

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



NORTH CAROLINA SCHOOL OF SCIENCE AND MATHEMATICS

DURHAM, 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
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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, North Carolina School of Science and Mathematics

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



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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 and any organization that receives public funding. 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
North Carolina School of Science and Mathematics
Durham, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the North Carolina School of Science and Mathematics (School), 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 School's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the North Carolina School of Science and Mathematics Foundation and Subsidiary (Foundation), the School's discretely presented component unit. Those statements were audited by other auditors, whose report has been furnished to us, and our opinions, insofar as they relate to the amounts included for the Foundation, are based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the Foundation 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 School's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the School's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the North Carolina School of Science and Mathematics, 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 March 14, 2018 on our consideration of the School's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School's internal control over financial reporting and compliance.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 14, 2018



MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The North Carolina School of Science and Mathematics (School) provides this overview and Management's Discussion and Analysis to assist in understanding the financial statements and notes to the financial statements presented herewith for the year ended June 30, 2017. This discussion describes important trends and events that have impacted the fiscal health of the School and that may continue to exert influence in future years. This discussion has been prepared by and is the responsibility of the School's management along with the financial statements and the notes to the financial statements thereto. The report should be read and considered in its entirety.

Using the Annual Report

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

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

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

The Notes to the Financial Statements should be read in conjunction with the financial statements. The Notes to the Financial Statements provide information regarding the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on deposits and investments, fair value measurements, receivables, capital assets, accounts payable, long-term liabilities, lease obligations, revenues, expenses, required information on pension plans and other post-employment benefits, insurance against losses, commitments, the School's blended component unit, and changes in financial accounting and reporting. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Reporting Entity

The financial statements report information about the School as a whole using accounting methods similar to those used in the private sector. The financial reporting entity for the financial statements is comprised of the School and two component units. The North

Carolina School of Science and Mathematics Student and Constituent Support Services, Inc. (SCSSI), a blended component unit, is a legally separate, nonprofit corporation and is reported as if it were part of the School. The North Carolina School of Science and Mathematics Foundation and Subsidiary (Foundation) is a legally separate, nonprofit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the School.

Financial Highlights

The School's financial position, as a whole, remained relatively stable during the fiscal year ended June 30, 2017. The School's net position decreased by only \$6,352.29 due to a combination of factors discussed further below.

Statement of Net Position

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

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

Condensed Statement of Net Position

	2017	2016	Increase/ (Decrease)	Percent Change
Assets:				
Current Assets	\$ 1,803,596.25	\$ 726,184.44	\$ 1,077,411.81	148.37%
Noncurrent Assets:				
Capital Assets, Net	41,940,546.52	38,435,197.85	3,505,348.67	9.12%
Other	1,997,617.02	5,702,724.32	(3,705,107.30)	-64.97%
Total Assets	45,741,759.79	44,864,106.61	877,653.18	1.96%
Deferred Outflows of Resources:				
Deferred Outflows for Pensions	4,438,263.32	1,193,636.00	3,244,627.32	271.83%
Liabilities:				
Current Portion of Long-Term Liabilities	281,658.36	247,532.77	34,125.59	13.79%
Other Current Liabilities	1,680,604.62	942,067.35	738,537.27	78.40%
Long-Term Liabilities	8,561,628.17	4,931,292.53	3,630,335.64	73.62%
Other Noncurrent Liabilities	55,162.62	73,392.33	(18,229.71)	-24.84%
Total Liabilities	10,579,053.77	6,194,284.98	4,384,768.79	70.79%
Deferred Inflows of Resources:				
Deferred Inflows for Pensions	296,031.00	552,167.00	(256,136.00)	-46.39%
Net Position:				
Net Investment in Capital Assets	40,711,885.07	37,717,608.72	2,994,276.35	7.94%
Restricted:				
Expendable	1,997,847.67	5,591,588.13	(3,593,740.46)	-64.27%
Unrestricted	(3,404,794.40)	(3,997,906.22)	593,111.82	14.84%
Total Net Position	\$ 39,304,938.34	\$ 39,311,290.63	\$ (6,352.29)	-0.02%

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

The condensed Statement of Net Position shows the School's total net position at June 30, 2017 was \$39,304,938.34, representing a small decrease of \$6,352.29.

The School's assets totaled \$45,741,759.79 at June 30, 2017, and increased \$877,653.18, or 1.96%. This change was primarily due to an increase in current assets of \$1,077,411.81, or 148.37%. This change was largely caused by increases in the cash carry forward balance of \$463,146.03 and increases in receivables from the School's Foundation of \$198,467.72. The decrease in other noncurrent assets of \$3,705,107.30, or 64.97%, was due to decreases in noncurrent restricted cash and cash equivalents of \$3,668,912.34 for capital purchases and repairs/renovations that were made in the current year and also is the main cause of the increase in capital assets (net) of \$3,505,348.67, or 9.12%. See the Capital Assets section below for more details.

The School's liabilities totaled \$10,579,053.77 at June 30, 2017, and increased \$4,384,768.79, or 70.79%, primarily due to an increase in long-term liabilities of \$3,630,335.64. This change is mainly due to the net effect of the additions to the net pension liability of \$3,776,917.00 and the \$98,937.41 reduction in the noncurrent portion of notes payable. Other current liabilities increased \$738,537.27, or 78.40%, primarily due to increases in capital payables of \$594,824.15, the majority of which were for the Western Campus design fees.

The School's net pension liability, deferred outflows, and deferred inflows are caused by allocations of the State's retirement system's cost-sharing pension plan balances to participating entities as required by GASB. Deferred inflows decreased \$256,136.00, or 46.39%, and deferred outflows increased \$3,244,627.32, or 271.83%, due to differences between projected and actual investment earnings as well as the averaging of investment

earnings over multiple annual periods as required by GASB. For more detailed information regarding pension plans, see Note 11 of the Notes to the Financial Statements.

Statement of Revenues, Expenses, and Changes in Net Position

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

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

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

	2017	2016	Increase/ (Decrease)	Percent Change
Operating Revenues:				
Student Tuition and Fees	\$ 467,355.88	\$ 129,683.21	\$ 337,672.67	260.38%
Sales and Services, Net	113,674.66	112,008.89	1,665.77	1.49%
Other Operating Revenues	270,625.37	228,318.61	42,306.76	18.53%
Total Operating Revenues	851,655.91	470,010.71	381,645.20	81.20%
Operating Expenses:				
Salaries and Benefits	18,609,103.88	17,064,600.96	1,544,502.92	9.05%
Supplies and Materials	1,386,190.80	1,226,152.96	160,037.84	13.05%
Services	2,566,239.34	2,347,092.95	219,146.39	9.34%
Utilities	997,851.98	1,006,484.97	(8,632.99)	-0.86%
Depreciation	1,259,963.88	1,238,514.95	21,448.93	1.73%
Total Operating Expenses	24,819,349.88	22,882,846.79	1,936,503.09	8.46%
Operating Loss	(23,967,693.97)	(22,412,836.08)	(1,554,857.89)	-6.94%
Nonoperating Revenues (Expenses):				
State Appropriations	21,699,939.58	20,271,766.27	1,428,173.31	7.05%
Noncapital Grants	324,345.39	156,429.99	167,915.40	107.34%
Noncapital Gifts	826,469.92	914,239.57	(87,769.65)	-9.60%
Interest and Fees on Debt	(13,853.45)	(8,304.81)	(5,548.64)	66.81%
Other Nonoperating Revenues	15,800.55	7,009.69	8,790.86	125.41%
Net Nonoperating Revenues	22,852,701.99	21,341,140.71	1,511,561.28	7.08%
Loss Before Other Revenues and Losses	(1,114,991.98)	(1,071,695.37)	(43,296.61)	-4.04%
Capital Appropriations	1,108,639.69	5,410,300.00	(4,301,660.31)	-79.51%
Capital Asset Impairment Loss		(4,246,174.70)	4,246,174.70	100.00%
Increase (Decrease) in Net Position	(6,352.29)	92,429.93	(98,782.22)	-106.87%
Net Position:				
Beginning of Year	39,311,290.63	39,218,860.70	92,429.93	0.24%
End of Year	\$ 39,304,938.34	\$ 39,311,290.63	\$ (6,352.29)	-0.02%
Total Revenues	\$ 24,826,851.04	\$ 27,229,756.23	\$ (2,402,905.19)	-8.82%
Total Expenses and Losses	\$ 24,833,203.33	\$ 27,137,326.30	\$ (2,304,122.97)	-8.49%

The condensed Statement of Revenues, Expenses, and Changes in Net Position shows the total operating loss for fiscal year 2017 was \$23,967,693.97, a decrease of \$1,554,857.89, or 6.94%, over the previous year.

Operating revenues were \$851,655.91, or 3.43%, of the School's total revenues. Operating revenues include student tuition and fees (from the summer camp programs), net sales and services, and other operating revenues. Student tuition and fees increased \$337,672.67, or 260.38%, due to the increase in summer camps offered and expanding to an additional campus. Other operating revenues increased \$42,306.76, or 18.53%, mainly due to an increase in receivables of \$59,596.23 from Burke County for distance education services provided.

Operating expenses increased \$1,936,503.09, or 8.46%, remaining relatively consistent with the prior year. The major increases in operating expenses included increases in salaries and benefits of \$1,544,502.92, or 9.05%, and supplies and materials of \$160,037.84, or 13.05%. Salaries and benefits changes were due primarily to the increase in the actuarially determined pension expense of \$981,517.00 and legislative salary increases. Supplies and materials expense changes resulted from an increase in spending in operations and maintenance of plant.

Net nonoperating revenues increased \$1,511,561.28, or 7.08%, over the prior year. The increase is due primarily to an increase in state appropriations of \$1,428,173.31, or 7.05%, and an increase in noncapital grants of \$167,915.40, or 107.34%, over the previous year. State appropriations increased primarily to cover the legislative increases for salaries and noncapital grants primarily increased due to the Eastern North Carolina Science, Technology, Engineering, and Math (ENC STEM) grant.

Capital appropriations decreased by \$4,301,660.31, or 79.51%. In the prior year \$1.4 million was appropriated for repair and renovation and \$4.0 million for capital projects, whereas the School only received \$674,770.00 in repair and renovation funds in the current year.

One of the School's weaknesses is the lack of diverse streams of revenues. Approximately 91.87% of the School's total revenues come from state appropriations and capital appropriations, 4.70% from other nonoperating revenues, and 3.43% from operating revenues. The School will continue to seek funding aggressively from all possible sources consistent with its mission and prudently manage the financial resources realized from these efforts to fund its operating activities.

Capital Assets

As shown in the following chart, net capital assets increased by \$3,505,348.67 during the current year due to various increases discussed below.

	2017	2016	Increase/ (Decrease)
Land	\$ 1,337,173.66	\$ 1,337,173.66	\$ 0.00
Construction in Progress	2,452,884.58		2,452,884.58
Art	10,092.76	10,092.76	
Buildings	53,605,755.96	52,811,261.03	794,494.93
Machinery and Equipment	2,936,841.51	2,021,754.86	915,086.65
General Infrastructure	2,450,236.01	1,940,055.66	510,180.35
Total Capital Assets	62,792,984.48	58,120,337.97	4,672,646.51
Less: Accumulated Depreciation	(20,852,437.96)	(19,685,140.12)	(1,167,297.84)
Net Capital Assets	<u>\$ 41,940,546.52</u>	<u>\$ 38,435,197.85</u>	<u>\$ 3,505,348.67</u>

Construction in progress increased mainly due to increases of \$1,967,724.58 for the cabling project that is scheduled to be completed in fiscal year 2018, as well as design costs of \$456,740.00 for the School's future Western Campus. General infrastructure (net) increased by \$429,782.67 due to the School capitalizing the paving project totaling \$510,180.35. Machinery and equipment (net) increased \$893,151.20 due to the purchase of a new security camera system, three pianos, a vehicle, and studio equipment upgrades.

For more detailed information about capital asset holdings, see Note 5 of the Notes to the Financial Statements.

Long-Term Liability Activity

As shown in the following chart, long-term liabilities increased \$3,664,461.23 during the current year primarily due to the \$3,776,917.00 increase in the net pension liability. The net pension liability is determined on an annual basis by an actuarial study commissioned by the State of North Carolina. Other reductions of \$100,853.77 were due to scheduled payments being made for the capital lease and note payable. Compensated absences were consistent with the prior year.

	2017	2016	Increase/ (Decrease)
Net Pension Liability	\$ 6,263,689.00	\$ 2,486,772.00	\$ 3,776,917.00
Notes Payable	627,214.58	722,730.41	(95,515.83)
Capital Leases Payable	5,659.95	10,997.89	(5,337.94)
Compensated Absences	1,946,723.00	1,958,325.00	(11,602.00)
Total Long-Term Liabilities	<u>\$ 8,843,286.53</u>	<u>\$ 5,178,825.30</u>	<u>\$ 3,664,461.23</u>

For detailed information about long-term liabilities, see Note 7 of the Notes to the Financial Statements.

Factors Impacting Future Periods

The School is the nation's first public residential high school focused on science, technology, engineering, and math. The School challenges and inspires talented students from across North Carolina through a residential campus, online programs, summer STEM enrichment programs, and distance offerings for schools and educators.

Discussions about expanding the School's programs to meet growing demand have been ongoing for more than a decade. The School's residential program reached capacity in 2011 due to physical space constraints on the Durham campus. The School has attempted to meet demand by growing enrollment in online programs.

In 2013, the North Carolina General Assembly (NCGA) commissioned a study on the feasibility of expanding the School by establishing a new campus in the western region of the State, specifically in facilities on state-owned land in Morganton, NC. The feasibility study concluded that approximately 300 residential students could be accommodated for an initial capital investment of \$60 million.

In order to address the expansion needs of the School, the NCGA included \$58 million in funding for a Western Campus of the School to be located in Morganton, NC (the NC School for Engineering and Technology) in the Connect NC bond proposal. North Carolina voters approved the bond referendum in March 2016. The concept of expanding the School's

services to more NC students has also been considered and endorsed in the School's strategic planning process involving trustees, faculty, students, alumni, and others.

The budget of \$58 million incorporates advanced planning, design, construction, testing surveys, and fees. As of January 25, 2018 the School was deeded 62.74 acres along with 10 buildings in Morganton, NC from the Department of Public Instruction to be used as the site for constructing the new campus. The projected opening of the Western Campus is Fall 2021.

Management believes that the School is well positioned to continue its level of excellence in service to students, the community, and governmental agencies. The School's ongoing efforts toward maximizing the State's resources with efficiency and effectiveness measures, along with UNC Tomorrow initiatives and the expansion plans for a Western Campus to address the needs of the State will enable it to provide the necessary resources to support this level of excellence.



FINANCIAL STATEMENTS

North Carolina School of Science and Mathematics
Statement of Net Position
June 30, 2017

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 951,864.18
Restricted Cash and Cash Equivalents	393,225.20
Receivables (Note 4)	109,753.99
Due from School Component Unit	312,035.54
Inventories	36,542.34
Prepaid Expenses	175.00
	<hr/>
Total Current Assets	1,803,596.25

Noncurrent Assets:

Restricted Cash and Cash Equivalents	1,996,037.19
Restricted Investments	1,579.83
Capital Assets - Nondepreciable (Note 5)	3,800,151.00
Capital Assets - Depreciable, Net (Note 5)	38,140,395.52
	<hr/>
Total Noncurrent Assets	43,938,163.54
	<hr/>
Total Assets	45,741,759.79

DEFERRED OUTFLOWS OF RESOURCES

Deferred Outflows Related to Pensions	<hr/> 4,438,263.32
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	1,039,631.50
Funds Held for Others	235,123.03
Unearned Revenue	404,887.32
Interest Payable	962.77
Long-Term Liabilities - Current Portion (Note 7)	281,658.36
	<hr/>
Total Current Liabilities	1,962,262.98

Noncurrent Liabilities:

Funds Held for Others	55,162.62
Long-Term Liabilities (Note 7)	8,561,628.17
	<hr/>
Total Noncurrent Liabilities	8,616,790.79
	<hr/>
Total Liabilities	10,579,053.77

DEFERRED INFLOWS OF RESOURCES

Deferred Inflows Related to Pensions	<hr/> 296,031.00
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North Carolina School of Science and Mathematics
Statement of Net Position
June 30, 2017

Exhibit A-1
Page 2 of 2

NET POSITION

Net Investment in Capital Assets	40,711,885.07
Restricted for:	
Expendable:	
Capital Projects	1,997,617.02
Debt Service	230.65
Unrestricted	<u>(3,404,794.40)</u>
Total Net Position	<u><u>\$ 39,304,938.34</u></u>

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

North Carolina School of Science and Mathematics
Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2017

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees	\$ 467,355.88
Sales and Services, Net (Note 9)	113,674.66
Other Operating Revenues	<u>270,625.37</u>

Total Operating Revenues	<u>851,655.91</u>
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EXPENSES

Operating Expenses:

Salaries and Benefits	18,609,103.88
Supplies and Materials	1,386,190.80
Services	2,566,239.34
Utilities	997,851.98
Depreciation	<u>1,259,963.88</u>

Total Operating Expenses	<u>24,819,349.88</u>
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Operating Loss	<u>(23,967,693.97)</u>
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NONOPERATING REVENUES (EXPENSES)

State Appropriations	21,699,939.58
Noncapital Grants	324,345.39
Noncapital Gifts	826,469.92
Interest and Fees on Debt	(13,853.45)
Other Nonoperating Revenues	<u>15,800.55</u>

Net Nonoperating Revenues	<u>22,852,701.99</u>
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Loss Before Other Revenues	(1,114,991.98)
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Capital Appropriations	<u>1,108,639.69</u>
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Decrease in Net Position	(6,352.29)
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NET POSITION

Net Position - July 1, 2016	<u>39,311,290.63</u>
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Net Position - June 30, 2017	<u>\$ 39,304,938.34</u>
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The accompanying notes to the financial statements are an integral part of this statement.

North Carolina School of Science and Mathematics
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2017

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 686,310.09
Payments to Employees and Fringe Benefits	(18,396,150.61)
Payments to Vendors and Suppliers	(4,843,155.17)
Other Receipts	225,803.67
	<hr/>
Net Cash Used by Operating Activities	(22,327,192.02)
	<hr/>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	21,699,939.58
Noncapital Grants	230,823.12
Noncapital Gifts	628,002.20
Other Receipts	15,800.55
	<hr/>
Total Cash Provided by Noncapital Financing Activities	22,574,565.45
	<hr/>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Capital Appropriations	1,108,639.69
Acquisition and Construction of Capital Assets	(4,170,488.40)
Principal Paid on Capital Debt and Leases	(100,853.77)
Interest and Fees Paid on Capital Debt and Leases	(14,000.07)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(3,176,702.55)
	<hr/>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	36,194.96
	<hr/>
Cash Provided by Investing Activities	36,194.96
	<hr/>
Net Decrease in Cash and Cash Equivalents	(2,893,134.16)
Cash and Cash Equivalents - July 1, 2016	6,234,260.73
	<hr/>
Cash and Cash Equivalents - June 30, 2017	\$ 3,341,126.57
	<hr/>

North Carolina School of Science and Mathematics
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	\$ (23,967,693.97)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	1,259,963.88
Changes in Assets and Deferred Outflows of Resources:	
Receivables	(104,666.77)
Inventories	1,503.18
Prepaid Expenses	(2.32)
Deferred Outflows for Pensions	(3,244,627.32)
Changes in Liabilities and Deferred Inflows of Resources:	
Accounts Payable and Accrued Liabilities	54,025.36
Unearned Revenue	105,279.55
Funds Held for Others	59,847.39
Net Pension Liability	3,776,917.00
Compensated Absences	(11,602.00)
Deferred Inflows for Pensions	(256,136.00)
Net Cash Used by Operating Activities	<u>\$ (22,327,192.02)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 951,864.18
Restricted Cash and Cash Equivalents	393,225.20
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>1,996,037.19</u>
Total Cash and Cash Equivalents - June 30, 2017	<u>\$ 3,341,126.57</u>

NONCASH CAPITAL AND FINANCING ACTIVITIES

Increase in Receivables Related to Nonoperating Income	\$ 198,467.72
Assets Acquired through Assumption of a Liability	594,824.15

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

**North Carolina School of Science and Mathematics
Foundation and Subsidiary
Consolidated Statement of Financial Position
June 30, 2017**

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	1,968,861
Investments		10,963,517
Accounts Receivable		1,427
Pledges Receivable		49,274
Prepaid Assets		13,155
Antique Optical Collection		41,405
Land		60,540
		<hr/>
Total Assets	\$	<u>13,098,179</u>

LIABILITIES

Accounts Payable and Accrued Expenses	\$	<u>158,732</u>
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NET ASSETS

Unrestricted		4,680,324
Temporarily Restricted		2,991,593
Permanently Restricted		<u>5,267,530</u>
		<hr/>
Total Net Assets		<u>12,939,447</u>
		<hr/>
Total Liabilities and Net Assets	\$	<u>13,098,179</u>

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

**North Carolina School of Science and Mathematics
Foundation and Subsidiary
Consolidated Statement of Activities
For the Fiscal Year Ended June 30, 2017**

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
OPERATING REVENUES, GAINS, AND OTHER SUPPORT				
Grants and Contributions	\$ 1,192,853	\$ 351,191	\$ 303,334	\$ 1,847,378
Investment Return Designated for Current Operations	168,161	271,702		439,863
Other Investment Income	18,119			18,119
Net Assets Released from Donor Restrictions	433,527	(433,527)		
Total Operating Revenues, Gains, and Other Support	1,812,660	189,366	303,334	2,305,360
OPERATING EXPENSES				
Programs	930,761			930,761
Fund Raising:				
Institutional Advancement	437,641			437,641
General and Administrative:				
Chancellor's Fund	71,059			71,059
Foundation Office	284,795			284,795
Staff Development	1,363			1,363
Bad Debt Expense	7,023			7,023
Total Operating Expenses	1,732,642			1,732,642
Change in Net Assets from Operations	80,018	189,366	303,334	572,718
Investment Gain in Excess of Amounts Designated for Current Operations	394,823	329,530		724,353
CHANGE IN NET ASSETS	474,841	518,896	303,334	1,297,071
Net Assets at Beginning of Year	4,205,483	2,472,697	4,964,196	11,642,376
Net Assets at End of Year	<u>\$ 4,680,324</u>	<u>\$ 2,991,593</u>	<u>\$ 5,267,530</u>	<u>\$ 12,939,447</u>

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

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

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

The SCSSI is governed by a seven-member board consisting of two ex-officio directors. All directors are employees of the School. The SCSSI's purpose is to receive, administer, and advance funds for the support of student services and program operations of the School. Because the members of the Board of Directors of the SCSSI are employees of the School and the SCSSI's sole purpose is to benefit the School, its financial statements have been blended with those of the School.

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

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

Discretely Presented Component Unit - The North Carolina School of Science and Mathematics Foundation and Subsidiary (Foundation) is a legally separate, tax-exempt nonprofit corporation and is reported as a discretely presented component unit based on the nature and

significance of its relationship to the School. SSM Holdings, LLC is the wholly owned subsidiary of the Foundation.

The Foundation acts primarily as a fundraising organization to supplement the resources that are available to the School in support of its programs. The Foundation operates exclusively for charitable and education purposes including, but not limited to, receiving, administering, and obtaining funds for the support of the academic and educational programs of the School. The Foundation board consists of 26 members. Although the School does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the School by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the School, the Foundation is considered a component unit of the School and is reported in separate financial statements because of the difference in its reporting model, as described below.

The Foundation is a private nonprofit organization that reports its financial results under the Financial Accounting Standards Board (FASB) Codification. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the School's financial reporting entity for these differences.

During the year ended June 30, 2017, the Foundation provided \$826,469.92 in support directly to the School and an additional \$905,933.70 on behalf of the School. Payments for program support included both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from Katie Wagstaff, President, North Carolina School of Science and Mathematics Foundation and Subsidiary, Post Office Box 2418, Durham, NC 27715-2418, or by calling (919) 416-2866.

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

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

- C. Basis of Accounting** - The financial statements of the School have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are

recognized when earned, and expenses are recorded when an obligation has been incurred, regardless of the timing of the cash flows.

Nonexchange transactions, in which the School receives (or gives) value without directly giving (or receiving) equal value in exchange, include state appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

- D. Cash and Cash Equivalents** - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, and deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. 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.

Money market mutual funds are reported at amortized cost, if purchased, or at fair value or appraised value at date of gift, if donated.

- F. Receivables** - Receivables consist of amounts due from Burke County related to distance education services provided and charges for auxiliary enterprises' sales and services. Receivables are considered fully collectible and therefore, no allowance for doubtful accounts is recorded.
- G. Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are valued at cost using the last invoice cost 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.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets in the following manner:

<u>Asset Class</u>	<u>Estimated Useful Life</u>
Buildings	10-75 years
Machinery & Equipment	2-25 years
General Infrastructure	10-75 years

The art collection is capitalized at cost or acquisition 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 whose use is limited by external parties or statute, and resources legally segregated for the payment of principal and interest as required by debt covenants.
- J. **Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include notes payable, net pension liability, and compensated absences that will not be paid within the next fiscal year.

The net pension liability represents the School'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 School's portion of the collective total pension liability less the fiduciary net position of the Teachers' and State Employees' Retirement System. See Note 11 for further information regarding the School's policies for recognizing liabilities, expenses, and deferred outflows of resources and deferred inflows of resources related to pensions.

- K. **Compensated Absences** - The School's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

- 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 School has the following item that qualifies for reporting in this category: deferred outflows related to pensions.

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 School has the following item that qualifies for reporting in this category: deferred inflows related to pensions.

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

Net Investment in Capital Assets - This represents the School's total investment in capital assets, 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 - Expendable - Expendable restricted net position includes resources for which the School is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

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

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

- N. Revenue and Expense Recognition** - The School classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Position. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the School's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as

student tuition and fees and sales and services. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

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

- O. Internal Sales Activities** - Certain institutional sales and service units provide goods and services to School departments, as well as to its customers. These institutional sales and service units include activities such as central stores, copy centers, and postal services. In addition, the School has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to School 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 School is required by *North Carolina General Statute 147-77* to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. However, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, may authorize the School to deposit its institutional trust funds in interest-bearing accounts and other investments authorized by the Board of Governors, without regard to any statute or rule of law relating to the investment of funds by fiduciaries. Although specifically exempted, the School may voluntarily deposit institutional trust funds and special funds with the State Treasurer. Special funds consist of moneys for athletics and agency funds held directly by the School.

Cash on hand at June 30, 2017 was \$600.00. The carrying amount of the School's deposits not with the State Treasurer was \$195,973.49, and the bank balance was \$201,974.30. Custodial credit risk is the risk that in the event of a bank failure, the School's deposits may not be returned to it. The School does not have a deposit policy for custodial credit risk. As of June 30, 2017, the School's bank balance was fully insured by federal depository insurance and was not exposed to custodial credit risk.

B. Investments

School - The School is authorized by the University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina to invest its special funds in the same manner as the State Treasurer is required to invest, as discussed below.

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; 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.

Short-Term Investment Fund - At June 30, 2017, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$3,144,553.08, which represents the School'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.

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 School may face should interest rate variances affect the fair value of investments. The School does not have a formal policy that addresses interest rate risk.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2017, for the School's investments.

Investment Type	Investment Maturities (in Years)	
	Amount	Less Than 1
Money Market Mutual Funds	\$ 1,579.83	\$ 1,579.83

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

At June 30, 2017, the School's investments had the following credit quality distribution for securities with credit exposure:

	AAA Aaa	
	Amount	
Money Market Mutual Funds	\$ 1,579.83	\$ 1,579.83

Rating Agency: Moody's

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

Investment Type	Amount
Deposits in the Short-Term Investment Fund	\$ 1,886,718
UNC Investment Fund	10,963,517
Total Investments	\$ 12,850,235

NOTE 3 - FAIR VALUE MEASUREMENTS

School - To the extent available, the School'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.

Short-Term Investment Fund - At year-end, \$3,144,553.08 of the School's investments were held in the STIF, which is a Level 2 investment. 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.

Foundation - The Foundation's investments are stated at fair value determined in accordance with Topic 820, Fair Value Measurement, of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC"). The Foundation has investments with the UNC Investment Fund and STIF. 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.

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

	Fair Value	Fair Value Measurements Using		
		Level 1	Level 2	Level 3
Investments by Fair Value Level				
Short-Term Investment Fund	\$ 1,886,718	\$ 0	\$ 1,886,718	\$ 0
UNC Investment Fund	10,963,517			10,963,517
Total Investments Measured at Fair Value	<u>\$ 12,850,235</u>	<u>\$ 0</u>	<u>\$ 1,886,718</u>	<u>\$ 10,963,517</u>

NOTE 4 - RECEIVABLES

Receivables at June 30, 2017, were as follows:

	Amount
Receivables:	
Due from Burke County	\$ 59,596.23
Accounts Receivable	<u>50,157.76</u>
Total Receivables	<u>\$ 109,753.99</u>

NOTE 5 - 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	\$ 1,337,173.66	\$ 0.00	\$ 0.00	\$ 1,337,173.66
Art	10,092.76			10,092.76
Construction in Progress		<u>3,757,559.86</u>	<u>1,304,675.28</u>	<u>2,452,884.58</u>
Total Capital Assets, Nondepreciable	<u>1,347,266.42</u>	<u>3,757,559.86</u>	<u>1,304,675.28</u>	<u>3,800,151.00</u>
Capital Assets, Depreciable:				
Buildings	52,811,261.03	794,494.93		53,605,755.96
Machinery and Equipment	2,021,754.86	1,007,752.69	92,666.04	2,936,841.51
General Infrastructure	<u>1,940,055.66</u>	<u>510,180.35</u>		<u>2,450,236.01</u>
Total Capital Assets, Depreciable	<u>56,773,071.55</u>	<u>2,312,427.97</u>	<u>92,666.04</u>	<u>58,992,833.48</u>
Less Accumulated Depreciation for:				
Buildings	17,499,054.63	1,064,964.71		18,564,019.34
Machinery and Equipment	1,341,766.31	114,601.49	92,666.04	1,363,701.76
General Infrastructure	<u>844,319.18</u>	<u>80,397.68</u>		<u>924,716.86</u>
Total Accumulated Depreciation	<u>19,685,140.12</u>	<u>1,259,963.88</u>	<u>92,666.04</u>	<u>20,852,437.96</u>
Total Capital Assets, Depreciable, Net	<u>37,087,931.43</u>	<u>1,052,464.09</u>		<u>38,140,395.52</u>
Capital Assets, Net	<u>\$ 38,435,197.85</u>	<u>\$ 4,810,023.95</u>	<u>\$ 1,304,675.28</u>	<u>\$ 41,940,546.52</u>

During the year ended June 30, 2017, the School incurred \$13,853.45 in interest costs related to the acquisition and construction of capital assets, all of which was charged in interest expense.

The School 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 value of the energy savings improvement assets associated with the Agreement is \$653,032.95 and is subject to security provisions in the Agreement to ensure timely debt service payments. Additional information regarding the UNC System Energy Savings Installment Financing Agreement can be found in Note 7.

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable and Accrued Liabilities:	
Accounts Payable	\$ 340,428.77
Accrued Payroll	104,378.58
Contracts Payable - Capital Assets	594,824.15
Total Accounts Payable and Accrued Liabilities	<u>\$ 1,039,631.50</u>

NOTE 7 - LONG-TERM LIABILITIES

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

	Balance July 1, 2016	Additions	Reductions	Balance June 30, 2017	Current Portion
Net Pension Liability	\$ 2,486,772.00	\$ 3,776,917.00	\$ 0.00	\$ 6,263,689.00	\$ 0.00
Notes Payable	722,730.41		95,515.83	627,214.58	98,937.41
Capital Leases Payable	10,997.89		5,337.94	5,659.95	5,659.95
Compensated Absences	1,958,325.00	1,140,122.00	1,151,724.00	1,946,723.00	177,061.00
Total Long-Term Liabilities	<u>\$ 5,178,825.30</u>	<u>\$ 4,917,039.00</u>	<u>\$ 1,252,577.77</u>	<u>\$ 8,843,286.53</u>	<u>\$ 281,658.36</u>

Additional information regarding capital lease obligations is included in Note 8.

Additional information regarding the net pension liability is included in Note 11.

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

	Annual Requirements	
	Notes Payable	
Fiscal Year	Principal	Interest
2018	\$ 98,937.41	\$ 10,876.40
2019	103,069.76	9,025.62
2020	107,324.48	7,097.87
2021	111,704.78	5,090.89
2022	116,213.90	3,002.35
2023	89,964.25	829.83
Total Requirements	<u>\$ 627,214.58</u>	<u>\$ 35,922.96</u>

C. Notes Payable - The School 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-ESCO Project	Banc of America Public Capital Corp	1.84%	02/14/2023	<u>\$ 746,248.00</u>	<u>\$ 119,033.42</u>	<u>\$ 627,214.58</u>

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to computer equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2017:

Fiscal Year	Amount
2018	\$ 6,001.38
Amount Representing Interest (6.03% Rate of Interest)	<u>341.43</u>
Present Value of Future Lease Payments	<u>\$ 5,659.95</u>

Machinery and equipment acquired under capital lease amounted to \$20,780.00 at June 30, 2017.

Depreciation for the capital assets associated with capital leases is included in depreciation expense, and accumulated depreciation for assets acquired under capital lease totaled \$11,630.18 at June 30, 2017.

B. Operating Lease Obligations - The School entered into operating leases for equipment and housing. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2017:

Fiscal Year	Amount
2018	\$ 68,681.69
2019	61,545.88
2020	55,335.44
2021	<u>56,450.00</u>
Total Minimum Lease Payments	<u>\$ 242,013.01</u>

Rental expense for all operating leases during the year was \$82,709.30.

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Net Revenues
Operating Revenues:			
Sales and Services, Net	<u>\$ 200,731.32</u>	<u>\$ 87,056.66</u>	<u>\$ 113,674.66</u>

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Utilities	Depreciation	Total
Instruction	\$ 9,814,943.10	\$ 555,890.39	\$ 387,516.75	\$ 0.00	\$ 0.00	\$ 10,758,350.24
Academic Support	251,031.73	26,562.01	37,528.01			315,121.75
Student Services	3,418,127.19	83,886.16	1,405,345.77			4,907,359.12
Institutional Support	3,979,219.87	135,804.53	480,776.76			4,595,801.16
Operations and Maintenance of Plant	1,145,781.99	584,047.71	255,072.05	997,851.98		2,982,753.73
Depreciation					1,259,963.88	1,259,963.88
Total Operating Expenses	<u>\$ 18,609,103.88</u>	<u>\$ 1,386,190.80</u>	<u>\$ 2,566,239.34</u>	<u>\$ 997,851.98</u>	<u>\$ 1,259,963.88</u>	<u>\$ 24,819,349.88</u>

NOTE 11 - 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 School'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 \$615,336.26, and the School's contributions were \$1,023,509.30 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 School reported a liability of \$6,263,689.00 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 School's proportion of the net pension liability was based on the present value of future salaries for the School relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2016, the School's proportion was 0.06815%, which was an increase of 0.00067 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%)
\$ 11,780,788.60	\$ 6,236,689.00	\$ 1,624,564.47

Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: For the year ended June 30, 2017, the School recognized pension expense of \$1,310,146.00. At June 30, 2017, the School 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	\$ 296,031.00
Changes of Assumptions	923,742.00	
Net Difference Between Projected and Actual Earnings on Pension Plan Investments	2,233,832.00	
Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions	257,180.02	
Contributions Subsequent to the Measurement Date	1,023,509.30	
Total	<u>\$ 4,438,263.32</u>	<u>\$ 296,031.00</u>

The amount of \$1,023,509.30 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:

Year Ended June 30:	Amount
2018	\$ 586,216.02
2019	583,438.00
2020	1,254,567.00
2021	694,502.00
Total	<u>\$ 3,118,723.02</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 School 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 School assumes no liability other than its contribution.

For the current fiscal year, the School had a total payroll of \$12,532,663.44, of which \$2,277,059.19 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year, less employer forfeitures of \$49,097.87, were \$106,652.98 and \$136,623.55, respectively. The amount of expense recognized in the current year related to ORP is equal to the employer contributions.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Benefits** - The School participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System (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 School 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 School 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 School made 100% of its annual required contributions to the Plan for the years ended June 30, 2017, 2016, and 2015, which were \$728,147.75, \$688,440.58, and \$660,831.10, respectively. The School assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available 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 School participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of 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 School 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 School made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2017, 2016, and 2015, which were \$47,624.12, \$50,403.69, and \$49,351.68, respectively. The School assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 13 - RISK MANAGEMENT

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

A. Employee Benefit Plans

1. State Health Plan

School employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a discretely presented component unit of the State of North Carolina. The Plan 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 School is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the School for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium.

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

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

3. Employee Dishonesty and Computer Fraud

The School is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. The School is charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$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 School's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The School is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The School retains the risk for workers' compensation.

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

NOTE 14 - COMMITMENTS

The School has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$82,632.46 and on other purchases were \$453,445.14 at June 30, 2017.

NOTE 15 - BLENDED COMPONENT UNIT

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

Condensed Statement of Net Position June 30, 2017

	North Carolina School of Science and Mathematics	NCSSM Student and Constituent Support Services, Inc.	Total
ASSETS			
Current Assets	\$ 1,585,598.42	\$ 217,997.83	\$ 1,803,596.25
Capital Assets, Net	41,940,546.52		41,940,546.52
Other Noncurrent Assets	1,997,617.02		1,997,617.02
Total Assets	45,523,761.96	217,997.83	45,741,759.79
DEFERRED OUTFLOWS OF RESOURCES	4,438,263.32		4,438,263.32
LIABILITIES			
Current Liabilities	1,810,960.81	151,302.17	1,962,262.98
Long-Term Liabilities	8,561,628.17		8,561,628.17
Other Noncurrent Liabilities	55,162.62		55,162.62
Total Liabilities	10,427,751.60	151,302.17	10,579,053.77
DEFERRED INFLOWS OF RESOURCES	296,031.00		296,031.00
NET POSITION			
Net Investment in Capital Assets	40,711,885.07		40,711,885.07
Restricted - Expendable	1,997,847.67		1,997,847.67
Unrestricted	(3,471,490.06)	66,695.66	(3,404,794.40)
Total Net Position	\$ 39,238,242.68	\$ 66,695.66	\$ 39,304,938.34

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

	North Carolina School of Science and Mathematics	NCSSM Student and Constituent Support Services, Inc.	Total
OPERATING REVENUES			
Student Tuition and Fees	\$ 467,355.88	\$ 0.00	\$ 467,355.88
Sales and Services, Net	28,681.01	84,993.65	113,674.66
Other Operating Revenues	252,696.00	17,929.37	270,625.37
Total Operating Revenues	748,732.89	102,923.02	851,655.91
OPERATING EXPENSES			
Operating Expenses	23,466,236.11	93,149.89	23,559,386.00
Depreciation	1,259,963.88		1,259,963.88
Total Operating Expenses	24,726,199.99	93,149.89	24,819,349.88
Operating Income (Loss)	(23,977,467.10)	9,773.13	(23,967,693.97)
NONOPERATING REVENUES (EXPENSES)			
State Appropriations	21,699,939.58		21,699,939.58
Noncapital Grants	324,345.39		324,345.39
Noncapital Gifts	826,469.92		826,469.92
Interest and Fees on Debt	(13,853.45)		(13,853.45)
Other Nonoperating Revenues	15,800.55		15,800.55
Net Nonoperating Revenues	22,852,701.99		22,852,701.99
Income (Loss) Before Other Revenues	(1,124,765.11)	9,773.13	(1,114,991.98)
Capital Appropriations	1,108,639.69		1,108,639.69
Increase (Decrease) in Net Position	(16,125.42)	9,773.13	(6,352.29)
NET POSITION			
Net Position, July 1, 2016	39,254,368.10	56,922.53	39,311,290.63
Net Position, June 30, 2017	\$ 39,238,242.68	\$ 66,695.66	\$ 39,304,938.34

*Condensed Statement of Cash Flows
June 30, 2017*

	North Carolina School of Science and Mathematics	NCSSM Student and Constituent Support Services, Inc.	Total
Net Cash Provided (Used) by Operating Activities	\$ (22,393,887.68)	\$ 66,695.66	\$ (22,327,192.02)
Total Cash Provided by Noncapital Financing Activities	22,574,565.45		22,574,565.45
Net Cash Used by Capital and Related Financing Activities	(3,176,702.55)		(3,176,702.55)
Cash Provided by Investing Activities	36,194.96		36,194.96
Net Increase (Decrease) in Cash and Cash Equivalents	(2,959,829.82)	66,695.66	(2,893,134.16)
Cash and Cash Equivalents, July 1, 2016	6,074,765.08	159,495.65	6,234,260.73
Cash and Cash Equivalents, June 30, 2017	\$ 3,114,935.26	\$ 226,191.31	\$ 3,341,126.57

NOTE 16 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

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

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

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

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

Exhibit C-1

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Proportionate Share Percentage of Collective Net Pension Liability	0.06815%	0.06748%	0.06684%	0.06340%
Proportionate Share of TSERS Collective Net Pension Liability	\$ 6,263,689.00	\$ 2,486,772.00	\$ 783,646.00	\$ 3,849,026.00
Covered Payroll	\$ 10,198,655.74	\$ 10,088,688.52	\$ 9,998,912.50	\$ 9,641,892.63
Net Pension Liability as a Percentage of Covered Payroll	61.42%	24.65%	7.84%	39.92%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	87.32%	94.64%	98.24%	90.60%

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

Exhibit C-2

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Contractually Required Contribution	\$ 1,023,509.30	\$ 933,177.00	\$ 923,115.00	\$ 868,905.50	\$ 803,169.66
Contributions in Relation to the Contractually Determined Contribution	<u>1,023,509.30</u>	<u>933,177.00</u>	<u>923,115.00</u>	<u>868,905.50</u>	<u>803,169.66</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	\$ 10,255,604.25	\$ 10,198,655.74	\$ 10,088,688.52	\$ 9,998,912.50	\$ 9,641,892.63
Contributions as a Percentage of Covered Payroll	9.98%	9.15%	9.15%	8.69%	8.33%

	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Contractually Required Contribution	\$ 697,242.55	\$ 473,324.21	\$ 363,185.65	\$ 343,212.03	\$ 326,047.96
Contributions in Relation to the Contractually Determined Contribution	<u>697,242.55</u>	<u>473,324.21</u>	<u>363,185.65</u>	<u>343,212.03</u>	<u>326,047.96</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	\$ 9,371,539.67	\$ 9,600,896.67	\$ 10,173,267.51	\$ 10,214,643.75	\$ 10,690,096.92
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.

**North Carolina School of Science and Mathematics
Notes to Required Supplementary Information
Schedule of School 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 reflects 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



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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the North Carolina School of Science and Mathematics (School), 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 School's basic financial statements, and have issued our report thereon dated March 14, 2018. Our report includes a reference to other auditors who audited the financial statements of the North Carolina School of Science and Mathematics Foundation and Subsidiary (Foundation), the School's discretely presented component unit, as described in our report on the School's financial statements. The financial statements of the Foundation were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with the Foundation.

Internal Control Over Financial Reporting

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

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

possibility that a material misstatement of the School's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. 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 School's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 School's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the School's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

March 14, 2018

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For additional information contact:
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This audit required 394 hours at an approximate cost of \$40,582.