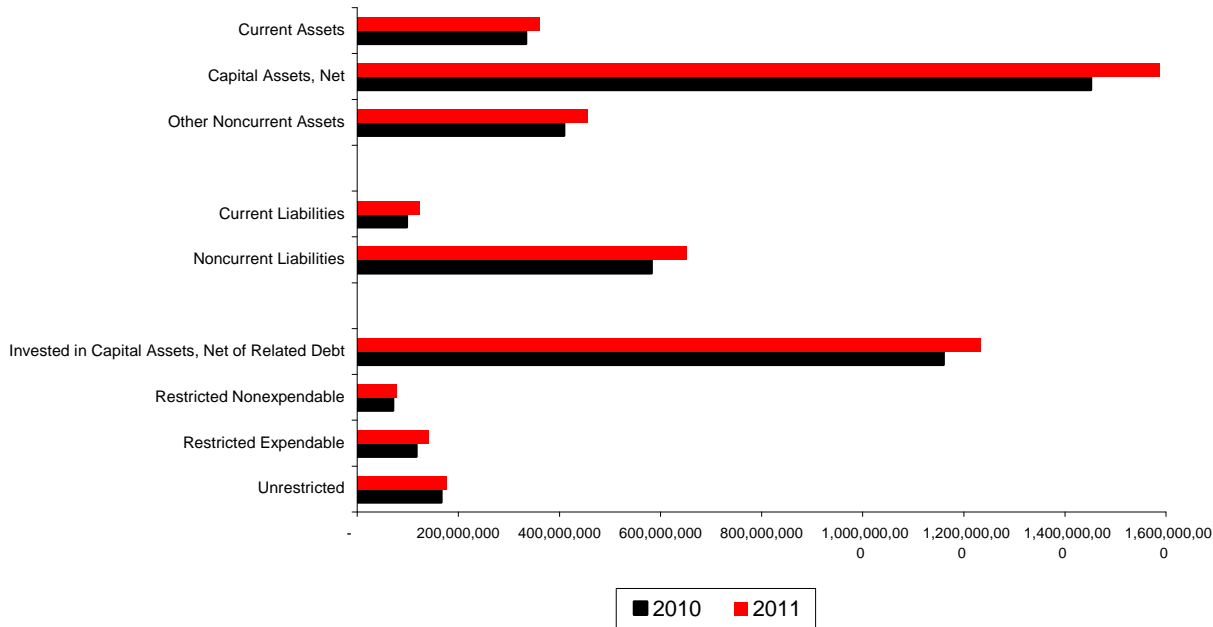
Following is a comparative analysis on the condensed balances reported in the *Statement of Net Assets* as of June 30, 2011, and 2010.

	2011	2010	Increase
<b>Assets</b>			
Current Assets	\$ 361,631,998	\$ 333,598,950	\$ 28,033,048
Capital Assets, Net	1,587,195,958	1,451,692,968	135,502,990
Other Noncurrent Assets	456,314,973	409,366,770	46,948,203
Total Assets	<u>2,405,142,929</u>	<u>2,194,658,688</u>	<u>210,484,241</u>
<b>Liabilities</b>			
Current Liabilities	124,000,320	98,270,439	25,729,881
Noncurrent Liabilities	651,340,776	582,135,211	69,205,565
Total Liabilities	<u>775,341,096</u>	<u>680,405,650</u>	<u>94,935,446</u>
<b>Net Assets</b>			
Invested in Capital Assets, Net of Related Debt	1,233,161,475	1,159,910,462	73,251,013
Restricted			
Nonexpendable	77,978,945	71,087,600	6,891,345
Expendable	140,828,579	116,907,131	23,921,448
Unrestricted	177,832,834	166,347,845	11,484,989
Total Net Assets	<u>\$ 1,629,801,833</u>	<u>\$ 1,514,253,038</u>	<u>\$ 115,548,795</u>



## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following graph illustrates the assets, liabilities and net assets of the University as of June 30, 2011, as compared to June 30, 2010.



Assets totaled \$2.41 billion, an increase of \$210.5 million over the prior year. This change in assets includes capital asset growth of \$135.5 million, an increase in other noncurrent assets of \$46.9 million, and an increase in current assets of \$28.0 million.

The capital asset growth of \$135.5 million is due to construction funding from capital grants and gifts, new capital financing and spending of prior year capital improvement monies. NC State received \$51.0 million in capital grants in 2011, primarily from the state's bond/certificates of participation (COPs) program, \$67.9 million in notes payable and commercial paper capital financing, and \$5.1 million in capital gifts.

The \$46.9 million increase in other noncurrent assets is primarily due to an increase in investments of \$74.7 million, consisting primarily of proceeds of the new Energy Conservation Loan and increases in market values and foundations deposits. In addition, endowment investments increased by \$18.3 million, primarily because of improvements in market values and gifts. These increases were partially offset by decreases in noncurrent cash, which was caused by smaller amounts remaining of the 2010 bond and notes payable proceeds remaining in cash in 2011 and higher amounts of restricted cash moved to current cash to cover current liabilities.

Current assets increased by \$28.0 million in fiscal year 2011. This increase was primarily the result of an increase in unrestricted cash of \$10.5 million and in restricted cash of \$12.9 million. Unrestricted cash growth was primarily in auxiliaries cash, such as Veterinary Medicine, Communication Technology, and also various sales and services trust funds. Changes in restricted cash, classified as current assets, primarily results from the movement of noncurrent cash to cover current liabilities for capital and debt purposes. Current capital and

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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debt liabilities were higher in 2011 and more cash was moved to current restricted cash. Current receivables also increased by \$2.3 million, mainly in general accounts receivables and intergovernmental (federal) receivables.

Liabilities totaled \$775.3 million, an increase of \$94.9 million over the prior year. The increase in liabilities is attributable to an increase in current liabilities of \$25.7 million and an increase in noncurrent liabilities of \$69.2 million.

Current liabilities totaled \$124.0 million. These liabilities include accounts payable and accrued liabilities, due to other entities, deferred revenue, and the current portion of University debt. Current liabilities increased \$25.7 million, primarily caused by \$10.0 million of new commercial paper debt and increased accounts payable and accrued liabilities. The largest factors in the \$9.3 million increase in accounts payable and accrued liabilities were in construction payables and contract retainage.

Noncurrent liabilities totaled \$651.3 million, and include accounts payable, deposits payable, funds held for other entities, funds held in trust in the investment pool, long-term debt, compensated absences and the hedging derivative liability. Noncurrent liabilities increased \$69.2 million as a result of multiple factors. In December 2010, the University issued a \$56.1 million installment financing contract to provide funds for energy conservation measures including combined heat and power cogeneration installation. The liability for funds held in trust for pool participants increased by \$25.9 million due to increased pool participation and increases in market value of investments held. Also, the funds held for others liability increased by \$2.7 million primarily due to affiliated foundation deposits in the University's cash accounts with the State Treasurer. The long-term portion of bonds payable dropped by \$15.4 million due to regular bond payments and amounts moved to the current portion of long-term debt. Other noncurrent liabilities increased or decreased by smaller, approximately off-setting amounts.

Net assets totaled \$1.63 billion, an increase of \$115.5 million over the prior year. Invested in plant, net of related debt, grew by \$73.2 million as the University obtained new capital resources, including debt financing and capital grants and gifts, and spent capital reserves. Unrestricted net assets rose by \$11.5 million, a 6.9% increase. Restricted expendable net assets rose \$23.9 million, including a \$9.3 million increase in endowed professorships. Restricted nonexpendable net assets also went up by \$6.9 million, including a \$4.7 million increase in endowed professorships. The growth in endowment professorship net assets was primarily attributable to gifts and improvement in market values of related investments.

The University's current assets are more than sufficient to cover current liabilities, with a ratio of 2.9 times compared to 3.4 times in the prior year. The University's total assets are significantly more than the University's liabilities with a ratio of 3.1 times as compared to 3.2 times in the prior year. These financial ratios are indicators of NC State's financial strength and its ability to meet current and long-term obligations.

### **Statement of Revenues, Expenses, and Changes in Net Assets**

The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information regarding the University's activities for the year ending June 30, 2011. The activity balances

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

are classified as operating, nonoperating, or other. Activities classified as operating include all revenues of the University except those considered nonoperating or those associated with funds received to enhance capital assets or permanent endowments. Operating expenses are all expenses except those related to interest expense on financing activities, loss on disposal of capital assets, and investment expenses (shown as net against investment income). Activities classified as nonoperating include state appropriations, noncapital gifts and grants revenue, investment income (net of investment expenses), and gains or losses on disposal of capital assets. Activities classified as other include capital gifts or grants and additions to permanent endowments. Overall, the *Statement of Revenues, Expenses, and Changes in Net Assets* provides information to evaluate the University's management of operations and maintenance of financial strength.

Following is a comparative analysis on the condensed balances reported in the *Statement of Revenues, Expenses, and Changes in Net Assets* for the fiscal years ended June 30, 2011, and 2010.

	2011	2010	Increase/ (Decrease)
<b>Operating Revenues</b>			
Student Tuition and Fees, Net	\$ 197,091,556	\$ 170,813,363	\$ 26,278,193
Federal Appropriations	16,842,963	18,480,582	(1,637,619)
Grants and Contracts	223,507,300	199,584,152	23,923,148
Sales and Services, Net	176,956,180	168,927,911	8,028,269
Other	15,206,546	15,935,453	(728,907)
<b>Total Operating Revenues</b>	<u>629,604,545</u>	<u>573,741,461</u>	<u>55,863,084</u>
<b>Operating Expenses</b>			
Salaries and Benefits	743,089,319	712,602,591	30,486,728
Supplies and Materials	124,591,377	111,260,760	13,330,617
Services	180,218,528	170,470,891	9,747,637
Scholarships and Fellowships	46,911,355	40,609,010	6,302,345
Utilities	37,853,283	36,023,202	1,830,081
Depreciation	56,449,786	54,464,008	1,985,778
<b>Total Operating Expenses</b>	<u>1,189,113,648</u>	<u>1,125,430,462</u>	<u>63,683,186</u>
Net Operating Loss	<u>(559,509,103)</u>	<u>(551,689,001)</u>	<u>(7,820,102)</u>
<b>Nonoperating Revenues (Expenses)</b>			
State Appropriations	478,423,298	472,039,507	6,383,791
State Aid - Federal Economic Recovery Funds	20,651,218	19,891,167	760,051
Noncapital Grants - Federal Student Financial Aid	29,675,741	24,581,555	5,094,186
Other Noncapital Grants and Gifts	75,777,496	68,201,515	7,575,981
Investment Income	19,971,035	17,101,221	2,869,814
Other	(11,568,535)	(11,978,920)	410,385
<b>Net Nonoperating Revenues</b>	<u>612,930,253</u>	<u>589,836,045</u>	<u>23,094,208</u>
<b>Gain (Loss) Before Other Revenue</b>	53,421,150	38,147,044	15,274,106
Capital Appropriations, Gifts, and Grants	56,089,827	42,680,320	13,409,507
Additions to Permanent Endowments	6,037,818	4,463,474	1,574,344
<b>Increase in Net Assets</b>	<u>\$ 115,548,795</u>	<u>\$ 85,290,838</u>	<u>\$ 30,257,957</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

### Operating and Nonoperating Activities

The following illustrates the relationships of operating and nonoperating revenue sources and expense functions to total revenue/expenses for the fiscal year 2011 and 2010, and the consistency of relationships between the two years.

#### Operating and Nonoperating Revenues

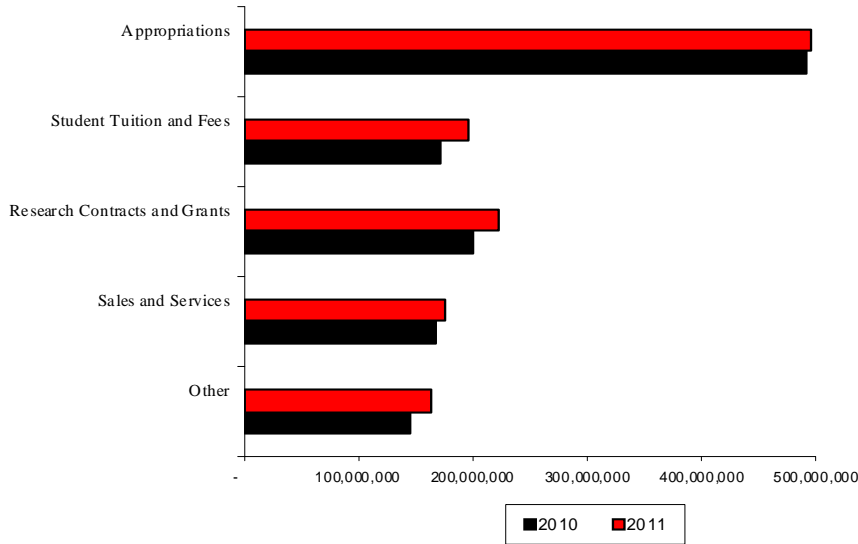
Title	% to Total 2011	% to Total 2010
State Appropriations	38%	40%
State Aid - Federal Economic Recovery Funds	2%	2%
Research Contracts and Grants	18%	17%
Student Tuition and Fees	16%	14%
Sales and Services	14%	14%
Noncapital Grants and Gifts	8%	8%
Federal Appropriations	1%	2%
Other	3%	3%
Total	100%	100%

#### Operating and Nonoperating Expenses

Title	% to Total 2011	% to Total 2010
Instruction	30%	30%
Research	18%	19%
Public Service	10%	10%
Auxiliary Enterprises	10%	10%
Operations & Maintenance of Plant	7%	7%
Academic Support	7%	6%
Institutional Support	6%	6%
Depreciation	5%	5%
Student Financial Aid	4%	4%
Student Services	2%	2%
Other	1%	1%
Total	100%	100%

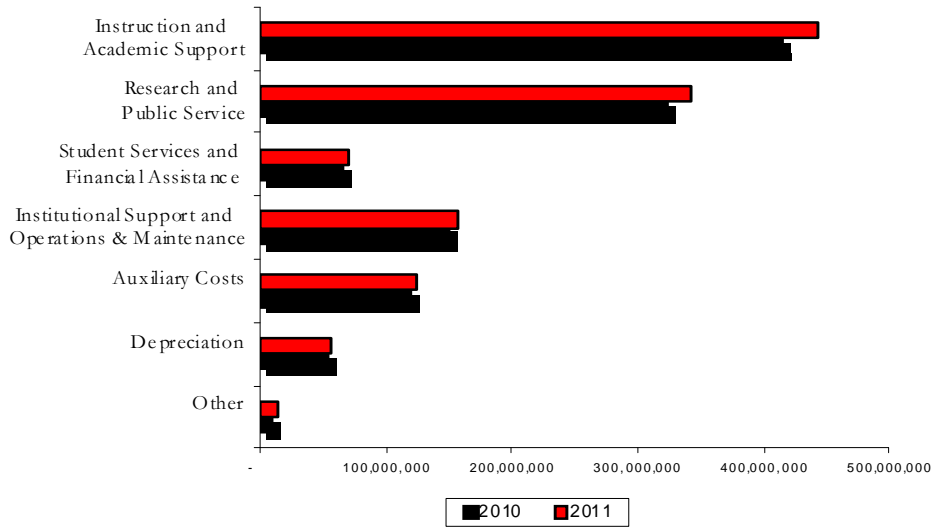
**MANAGEMENT’S DISCUSSION AND ANALYSIS (CONTINUED)**

**Operating and Nonoperating Revenues**



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

**Operating and Nonoperating Expenses**



Total revenues (operating and nonoperating) increased \$80.0 million or 6.8% compared to the prior year. State appropriations rose by \$6.4 million or 1.4% from the prior year. However, state appropriations were still \$9.3 million below the pre-recession 2008 level, and there were no capital appropriations, compared with \$38.0 million in 2008. The University did receive \$20.7 million in federal economic recovery funds from the State, up \$0.8 million from 2010. Student tuition and fees increased \$26.3 million as rates increased for all students. The University continued to grow its research mission, with research contracts and grants increasing \$23.9 million or 12.0%. Federal student financial aid was up \$5.1 million as

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

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student need for aid continued higher. Also, noncapital gifts were up \$6.5 million as foundations and individuals increased support for University programs. Investment income grew \$2.9 million as market values of investments improved.

Total expenses (operating and nonoperating) showed a moderate rise in 2011, increasing \$64.7 million or 5.7% compared to the prior year. Salaries and benefits increased \$30.5 million or 4.3%, with Instruction and Auxiliary Enterprises showing the largest increases. Spending on supplies also rose in 2011. The \$13.3 million supplies increase included large increases in information technology, database access and library and educational supplies, with spending increases highest in Research, Academic Support and Institutional Support. Services increased \$9.8 million with the largest increases in Instruction and Public Service, including spending on contracts, sub-contracts, rental of real property, maintenance agreements and travel. With the increased tuition and fees, the scholarship expense increased by \$6.3 million or 15.5%.

### **Other Activity**

Other activity totaled \$62.1 million, up \$15.0 million from the prior year. Capital grants increased by \$13.4 million, primarily in State bond/COPs aid. Because of budget limitations, the University had no new capital appropriations. Additions to permanent endowments rose by \$1.6 million to \$6.0 million as the economy and markets showed some improvement.

### **Capital Assets and Long-Term Debt Activities**

#### **Capital Assets**

The University capitalizes assets that have a value or cost equal to or greater than \$5,000 at the date of acquisition and an expected useful life of more than one year except for internally generated software which is capitalized when the value or cost is \$1,000,000 or greater and other intangible assets which are capitalized when the value or cost is \$100,000 or greater. Repairs and renovations that do not extend the life of the building beyond the expected useful life at acquisition, nor increase the future service potential of the building are expensed and not capitalized.

Machinery and equipment are depreciated over their estimated useful lives, generally 4 to 22 years beginning in the year of acquisition. Buildings and general infrastructure are depreciated over their estimated useful lives, generally 10 to 50 years for buildings and 15 to 75 years for general infrastructure beginning in the year that the construction is completed or, if purchased after construction, when acquired. Computer software is depreciated over a useful life of 2 to 15 years. Land, construction in progress, and computer software in development are nondepreciable capital assets. When a construction project is completed, the capital project costs are moved from the construction in progress account to either Buildings or General Infrastructure as appropriate.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

As shown in the following table, the University increased its net capital assets by \$135.5 million during fiscal year 2011.

	<u>2011</u>	<u>2010</u>	<u>Increase/ (Decrease)</u>
Land	\$ 36,587,946	\$ 38,285,610	\$ (1,697,664)
Construction in Progress	138,800,118	162,025,112	(23,224,994)
Computer Software in Development	4,944,349	2,385,000	2,559,349
Buildings	1,590,876,263	1,426,874,142	164,002,121
Machinery and Equipment	285,672,390	262,528,573	23,143,817
General Infrastructure	179,061,165	160,499,489	18,561,676
Computer Software	<u>2,291,073</u>	<u>2,166,073</u>	<u>125,000</u>
Total Capital Assets	2,238,233,304	2,054,763,999	183,469,305
Accumulated Depreciation	<u>(651,037,346)</u>	<u>(603,071,031)</u>	<u>(47,966,315)</u>
Net Capital Assets	<u>\$ 1,587,195,958</u>	<u>\$ 1,451,692,968</u>	<u>\$ 135,502,990</u>

In addition to costs incurred, the University had \$109.1 million in outstanding commitments for construction projects as of June 30, 2011.

During fiscal year 2011 NC State continued to build new facilities and work on renovations to modernize campus. Funding for these improvements came from funds provided by University debt financing and NC bonds and certificates of participation.

Following are some of the major construction projects that were completed or were in progress as of June 30, 2011.

The Randall B. Terry, Jr. Companion Animal Veterinary Medical Center was completed in fiscal year 2011. The Terry Center is one of the nation's largest veterinary hospitals and more than twice the size of the original hospital at 110,000 square feet. With state-of-the-art technology throughout, the hospital will examine and treat more than 20,000 patients annually. Some of the Center's design features include: 30 exam rooms and 10 surgery suites, both doubling the old hospital's capacity. With three dedicated emergency exam rooms, an expanded ICU and patient visitation area, pneumatic tube system, teaching space in each pavilion and a spacious pharmacy specializing in sterile compounds for pet health care needs, the Terry Center will be a national leader in pet health care and instruction for years to come.

The new 248,000 square foot Engineering Building III opened in September 2010. This state-of-the-art facility houses the Department of Mechanical and Aerospace Engineering and the Joint NC State-UNC Department of Biomedical Engineering. The new building contains some 80 laboratories, two wind tunnels, a flight test cell, anechoic chambers and classrooms and offices for faculty and graduate students. It also has the first "green" roof on Centennial Campus and is part of the University's efforts to reduce greenhouse gas emissions by including drought resistant plants on the roof. This feature is projected to save an estimated 25-50 percent on heating and cooling costs. With the addition of this building, two-thirds of all the University's College of Engineering students are now on Centennial Campus.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

As part of the continuing growth of Centennial Campus, another parking deck was completed off of Partners Way drive, between EBI and Partners I. The four story, 181,447 square foot building was designed to hold 800 parking spaces for the expanding Centennial Campus.

Safety renovations to E.S. King Village were completed. These renovations consisted of providing new fire sprinkler systems and an extensive telecom infrastructure to 17 residence halls that service the University's married, graduate and non-traditional undergraduate students. New exterior underground fire mains, underground telecommunication duct banks, and sprinkler risers and telecommunication systems are now in each building providing safer and more updated living conditions for students.

The University also upgraded several of its 4-H buildings in 2011. A major new conference center in Tyrell Co. in Eastern NC is expected to be the University's first "green" LEED-certified building. The new building offers a gymnasium, kitchen, dining facilities, an office and three classrooms in its 21,000 square feet area. The center's green features include insulation made from recycled denim, recycled ceramic tile, concrete exterior panels and bamboo flooring. Lighting is controlled by sensors, windows are treated to allow light in but keep heat out and a rain garden helps filter runoff from the building. An efficient geothermal system heats and cools the building helping this building to be an environmentally friendly way to serve the youth and adults of North Carolina.

More information about the University's long-range capital plan is located at [http://www.ncsu.edu/facilities/construction\\_info/index.htm](http://www.ncsu.edu/facilities/construction_info/index.htm).

### Long-Term Debt Activities

The University incurs long-term debt to finance construction projects, to purchase equipment using lease arrangements and to provide for accumulated unused vacation benefits for employees. As shown in the following chart, the University increased its long-term debt by \$44.1 million during fiscal year 2011.

	<u>2011</u>	<u>2010</u>	<u>Increase/ (Decrease)</u>
Bonds Payable	\$ 311,337,360	\$ 323,109,579	\$ (11,772,219)
Capital Leases Payable	246,764	388,055	(141,291)
Notes Payable	80,056,251	23,650,703	56,405,548
Compensated Absences	<u>55,460,852</u>	<u>55,817,030</u>	<u>(356,178)</u>
Total Long-term Liabilities	<u>\$ 447,101,227</u>	<u>\$ 402,965,367</u>	<u>\$ 44,135,860</u>

Long-term liabilities rose by \$44.1 million, primarily due to the issue of a \$56.1 million tax-exempt installment financing contract in December 2010. The financing was issued to provide funds for energy conservation at two steam and chilled water central distribution facilities. With no new bonds in fiscal year 2011, bonds payable decreased by some \$11.8 million in principal payments. Compensated absences and capital leases showed small decreases.



**Economic Factors That Will Affect the Future**

The State of North Carolina has not been spared the severe state revenue shortfalls experienced by almost all states as a result of the nation's 2009 recession and economic decline. The North Carolina General Assembly passed a 2011-12 Appropriation Bill that reduced NC State University's state appropriated funds by \$79.3 million and provided no direct offset through a tuition increase as it had done for 2010-11. However, the University did receive \$11.1 million in state appropriated funds related to projected enrollment increases for the 2011-12 academic year. And, while no significant additional reduction in state appropriations was included for the second year of the 2011-13 biennium, continued growth in the state's unemployment rate could certainly cause the General Assembly to reconsider the 2012-13 appropriations.

As early as Spring 2009 the NC State University administration started to plan for an anticipated major reduction in state appropriated funds for the 2011-13 biennium. Prior to FY 2009-10, the administration made the decision to reduce recurring budgets by 10% to accommodate both the recurring state-directed 5% reduction and any one-time reversions during 2009-10. While some portion of the remaining funds from the 10% reduction were reallocated in FY 2010-11 on a recurring basis to fund 25 new faculty positions, the majority of this reduction balance was available to lessen the impact of the FY 2011-12 funding loss on the core academic programs and services. The final reduction allocated to the campus exempted the student financial aid budget and protected utilities, library, and college budgets with a lower percentage reduction while administrative units received an approximately 40-50% larger percentage reduction.

State revenues for fiscal year 2011-12 are tracking at the currently appropriated level but it is too early in the fiscal year to ignore the potential for additional state budget reversions or reductions. The University administration has held sufficient unallocated resources to cover up to a 2% additional reversion of state funds without adversely impacting campus budgets. Enrollment still remains strong although severe reductions in need-based state funded student financial aid programs could have a more long term negative impact on enrollment and, at a minimum, will cause an increase in student debt. NC State University was recently designated by US News and World Report, as the #3 "best value" among public universities which is a tribute to our faculty and staff and the willingness of the General Assembly and the Governor to aggressively support North Carolina's higher education system.

This careful budget planning and allocation of budget reductions over the preceding years has NC State well positioned for the coming decade. The NC State University Board of Trustees adopted a new 2011-2020 strategic plan that specifies five major goals to promote and preserve the core mission of North Carolina's premiere Land Grant University. The plan has a strong focus on the science, technology, education, and mathematics disciplines and places a high priority on operational efficiency. To complement the strategic plan the administration has begun implementing an aggressive realignment of academic programs, support services, and business operations at all levels of the university.

**North Carolina State University**  
**Statement of Net Assets**  
**June 30, 2011**

**Exhibit A-1**  
**Page 1 of 2**

**ASSETS**

Current Assets:

Cash and Cash Equivalents	\$ 203,211,185
Restricted Cash and Cash Equivalents	91,121,258
Restricted Short-Term Investments	20
Receivables, Net (Note 4)	47,633,889
Due from Primary Government	9,238,807
Due from State of North Carolina Component Units	2,545,697
Inventories	5,012,900
Notes Receivable, Net (Note 4)	2,868,242
	<hr/>
Total Current Assets	361,631,998
	<hr/>

Noncurrent Assets:

Restricted Cash and Cash Equivalents	72,627,926
Endowment Investments	161,402,165
Other Investments	205,086,977
Deferred Outflow of Resources (Note 9)	9,015,452
Notes Receivable, Net (Note 4)	8,182,453
Capital Assets - Nondepreciable (Note 5)	180,332,413
Capital Assets - Depreciable, Net (Note 5)	1,406,863,545
	<hr/>
Total Noncurrent Assets	2,043,510,931
	<hr/>

Total Assets	2,405,142,929
	<hr/>

**LIABILITIES**

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	51,185,186
Due to Primary Government	5,867,979
Unearned Revenue	37,422,160
Interest Payable	4,044,322
Short-Term Debt (Note 7)	10,000,000
Long-Term Liabilities - Current Portion (Note 8)	15,480,673
	<hr/>
Total Current Liabilities	124,000,320
	<hr/>

Noncurrent Liabilities:

Accounts Payable (Note 6)	1,456,434
Deposits Payable	791,658
Funds Held for Others	35,581,407
U. S. Government Grants Refundable	5,757,955
Funds Held in Trust for Pool Participants	167,117,316
Hedging Derivative Liability (Note 9)	9,015,452
Long-Term Liabilities (Note 8)	431,620,554
	<hr/>
Total Noncurrent Liabilities	651,340,776
	<hr/>

Total Liabilities	775,341,096
	<hr/>

*North Carolina State University*  
*Statement of Net Assets*  
*June 30, 2011*

*Exhibit A-1*  
*Page 2 of 2*

**NET ASSETS**

Invested in Capital Assets, Net of Related Debt	1,233,161,475
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	10,394,760
Endowed Professorships	52,713,342
Departmental Uses	6,497,146
Loans	7,146,605
Other	1,227,092
Expendable:	
Scholarships and Fellowships	22,776,099
Research	15,685,651
Endowed Professorships	41,629,279
Departmental Uses	28,325,427
Loans	1,572,978
Capital Projects	15,521,948
Debt Service	7,555,774
Other	7,761,423
Unrestricted	<u>177,832,834</u>
Total Net Assets	<u><u>\$ 1,629,801,833</u></u>

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

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

**Exhibit A-2**

**REVENUES**

Operating Revenues:

Student Tuition and Fees, Net (Note 11)	\$ 197,091,556
Federal Appropriations	16,842,963
Federal Grants and Contracts	123,803,140
State and Local Grants and Contracts	38,068,044
Nongovernmental Grants and Contracts	61,636,116
Sales and Services, Net (Note 11)	176,956,180
Interest Earnings on Loans	217,702
Other Operating Revenues, Net (Note 11)	14,988,844
	<hr/>
Total Operating Revenues	629,604,545

**EXPENSES**

Operating Expenses:

Salaries and Benefits	743,089,319
Supplies and Materials	124,591,377
Services	180,218,528
Scholarships and Fellowships	46,911,355
Utilities	37,853,283
Depreciation	56,449,786
	<hr/>
Total Operating Expenses	1,189,113,648
	<hr/>
Operating Loss	(559,509,103)

**NONOPERATING REVENUES (EXPENSES)**

State Appropriations	478,423,298
State Aid - Federal Economic Recovery Funds	20,651,218
Noncapital Grants - Student Financial Aid	29,675,741
Other Noncapital Grants	25,196,153
Noncapital Gifts	50,581,343
Investment Income (Net of Investment Expense of \$552,553)	19,971,035
Interest and Fees on Debt	(12,614,638)
Federal Interest Subsidy on Debt	1,436,654
Other Nonoperating Expenses	(390,551)
	<hr/>
Net Nonoperating Revenues	612,930,253
	<hr/>
Income Before Other Revenues and Expenses	53,421,150
Capital Grants	51,022,330
Capital Gifts	5,067,497
Additions to Endowments	6,037,818
	<hr/>
Increase in Net Assets	115,548,795

**NET ASSETS**

Net Assets - July 1, 2010	<hr/> 1,514,253,038
Net Assets - June 30, 2011	<hr/> \$ 1,629,801,833

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

**North Carolina State University**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended June 30, 2011**

**Exhibit A-3**

**Page 1 of 2**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Received from Customers	\$ 612,672,371
Payments to Employees and Fringe Benefits	(742,186,159)
Payments to Vendors and Suppliers	(343,093,189)
Payments for Scholarships and Fellowships	(46,911,355)
Loans Issued	(650,929)
Collection of Loans	1,557,512
Interest Earned on Loans	854,206
Other Receipts	14,988,844
	<hr/>
Net Cash Used by Operating Activities	(502,768,699)

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

State Appropriations	478,423,298
State Aid - Federal Economic Recovery Funds	20,651,218
Noncapital Grants - Student Financial Aid	29,675,741
Other Noncapital Grants	23,075,036
Noncapital Gifts	50,927,590
Additions to Endowments	6,037,818
Federal Family Education Loan Receipts	534,363
Federal Family Education Loan Disbursements	(587,527)
William D. Ford Direct Lending Receipts	109,149,597
William D. Ford Direct Lending Disbursements	(109,138,925)
Related Activity Agency Receipts	33,824,053
Related Activity Agency Disbursements	(31,114,114)
External Participation in Investment Fund Receipts	15,404,216
External Participation in Investment Fund Disbursements	(524,748)
Other Payments	(21,186)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	626,316,430

**CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES**

Proceeds from Capital Debt	67,880,548
Capital Grants	50,524,475
Capital Gifts	3,911,940
Proceeds from Sale of Capital Assets	405,655
Acquisition and Construction of Capital Assets	(179,223,545)
Principal Paid on Capital Debt and Leases	(12,726,291)
Interest and Fees Paid on Capital Debt and Leases	(13,773,389)
Federal Interest Subsidy on Debt Received	1,436,654
Other Payments	(310,368)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(81,874,321)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Proceeds from Sales and Maturities of Investments	7,658,365
Investment Income	1,549,782
Purchase of Investments and Related Fees	(71,248,847)
	<hr/>
Net Cash Used by Investing Activities	(62,040,700)
	<hr/>
Net Decrease in Cash and Cash Equivalents	(20,367,290)
Cash and Cash Equivalents - July 1, 2010	387,327,659
	<hr/>
Cash and Cash Equivalents - June 30, 2011	\$ 366,960,369

**North Carolina State University**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended June 30, 2011**

**Exhibit A-3**

**Page 2 of 2**

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

Operating Loss	\$ (559,509,103)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	56,449,786
Allowances, Write-Offs, and Amortizations	216,742
Changes in Assets and Liabilities:	
Receivables (Net)	(1,645,804)
Due from Primary Government	(64,506)
Inventories	(237,242)
Accounts Payable and Accrued Liabilities	673,411
Due to Primary Government	430,699
Unearned Revenue	1,132,711
Compensated Absences	(356,178)
Deposits Payable	140,785
	<u>502,768,699</u>
Net Cash Used by Operating Activities	<u>\$ (502,768,699)</u>

**RECONCILIATION OF CASH AND CASH EQUIVALENTS**

Current Assets:	
Cash and Cash Equivalents	\$ 203,211,185
Restricted Cash and Cash Equivalents	91,121,258
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>72,627,926</u>
Total Cash and Cash Equivalents - June 30, 2011	<u>\$ 366,960,369</u>

**NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

Assets Acquired through a Gift	\$ 1,232,744
Change in Fair Value of Investments	45,761,221
Loss on Disposal of Capital Assets	(934,095)
Amortization of Bond Premium/Discounts	(662,219)

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

***North Carolina State University Foundations  
Statement of Financial Position  
June 30, 2011***

***Exhibit B-1***

	<b>North Carolina State University Foundation, Inc.</b>	<b>NC State Student Aid Association, Inc.</b>
<b>ASSETS</b>		
Cash and Cash Equivalents	\$ 8,002,145	\$ 17,729,468
Investments	9,109,363	29,969,732
Investments with University Investment Pool	74,231,298	
Cash Surrender Value of Life Insurance	225,079	105,203
Real Estate Held for Resale	3,275,936	7,807,679
Receivables, Net	373,105	320,688
Pledges Receivable/Promises	20,027,613	28,307,596
Externally Managed Irrevocable Trust	20,155,285	
Prepaid Expenses		46,184
Notes/Loans Receivable, Net		46,350
Deferred Charges		245,861
Property and Equipment, Net	4,522,245	50,824,541
Total Assets	<u>139,922,069</u>	<u>135,403,302</u>
<b>LIABILITIES</b>		
Accounts Payable and Accrued Expenses	1,465,112	467,795
Deferred Revenue	90,708	3,417,545
Interest Payable		123,354
Deposits Payable		1,715
Funds Held for Others	614,485	
Interest Rate Swap Fair Value Liability		2,566,777
Split Interest Agreement Obligations	17,392,000	
Notes Payable		1,279,564
Bonds Payable		43,270,000
Total Liabilities	<u>19,562,305</u>	<u>51,126,750</u>
<b>NET ASSETS</b>		
Unrestricted	8,538,040	18,919,073
Temporarily Restricted	46,995,411	31,710,735
Permanently Restricted	64,826,313	33,646,744
Total Net Assets	<u>\$ 120,359,764</u>	<u>\$ 84,276,552</u>

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

**North Carolina State University Foundations**  
**Statement of Activities**  
**For the Fiscal Year Ended June 30, 2011**

**Exhibit B-2**

	<b>North Carolina State University Foundation, Inc.</b>	<b>NC State Student Aid Association, Inc.</b>
<b>CHANGES IN UNRESTRICTED NET ASSETS</b>		
Revenues, Gains and Losses:		
Contributions	\$ 12,268	\$ 8,180,221
Changes in Pledges Receivable	(251,261)	
Donated Services and Noncash Contributions	577,000	2,105,965
Student Housing Rents		2,728,684
Investment Income	86,848	438,169
Net Unrealized and Realized Gains on Long-Term Investments	1,532,643	3,923,470
Unrealized Gain on Swap Contracts		415,224
Net Asset Reclassification - Underwater Endowments	3,178,876	
Other	3,373,250	1,568,918
Total Unrestricted Revenues, Gains and Losses	<u>8,509,624</u>	<u>19,360,651</u>
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	7,024,027	
Facility Improvements		6,246,761
Total Net Assets Released from Restrictions	<u>7,024,027</u>	<u>6,246,761</u>
Total Unrestricted Revenues, Gains, Losses and Other Support	<u>15,533,651</u>	<u>25,607,412</u>
Expenses:		
University Support	6,541,686	8,864,657
University Facilities Support	2,509,062	6,246,761
Student Housing		3,026,630
Management and General	293,474	719,187
Fund Raising	1,246,679	2,914,603
Total Expenses	<u>10,590,901</u>	<u>21,771,838</u>
Increase in Unrestricted Net Assets	<u>4,942,750</u>	<u>3,835,574</u>
<b>CHANGES IN TEMPORARILY RESTRICTED NET ASSETS</b>		
Contributions	8,003,695	2,279,927
Changes in Pledges Receivable	833,952	
Investment Income	36,315	106,956
Net Unrealized and Realized Gains on Long-Term Investments	11,365,801	104,083
Unrealized Gain on Swap Contracts		387,350
Net Asset Reclassification - Underwater Endowments	(3,178,876)	
Vaughn Towers Revenue		3,740,939
Other	(808,500)	113,872
Net Assets Released from Restrictions:		
Satisfaction of Program Restrictions	(7,024,027)	
Facility Improvements		(6,246,761)
Increase in Temporarily Restricted Net Assets	<u>9,228,360</u>	<u>486,366</u>
<b>CHANGES IN PERMANENTLY RESTRICTED NET ASSETS</b>		
Contributions	15,138,585	349,469
Changes in Pledges Receivable	6,962,166	
Investment Income	112,127	
Net Unrealized and Realized Gains on Long-Term Investments	260,684	
Change in Value of Split Interest Agreements	(386,736)	
Other	701,090	
Increase in Permanently Restricted Net Assets	<u>22,787,916</u>	<u>349,469</u>
Increase in Net Assets	36,959,026	4,671,409
Net Assets at Beginning of Year	83,400,738	79,605,143
Net Assets at End of Year	<u>\$ 120,359,764</u>	<u>\$ 84,276,552</u>



**NORTH CAROLINA STATE UNIVERSITY  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2011**

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

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

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

**Blended Component Units** - Although legally separate, the NC State Investment Fund, Inc. (Investment Fund) and the NC State University Partnership Corporation (Corporation), component units of the University, are reported as if they were part of the University.

The Investment Fund is governed by a Members Board consisting of six ex officio directors and five elected representatives. The Investment Fund's purpose is to support the University by operating an investment fund for charitable nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The Investment Fund is a governmental external investment pool. Because the majority of the Members Board of the Investment Fund consists of University administrators and board members and the Investment Fund's primary purpose is to benefit North Carolina State University, its financial statements have been blended with those of the University.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

During the year ended June 30, 2011, the Foundation distributed \$9,435,763 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Foundations Accounting and Investments Office, Campus Box 7207, Raleigh, NC 27695, or by calling (919) 513-7149.

During the year ended June 30, 2011, the Athletic Club distributed \$8,131,217 to the University for both restricted and unrestricted purposes. Complete financial statements for the Athletic Club can be obtained from the NC State Student Aid Association, PO Box 37100, Raleigh, NC 27627, or by calling (919) 865-1500.

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

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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

Money market funds, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated. Private equity funds consist primarily of investments that are not readily marketable. Investments in these categories, which are managed externally, are valued utilizing the most current information provided by the general partner.

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity or for a specified period of time, along with any accumulated investment

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an estimated useful life of more than one year except for internally generated software which is capitalized when the value or cost is \$1,000,000 or greater and other intangible assets which are capitalized when the value or cost is \$100,000 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 15 to 75 years for general infrastructure, 10 to 50 years for buildings, 4 to 22 years for equipment, and 2 to 15 years for computer software.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

**O. Revenue and Expense Recognition** - The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

### NOTE 2 - DEPOSITS AND INVESTMENTS

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



**NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

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At June 30, 2011, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$365,031,425 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 "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2011 was \$226,991. The carrying amount of the University's deposits not with the State Treasurer was \$1,701,953 and the bank balance was \$1,742,215. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University follows the Cash Management Plan (Plan) approved by the North Carolina Office of the State Controller. As provided by the Plan, all funds belonging to the University are deposited with the State Treasurer pursuant to G.S. 147-77 and G.S. 147-69.1. As provided by the Plan, imprest checking accounts are established with outside banks when considered effective in meeting management objectives. All imprest checking accounts are authorized by the University Treasurer and are limited to the minimum amount needed for sanctioned purposes. In addition, pursuant to G.S. 116-36(e), the University invests certain endowment funds with outside bank accounts. The University does not have a deposit policy for custodial credit risk. As of June 30, 2011, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	\$	13,463
Uninsured and Collateral Held by Pledging Bank's Trust Department not in University's Name		903,182
Total	\$	916,645

**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)

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

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

Investments are subject to the following risks.

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

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

**Long-Term Investment Pool** - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unit value method. Under this method, each

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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participating fund's investment balance is determined based on market value. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

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

### *Long-Term Investment Pool*

*(Excludes Amounts Reported in the Investment Fund)*

<b>Investment Type</b>	<u>Fair Value</u>
Pooled Investments - BNY Mellon	<u>\$ 316,018</u>

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

The Investment Fund is not subject to any formal oversight other than that provided by the Investment Fund Members Board or its Board of Directors. The Members Board is responsible for adopting investment objectives and policies and for monitoring policy implementation and investment performance. The Members Board has chosen not to make individual security selection decisions. The Board of Directors has the responsibility to oversee the allocation of the Investment Fund's portfolio among the asset classes, investment vehicles, and investment managers.

BNY Mellon is the custodian for the pool and provides the University with quarterly statements defining income and fair value information, which is then allocated among the fund's participants. Each participant holds Master Trust Units of the Fund. The unit price fluctuates based on the investment experience of the investment pool. There are no

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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involuntary participants in the pool. The University has not provided or obtained any legally binding guarantees during the period to support the value for the pool's investments. The annual financial report for the external investment pool may be obtained from the Foundations Accounting and Investment Office, Campus Box 7207, Raleigh, NC 27695 or by calling (919) 513-7149 or at [http://www.fis.ncsu.edu/foundations\\_accounting/investment-fund/](http://www.fis.ncsu.edu/foundations_accounting/investment-fund/).

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

### *Investment Fund*

<b>Investment Type</b>	<u>Fair Value</u>
UNC Investment Fund	\$ 342,879,105
Private Equity Limited Partnerships	<u>27,359,413</u>
Total Investment Fund	<u>\$ 370,238,518</u>

**UNC Investment Fund, LLC** - At June 30, 2011, the University's investments include \$342,879,105 which represents the University's equity position in the UNC Investment Fund, LLC (System Fund). The System Fund is an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating. Asset and ownership interests of the System Fund are determined on a market unit valuation basis each month. Investment risks associated with the System Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**Non-Pooled Investments** - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2011, for the University's non-pooled investments.

### *Non-Pooled Investments*

Investment Type	Fair Value	Investment Maturities (in Years) <u>Less</u> <u>Than 1</u>
Debt Securities		
Money Market Mutual Funds	\$ 46,153,931	\$ 46,153,931
Other Securities		
Investments in Real Estate	23,670,492	
Domestic Stocks	291,899	
Collections and Mineral Rights	49,602	
Total Non-Pooled Investments	<u>\$ 70,165,924</u>	

At June 30, 2011, the University's non-pooled investments had the following credit quality distribution for securities with credit exposure (based on Moody's and S&P ratings):

	Fair Value	AAA Aaa
Money Market Mutual Funds	<u>\$ 46,153,931</u>	<u>\$ 46,153,931</u>

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

Investment Type	Fair Value
Debt Securities	
Money Market Mutual Funds	\$ 46,153,931
Other Securities	
UNC Investment Fund	342,879,105
Investments in Real Estate	23,670,492
Private Equity Limited Partnerships	27,359,413
Pooled Investments	316,018
Domestic Stocks	291,899
Collections and Mineral Rights	49,602
Total Investments	<u>\$ 440,720,460</u>

Total investments include \$74,231,298 held in the "Investment Fund" for the North Carolina State University Foundation, Inc. This amount is excluded from the University prepared financial statements and included in the accompanying component unit financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University pooled endowment funds are determined by applying 4% (the Board approved spending rate) to the average market value of the long term investment pool (for a 20 quarter period), divided by the number of investment units in the pool to determine the "average spending amount" per unit of investment. The individual endowment fund payout or spending budget is then determined by applying the "average spending amount" to the number of investment units held by the individual endowment fund. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference. At June 30, 2011, endowment net assets of \$104,160,523 were available to be spent, of which \$85,997,481 was restricted to specific purposes.

During the current fiscal year, the University experienced positive investment gains, but not sufficient to recoup prior year losses. As a result, at June 30, 2011, \$385,359 of eroded corpus has been reported against the nonexpendable endowment as compared to \$2,862,123 at the prior fiscal year end.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 4 - RECEIVABLES

Receivables at June 30, 2011, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
<b>Current Receivables:</b>			
Students	\$ 4,101,175	\$ 2,172,501	\$ 1,928,674
Accounts	25,928,329	2,502,815	23,425,514
Intergovernmental	21,932,561		21,932,561
Interest on Loans	320,327	278,858	41,469
Federal Interest Subsidy on Debt	305,671		305,671
	<b>Total Current Receivables</b>	<b>\$ 4,954,174</b>	<b>\$ 47,633,889</b>
<b>Notes Receivable:</b>			
<b>Notes Receivable - Current:</b>			
Federal Loan Programs	\$ 2,589,043	\$ 7,559	\$ 2,581,484
Institutional Student Loan Programs	288,329	1,571	286,758
	<b>Total Notes Receivable - Current</b>	<b>\$ 9,130</b>	<b>\$ 2,868,242</b>
<b>Notes Receivable - Noncurrent:</b>			
Federal Loan Programs	\$ 8,678,389	\$ 588,231	\$ 8,090,158
Institutional Student Loan Programs	227,655	135,360	92,295
	<b>Total Notes Receivable - Noncurrent</b>	<b>\$ 723,591</b>	<b>\$ 8,182,453</b>

### 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	\$ 38,285,610	\$ 0	\$ 1,697,664	\$ 36,587,946
Construction in Progress	162,025,112	104,736,370	127,961,364	138,800,118
Computer Software in Development	2,385,000	2,559,349		4,944,349
	<b>Total Capital Assets, Nondepreciable</b>	<b>107,295,719</b>	<b>129,659,028</b>	<b>180,332,413</b>
Capital Assets, Depreciable:				
Buildings	1,426,874,142	164,889,895	887,774	1,590,876,263
Machinery and Equipment	262,528,573	31,672,660	8,528,843	285,672,390
General Infrastructure	160,499,489	18,562,626	950	179,061,165
Computer Software	2,166,073	125,000		2,291,073
	<b>Total Capital Assets, Depreciable</b>	<b>215,250,181</b>	<b>9,417,567</b>	<b>2,057,900,891</b>
Less Accumulated Depreciation for:				
Buildings	389,075,357	34,856,265	473,209	423,458,413
Machinery and Equipment	178,180,473	16,833,990	8,010,262	187,004,201
General Infrastructure	34,891,846	4,472,182		39,364,028
Computer Software	923,355	287,349		1,210,704
	<b>Total Accumulated Depreciation</b>	<b>56,449,786</b>	<b>8,483,471</b>	<b>651,037,346</b>
	<b>Total Capital Assets, Depreciable, Net</b>	<b>158,800,395</b>	<b>934,096</b>	<b>1,406,863,545</b>
<b>Capital Assets, Net</b>	<b>\$ 1,451,692,968</b>	<b>\$ 266,096,114</b>	<b>\$ 130,593,124</b>	<b>\$ 1,587,195,958</b>

## 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:

<b>Current Accounts Payable and Accrued Liabilities</b>	
Accounts Payable	\$ 32,460,351
Accrued Payroll	10,779,048
Contract Retainage	6,439,090
Intergovernmental Payables	19,199
Severance Payable	1,105,469
Other	382,029
<b>Total Current Accounts Payable and Accrued Liabilities</b>	<b>\$ 51,185,186</b>
<b>Noncurrent Accounts Payable and Accrued Liabilities</b>	
Severance Payable	\$ 881,434
Other	575,000
<b>Total Noncurrent Accounts Payable and Accrued Liabilities</b>	<b>\$ 1,456,434</b>

### NOTE 7 - SHORT-TERM DEBT - COMMERCIAL PAPER PROGRAM

The University has available Commercial Paper Program financing for short-term credit up to \$100,000,000 to finance capital construction projects. The University's available funds are pledged to the Commercial Paper Program financing with the anticipation of converting to general revenue bond financing in the future. As of June 30, 2011, \$10,000,000 in Tax-Exempt Commercial Paper was outstanding.

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	\$ 0	\$ 10,000,000	\$ 0	\$ 10,000,000

### 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	\$ 314,850,000	\$ 0	\$ 11,110,000	\$ 303,740,000	\$ 12,465,000
Add Premium	8,259,579		662,219	7,597,360	
<b>Total Revenue Bonds Payable</b>	<b>323,109,579</b>		<b>11,772,219</b>	<b>311,337,360</b>	<b>12,465,000</b>
Notes Payable	23,650,703	57,880,548	1,475,000	80,056,251	65,131
Capital Leases Payable	388,055		141,291	246,764	122,634
Compensated Absences	55,817,030	33,578,724	33,934,902	55,460,852	2,827,908
<b>Total Long-Term Liabilities</b>	<b>\$ 402,965,367</b>	<b>\$ 91,459,272</b>	<b>\$ 47,323,412</b>	<b>\$ 447,101,227</b>	<b>\$ 15,480,673</b>

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	Principal Paid Through June 30, 2011	Principal Outstanding June 30, 2011
<b>GENERAL REVENUE</b>						
Refund Housing System Series L & M	2002B	4.4% - 5%	10/01/2014	\$ 8,800,000	\$ 5,420,000	\$ 3,380,000
Housing System Projects/Doak Field Projects	2003A	3% - 5%	10/01/2018	26,735,000	875,000	25,860,000
Housing System Projects/Doak Field Projects	2003B	3.48% swap*	10/01/2027	45,660,000	2,305,000	43,355,000
Various Construction Projects	2005A	4.6% - 5%	10/01/2025	81,615,000	14,000,000	67,615,000
Various Construction Projects	2008A	3.862% swap*	10/01/2028	66,605,000		66,605,000
Various Construction Projects	2008B	3% - 5%	10/01/2020	26,955,000	7,660,000	19,295,000
Various Construction Projects	2010A	3% - 5%	10/01/2022	18,065,000		18,065,000
Various Construction Projects	2010B	5.079% - 6.027%**	10/01/2035	59,565,000		59,565,000
Total Revenue Bonds Payable (principal only)				<u>\$ 334,000,000</u>	<u>\$ 30,260,000</u>	<u>303,740,000</u>
Plus: Unamortized Premium						<u>7,597,360</u>
Total Revenue Bonds Payable						<u>\$ 311,337,360</u>

\* For variable rate debt, interest rates in effect at June 30, 2011 are included. For variable rate debt with interest rate swaps, the synthetic fixed rates are included.

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

### 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 entered into take out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Under the Agreement, any bonds purchased through the Liquidity Facility become Liquidity Provider Bonds and shall, from the date of such purchase and while they are Liquidity Provider Bonds, bear interest at the Liquidity Provider rate (the greater of the bank prime commercial lending rate and federal funds rate plus 0.5%). Upon remarketing of Liquidity Provider Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Liquidity Provider Bonds. Payment of the interest on the Liquidity Provider Bonds is due the first business day of each month in which Liquidity Provider Bonds are outstanding. At June 30, 2011, there were no Liquidity Provider Bonds held by the Liquidity Facility. The original Liquidity Facility expiration date has been extended and is scheduled to expire on November 30, 2015, unless otherwise extended based on the terms of the Agreement.

Upon expiration or termination of the Agreement, the University is required to redeem (purchase) the Liquidity Provider Bonds held by the Liquidity Facility in 12 quarterly installments, beginning the first business day of January, April, July or October, whichever first occurs on or following the Purchase Date along with the accrued interest at the Liquidity Provider rate. In the event the entire issue of \$43,355,000 of demand bonds was “put” and not resold, the University would be required to pay \$15 million a year for three years under this agreement assuming a 3.25% interest rate.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

Under the Agreement, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Base Rate (the greater of the bank prime commercial lending rate and the federal funds rate plus 3.0%) for 30 days. For the period of 31 through 60 days after purchase, the Bank Bonds bear interest at the Base Rate plus 1.0%. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is due the first business day of each month in which Bank Bonds are outstanding. At June 30, 2011, there were no Bank Bonds held by the Liquidity Facility. The original Liquidity Facility expiration date has been extended and is scheduled to expire on October 10, 2013, unless otherwise extended based on the terms of the Agreement.

After the purchase of the Bank Bonds, or expiration or termination of the Agreement, the University is required to redeem (purchase) the Bank bonds held by the Liquidity Facility in six semi-annual installments, beginning the first business day of the month which next occurs on or following 61 days after the Purchase Date along with accrued interest at the Bank Bond rate plus 2.0%. In the event the entire issue of \$66,605,000 of demand bonds was "put" and not resold, the University would be required to pay \$24 million a year for three years under this agreement assuming a 5.25% interest rate.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Annual Requirements				
	Revenue Bonds Payable			Notes Payable	
	Principal	Interest	Interest Rate Swaps, Net	Principal	Interest
2012	\$ 12,465,000	\$ 9,517,687	\$ 2,724,393	\$ 65,131	\$ 4,631,142
2013	13,185,000	9,005,040	2,724,393	1,473,227	3,412,067
2014	13,830,000	8,458,825	2,724,393	1,860,775	3,340,561
2015	13,470,000	7,866,620	2,724,393	2,140,857	3,254,782
2016	13,155,000	7,303,668	2,664,041	2,432,294	3,156,872
2017-2021	71,525,000	29,327,467	11,150,741	18,537,168	13,760,571
2022-2026	85,080,000	20,283,920	6,031,779	31,786,441	8,465,667
2027-2031	65,675,000	13,019,841	274,413	21,760,358	1,459,061
2032-2036	15,355,000	2,385,939			
Total Requirements	<u>\$ 303,740,000</u>	<u>\$ 107,169,007</u>	<u>\$ 31,018,546</u>	<u>\$ 80,056,251</u>	<u>\$ 41,480,723</u>

Interest on the variable rate 2003B general revenue bonds is calculated at 0.08% at June 30, 2011

Interest on the variable rate 2008A general revenue bonds is calculated at 0.09% at June 30, 2011

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

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

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

Financial Institution	Interest Rate/Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2011	Compounded Interest	Principal Outstanding June 30, 2011
BB&T	4.97%	06/01/2030	\$ 19,700,703	\$ 0	\$ 0	\$ 19,700,703
Bank of America	4.07%	08/17/2028	56,060,010		1,150,538	57,210,548
Suntrust	Variable	12/31/2011	5,000,000	2,525,000		2,475,000
Fifth Third Bank	Variable	11/30/2011	670,000			670,000
			<u>\$ 81,430,713</u>	<u>2,525,000</u>	<u>\$ 1,150,538</u>	<u>\$ 80,056,251</u>

## 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	Classification	Liability
<i>Hedging Derivative Instruments</i>					
<i>Cash Flow Hedges</i>					
Pay-Fixed Interest Rate Swap		Deferred Outflow of Resources		Hedging	
2003 B Bonds	\$ 24,655,000		\$ 768,346	Derivative Liability	\$ (2,450,143)
Pay-Fixed Interest Rate Swap		Deferred Outflow of Resources		Hedging	
2008 A Bonds	50,000,000		611,730	Derivative Liability	(6,565,309)
			<u>\$ 1,380,076</u>		<u>\$ (9,015,452)</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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				Pay 3.54%
	Flows on General Revenue				Receive 75%
	2003B Series Bonds	\$ 24,655,000	06/20/03	10/01/27	LIBOR
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash				Pay 3.862%
	Flows on General Revenue				Receive
	2008A Series Bonds	50,000,000	09/01/08	10/01/26	SIFMA

As of June 30, 2011, the synthetic interest rates on the swapped portion of the 2003B and 2008A bonds were 3.48% and 3.862%, respectively. The fair value of the pay-fixed interest rate swaps was estimated using the market value method. This method calculates the market price of traded instruments.

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

### *Hedging Derivative Risks*

*Credit Risk:* At June 30, 2011, the University was not exposed to credit risk on its interest rate swaps because the swaps had negative fair values. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. The swap agreements require termination should the University's or the counterparty's credit rating fall below either Baa2 as issued by Moody's or BBB as issued by S&P or Fitch. Also, under the terms of the swap agreements, should one party become insolvent or otherwise default on its obligations, provisions permit the nondefaulting party to accelerate and terminate all outstanding transactions. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A3 as determined by Moody's or A- as determined by S&P, the swap will be collateralized by the counterparty with cash, U.S. government or agency securities. If the counterparty is required to collateralize, then the collateral will be posted with a third party custodian or secured party. The swaps agreements entered into by the University are held with separate counterparties. All the counterparties are rated A or better.

*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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The fair values are the market values as of June 30, 2011. Both of the swaps outstanding have termination dates greater than 15 years. As the yield curve rises, the value of the swaps will increase and as rates fall, the value of the swaps will decrease.

*Basis Risk:* The University is exposed to basis risk on the swaps when the variable payment received is based on an index other than Securities Industry on Financial Markets Association (SIFMA). Should the relationship between London Interbank Offering Rate (LIBOR) and SIFMA move to convergence, the expected cost savings may not be realized. The current outstanding swaps and the related bonds reset rates weekly and pay monthly. As of June 30, 2011, the SIFMA rate was .09%, whereas 75% of LIBOR was .14%.

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

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

### NOTE 10 - LEASE OBLIGATIONS

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

<u>Fiscal Year</u>	<u>Amount</u>
2012	\$ 122,634
2013	75,626
2014	57,524
2015	804
Total Minimum Lease Payments	256,588
Amount Representing Interest (0.939% Rate of Interest)	9,824
Present Value of Future Lease Payments	<u>\$ 246,764</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Machinery and equipment acquired under capital lease amounted to \$543,933 at June 30, 2011. Depreciation for the capital assets associated with capital leases is included in depreciation expense.

- B. Operating Lease Obligations** - The University entered into operating leases for equipment and property rental. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2011:

Fiscal Year	Amount
2012	\$ 5,616,793
2013	4,340,842
2014	3,800,838
2015	3,502,208
2016	3,265,104
2017-2021	15,645,226
2022-2026	15,125,000
2027-2029	6,806,250
Total Minimum Lease Payments	\$ 58,102,261

Rental expense for all operating leases during the year was \$6,432,650.

### NOTE 11 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
<b>Operating Revenues:</b>					
<b>Student Tuition and Fees</b>	\$ 269,042,648	\$ 598,220	\$ 71,413,631	\$ (60,759)	\$ 197,091,556
<b>Other Operating Revenues</b>	\$ 21,218,713	\$ 6,187,898	\$ 0	\$ 41,971	\$ 14,988,844
<b>Sales and Services</b>	\$ 243,270,442	\$ 50,845,452	\$ 15,233,280	\$ 235,530	\$ 176,956,180

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 12 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 302,813,760	\$ 30,324,864	\$ 32,009,991	\$ 0	\$ 3,066	\$ 0	\$ 365,151,681
Research	152,506,512	18,972,064	45,847,430		868,644		218,194,650
Public Service	85,492,527	9,448,331	27,412,053		394,649		122,747,560
Academic Support	40,616,810	18,594,679	17,736,023		37,675		76,985,187
Student Services	14,438,311	1,924,103	5,252,971		191,277		21,806,662
Institutional Support	55,665,781	6,255,464	13,989,678		66,151		75,977,074
Operations and Maintenance of Plant	35,131,441	6,573,499	7,274,093		30,825,190		79,804,223
Student Financial Aid	1,214,629	291,207	240,448	46,911,355			48,657,639
Auxiliary Enterprises	55,209,548	32,207,166	30,455,841		5,466,631		123,339,186
Depreciation						56,449,786	56,449,786
Total Operating Expenses	<u>\$ 743,089,319</u>	<u>\$ 124,591,377</u>	<u>\$ 180,218,528</u>	<u>\$ 46,911,355</u>	<u>\$ 37,853,283</u>	<u>\$ 56,449,786</u>	<u>\$ 1,189,113,648</u>

### 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 \$639,010,773, of which \$304,348,067 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$15,004,360 and \$18,260,884, respectively.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 \$15,004,360, \$10,741,148, and \$10,536,565, respectively.

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

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

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 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 \$639,010,773, of which \$220,275,074 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$15,066,815 and \$13,216,504, 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$2,761,099 for the year ended June 30, 2011.

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 \$127,444. The voluntary contributions by employees amounted to \$4,522,261 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. No costs are incurred by the University. The voluntary contributions by employees amounted to \$11,454,047 for the year ended June 30, 2011.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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North Carolina Cooperative Extension employees with federal appointments prior to January 1, 1987 participate in the Civil Service Retirement System. Currently, 54 employees participate in CSRS. Participating employees and the University are required by federal statute to contribute 7% of salary to CSRS. In addition, the CSRS employees may contribute to the Thrift Savings Plan (a defined contribution plan managed by the Federal Retirement Thrift Investment Board) up to the IRS annual elective limits with no agency matching contributions. Total employee and employer contributions for CSRS for the year ended June 30, 2011, were \$376,475 and \$402,638, respectively. Employees covered under CSRS contributed \$18,639 to the Thrift Savings Plan.

Under the Federal Employees Retirement System (FERS), employees are required to contribute 0.8% of salary and the University 11.2%. Currently, seven employees participate in FERS. In addition, the FERS employees may contribute to the Thrift Savings Plan up to the IRS annual elective limits with an agency matching contribution of up to 5% of the employee's contribution. Total employee and employer contributions for the year ended June 30, 2011, were \$5,379 and \$77,825, respectively. For employees covered under FERS, the total employee and employer contributions to the Thrift Savings Plan for the year ended June 30, 2011, were \$76,703 and \$33,230, respectively.

### NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 \$25,706,534, \$23,250,220, and \$21,576,756, 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 "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

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

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2011, the University made a statutory contribution of 0.52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2010, and 2009, were 0.52% and 0.52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2011, 2010, and 2009, which were \$2,728,040, \$2,686,692, and \$2,736,564, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

### NOTE 15 - RISK MANAGEMENT

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

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

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

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

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is procured

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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through the State's Agent of Record and approved by the North Carolina Department of Insurance. The University is charged a premium by the private insurance company. Coverage limit is \$1,000,000 per occurrence. The applicable deductible is \$25,000 per occurrence.

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

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

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 established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$109,062,102 at June 30, 2011.

The University has amended the Use Agreement for the RBC Center with the Centennial Authority (a related party) and therein agreed to make scheduled capital contributions totaling \$6,000,000 to the Authority's Building Enhancement Fund over a 15 year period. The total outstanding commitment on this agreement is \$4,950,000 as of June 30, 2011.

**B. Pending Litigation and Claims** - As previously reported, the Environmental Protection Agency (EPA) filed a civil action against the University pursuant to the Comprehensive Environmental Response, Compensation and Liability Act. The complaint sought relief that would cause the University to enter into remediation of a hazardous waste site known as "Lot86." The University is involved in ongoing discussions and negotiations with the EPA concerning the appropriate means for addressing the remediation. A Consent Decree executed by North Carolina State University and the EPA has been approved by the Court. Remedial clean-up pursuant to the Consent Decree continues. The remediation costs remaining are estimated to be approximately \$1,600,000.

As previously reported, the NC School Boards Association, et. al. filed a civil action against various state officials in their official capacity seeking a judicial determination as to whether the state constitution requires certain monetary payments collected by state agencies to be paid to the local county school funds. On July 1, 2005, the NC Supreme Court held in favor of the school boards with regard to parking fines. The matter was remanded back to the trial court for disposition in accordance with the Superior Court's decision. On August 8, 2008, the Wake County Superior Court issued judgment that the estimated amounts collected from January 1, 1996, to June 30, 2005, by UNC Campuses belong and should have been paid to the public schools of the State by payment to the State's Civil Penalty and Forfeiture Fund. The manner in which the judgment will be settled is uncertain and is to be determined by the North Carolina General Assembly. At issue for NC State University is approximately \$6,749,207 in transportation fines collected since January 1, 1996, to June 30, 2005. Of this amount, the University has transferred \$2,273,817 to the Office of State Budget and Management, leaving approximately \$4,475,390 still outstanding. Since July 2005, the University has been forwarding transportation fine collections, less collection basis costs, to the Office of State Budget and Management on a monthly basis.

As previously reported, on September 16, 2005, Ward Transformer Company, Inc. and related entities (collectively the "Ward Performing Parties") entered into a Settlement Agreement with the United States Environmental Protection Agency ("EPA"). In the Agreement, the Ward Performing Parties agreed to fund and carry out a removal action to address PCB contamination at and in the vicinity of the 11 acre Ward Transformer facility on Mount Herman Road near the Raleigh-Durham International Airport. It is currently estimated that the removal action will involve the excavation and onsite treatment or offsite disposal of approximately 60,000 cubic yards, or about 220,000 tons, of PCB contaminated soils. Current estimates indicate that the costs may be in the range upwards of \$20 million. The Ward Performing Parties have notified NC State that they believe that the University is responsible for

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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some of the PCB contamination because NC State allegedly had Ward repair and refurbish transformers during the 1960's through the 1990's. On March 24, 2010, the Court granted the University's Motion to Dismiss based on the 11th Amendment sovereign immunity. However, this case is still open pending an appeal by the plaintiffs.

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

### NOTE 17 - RELATED PARTIES

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

These organizations serve as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. As described in Note 1 to the financial statements, the North Carolina State University Foundation, Inc. and the NC State Student Aid Association, Inc. are considered component units of the University for reporting purposes and their financial statements are presented separately as part of the University's financial statements. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the other foundations, except for support from each organization to the University. This support of the foundations, excluding amounts from the North Carolina State University Foundation, Inc. and the NC State Student Aid Association, Inc. approximated \$26,328,557 for the year ended June 30, 2011.

**Nonprofit Corporation** - The Centennial Authority (Authority) was created by the 1995 General Assembly (Senate Bill 606) for the purpose of studying, designing, planning, constructing, owning, promoting, financing, and operating a regional facility on land owned by the State. Prior to this act, the General Assembly authorized the construction by the University of a facility to be



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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known as the “Entertainment and Sports Arena” (ESA). This facility serves as a regional sports entertainment center and is available for cultural performances, sporting events, and other activities of the University or of other entities (the Centennial Center project). With the 1995 legislation, the Centennial Center project was transferred to the Authority.

The Authority entered into a Ground Lease with the State of North Carolina to lease land for the ESA for a period of 99 years at an annual rent of \$1. The University entered into a Use Agreement with the Authority. Both parties agreed that the University shall be the primary and preferred user of all areas of the ESA. The University is required to pay the greater of 10% of gross ticket revenues or \$47,783 for each men’s and \$20,899 for each women’s basketball game to compensate the Authority for facility rental and operating expenses. Rent and expense payments for miscellaneous events will be negotiated on an event by event basis based on the availability of the ESA and the anticipated attendance.

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

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

### **NOTE 18 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING**

For the fiscal year ended June 30, 2011, the University implemented the following pronouncement issued by 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.

### **NOTE 19 - SUBSEQUENT EVENTS**

On September 19, 2011, the University borrowed \$10,000,000 through the commercial paper financing program. These funds provide interim funding for the expansion and renovation of the Talley Student Center.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### NOTE 20 - DISCRETELY PRESENTED COMPONENT UNITS

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

#### North Carolina State University Foundation, Inc.

##### ENDOWMENT

The Foundation's endowment consists of approximately 490 individual funds established for a variety of purposes related to the mission of the University. The endowment includes both donor-restricted endowments and funds designated by the Foundation Board to function as endowments. Net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions. The majority of the Foundation's signed endowment gift agreements with donors have donor-imposed restrictions which stipulate that principal shall not be used to fund spending.

##### Interpretation of Relevant Law:

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

##### Funds with Deficiencies:

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the original gift value. These deficiencies generally result from unfavorable market fluctuations which produce unrealized losses to the fund. Deficiencies of this nature are reported in unrestricted net assets, and were \$180,239 as of June 30, 2011.

##### Investment Return Objectives and Risk Parameters:

The Foundation has adopted investment and spending policies for endowment assets that attempt to provide a stable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for donor-specified periods as well as board-designated funds. The endowment assets are invested through the NCSIF in a manner that is intended to produce results that exceed a

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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70% S&P 500 Index/30% Barclays Aggregate Bond Index benchmark over rolling five and ten year periods while assuming a moderate level of investment risk.

### Spending Policy:

The Foundation has a policy of appropriating for programmatic spending each year 4.0% of its endowment fund's average market value over the prior 20 quarters through the fiscal year-end preceding the fiscal year in which the spending is planned. This is consistent with the Foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return. However, in declining market conditions many endowments are not able to fund spending at the 4% level. Unless the gift instrument specifies otherwise, up to 15% of the corpus of an endowment may be expended if reserves are not sufficient to fund the programmatic spending amount, subject to the guidelines provided by UPMIFA. However, if the gift instrument does not allow spending of corpus, the Foundation does not initiate or renew spending for the individual endowments affected by declining market conditions until their market value has been recovered and exceeds their original gift value. In establishing the spending policy, the Foundation considered the long-term expected return on its endowment. Spending budgets for fiscal year 2011 were calculated at \$746,605 and \$878,955 for fiscal year 2012.

### Strategies Employed for Achieving Investment Objectives:

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

NCSIF's investments are diversified both by asset class (e.g. common stocks and fixed income securities) and within asset classes (e.g., within common stocks by economic sector, geographic area, industry, quality, and size). In addition, the NCSIF seeks to diversify exposure to all asset classes through the use of multiple managers that use a variety of investment approaches.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following represents changes in endowment net assets for the fiscal year ended June 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, Beginning of Year	\$ (1,242,817)	\$ 22,155,777	\$ 42,038,397	\$ 62,951,357
Net Asset Reclassification - Underwater Endowments	3,178,876	(3,178,876)		
Endowment Net Assets After Reclassification	1,936,059	18,976,901	42,038,397	62,951,357
Total Investment Return	571,050	11,269,012	372,811	12,212,873
Contributions, Including Change in Accrued Pledges			22,113,157	22,113,157
Appropriations of Endowment Assets for Expenditure	(105,180)	(900,480)		(1,005,660)
Change in Value of Split Interest Agreements			(386,736)	(386,736)
Other changes:				
Transfers			688,684	688,684
Endowment Net Assets, End of Year	<u>\$ 2,401,929</u>	<u>\$ 29,345,433</u>	<u>\$ 64,826,313</u>	<u>\$ 96,573,675</u>

The following represents endowment net asset composition by type of fund, as of June 30, 2011:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Undesignated - Underwater Endowments	\$ (180,239)	\$ 0	\$ 0	\$ (180,239)
Donor Restricted Endowment Funds	2,582,168	29,345,433	64,826,313	96,753,914
Total Funds	<u>\$ 2,401,929</u>	<u>\$ 29,345,433</u>	<u>\$ 64,826,313</u>	<u>\$ 96,573,675</u>

### LONG-TERM INVESTMENTS

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

Investments at June 30, 2011 consisted of:

	Cost	Fair Value
STIF	\$ 434,920	\$ 434,920
NC State Investment Fund, Inc. (NCSIF)	72,043,812	74,231,298
BNY Mellon - Life Income Funds	5,360,673	6,544,094
Citicorp Trust Bank	394,605	472,390
Total	<u>\$ 78,234,010</u>	<u>\$ 81,682,702</u>

Investments held by the NCSIF at June 30, 2011 were made up of limited partnerships. As of June 30, 2011, approximately 91% of these limited partnerships were with the UNC Management Company (UNCMC), and 9% were committed to or in other private equity investments with JP Morgan, Blackrock, and SEI. NCSIF's net assets were valued at

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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approximately \$378,260,000 at June 30, 2011. The Foundation's investment in the NCSIF represents approximately 19.6% of the member equity of NCSIF at June 30, 2011.

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

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

### FAIR VALUE MEASUREMENT

The Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification (ASC) 820 provides a framework for measuring fair value under generally accepted accounting principles. ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. ASC 820 also establishes a fair value hierarchy, which prioritizes the valuation inputs into three broad levels.

The fair value hierarchy of inputs is summarized in the three broad levels listed below:

Level 1 - quoted prices in active markets for identical investments

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

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Assets itemized below are measured at fair value on a recurring basis using market and income approaches. The market approach was used for Level 2 and the income approach was used for Level 3.

	Level 1	Level 2	Level 3	Total Fair Value
STIF	\$ 434,920	\$ 0	\$ 0	\$ 434,920
Common fund Intermediate Term Fund		1,657,959		1,657,959
NC State Investment Fund, Inc.			74,231,298	74,231,298
BNY Mellon - Life Income Funds		6,544,094		6,544,094
Citicorp Trust Bank		472,390		472,390
Externally Managed Irrevocable Trust		20,155,285		20,155,285
Beneficial Interest in Life Insurance Policies			225,079	225,079
Total	<u>\$ 434,920</u>	<u>\$ 28,829,728</u>	<u>\$ 74,456,377</u>	<u>\$ 103,721,025</u>

The following is a reconciliation of the assets measured at fair value on a recurring basis in which significant unobservable inputs (Level 3) were used in determining value:

	NC State Investment Fund, Inc.	Beneficial Interest in Life Insurance Policies
Beginning Balance	\$ 55,652,218	\$ 202,473
Unrealized Gain on Investments	8,359,862	22,606
Realized Gain on Investments	68,073	
Net Investment	<u>10,151,145</u>	
Ending Balance	<u>\$ 74,231,298</u>	<u>\$ 225,079</u>

### LIFE INCOME FUNDS

The financial statements include assets and liabilities of charitable gift annuities and unitrust agreements for which the Foundation is trustee. The grantors and/or beneficiaries retain future income interests in these assets until their death. These life income funds are recorded at fair value at the date of gift. Life income funds at June 30, 2011 have an asset balance of \$7,016,484.

The liabilities for distributions to grantors and/or beneficiaries are computed using Internal Revenue Code annuity valuation tables, the distribution terms of the agreements, and the life expectancy of the beneficiaries, and totaled \$3,922,971 at June 30, 2011. Payments from these funds were \$501,773 during the year ended June 30, 2011. In fiscal year 2010, an unrestricted reserve account was established in the Foundation's Charitable Gift Annuity (CGA) pool to receive 5% from all new CGAs established to offset the liabilities for any annuities that reach exhaustion. The goal is to build the unrestricted reserve fund to equal 5% of the total value of the Foundation's CGA pool. As of June 30, 2011, the CGA reserve balance was \$12,694.

In addition to the above life income funds, the Foundation has been named the recipient of an externally managed trust which represents irrevocable life income funds with a current market value totaling \$20,155,285 and life income funds payable of \$13,254,063 as of June 30, 2011. The Foundation is not serving as trustee for these funds. These life income funds have been

## **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

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reflected in the financial statements at their fair value and estimated future distributions to the beneficiaries have also been reflected in the financial statements and were computed using Internal Revenue Code annuity valuation tables, the distribution terms of the agreements, and the life expectancy of the beneficiaries.

### **PLEDGES RECEIVABLE**

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

	<u>Amount</u>
Receivable in Less Than One Year	\$ 7,631,958
Receivable in One to Five Years	10,228,705
Receivable in More Than Five Years	<u>4,010,127</u>
Total Gross Pledges Receivable	21,870,790
Less: Allowance for Uncollectible Pledges	730,000
Less: Unamortized Discount	<u>1,113,177</u>
Net Pledges Receivable	<u>\$ 20,027,613</u>

On a periodic basis, the Foundation evaluates its receivables and establishes an allowance for doubtful accounts, based on history of past write-offs and current credit conditions. Active past due pledges receivable are reviewed twice yearly by the Advancement Services office in order to determine if it is appropriate to write off such pledges.

### **NC State Student Aid Association, Inc.**

### **CONCENTRATIONS OF CREDIT RISK**

The Association maintains cash balances at several financial institutions located in Raleigh, North Carolina, and in several brokerage accounts located in North Carolina. The balances in the financial institutions are insured by the Federal Deposit Insurance Corporation up to \$250,000 at June 30, 2011. At June 30, 2011, cash balances in a non-interest bearing account are insured for an unlimited amount. This temporary unlimited insurance expires on December 31, 2012. The balances in the brokerage accounts are insured at varying amounts. The Association's uninsured cash balances totaled \$404,132 at June 30, 2011.

### **PLEDGES RECEIVABLE**

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Pledges receivable at June 30, 2011 are as follows:

	Amount
Pledges Receivable	\$ 35,880,827
Less: Allowance for Uncollectible Pledges	1,789,873
Less: Discount on Pledges	5,783,358
	28,307,596
Less: Current Portion	8,032,146
Pledges Due After One Year	\$ 20,275,450

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

	Amount
Receivable in Less Than One Year	\$ 8,450,502
Receivable in One to Five Years	19,619,725
Receivable in More Than Five Years	7,810,600
	35,880,827
Less: Allowance for Uncollectible Pledges	1,789,873
Less: Discount on Pledges	5,783,358
Net Pledges Receivable	\$ 28,307,596

At June 30, 2011, Goal Line Drive pledges totaling \$9,204,621 and Wolfpack Pride pledges totaling \$1,187,493 were pledged as collateral for the Goal Line Drive bond payable and the Vaughn Towers bond payable. These pledge totals are reflected at the present value of estimated future cash flows less an allowance for uncollectible pledges.

### INVESTMENTS

The Association held the following investments at June 30, 2011:

	Historical Cost	Market Value
U.S. Government Obligations	\$ 5,198,665	\$ 4,206,241
Marketable Equity Securities	13,730,841	15,858,698
Other Marketable Debt Securities	3,408,671	3,543,452
Partnership Interests	4,462,716	4,633,088
Mutual Funds	1,683,347	1,728,253
Total	\$ 28,484,240	\$ 29,969,732



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Investment income consists of the following:

	Amount
Interest	\$ 359,056
Dividends	425,730
Realized Gain on Sale of Investments	736,455
Unrealized Gain on Investments	3,291,098
Investment Expenses	(239,661)
Total	<u>\$ 4,572,678</u>

### **LONG-TERM DEBT**

#### **BOND INDENTURE--GOAL LINE DRIVE**

The Association, through the North Carolina Capital Facilities Finance Agency issued \$40,000,000 of bonds during 2002. The bonds are secured by the Goal Line Drive pledges, Wolfpack Pride Campaign pledges, and the Medlin property. The bonds are also secured by approximately \$2,000,000 in scoreboard revenues received from NCSU through 2010. The proceeds from these bonds were used for the Carter-Finley Stadium expansion and improvements. The bonds pay interest monthly at a variable rate equal to .35% plus the higher of the federal funds rate plus ½% or Bank of America's publicly announced prime rate.

The Association also must pay Bank of America a letter of credit fee. This fee, paid quarterly, is 1.75% of the outstanding debt balance. The Association must also pay annually \$17,000 of agency and \$5,000 of trustee fees. The Association pays a remarketing fee annually to Bank of America. This fee is .1% of the outstanding debt balance. The bond matures in 2012.

#### **BOND INDENTURES--WOLFPACK CLUB STUDENT HOUSING FOUNDATION**

The Housing Foundation, through the North Carolina Capital Facilities Finance Agency issued a \$23,710,000 Series 2003A bond and a \$1,235,000 Series 2003B bond in June 2003. The proceeds from these bonds were used to construct a residence hall for NCSU students and student athletes. The bonds paid interest monthly at variable rates. The Series 2003A bonds paid interest based on a variable rate established weekly by Wachovia Bank, remarketing agent. The Series 2003B bonds paid interest based on a variable rate established monthly by the remarketing agent. The Housing Foundation paid a letter of credit fee quarterly to Wachovia Bank. The fee, paid quarterly, is 1.50% of the outstanding balance. The Housing Foundation paid a remarketing fee semi-annually to Wachovia Bank. This fee is .125% of the outstanding balance. The Series 2003A bonds mature in July 2035. The Series 2003B bonds matured in July 2009.

In November 2009, the Series 2003A bond was refinanced with Branch Banking & Trust (BB&T) through a \$22,780,000 Series 2009 bond, issued through the North Carolina Capital Facilities Finance Agency. The bond pays interest monthly at a variable rate based on the monthly LIBOR rate. The variable rate was 1.75% at June 30, 2011.

## **NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)**

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The Housing Foundation has entered into a swap contract for a majority of this debt to hedge against interest rate fluctuations. The swap was issued at market terms so that it had no value at its inception. The carrying amount of the swap has been adjusted to its fair value at June 30, 2011, which, because of changes in forecasted levels of interest rates, resulted in reporting a liability of \$1,294,950 at June 30, 2011, for the fair value of the net payments forecasted under the swap.

### **BOND INDENTURES--VAUGHN TOWERS**

The Association, through the North Carolina Capital Facilities Finance Agency issued a \$15,855,000 Series 2004A bond and a \$17,685,000 Series 2004B bond in November 2004. The proceeds from these bonds were used to construct Vaughn Towers at Carter-Finley Stadium. The bonds pay interest monthly at variable rates. The Series 2004A bond pays interest based on a variable rate established weekly by Wachovia Bank, remarketing agent. The Series 2004B bond pays interest based on a variable rate established weekly by Banc of America Securities, LLC, remarketing agent. The Association must pay a 1.85% quarterly letter of credit fee. The Association pays an annual remarketing fee of .10% of the outstanding bonds to the remarketing agents. The Series 2004A bond matures in September 2024. The Series 2004B bond matures in September 2018.

The Association has entered into swap contracts for a majority of this debt to hedge against interest rate fluctuations. The swaps were issued at market terms so that they had no value at their inception. The carrying amount of the swaps have been adjusted to their fair value at June 30, 2011, which, because of changes in forecasted levels of interest rates, resulted in reporting a liability of \$1,152,951 at June 30, 2011, for the fair value of the net payments forecasted under the swap.

### **NOTES PAYABLE--NORTH END ZONE**

During the year ended June 30, 2008, the Association converted the bank lines of credit with Wachovia Bank and Bank of America into notes payable. Certain endowment investment accounts serve as collateral on these notes. The note payable to Wachovia Bank has an annual principal payment requirement of \$120,960 plus interest at LIBOR (0.7269% at June 30, 2011) plus 1.5% through November 2012, at which time the remaining principal is due. The note payable to Bank of America has an annual principal payment requirement of \$130,786 plus interest at LIBOR (0.7269% at June 30, 2011) plus 1.5% through November 2012, at which time the remaining principal is due.

The Association has entered into swap contracts for a majority of this debt to hedge against interest rate fluctuations. The swaps were issued at market terms so that they had no value at their inception. The carrying amount of the swaps have been adjusted to their fair market value at June 30, 2011, which because of changes in forecasted levels of interest rates, resulted in reporting a liability of \$118,876 at June 30, 2011, for the fair value of the net payments forecasted under the swap.

The adjustments on the value of the swap contracts resulted in an unrealized gain of \$802,574 which is reported in the Statements of Activities for the year ended June 30, 2011.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Long-term debt consists of the following at June 30, 2011:

	Amount
Goal Line Drive Bond Indenture	\$ 4,060,000
Wolfpack Club Student Housing Foundation - Series 2009	22,405,000
Vaughn Towers Project - Series 2004A	15,855,000
Vaughn Towers Project - Series 2004B	950,000
Note Payable - Wachovia Bank	726,766
Note Payable - Bank of America	552,798
	44,549,564
Less: Amount Classified as Current Liability	5,656,746
Amount Due After One Year	\$ 38,892,818

Maturities of long-term debt are as follows:

	Amount
2012	\$ 5,656,746
2013	1,442,818
2014	445,000
2015	470,000
2016	495,000
Thereafter	36,040,000
Total	\$ 44,549,564

### LETTERS OF CREDIT

Pursuant to the issuance of the Goal Line Drive bonds payable, the Association obtained an irrevocable letter of credit in the amount of \$40,460,274. The original letter of credit expired March 15, 2010, and was extended until April 15, 2012.

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

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

### CASH REQUIRED FOR GOAL LINE DRIVE BOND MATURITIES AND FEES

The administrative agent requires that contributions and revenues received after March 2002 for the Goal Line Drive Campaign and the Pride Campaign be placed in separate bank accounts. These monies can only be used for principal payments, interest payments, and loan fees. At June 30, 2011, cash held for bond obligations totaled \$7,511,422. The administrative

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

expenses for the Goal Line Drive Campaign are being paid for by the Pride Campaign and the Association's operating fund. These expenses will be reimbursed once the debt has been retired. At June 30, 2011, the amount due to Wolfpack Pride from Goal Line Drive was \$9,119,750 and the amount due to the Association's operating fund from Goal Line Drive was \$12,601,484.

### FAIR VALUE MEASUREMENTS

The following table provides information by level for assets and liabilities that are measured at fair value on a recurring basis at June 30, 2011:

	Fair Value	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2
<b>Assets:</b>			
Investments:			
U.S. Government Obligations	\$ 4,206,241	\$ 4,206,241	\$ 0
Marketable Equity Securities	15,858,698	15,858,698	
Other Marketable Debt Securities	3,543,452	3,543,452	
Partnership Interests	4,633,088		4,633,088
Mutual Funds	1,728,253	1,728,253	
	<u>\$ 29,969,732</u>	<u>\$ 25,336,644</u>	<u>\$ 4,633,088</u>
Total Assets			
<b>Liabilities:</b>			
Swap Contract:			
Wolfpack Club Student Housing	\$ 1,294,950	\$ 0	\$ 1,294,950
Vaughn Towers	1,152,951		1,152,951
North End Zone	118,876		118,876
	<u>\$ 2,566,777</u>	<u>\$ 0</u>	<u>\$ 2,566,777</u>
Total Liabilities			

### ENDOWMENT FUND

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

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

For the year ended June 30, 2011, the Association has classified as permanently restricted net assets the original value of gifts donated to the permanent endowment. Gains and losses will be classified as unrestricted net assets until those amounts are appropriated for expenditure by the Association in a manner consistent with the standard of prudence described in UPMIFA.

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

Changes in endowment assets for the year ended June 30, 2011 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment Net Assets, Beginning of Year	\$ (8,007,855)	\$ 52,341	\$ 33,297,275	\$ 25,341,761
Investment Return:				
Investment Income	250,811	57,062		307,873
Realized Gain on Sale of Investments	423,715			423,715
Net Appreciation on Investments	2,392,897			2,392,897
Total Investment Return	3,067,423	57,062		3,124,485
Contributions			349,469	349,469
Increase in CSV of Life Insurance Policies	2,940			2,940
Appropriation of Endowment Assets for Expenditure	(1,326,310)	(52,341)		(1,378,651)
Endowment Net Assets, End of Year	<u>\$ (6,263,802)</u>	<u>\$ 57,062</u>	<u>\$ 33,646,744</u>	<u>\$ 27,440,004</u>

### *Funds with Deficiencies*

From time to time, the fair value of assets associated with donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the Association to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets were \$6,206,740 as of June 30, 2011. These deficiencies resulted from unfavorable market fluctuations.

### *Investment Return Objectives and Strategies*

The Association's investment policies include several investment objectives relative to its long-term investments, including permanent endowment funds. These objectives include (1) preservation of capital, (2) prudent investment of capital, (3) production of reasonable earnings and (4) low-risk growth in principal of invested capital. To achieve these objectives, the Association has employed the investment strategy of diversifying amongst various fund managers. The investment composition at any given time is dependent upon a number of factors, including the amount available for investment and current market conditions.

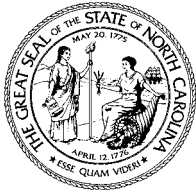
### *Spending Policy and How the Investment Objectives Relate to Spending Policy*

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

## **LOAN COVENANT**

The Housing Foundation is required to maintain a debt service ratio of at least 1.00 to 1.00 in order to be in compliance with the terms of the Series 2009 bond agreement. The Foundation was in compliance with this covenant at June 30, 2011.

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**Beth A. Wood, CPA**  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the 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**

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Board of Trustees  
North Carolina State University  
Raleigh, North Carolina

We have audited the financial statements of North Carolina State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 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 18 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 NC State Investment Fund and the discretely presented component units, as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

**Internal Control Over Financial Reporting**

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

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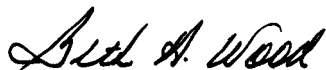
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination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

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Audit reports issued by the Office of the State Auditor can be obtained from the web site at [www.ncauditor.net](http://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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