

STATE OF NORTH CAROLINA

NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS

DURHAM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS

DURHAM, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2012

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

THOMAS W. ROSS, PRESIDENT

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Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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Raleigh, NC 27699-0601
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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Board of Trustees, North Carolina School of Science and Mathematics

We have completed a financial statement audit of North Carolina School of Science and Mathematics 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.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements disclosed certain deficiencies and/or instances of noncompliance that are detailed in the Audit Findings and Responses section of this report. The School's response is included following the finding.

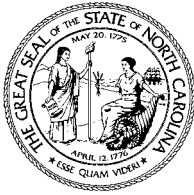
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

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

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
North Carolina School of Science and Mathematics
Durham, North Carolina

We have audited the accompanying financial statements of the North Carolina School of Science and Mathematics, 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 School's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the School'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 North Carolina School of Science and Mathematics Foundation, Inc., the School's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinions, insofar as they relate to the amounts included for that entity, are based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the North Carolina School of Science and Mathematics 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 report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of North Carolina School of Science and Mathematics 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 May 8, 2013 on our consideration of the School'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

May 8, 2013

NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The North Carolina School of Science and Mathematics (School) provides this overview and Management's Discussion and Analysis to assist in understanding the financial statements and notes to the financial statements presented herewith for the year ended June 30, 2012. This discussion describes important trends and events that have impacted the fiscal health of the School and that may continue to exert influence in future years. This discussion has been prepared by and is the responsibility of the School's management along with the financial statements and the notes to the financial statements thereto. The report should be read and considered in its entirety.

Using the Annual Report

This annual report consists of a series of financial statements, notes to the financial statements, and other information prepared in accordance with the Governmental Accounting Standards Board (GASB). The GASB establishes standards for external financial reporting for public colleges and universities and requires that financial statements be presented on a consolidated basis for the School as a whole. These standards were used in the preparation of this document. The statements are prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. Comparative information for the prior fiscal year is also presented in the condensed financial statements.

The basic financial statements 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 Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets are discussed in later sections of this discussion and analysis.

The Statement of Cash Flows provides information relative to the School'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.

The Notes to the Financial Statements should be read in conjunction with the financial statements. 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, capital assets, accounts payable, long-term liabilities, lease obligations, expenses, required information on pension plans and other post-employment benefits, insurance against losses, commitments and contingencies, and restatement of prior year net assets. Overall, these

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Reporting Entity

The financial statements report information about the School as a whole using accounting methods similar to those used in the private-sector. The financial reporting entity for the financial statements is comprised of the School and two component units. The NCSSM Student and Constituent Support Services, Inc., a blended component unit, is a legally separate not-for-profit corporation and is reported as if it was part of the School. The North Carolina School of Science and Mathematics Foundation Inc., 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 School. The component units are subject to independent outside audits due to organizational requirements or source of funding.

Financial Highlights

The School's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2012. However, the combined net assets for the School decreased \$1.11 million, which is a decrease of 2.45% when compared to the prior year net assets, as restated.

Statement of Net Assets

The Statement of Net Assets presents the assets, liabilities, and net assets of the School as of the end of the fiscal year. The statement is a point-in-time statement presenting a fiscal snapshot of the School. From the data presented, readers of the Statement of Net Assets are able to determine the assets available to continue the operations of the School. They are also able to determine how much the School owes to vendors and others and how much is held for future use by the School. Finally, the Statement of Net Assets provides a picture of the net assets and their availability for expenditure by the School.

Net assets are divided into categories to show the availability to meet the School's obligations. The first category, invested in capital assets, provides the School's equity in property, plant, and equipment. The next category is restricted net assets and includes resources which the School is obligated to spend on capital projects. The final category is unrestricted net assets. Unrestricted net assets are available to the School for any lawful purpose. Although unrestricted net assets are not subject to externally imposed stipulations, substantially all of the School's unrestricted net assets have been designated for various programs and initiatives.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

North Carolina School of Science and Mathematics Condensed Statement of Net Assets

	<u>2012</u>	<u>2011</u> <u>(as restated)</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Assets:				
Current Assets	\$ 544,545.51	\$ 522,556.13	\$ 21,989.38	4.21%
Noncurrent Assets:				
Restricted Cash	13,790.43	298,891.80	(285,101.37)	(95.39%)
Capital Assets	<u>45,425,618.04</u>	<u>46,354,831.85</u>	<u>(929,213.81)</u>	(2.00%)
Total Assets	<u>45,983,953.98</u>	<u>47,176,279.78</u>	<u>(1,192,325.80)</u>	(2.53%)
Liabilities:				
Current Liabilities	407,780.03	490,037.59	(82,257.56)	(16.79%)
Noncurrent Liabilities	<u>1,440,789.00</u>	<u>1,444,614.00</u>	<u>(3,825.00)</u>	(0.26%)
Total Liabilities	<u>1,848,569.03</u>	<u>1,934,651.59</u>	<u>(86,082.56)</u>	(4.45%)
Net Assets:				
Invested in Capital Assets	45,425,618.04	46,354,831.85	(929,213.81)	(2.00%)
Restricted:				
Expendable				
Capital Projects	13,790.43	298,891.80	(285,101.37)	(95.39%)
Unrestricted	<u>(1,304,023.52)</u>	<u>(1,412,095.46)</u>	<u>108,071.94</u>	(7.65%)
Total Net Assets	<u>\$ 44,135,384.95</u>	<u>\$ 45,241,628.19</u>	<u>\$ (1,106,243.24)</u>	(2.45%)

Net Assets categories are defined in Note 1 (K) of the Notes to the Financial Statements.

As of June 30, 2012, the total School's net assets were \$44.14 million. The School's capital assets of \$45.43 million represent 98.79% of total assets. Total assets decreased \$1.19 million, or 2.53% mainly due to a decrease in cash and cash equivalents and depreciation allocated to the cost of capital assets. The decrease in cash and cash equivalents was caused by increased spending of capital improvement funds for various construction projects.

The School's liabilities totaled \$1.85 million at June 30, 2012. Current liabilities, which include accounts payable, funds held for others, and the current portion of compensated absences decreased \$82,258, or 16.79%, primarily due to the availability of cash during the month of June which was used to reduce current payables. Noncurrent liabilities of \$1.44 million represent compensated absences. Details of both current and noncurrent liabilities are shown on the Statement of Net Assets and in Notes 4 and 5.

Unrestricted net assets were negative \$1.30 million due primarily to \$1.57 million liability for unpaid leave benefits. The deficit in unrestricted net assets decreased \$108,072, or 7.65%, mainly due to the approval of the appropriation carry forward. Restricted net assets decreased \$285,101, or 95.39% as a result of the additional spending on construction projects.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. The School's dependency on state aid, certain grants, and gifts will result in operating deficits since the GASB requires that state appropriations, certain grants, and gifts be classified as nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The change in total net assets as presented on the Condensed Statement of Net Assets is based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of the statement is to present the revenues received by the School, both operating and nonoperating, the expenses paid by the School, operating and nonoperating, and any other revenues, expenses, and any gains and/or losses received or spent by the School.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the School. 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 School. Nonoperating revenues are revenues received for which goods and services are not provided. Capital appropriations are considered neither operating nor nonoperating revenues and are reported after "Loss Before Other Revenues."

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

North Carolina School of Science and Mathematics Statement of Revenues, Expenses, and Changes in Net Assets

	2012	2011 (as restated)	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Sales and Services	\$ 539,205.02	\$ 735,810.86	\$ (196,605.84)	(26.72%)
Other	27,345.76	63,333.26	(35,987.50)	(56.82%)
Total Operating Revenues	<u>566,550.78</u>	<u>799,144.12</u>	<u>(232,593.34)</u>	(29.11%)
Operating Expenses:				
Salaries and Benefits	14,716,638.78	14,498,683.28	217,955.50	1.50%
Supplies and Materials	1,275,285.65	1,260,926.95	14,358.70	1.14%
Services	1,954,600.80	2,315,981.24	(361,380.44)	(15.60%)
Utilities	1,050,338.40	1,060,918.63	(10,580.23)	(1.00%)
Depreciation	1,312,993.93	1,161,757.11	151,236.82	13.02%
Total Operating Expenses	<u>20,309,857.56</u>	<u>20,298,267.21</u>	<u>11,590.35</u>	0.06%
Operating Loss	(19,743,306.78)	(19,499,123.09)	(244,183.69)	1.25%
Nonoperating Revenues				
State Appropriations	17,680,507.73	18,025,863.97	(345,356.24)	(1.92%)
Noncapital Grants	736,581.62	388,801.82	347,779.80	89.45%
Other Nonoperating Revenues	2,399.70	2,053.55	346.15	16.86%
Nonoperating Revenues	<u>18,419,489.05</u>	<u>18,416,719.34</u>	<u>2,769.71</u>	0.02%
Loss Before Other Revenues	(1,323,817.73)	(1,082,403.75)	(241,413.98)	22.30%
Capital Appropriations	211,374.49	354,543.93	(143,169.44)	(40.38%)
Capital Gifts	6,200.00	6,200.00	6,200.00	100.00%
Decrease in Net Assets	(1,106,243.24)	(727,859.82)	(378,383.42)	51.99%
Net Assets - July 1	<u>45,241,628.19</u>	<u>45,969,488.01</u>	<u>(727,859.82)</u>	(1.58%)
Net Assets - June 30	<u>\$ 44,135,384.95</u>	<u>\$ 45,241,628.19</u>	<u>\$ (1,106,243.24)</u>	(2.45%)

The Statement of Revenues, Expenses, and Changes in Net Assets shows a decrease in net assets of \$1.11 million for the fiscal year. The total operating loss for fiscal year 2012 was \$19.74 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB, the School shows a significant operating loss.

State appropriations are received through an allotment and requisition system through the North Carolina Office of State Budget and Management and the North Carolina Office of the State Controller. For the fiscal year ending June 30, 2012, appropriations from the State for the School were \$17.68 million for operations.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating revenues include sales and services and other operating revenues. The \$232,593 decrease in operating revenues is the result of outsourcing contracting services provided to students and a decrease in program activity due to North Carolina's economy.

Operating expenses, including depreciation of \$1.31 million, totaled \$20.31 million. Of this total, \$14.72 million was used for salaries and benefits and \$1.95 million was for services. Salaries increased approximately \$217,956 due to positions that were vacant during prior years being filled. Services consisted of contractual agreements, data processing services, travel, and communication expenses and decreased by \$361,380, or 15.60%. Supplies and materials increased by \$14,359 or 1.14% and utilities decreased by \$10,580 or 1.00%. Departmental reallocations of spending based on current year changes in priorities to cover program objectives account for the changes in services and supplies and materials. Depreciation increased \$151,237 or 13.02%. Overall operating expenses increased by \$11,590 or 0.06%.

Noncapital grants increased \$347,780, or 89.45%. This increase is primarily due to grants for a summer student ventures program and to fund an energy grant position. Other nonoperating revenues increased minimally. Capital appropriations decreased \$143,169 and include appropriations from the State that can only be used for repair and renovations and decreased as a result of funds being remitted back to the State as requested during the fiscal year.

One of the School's weaknesses is the lack of diverse streams of revenues. Approximately 92% of the School's revenues come from state appropriations. The remaining 8% includes voluntary private support from individuals, foundations, and corporations, along with government and other sponsored programs. The School will continue to seek funding aggressively from all possible sources consistent with its mission and prudently manage the financial resources realized from these efforts to fund its operating activities.

Capital Assets

Primary capital projects for fiscal year 2012 included the Discovery Center Planning. Total capital assets, net of accumulated depreciation, at June 30, 2012 were \$45.43 million. For more detailed information about capital asset holdings, see Note 3 of the Notes to the Financial Statements.

Factors Impacting Future Periods

Management believes that the School is well positioned to continue its level of excellence in service to students, the community, and governmental agencies. The School's ongoing efforts toward maximizing the State's resources with efficiency and effectiveness measures, along with UNC Tomorrow initiatives to address needs of the State will enable it to provide the necessary resources to support this level of excellence. However, reductions in state appropriations will continue to impact the ability of the School to maintain resources to provide programs and services and to meet the growing demands of the State and its citizens.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

A crucial element to the School's future will continue to be its relationship with the State of North Carolina. It should be noted that the School's state appropriations will be decreased in 2012-2013 due to the continuing decline in the economy of North Carolina. While it is not possible to predict the ultimate results, management believes that with cost reduction measures implemented and the continued support of the State of North Carolina, the School's financial condition is strong enough to withstand the current economic uncertainties. The School developed a strategic plan in 2011-2012 that will enable the School to develop and implement a blueprint for the future. The year-long project included representatives from all constituencies of the School and is being reviewed and updated in the future in response to needs of all constituencies served by the School.

***North Carolina School of Science and Mathematics
Statement of Net Assets
June 30, 2012***

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 192,616.93
Restricted Cash and Cash Equivalents	269,465.45
Receivables	47,049.14
Inventories	35,413.99
	<hr/>
Total Current Assets	544,545.51

Noncurrent Assets:

Restricted Cash and Cash Equivalents	13,790.43
Capital Assets - Nondepreciable (Note 3)	5,593,441.12
Capital Assets - Depreciable, Net (Note 3)	39,832,176.92
	<hr/>
Total Noncurrent Assets	45,439,408.47
	<hr/>
Total Assets	45,983,953.98

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 4)	115,205.20
Funds Held for Others	165,755.83
Long-Term Liabilities - Current Portion (Note 5)	126,819.00
	<hr/>
Total Current Liabilities	407,780.03

Noncurrent Liabilities:

Long-Term Liabilities (Note 5)	1,440,789.00
	<hr/>
Total Liabilities	1,848,569.03

NET ASSETS

Invested in Capital Assets	45,425,618.04
Restricted for:	
Expendable:	
Capital Projects	13,790.43
Unrestricted	<hr/> (1,304,023.52)
Total Net Assets	<hr/> <hr/> \$ 44,135,384.95

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

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

Exhibit A-2

REVENUES

Operating Revenues:	
Sales and Services	\$ 539,205.02
Other Operating Revenues	27,345.76
	<hr/>
Total Operating Revenues	566,550.78
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	14,716,638.78
Supplies and Materials	1,275,285.65
Services	1,954,600.80
Utilities	1,050,338.40
Depreciation	1,312,993.93
	<hr/>
Total Operating Expenses	20,309,857.56
	<hr/>
Operating Loss	(19,743,306.78)
	<hr/>

NONOPERATING REVENUES

State Appropriations	17,680,507.73
Noncapital Grants	736,581.62
Other Nonoperating Revenues	2,399.70
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Nonoperating Revenues	18,419,489.05
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Loss Before Other Revenues	(1,323,817.73)
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Capital Appropriations	211,374.49
Capital Gifts	6,200.00
	<hr/>
Decrease in Net Assets	(1,106,243.24)
	<hr/>

NET ASSETS

Net Assets - July 1, 2011 as Restated (Note 12)	45,241,628.19
	<hr/>
Net Assets - June 30, 2012	\$ 44,135,384.95
	<hr/> <hr/>

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

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

Exhibit A-2

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Net Assets - June 30, 2012	\$ 44,135,384.95
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The accompanying notes to the financial statements are an integral part of this statement.

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

Exhibit A-2

REVENUES

Operating Revenues:	
Sales and Services	539,205.02
Other Operating Revenues	27,345.76
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Total Operating Revenues	566,550.78
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EXPENSES

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Operating Loss	(19,743,306.78)
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NONOPERATING REVENUES

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Other Nonoperating Revenues	2,399.70
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Nonoperating Revenues	18,419,489.05
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NET ASSETS

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Net Assets - June 30, 2012	\$ 44,135,384.95
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The accompanying notes to the financial statements are an integral part of this statement.

***North Carolina School of Science and Mathematics
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012***

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 565,380.74
Payments to Employees and Fringe Benefits	(14,657,022.49)
Payments to Vendors and Suppliers	(4,453,628.92)
Other Receipts	27,711.43
	<u>27,711.43</u>
Net Cash Used by Operating Activities	<u>(18,517,559.24)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	17,680,507.73
Noncapital Grants	736,581.62
	<u>736,581.62</u>
Cash Provided by Noncapital Financing Activities	<u>18,417,089.35</u>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Capital Appropriations	211,374.49
Acquisition and Construction of Capital Assets	(377,580.12)
	<u>(377,580.12)</u>
Net Cash Used by Capital Financing and Related Financing Activities	<u>(166,205.63)</u>
Net Decrease in Cash and Cash Equivalents	(266,675.52)
Cash and Cash Equivalents - July 1, 2011	742,548.33
	<u>742,548.33</u>
Cash and Cash Equivalents - June 30, 2012	<u>\$ 475,872.81</u>

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

Operating Loss	\$ (19,743,306.78)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	1,312,993.93
Nonoperating Other Income	2,399.70
Changes in Assets and Liabilities:	
Receivables	(1,170.04)
Inventories	(2,393.49)
Accounts Payable and Accrued Liabilities	(136,270.29)
Funds Held for Others	25,311.73
Compensated Absences	24,876.00
	<u>24,876.00</u>
Net Cash Used by Operating Activities	<u>\$ (18,517,559.24)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 192,616.93
Restricted Cash and Cash Equivalents	269,465.45
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	13,790.43
	<u>13,790.43</u>
Total Cash and Cash Equivalents - June 30, 2012	<u>\$ 475,872.81</u>

NONCASH CAPITAL ACTIVITIES

Assets Acquired Through a Gift	\$ 6,200.00
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The accompanying notes to the financial statements are an integral part of this statement.

***North Carolina School of Science and Mathematics
Foundation, Inc.
Statement of Financial Position
June 30, 2012***

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	2,819,525
Investments		5,546,952
Accounts Receivable		1,982
Pledges Receivable		53,025
Prepaid Expenses		1,099
In-Kind Gifts		41,405
Land		60,540
		<hr/>
Total Assets		8,524,528
		<hr/>

LIABILITIES

Accounts Payable and Accrued Expenses		88,249
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NET ASSETS

Unrestricted		2,895,939
Temporarily Restricted		1,882,313
Permanently Restricted		3,658,027
		<hr/>
Total Net Assets	\$	8,436,279
		<hr/> <hr/>

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

***North Carolina School of Science and Mathematics
Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2012***

Exhibit B-2

CHANGES IN UNRESTRICTED NET ASSETS

Operating Revenues, Gains, and Other Support:	
Grants and Contributions	\$ 1,428,704
Investment Return Designated for Current Operations	49,247
Other Investment Income	19,137
Net Assets Resleased from Donor Restrictions	<u>249,822</u>
Total Operating Revenues, Gains, and Other Support	1,746,910
Operating Expenses	
Programs	669,165
Fundraising	165,462
General and Administrative	<u>305,677</u>
Total Operating Expenses	1,140,304
Change in Net Assets from Operations	606,606
Investment Losses Other Than Amounts Designated for Current Operations	(30,218)
Increase in Unrestricted Net Assets	<u>576,388</u>

CHANGES IN TEMPORARILY RESTRICTED NET ASSETS

Operating Revenues, Gains, and Other Support:	
Grants and Contributions	118,018
Investment Return Designated for Current Operations	166,523
Other Investment Loss	(1,871)
Net Assets Resleased from Donor Restrictions	<u>(249,822)</u>
Total Operating Revenues, Gains, and Other Support	32,848
Investment Losses Other Than Amounts Designated for Current Operations	(98,940)
Decrease in Temporarily Restricted Net Assets	<u>(66,092)</u>

CHANGES IN PERMANENTLY RESTRICTED NET ASSETS

Operating Revenues, Gains, and Other Support:	
Grants and Contributions	<u>296,849</u>
Increase in Permanently Restricted Net Assets	<u>296,849</u>
Increase in Net Assets	807,145
Net Assets at Beginning of Year	<u>7,629,134</u>
Net Assets at End of Year	<u><u>\$ 8,436,279</u></u>

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

NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS
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 North Carolina School of Science and Mathematics (School) 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 School and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor and the Board of Trustees have delegated responsibilities for financial accountability of the School's funds. The School's component units are either blended or discretely presented in the School's financial statements. The blended component unit, although legally separate, is, in substance, part of the School's operations and therefore, is reported as if it was part of the School. The discretely presented component unit's financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize its legal separateness.

Blended Component Unit - Although legally separate, NCSSM Student and Constituent Support Services, Inc. (SCSSI), a component unit of the School, is reported as if it was part of the School.

The SCSSI is governed by five ex officio directors that must be employees of the School. The ex officio directors consist of the Chancellor, the Vice Chancellor for Student Life, the Director of Student Services, the Vice Chancellor for Administration, and the School Store Manager. Because the members of the Board of Directors of the SCSSI are officials of the School and the SCSSI's sole purpose is to benefit the School, its financial statements have been blended with those of the School.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Separate financial statements for the SCSSI may be obtained from Dr. Joan Barber, Executive Director, North Carolina School of Science and Mathematics, Post Office Box 2418, Durham, NC 27715-2418, or by calling (919) 416-2801.

Discretely Presented Component Unit – The North Carolina School of Science and Mathematics 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 School.

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the School in support of its programs. The Foundation board consists of 21 members. Although the School 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 School by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the School, the Foundation is considered a component unit of the School and is reported in separate financial statements because of the difference in its reporting model, as described below.

The Foundation is a private not-for-profit organization that 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 School's financial reporting entity for these differences.

During the year ended June 30, 2012, the Foundation distributed \$630,691 directly to the School and paid an additional \$416,733 on behalf of the School for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Katie Wagstaff, President, North Carolina School of Science and Mathematics Foundation, Inc., Post Office Box 2418, Durham, NC 27715-2418, or by calling (919) 416-2866.

- 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*

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities, the full scope of the School'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 School 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 School 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 School receives (or gives) value without directly giving (or receiving) equal value in exchange, include state appropriations, certain grants, and donations. Revenues are recognized 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, 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. Receivables** – Receivables include amounts due from state agencies and are reported at gross.
- F. Inventories** - Inventories, consisting of expendable supplies, are valued at cost using the last invoice cost method.
- G. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs.

The School 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 10 to 75 years for general infrastructure, 10 to 75 years for buildings, and 2 to 25 years for equipment.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- H. 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.
- I. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include compensated absences that will not be paid within the next fiscal year.
- J. Compensated Absences** - The School's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

There is no liability for unpaid accumulated sick leave because the School 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.

- K. Net Assets** - The School's net assets are classified as follows:

Invested in Capital Assets - This represents the School's total investment in capital assets.

Restricted Net Assets - Expendable - Expendable restricted net assets include resources for which the School is legally or contractually

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets - Unrestricted net assets include resources derived from unrestricted gifts not subject to donor-imposed stipulations and interest income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the School.

- L. Revenue and Expense Recognition** - The School 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 School's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions. 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 School are considered nonoperating since these are either investing, capital, or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - Unless specifically exempt, the School 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 School 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 School may voluntarily deposit institutional trust funds, endowment funds, special funds, revenue bond

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the School.

At June 30, 2012, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$380,705.66 which represents the School'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 \$500.00. The carrying amount of the School's deposits not with the State Treasurer was \$94,667.15 and the bank balance was \$99,303.14. Custodial credit risk is the risk that in the event of a bank failure, the School's deposits may not be returned to it. The School does not have a deposit policy for custodial credit risk. As of June 30, 2012, the School's bank balance was fully insured by federal depository insurance and was not exposed to custodial credit risk.

- B. Investments of Component Unit** – Investments of the School'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	\$ 5,457,635
Other Mutual Funds	<u>89,317</u>
	<u>\$ 5,546,952</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - 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	\$ 1,337,173.66	\$ 0.00	\$ 0.00	\$ 1,337,173.66
Art	10,092.76			10,092.76
Construction in Progress	3,878,579.58	367,595.12		4,246,174.70
Total Capital Assets, Nondepreciable	5,225,846.00	367,595.12		5,593,441.12
Capital Assets, Depreciable:				
Buildings	51,356,149.10			51,356,149.10
Machinery and Equipment	1,990,190.10	16,185.00	325,250.60	1,681,124.50
General Infrastructure	1,695,363.00			1,695,363.00
Total Capital Assets, Depreciable	55,041,702.20	16,185.00	325,250.60	54,732,636.60
Less Accumulated Depreciation for:				
Buildings	12,328,576.04	1,031,855.27		13,360,431.31
Machinery and Equipment	1,080,958.43	242,332.14	325,250.60	998,039.97
General Infrastructure	503,181.88	38,806.52		541,988.40
Total Accumulated Depreciation	13,912,716.35	1,312,993.93	325,250.60	14,900,459.68
Total Capital Assets, Depreciable, Net	41,128,985.85	(1,296,808.93)		39,832,176.92
Capital Assets, Net	\$ 46,354,831.85	\$ (929,213.81)	\$ 0.00	\$ 45,425,618.04

NOTE 4 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 67,134.66
Accrued Payroll	48,070.54
Total Accounts Payable and Accrued Liabilities	\$ 115,205.20

NOTE 5 - 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
Compensated Absences	\$ 1,542,732.00	\$ 747,298.00	\$ 722,422.00	\$ 1,567,608.00	\$ 126,819.00

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - OPERATING LEASE OBLIGATIONS

The School entered into operating leases for equipment and housing. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2012:

<u>Fiscal Year</u>	<u>Amount</u>
2013	\$ 32,840.03
2014	17,111.90
2015	3,186.88
Total Minimum Lease Payments	\$ 53,138.81

Rental expense for all operating leases during the year was \$123,752.17.

NOTE 7 - OPERATING EXPENSES BY FUNCTION

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

	<u>Salaries and Benefits</u>	<u>Supplies and Materials</u>	<u>Services</u>	<u>Utilities</u>	<u>Depreciation</u>	<u>Total</u>
Instruction	\$ 7,441,922.97	\$ 308,364.18	\$ 88,978.96	\$ 0.00	\$ 0.00	\$ 7,839,266.11
Academic Support	279,342.73	64,855.05	36,908.90			381,106.68
Student Services	2,467,937.48	132,007.02	1,471,853.70			4,071,798.20
Institutional Support	3,514,857.58	111,603.05	245,704.97			3,872,165.60
Operations and Maintenance of Plant	1,012,578.02	658,456.35	111,154.27	1,050,338.40		2,832,527.04
Depreciation					1,312,993.93	1,312,993.93
Total Operating Expenses	\$ 14,716,638.78	\$ 1,275,285.65	\$ 1,954,600.80	\$ 1,050,338.40	\$ 1,312,993.93	\$ 20,309,857.56

NOTE 8 - PENSION PLANS

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

The Teachers' and State Employees' Retirement System (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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 School had a total payroll of \$11,454,006.95, of which \$9,371,539.67 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$697,242.55 and \$562,292.38, 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 School made 100% of its annual required contributions for the years ended June 30, 2012, 2011, and 2010, which were \$697,242.55, \$473,324.21, and \$363,185.65, 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 School may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 School assumes no liability other than its contribution.

For the current fiscal year, the School had a total payroll of \$11,454,006.95, of which \$1,131,828.65 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$77,417.08 and \$67,909.72, 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 School. The voluntary contributions by employees amounted to \$41,809.96 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 School. The voluntary contributions by employees amounted to \$82,889.00 for the year ended June 30, 2012.

Internal Revenue Code Section 403(b) and 403(b)(7) Plans - Eligible School 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 Prudential, Fidelity, TIAA CREF, and Lincoln Investment Planning. No costs are incurred by the School. The voluntary contributions by employees amounted to \$153,590.81 for the year ended June 30, 2012.

NOTE 9 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Benefits** - The School 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 Board of Trustees of the State Health Plan for Teachers and State Employees.

For the current fiscal year the School 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%,

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

respectively. The School made 100% of its annual required contributions to the Plan for the years ended June 30, 2012, 2011, and 2010, which were \$525,168.42, \$524,082.34, and \$507,485.34, respectively. The School 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 School 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 School made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2011, and 2010, were .52% and .52%, respectively. The School made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2012, 2011, and 2010, which were \$54,617.52, \$55,616.90, and \$58,642.75, respectively. The School assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 10 - RISK MANAGEMENT

The School 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 School pays the premium, based on a composite rate, directly to the private insurer.

The School 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 School 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 School pays premiums to the North Carolina Department of Insurance for the coverage.

The School 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. The School is 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 School purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. Examples include, but are not limited to, fine arts, boiler and machinery, excess liability, university intern general liability, and volunteer accident and health.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

compensation in accordance with the North Carolina Workers' Compensation Act. The School 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 11 - COMMITMENTS

The School has established an encumbrance system to track its outstanding commitments on construction projects. Outstanding commitments on construction contracts were \$13,790.43 at June 30, 2012.

NOTE 12 - NET ASSET RESTATEMENT

As of July 1, 2011, net assets as previously reported were restated as follows:

	<u>Amount</u>
July 1, 2011 Net Assets as Previously Reported	\$ 44,919,805.04
Restatement: Errors in Offsetting Liabilities upon Payment	<u>321,823.15</u>
July 1, 2011 Net Assets as Restated	<u><u>\$ 45,241,628.19</u></u>

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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
North Carolina School of Science and Mathematics
Durham, North Carolina

We have audited the financial statements of the North Carolina School of Science and Mathematics, 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 School's basic financial statements and have issued our report thereon dated May 8, 2013. 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 discretely presented component unit, as described in our report on the School's financial statements. The financial statements of the discretely presented component unit were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

The School's management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the School'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 School's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the School's internal control over financial reporting.

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

**INDEPENDENT AUDITOR’S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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possibility that a material misstatement of the School’s financial statements will not be prevented, or detected and corrected on a timely basis.

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

A significant deficiency is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the finding in the Audit Findings and Responses section of this report to be significant deficiencies.

Compliance and Other Matters

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

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

This report is intended solely for the information and use of management of the School, 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

May 8, 2013

AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

The following audit finding was identified during the current audit and describes conditions that represent deficiencies in internal control.

1. DEFICIENCIES IN FINANCIAL REPORTING

The financial statements and related notes to the financial statements prepared by the School contained misstatements that were corrected as a result of our audit. The misstatements indicate that the School's internal control over financial reporting was not effective, and without these corrections the financial statements could be misleading to users. Misstatements noted during our audit included:

- Current unrestricted cash and cash equivalents was understated by \$95,167.15 and current restricted cash and cash equivalents was overstated by the same amount due to a classification error made while recording transactions of the blended component unit.
- The School failed to properly eliminate institutional transfers-in at year-end. As a result, grants, aids, and subsidies expense was overstated by \$246,270.00, services expense by \$71,861.11 and noncapital grants was understated by \$94,324.70.
- The School failed to properly reduce certain current and prior years' liabilities when paid. As a result, accounts payable and funds held for others were overstated by \$86,467.20 and \$296,962.11, respectively. The amount of liabilities from prior periods incorrectly reported resulted in a restatement of prior period net asset balances of \$321,823.15.
- The School failed to properly capitalize expenses to construction in progress, which resulted in an understatement of \$224,585.72 for nondepreciable capital assets and an overstatement of supplies expense by the same amount.
- The School's financial statements did not agree to the general ledger accounting records. While preparing the financial statements, the School recorded transactions of the blended component unit with the financial statements but did not adjust the general ledger accounting records.
- The School did not properly disclose the cash position with the State Treasurer in the notes to the financial statements. The amount disclosed in the notes to the financial statements was overstated by \$2,157,257.81.
- The Statement of Cash Flows needed significant adjustments to correctly and fairly present the activity of the School.

The School's management is responsible for the fair presentation of the financial statements and related notes to the financial statements in conformity with accounting principles generally accepted in the United States. Best practices for financial statement

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

preparation include adequate review of financial statements and related notes to the financial statements to ensure that no material misstatements or errors occur.

Recommendation: The School should place greater emphasis on year-end financial reporting process and strengthen internal controls to ensure the completeness and accuracy of the financial statements and related notes to the financial statements.

School's Response: After reviewing the Audit finding, we have determined that overall the finding is valid. We also concur with the recommendation to place greater emphasis on the year-end financial reporting process and overall internal control to ensure the accuracy of our financial statements. We are confident that the changes we have and will implement in the year-end review process, including a year-end checklist, will address the deficiencies noted in the audit finding.

ORDERING INFORMATION

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This audit required 673 audit hours at an approximate cost of \$48,456.