

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA
FINANCIAL STATEMENT AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2017

A CONSTITUENT INSTITUTION OF THE UNIVERSITY OF NORTH CAROLINA
SYSTEM AND A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA



NCOSA
The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, 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, 2017, 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 black ink that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

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Office of the State Auditor



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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the University of North Carolina School of the Arts (University), a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2017, 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 3.09 percent, 0.43 percent, and 1.62 percent, respectively, of the assets, net position, and revenues of the University; nor the financial statements of the University of North Carolina School of the Arts Program Support Corporation, which represent less than one percent of the respective assets, net position, and revenues of the University. In addition, we did not audit 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, the University of North Carolina School of the Arts Program Support Corporation, and the University of North Carolina School of the Arts Foundation, Inc. were not audited in accordance with *Government Auditing Standards*.

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 respective financial position of the University of North Carolina School of the Arts, and its discretely presented component unit, as of June 30, 2017, and the respective 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.

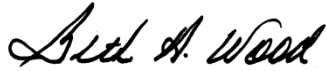
Other Matters – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and other required supplementary information, as listed in the table of contents, 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 October 31, 2017 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 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.

A handwritten signature in black ink, reading "Beth A. Wood". The signature is written in a cursive, flowing style.

Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

October 31, 2017



MANAGEMENT'S DISCUSSION AND ANALYSIS



Introduction

This section of the University of North Carolina School of the Arts financial report provides an overview of the financial position and activities for the year ended June 30, 2017. 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 standards issued by the Governmental Accounting Standards Board (GASB). 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 post employment benefits, insurance against losses, commitments and contingencies, and if necessary, a discussion of accounting changes, adjustments to prior periods, and events subsequent to the University's financial statement period. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

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 purpose of the Statement of Net Position is to present the readers of the financial statements a fiscal snapshot of the University of North Carolina School of the Arts. The Statement of Net Position presents end-of-year data concerning assets

(current and noncurrent), liabilities (current and noncurrent), and net position (assets plus deferred outflows minus liabilities plus deferred inflows).

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 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 net position 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 donors and/or external entities that have placed certain restrictions on the use of the assets. This category includes restricted funds for endowment 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,		
	2017	2016	Change
Assets			
Current Assets	\$ 34,921,676.71	\$ 25,540,658.43	\$ 9,381,018.28
Capital Assets, Net	122,219,542.14	124,613,534.10	(2,393,991.96)
Other Noncurrent Assets	21,999,995.20	21,994,312.69	5,682.51
Total Assets	179,141,214.05	172,148,505.22	6,992,708.83
Deferred Outflows of Resources			
Deferred Outflows Related to Pensions	5,572,882.00	1,274,146.00	4,298,736.00
Liabilities			
Current Liabilities	5,031,642.04	4,172,905.75	858,736.29
Long-Term Liabilities	15,616,989.07	11,534,727.11	4,082,261.96
Other Noncurrent Liabilities	576,932.03	509,103.68	67,828.35
Total Liabilities	21,225,563.14	16,216,736.54	5,008,826.60
Deferred Inflows of Resources			
Deferred Inflows Related to Pensions	360,232.00	655,269.00	(295,037.00)
Deferred Inflows Related to Endowments	1,000,000.00		1,000,000.00
Total Deferred Inflows of Resources	1,360,232.00	655,269.00	704,963.00
Net Position			
Net Investment in Capital Assets	115,483,898.47	117,128,508.22	(1,644,609.75)
Restricted:			
Nonexpendable	15,007,702.93	15,051,203.27	(43,500.34)
Expendable	14,911,626.55	9,743,032.28	5,168,594.27
Unrestricted	16,725,072.96	14,627,901.91	2,097,171.05
Total Net Position	\$ 162,128,300.91	\$ 156,550,645.68	\$ 5,577,655.23

The total assets of the University increased by \$6,992,708.83 for the year, with increases in current assets and other noncurrent assets of \$9,381,018.28 and \$5,682.51, respectively, offset by a decrease in capital assets, net of \$2,393,991.96. Of the \$9,381,018.28 change in current assets, the majority of the increase was attributable to increases in due from university component unit of \$6,280,100.58, unrestricted cash and cash equivalents of \$1,351,796.29, and prepaid assets of \$1,250,000.00; offset with other small changes in other current assets. The increase in the due from university component unit is mainly as a result of approximately \$5.2 million gifts for capital projects and a \$1.0 million gift for a new endowment that will be transferred to the school in the next fiscal year. This new endowment has been recorded as a deferred inflow related to endowments as of June 30, 2017. Related to the change in the unrestricted cash balance, housing services, food services, summer workshops, and other auxiliaries also experienced increased cash compared to prior year. These increases were a direct result of increased student enrollment and an increase in student tuition and fee rates. The increase in prepaid assets of \$1,250,000.00 is resulting from a new note payable the School signed prior to June 30, 2017, for purchases of equipment and services for the one card project that required a down payment of \$500,000.00 and the remaining payments to be paid over the next two fiscal years. The decrease of \$2,393,991.96 in capital assets primarily represents the net effect of an increase in buildings, equipment, construction in progress, and depreciation expense. The University completed and capitalized the primary electrical infrastructure project that was in construction in progress in the prior year. These increases in capital assets were mainly offset by a reduction of depreciable capital assets due to the annual depreciation charge. The change in other noncurrent assets of \$5,682.51 was primarily due to a decrease in restricted cash of \$1,353,711.70, offset with an increase in endowments investments of \$1,235,707.67 and other small changes in other noncurrent assets. The decrease in restricted cash was the result of a decrease in capital funds on hand compared to prior year due to the completion of the primary electrical infrastructure project. The increase of endowments investments was due to continued improvement in the market which resulted in gains on investments.

The total liabilities of the University increased \$5,008,826.60, with the majority of the increases in current liabilities and long-term liabilities of \$858,736.29 and \$4,082,261.96, respectively. The increase in current liabilities was attributable to the school issuing notes payable debt in the amount of \$1,009,322.63 for the one card project. Of this amount, \$750,000.00 is due in the next fiscal year and the remaining \$259,322.63 will be due in fiscal year 2019. The increase in long-term liabilities resulted from the University recording the current year additions for the net pension liability due to GASB Statement No. 68, Accounting and Financial Reporting for Pensions (GASB 68) and new notes payable issued, offset by the University continuing to pay down its capital debt for the UNCSCA Housing Corporation 2015 certificate of participation and notes payable.

Deferred outflows related to pensions for the University were \$5,572,882.00 at June 30, 2017. This was an increase from the prior year of \$4,298,736.00 because of a change in actuarial assumptions by the pension plan trustees. Approximately \$1.4 million of this deferred outflow will reduce the net pension liability for the year ended June 30, 2018. The University also recorded deferred inflows for pensions in the amount of \$360,232.00. This amount represents the net amount of the University's pension deferrals that will decrease pension expense in fiscal years 2018 to 2021. For more information about the University's deferred outflows and inflows related to pensions, refer to Note 12 of the Notes to the Financial Statements.

The University's net position was \$162,128,300.91 at June 30, 2017, an increase of \$5,577,655.23 from the prior year. The significant changes within net position are in the categories of net investment in capital assets, with a decrease of \$1.6 million, restricted for nonexpendable loans, with a decrease of \$43,500.34, restricted for expendable capital projects increase of \$3.6 million, increases in restricted for expendable endowed professorships and restricted for expendable departmental uses of \$826,344.11 and \$826,202.77, respectively, and unrestricted net position, with an increase of \$2.0 million. The decrease in net investment in capital assets is a net result of increases of new capitalized capital assets less current year depreciation expense. The increases of restricted for expendable capital projects is as a result of approximately \$5.2 million gifts for capital projects to be transferred from the Foundation, offset by a decrease in funds on hand due to completion of the primary electrical infrastructure project. A large portion of the increase in restricted for expendable for endowed professorships and departmental uses was as a result of continued improvement in the market which resulted in gains on investments compared to prior year. The increase in unrestricted net position was due primarily to the increase in noncapital gifts of \$548,795.29, as well as an increase in student enrollment and tuition rates, which resulted in additional tuition and sales and services revenues totaling \$1,317,832.79.

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 nonoperating, and any other revenues, expenses, gains and losses received or spent by the University.

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

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

	Year Ended June 30,		
	2017	2016	Change
Operating Revenues			
Student Tuition and Fees, Net	\$ 15,052,284.97	\$ 14,454,043.83	\$ 598,241.14
Sales and Services, Net	8,303,948.02	7,584,356.37	719,591.65
Other Operating Revenues	786,648.88	661,819.89	124,828.99
Total Operating Revenues	24,142,881.87	22,700,220.09	1,442,661.78
Operating Expenses			
Salaries and Benefits	40,597,053.02	36,746,300.80	3,850,752.22
Supplies and Materials	4,399,379.29	3,878,124.77	521,254.52
Services	10,271,180.57	10,287,759.67	(16,579.10)
Scholarships and Fellowships	1,572,023.04	1,393,012.49	179,010.55
Utilities	2,131,473.27	2,075,988.66	55,484.61
Depreciation	4,130,193.71	3,996,419.05	133,774.66
Total Operating Expenses	63,101,302.90	58,377,605.44	4,723,697.46
Operating Loss	(38,958,421.03)	(35,677,385.35)	(3,281,035.68)
Nonoperating Revenues (Expenses)			
State Appropriations	31,003,555.00	29,620,047.00	1,383,508.00
Noncapital Grants - Student Financial Aid	1,874,542.39	1,735,476.70	139,065.69
Noncapital Grants	129,252.56	199,667.00	(70,414.44)
Noncapital Gifts	2,715,704.47	2,166,909.18	548,795.29
Investment Income (Loss), Net	2,470,803.55	(204,844.80)	2,675,648.35
Interest and Fees on Debt	(187,245.52)	(192,527.28)	5,281.76
Other Nonoperating Revenues (Expenses)	146,089.03	(16,179.33)	162,268.36
Net Nonoperating Revenues	38,152,701.48	33,308,548.47	4,844,153.01
Loss Before Other Revenues	(805,719.55)	(2,368,836.88)	1,563,117.33
Capital Appropriations	96,777.00	1,714,471.19	(1,617,694.19)
Capital Grants	679,494.01	1,530,807.36	(851,313.35)
Capital Gifts	5,607,103.77	231,371.85	5,375,731.92
Additions to Endowments		2,520.00	(2,520.00)
Total Other Revenues	6,383,374.78	3,479,170.40	2,904,204.38
Increase in Net Position	5,577,655.23	1,110,333.52	4,467,321.71
Beginning Net Position	156,550,645.68	155,440,312.16	1,110,333.52
Ending Net Position	\$ 162,128,300.91	\$ 156,550,645.68	\$ 5,577,655.23

The Statement of Revenues, Expenses, and Changes in Net Position reflects an increase in the net position at the end of the year. Total revenues for the fiscal year were \$68,866,203.65 compared to \$59,901,490.37 from the previous year, an increase of \$8,964,713.28. 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, net increased by \$598,241.14. This increase was primarily the result of an increase in tuition and fee rates during the year, offset by small changes in unearned revenue and scholarship discounts. The tuition rate increase per student ranged from \$250.00 to \$600.00, and the fee rates increase per student ranged from \$10.00 to \$51.00.
- Sales and services, net increased by \$719,591.65. This change was primarily the result of an increase in housing and food services, summer workshops, and other school productions revenue as a result of increased student enrollment.
- State appropriations increased \$1,383,508.00. This change was mainly as a result of enrollment growth and increase funding to support a legislatively approved salary bonus.
- Noncapital gifts increased \$548,795.29. This increase was mainly as a result of increased funding provided by the University's Foundation to support scholarships and University operational costs.
- Investment income, net increased by \$2,675,648.35 as a result of continued improvement in the market, which resulted in gains on investments compared to prior year.
- Capital appropriations decreased \$1,617,694.19 primarily as a result of repair and renovations funds allocated based on reimbursable basis compared to the prior year.
- Capital grants decreased \$851,313.35 primarily as a result of the final reimbursements received for the Library, Central Storage Facility, Campus Police, and Film School Production Design Facility buildings completed in the prior fiscal years. In addition, the University has taken on fewer capital projects since the completion of these buildings.
- Capital gifts increased \$5,375,731.92 primarily as a result of approximately \$5.2 million gifts for capital projects that will be transferred to the University in the next fiscal year from the Foundation. The \$5.0 million gift is for the Performance Place renovations and the remaining is for various other capital projects.

Total expenses were \$63,288,548.42 for fiscal year ended June 30, 2017 and \$58,791,156.85 for 2016. Operating expenses totaled \$63,101,302.90 for the year compared to \$58,377,605.44 from the previous year, an increase of \$4,723,697.46. The significant changes include:

- Salaries and benefits increased \$3,850,752.22 primarily due to enrollment growth funds, legislative salary increases and merit bonus awarded for all employees, and increases to the University's share of insurance premiums and retirement contributions.
- Supplies and materials increased by \$521,254.52. This increase was a result of additional maintenance projects for repairs and renovations, offset by decreased purchases in supplies and equipment compared to prior year.

Capital Asset and Debt Administration

The University's capital assets, net of accumulated depreciation at June 30, 2017, were \$122,219,542.14. Construction projects in progress for the 2016-2017 fiscal year totaled \$208,935.00. During the year, the University completed and capitalized the primary electrical infrastructure project in the amount of \$1.8 million. For more information about the University's capital asset holdings, refer to Note 6 of the Notes to the Financial Statements.

The University had \$17,203,001.82 in outstanding long-term debt at June 30, 2017, and continues to make all of its debt payments in a timely manner. As previously mentioned, a new notes payable was issued during the 2016-2017 fiscal year related to the one card project. Refer to Note 8 of the Notes to the Financial Statements for more detailed information about the University's debt obligations.

Highlights

The University of the North Carolina School of the Arts (UNCSA) is consistently recognized for academic quality, excellent education, quality of life, and great value. Highlights from recent achievements, rankings, and distinctions include:

- UNCSA wins national and international marketing awards. Advertising and marketing materials for the University of North Carolina School of the Arts have won national awards from Higher Education Marketing Report and international awards from the Council for the Advancement and Support of Education (CASE). Higher Education Marketing Report, which sponsored the 32nd Annual Educational Advertising Awards, awarded UNCSA four gold awards, a silver award, and a bronze award. CASE, an international professional association serving more than 3,670 educational institutions, presented UNCSA with an Award of Excellence and a Special Merit Award.
- The School of Filmmaking at the University of North Carolina School of the Arts is among the nation's best film schools, according to *The Hollywood Reporter*, a prestigious voice of the entertainment industry. UNCSA's Film School is ranked No. 14 for the third year in a row in the publication's sixth annual list of "The Top 25 American Film Schools." Also, *MovieMaker* magazine included the school in its list of 40 best film schools in the U.S. and Canada. The *MovieMaker* list organized schools alphabetically by region without assigning rank.
- UNCSA partners with leading tech and industry companies, and is working with the same equipment that's new to Hollywood. The School of Filmmaking is one of 11 schools nationwide to be chosen by Facebook-owned Oculus to receive state-of-the-art equipment. The school also has received Samsung Gear VR headsets and phones, Samsung Gear 360 cameras, and Rift-ready top-of-the-line computers from Advanced Micro Devices, equipment that is used in digital gaming and narrative filmmaking. The University of North Carolina School of the Arts is leading the way, whose faculty and students are at the forefront of developing the playbook for bringing virtual reality to consumers.
- Two undergraduates attending the School of Music at UNCSA recently took top prizes in the 2017 Rosen-Schaffel Competition for Young and Emerging Artists. Violinist Eva Wetzel was awarded First Prize and the Audience Award, while pianist Owen Dodds earned Third Prize. The Rosen-Schaffel Competition is a

program of an Appalachian Summer Festival, Appalachian's annual summer festival of the performing and visual arts.

- Lighting design alumnus wins Princess Grace Award. Christopher Annas-Lee, Design & Production alum 2014, won the prestigious Theater Fellowship for his work with Gala Hispanic Theatre.
- Several alumni of UNCSCA have been nominated for Emmy Awards or are affiliated with Emmy-nominated shows.
- J.T. Rogers, School of Drama alum 1990, won a Tony award for "Oslo" for best play. "Oslo" opened off-Broadway in June 2016 and ran for 10 weeks before transferring to Broadway in April 2017.

Economic Outlook

The University of North Carolina School of the Arts continued to manage and use its resources wisely in fiscal year 2017, due to effective institutional planning and continued support from the State to meet the educational needs of the University. The University's management team led by Chancellor M. Lindsay Bierman remains fully committed to student affordability and prudent use of resources by spending carefully, wisely, and thoughtfully and allocating its resources strategically to support the University's core academic mission.

State appropriations comprised approximately 44% of the University's annual revenues during fiscal year 2017. As a result of modest increases in operating revenues and state appropriations, the University was able to provide increased support to its instructional mission.

The University continues to recruit, admit, and retain top-caliber students even as we compete against the most selective public and private performing arts conservatory schools in the country. Although applications to the University for Fall 2017 reached a new high of 2,210 compared to 2,158 for Fall 2016, the University enrollment declined with 1,268 students enrolled in Fall 2017 compared to 1,305 in the prior year.

As fiscal year 2018 progresses, the University will build on its efforts to plan and manage its precious resources to create unparalleled learning opportunities for our students and to establish strong ties to communities throughout North Carolina and beyond. Overall, the University sees strong enrollment numbers and the financial position remains positive. Management continues to maintain a close watch over resources to ensure the ability to react to unknown internal and external issues and sustain its current high quality financial position.



FINANCIAL STATEMENTS

University of North Carolina School of the Arts
Statement of Net Position
June 30, 2017

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 22,827,718.12
Restricted Cash and Cash Equivalents	4,084,447.44
Receivables, Net (Note 5)	113,486.30
Due from University Component Units	6,371,150.00
Inventories	194,457.71
Notes Receivable, Net (Note 5)	80,417.14
Prepaid Items	1,250,000.00
Total Current Assets	34,921,676.71

Noncurrent Assets:

Restricted Cash and Cash Equivalents	1,599,424.25
Endowment Investments	19,849,481.79
Restricted Investments	4,281.84
Notes Receivable, Net (Note 5)	287,484.69
Prepaid Items	259,322.63
Capital Assets - Nondepreciable (Note 6)	6,361,596.45
Capital Assets - Depreciable, Net (Note 6)	115,857,945.69
Total Noncurrent Assets	144,219,537.34
Total Assets	179,141,214.05

DEFERRED OUTFLOWS OF RESOURCES

Deferred Outflows Related to Pensions	5,572,882.00
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 7)	1,643,781.92
Due to Primary Government	5,535.29
Unearned Revenue	1,781,845.24
Interest Payable	14,466.84
Long-Term Liabilities - Current Portion (Note 8)	1,586,012.75
Total Current Liabilities	5,031,642.04

Noncurrent Liabilities:

Funds Held for Others	96,176.89
U. S. Government Grants Refundable	480,755.14
Long-Term Liabilities (Note 8)	15,616,989.07
Total Noncurrent Liabilities	16,193,921.10
Total Liabilities	21,225,563.14

DEFERRED INFLOWS OF RESOURCES

Deferred Inflows Related to Pensions	360,232.00
Deferred Inflows Related to Endowments	1,000,000.00
Total Deferred Inflows of Resources	1,360,232.00

University of North Carolina School of the Arts
Statement of Net Position
June 30, 2017

Exhibit A-1
Page 2 of 2

NET POSITION

Net Investment in Capital Assets	115,483,898.47
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	322,503.20
Endowed Professorships	10,010,167.91
Departmental Uses	4,641,145.21
Loans	33,886.61
Expendable:	
Scholarships and Fellowships	241,019.49
Endowed Professorships	3,629,423.64
Departmental Uses	3,911,840.78
Capital Projects	7,129,342.64
Unrestricted	<u>16,725,072.96</u>
Total Net Position	<u><u>\$ 162,128,300.91</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, 2017

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 10)	\$ 15,052,284.97
Federal Grants and Contracts	212,800.94
Sales and Services, Net (Note 10)	8,303,948.02
Interest Earnings on Loans	4,774.75
Other Operating Revenues	569,073.19

Total Operating Revenues	<u>24,142,881.87</u>
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EXPENSES

Operating Expenses:

Salaries and Benefits	40,597,053.02
Supplies and Materials	4,399,379.29
Services	10,271,180.57
Scholarships and Fellowships	1,572,023.04
Utilities	2,131,473.27
Depreciation	4,130,193.71

Total Operating Expenses	<u>63,101,302.90</u>
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Operating Loss	<u>(38,958,421.03)</u>
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	31,003,555.00
Noncapital Grants - Student Financial Aid	1,874,542.39
Noncapital Grants	129,252.56
Noncapital Gifts	2,715,704.47
Investment Income (Net of Investment Expense of \$96,699.76)	2,470,803.55
Interest and Fees on Debt	(187,245.52)
Other Nonoperating Revenues	146,089.03

Net Nonoperating Revenues	<u>38,152,701.48</u>
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Loss Before Other Revenues	(805,719.55)
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Capital Appropriations	96,777.00
Capital Grants	679,494.01
Capital Gifts	<u>5,607,103.77</u>

Increase in Net Position	5,577,655.23
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NET POSITION

Net Position - July 1, 2016	<u>156,550,645.68</u>
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Net Position - June 30, 2017	<u><u>\$ 162,128,300.91</u></u>
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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, 2017

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 23,797,579.81
Payments to Employees and Fringe Benefits	(40,597,803.66)
Payments to Vendors and Suppliers	(17,191,766.59)
Payments for Scholarships and Fellowships	(1,572,023.04)
Loans Issued	(77,000.00)
Collection of Loans	75,371.80
Interest Earned on Loans	1,213.36
Net Cash Used by Operating Activities	<u>(35,564,428.32)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	31,003,555.00
Noncapital Grants - Student Financial Aid	1,874,542.39
Noncapital Grants	129,252.56
Noncapital Gifts	2,731,162.89
William D. Ford Direct Lending Receipts	7,622,482.00
William D. Ford Direct Lending Disbursements	(7,622,482.00)
Related Activity Agency Disbursements	66,169.14
Other Receipts	311,127.29
Net Cash Provided by Noncapital Financing Activities	<u>36,115,809.27</u>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Capital Appropriations	96,777.00
Capital Grants	679,494.01
Capital Gifts	224,544.77
Proceeds from Sale of Capital Assets	18,978.38
Acquisition and Construction of Capital Assets	(1,723,632.80)
Principal Paid on Capital Debt	(545,981.11)
Interest and Fees Paid on Capital Debt	(188,369.80)
Net Cash Used by Capital Financing and Related Financing Activities	<u>(1,438,189.55)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	984,655.43
Investment Income	345,562.31
Net Cash Provided by Investing Activities	<u>1,330,217.74</u>
Net Increase in Cash and Cash Equivalents	443,409.14
Cash and Cash Equivalents - July 1, 2016	<u>28,068,180.67</u>
Cash and Cash Equivalents - June 30, 2017	<u>\$ 28,511,589.81</u>

University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2017

Exhibit A-3
Page 2 of 2

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

Operating Loss	\$ (38,958,421.03)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	4,130,193.71
Allowances	47,316.93
Changes in Assets and Deferred Outflows of Resources:	
Receivables, Net	(37,800.25)
Inventories	(19,626.03)
Notes Receivable, Net	(1,628.20)
Prepaid Items	(1,509,322.63)
Deferred Outflows for Pensions	(4,298,736.00)
Changes in Liabilities and Deferred Inflows of Resources:	
Accounts Payable and Accrued Liabilities	149,915.58
Due to Primary Government	(8,092.81)
Unearned Revenue	(229,948.45)
Net Pension Liability	4,671,017.00
Notes Payable	1,009,322.63
U. S. Government Grants Refundable	1,659.21
Compensated Absences	(215,240.98)
Deferred Inflows for Pensions	(295,037.00)
Net Cash Used by Operating Activities	<u><u>\$ (35,564,428.32)</u></u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 22,827,718.12
Restricted Cash and Cash Equivalents	4,084,447.44
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>1,599,424.25</u>
Total Cash and Cash Equivalents - June 30, 2017	<u><u>\$ 28,511,589.81</u></u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 312,099.48
Assets Acquired through a Gift	87,000.00
Change in Fair Value of Investments	1,829,754.80
Loss on Disposal of Capital Assets	(165,038.26)
Increase in Receivables Related to Nonoperating Income	6,280,100.58

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

University of North Carolina School of the Arts Foundation, Inc.
Consolidated Statement of Financial Position
June 30, 2017

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	15,386,660
Investments		36,663,190
Annuity Investments		407,556
Prepaid Expenses and Other Current Assets		59,729
Pledges Receivable, Net		7,791,697
Beneficial Interest in Perpetual Trusts		760,959
Property		60,001
Other Long-Term Assets		77,896
		<hr/>
Total Assets	\$	61,207,688
		<hr/>

LIABILITIES

Accounts Payable and Accrued Expenses	\$	97,107
Annuity Obligations		47,111
Due to UNCSCA		6,200,000
		<hr/>
Total Liabilities		6,344,218
		<hr/>

NET ASSETS

Unrestricted		707,985
Temporarily Restricted		15,502,396
Permanently Restricted		38,653,089
		<hr/>
Total Net Assets		54,863,470
		<hr/>
Total Liabilities and Net Assets	\$	61,207,688
		<hr/>

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

University of North Carolina School of the Arts Foundation, Inc.
Consolidated Statement of Activities
For the Fiscal Year Ended June 30, 2017

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES AND SUPPORT				
Gifts and Grants	\$ 623,877	\$ 6,999,586	\$ 7,852,314	\$ 15,475,777
Interest and Dividend Income	906	47,303		48,209
Change in Fair Value of:				
Annuity Investments			39,635	39,635
Perpetual Trusts			8,276	8,276
Annuity Obligations			2,484	2,484
Other Long-Term Assets			(20,000)	(20,000)
Net Gain on Other Investments Reported at Fair Value	2,979	4,018,503	70,473	4,091,955
Other Income	27,405	196,229		223,634
Net Assets Released from Restrictions	5,726,086	(5,726,086)		
Total Revenues and Support	6,381,253	5,535,535	7,953,182	19,869,970
EXPENDITURES				
Program Services:				
School Programs	1,647,115			1,647,115
Scholarships and Awards	1,904,587			1,904,587
TSKIA Programs	1,642,629			1,642,629
Total Program Services	5,194,331			5,194,331
Supporting Services:				
Development Costs	382,972			382,972
Administrative Costs	482,065			482,065
Investment Management Fees	178,928			178,928
Total Supporting Services	1,043,965			1,043,965
Total Expenditures	6,238,296			6,238,296
Change in Net Assets Before Reclassifications and Transfers	142,957	5,535,535	7,953,182	13,631,674
Reclassification from Agency Funds		617,095		617,095
Transfer Between Funds		(10,728)	10,728	
Transfers Due to UNCSA		(6,295,559)		(6,295,559)
Change in Net Assets	142,957	(153,657)	7,963,910	7,953,210
NET ASSETS				
Net Assets, Beginning of Year	565,028	15,656,053	30,689,179	46,910,260
Net Assets, End of Year	\$ 707,985	\$ 15,502,396	\$ 38,653,089	\$ 54,863,470

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



NOTES TO THE FINANCIAL STATEMENTS

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 (University) is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. See below for further discussion of the University's component units. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

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.

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 the Program Support Corporation may be obtained from the University Controller's Office, P.O. Box 12189, Winston-Salem, NC 27117, or by calling (336) 770-3304.

Condensed combining information regarding blended component units is provided in Note 16.

Discretely Presented Component Unit - The University of North Carolina School of the Arts Foundation, Inc. (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 University.

The Foundation acts primarily as a fundraising 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, 2017, the Foundation distributed \$3,061,603.93 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University of North Carolina School of the Arts Foundation, Inc., P.O. Box 12189, Winston-Salem, NC 27117.

- 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, 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** - To the extent available, investments are recorded at fair value based on quoted market prices in active markets on a trade-date basis. Additional information regarding the fair value measurement of investments is disclosed in Note 3. 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 change in the 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 acquisition value at date of donation in the case of gifts. Donated

capital assets acquired prior to July 1, 2015 are stated at fair value as of the date of donation. 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 in the following manner:

<u>Asset Class</u>	<u>Estimated Useful Life</u>
Buildings	50 years
Machinery and Equipment	5-25 years
Specialized Musical Instruments	25-50 years
General Infrastructure	50 years

The Regis Film collection, acquired prior to July 1, 2015, is capitalized at cost or fair value at the date of donation. This collection is considered inexhaustible and is therefore not depreciated.

- I. **Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted for the acquisition or construction of capital assets, resources legally segregated for the payment of principal and interest as required by debt covenants, unspent debt proceeds, and endowment and other restricted investments.
- J. **Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of certificates of participation, net pension liability, notes payable, and compensated absences that will not be paid within the next fiscal year.

Deferred gains and losses on refundings are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method, and are aggregated as deferred outflows of resources or deferred inflows of resources on the Statement of Net Position. Issuance costs are expensed in the reporting period in which they are incurred.

The net pension liability represents the University's proportionate share of the collective net pension liability reported in the State of North Carolina's 2016 *Comprehensive Annual Financial Report*. This liability represents the University's portion of the collective total pension liability less the fiduciary net position of the Teachers' and State Employees' Retirement System. See Note 12 for further information regarding the University's policies for recognizing liabilities, expenses, and deferred

outflows of resources and deferred inflows of resources related to pensions.

- 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. Deferred Outflows/Inflows of Resources** - In addition to assets, the Statement of Net Position reports a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The University has deferred outflows related to pensions that qualify for reporting in this category.

In addition to liabilities, the Statement of Net Position reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until then. The University has the following items that qualify for reporting in this category: deferred inflows related to pensions and deferred inflows related to endowments.

- M. 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 liabilities 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.

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. Both restricted and unrestricted net position include consideration of deferred outflows of resources and deferred inflows of resources.

- N. **Scholarship Discounts** - Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net 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.
- O. **Revenue and Expense Recognition** - The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net 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*.

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

- P. Internal Sales Activities** - 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, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for agency funds held directly by the University.

Cash on hand at June 30, 2017 was \$2,040.00. As of June 30, 2017, the University did not have any cash outside the State Treasurer's STIF; therefore, the University was not exposed to custodial credit risk. 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.

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 and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as discussed below.

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; certificates of deposit and other deposit accounts of specified financial institutions; prime quality commercial paper; asset-backed securities with specified ratings, specified bills of exchange or time drafts, and corporate bonds/notes with specified ratings; 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 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 as defined by GASB Statement No. 40, *Deposit and Investment Risk Disclosures - An Amendment of GASB Statement No. 3*.

Interest Rate Risk: Interest rate risk is the risk the University may face should interest rate variances affect the 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.

Short-Term Investment Fund - At June 30, 2017, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$28,509,549.81, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund (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 or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2017. Assets and shares of the STIF are valued at 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 North Carolina Department of State Treasurer Investment Programs' separately issued audit report. This separately issued report can be obtained from the Department of State Treasurer, 3200 Atlantic Avenue, Raleigh, NC 27604 or can be accessed from the Department of State Treasurer's website at <https://www.nctreasurer.com/> in the Audited Financial Statements section.

UNC Investment Fund, LLC - At June 30, 2017, the University's investments include \$19,849,481.79, 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, does not have a credit rating, and is not subject to any regulatory oversight. 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 investments by type and investments subject to interest rate risk at June 30, 2017, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Amount	Investment Maturities (in Years)
		Less Than 1
Debt Securities		
Money Market Mutual Funds	\$ 4,281.84	\$ 4,281.84

At June 30, 2017, the Money Market Mutual Funds, with an amortized cost of \$4,281.84, were rated AAAM by Standard and Poor's.

Total Investments - The following table presents the total investments at June 30, 2017:

Investment Type	Amount
Debt Securities	
Money Market Mutual Funds	\$ 4,281.84
Other Securities	
UNC Investment Fund	19,849,481.79
Total Investments	\$ 19,853,763.63

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:

	Amount
Investment Type	
UNC Investment Fund	\$ 36,663,190.00
Mutual Funds	407,556.00
Total Investments	\$ 37,070,746.00

C. Reconciliation of Deposits and Investments - A reconciliation of deposits and investments for the University as of June 30, 2017, is as follows:

Cash on Hand	\$ 2,040.00
Deposits in the Short-Term Investment Fund	28,509,549.81
External Investment Pool	19,849,481.79
Non-Pooled Investments	4,281.84
Total Deposits and Investments	\$ 48,365,353.44
Deposits	
Current	
Cash and Cash Equivalents	\$ 22,827,718.12
Restricted Cash and Cash Equivalents	4,084,447.44
Noncurrent:	
Restricted Cash and Cash Equivalents	1,599,424.25
Total Deposits	28,511,589.81
Investments	
Noncurrent:	
Endowment Investments	19,849,481.79
Restricted Investments	4,281.84
Total Investments	19,853,763.63
Total Deposits and Investments	\$ 48,365,353.44

NOTE 3 - FAIR VALUE MEASUREMENTS

University

To the extent available, the University's investments are recorded at fair value as of June 30, 2017. GASB Statement No. 72, *Fair Value Measurement and*

Application, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Level 1	Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.
Level 2	Investments with inputs - other than quoted prices included within Level 1 - that are observable for an asset, either directly or indirectly.
Level 3	Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

The following table summarizes the University's investments, including the Short-Term Investment Fund, within the fair value hierarchy at June 30, 2017:

	Fair Value Measurements Using			
	Fair Value	Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investments by Fair Value Level				
Short-Term Investment Fund	\$ 28,509,549.81	\$ 0.00	\$ 28,509,549.81	\$ 0.00
UNC Investment Fund	19,849,481.79			19,849,481.79
Total Investments by Fair Value Level	<u>\$ 48,359,031.60</u>	<u>\$ 0.00</u>	<u>\$ 28,509,549.81</u>	<u>\$ 19,849,481.79</u>

Short-Term Investment Fund - Ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian.

UNC Investment Fund - Ownership interests of the UNC Investment Fund are determined on a market unit valuation basis each month and in accordance with the UNC Investment Fund's operating procedures.

Component Unit

The fair value of cash and cash equivalents and accounts payable and accrued expenses is not materially different than their carrying amounts, as reported, since they approximate the amount for which the assets could be sold or the liabilities could be settled. The discount rate used for pledges receivable approximates a market rate. Accordingly, the carrying value approximates fair value. The fair value of annuity obligations approximate carrying amounts as discount rates on these obligations approximate market. Investments are carried at fair value.

Assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1	Quoted market prices in active markets for identical assets or liabilities;
Level 2	Observable market-based inputs or unobservable inputs that are corroborated by market data;
Level 3	Unobservable inputs that are not corroborated by market data.

The following are the assets and liabilities measured at fair value as of June 30, 2017:

	Level 1	Level 2	Level 3	Total
Assets				
UNC Investment Fund	\$ 0.00	\$ 0.00	\$ 36,663,190.00	\$ 36,663,190.00
Mutual Funds	407,556.00			407,556.00
Total Assets at Fair Value	<u>\$ 407,556.00</u>	<u>\$ 0.00</u>	<u>\$ 36,663,190.00</u>	<u>\$ 37,070,746.00</u>
Liabilities:				
Annuity Obligations	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 47,111.00</u>	<u>\$ 47,111.00</u>

NOTE 4 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, state law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may also appropriate expenditures from eligible nonexpendable balances if deemed prudent and necessary to

meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. However, a majority of the University's endowment donor agreements prohibit spending of nonexpendable balances and therefore the related nonexpendable balances are not eligible for expenditure. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy by which the rate of spending for a fiscal year is calculated between 2% to 5% 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, 2017, net appreciation of \$5,354,743.33 was available to be spent and was classified in net position as restricted expendable for scholarships and fellowships, endowed professorships, and departmental uses as it is restricted for specific purposes.

NOTE 5 - RECEIVABLES

Receivables at June 30, 2017, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 46,138.83	\$ 25,200.78	\$ 20,938.05
Accounts	40,384.42		40,384.42
Interest on Loans	52,163.83		52,163.83
Total Current Receivables	<u>\$ 138,687.08</u>	<u>\$ 25,200.78</u>	<u>\$ 113,486.30</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 108,396.68	\$ 27,979.54	\$ 80,417.14
Institutional Student Loan Programs	3,865.75	3,865.75	
Total Notes Receivable - Current	<u>\$ 112,262.43</u>	<u>\$ 31,845.29</u>	<u>\$ 80,417.14</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 491,603.30</u>	<u>\$ 204,118.61</u>	<u>\$ 287,484.69</u>

NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2017, is presented as follows:

	Balance July 1, 2016	Increases	Decreases	Balance June 30, 2017
Capital Assets, Nondepreciable:				
Land and Permanent Easements	\$ 4,313,652.83	\$ 0.00	\$ 0.00	\$ 4,313,652.83
Art, Literature, and Artifacts	1,839,008.62			1,839,008.62
Construction in Progress	500,785.86	1,541,010.34	1,832,861.20	208,935.00
Total Capital Assets, Nondepreciable	6,653,447.31	1,541,010.34	1,832,861.20	6,361,596.45
Capital Assets, Depreciable:				
Buildings	149,402,948.28	45,736.00		149,448,684.28
Machinery and Equipment	14,612,728.86	379,208.05	381,187.28	14,610,749.63
General Infrastructure	5,107,656.50	1,787,125.20		6,894,781.70
Total Capital Assets, Depreciable	169,123,333.64	2,212,069.25	381,187.28	170,954,215.61
Less Accumulated Depreciation for:				
Buildings	42,618,433.75	3,221,759.11		45,840,192.86
Machinery and Equipment	7,032,050.96	794,367.30	197,170.64	7,629,247.62
General Infrastructure	1,512,762.14	114,067.30		1,626,829.44
Total Accumulated Depreciation	51,163,246.85	4,130,193.71	197,170.64	55,096,269.92
Total Capital Assets, Depreciable, Net	117,960,086.79	(1,918,124.46)	184,016.64	115,857,945.69
Capital Assets, Net	\$ 124,613,534.10	\$ (377,114.12)	\$ 2,016,877.84	\$ 122,219,542.14

During the year ended June 30, 2017, the University incurred \$187,245.52 in interest costs related to the acquisition and construction of capital assets. All of these costs were charged in interest expense.

The University has pledged the energy savings improvements installed in its buildings and other structures financed through the UNC System Guaranteed Energy Savings Installment Financing Agreement (agreement) dated September 1, 2014. The carrying value of the energy savings improvement assets associated with the agreement is \$1,482,406.34 and is subject to security provisions in the agreement to ensure timely debt service payments. Additional information regarding the agreement can be found in Note 8.

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2017, were as follows:

	Amount
Current Accounts Payable and Accrued Liabilities	
Accounts Payable	\$ 1,350,732.62
Accrued Payroll	186,659.10
Contract Retainage	106,390.20
Total Current Accounts Payable and Accrued Liabilities	\$ 1,643,781.92

NOTE 8 - LONG-TERM LIABILITIES**A. Changes in Long-Term Liabilities** - A summary of changes in the long-term liabilities for the year ended June 30, 2017, is presented as follows:

	Balance July 1, 2016	Additions	Reductions	Balance June 30, 2017	Current Portion
Certificates of Participation	\$ 5,105,000.00	\$ 0.00	\$ 299,000.00	\$ 4,806,000.00	\$ 308,000.00
Net Pension Liability	2,951,107.00	4,671,017.00		7,622,124.00	
Notes Payable	1,868,807.14	1,009,322.63	246,981.11	2,631,148.66	1,005,828.46
Compensated Absences	2,358,970.14	1,257,092.99	1,472,333.97	2,143,729.16	272,184.29
Total Long-Term Liabilities	\$ 12,283,884.28	\$ 6,937,432.62	\$ 2,018,315.08	\$ 17,203,001.82	\$ 1,586,012.75

Additional information regarding the net pension liability is included in Note 12.

B. Certificates of Participation - The University was indebted for certificates of participation for the purposes shown in the following table:

Purpose	Series	Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2017	Principal Outstanding June 30, 2017	See Table Below
Certificates of Participation							
Student Housing Project, Series 2015	(A)	2.99%	06/01/2030	<u>\$ 5,400,000.00</u>	<u>\$ 594,000.00</u>	<u>\$ 4,806,000.00</u>	(1)

(A) University of North Carolina School of the Arts Student Housing Project, Series 2015 (Refunding of 2005 COPs)

The University has pledged future revenues, net of specific operating expenses, to repay 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)	Housing Revenues	\$ 5,871,067.90	\$ 620,711.19	\$ 299,000.00	\$ 151,894.34	73%

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2017, are as follows:

Fiscal Year	Annual Requirements			
	Certificates of Participation		Notes Payable	
	Principal	Interest	Principal	Interest
2018	\$ 308,000.00	\$ 143,699.40	\$ 1,005,828.46	\$ 28,123.77
2019	317,000.00	134,490.20	525,836.36	23,338.08
2020	327,000.00	125,011.90	277,515.44	18,353.41
2021	336,000.00	115,234.60	288,841.83	13,163.85
2022	346,000.00	105,188.20	300,501.31	7,763.37
2023-2027	1,894,000.00	364,241.80	232,625.26	2,145.76
2028-2030	1,278,000.00	77,201.80		
Total Requirements	\$ 4,806,000.00	\$ 1,065,067.90	\$ 2,631,148.66	\$ 92,888.24

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

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2017	Principal Outstanding June 30, 2017
UNC System Guaranteed Energy Savings Project	Banc of America Public Capital Corp	1.84%	02/14/2023	\$ 1,929,618.00	\$ 307,791.97	\$ 1,621,826.03
Blackboard Surveillance Upgrade and Integration	Blackboard	0.00%	10/30/2018	1,509,322.63	500,000.00	1,009,322.63
Total Notes Payable				\$ 3,438,940.63	\$ 807,791.97	\$ 2,631,148.66

NOTE 9 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for copiers. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2017:

Fiscal Year	Amount
2018	\$ 74,557.87
2019	38,419.73
2020	13,920.93
2021	1,960.40
Total Minimum Lease Payments	\$ 128,858.93

Rental expense for all operating leases during the year was \$275,979.18.

NOTE 10 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees, Net	<u>\$ 20,218,466.43</u>	<u>\$ 0.00</u>	<u>\$ 5,151,601.20</u>	<u>\$ 14,580.26</u>	<u>\$ 15,052,284.97</u>
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 4,530,703.78	\$ 0.00	\$ 1,154,785.72	\$ 0.00	\$ 3,375,918.06
Dining	3,054,142.34		758,404.29		2,295,738.05
Health, Physical Education, and Recreation Services	276,405.85	12,791.38			263,614.47
Parking	107,544.94	4,888.12			102,656.82
Other	75,409.30	300.00			75,109.30
Sales and Services of Education and Related Activities:					
University Production Revenues	870,952.91	33,039.42			837,913.49
Other	<u>1,358,258.14</u>	<u>5,260.31</u>			<u>1,352,997.83</u>
Total Sales and Services, Net	<u>\$ 10,273,417.26</u>	<u>\$ 56,279.23</u>	<u>\$ 1,913,190.01</u>	<u>\$ 0.00</u>	<u>\$ 8,303,948.02</u>

NOTE 11 - 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	\$ 15,372,937.44	\$ 882,427.26	\$ 1,391,082.44	\$ 0.00	\$ 0.00	\$ 0.00	\$ 17,646,447.14
Public Service	500,039.18	161,139.87	506,308.57				1,167,487.62
Academic Support	5,315,896.84	366,627.50	225,180.18				5,907,704.52
Student Services	1,091,394.50	37,924.99	710,921.22				1,840,240.71
Institutional Support	8,630,812.84	1,570,237.95	2,210,773.56				12,411,824.35
Operations and Maintenance of Plant	5,717,097.17	574,196.39	1,251,081.69		1,777,135.11		9,319,510.36
Student Financial Aid				1,572,023.04			1,572,023.04
Auxiliary Enterprises	3,968,875.05	806,825.33	3,975,832.91		354,338.16		9,105,871.45
Depreciation						4,130,193.71	4,130,193.71
Total Operating Expenses	<u>\$ 40,597,053.02</u>	<u>\$ 4,399,379.29</u>	<u>\$ 10,271,180.57</u>	<u>\$ 1,572,023.04</u>	<u>\$ 2,131,473.27</u>	<u>\$ 4,130,193.71</u>	<u>\$ 63,101,302.90</u>

NOTE 12 - PENSION PLANS**A. Defined Benefit Plan**

Plan Administration: The State of North Carolina administers the Teachers' and State Employees' Retirement System (TSERS) plan. This plan is a cost-sharing, multiple-employer, defined benefit pension plan established by the State to provide pension benefits for general

employees and law enforcement officers (LEOs) of the State, general employees and LEOs of its component units, and employees of Local Education Agencies (LEAs) and charter schools not in the reporting entity. Membership is comprised of employees of the State (state agencies and institutions), universities, community colleges, and certain proprietary component units along with the LEAs and charter schools that elect to join the Retirement System. Benefit provisions are established by General Statute 135-5 and may be amended only by the North Carolina General Assembly.

Benefits Provided: TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of general members who die while in active service or within 180 days of their last day of service and who also have either completed 20 years of creditable service regardless of age, or have completed five years of service and have reached age 60. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

Contributions: Contribution provisions are established by General Statute 135-8 and may be amended only by the North Carolina General Assembly. Employees are required to contribute 6% of their annual pay. The contribution rate for employers is set each year by the North Carolina General Assembly in the Appropriations Act based on the actuarially-determined rate recommended by the actuary. The University's contractually-required contribution rate for the year ended June 30, 2017 was 9.98% of covered payroll. Employee contributions to the pension plan were \$851,111.59, and the University's contributions were \$1,415,682.28 for the year ended June 30, 2017.

The TSERS plan's financial information, including all information about the plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, is included in the State of North Carolina's fiscal year 2016 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

TSERS Basis of Accounting: The financial statements of the TSERS plan were prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. The plan's fiduciary net position was determined on the same basis used by the pension plan.

Methods Used to Value TSERS Investment: Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The pension trust funds are the primary participants in the Long-term Investment portfolio and the sole participants in the External Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Credit Investment, and Inflation Protection Investment portfolios. The Fixed Income Asset Class includes the Long-Term Investment and External Fixed Income Investment Portfolios. The Global Equity Asset Class includes the Equity Investment Portfolio. The investment balance of each pension trust fund represents its share of the fair market value of the net position of the various portfolios within the pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2016 *Comprehensive Annual Financial Report*.

Net Pension Liability: At June 30, 2017, the University reported a liability of \$7,622,124.00 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015, and update procedures were used to roll forward the total pension liability to June 30, 2016. The University's proportion of the net pension liability was based on the present value of future salaries for the University relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2016, the University's proportion was 0.08293%, which was an increase of 0.00285 from its proportion measured as of June 30, 2015.

Actuarial Assumptions: The following table presents the actuarial assumptions used to determine the total pension liability for the TSERS plan at the actuarial valuation date:

Valuation Date	12/31/2015
Inflation	3%
Salary Increases*	3.50% - 8.10%
Investment Rate of Return**	7.25%

* Salary increases include 3.5% inflation and productivity factor.

** Investment rate of return is net of pension plan investment expense, including inflation.

TSERS currently uses mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer), and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2015 valuations were based on the results of an actuarial experience study for the period January 1, 2010 through December 31, 2014.

Future ad hoc Cost of Living Adjustment (COLA) amounts are not considered to be substantively automatic and are therefore not included in the measurement.

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the U.S. Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016 (the valuation date) are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return
Fixed Income	1.4%
Global Equity	5.3%
Real Estate	4.3%
Alternatives	8.9%
Credit	6.0%
Inflation Protection	4.0%

The information in the preceding table is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess

return expectations over benchmark averages. All rates of return and inflation are annualized.

Discount Rate: The discount rate used to measure the total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate: The following presents the net pension liability of the plan at June 30, 2016 calculated using the discount rate of 7.25%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.25%) or 1-percentage point higher (8.25%) than the current rate:

Net Pension Liability		
1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
\$ 14,335,741.72	\$ 7,622,124.00	\$ 1,976,891.15

Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: For the year ended June 30, 2017, the University recognized pension expense of \$1,569,266.00. At June 30, 2017, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Employer Balances of Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions by Classification:		
	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Actual and Expected Experience	\$ 0.00	\$ 360,232.00
Changes of Assumptions	1,124,078.00	
Net Difference Between Projected and Actual Earnings on Pension Plan Investments	2,718,294.00	
Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions	314,827.72	
Contributions Subsequent to the Measurement Date	1,415,682.28	
Total	\$ 5,572,882.00	\$ 360,232.00

The amount of \$1,415,682.28 reported as deferred outflows of resources related to pensions will be included as a reduction of the net pension liability in the fiscal year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Schedule of the Net Amount of the Employer's Balances of
Deferred Outflows of Resources and Deferred Inflows of
Resources That will be Recognized in Pension Expense:

<u>Year Ended June 30:</u>	<u>Amount</u>
2018	\$ 688,334.00
2019	695,040.00
2020	1,553,000.00
2021	<u>860,593.72</u>
Total	<u>\$ 3,796,967.72</u>

- B. Defined Contribution Plan** - The Optional Retirement Program (ORP) is a defined contribution pension plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and staff of the University may join the ORP instead of the TSERS. The Board of Governors of the University of North Carolina is responsible for the administration of the ORP and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the ORP and approves the form and contents of the contracts and trust agreements.

Participants in the ORP are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the ORP. 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, 2017, 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 \$31,380,652.72, of which \$12,691,442.52 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$868,094.67 and \$761,486.55, respectively. The amount of expense recognized in the current year related to ORP is equal to the employer contributions.

NOTE 13 - 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 (TSERS) or the Optional Retirement Program (ORP). 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 TSERS 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 period July 1, 2016 through December 31, 2016, the University contributed 5.60% of the covered payroll under TSERS and ORP to the Fund, and for the period January 1, 2017 through June 30, 2017, the University contributed 6.02% of the covered payroll under TSERS and ORP to the Fund. Required contribution rates for the years ended June 30, 2016, and 2015, were 5.60% and 5.49%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2017, 2016, and 2015, which were \$1,561,532.54, \$1,319,593.13, and \$1,227,235.27, 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 on the North Carolina Office of the State Controller's website at <http://www.osc.nc.gov/> 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 TSERS and ORP. 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, 2017, the University made a statutory contribution of .38% of covered payroll under TSERS and ORP to the DIPNC. Required contribution rates for the years ended June 30, 2016, and 2015, were .41% in both years. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2017, 2016, and 2015, which were \$102,131.22, \$96,613.07, and \$91,651.45, 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 14 - RISK MANAGEMENT

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

A. Employee Benefit Plans

1. State Health Plan

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 is funded by employer and employee contributions. The Plan has contracted with third parties to process claims.

2. Death Benefit Plan of North Carolina

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.

B. Other Risk Management and Insurance Activities**1. Automobile, Fire, and Other Property Losses**

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.

2. Public Officers' and Employees' Liability Insurance

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.

3. Employee Dishonesty and Computer Fraud

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 \$100,000 deductible.

4. Statewide Workers' Compensation Program

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

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.

5. Other Insurance Held by the University

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.

NOTE 15 - 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 \$1,398,306.40 and on other purchases were \$382,458.64 at June 30, 2017.
- 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.

NOTE 16 - BLENDED COMPONENT UNITS

Condensed combining information for the University's blended component units for the year ended June 30, 2017, is presented as follows:

*Condensed Statement of Net Position
June 30, 2017*

	University	Housing Corporation	Program Support Corporation	Total
ASSETS				
Current Assets	\$ 33,629,571.71	\$ 1,174,828.00	\$ 117,277.00	\$ 34,921,676.71
Capital Assets, Net	116,773,793.14	4,363,124.00	1,082,625.00	122,219,542.14
Other Noncurrent Assets	21,999,995.20			21,999,995.20
Total Assets	172,403,360.05	5,537,952.00	1,199,902.00	179,141,214.05
TOTAL DEFERRED OUTFLOWS OF RESOURCES	5,572,882.00			5,572,882.00
LIABILITIES				
Current Liabilities	4,699,755.04	329,865.00	2,022.00	5,031,642.04
Long-Term Liabilities	11,118,989.07	4,498,000.00		15,616,989.07
Other Noncurrent Liabilities	568,282.03	8,650.00		576,932.03
Total Liabilities	16,387,026.14	4,836,515.00	2,022.00	21,225,563.14
TOTAL DEFERRED INFLOWS OF RESOURCES	1,360,232.00			1,360,232.00
NET POSITION				
Net Investment in Capital Assets	114,844,149.47	(442,876.00)	1,082,625.00	115,483,898.47
Restricted - Nonexpendable	15,007,702.93			15,007,702.93
Restricted - Expendable	14,911,626.55			14,911,626.55
Unrestricted	15,465,504.96	1,144,313.00	115,255.00	16,725,072.96
Total Net Position	\$ 160,228,983.91	\$ 701,437.00	\$ 1,197,880.00	\$ 162,128,300.91

*Condensed Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2017*

	University	Housing Corporation	Program Support Corporation	Eliminations	Total
OPERATING REVENUES					
Operating Revenues	\$ 15,909,972.85	\$ 0.00	\$ 40,890.00	\$ (111,929.00)	\$ 15,838,933.85
Sales and Services, Net	7,187,257.02	1,116,691.00			8,303,948.02
Total Operating Revenues	23,097,229.87	1,116,691.00	40,890.00	(111,929.00)	24,142,881.87
OPERATING EXPENSES					
Operating Expenses	58,563,463.19	496,391.00	23,184.00	(111,929.00)	58,971,109.19
Depreciation	4,019,940.71	110,253.00			4,130,193.71
Total Operating Expenses	62,583,403.90	606,644.00	23,184.00	(111,929.00)	63,101,302.90
Operating Income (Loss)	(39,486,174.03)	510,047.00	17,706.00		(38,958,421.03)
NONOPERATING REVENUES (EXPENSES)					
Investment Income, Net	2,457,206.55	13,597.00			2,470,803.55
Interest and Fees on Capital Asset Related Debt	(32,351.52)	(154,894.00)			(187,245.52)
Other Nonoperating Revenues	35,869,143.45				35,869,143.45
Net Nonoperating Revenues (Expenses)	38,293,998.48	(141,297.00)			38,152,701.48
Capital Appropriations	96,777.00				96,777.00
Capital Grants and Gifts	6,286,597.78				6,286,597.78
Increase in Net Position	5,191,199.23	368,750.00	17,706.00		5,577,655.23
NET POSITION					
Net Position, July 1, 2016	155,037,784.68	332,687.00	1,180,174.00		156,550,645.68
Net Position, June 30, 2017	\$ 160,228,983.91	\$ 701,437.00	\$ 1,197,880.00	\$ 0.00	\$ 162,128,300.91

Condensed Statement of Cash Flows
June 30, 2017

	University	Housing Corporation	Program Support Corporation	Total
Net Cash Provided (Used) by Operating Activities	\$ (36,189,989.32)	\$ 611,027.00	\$ 14,534.00	\$ (35,564,428.32)
Net Cash Provided by Noncapital Financing Activities	36,115,809.27			36,115,809.27
Net Cash Used by Capital and Related Financing Activities	(973,420.55)	(464,769.00)		(1,438,189.55)
Net Cash Provided by Investing Activities	1,316,620.74	13,597.00		1,330,217.74
Net Increase in Cash and Cash Equivalents	269,020.14	159,855.00	14,534.00	443,409.14
Cash and Cash Equivalents, July 1, 2016	26,968,895.67	999,697.00	99,588.00	28,068,180.67
Cash and Cash Equivalents, June 30, 2017	\$ 27,237,915.81	\$ 1,159,552.00	\$ 114,122.00	\$ 28,511,589.81

NOTE 17 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2017, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*

GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*

GASB Statement No. 80, *Blending Requirements for Certain Component Units - An Amendment of GASB Statement No. 14*

GASB Statement No. 82, *Pension Issues - An amendment of GASB Statement No. 67, No. 68, and No. 73*

GASB Statement No. 73 establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans*, and Statement 68 for pension plans and pensions that are within their respective scopes.

GASB Statement No. 74 establishes new accounting and financial reporting requirements for defined benefit other postemployment benefits (OPEB) plans that replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined*

Contribution Plans, as amended, Statement 43, and Statement No. 50, *Pension Disclosures*. This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined benefit OPEB through OPEB plans that are *not* administered through trusts that meet the specified criteria.

GASB Statement No. 78 amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that (1) is not a state or local governmental pension plan, (2) is used to provide defined benefit pensions both to employees of state or local governmental employers and to employees of employers that are not state or local governmental employers, and (3) has no predominant state or local governmental employer (either individually or collectively with other state or local governmental employers that provide pensions through the pension plan). This Statement establishes requirements for recognition and measurement of pension expense, expenditures, and liabilities; note disclosures; and required supplementary information for pensions that have the characteristics described above.

GASB Statement No. 80 clarifies the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity*, as amended. This Statement amends the blending requirements for the financial statement presentation of component units of all state and local governments. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

GASB Statement No. 82 addresses certain issues with respect to Statements No. 67, *Financial Reporting for Pension Plans*, No. 68, *Accounting and Financial Reporting for Pensions*, and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.



REQUIRED SUPPLEMENTARY INFORMATION

University of North Carolina School of the Arts
Required Supplementary Information
Schedule of the Proportionate Net Pension Liability
Teachers' and State Employees' Retirement System
Last Four Fiscal Years

Exhibit C-1

	2016	2015	2014	2013
Proportionate Share Percentage of Collective Net Pension Liability	0.08293%	0.08008%	0.08128%	0.08190%
Proportionate Share of TSERS Collective Net Pension Liability	\$ 7,622,124.00	\$ 2,951,107.00	\$ 952,944.00	\$ 4,972,165.00
Covered Payroll	\$ 12,263,260.70	\$ 12,074,597.76	\$ 12,111,613.34	\$ 12,300,093.04
Net Pension Liability as a Percentage of Covered Payroll	62.15%	24.44%	7.87%	40.42%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	87.32%	94.64%	98.24%	90.60%

**University of North Carolina School of the Arts
Required Supplementary Information
Schedule of University Contributions
Teachers' and State Employees' Retirement System
Last Ten Fiscal Years**

Exhibit C-2

	2017	2016	2015	2014	2013
Contractually Required Contribution	\$ 1,415,682.28	\$ 1,122,088.35	\$ 1,104,825.70	\$ 1,052,499.20	\$ 1,024,597.75
Contributions in Relation to the Contractually Determined Contribution	<u>1,415,682.28</u>	<u>1,122,088.35</u>	<u>1,104,825.70</u>	<u>1,052,499.20</u>	<u>1,024,597.75</u>
Contribution Deficiency (Excess)	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Covered Payroll	\$ 14,185,193.23	\$ 12,263,260.70	\$ 12,074,597.76	\$ 12,111,613.34	\$ 12,300,093.04
Contributions as a Percentage of Covered Payroll	9.98%	9.15%	9.15%	8.69%	8.33%

	2012	2011	2010	2009	2008
Contractually Required Contribution	\$ 881,137.64	\$ 607,338.98	\$ 419,387.66	\$ 415,060.57	\$ 344,977.74
Contributions in Relation to the Contractually Determined Contribution	<u>881,137.64</u>	<u>607,338.98</u>	<u>419,387.66</u>	<u>415,060.57</u>	<u>344,977.74</u>
Contribution Deficiency (Excess)	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>
Covered Payroll	\$ 11,843,247.87	\$ 12,319,249.00	\$ 11,747,553.49	\$ 12,352,993.12	\$ 11,310,745.72
Contributions as a Percentage of Covered Payroll	7.44%	4.93%	3.57%	3.36%	3.05%

Note: Changes in benefit terms, methods, and assumptions are presented in the Notes to Required Supplementary Information (RSI) schedule following the pension RSI tables.

**University of North Carolina School of the Arts
Notes to Required Supplementary Information
Schedule of University Contributions
Teachers' and State Employees' Retirement System
Last Ten Fiscal Years**

Changes of Benefit Terms:

				<u>Cost of Living Increase</u>					
<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
N/A	N/A	1.00%	N/A	N/A	N/A	2.20%	2.20%	3.00%	2.00%

Changes of assumptions. In 2008, 2012, and 2015, the actuarial assumptions were updated to more closely reflect actual experience. In 2015, the North Carolina Retirement Systems' consulting actuaries performed the quinquennial investigation of each retirement systems' actual demographic and economic experience (known as the "Experience Review"). The Experience Review provides the basis for selecting the actuarial assumptions and methods used to determine plan liabilities and funding requirements. The most recent Experience Review examined each plan's experience during the period between January 1, 2010, and December 31, 2014. Based on the findings, the Board of Trustees of the Teachers' and State Employees' Retirement System adopted a number of new actuarial assumptions and methods. The most notable changes to the assumptions include updates to the mortality tables and the mortality improvement projection scales to reflect reduced rates of mortality and significant increases in mortality improvements. These assumptions were adjusted to reflect the mortality projection scale MP-2015, released by the Society of Actuaries in 2015. In addition, the assumed rates of retirement, salary increases, and rates of termination from active employment were reduced to more closely reflect actual experience.

The Notes to Required Supplementary Information reflect the most recent available information included in the State of North Carolina's 2016 *Comprehensive Annual Financial Report*.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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Raleigh, NC 27699-0600
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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 AUDIT STANDARDS**

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 (University), a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated October 31, 2017. 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, the University of North Carolina School of the Arts Program Support 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, the University of North Carolina School of the Arts Program Support 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 opinions 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, 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

October 31, 2017

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For additional information contact:
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919-807-7513



This audit required 618.5 hours at an approximate cost of \$63,706.