

STATE OF NORTH CAROLINA

NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS

DURHAM, NORTH CAROLINA

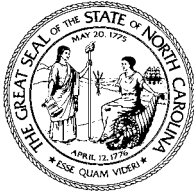
FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2014

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of North Carolina School of Science and Mathematics for the year ended June 30, 2014, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

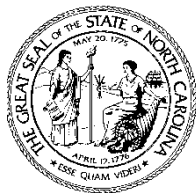
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

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

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of North Carolina School of Science and Mathematics, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the School'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 North Carolina School of Science and Mathematics Foundation and Subsidiary, the School's discretely presented component unit. Those statements were audited by other auditors, whose report has been furnished to us, and our opinions, insofar as they relate to the amounts included for the North Carolina School of Science and Mathematics Foundation and Subsidiary, are based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the North Carolina School of Science and Mathematics Foundation and Subsidiary were not audited in accordance with *Government Auditing Standards*.

INDEPENDENT AUDITOR'S REPORT (CONTINUED)

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 School'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 School'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 report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of North Carolina School of Science and Mathematics and its discretely presented component unit, as of June 30, 2014, 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

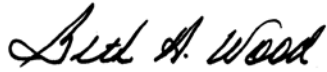
Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting 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 April 29, 2015 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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 School's internal control over financial reporting and compliance.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

April 29, 2015

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

Introduction

The North Carolina School of Science and Mathematics (School) provides this overview and Management's Discussion and Analysis to assist in understanding the financial statements and notes to the financial statements presented herewith for the year ended June 30, 2014. This discussion describes important trends and events that have impacted the fiscal health of the School and that may continue to exert influence in future years. This discussion has been prepared by and is the responsibility of the School's management along with the financial statements and the notes to the financial statements thereto. The report should be read and considered in its entirety.

Using the Annual Report

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

The basic financial statements include the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows. The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position are discussed in later sections of this discussion and analysis.

The Statement of Cash Flows provides information relative to the School's sources and uses of cash for operating activities, noncapital financing activities, and capital and related financing 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.

The Notes to the Financial Statements should be read in conjunction with the financial statements. The Notes to the Financial Statements provide information regarding the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on deposits and investments, receivables, capital assets, accounts payable, long-term liabilities, lease obligations, revenues, expenses, required information on pension plans and other post-employment benefits,

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

insurance against losses, commitments, and blended component unit. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Reporting Entity

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

Financial Highlights

The School's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2014. However, the combined net position for the School increased \$270,064, which is an increase of 0.63% when compared to the prior year net position.

Statement of Net Position

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	<u>2014</u>	<u>2013</u>	<u>Increase/ (Decrease)</u>	<u>Percent Change</u>
Assets:				
Current Assets	\$ 513,606.84	\$ 774,251.84	\$ (260,645.00)	(33.66%)
Noncurrent Assets:				
Restricted Cash	1,580,388.77	721,123.39	859,265.38	119.16%
Capital Assets	43,374,071.49	44,262,542.08	(888,470.59)	(2.01%)
Total Assets	<u>45,468,067.10</u>	<u>45,757,917.31</u>	<u>(289,850.21)</u>	(0.63%)
Liabilities:				
Current Liabilities	415,889.46	835,783.33	(419,893.87)	(50.24%)
Noncurrent Liabilities	1,645,352.00	1,785,372.45	(140,020.45)	(7.84%)
Total Liabilities	<u>2,061,241.46</u>	<u>2,621,155.78</u>	<u>(559,914.32)</u>	(21.36%)
Net Position:				
Net Investment in Capital Assets	43,374,071.49	44,262,542.08	(888,470.59)	(2.01%)
Restricted:				
Expendable				
Capital Projects	1,580,388.77	570,092.94	1,010,295.83	177.22%
Unrestricted	(1,547,634.62)	(1,695,873.49)	148,238.87	8.74%
Total Net Position	<u>\$ 43,406,825.64</u>	<u>\$ 43,136,761.53</u>	<u>\$ 270,064.11</u>	0.63%

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

As of June 30, 2014, the total School's net position was \$43.41 million. The School's capital assets of \$43.37 million represent 95.39% of total assets. Total assets decreased \$289,850, or 0.63%, mainly due to spending restricted grant funds (current assets) during the fiscal year. The increase in noncurrent restricted cash was due to an increase in unexpended appropriated capital improvements funds for various construction projects which were awarded late in the fiscal year and not used during the current year. The decrease in noncurrent capital assets was due to depreciation for the current year.

The School's liabilities totaled \$2.06 million at June 30, 2014. Current liabilities, which include accounts payable, funds held for others, unearned revenue, and the current portion of compensated absences, decreased \$419,894, or 50.24%, primarily due to prior year unearned revenue from a cost reimbursement grant that was earned during the fiscal year in the amount of \$393,344 and a decrease in accounts payable of \$101,556 due to the School paying more of its bills by year-end. The decrease in noncurrent liabilities of \$140,020, or 7.84%, is mainly due to a decrease in refundable student deposits of \$151,030 which was offset by an increase in compensated absences by \$11,010. Refundable student deposits dropped sharply due to the School paying students back prior to year-end rather than after year-end. Details of both current and noncurrent liabilities are shown on the Statement of Net Position and in Notes 5 and 6.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Unrestricted net position increased by \$148,239 to negative \$1.55 million. This was due primarily to the decrease in noncurrent liabilities noted above. Restricted net position increased \$1.01 million, or 177.22%, as a result of the additional appropriations received for construction projects that will be spent during the next fiscal year.

Statement of Revenues, Expenses, and Changes in Net Position

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

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

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the School. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues and to carry out the mission of the School. Nonoperating revenues are revenues received for which goods and services are not provided. Capital appropriations are considered neither operating nor nonoperating revenues and are reported after "Loss Before Other Revenues."

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	2014	2013	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees	\$ 55,662.39	\$ 0.00	\$ 55,662.39	100.00%
Sales and Services, Net	566,955.25	637,316.88	(70,361.63)	(11.04%)
State and Local Grants and Contracts	653,826.07	121,173.93	532,652.14	439.58%
Other	145,990.14	9,610.64	136,379.50	1419.05%
Total Operating Revenues	1,422,433.85	768,101.45	654,332.40	85.19%
Operating Expenses:				
Salaries and Benefits	16,684,370.11	15,816,809.42	867,560.69	5.49%
Supplies and Materials	1,013,737.43	1,627,934.72	(614,197.29)	(37.73%)
Services	2,645,616.34	3,176,488.66	(530,872.32)	(16.71%)
Utilities	1,016,668.41	1,064,350.33	(47,681.92)	(4.48%)
Depreciation	1,182,355.75	1,178,648.96	3,706.79	0.31%
Total Operating Expenses	22,542,748.04	22,864,232.09	(321,484.05)	(1.41%)
Operating Loss	(21,120,314.19)	(22,096,130.64)	975,816.45	(4.42%)
Nonoperating Revenues				
State Appropriations	19,098,535.19	19,189,280.62	(90,745.43)	(0.47%)
Noncapital Grants	6,024.93	377,543.22	(371,518.29)	(98.40%)
Noncapital Gifts	500,825.74	347,300.45	153,525.29	44.21%
Other Nonoperating Expenses	(3,634.56)	4,282.93	(7,917.49)	(184.86%)
Nonoperating Revenues	19,601,751.30	19,918,407.22	(316,655.92)	(1.59%)
Loss Before Other Revenues	(1,518,562.89)	(2,177,723.42)	659,160.53	(30.27%)
Capital Appropriations	1,788,627.00	1,179,100.00	609,527.00	51.69%
Increase in Net Position	270,064.11	(998,623.42)	1,268,687.53	(127.04%)
Net Position - July 1	43,136,761.53	44,135,384.95	(998,623.42)	(2.26%)
Net Position - June 30	\$ 43,406,825.64	\$ 43,136,761.53	\$ 270,064.11	0.63%

The Statement of Revenues, Expenses, and Changes in Net Position shows an increase in net position of \$270,064 for the fiscal year. The total operating loss for fiscal year 2014 was \$21.12 million. Since the State of North Carolina appropriations are not included within operating revenue per GASB, the School shows a significant operating loss.

Operating revenues include student tuition and fees, sales and services, state and local grants and contracts, and other operating revenues. The \$654,332 increase in operating revenues is primarily the result of an increase of \$532,652 in state and local grants and contracts from a Department of Public Instruction grant and an increase in other operating revenues of \$136,380 due to increases in rental income, registration fees, and AP exams. During the year there was an increased focus towards tuition and fees for summer programs offered to students of which the School gained approval from North Carolina legislation. This effort

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

caused an increase in tuition and fees of \$55,662 as compared to the prior year. Focus on these programs is expected to continue going forward.

Operating expenses, including depreciation of \$1.18 million, totaled \$22.54 million. Of this total, \$16.68 million was used for salaries and benefits and \$2.65 million was for services. During fiscal year 2014, salaries and benefits increased \$867,561 based on a job description study of employees which occurred in fiscal year 2013. The job description study caused several employees to be reclassified to higher level positions causing an increase in salaries and associated benefits. Services consisted of contractual agreements, repairs and maintenance, data processing services, travel, and communication expenses and decreased by \$530,872, or 16.71%, due to departmental reallocations of spending based on current year changes in priorities to cover program objectives. Utilities decreased by \$47,682, or 4.48%, due to cost savings measures and efficiencies. Supplies and materials decreased by \$614,197, or 37.73%, due to cost savings measures and efficiencies in addition to decreased funding and availability of one time funding received in the prior year. In the prior year equipment items were purchased with one-time funding that was not available in 2014. Depreciation increased \$3,707, or 0.31%. Overall operating expenses decreased by \$321,484, or 1.41%.

State appropriations are received through an allotment and requisition system through the North Carolina Office of State Budget and Management and the North Carolina Office of the State Controller. For the fiscal year ending June 30, 2014, appropriations from the State for the School were \$19.10 million for operations. Noncapital grants decreased \$371,518 due to decreased funding from UNC-General Administration, and noncapital gifts increased \$153,525 due to increased funds received from the Foundation.

New capital appropriations of \$1.79 million were received for repairs and renovations and construction projects.

One of the School's weaknesses is the lack of diverse streams of revenues. Approximately 83.71% of the School's revenues come from state appropriations. The remaining 16.29% includes voluntary private support from individuals, foundations, and corporations, along with government and other sponsored programs. The School will continue to seek funding aggressively from all possible sources consistent with its mission and prudently manage the financial resources realized from these efforts to fund its operating activities.

Capital Assets

Primary capital projects for fiscal year 2014 included the Discovery Center Planning. The Discovery Center reported on the financial statements as construction in progress is still a major state construction request for the School and is awaiting approval by the State for additional funding. Total capital assets, net of accumulated depreciation, at June 30, 2014 were \$43.37 million. During fiscal year 2014, the School had increases in general infrastructure as a result of several roadway and driveway improvements. For more detailed information about capital asset holdings, see Note 4 of the Notes to the Financial Statements.

Factors Impacting Future Periods

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

A crucial element to the School's future will continue to be its relationship with the State of North Carolina. It should be noted that the School's state appropriations will be decreased in 2014-2015 due to the continuing decline in the economy of North Carolina. While it is not possible to predict the ultimate results, management believes that with cost reduction measures implemented and the continued support of the State of North Carolina, the School's financial condition is strong enough to withstand the current economic uncertainties. The School developed a strategic plan in 2012-2013 that is enabling the School to develop and implement a blueprint for the future. The year-long term project included representatives from all constituencies of the School and is being reviewed and updated in the future in response to needs of all constituencies served by the School.

North Carolina School of Science and Mathematics
Statement of Net Position
June 30, 2014

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 361,251.15
Restricted Cash and Cash Equivalents	94,730.96
Receivables, Net (Note 3)	14,972.07
Inventories	42,652.66
	<hr/>
Total Current Assets	513,606.84

Noncurrent Assets:

Restricted Cash and Cash Equivalents	1,580,388.77
Capital Assets - Nondepreciable (Note 4)	5,642,633.62
Capital Assets - Depreciable, Net (Note 4)	37,731,437.87
	<hr/>
Total Noncurrent Assets	44,954,460.26

Total Assets	<hr/> <hr/> 45,468,067.10
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DEFERRED OUTFLOWS OF RESOURCES

0.00

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 5)	202,670.38
Funds Held for Others	74,138.09
Unearned Revenue	5,481.99
Long-Term Liabilities - Current Portion (Note 6)	133,599.00
	<hr/>
Total Current Liabilities	415,889.46

Noncurrent Liabilities:

Long-Term Liabilities, Net (Note 6)	<hr/> 1,645,352.00
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Total Liabilities	<hr/> <hr/> 2,061,241.46
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DEFERRED INFLOWS OF RESOURCES

0.00

NET POSITION

Net Investment in Capital Assets	43,374,071.49
Restricted for Expendable:	
Capital Projects	1,580,388.77
Unrestricted	<hr/> (1,547,634.62)
Total Net Position	<hr/> <hr/> \$ 43,406,825.64

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

***North Carolina School of Science and Mathematics
Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2014***

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees	\$ 55,662.39
State and Local Grants and Contracts	653,826.07
Sales and Services, Net (Note 8)	566,955.25
Other Operating Revenues	145,990.14
	<hr/>
Total Operating Revenues	1,422,433.85
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	16,684,370.11
Supplies and Materials	1,013,737.43
Services	2,645,616.34
Utilities	1,016,668.41
Depreciation	1,182,355.75
	<hr/>
Total Operating Expenses	22,542,748.04
	<hr/>
Operating Loss	(21,120,314.19)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	19,098,535.19
Noncapital Grants	6,024.93
Noncapital Gifts	500,825.74
Other Nonoperating Expenses	(3,634.56)
	<hr/>
Net Nonoperating Revenues	19,601,751.30
	<hr/>
Loss Before Other Revenues	(1,518,562.89)
	<hr/>
Capital Appropriations	1,788,627.00
	<hr/>
Increase in Net Position	270,064.11

NET POSITION

Net Position - July 1, 2013	43,136,761.53
	<hr/>
Net Position - June 30, 2014	\$ 43,406,825.64
	<hr/> <hr/>

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

North Carolina School of Science and Mathematics
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2014

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 873,613.28
Payments to Employees and Fringe Benefits	(16,642,308.88)
Payments to Vendors and Suppliers	(4,757,637.54)
Other Receipts	11,587.93
	<u> </u>
Net Cash Used by Operating Activities	<u>(20,514,745.21)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	19,098,535.19
Noncapital Grants	6,024.93
Noncapital Gifts	500,825.74
Other Payments	(3,634.56)
	<u> </u>
Net Cash Provided by Noncapital Financing Activities	<u>19,601,751.30</u>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

State Capital Appropriations	1,788,627.00
Acquisition and Construction of Capital Assets	(293,885.16)
	<u> </u>
Net Cash Provided by Capital Financing and Related Financing Activities	<u>1,494,741.84</u>

Net Increase in Cash and Cash Equivalents	581,747.93
Cash and Cash Equivalents - July 1, 2013	1,454,622.95
	<u> </u>
Cash and Cash Equivalents - June 30, 2014	<u><u>\$ 2,036,370.88</u></u>

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

Operating Loss	\$ (21,120,314.19)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	1,182,355.75
Changes in Assets and Liabilities:	
Receivables, Net	(9,486.35)
Inventories	(7,386.10)
Accounts Payable and Accrued Liabilities	(101,556.03)
Funds Held for Others	(134,402.21)
Unearned Revenue	(393,344.08)
Compensated Absences	69,388.00
	<u> </u>
Net Cash Used by Operating Activities	<u><u>\$ (20,514,745.21)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 361,251.15
Restricted Cash and Cash Equivalents	94,730.96
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	1,580,388.77
	<u> </u>
Total Cash and Cash Equivalents - June 30, 2014	<u><u>\$ 2,036,370.88</u></u>

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

***North Carolina School of Science and Mathematics
Foundation and Subsidiary
Statement of Financial Position
June 30, 2014***

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	2,549,486
Investments		8,008,783
Real Estate Held for Resale		135,900
Accounts Receivable		3,482
Pledges Receivable/Promises		127,458
Prepaid Assets		5,670
In-Kind Gifts		41,405
Land		60,540
		<hr/>
Total Assets		10,932,724

LIABILITIES

Accounts Payable and Accrued Expenses		<hr/> 183,655
---------------------------------------	--	---------------

NET ASSETS

Unrestricted		3,752,336
Temporarily Restricted		3,208,430
Permanently Restricted		<hr/> 3,788,303
Total Net Assets	\$	<hr/> <hr/> 10,749,069

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

***North Carolina School of Science and Mathematics
Foundation and Subsidiary
Statement of Activities
For the Fiscal Year Ended June 30, 2014***

Exhibit B-2

CHANGES IN UNRESTRICTED NET ASSETS

Revenues, Gains, and Other Support:	
Grants and Contributions	\$ 1,011,757
Investment Return Designated for Current Operations	69,331
Other Investment Income	11,946
Other Income	152,097
Net Assets Released from Donor Restrictions	<u>222,134</u>
Total Operating Revenues, Gains, and Support	1,467,265
Operating Expenses:	
Programs	792,718
Fund Raising	87,898
General and Administrative	<u>315,201</u>
Total Operating Expenses	1,195,817
Change in Net Assets from Operations	271,448
Investment Return in Excess of Amounts Designated for Current Operations	<u>244,136</u>
Increase in Unrestricted Net Assets	<u>515,584</u>

CHANGES IN TEMPORARILY RESTRICTED NET ASSETS

Revenues, Gains, and Other Support:	
Grants and Contributions	305,917
Investment Return Designated for Current Operations	198,334
Other Investment Income	23,758
Net Assets Released from Donor Restrictions	<u>(222,134)</u>
Total Operating Revenues, Gains, and Support	305,875
Operating Expenses:	
General and Administrative	27,953
Change in Net Assets from Operations	277,922
Investment Return in Excess of Amounts Designated for Current Operations	<u>497,232</u>
Increase in Temporarily Restricted Net Assets	<u>775,154</u>

CHANGES IN PERMANENTLY RESTRICTED NET ASSETS

Revenues, Gains, and Other Support:	
Grants and Contributions	<u>10,716</u>
Operating Expenses:	
General and Administrative	6,345
Increase in Permanently Restricted Net Assets	<u>4,371</u>
Increase in Net Assets	1,295,109
Net Assets at Beginning of Year	<u>9,453,960</u>
Net Assets at End of Year	<u>\$ 10,749,069</u>

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

NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2014

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements present all funds belonging to the School and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor and the Board of Trustees have delegated responsibilities for financial accountability of the School's funds. The School's component units are either blended or discretely presented in the School's financial statements. See below for further discussion of the School's component units.

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

The SCSSI is governed by seven board of directors consisting of two ex officio directors. All directors are employees of the School. The ex officio directors consist of the Chancellor and the Vice Chancellor for Student Life. Because the members of the Board of Directors of the SCSSI are employees of the School and the SCSSI's sole purpose is to benefit the School, its financial statements have been blended with those of the School.

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

Condensed combining information regarding blended component units is provided in Note 14.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Discretely Presented Component Unit – The North Carolina School of Science and Mathematics Foundation and Subsidiary (Foundation) is a legally separate nonprofit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the School. SSM Holdings, LLC is the wholly owned subsidiary of the Foundation.

The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the School in support of its programs. The Foundation operates exclusively for charitable and educational purposes including, but not limited to, receiving, administering, and obtaining funds for the support of the academic and educational programs of the North Carolina School of Science and Mathematics. The Foundation board consists of 21 members. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the School, the Foundation is considered a component unit of the School and is reported in separate financial statements because of the difference in its reporting model, as described below.

The Foundation is a private nonprofit organization that 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 School's financial reporting entity for these differences.

During the year ended June 30, 2014, the Foundation distributed \$586,136 directly to the School and paid an additional \$629,556 on behalf of the School for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Katie Wagstaff, President, North Carolina School of Science and Mathematics Foundation and Subsidiary, Post Office Box 2418, Durham, NC 27715-2418, or by calling (919) 416-2866.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Nonexchange transactions, in which the School receives (or gives) value without directly giving (or receiving) equal value in exchange, include state appropriations, certain grants, and donations. Revenues are recognized, 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. Receivables** - Receivables consist of amounts due from former employees. Receivables also include amounts due from the federal government in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.

- F. Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are valued at cost using the last invoice cost method.

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

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 75 years for general infrastructure, 10 to 75 years for buildings, and 2 to 25 years for equipment.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- H. Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted for the acquisition or construction of capital assets and resources whose use is limited by external parties or statute.
- I. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include compensated absences that will not be paid within the next fiscal year.
- J. Compensated Absences** - The School's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

- K. Net Position**- The School's net position is classified as follows:

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 School.

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

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

- M. Internal Sales Activities** - Certain institutional sales and services units provide goods and services to School departments, as well as to its customers. These institutional sales and services units include activities such as central stores, copy centers, and postal services. All internal sales activities to School departments from sales and services units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the sales and services 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 School is required by *North Carolina General Statute 147-77* to deposit moneys received with the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

State Treasurer or with a depository institution in the name of the State Treasurer. However, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, may authorize the School to deposit its institutional trust funds in interest-bearing accounts and other investments authorized by the Board of Governors, without regard to any statute or rule of law relating to the investment of funds by fiduciaries. Although specifically exempted, the School may voluntarily deposit institutional trust funds and special funds with the State Treasurer. Special funds consist of moneys for athletics and agency funds held directly by the School.

At June 30, 2014, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$1,944,979.54 which represents the School'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 1.3 years as of June 30, 2014. 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 clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Cash on hand at June 30, 2014 was \$600.00. The carrying amount of the School's deposits not with the State Treasurer was \$90,791.34 and the bank balance was \$71,670.97. Custodial credit risk is the risk that in the event of a bank failure, the School's deposits may not be returned to it. The School does not have a deposit policy for custodial credit risk. As of June 30, 2014, the School's bank balance was fully insured by federal depository insurance and was not exposed to custodial credit risk.

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

Investment Type	Fair Value
UNC Investment Fund	\$ 8,008,783

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - RECEIVABLES

Receivables at June 30, 2014, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Intergovernmental	\$ 3,694.78	\$ 3,694.78	\$ 0.00
Other	54,451.04	39,478.97	14,972.07
Total Current Receivables	\$ 58,145.82	\$ 43,173.75	\$ 14,972.07

NOTE 4 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2014, is presented as follows:

	Balance July 1, 2013	Increases	Decreases	Balance June 30, 2014
Capital Assets, Nondepreciable:				
Land	\$ 1,337,173.66	\$ 0.00	\$ 0.00	\$ 1,337,173.66
Art	10,092.76			10,092.76
Construction in Progress	4,246,174.70	49,192.50		4,295,367.20
Total Capital Assets, Nondepreciable	5,593,441.12	49,192.50	0.00	5,642,633.62
Capital Assets, Depreciable:				
Buildings	51,356,149.10			51,356,149.10
Machinery and Equipment	1,682,541.60			1,682,541.60
General Infrastructure	1,695,363.00	244,692.66		1,940,055.66
Total Capital Assets, Depreciable	54,734,053.70	244,692.66	0.00	54,978,746.36
Less Accumulated Depreciation for:				
Buildings	14,390,986.58	1,030,863.66		15,421,850.24
Machinery and Equipment	1,090,571.24	78,050.57		1,168,621.81
General Infrastructure	583,394.92	73,441.52		656,836.44
Total Accumulated Depreciation	16,064,952.74	1,182,355.75	0.00	17,247,308.49
Total Capital Assets, Depreciable, Net	38,669,100.96	(937,663.09)	0.00	37,731,437.87
Capital Assets, Net	\$ 44,262,542.08	\$ (888,470.59)	\$ 0.00	\$ 43,374,071.49

The carrying amount of temporary impaired capital assets idle at year end is \$4,246,174.70 for construction in progress.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2014, were as follows:

	<u>Amount</u>
Current Accounts Payable and Accrued Liabilities	
Accounts Payable	\$ 115,401.91
Accrued Payroll	<u>87,268.47</u>
Total	<u><u>\$ 202,670.38</u></u>

NOTE 6 - LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities for the year ended June 30, 2014, is presented as follows:

	<u>Balance July 1, 2013</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2014</u>	<u>Current Portion</u>
Compensated Absences	<u>\$ 1,709,563.00</u>	<u>\$ 1,056,900.00</u>	<u>\$ 987,512.00</u>	<u>\$ 1,778,951.00</u>	<u>\$ 133,599.00</u>

NOTE 7 - OPERATING LEASE OBLIGATIONS

The School entered into operating leases for equipment and housing. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2014:

<u>Fiscal Year</u>	<u>Amount</u>
2015	\$ 75,762.62
2016	64,390.03
2017	7,253.64
2018	<u>158.47</u>
Total Minimum Lease Payments	<u><u>\$ 147,564.76</u></u>

Rental expense for all operating leases during the year was \$102,903.04.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - REVENUES

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

	Gross Revenues	Sales Eliminations	Net Revenues
Operating Revenues:			
Sales and Services	\$ 642,205.29	\$ 75,250.04	\$ 566,955.25

NOTE 9 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Utilities	Depreciation	Total
Instruction	\$ 8,804,504.87	\$ 247,467.48	\$ 190,878.36	\$ 0.00	\$ 0.00	\$ 9,242,850.71
Academic Support	313,226.73	98,899.13	34,230.34			446,356.20
Student Services	3,045,257.58	160,208.88	1,500,984.42			4,706,450.88
Institutional Support	3,521,514.76	48,553.94	268,979.12			3,839,047.82
Operations and Maintenance of Plant	999,866.17	458,608.00	650,544.10	1,016,668.41		3,125,686.68
Depreciation					1,182,355.75	1,182,355.75
Total Operating Expenses	\$ 16,684,370.11	\$ 1,013,737.43	\$ 2,645,616.34	\$ 1,016,668.41	\$ 1,182,355.75	\$ 22,542,748.04

NOTE 10 - PENSION PLANS

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

The Teachers' and State Employees' Retirement System (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, 2014, these rates were set at 8.69% of covered payroll for employers and 6% of covered payroll for members.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the current fiscal year, the School had a total payroll of \$12,859,514.79, of which \$9,998,912.50 was covered under the TSERS. Total employer and employee contributions for pension benefits for the year were \$868,905.50 and \$599,934.75, respectively.

Required employer contribution rates for the years ended June 30, 2013, and 2012, were 8.33% and 7.44%, respectively, while employee contributions were 6% each year. The School made 100% of its annual required contributions for the years ended June 30, 2014, 2013, and 2012, which were \$868,905.50, \$803,169.66, and \$697,242.55, respectively.

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

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the School may join the Program instead of the 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.

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, 2014, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The School assumes no liability other than its contribution.

For the current fiscal year, the School had a total payroll of \$12,859,514.79, of which \$1,622,777.50 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$110,997.98 and \$97,366.65, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS

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

The Plan's benefit and contribution provisions are established by 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.

For the current fiscal year the School contributed 5.40% 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, 2013, and 2012, were 5.30% and 5.0%, respectively. The School made 100% of its annual required contributions to the Plan for the years ended June 30, 2014, 2013, and 2012, which were \$627,571.26, \$578,996.06, and \$525,168.42, respectively. The School assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2014, the School 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. Required contribution rates for the years ended June 30, 2013, and 2012, were .44% and .52%, respectively. The School made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2014, 2013, and 2012, which were \$51,135.44, \$48,067.60, and \$54,617.52, respectively. The School assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 12 - RISK MANAGEMENT

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

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

The School is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the School for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

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

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 13 - COMMITMENTS

The School has established an encumbrance system to track its outstanding commitments on purchases. Outstanding commitments on purchase contracts were \$1,611,328.79 at June 30, 2014.

NOTE 14 - BLENDED COMPONENT UNIT

Condensed combining information for the School's blended component unit for the year ended June 30, 2014, is presented as follows:

	North Carolina School of Science and Mathematics	NCSSM Student and Constituent Support Services, Inc.	Total
ASSETS			
Current Assets	\$ 385,964.97	\$ 127,641.87	\$ 513,606.84
Capital Assets	43,374,071.49		43,374,071.49
Other Noncurrent Assets	1,580,388.77		1,580,388.77
Total Assets	<u>45,340,425.23</u>	<u>127,641.87</u>	<u>45,468,067.10</u>
Deferred Outflow of Resources	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
LIABILITIES			
Current Liabilities	374,760.82	41,128.64	415,889.46
Noncurrent Liabilities	1,645,352.00		1,645,352.00
Total Liabilities	<u>2,020,112.82</u>	<u>41,128.64</u>	<u>2,061,241.46</u>
Deferred Inflows of Resources	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
NET POSITION			
Net Investment in Capital Assets	43,374,071.49		43,374,071.49
Restricted - Expendable	1,580,388.77		1,580,388.77
Unrestricted	(1,634,147.85)	86,513.23	(1,547,634.62)
Total Net Position	<u>\$ 43,320,312.41</u>	<u>\$ 86,513.23</u>	<u>\$ 43,406,825.64</u>

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

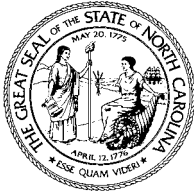
Condensed Statement of Revenues, Expenses, and Changes in Net Position For the Fiscal Year Ended June 30, 2014

	North Carolina School of Science and Mathematics	NCSSM Student and Constituent Support Services, Inc.	Total
OPERATING REVENUES			
Student Tuition and Fees	\$ 55,662.39	\$ 0.00	\$ 55,662.39
State and Local Grants and Contracts	653,826.07		653,826.07
Sales and Services, Net	90,665.95	476,289.30	566,955.25
Other Operating Revenues	145,834.96	155.18	145,990.14
Total Operating Revenues	<u>945,989.37</u>	<u>476,444.48</u>	<u>1,422,433.85</u>
OPERATING EXPENSES			
Operating Expenses	20,867,030.29	493,362.00	21,360,392.29
Depreciation	1,182,355.75		1,182,355.75
Total Operating Expenses	<u>22,049,386.04</u>	<u>493,362.00</u>	<u>22,542,748.04</u>
Operating Loss	<u>(21,103,396.67)</u>	<u>(16,917.52)</u>	<u>(21,120,314.19)</u>
NONOPERATING REVENUES (EXPENSES)			
State Appropriations	19,098,535.19		19,098,535.19
Noncapital Grants	2,919.46	3,105.47	6,024.93
Noncapital Gifts	500,825.74		500,825.74
Other Nonoperating Expenses	(3,634.56)		(3,634.56)
Net Nonoperating Revenues	<u>19,598,645.83</u>	<u>3,105.47</u>	<u>19,601,751.30</u>
Capital Appropriations	1,788,627.00		1,788,627.00
Increase (Decrease) in Net Position	<u>283,876.16</u>	<u>(13,812.05)</u>	<u>270,064.11</u>
NET POSITION			
Net Position, July 1, 2013	43,036,436.25	100,325.28	43,136,761.53
Net Position, June 30, 2014	<u>\$ 43,320,312.41</u>	<u>\$ 86,513.23</u>	<u>\$ 43,406,825.64</u>

Condensed Statement of Cash Flows June 30, 2014

	North Carolina School of Science and Mathematics	NCSSM Student and Constituent Support Services, Inc.	Total
Net Cash Provided (Used) by Operating Activities	\$ (20,521,331.83)	\$ 6,586.62	\$ (20,514,745.21)
Net Cash Provided by Noncapital Financing Activities	19,598,645.83	3,105.47	19,601,751.30
Net Cash Provided by Capital Financing and Related Financing Activities	<u>1,494,741.84</u>		<u>1,494,741.84</u>
Net Increase in Cash and Cash Equivalents	572,055.84	9,692.09	581,747.93
Cash and Cash Equivalents, July 1, 2013	<u>1,372,923.70</u>	<u>81,699.25</u>	<u>1,454,622.95</u>
Cash and Cash Equivalents, June 30, 2014	<u>\$ 1,944,979.54</u>	<u>\$ 91,391.34</u>	<u>\$ 2,036,370.88</u>

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

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

We have audited, 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 North Carolina School of Science and Mathematics, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the School's basic financial statements, and have issued our report thereon dated April 29, 2015. Our report includes a reference to other auditors who audited the financial statements of the North Carolina School of Science and Mathematics Foundation and Subsidiary, the School's discretely presented component unit, as described in our report on the School's financial statements. The financial statements of the North Carolina School of Science and Mathematics Foundation and Subsidiary 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 the North Carolina School of Science and Mathematics Foundation and Subsidiary.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the School'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control. Accordingly, we do not express an opinion on the effectiveness of the School's internal control.

**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 (CONTINUED)**

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the School’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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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. We did identify certain deficiencies in internal control, described in the accompanying Audit Findings and Responses section, that we consider to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the School’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*.


School’s Response to Findings

The School’s responses to the finding identified in our audit are described in the accompanying Audit Findings and Responses section. The School’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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

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 result of that testing, and not to provide an opinion on the effectiveness of the School'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 entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

April 29, 2015

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

The following audit finding was identified during the current audit and describe conditions that represent deficiencies in internal control or noncompliance with laws, regulations, contracts, grant agreements, or other matters.

DEFICIENCIES IN FINANCIAL REPORTING INCREASES THE RISK THAT USERS WILL BE MISLED AS TO THE SCHOOL'S FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The financial statements and related notes to the financial statements prepared by the School contained errors and misclassifications that were corrected as a result of our audit. Errors and misclassifications identified during our audit include:

- The School received \$653,826 in grant funds to be used for a particular purpose. Errors were noted in accounting for these grant funds.
 - 1) The \$653,826 in grant revenue was incorrectly recorded as sales and services revenues. As a result, sales and services revenues were overstated and state and local contracts and grants revenues were understated.
 - 2) The School incorrectly recorded a portion of the grant revenues and expenses twice. As a result, both nonoperating revenues and services expenses were overstated by \$467,880.
- Roadway and driveway improvements of \$244,693 were incorrectly recorded as increases to buildings in the capital asset note disclosure.
- Sales and services revenues and supplies and materials expenses were overstated by \$75,250 because the School did not properly record internal sales eliminations¹.
- The School incorrectly presented a restatement to beginning net position for \$7,875 on the Statement of Revenues, Expenses, and Changes in Net Position that could not be supported and was only used to balance the financial statements.
- The School did not properly reclassify funds received from another institution from transfers-in to the appropriate revenue accounts. As a result, noncapital grants revenues were understated.
- The Statement of Cash Flows and notes to the financial statements required multiple adjustments to correctly and fairly present the activities of the School.

¹ See Note 1M in the notes to the financial statements for additional information on internal sales activities.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Without these corrections, users of the financial statements could be misled about the School's financial condition and results of operations, and these errors indicate that the School's internal controls over financial reporting were not effective.

According to the School, due to recent changes in roles and responsibilities in the accounting and financial reporting office, an adequate review was not in place, resulting in the errors and misclassifications identified.

The School's management is responsible for the fair presentation of the financial statements and related notes to the financial statements in conformity with accounting principles generally accepted in the United States. Best practices for financial statement preparation include adequate review of the financial statements and related notes to the financial statements to ensure that no material misstatements or errors occur.

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

School's Response: After reviewing the audit finding we have determined that overall the finding is valid. We also concur with the recommendation to place greater emphasis on the year-end financial reporting process and overall internal control to ensure the accuracy of our financial statements. We will provide additional training for our staff on year-end processing as well as increased coordination with the Office of the State Controller (OSC) and General Administration (GA) as it pertains to year-end close out procedures. We are confident that the changes we will implement in the year-end review process, including a year-end checklist, will address the deficiencies noted in the audit finding.

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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Internet: <http://www.ncauditor.net>

To report alleged incidents of fraud, waste or abuse in state government contact the:

Office of the State Auditor Fraud Hotline: 1-800-730-8477

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For additional information contact:

Bill Holmes

Director of External Affairs