



STATE OF NORTH CAROLINA

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2012

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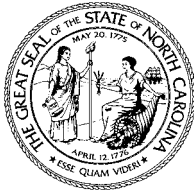
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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of the University of North Carolina School of the Arts for the year ended June 30, 2012, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

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

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the University of North Carolina School of the Arts, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2012, 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 University of North Carolina School of the Arts Housing Corporation, which represent 5 percent and 2 percent, respectively, of the assets and revenues of the University; nor the financial statements of the University of North Carolina School of the Arts Foundation, Inc., the University's discretely presented component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.


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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of North Carolina School of the Arts and its discretely presented component unit as of June 30, 2012, 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)

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2012 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.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. However, we do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



Beth A. Wood, CPA
State Auditor

December 11, 2012

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



Introduction

This section of the University of North Carolina School of the Arts financial report provides an overview of the financial position and activities for the year ended June 30, 2012. This discussion has been prepared by management along with the financial statements and related notes to the financial statements and should be read in conjunction with the financial statements and the notes thereto, which follow this section. This discussion and analysis is designed to focus on current activities, resulting change, and current known facts.

Using the Financial Statements

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Net Assets

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

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

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

Condensed Statement of Net Assets

	Year Ended June 30,		
	2012	2011	Change
Assets			
Current Assets	\$ 17,516,370.49	\$ 14,787,167.03	\$ 2,729,203.46
Capital Assets, Net	94,707,546.09	94,216,030.51	491,515.58
Other Noncurrent Assets	15,213,725.63	14,889,954.05	323,771.58
Total Assets	127,437,642.21	123,893,151.59	3,544,490.62
Liabilities			
Current Liabilities	3,564,911.67	2,680,896.24	884,015.43
Noncurrent Liabilities	9,836,826.28	10,537,181.36	(700,355.08)
Total Liabilities	13,401,737.95	13,218,077.60	183,660.35
Net Assets			
Invested in Capital Assets, Net of Related Debt	86,432,546.09	85,441,782.64	990,763.45
Restricted:			
Nonexpendable	12,298,494.19	11,296,762.06	1,001,732.13
Expendable	3,353,207.17	4,038,338.75	(685,131.58)
Unrestricted	11,951,656.81	9,898,190.54	2,053,466.27
Total Net Assets	\$ 114,035,904.26	\$ 110,675,073.99	\$ 3,360,830.27

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The total assets of the University increased \$3,544,490.62 for the year, with a majority of the increase representing current assets of \$2,729,203.46. Of the \$2,729,203.46 increase in current assets, approximately \$1,675,000.00 is related to an increase in cash and cash equivalents. Approximately \$600,000.00 of this difference relates to the State allowing the University to carry forward more cash into the subsequent year rather than reverting it. Approximately \$850,000.00 of the increase relates to an increase in auxiliary administration and food service funds as a result of increased meal rates. Also, in fiscal year 2011-2012 funds received from the Nutcracker production were moved from state to institutional trust funds; thus, increasing current assets by approximately \$215,000.00. A \$491,515.58 increase in capital assets also attributed to the increase in total assets. This change represents the net effect of an increase in construction in progress and a decrease in capital assets, net of accumulated depreciation. The University began the construction phase of four buildings and as a result, construction in progress increased by \$2,743,729.58 during the year. This was offset by the reduction of depreciable capital assets mainly due to the annual depreciation.

The total liabilities of the University increased \$183,660.35. An increase of \$884,015.43 in current liabilities was largely offset by a decrease of \$700,355.08 in noncurrent liabilities. Of the \$884,015.43 increase in current liabilities, \$334,661.12 was due to an increase in accounts payable and accrued payroll. As mentioned above, the University is in the process of constructing four new buildings. As a result, accounts payable for capital projects increased by approximately \$516,000.00 compared to the prior year. This increase was offset by a decrease in other accounts payable and accrued payroll of approximately \$181,000.00. In addition, the overall liability for compensated absences increased by approximately \$55,700.00; however, the current portion increased by approximately \$285,000.00. The decrease in noncurrent liabilities resulted from two main factors. First, the University continues to pay down its capital debt for revenue bonds and certificates of participation, which approximated \$500,000 for the year. Also, as previously mentioned, the amount of compensated absences liability classified as current increased; thus, decreasing the noncurrent balance.

Statement of Revenues, Expenses, and Changes in Net Assets

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	Year Ended June 30,		
	2012	2011	Change
Operating Revenues			
Student Tuition and Fees, Net	\$ 10,945,396.16	\$ 9,801,573.10	\$ 1,143,823.06
Sales and Services, Net	6,133,794.20	6,200,123.77	(66,329.57)
Other Operating Revenues	812,825.22	600,646.93	212,178.29
Total Operating Revenues	17,892,015.58	16,602,343.80	1,289,671.78
Operating Expenses:			
Salaries and Benefits	30,276,646.70	31,919,895.09	(1,643,248.39)
Supplies and Materials	3,895,518.41	4,508,110.47	(612,592.06)
Services	7,147,869.00	6,299,756.66	848,112.34
Scholarships and Fellowships	1,566,567.97	1,257,124.46	309,443.51
Utilities	1,815,531.00	1,838,903.61	(23,372.61)
Depreciation	2,871,623.94	2,844,686.09	26,937.85
Total Operating Expenses	47,573,757.02	48,668,476.38	(1,094,719.36)
Operating Loss	(29,681,741.44)	(32,066,132.58)	2,384,391.14
Nonoperating Revenues (Expenses)			
State Appropriations	25,787,944.05	25,466,151.69	321,792.36
State Aid - Federal Recovery Funds		1,374,613.00	(1,374,613.00)
Noncapital Grants - Student Financial Aid	1,495,380.25	1,530,387.91	(35,007.66)
Other Noncapital Grants	10,000.00	17,800.00	(7,800.00)
Noncapital Gifts	2,716,558.62	2,359,049.12	357,509.50
Investment Income	418,240.46	1,582,513.64	(1,164,273.18)
Interest and Fees on Debt	(394,009.92)	(414,102.55)	20,092.63
Other Nonoperating Expenses	(306,522.02)	(24,259.82)	(282,262.20)
Net Nonoperating Revenues	29,727,591.44	31,892,152.99	(2,164,561.55)
Gain (Loss) Before Other Revenues	45,850.00	(173,979.59)	219,829.59
Capital Grants	2,324,438.65	1,206,952.95	1,117,485.70
Capital Gifts	57,536.00	1,192,006.12	(1,134,470.12)
Additions to Endowments	933,005.62	1,921,716.27	(988,710.65)
Total Other Revenues	3,314,980.27	4,320,675.34	(1,005,695.07)
Increase in Net Assets	3,360,830.27	4,146,695.75	(785,865.48)
Beginning Net Assets	110,675,073.99	106,528,378.24	4,146,695.75
Ending Net Assets	\$ 114,035,904.26	\$ 110,675,073.99	\$ 3,360,830.27

The Statement of Revenues, Expenses, and Changes in Net Assets reported an increase in net assets at the end of the year. Total net revenues were \$50,934,587.29 for fiscal year ended June 30, 2012 and \$52,815,172.13 for 2011. Some of the highlights of the revenue accounts presented on the Statement of Revenues, Expenses, and Changes in Net Assets are as follows:

- Student tuition and fees, net increased by \$1,143,823.06. This increase was mainly due to an increase in the tuition rate during the year. There was a \$500 tuition rate increase per resident student and a \$1,000 tuition rate increase per non-resident student.
- State aid - federal recovery funds decreased by \$1,374,613.00 due to the University not receiving any American Recovery and Reinvestment Act (ARRA) funds in fiscal year 2012.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

- Investment income decreased by \$1,164,273.18 as a result of the financial market not being as strong as it was in the prior year.
- Capital grants increased \$1,117,485.70 mainly due to increased state funding related to the construction of the Library, Central Storage Facility, and the Film School Production Design Facility.
- Capital gifts decreased by \$1,134,470.12 mainly due to the Foundation donating the Chancellor's residence to the University in the prior year.
- Additions to endowments decreased by \$988,710.65. In fiscal year 2011, the University received \$1,083,333.33 to create three new endowments, as well as \$838,382.94 in additional funding for existing endowments. In fiscal year 2012, no new endowments were created; however, the University did receive \$933,005.62 of additional funding for existing endowments in the current year.

Operating expenses totaled \$47,573,757.02 for the year compared to \$48,668,476.38 from the previous year, a decrease of \$1,094,719.36. The significant changes include the following:

- Salaries and benefits decreased by \$1,643,248.39. This decrease is a result of staffing reductions made as a result of legislatively mandated budget reductions.
- Supplies and materials decreased by \$612,592.06. This reduction was a result of a conscious management decision to reduce spending in fiscal year 2011-12 in order to prepare for possible year end reversions.
- Services increased by \$848,112.34. This increase can be attributed to several factors:

Other contractual services expense increased approximately \$100,000 mainly due to the University entering into a new contractual arrangement with a local medical center to provide a physician assistant at an annual contract amount of \$68,000. The contract was implemented in April 2011; therefore, fiscal year 2012 was the first full year of the contract.

The amount paid to the University's food service vendor increased by approximately \$100,000. This increase can be attributed to the combination of an increase in the contract rate and an increase in the length of the school calendar.

Advertising expense increased by approximately \$104,000. Several factors contributed to this increase, including additional advertising for the new summer programs and for the Music Academy of the American South (MAAS) event. In addition, 2011-12 was the first year that recruitment advertising was paid for from one fund rather than spreading among various funds (including the Foundation).

Other aid and grants expense increased by approximately \$106,000. The majority of this change was due to an increased amount of funds given by the Kenan operating fund to the UNCSA Foundation to support a guest artist program.

The largest services expense increase was in the repairs and maintenance-building line item. These expenses increased by approximately \$358,000 due to the University not receiving funding for repairs and renovations for the past three years. As a result, more operational funds were needed to cover repair and renovation costs. In the 2011-12 year,

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

some of the major repair and renovation projects included carpet replacement and floor repair, building automation controls repair and upgrades, and HVAC repairs.

- Scholarships and fellowships increased by \$309,443.51. This increase is a direct result of the tuition rate increase mentioned above. A portion of the revenue generated by the tuition increase was allocated for campus-based grants. In 2011-12, the amount of campus-based grants awarded was approximately \$267,000.00 more than in 2010-11.

Capital Asset and Debt Administration

The University's capital assets, net of accumulated depreciation at June 30, 2012, were \$94,707,546.09. Construction projects in progress for the 2011-2012 fiscal year totaling \$3,896,409.35 pertain to the Library, Campus Police Operation Center, Central Storage Facility, and the Film School Production Design Facility. For more information about the University's capital asset holdings, refer to Note 5 of the Notes to the Financial Statements.

The University had \$10,219,264.09 in outstanding long-term debt at June 30, 2012, and continues to make all of its debt payments in a timely manner. No new debt was issued during the 2011-2012 fiscal year. Refer to Note 7 of the Notes to the Financial Statements for more detailed information about the University's debt obligations.

Economic Outlook

The North Carolina economic growth in the upcoming year is expected to be sluggish and below the level of the nation. However, the modest growth in revenues predicted for North Carolina allowed the legislature to restore the 2012-2013 UNC System Management Flexibility Reduction of \$9.18 million to the State's budget. In addition, UNC School of the Arts received \$1 million in additional appropriation as one of the three campuses that specializes in the arts and sciences.

The state legislature also approved the institutional based tuition increases moved forward by the Board of Governors for the 2012-13 fiscal year. The impact of these additional revenues allowed the University to partially restore some of the budget reductions from the 2011-2012 fiscal year. The University used 60% of the revenues that the tuition increase generated to offset the budget reductions. The remaining 40% of the tuition increase revenues was used for need based financial aid.

The UNC School of the Arts Enrollment Committee refined the approach to modeling enrollment growth for the 2012-2013 fiscal year. This team worked collaboratively with the Deans to establish appropriate fall 2012 headcount targets. Taking the yearly attrition into account, the reported projection for fiscal year 2013 is 1,169 student full-time equivalents (FTE). When the Board of Governors submitted their request for funding on the University System's projected enrollment growth, the General Assembly responded by only funding the "net" enrollment change. This translated into the inability to hold harmless the schools that have projections below what they are currently budgeted. Luckily, the UNC School of the Arts did not fall into that category. However, this action did result in a 42% reduction to the University's enrollment increase request.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

The University has been extremely successful in private fundraising for endowed professorships. Taking advantage of the challenge grant program established by the C.D. Spangler Foundation and the Distinguished Professors Endowed Trust Fund of the State of North Carolina, the University just named its fifth endowed professorship as the Dale M. Pollock Distinguished Professorship in Filmmaking. Other endowed professorships are the Malcolm and Patricia Brown Distinguished Professorship in Music in the Fletcher Opera Institute, the Beautiful Voices Endowed Scholarship in honor of Tom Kenan, and the Jean Mary DePasquale Shaprut Endowed Costume Scholarship.

The University continues to execute its long-range plan to expand its facilities with new construction projects. The four new buildings currently under construction include the Library, Central Storage, Campus Police, and the Film Production Design Facility. All four of these buildings should be completed in the fall of 2013. Repair and renovation funding related to the 2011-2012 fiscal year was only partially funded due to the State Medicaid shortfall in June, 2012. These funds were received in fiscal year 2012-2013. The University will also receive a repair and renovation allocation for the 2012-2013 fiscal year. The funds will be used to replace two of the HVAC cooling components at the Stevens Center, replace part of the high voltage infrastructure on campus, replace a roof on Workplace West III, and perform renovation and preservation work on the Advancement house.

University of North Carolina School of the Arts
Statement of Net Assets
June 30, 2012

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 14,240,845.58
Restricted Cash and Cash Equivalents	2,797,563.57
Receivables, Net (Note 4)	117,528.62
Due from University Component Unit	11,402.00
Inventories	273,319.50
Notes Receivable, Net (Note 4)	75,711.22
	<hr/>
Total Current Assets	17,516,370.49

Noncurrent Assets:

Restricted Cash and Cash Equivalents	925,786.02
Endowment Investments	12,824,536.30
Restricted Investments	646,910.86
Other Investments	52,435.09
Notes Receivable, Net (Note 4)	271,635.36
Bond Issuance Costs, Net of Amortization of 164,374	492,422.00
Capital Assets - No depreciable (Note 5)	10,093,113.15
Capital Assets - Depreciable, Net (Note 5)	84,614,432.94
	<hr/>
Total Noncurrent Assets	109,921,271.72
	<hr/>
Total Assets	127,437,642.21

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	1,149,431.13
Due to Primary Government	13,119.35
Unearned Revenue	1,477,183.34
Interest Payable	44,212.83
Long-Term Liabilities - Current Portion (Note 7)	880,965.02
	<hr/>
Total Current Liabilities	3,564,911.67

Noncurrent Liabilities:

Deposits Payable	68,155.00
Funds Held for Others	7,668.69
U. S. Government Grants Refundable	422,703.52
Long-Term Liabilities (Note 7)	9,338,299.07
	<hr/>
Total Noncurrent Liabilities	9,836,826.28
	<hr/>
Total Liabilities	13,401,737.95

University of North Carolina School of the Arts
Statement of Net Assets
June 30, 2012

Exhibit A-1
Page 2 of 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	86,432,546.09
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	320,469.98
Endowed Professorships	8,519,466.81
Departmental Uses	3,373,935.21
Loans	84,622.19
Expendable:	
Scholarships and Fellowships	791,624.59
Endowed Professorships	588,289.65
Departmental Uses	1,315,001.41
Capital Projects	77,299.74
Debt Service	580,991.78
Unrestricted	<u>11,951,656.81</u>
Total Net Assets	<u><u>\$ 114,035,904.26</u></u>

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

University of North Carolina School of the Arts
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2012

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 10,945,396.16
Federal Grants and Contracts	162,022.14
Sales and Services, Net (Note 9)	6,133,794.20
Interest Earnings on Loans	4,313.52
Other Operating Revenues	646,489.56
	<hr/>
Total Operating Revenues	17,892,015.58
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	30,276,646.70
Supplies and Materials	3,895,518.41
Services	7,147,869.00
Scholarships and Fellowships	1,566,567.97
Utilities	1,815,531.00
Depreciation	2,871,623.94
	<hr/>
Total Operating Expenses	47,573,757.02
	<hr/>
Operating Loss	(29,681,741.44)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	25,787,944.05
Noncapital Grants - Student Financial Aid	1,495,380.25
Other Noncapital Grants	10,000.00
Noncapital Gifts	2,716,558.62
Investment Income (Net of Investment Expense of \$60,566.30)	418,240.46
Interest and Fees on Debt	(394,009.92)
Other Nonoperating Expenses	(306,522.02)
	<hr/>
Net Nonoperating Revenues	29,727,591.44
	<hr/>
Income Before Other Revenues	45,850.00
	<hr/>
Capital Grants	2,324,438.65
Capital Gifts	57,536.00
Additions to Endowments	933,005.62
	<hr/>
Increase in Net Assets	3,360,830.27

NET ASSETS

Net Assets - July 1, 2011	110,675,073.99
	<hr/>
Net Assets - June 30, 2012	\$ 114,035,904.26
	<hr/> <hr/>

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

University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 18,182,406.87
Payments to Employees and Fringe Benefits	(30,314,511.82)
Payments to Vendors and Suppliers	(13,294,616.02)
Payments for Scholarships and Fellowships	(1,566,567.97)
Loans Issued	(81,560.85)
Collection of Loans	126,009.19
Interest Earned on Loans	4,130.43
Student Deposits Received	71,255.00
Student Deposits Returned	(57,000.00)
Other Payments	(820.06)
	<hr/>
Net Cash Used by Operating Activities	(26,931,275.23)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	25,787,944.05
Noncapital Grants - Student Financial Aid	1,495,380.25
Other Noncapital Grants	10,000.00
Noncapital Gifts	2,716,558.62
Additions to Endowments	933,005.62
William D. Ford Direct Lending Receipts	6,682,641.00
William D. Ford Direct Lending Disbursements	(6,682,641.00)
Related Activity Agency Receipts	5,842.63
Other Receipts	22,533.98
	<hr/>
Net Cash Provided by Noncapital Financing Activities	30,971,265.15

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Capital Grants	2,324,438.65
Proceeds from Sale of Capital Assets	17,226.63
Acquisition and Construction of Capital Assets	(2,821,443.39)
Principal Paid on Capital Debt and Leases	(499,247.87)
Interest and Fees Paid on Capital Debt and Leases	(377,326.36)
Other Payments	(1,282.56)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(1,357,634.90)

CASH FLOWS FROM INVESTING ACTIVITIES

Investment Income	105,702.33
Purchase of Investments and Related Fees	(980,092.25)
	<hr/>
Net Cash Used by Investing Activities	(874,389.92)
	<hr/>
Net Increase in Cash and Cash Equivalents	1,807,965.10
Cash and Cash Equivalents - July 1, 2011	16,156,230.07
	<hr/>
Cash and Cash Equivalents - June 30, 2012	\$ 17,964,195.17

University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012

Exhibit A-3
Page 2 of 2

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

Operating Loss	\$ (29,681,741.44)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	2,871,623.94
Allowances, Write-Offs, and Amortizations	1,268.49
Changes in Assets and Liabilities:	
Receivables (Net)	(23,701.99)
Due from University Component Unit	41,263.00
Inventories	(41,436.57)
Accounts Payable and Accrued Liabilities	(489,312.11)
US Government Grants Refundable	3,623.68
Due to Primary Government	(1,754.07)
Unearned Revenue	274,434.28
Compensated Absences	55,754.22
Deposits Payable	14,255.00
Student Loans Issued	(81,560.85)
Student Loan Principal Repayments	126,009.19
	<hr/>
Net Cash Used by Operating Activities	<u>\$ (26,931,275.23)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 14,240,845.58
Restricted Cash and Cash Equivalents	2,797,563.57
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	925,786.02
	<hr/>
Total Cash and Cash Equivalents - June 30, 2012	<u>\$ 17,964,195.17</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 57,536.00
Change in Fair Value of Investments	292,351.73
Loss on Disposal of Capital Assets	322,586.47

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Financial Position
June 30, 2012

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$ 2,434,928
Investments	18,370,338
Annuity Investments	567,954
Prepaid Expenses and Other Current Assets	41,572
Pledges Receivable, Net	5,996,174
Beneficial Interest in Perpetual Trusts	743,736
Beneficial Interest in Charitable Remainder Trusts	133,559
Property, Plant and Equipment, Net	<u>80,001</u>
Total Assets	<u><u>\$ 28,368,262</u></u>

LIABILITIES AND NET ASSETS

Accounts Payable and Accrued Expenses	\$ 45,992
Annuity Obligations	<u>251,136</u>
Total Liabilities	<u>297,128</u>

NET ASSETS

Unrestricted	88,942
Temporarily Restricted	3,669,877
Permanently Restricted	<u>24,312,315</u>
Total Net Assets	<u>28,071,134</u>
Total Liabilities and Net Assets	<u><u>\$ 28,368,262</u></u>

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2012

Exhibit B-2

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUES AND SUPPORT				
Gifts and Grants	\$ 548,594	\$ 2,115,552	\$ 6,261,970	\$ 8,926,116
Interest and Dividend Income	585	959		1,544
Change in Fair Value of:				
Annuity Investments			17,954	17,954
Perpetual Trusts			(20,307)	(20,307)
Charitable Remainder Trusts			(38,857)	(38,857)
Annuity Obligations			57,612	57,612
Net Gain on Other Investments Reported at Fair Value	88,485	335,151	60,299	483,935
Other Income	57,250	225,042	18	282,310
Net Assets Released from Restrictions	<u>2,150,788</u>	<u>(2,150,788)</u>		
Total Revenues and Support	2,845,702	525,916	6,338,689	9,710,307
EXPENSES				
Program Services:				
Scholarships and Awards	833,329			833,329
School Programs	<u>1,258,063</u>			<u>1,258,063</u>
Total Program Services	2,091,392			2,091,392
Supporting Services:				
Administrative Costs	255,587			255,587
Investment Management Fees	88,485			88,485
Development Costs	<u>245,177</u>			<u>245,177</u>
Total Supporting Services	<u>589,249</u>			<u>589,249</u>
Total Expenses	<u>2,680,641</u>			<u>2,680,641</u>
Change in Net Assets Before Transfers	165,061	525,916	6,338,689	7,029,666
Transfer of Property to Semans Art Fund	<u>(60,000)</u>		<u>(902,341)</u>	<u>(962,341)</u>
Change in Net Assets	105,061	525,916	5,436,348	6,067,325
NET ASSETS				
Net Assets - Beginning of Year	<u>(16,119)</u>	<u>3,143,961</u>	<u>18,875,967</u>	<u>22,003,809</u>
Net Assets - End of Year	<u>\$ 88,942</u>	<u>\$ 3,669,877</u>	<u>\$ 24,312,315</u>	<u>\$ 28,071,134</u>

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

UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

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

Blended Component Unit - Although legally separate, the University of North Carolina School of the Arts Housing Corporation (Housing Corporation), a component unit of the University, is reported as if it was part of the University.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

During the year ended June 30, 2012, the Foundation distributed \$2,091,392.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University of North Carolina School of the Arts Foundation, Inc., P.O. Box 12189, Winston-Salem, NC 27107.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Public Colleges and Universities, the full scope of the University's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

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

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

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange, include 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, and deposits held by the State Treasurer in the Short-Term Investment Fund. The Short-Term Investment Fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

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

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

- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

G. Inventories - Inventories, consisting of expendable supplies, are valued at cost using the last invoice cost method. Merchandise for resale is valued using the retail inventory method.

H. Capital Assets - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 50 years for general infrastructure and buildings, and 5 to 20 years for equipment, except for specialized filmmaking equipment (25 years) and specialized musical instruments (25 to 50 years).

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

I. Restricted Assets - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted for the acquisition or construction of capital assets, resources legally segregated for the payment of principal and interest as required by debt covenants, unspent debt proceeds, and endowment and other restricted investments.

J. Noncurrent Long-Term Liabilities - Noncurrent long-term liabilities include principal amounts of revenue bonds payable, certificates of participation, and compensated absences that will not be paid within the next fiscal year.

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

K. Compensated Absences - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

system in place at the University. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - Unless specifically exempt, the University is required by *North Carolina General Statute 147-77* to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. However, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, may authorize the University to deposit its institutional trust funds in interest-bearing accounts and other investments authorized by the Board of Governors, without regard to any statute or rule of law relating to the investment of funds by fiduciaries. Although specifically exempted, the University may voluntarily deposit institutional trust funds, endowment funds, special funds, revenue bond proceeds, and debt service funds with the State Treasurer. Special funds consist of moneys for agency funds held directly by the University.

At June 30, 2012, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$17,884,420.64 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 1.5 years as of June 30, 2012. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Cash on hand at June 30, 2012 was \$4,930.00. The carrying amount of the University's deposits not with the State Treasurer was \$74,844.53 and the bank balance was \$76,114.39. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2012, the University's bank balance was not exposed to custodial credit risk.

B. Investments

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

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

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

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

Investments are subject to the following risks.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

UNC Investment Fund, LLC - At June 30, 2012, the University's investments include \$12,824,536.30 which represents the University's equity position in the UNC Investment Fund, LLC (UNC Investment Fund). The UNC Investment 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 UNC Investment Fund are determined on a market unit valuation basis each month. Investment risks associated with the UNC Investment 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.

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2012, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	<u>Fair Value</u>	<u>Investment Maturities (in Years) Less Than 1</u>
		Debt Securities
Money Market Mutual Funds	<u>\$ 699,345.95</u>	<u>\$ 699,345.95</u>

At June 30, 2012, the Money Market Mutual Funds, with a fair value of \$699,345.95, were rated AAAM by Standard and Poor's.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments - The following table presents the fair value of the total investments at June 30, 2012:

	<u>Fair Value</u>
Investment Type	
Debt Securities	
Money Market Mutual Funds	\$ 699,345.95
Other Securities	
UNC Investment Fund	<u>12,824,536.30</u>
Total Investments	<u>\$ 13,523,882.25</u>

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

	<u>Fair Value</u>
Investment Type	
UNC Investment Fund II, LLC	<u>\$ 18,370,338.00</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. Reconciliation of Deposits and Investments - A reconciliation of deposits and investments for the University as of June 30, 2012, is as follows:

Cash on Hand	\$	4,930.00
Amount of Deposits with Private Financial Institutions		74,844.53
Deposits in the Short-Term Investment Fund		17,884,420.64
Investments in the UNC Investment Fund		12,824,536.30
Non-Pooled Investments		699,345.95
		<u>31,488,077.42</u>
Total Deposits and Investments	\$	<u>31,488,077.42</u>
Deposits		
Current:		
Cash and Cash Equivalents	\$	14,240,845.58
Restricted Cash and Cash Equivalents		2,797,563.57
Noncurrent:		
Restricted Cash and Cash Equivalents		925,786.02
		<u>17,964,195.17</u>
Total Deposits	\$	<u>17,964,195.17</u>
Investments		
Noncurrent:		
Endowment Investments	\$	12,824,536.30
Restricted Investments		646,910.86
Other Investments		52,435.09
		<u>13,523,882.25</u>
Total Investments	\$	<u>13,523,882.25</u>

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's endowment funds are based on an adopted spending policy by which the rate of spending for a fiscal year is calculated at 4% of the trailing three year average, if applicable. To the extent that the total return for the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2012, net appreciation of \$588,289.65 was available to be spent, all of which was classified in net assets as restricted expendable: endowed professorships as it is restricted for specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2012, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 39,447.31	\$ 10,743.52	\$ 28,703.79
Accounts	32,988.48		32,988.48
Intergovernmental	13,688.08		13,688.08
Interest on Loans	42,148.27		42,148.27
Total Current Receivables	\$ 128,272.14	\$ 10,743.52	\$ 117,528.62
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 99,978.17	\$ 27,145.20	\$ 72,832.97
Institutional Student Loan Programs	11,467.45	8,589.20	2,878.25
Total Notes Receivable - Current	\$ 111,445.62	\$ 35,734.40	\$ 75,711.22
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 464,459.41	\$ 192,824.05	\$ 271,635.36

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2012, is presented as follows:

	Balance July 1, 2011	Increases	Decreases	Balance June 30, 2012
Capital Assets, Nondepreciable:				
Land	\$ 4,076,440.33	\$ 215,497.50	\$ 0.00	\$ 4,291,937.83
Art, Literature, and Artifacts	1,904,765.97			1,904,765.97
Construction in Progress	1,152,679.77	2,743,729.58		3,896,409.35
Total Capital Assets, Nondepreciable	7,133,886.07	2,959,227.08		10,093,113.15
Capital Assets, Depreciable:				
Buildings	107,579,486.19	70,350.00	292,494.00	107,357,342.19
Machinery and Equipment	10,814,556.95	673,375.54	186,681.52	11,301,250.97
General Infrastructure	5,107,656.50			5,107,656.50
Total Capital Assets, Depreciable	123,501,699.64	743,725.54	479,175.52	123,766,249.66
Less Accumulated Depreciation for:				
Buildings	30,557,750.71	2,146,091.61	34,181.11	32,669,661.21
Machinery and Equipment	4,859,808.00	623,379.20	105,181.31	5,378,005.89
General Infrastructure	1,001,996.49	102,153.13		1,104,149.62
Total Accumulated Depreciation	36,419,555.20	2,871,623.94	139,362.42	39,151,816.72
Total Capital Assets, Depreciable, Net	87,082,144.44	(2,127,898.40)	339,813.10	84,614,432.94
Capital Assets, Net	\$ 94,216,030.51	\$ 831,328.68	\$ 339,813.10	\$ 94,707,546.09

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2012, were as follows:

	Amount
Accounts Payable	\$ 1,017,967.94
Accrued Payroll	90,738.34
Contract Retainage	40,724.85
Total Accounts Payable and Accrued Liabilities	\$ 1,149,431.13

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2012, is presented as follows:

	Balance July 1, 2011	Additions	Reductions	Balance June 30, 2012	Current Portion
Revenue Bonds Payable	\$ 2,280,000.00	\$ 0.00	\$ 325,000.00	\$ 1,955,000.00	\$ 335,000.00
Certificates of Participation	6,475,000.00		155,000.00	6,320,000.00	160,000.00
Total Revenue Bonds Payable and Certificates of Participation	<u>8,755,000.00</u>		<u>480,000.00</u>	<u>8,275,000.00</u>	<u>495,000.00</u>
Capital Leases Payable	19,247.87		19,247.87		
Compensated Absences	1,888,509.87	1,170,764.00	1,115,009.78	1,944,264.09	385,965.02
Total Long-Term Liabilities	<u>\$ 10,662,757.74</u>	<u>\$ 1,170,764.00</u>	<u>\$ 1,614,257.65</u>	<u>\$ 10,219,264.09</u>	<u>\$ 880,965.02</u>

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2012	Principal Outstanding June 30, 2012	See Table Below
Revenue Bonds Payable							
The University of North Carolina System Pool Revenue Bonds							
Fitness and Student Center Project	A	3.25%-5.25%	10/01/2018	\$ 2,650,000.00	\$ 1,440,000.00	\$ 1,210,000.00	(1)
Refunding 1998B and 2000 UNC System Pool Revenue Bonds	B	3.00%-4.25%	04/01/2019	1,900,000.00	1,155,000.00	745,000.00	
Total UNC System Pool Revenue Bonds				<u>4,550,000.00</u>	<u>2,595,000.00</u>	<u>1,955,000.00</u>	
Certificates of Participation							
Student Housing Project	C	3.50%-4.50%	06/01/2036	7,200,000.00	880,000.00	6,320,000.00	(2)
Total Revenue Bonds Payable and Certificates of Participation				<u>\$ 11,750,000.00</u>	<u>\$ 3,475,000.00</u>	<u>\$ 8,275,000.00</u>	

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

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

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

Fund reservations in the amount of \$433,325.00 required by the Series 2005 Certificates of Participation Indenture for the Student Housing Project were established and recorded in a Reserve Fund with the fiscal agent. At June 30, 2012, the balance in the Reserve Fund was \$485,760.09. In addition, the University contributes to a Maintenance and Equipment Reserve Fund also required by the indenture. At June 30, 2012, the balance in this reserve was \$213,585.86.

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year			Estimate of % of Revenues Pledged
			Revenues Net of Expenses	Principal	Interest	
(1)	Facility Debt Fee Revenues	\$ 1,688,169.63	\$ 241,167.09	\$ 140,000.00	\$ 60,412.50	84%
(2)	Housing Revenues	13,171,049.04	552,646.07	155,000.00	275,450.00	78%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2012, are as follows:

<u>Fiscal Year</u>	<u>Annual Requirements</u>			
	<u>Revenue Bonds Payable</u>		<u>Certificates of Participation</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2013	\$ 335,000.00	\$ 82,887.50	\$ 160,000.00	\$ 270,025.00
2014	355,000.00	67,481.25	165,000.00	264,425.00
2015	230,000.00	51,700.00	170,000.00	258,443.76
2016	245,000.00	41,450.00	180,000.00	251,643.76
2017	250,000.00	30,662.50	185,000.00	244,893.76
2018-2022	540,000.00	27,225.00	1,050,000.00	1,106,668.80
2023-2027			1,280,000.00	872,143.78
2028-2032			1,585,000.00	566,550.02
2033-2036			1,545,000.00	177,525.00
Total Requirements	\$ 1,955,000.00	\$ 301,406.25	\$ 6,320,000.00	\$ 4,012,318.88

NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for copiers. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2012:

<u>Fiscal Year</u>	<u>Amount</u>
2013	\$ 23,761.84
2014	1,350.00
Total Minimum Lease Payments	\$ 25,111.84

Rental expense for all operating leases during the year was \$47,692.38.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees	\$ 14,773,590.62	\$ 0.00	\$ 3,823,779.01	\$ 4,415.45	\$ 10,945,396.16
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 3,730,876.88	\$ 0.00	\$ 960,632.49	\$ 0.00	\$ 2,770,244.39
Dining	2,521,525.67		628,078.51		1,893,447.16
Health, Physical Education, and Recreation Services	185,121.14				185,121.14
Bookstore	213,320.08				213,320.08
Parking	61,475.82	3,418.22			58,057.60
Other	39,722.89				39,722.89
Sales and Services of Education and Related Activities					
University Production Revenues	723,192.37	14,539.83			708,652.54
Other	265,228.40				265,228.40
Total Sales and Services	\$ 7,740,463.25	\$ 17,958.05	\$ 1,588,711.00	\$ 0.00	\$ 6,133,794.20

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 12,581,526.47	\$ 1,202,763.12	\$ 565,849.01	\$ 0.00	\$ 0.00	\$ 0.00	\$ 14,350,138.60
Public Service	217,625.54	35,219.97	376,798.71				629,644.22
Academic Support	3,781,713.17	472,937.33	419,529.52				4,674,180.02
Student Services	1,008,529.91	33,977.14	268,280.46				1,310,787.51
Institutional Support	5,389,962.30	646,162.16	1,810,270.51		3,400.10		7,849,795.07
Operations and Maintenance of Plant	4,135,482.58	1,161,166.08	1,050,524.18		1,382,589.46		7,729,762.30
Student Financial Aid				1,566,567.97			1,566,567.97
Auxiliary Enterprises	3,161,806.73	343,292.61	2,656,616.61		429,541.44		6,591,257.39
Depreciation						2,871,623.94	2,871,623.94
Total Operating Expenses	\$ 30,276,646.70	\$ 3,895,518.41	\$ 7,147,869.00	\$ 1,566,567.97	\$ 1,815,531.00	\$ 2,871,623.94	\$ 47,573,757.02

NOTE 11 - PENSION PLANS

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Teachers' and State Employees' Retirement System (Plan) 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, 2012, these rates were set at 7.44% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$23,661,909.91, of which \$11,843,247.87 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$881,137.64 and \$710,594.87, respectively.

Required employer contribution rates for the years ended June 30, 2011, and 2010, were 4.93% and 3.57%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2012, 2011, and 2010, which were \$881,137.64, \$607,338.98, and \$419,387.66, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2012, 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 \$23,661,909.91, of which \$8,676,781.96 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$593,491.89 and \$520,606.92, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans - Internal Revenue Code Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$34,468.00 for the year ended June 30, 2012.

Internal Revenue Code 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, 2012,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

were \$126,055.64. The voluntary contributions by employees amounted to \$152,974.64 for the year ended June 30, 2012.

Internal Revenue Code Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. The plan administrators are TIAA-CREF and Fidelity. No costs are incurred by the University. The voluntary contributions by employees amounted to \$131,170.92 for the year ended June 30, 2012.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

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

The Plan's benefit and contribution provisions are established by the State Treasurer and the Board of Trustees of the State Health Plan for Teachers and State Employees as authorized by Chapter 135, Article 3B, of the General Statutes. The Plan does not provide for automatic post-retirement benefit increases.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Board of Trustees of the State Health Plan for Teachers and State Employees.

For the current fiscal year the University contributed 5.0% 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, 2011, and 2010, were 4.9% and 4.5%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2012, 2011, and 2010, which were \$1,026,001.49, \$1,077,453.08, and \$957,576.11, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

- 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, 2012, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. The required contribution rate for the years ended June 30, 2011 and 2010 was .52% for both years. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2012, 2011, and 2010, which were \$106,704.16, \$114,341.96, and \$110,653.24, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 13 - RISK MANAGEMENT

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

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 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

(Plan), a discretely presented component unit of the State of North Carolina. The Plan has contracted with third parties to process claims.

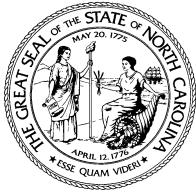
The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the University's primary responsibility is to arrange for and provide the necessary treatment 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 14 - COMMITMENTS AND CONTINGENCIES

- A. **Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$2,090,560.71 and on other purchases were \$561,175.24 at June 30, 2012.
- B. **Pending Litigation and Claims** - The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.



Beth A. Wood, CPA
State Auditor

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

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

We have audited the financial statements of the University of North Carolina School of the Arts, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2012, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 11, 2012. Our report includes a reference to 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. Other auditors audited the financial statements of the University of North Carolina School of the Arts Housing Corporation and the discretely presented component unit, the University of North Carolina School of the Arts Foundation, Inc., as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

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

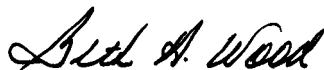
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination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

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

Compliance and Other Matters

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

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



Beth A. Wood, CPA
State Auditor

December 11, 2012

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This audit required 866.5 audit hours at an approximate cost of \$62,388. The cost represents .05% of the University's total assets and .13% of total expenses subjected to audit.