

# 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, 2013**

**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, 2013**

**BOARD OF GOVERNORS**

**THE UNIVERSITY OF NORTH CAROLINA**

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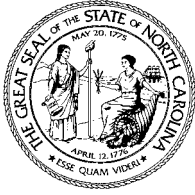
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Beth A. Wood, CPA  
State Auditor

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

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**AUDITOR'S TRANSMITTAL**

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The Honorable Pat McCrory, 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, 2013, 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".

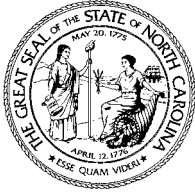
Beth A. Wood, CPA  
State Auditor

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# Office of the State Auditor



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## INDEPENDENT AUDITOR'S REPORT

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

### Report on the Financial Statements

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, 2013, and the related notes to the financial statements, which collectively comprise the University's basic financial statements as listed in the table of contents.

### Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

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 statements were audited by other auditors, whose reports have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based solely 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 from material misstatement. The financial statements of the University of North Carolina School of the Arts Housing Corporation and the University of North Carolina School of the Arts Foundation, Inc. were not audited in accordance with *Government Auditing Standards*.

## **INDEPENDENT AUDITOR'S REPORT (CONTINUED)**

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An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

### Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the University of North Carolina School of the Arts and its discretely presented component unit, as of June 30, 2013, and the changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### Other Matters – Required Supplementary Information

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 a 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 our audit of the basic financial statements. 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.


### Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 26, 2013 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, and grant agreements and other matters. The purpose of that report is to describe the

## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control over financial reporting and compliance.



Beth A. Wood, CPA  
State Auditor

Raleigh, North Carolina

November 26, 2013

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

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### 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, 2013. 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 Position; the Statement of Revenues, Expenses, and Changes in Net Position; 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 Position as adjusted for changes in the beginning and ending balances of noncash accounts on the Statement of Net Position. For the purpose of this discussion, we will address the Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position.

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 postemployment 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 Position

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

From the data presented, readers of the Statement of Net Position 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 Position provides a picture of the net position (assets minus liabilities) and their availability for expenditure by the University.

Net position is divided into three major categories. The first category, net investment in capital assets, provides the University's equity in property, plant and equipment owned by the University. The next category is restricted net position, which is divided into two categories, nonexpendable and expendable. Nonexpendable restricted net position includes endowment investments, which are only available for investment purposes, and student loan funds. Expendable restricted net position is 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 position, which is 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 Position

	Year Ended June 30,		
	2013	2012	Change
<b>Assets</b>			
Current Assets	\$ 19,756,497.13	\$ 17,516,370.49	\$ 2,240,126.64
Capital Assets, Net	98,299,596.26	94,707,546.09	3,592,050.17
Other Noncurrent Assets	17,816,739.13	15,213,725.63	2,603,013.50
Total Assets	<u>135,872,832.52</u>	<u>127,437,642.21</u>	<u>8,435,190.31</u>
<b>Liabilities</b>			
Current Liabilities	4,663,323.61	3,564,911.67	1,098,411.94
Noncurrent Liabilities	9,360,213.13	9,836,826.28	(476,613.15)
Total Liabilities	<u>14,023,536.74</u>	<u>13,401,737.95</u>	<u>621,798.79</u>
<b>Net Position</b>			
Net Investment in Capital Assets	90,519,596.26	86,432,546.09	4,087,050.17
Restricted:			
Nonexpendable	13,532,745.18	12,298,494.19	1,234,250.99
Expendable	4,949,454.54	3,353,207.17	1,596,247.37
Unrestricted	12,847,499.80	11,951,656.81	895,842.99
Total Net Position	<u>\$ 121,849,295.78</u>	<u>\$ 114,035,904.26</u>	<u>\$ 7,813,391.52</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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The total assets of the University increased by \$8,435,190.31 for the year, with increases in current assets, net capital assets, and other noncurrent assets of \$2,240,126.64, \$3,592,050.17, and \$2,603,013.50, respectively. Of the \$2,240,126.64 increase in current assets, approximately \$1,400,000.00 is related to an increase in unrestricted cash and cash equivalents and approximately \$800,000.00 is related to restricted cash and cash equivalents, offset with small decreases in receivables and inventories. An increase of approximately \$1,342,000.00 in unrestricted cash is due to an increase in auxiliary fees for fiscal year 2012-2013, offset with a decrease in this cash of approximately \$359,000.00 in housing services as a result of increased expenditures related to renovations projects. The remaining variance is due to an increase in the amount of cash the State allowed the University to carry forward to the next year, in addition to increases within other auxiliary and trust fund cash accounts. The \$800,000.00 increase in current restricted cash and cash equivalents is primarily due to the reclassification of noncurrent restricted cash of approximately \$1,100,000.00 to current restricted cash to cover related current plant liabilities. Also, in fiscal year 2012-2013, funds generated from certain university fees were moved from state to institutional trust funds; thus, increasing current restricted cash by approximately \$437,000.00. These increases were offset by a decrease in current restricted cash of approximately \$340,000.00 as a result of the Kenan Institute for the Arts funds being transferred to the Foundation, coupled with a decrease in funding from the Kenan Foundation of approximately \$250,000.00 in the current year compared to the prior fiscal year. The increase of \$3,592,050.17 in net capital assets is primarily attributable to increases in construction in progress and equipment of approximately \$6,500,000.00, netted against the current year's depreciation of approximately \$2,800,000.00. The University is in the process of constructing four new buildings, which is the primary reason for the increase in construction in progress during the year of approximately \$5,500,000.00. Other noncurrent assets increased primarily due to an increase in endowment investments of \$2,436,765.12. This increase in endowment investments is the result of new endowments of approximately \$1,000,000.00 during the year, as well as gains on investments of approximately \$1,600,000.00, offset against withdrawals of investments and investment expenses of approximately \$240,000.00.

The total liabilities of the University increased \$621,798.79, with a significant increase of \$1,098,411.94 in current liabilities. Of the \$1,098,411.94 increase in current liabilities, \$1,187,706.87 is due to an increase in accounts payable and accrued payroll, offset with a small decrease in the current portion of long-term liabilities. The significant portion of the accounts payable increase is as a result of year-end accruals associated with the ongoing capital projects, which increased by approximately \$1,100,000.00 compared to the prior year. The decrease in noncurrent liabilities is primarily the result of the University continuing to pay down its revenue bonds and certificates of participation debt.

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

The Statement of Revenues, Expenses, and Changes in Net Position reports the University's results of operation for the fiscal year. Changes in total net position presented on the Statement of Net Position are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Position. The purpose of this statement is to present the revenues received by the University and expenses paid by the University, both operating and

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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, state appropriations are nonoperating because they are provided by the state legislature which receives no goods or services in return for these revenues.

### Condensed Statement of Revenues, Expenses, and Changes in Net Position

	Year Ended June 30,		
	2013	2012	Change
<b>Operating Revenues</b>			
Student Tuition and Fees, Net	\$ 10,793,130.66	\$ 10,945,396.16	\$ (152,265.50)
Sales and Services, Net	6,441,113.61	6,133,794.20	307,319.41
Other Operating Revenues	618,331.11	812,825.22	(194,494.11)
<b>Total Operating Revenues</b>	<b>17,852,575.38</b>	<b>17,892,015.58</b>	<b>(39,440.20)</b>
Operating Expenses:			
Salaries and Benefits	31,281,309.06	30,276,646.70	1,004,662.36
Supplies and Materials	3,329,480.34	3,895,518.41	(566,038.07)
Services	7,353,307.14	7,147,869.00	205,438.14
Scholarships and Fellowships	1,407,482.68	1,566,567.97	(159,085.29)
Utilities	1,957,289.58	1,815,531.00	141,758.58
Depreciation	2,858,888.86	2,871,623.94	(12,735.08)
<b>Total Operating Expenses</b>	<b>48,187,757.66</b>	<b>47,573,757.02</b>	<b>614,000.64</b>
<b>Operating Loss</b>	<b>(30,335,182.28)</b>	<b>(29,681,741.44)</b>	<b>(653,440.84)</b>
<b>Nonoperating Revenues (Expenses)</b>			
State Appropriations	27,154,238.26	25,787,944.05	1,366,294.21
Noncapital Grants - Student Financial Aid	1,666,561.92	1,495,380.25	171,181.67
Noncapital Grants	11,000.00	10,000.00	1,000.00
Noncapital Gifts	1,518,355.78	2,716,558.62	(1,198,202.84)
Investment Income, Net	1,744,201.20	418,240.46	1,325,960.74
Interest and Fees on Debt	(374,715.25)	(394,009.92)	19,294.67
Other Nonoperating Expenses	(141,464.20)	(306,522.02)	165,057.82
<b>Net Nonoperating Revenues</b>	<b>31,578,177.71</b>	<b>29,727,591.44</b>	<b>1,850,586.27</b>
<b>Income Before Other Revenues</b>	<b>1,242,995.43</b>	<b>45,850.00</b>	<b>1,197,145.43</b>
Capital Appropriations	873,200.00		873,200.00
Capital Grants	4,363,450.39	2,324,438.65	2,039,011.74
Capital Gifts	322,834.10	57,536.00	265,298.10
Additions to Endowments	1,010,911.60	933,005.62	77,905.98
<b>Total Other Revenues</b>	<b>6,570,396.09</b>	<b>3,314,980.27</b>	<b>3,255,415.82</b>
<b>Increase in Net Position</b>	<b>7,813,391.52</b>	<b>3,360,830.27</b>	<b>4,452,561.25</b>
<b>Beginning Net Position</b>	<b>114,035,904.26</b>	<b>110,675,073.99</b>	<b>3,360,830.27</b>
<b>Ending Net Position</b>	<b>\$ 121,849,295.78</b>	<b>\$ 114,035,904.26</b>	<b>\$ 7,813,391.52</b>

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

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The Statement of Revenues, Expenses, and Changes in Net Position reported an increase in the net position at the end of the year. Total net revenues were \$56,001,149.18 for fiscal year ended June 30, 2013 and \$50,934,587.29 for 2012. Some of the highlights of the revenue accounts presented on the Statement of Revenues, Expenses, and Changes in Net Position are as follows:

- Student tuition and fees decreased by \$152,265.50. This decrease resulted from an increase in tuition and fee rates, offset by an increase of approximately \$679,000.00 in scholarship discounts for tuition and fees.
- Sales and services increased \$307,319.41. This change was the result of an increase in revenues associated with summer workshops, school productions, and other auxiliary functions, offset by an increase of approximately \$300,000.00 in scholarship discounts for sales and services.
- State appropriations increased \$1,366,294.21 mainly as a result of increased funding to support legislatively-approved salary increases.
- Noncapital gifts decreased by \$1,198,202.84 mainly due to the transfer of the Kenan Institute for the Arts funds to the Foundation. In previous years, the Kenan Institute for the Arts funds were managed by the University. The funds were moved this year at the direction of the donor. All future gifts received on behalf of the Kenan Institute for the Arts will be received by the Foundation.
- Investment income increased by \$1,325,960.74 as a result of continued improvement in the financial market which resulted in gains on investments.
- The University received \$873,200.00 in capital appropriations as a result of the State providing repair and renovation funds.
- Capital grants increased \$2,039,011.74 mainly due to increased state funding for the construction of the new library. The source of this funding was state issued certificates of participation.

Operating expenses totaled \$48,187,757.66 for the year compared to \$47,573,757.02 from the previous year, an increase of \$614,000.64. The significant changes include:

- Salaries and benefits increased \$1,004,662.36 primarily due to legislatively-approved salary increases for fiscal year 2012-2013.
- Supplies and materials decreased by \$566,038.07. This reduction was a result of a conscious management decision to continue to reduce spending in fiscal year 2012-2013 in order to prepare for possible budget reductions.

### **Capital Asset and Debt Administration**

The University's capital assets, net of accumulated depreciation at June 30, 2013, were \$98,299,596.26. Construction projects in progress for the 2012-2013 fiscal year totaled \$9,458,953.90. The University is currently constructing a new Library, Campus Police Operation Center, Central Storage Facility, and Film School Production Design Facility. For

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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more information about the University's capital asset holdings, refer to Note 5 of the Notes to the Financial Statements.

The University had \$7,780,000.00 in outstanding capital debt at June 30, 2013, and continues to make all of its debt payments in a timely manner. No new debt was issued during the 2012-2013 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 economy remains in a slow-growth recovery phase. The housing market forecasts are expected to fuel improvements as 2014 approaches. The State predicts unemployment to experience a gradual improvement with the increase of new jobs on the horizon. However, the revenue outlook for the State is not predicted to pick up steadily until the end of the biennium.

The State reduced the University System budget by 4.7% or \$65.8 million in management flexibility funds for fiscal year 2013-2014; however, UNCSCA was exempt from this reduction. The University did receive a reduction of \$333,000 in UNC strategic directions initiatives. The administration managed these reductions with an emphasis of trying to preserve the core instructional budgets. Student enrollment remains strong and continues to provide a constant revenue stream. Deans are doing an excellent job with recruiting outstanding student talent.

The construction of four new buildings is scheduled to be completed in the 2013-2014 fiscal year and they include the Library, Campus Police Operation Center, Central Storage Facility, and the Film School Production Design Facility. Although state funding for repair and renovation needs remains short of needed amounts, the University continues to receive repair and renovations support from the State.

As the University continues to progress, it will celebrate its 50th anniversary. Plans are underway to produce another all school musical that will not only celebrate the anniversary but will raise scholarship funds for students. There will be a celebratory book designed and printed that reflects the history of UNCSCA. The plan to create a video documentary from video clips in the University's archival records will be a historical first for the University.

**University of North Carolina School of the Arts**  
**Statement of Net Position**  
**June 30, 2013**

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

**ASSETS**

Current Assets:

Cash and Cash Equivalents	\$ 15,690,853.23
Restricted Cash and Cash Equivalents	3,636,463.12
Receivables, Net (Note 4)	84,936.15
Due from University Component Units	37,046.00
Inventories	238,892.36
Notes Receivable, Net (Note 4)	68,306.27
	<hr/>
Total Current Assets	19,756,497.13

Noncurrent Assets:

Restricted Cash and Cash Equivalents	1,021,461.67
Endowment Investments	15,261,301.42
Restricted Investments	680,999.61
Other Investments	52,461.75
Bond Issuance Costs	471,830.00
Notes Receivable, Net (Note 4)	328,684.68
Capital Assets - Nondepreciable (Note 5)	15,623,160.35
Capital Assets - Depreciable, Net (Note 5)	82,676,435.91
	<hr/>
Total Noncurrent Assets	116,116,335.39

Total Assets	<hr/> <hr/> 135,872,832.52
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**DEFERRED OUTFLOWS OF RESOURCES**

Total Deferred Outflows of Resources	<hr/> 0.00
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**LIABILITIES**

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	2,337,138.00
Due to Primary Government	17,169.54
Unearned Revenue	1,481,647.81
Interest Payable	39,927.33
Long-Term Liabilities - Current Portion (Note 7)	787,440.93
	<hr/>
Total Current Liabilities	4,663,323.61

Noncurrent Liabilities:

Deposits Payable	35,300.00
Funds Held for Others	954.80
U. S. Government Grants Refundable	479,804.15
Long-Term Liabilities (Note 7)	8,844,154.18
	<hr/>
Total Noncurrent Liabilities	9,360,213.13

Total Liabilities	<hr/> <hr/> 14,023,536.74
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**DEFERRED INFLOWS OF RESOURCES**

Total Deferred Inflows of Resources	<hr/> 0.00
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**University of North Carolina School of the Arts**  
**Statement of Net Position**  
**June 30, 2013**

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

**NET POSITION**

Net Investment in Capital Assets	90,519,596.26
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	322,077.21
Endowed Professorships	9,738,641.81
Departmental Uses	3,383,835.21
Loans	88,190.95
Expendable:	
Scholarships and Fellowships	557,858.47
Endowed Professorships	1,442,510.69
Departmental Uses	1,577,625.23
Capital Projects	246,511.21
Debt Service	1,124,948.94
Unrestricted	<u>12,847,499.80</u>
Total Net Position	<u><u>\$ 121,849,295.78</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 Position**  
**For the Fiscal Year Ended June 30, 2013**

**Exhibit A-2**

**REVENUES**

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 10,793,130.66
Federal Grants and Contracts	8,652.42
Nongovernmental Grants and Contracts	27,000.00
Sales and Services, Net (Note 9)	6,441,113.61
Interest Earnings on Loans	1,617.42
Other Operating Revenues	581,061.27

Total Operating Revenues	17,852,575.38
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**EXPENSES**

Operating Expenses:

Salaries and Benefits	31,281,309.06
Supplies and Materials	3,329,480.34
Services	7,353,307.14
Scholarships and Fellowships	1,407,482.68
Utilities	1,957,289.58
Depreciation	2,858,888.86

Total Operating Expenses	48,187,757.66
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Operating Loss	(30,335,182.28)
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**NONOPERATING REVENUES (EXPENSES)**

State Appropriations	27,154,238.26
Noncapital Grants - Student Financial Aid	1,666,561.92
Noncapital Grants	11,000.00
Noncapital Gifts	1,518,355.78
Investment Income (Net of Investment Expense of \$71,341.34)	1,744,201.20
Interest and Fees on Debt	(374,715.25)
Other Nonoperating Expenses	(141,464.20)

Net Nonoperating Revenues	31,578,177.71
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Income Before Other Revenues	1,242,995.43
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Capital Appropriations	873,200.00
Capital Grants	4,363,450.39
Capital Gifts	322,834.10
Additions to Endowments	1,010,911.60

Increase in Net Position	7,813,391.52
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**NET POSITION**

Net Position - July 1, 2012	114,035,904.26
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Net Position - June 30, 2013	\$ 121,849,295.78
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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, 2013**

**Exhibit A-3**  
**Page 1 of 2**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Received from Customers	\$ 17,905,379.87
Payments to Employees and Fringe Benefits	(31,336,352.48)
Payments to Vendors and Suppliers	(12,416,829.01)
Payments for Scholarships and Fellowships	(1,407,482.68)
Loans Issued	(108,095.00)
Collection of Loans	106,748.65
Interest Earned on Loans	1,772.81
Student Deposits Received	33,000.00
Student Deposits Returned	(65,855.00)
	<hr/>
Net Cash Used by Operating Activities	(27,287,712.84)

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

State Appropriations	27,154,238.26
Noncapital Grants - Student Financial Aid	1,666,561.92
Noncapital Grants	11,000.00
Noncapital Gifts	1,518,355.78
Additions to Endowments	1,010,911.60
William D. Ford Direct Lending Receipts	6,362,988.00
William D. Ford Direct Lending Disbursements	(6,362,988.00)
Related Activity Agency Disbursements	(6,714.09)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	31,354,353.47

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

State Capital Appropriations	873,200.00
Capital Grants	4,363,450.39
Capital Gifts	166,000.00
Proceeds from Sale of Capital Assets	12,916.03
Acquisition and Construction of Capital Assets	(5,320,156.18)
Principal Paid on Capital Debt and Leases	(495,000.00)
Interest and Fees Paid on Capital Debt and Leases	(358,408.75)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(757,998.51)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Proceeds from Sales and Maturities of Investments	142,926.47
Investment Income	117,346.25
Purchase of Investments and Related Fees	(1,184,331.99)
	<hr/>
Net Cash Used by Investing Activities	(924,059.27)
	<hr/>
Net Increase in Cash and Cash Equivalents	2,384,582.85
Cash and Cash Equivalents - July 1, 2012	17,964,195.17
	<hr/>
Cash and Cash Equivalents - June 30, 2013	\$ 20,348,778.02

**University of North Carolina School of the Arts**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended June 30, 2013**

**Exhibit A-3**

**Page 2 of 2**

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

Operating Loss	\$ (30,335,182.28)
Adjustments to Reconcile Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	2,858,888.86
Allowances and Write-Offs	149,082.12
Changes in Assets and Liabilities:	
Receivables (Net)	32,592.47
Due from University Component Units	(25,644.00)
Inventories	34,427.14
Accounts Payable and Accrued Liabilities	59,377.89
U. S. Government Grants Refundable	57,100.63
Due to Primary Government	4,050.19
Unearned Revenue	4,464.47
Compensated Absences	(92,668.98)
Deposits Payable	(32,855.00)
Student Loans Issued	(108,095.00)
Student Loan Principal Repayments	106,748.65
	<hr/>
Net Cash Used by Operating Activities	<u>\$ (27,287,712.84)</u>

**RECONCILIATION OF CASH AND CASH EQUIVALENTS**

Current Assets:	
Cash and Cash Equivalents	\$ 15,690,853.23
Restricted Cash and Cash Equivalents	3,636,463.12
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	1,021,461.67
	<hr/>
Total Cash and Cash Equivalents - June 30, 2013	<u>\$ 20,348,778.02</u>

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

Assets Acquired through the Assumption of a Liability	\$ 1,850,617.71
Assets Acquired through a Gift	156,834.10
Change in Fair Value of Investments	1,626,854.95
Loss on Disposal of Capital Assets	141,464.20

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, 2013***

***Exhibit B-1***

**ASSETS**

Cash and Cash Equivalents	\$ 3,281,622
Investments	22,019,250
Annuity Investments	543,474
Prepaid Expenses and Other Current Assets	44,331
Pledges Receivable, Net	4,467,895
Beneficial Interest in Perpetual Trusts	754,388
Land	80,001
Other Long-Term Assets	144,245
	<hr/>
Total Assets	<u>\$ 31,335,206</u>

**LIABILITIES AND NET ASSETS**

Accounts Payable and Accrued Expenses	\$ 137,800
Annuity Obligations	205,630
	<hr/>
Total Liabilities	<u>343,430</u>

**NET ASSETS**

Unrestricted	335,295
Temporarily Restricted	5,432,325
Permanently Restricted	25,224,156
	<hr/>
Total Net Assets	<u>30,991,776</u>
	<hr/>
Total Liabilities and Net Assets	<u>\$ 31,335,206</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, 2013**

**Exhibit B-2**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
<b>REVENUES AND SUPPORT</b>				
Gifts and Grants	\$ 450,461	\$ 2,880,851	\$ 670,011	\$ 4,001,323
Interest and Dividend Income	524	1,865		2,389
Change in Fair Value of:				
Annuity Investments			31,805	31,805
Perpetual Trusts			10,652	10,652
Annuity Obligations			(10,779)	(10,779)
Net Gain on Other Investments Reported at Fair Value	315,186	1,837,892	199,466	2,352,544
Other Income	52,411	183,972	10,686	247,069
Net Assets Released from Restrictions	<u>3,316,132</u>	<u>(3,316,132)</u>		
Total Revenues and Support	4,134,714	1,588,448	911,841	6,635,003
<b>EXPENSES</b>				
Program Services:				
Scholarships and Awards	1,038,933			1,038,933
School Programs	<u>2,056,445</u>			<u>2,056,445</u>
Total Program Services	3,095,378			3,095,378
Supporting Services:				
Administrative Costs	277,011			277,011
Investment Management Fees	103,312			103,312
Development Costs	<u>312,660</u>			<u>312,660</u>
Total Supporting Services	<u>692,983</u>			<u>692,983</u>
Total Expenses	<u>3,788,361</u>			<u>3,788,361</u>
Change in Net Assets Before Transfers	346,353	1,588,448	911,841	2,846,642
Transfer of Property to (from) UNC School of Arts, Net	<u>(100,000)</u>	<u>174,000</u>		<u>74,000</u>
Change in Net Assets	246,353	1,762,448	911,841	2,920,642
<b>NET ASSETS</b>				
Net Assets - Beginning of Year	<u>88,942</u>	<u>3,669,877</u>	<u>24,312,315</u>	<u>28,071,134</u>
Net Assets - End of Year	<u>\$ 335,295</u>	<u>\$ 5,432,325</u>	<u>\$ 25,224,156</u>	<u>\$ 30,991,776</u>

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

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**UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2013**

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. 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 units, although legally separate, are, in substance, part of the University's operations and therefore, are reported as if they were part of the University. 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 Units** - Although legally separate, the University of North Carolina School of the Arts Housing Corporation (Housing Corporation) and the University of North Carolina School of the Arts Program Support Corporation (Program Support Corporation), component units of the University, are reported as if they were 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)

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The Program Support Corporation board consists of at least three and no more than 12 appointed directors. Its purpose is to foster, promote, manage, assist, and support the schools of Dance, Design and Production, Drama, Filmmaking, and Music, and any other related activity of the University of North Carolina School of the Arts. 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.

Separate financial statements for the Housing Corporation and Program Support Corporation may be obtained from the University Controller's Office, P.O. Box 12189, Winston-Salem, NC 27107, or by calling (336) 770-3304.

Condensed combining information regarding blended component units is provided in Note 15.

**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 the Financial Accounting Standards Board (FASB) Codification. 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, 2013, the Foundation distributed \$1,929,551.65 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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obtained from the University of North Carolina School of the Arts Foundation, Inc., P.O. Box 12189, Winston-Salem, NC 27107.

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

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

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

- 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 (STIF). The STIF maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

- E. Investments** - Investments generally are reported at fair value, as determined by quoted market prices or estimated amounts determined by management if quoted market prices are not available. Fair value for investments in the UNC Investment Fund was based on amounts reported to the University by UNC Management Company, Inc. University management reviews and evaluates the values provided by UNC Management Company, Inc. as well as the valuation methods and assumptions used in determining the fair value of such investments.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net increase 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.
- 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 25 years for equipment, except for 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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- 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 (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 Position** - The University's net position is classified as follows:

**Net Investment in Capital Assets** - 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 Net Investment in Capital Assets.

**Restricted Net Position - Nonexpendable** - Nonexpendable restricted net position includes 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

**Unrestricted Net Position** - Unrestricted net position includes resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

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

- M. Scholarship Discounts** - Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Position. 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 Position. 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 Position. 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*.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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.

### 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, 2013, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$20,341,028.02 which represents the University's equity position in the State Treasurer's STIF. The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2013. Assets and shares of the STIF 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 STIF) 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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clicking on “Reports” or by calling the State Controller’s Financial Reporting Section at (919) 707-0500.

Cash on hand at June 30, 2013 was \$2,430.00. The carrying amount and bank balance of the University’s deposits not with the State Treasurer was \$5,320.00. 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, 2013, 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 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Investments are subject to the following risks.

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

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

**UNC Investment Fund, LLC** - At June 30, 2013, the University's investments include \$15,261,301.42 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, 2013, for the University's non-pooled investments.

### *Non-Pooled Investments*

Investment Type	Fair Value	Investment Maturities (in Years) <u>Less</u> <u>Than 1</u>
Debt Securities		
Money Market Mutual Funds	\$ 733,461.36	\$ 733,461.36

At June 30, 2013, the Money Market Mutual Funds, with a fair value of \$733,461.36, were rated AAAM by Standard and Poor's.

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

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**Total Investments** - The following table presents the fair value of the total investments at June 30, 2013:

<b>Investment Type</b>	<u>Fair Value</u>
Debt Securities	
Money Market Mutual Funds	\$ 733,461.36
Other Securities	
UNC Investment Fund	<u>15,261,301.42</u>
<b>Total Investments</b>	<u><u>\$ 15,994,762.78</u></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:

<b>Investment Type</b>	<u>Fair Value</u>
UNC Investment Fund II, LLC	<u><u>\$ 22,019,250.00</u></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, 2013, is as follows:

Cash on Hand	\$	2,430.00
Amount of Deposits with Private Financial Institutions		5,320.00
Deposits in the Short-Term Investment Fund		20,341,028.02
Investments in the UNC Investment Fund		15,261,301.42
Non-Pooled Investments		<u>733,461.36</u>
<b>Total Deposits and Investments</b>	<b>\$</b>	<b><u>36,343,540.80</u></b>
Deposits		
Current:		
Cash and Cash Equivalents	\$	15,690,853.23
Restricted Cash and Cash Equivalents		3,636,463.12
Noncurrent:		
Restricted Cash and Cash Equivalents		<u>1,021,461.67</u>
<b>Total Deposits</b>		<u>20,348,778.02</u>
Investments		
Noncurrent:		
Endowment Investments		15,261,301.42
Restricted Investments		680,999.61
Other Investments		<u>52,461.75</u>
<b>Total Investments</b>		<u>15,994,762.78</u>
<b>Total Deposits and Investments</b>	<b>\$</b>	<b><u>36,343,540.80</u></b>

### 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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 position endowment balances to make up the difference. At June 30, 2013, net appreciation of \$1,469,846.47 was available to be spent, all of which was classified in net position as restricted expendable for scholarships and fellowships and endowed professorships as it is restricted for specific purposes.

### NOTE 4 - RECEIVABLES

Receivables at June 30, 2013, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
<b>Current Receivables:</b>			
Students	\$ 21,539.36	\$ 10,798.48	\$ 10,740.88
Accounts	32,202.39		32,202.39
Interest on Loans	41,992.88		41,992.88
	<u>95,734.63</u>	<u>10,798.48</u>	<u>84,936.15</u>
<b>Total Current Receivables</b>	<u>\$ 95,734.63</u>	<u>\$ 10,798.48</u>	<u>\$ 84,936.15</u>
<b>Notes Receivable:</b>			
<b>Notes Receivable - Current:</b>			
Federal Loan Programs	\$ 91,406.28	\$ 27,154.26	\$ 64,252.02
Institutional Student Loan Programs	14,633.45	10,579.20	4,054.25
	<u>106,039.73</u>	<u>37,733.46</u>	<u>68,306.27</u>
<b>Total Notes Receivable - Current</b>	<u>\$ 106,039.73</u>	<u>\$ 37,733.46</u>	<u>\$ 68,306.27</u>
<b>Notes Receivable - Noncurrent:</b>			
Federal Loan Programs	\$ 471,200.65	\$ 142,515.97	\$ 328,684.68
	<u>471,200.65</u>	<u>142,515.97</u>	<u>328,684.68</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2013, is presented as follows:

	Balance July 1, 2012	Increases	Decreases	Balance June 30, 2013
Capital Assets, Nondepreciable:				
Land	\$ 4,291,937.83	\$ 1,715.00	\$ 0.00	\$ 4,293,652.83
Art, Literature, and Artifacts	1,904,765.97		34,212.35	1,870,553.62
Construction in Progress	3,896,409.35	5,562,544.55		9,458,953.90
<b>Total Capital Assets, Nondepreciable</b>	<b>10,093,113.15</b>	<b>5,564,259.55</b>	<b>34,212.35</b>	<b>15,623,160.35</b>
Capital Assets, Depreciable:				
Buildings	107,357,342.19			107,357,342.19
Machinery and Equipment	11,301,250.97	1,041,059.71	401,562.40	11,940,748.28
General Infrastructure	5,107,656.50			5,107,656.50
<b>Total Capital Assets, Depreciable</b>	<b>123,766,249.66</b>	<b>1,041,059.71</b>	<b>401,562.40</b>	<b>124,405,746.97</b>
Less Accumulated Depreciation for:				
Buildings	32,669,661.21	2,147,146.86		34,816,808.07
Machinery and Equipment	5,378,005.89	609,588.87	281,394.52	5,706,200.24
General Infrastructure	1,104,149.62	102,153.13		1,206,302.75
<b>Total Accumulated Depreciation</b>	<b>39,151,816.72</b>	<b>2,858,888.86</b>	<b>281,394.52</b>	<b>41,729,311.06</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>84,614,432.94</b>	<b>(1,817,829.15)</b>	<b>120,167.88</b>	<b>82,676,435.91</b>
<b>Capital Assets, Net</b>	<b>\$ 94,707,546.09</b>	<b>\$ 3,746,430.40</b>	<b>\$ 154,380.23</b>	<b>\$ 98,299,596.26</b>

### NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2013, were as follows:

	Amount
Accounts Payable	\$ 1,971,452.66
Accrued Payroll	128,363.90
Contract Retainage	237,321.44
<b>Total Accounts Payable and Accrued Liabilities</b>	<b>\$ 2,337,138.00</b>

## 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, 2013, is presented as follows:

	Balance July 1, 2012	Additions	Reductions	Balance June 30, 2013	Current Portion
Revenue Bonds Payable	\$ 1,955,000.00	\$ 0.00	\$ 335,000.00	\$ 1,620,000.00	\$ 355,000.00
Certificates of Participation	6,320,000.00		160,000.00	6,160,000.00	165,000.00
Total Revenue Bonds Payable and Certificates of Participation	8,275,000.00		495,000.00	7,780,000.00	520,000.00
Compensated Absences	1,944,264.09	1,247,693.10	1,340,362.08	1,851,595.11	267,440.93
<b>Total Long-Term Liabilities</b>	<b>\$ 10,219,264.09</b>	<b>\$ 1,247,693.10</b>	<b>\$ 1,835,362.08</b>	<b>\$ 9,631,595.11</b>	<b>\$ 787,440.93</b>

#### 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, 2013	Principal Outstanding June 30, 2013	See Table Below
<b>Revenue Bonds Payable</b>							
<b>The University of North Carolina System Pool Revenue Bonds</b>							
Fitness and Student Center Project	A	3.25%-5.25%	10/01/2018	\$ 2,650,000.00	\$ 1,590,000.00	\$ 1,060,000.00	(1)
Refunding 1998B and 2000 UNC System Pool Revenue Bonds	B	3.00%-4.25%	04/01/2019	1,900,000.00	1,340,000.00	560,000.00	
Total UNC System Pool Revenue Bonds				4,550,000.00	2,930,000.00	1,620,000.00	
<b>Certificates of Participation</b>							
Student Housing Project	C	3.50%-4.50%	06/01/2036	7,200,000.00	1,040,000.00	6,160,000.00	(2)
Total Revenue Bonds Payable and Certificates of Participation				\$ 11,750,000.00	\$ 3,970,000.00	\$ 7,780,000.00	

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

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

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

Fund reservations in the amount of \$433,325.00 required by the Series 2005 Certificates of Participation Indenture for the Student Housing Project were established and recorded in a Reserve Fund with the fiscal agent. At June 30, 2013, the balance in the Reserve Fund was \$485,786.75. In addition, the University contributes to a Maintenance and Equipment Reserve Fund also required by the indenture. At June 30, 2013, the balance in this reserve was \$247,674.61.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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	\$ 1,209,981.25	\$ 231,654.40	\$ 150,000.00	\$ 52,800.00	87%
(2)	Housing Revenues	9,902,293.88	540,104.68	160,000.00	270,025.00	83%

**C. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2013, are as follows:

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Certificates of Participation	
	Principal	Interest	Principal	Interest
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	265,000.00	19,537.50	195,000.00	237,493.76
2019-2023	275,000.00	7,687.50	1,090,000.00	1,064,387.54
2024-2028			1,335,000.00	817,037.54
2029-2033			1,655,000.00	495,968.76
2034-2036			1,185,000.00	108,000.00
<b>Total Requirements</b>	<b>\$ 1,620,000.00</b>	<b>\$ 218,518.75</b>	<b>\$ 6,160,000.00</b>	<b>\$ 3,742,293.88</b>

### NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for copiers and rental of storage buildings. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2013:

Fiscal Year	Amount
2014	\$ 99,861.80
2015	61,249.55
2016	15,883.95
<b>Total Minimum Lease Payments</b>	<b>\$ 176,995.30</b>

Rental expense for all operating leases during the year was \$256,705.46.

## 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
<b>Operating Revenues:</b>					
<b>Student Tuition and Fees</b>	\$ 15,296,405.98	\$ 0.00	\$ 4,503,220.36	\$ 54.96	\$ 10,793,130.66
<b>Sales and Services:</b>					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 3,804,563.30	\$ 0.00	\$ 1,122,315.09	\$ 0.00	\$ 2,682,248.21
Dining	2,587,541.58		749,457.65		1,838,083.93
Health, Physical Education, and Recreation Services	266,771.29				266,771.29
Bookstore	213,763.15				213,763.15
Parking	79,785.00	14,235.00			65,550.00
Other	59,231.87				59,231.87
Sales and Services of Education and Related Activities					
University Production Revenues	662,945.41				662,945.41
Other	669,887.38	17,367.63			652,519.75
<b>Total Sales and Services</b>	<b>\$ 8,344,488.98</b>	<b>\$ 31,602.63</b>	<b>\$ 1,871,772.74</b>	<b>\$ 0.00</b>	<b>\$ 6,441,113.61</b>

\* Note: The Allowance for Uncollectibles is equivalent to the change in the Allowance for Doubtful Accounts, excluding items such as direct write-offs.

### 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	\$ 13,001,528.37	\$ 1,138,600.33	\$ 983,508.16	\$ 0.00	\$ 0.00	\$ 0.00	\$ 15,123,636.86
Research	7,212.43	3,750.13	2,492.00				13,454.56
Public Service	257,709.27	60,640.49	432,644.41				750,994.17
Academic Support	3,902,918.67	332,988.34	288,937.21				4,524,844.22
Student Services	980,221.12	25,769.80	335,529.47				1,341,520.39
Institutional Support	6,073,213.07	836,068.43	1,657,025.59		139.09		8,566,446.18
Operations and Maintenance of Plant	4,041,307.19	433,514.74	955,251.67		1,495,585.08		6,925,658.68
Student Financial Aid				1,407,482.68			1,407,482.68
Auxiliary Enterprises	3,017,198.94	498,148.08	2,697,918.63		461,565.41		6,674,831.06
Depreciation						2,858,888.86	2,858,888.86
<b>Total Operating Expenses</b>	<b>\$ 31,281,309.06</b>	<b>\$ 3,329,480.34</b>	<b>\$ 7,353,307.14</b>	<b>\$ 1,407,482.68</b>	<b>\$ 1,957,289.58</b>	<b>\$ 2,858,888.86</b>	<b>\$ 48,187,757.66</b>

### 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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the time of employment; otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

The Teachers' and State Employees' Retirement System (TSERS) 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. TSERS is administered by a 14-member Board of Trustees, with the State Treasurer serving as Chairman of the Board.

Benefit and contribution provisions for the TSERS 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, 2013, these rates were set at 8.33% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$24,385,942.86, of which \$12,300,093.04 was covered under the TSERS. Total employer and employee contributions for pension benefits for the year were \$1,024,597.75 and \$738,005.58, respectively.

Required employer contribution rates for the years ended June 30, 2012, and 2011, were 7.44% and 4.93%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2013, 2012, and 2011, which were \$1,024,597.75, \$881,137.64, and \$607,338.98, 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 TSERS. 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)

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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, 2013, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$24,385,942.86, of which \$8,805,757.79 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$602,313.83 and \$528,345.47, 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 \$35,883.00 for the year ended June 30, 2013.

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, 2013,



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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were \$129,127.22. The voluntary contributions by employees amounted to \$146,338.96 for the year ended June 30, 2013.

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 \$127,170.24 for the year ended June 30, 2013.

### **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 Chapter 135, Article 3B, of the General Statutes, and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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For the current fiscal year the University contributed 5.30% 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, 2012, and 2011, were 5.0% and 4.9%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2013, 2012, and 2011, which were \$1,118,610.09, \$1,026,001.49, and \$1,077,453.08, 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, 2013, the University made a statutory contribution of .44% 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, 2012 and 2011 was .52% for both years. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2013, 2012, and 2011, which were \$92,865.74, \$106,704.16, and \$114,341.96, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

### NOTE 13 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 (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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 \$29,131,427.06 and on other purchases were \$504,503.15 at June 30, 2013.
- 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 15 - BLENDED COMPONENT UNITS

Condensed combining information for the University's blended component units for the year ended June 30, 2013, is presented as follows:

#### *Condensed Statement of Net Position June 30, 2013*

	Housing Corporation	Program Support Corporation	Total
<b>ASSETS</b>			
Current Assets	\$ 477,868	\$ 99,661	\$ 577,529
Capital Assets	4,798,265	1,114,170	5,912,435
Other Noncurrent Assets	1,205,269		1,205,269
Total Assets	6,481,402	1,213,831	7,695,233
<b>LIABILITIES</b>			
Current Liabilities	217,260	2,029	219,289
Noncurrent Liabilities	5,999,135		5,999,135
Total Liabilities	6,216,395	2,029	6,218,424
<b>NET POSITION</b>			
Net Investment in Capital Assets	(389,905)	1,114,170	724,265
Restricted - Expendable	679,727		679,727
Unrestricted	(24,815)	97,632	72,817
Total Net Position	\$ 265,007	\$ 1,211,802	\$ 1,476,809

#### *Condensed Statement of Revenues, Expenses, and Changes in Net Position For the Fiscal Year Ended June 30, 2013*

	Housing Corporation	Program Support Corporation	Total
<b>OPERATING REVENUES</b>			
Rental Income	\$ 934,389	\$ 0	\$ 934,389
Sales and Services		19,125	19,125
Total Operating Revenues	934,389	19,125	953,514
<b>OPERATING EXPENSES</b>			
Operating Expenses	403,049	12,411	415,460
Depreciation	109,916		109,916
Total Operating Expenses	512,965	12,411	525,376
Operating Income	421,424	6,714	428,138
<b>NONOPERATING REVENUES (EXPENSES)</b>			
Noncapital Gifts		100	100
Investment Income	2,664		2,664
Interest and Fees on Capital Asset Related Debt	(293,383)		(293,383)
Other Nonoperating Expenses		(10,830)	(10,830)
Net Nonoperating Expenses	(290,719)	(10,730)	(301,449)
Increase (Decrease) in Net Position	130,705	(4,016)	126,689
<b>NET POSITION</b>			
Net Position, July 1, 2012	134,302	1,215,818	1,350,120
Net Position, June 30, 2013	\$ 265,007	\$ 1,211,802	\$ 1,476,809

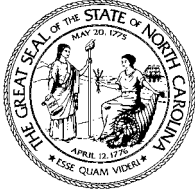
## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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### *Condensed Statement of Cash Flows* *June 30, 2013*

	<u>Housing Corporation</u>	<u>Program Support Corporation</u>	<u>Total</u>
Net Cash Provided by Operating Activities	\$ 540,456	\$ 7,338	\$ 547,794
Net Cash Used by Capital and Related Financing Activities	(433,260)		(433,260)
Net Cash Used by Investing Activities	(31,449)		(31,449)
Net Increase in Cash and Cash Equivalents	75,747	7,338	83,085
Cash and Cash Equivalents, July 1, 2012	<u>402,121</u>	<u>91,773</u>	<u>493,894</u>
Cash and Cash Equivalents, June 30, 2013	<u>\$ 477,868</u>	<u>\$ 99,111</u>	<u>\$ 576,979</u>

# Office of the State Auditor



**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**

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

We have audited, in accordance with the 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, 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, 2013, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated November 26, 2013. Our report includes a reference to other auditors who 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. The financial statements of the University of North Carolina School of the Arts Housing Corporation and the discretely presented component unit were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with those entities.

### Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

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,

**INDEPENDENT AUDITOR'S REPORT  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
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GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

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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. 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.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA  
State Auditor

Raleigh, North Carolina

November 26, 2013



## ORDERING INFORMATION

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Copies of this report may be obtained by contacting the:

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For additional information contact:

Bill Holmes

Director of External Affairs