

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



THE UNIVERSITY OF NORTH CAROLINA SYSTEM OFFICE

CHAPEL HILL, NORTH CAROLINA
FINANCIAL STATEMENT AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2019

ADMINISTRATIVE BODY 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



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AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, Governor
The General Assembly of North Carolina
Board of Governors, University of North Carolina System

We have completed a financial statement audit of The University of North Carolina System Office for the year ended June 30, 2019, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

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

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency 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

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Governors
University of North Carolina System
Chapel Hill, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of The University of North Carolina System Office (UNC System Office), the administrative body of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the UNC System Office'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 an opinion on these financial statements based on our audit. 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.

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 UNC System Office'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 UNC System Office'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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of The University of North Carolina System Office, as of June 30, 2019, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements of The University of North Carolina System Office are intended to present the financial position, changes in financial position, and cash flows that are only attributable to the transactions of The University of North Carolina System Office. They do not purport to, and do not, present fairly the financial position of the University of North Carolina System as of June 30, 2019, the changes in its financial position, or its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

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 February 18, 2020 on our consideration of the UNC System Office'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 UNC System Office's internal control over financial reporting and compliance.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

February 18, 2020



MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The University of North Carolina System Office (UNC System Office) 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, 2019, and includes comparative data for the year ended June 30, 2018. This discussion describes important trends and events that have impacted the fiscal health of the UNC System Office and that may continue to exert influence in future years. This discussion has been prepared by and is the responsibility of the UNC System Office's management along with the financial statements and the notes 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 UNC System Office 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; the Statement of Cash Flows; and the Notes to the Financial Statements. 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 UNC System Office's sources and uses of cash for operating activities, noncapital financing activities, capital financing 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, adoption of GASB accounting pronouncements in the fiscal period, authority for and associated risk of deposits and investments, detailed information on deposits and investments, accounts receivable, capital assets, accounts payable, long-term liabilities, lease obligations, revenues, expenses, insurance against losses, commitments and contingencies, blended component unit, and required information on pension plans and other postemployment benefits, including the net position impact from the adoption of GASB Statements No. 68 and 75. 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 UNC System Office as a whole using accounting methods similar to those used in the private-sector. The UNC System Office's supporting organization, The University of North Carolina Foundation, Inc. (Foundation), is a legally separate not-for-profit corporation and is reported as a blended component unit based on the nature and significance of its relationship to the UNC System Office. Therefore, the results of its operations are blended with the UNC System Office's financial statements and are included in this discussion and analysis. The reporting entity also includes the University of North Carolina Center for Public Television and UNC Association of Student Government, divisions within the UNC System Office. Although the Foundation, the University of North Carolina Center for Public Television, and the UNC Association of Student Government organizations are all included in the UNC System Office reporting entity, each organization is subject to an independent outside audit due to organizational requirements or source of funding.

Financial Highlights

The UNC System Office's financial position, as a whole, increased significantly during the fiscal year ended June 30, 2019. The condensed net position for the UNC System Office increased by \$42.67 million or 50.86% compared to the prior year net position. The UNC System Office's endowment performance return in the UNC Investment Fund, LLC decreased to 7.54% from 11.86% from last fiscal year.

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

Net position is divided into categories to show the availability to meet the UNC System Office obligations. The first category, net investment in capital assets, provides the UNC System Office's equity in property, plant, and equipment. The next net position category is restricted net position, which is divided into two categories, nonexpendable and expendable. Restricted nonexpendable net position consists primarily of the UNC System Office's permanent endowment funds and is only available for investment purposes. Expendable restricted net position is available for use by the UNC System Office, but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net position. Unrestricted net position is available to the UNC System Office for any lawful purpose. Although unrestricted net position is not subject to externally imposed stipulations, substantially all of the UNC System Office's unrestricted net position has been designated for various programs and initiatives.

| Condensed Statement of Net Position | | | | |
|---|--------------------------|-------------------------|-------------------------|-------------------|
| | 2019 | 2018 (as Restated) | Increase/ (Decrease) | Percent Change |
| Assets: | | | | |
| Current Assets | \$ 126,486,969.30 | \$ 94,485,007.88 | \$ 32,001,961.42 | 33.87% |
| Noncurrent Assets: | | | | |
| Other | 102,318,382.21 | 96,792,865.19 | 5,525,517.02 | 5.71% |
| Capital Assets, Net | 58,251,087.58 | 38,973,776.89 | 19,277,310.69 | 49.46% |
| Total Assets | 287,056,439.09 | 230,251,649.96 | 56,804,789.13 | 24.67% |
| Total Deferred Outflows of Resources | 8,318,627.00 | 7,282,206.00 | 1,036,421.00 | 14.23% |
| Liabilities: | | | | |
| Current | | | | |
| Long-Term Liabilities - Current Portion | 515,195.43 | 271,194.53 | 244,000.90 | 89.97% |
| Other Current Liabilities | 20,792,623.15 | 16,800,943.52 | 3,991,679.63 | 23.76% |
| Noncurrent | | | | |
| Long-Term Liabilities | 62,307,549.93 | 69,009,231.87 | (6,701,681.94) | (9.71%) |
| Other Noncurrent Liabilities | 987,654.86 | 160,547.07 | 827,107.79 | 515.18% |
| Total Liabilities | 84,603,023.37 | 86,241,916.99 | (1,638,893.62) | (1.90%) |
| Total Deferred Inflows of Resources | 84,206,560.19 | 67,393,209.40 | 16,813,350.79 | 24.95% |
| Net Position: | | | | |
| Net Investment in Capital Assets | 53,373,340.94 | 38,543,671.99 | 14,829,668.95 | 38.47% |
| Restricted: | | | | |
| Nonexpendable | 14,796,987.42 | 14,796,987.42 | | |
| Expendable | 100,507,473.31 | 85,315,722.74 | 15,191,750.57 | 17.81% |
| Unrestricted | (42,112,319.14) | (54,757,652.58) | 12,645,333.44 | 23.09% |
| Total Net Position | \$ 126,565,482.53 | \$ 83,898,729.57 | \$ 42,666,752.96 | 50.86% |

Net position categories are defined in Note 1.N of the notes to the financial statements.

As of June 30, 2019, total net position for the UNC System Office was \$126.57 million. The UNC System Office's net investment in capital assets of \$53.37 million represents 42.17% of total net position. The increase in net investment in capital assets of \$14.83 million or 38.47% is primarily due to the ongoing construction project for the Spectrum Incentive Auction Repack. See the capital assets section below for more information. Restricted expendable net position increased by \$15.19 million or 17.81% primarily due to an increase in state appropriations for the Opportunity Scholarship Grant Fund Reserve (established by General Statute 115C-562.8). Unrestricted net position increased by \$12.65 million or 23.09% primarily from the recognition of amounts related to other postemployment benefits.

Total assets increased by \$56.80 million or 24.67%. Current assets increased by \$32.0 million or 33.87% primarily due to increases in cash balances resulting from the receipt of funds for the Opportunity Scholarship Grant Fund Reserve and increases in amounts receivable by UNC TV from the Federal Communications Commission related to the Spectrum Incentive Auction Repack. Other noncurrent assets increased by \$5.53 million or 5.71% primarily due to an increase in cash restricted for construction related to the Repack as well as an increase in endowment investments resulting from current year investment earnings. Net capital assets increased \$19.28 million or 49.46% primarily due to the ongoing construction project for the Spectrum Incentive Auction Repack. See the capital assets section below for more details. Total deferred outflows of resources increased by \$1.04 million or 14.23% as a result of the required recognition of amounts related to pension plan and other postemployment benefits (see Notes 13 and 14).

Total liabilities, which were \$84.60 million at June 30, 2019, remained relatively stable during the year ended June 30, 2019. Total liabilities decreased \$1.64 million or 1.90%. Details of both current and noncurrent liabilities are shown on the Statement of Net Position and in Notes 7 and 8. Total deferred inflows of resources increased \$16.81 million or 24.95% primarily due to the receipt of additional funds for the Opportunity Scholarship Grant Fund Reserve received each year (established by General Statute 115C-562.8). These amounts are forward funded and cannot be used until the subsequent fiscal year. The increase is also due to the recognition of amounts related to other postemployment benefits.

The UNC System Office's current assets of \$126.49 million covered the current liabilities of \$21.31 million, at a ratio of 5.94 (\$5.94 in current assets for every \$1.00 in current liabilities).

Summary 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 UNC System Office's dependency on state aid, certain grants, and gifts will result in operating deficits since the GASB requires that state appropriations, certain grants, and gifts be classified as nonoperating revenues. The utilization of long-lived assets, referred to as capital assets, is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

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

Generally speaking, operating revenues are earned for providing goods and services to the various customers and constituencies of the UNC System Office. Operating expenses are those expenses incurred to acquire or produce the goods and services provided in return for the operating revenues and to carry out the mission of the UNC System Office. Nonoperating revenues are revenues earned for which goods and services are not provided. Capital contributions are considered neither operating nor nonoperating revenues and are reported after "Income Before Other Revenues."

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

| | 2019 | 2018 (as Restated) | Increase/ (Decrease) | Percent Change |
|---|--------------------------|-------------------------|-------------------------|-------------------|
| Operating Revenues: | | | | |
| Sales and Services | \$ 11,765,406.22 | \$ 13,546,482.18 | \$ (1,781,075.96) | (13.15%) |
| Other | 30,485.01 | 27,150.62 | 3,334.39 | 12.28% |
| Total Operating Revenues | 11,795,891.23 | 13,573,632.80 | (1,777,741.57) | (13.10%) |
| Operating Expenses: | | | | |
| Salaries and Benefits | 37,420,022.47 | 40,799,247.44 | (3,379,224.97) | (8.28%) |
| Supplies and Materials | 3,378,586.32 | 2,281,639.24 | 1,096,947.08 | 48.08% |
| Services | 37,059,756.17 | 30,528,724.37 | 6,531,031.80 | 21.39% |
| Utilities | 1,612,794.00 | 1,657,566.47 | (44,772.47) | (2.70%) |
| Depreciation | 2,809,662.90 | 2,972,112.11 | (162,449.21) | (5.47%) |
| Total Operating Expenses | 82,280,821.86 | 78,239,289.63 | 4,041,532.23 | 5.17% |
| Operating Loss | (70,484,930.63) | (64,665,656.83) | 5,819,273.80 | 9.00% |
| Nonoperating Revenues (Expenses) | | | | |
| State Appropriations | 342,026,381.04 | 316,386,307.81 | 25,640,073.23 | 8.10% |
| Noncapital Grants | 57,348,064.58 | 43,986,107.13 | 13,361,957.45 | 30.38% |
| Noncapital Gifts, Net | 13,700,648.59 | 13,954,666.17 | (254,017.58) | (1.82%) |
| Investment Income, Net | 8,776,614.15 | 10,790,815.82 | (2,014,201.67) | (18.67%) |
| Interest and Fees on Debt | (7,392.85) | (3,935.84) | 3,457.01 | 87.83% |
| Grants, Aid and Subsidies | (330,428,929.00) | (309,434,305.02) | 20,994,623.98 | 6.78% |
| Other Nonoperating Expenses | (783,444.58) | (97,034.76) | 686,409.82 | 707.39% |
| Net Nonoperating Revenues | 90,631,941.93 | 75,582,621.31 | 15,049,320.62 | 19.91% |
| Income Before Other Revenues | 20,147,011.30 | 10,916,964.48 | 9,230,046.82 | 84.55% |
| Capital Contributions | 22,519,741.66 | 1,037,646.00 | 21,482,095.66 | 2070.27% |
| Increase in Net Position | 42,666,752.96 | 11,954,610.48 | 30,712,142.48 | 256.91% |
| Net Position | | | | |
| Net Position - July 1 | 83,898,729.57 | 71,944,119.09 | 11,954,610.48 | 16.62% |
| Net Position - June 30 | <u>\$ 126,565,482.53</u> | <u>\$ 83,898,729.57</u> | <u>\$ 42,666,752.96</u> | <u>50.86%</u> |
| Total Revenues | \$ 456,281,888.31 | \$ 399,738,236.96 | \$ 56,543,651.35 | 14.15% |
| Total Expenses | \$ 413,615,135.35 | \$ 387,783,626.48 | \$ 25,831,508.87 | 6.66% |

The Statement of Revenues, Expenses, and Changes in Net Position shows an increase in net position of \$42.67 million for the fiscal year. The total operating loss for fiscal year 2019 was \$70.48 million. Since the State of North Carolina appropriation is not included within operating revenue per GASB, the UNC System Office shows a significant operating loss.

The state appropriations are received through an allotment and requisition system through the North Carolina Office of State Budget and Management and the North Carolina Office of State Controller. For the fiscal year ended June 30, 2019, the appropriations from the State for the UNC System Office increased by \$25.64 million or 8.10% for operations. The increase is primarily due to an increase in funding for the Opportunity Scholarships.

Grants, aid and subsidies increased by \$20.99 million or 6.78% primarily due to the increase of funds available for the Opportunity Scholarships. Noncapital grants increased by \$13.36 million or 30.38% due to an increase in grants such as the NC Teaching Fellows Program.

Investment income decreased \$2.01 million or 18.67% due to decreased market investment performance during the fiscal year.

Operating revenues include sales and services (including academic affairs private college licensure fees, Go Global exchange programs, School Leadership Development training and conferencing services, etc.) and other operating revenues. For fiscal year 2019, sales and services decreased by \$1.78 million or 13.15% primarily due to the transfer of the New Teacher Support Program from the UNC System Office to a university during the fiscal year.

Operating expenses, including depreciation of \$2.81 million, totaled \$82.28 million. Of this total, \$37.42 million was used for salaries and benefits and \$37.06 million was for services. Services consisted of contractual agreements, data processing services, travel, and communication expenses. Services increased by \$6.53 million or 21.39% mainly due to an increase in development and support services for the Data Modernization initiative.

Capital contributions increased by \$21.48 million to a total of \$22.52 million due to an increase in federal grants related to the Spectrum Incentive Auction Repack.

One of the UNC System Office's greatest strengths is the diverse streams of revenues, including voluntary private support from individuals, foundations, and corporations, along with government and other sponsored programs, state appropriations, and investment income. The UNC System Office has in the past and 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

The primary capital project for fiscal year 2019 was the replacement of UNC TV transmitters and antennas, as all were impacted by the Spectrum Incentive Auction Repack. The construction commitments identified in Note 16 are primarily related to this project. Total capital assets, net of accumulated depreciation, at June 30, 2019 were \$58.25 million. For more detailed information about capital asset holdings, see Note 6 of the notes to the financial statements.

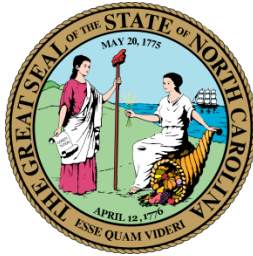
Factors Impacting Future Periods

Management believes that the UNC System Office is well positioned to continue its level of excellence in service to UNC constituent institutions, students, the community, and governmental agencies. The UNC System Office's ongoing efforts toward maximizing the state's resources with efficiency and effectiveness measures will enable it to provide the necessary resources to support this level of excellence. However, fluctuations in state appropriations will continue to impact the ability of the UNC System Office to maintain resources to provide programs and services, including financial aid, to meet the growing demands of the State and its citizens.

A crucial element to the UNC System Office's future will continue to be its relationship with the State of North Carolina. Private gifts are an important supplement to the fundamental support from the State and other revenue sources. Fluctuations in market conditions will continue to affect future level of donor funding the UNC System Office receives from corporate and individual giving, including the support received through The University of North Carolina Center for Public Television.

The UNC System Office will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy to insulate the UNC System Office's operations from temporary market volatility.

While it is not possible to predict the ultimate results, management believes that with cost reduction measures previously implemented and the continued support of the State of North Carolina and faithful donors, the UNC System Office's financial condition is strong enough to weather economic uncertainties.



FINANCIAL STATEMENTS

The University of North Carolina System Office
Statement of Net Position
June 30, 2019

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

| | |
|--------------------------------------|-----------------------|
| Cash and Cash Equivalents | \$ 8,737,379.26 |
| Restricted Cash and Cash Equivalents | 101,979,429.98 |
| Restricted Short-Term Investments | 115,998.60 |
| Receivables, Net (Note 5) | 13,374,813.45 |
| Inventories | 25,231.89 |
| Prepaid Items | 2,254,116.12 |
| Total Current Assets | <u>126,486,969.30</u> |

Noncurrent Assets:

| | |
|--|-----------------------|
| Restricted Cash and Cash Equivalents | 10,738,927.64 |
| Endowment Investments | 84,955,099.10 |
| Restricted Investments | 6,429,348.48 |
| Beneficial Interest in Assets Held by Others | 145,335.99 |
| Net Other Postemployment Benefits Asset | 49,671.00 |
| Capital Assets - Nondepreciable (Note 6) | 21,598,964.55 |
| Capital Assets - Depreciable, Net (Note 6) | 36,652,123.03 |
| Total Noncurrent Assets | <u>160,569,469.79</u> |
| Total Assets | <u>287,056,439.09</u> |

DEFERRED OUTFLOWS OF RESOURCES

| | |
|--|---------------------|
| Deferred Outflows Related to Pensions | 6,311,686.00 |
| Deferred Outflows Related to Other Postemployment Benefits (Note 14) | 2,006,941.00 |
| Total Deferred Outflows of Resources | <u>8,318,627.00</u> |

LIABILITIES

Current Liabilities:

| | |
|---|----------------------|
| Accounts Payable and Accrued Liabilities (Note 7) | 8,075,556.66 |
| Funds Held for Others | 5,507,225.60 |
| Unearned Revenue | 7,209,070.15 |
| Interest Payable | 770.74 |
| Long-Term Liabilities - Current Portion (Note 8) | 515,195.43 |
| Total Current Liabilities | <u>21,307,818.58</u> |

Noncurrent Liabilities:

| | |
|--------------------------------|----------------------|
| Funds Held in Trust for Others | 987,654.86 |
| Long-Term Liabilities (Note 8) | 62,307,549.93 |
| Total Noncurrent Liabilities | <u>63,295,204.79</u> |
| Total Liabilities | <u>84,603,023.37</u> |

DEFERRED INFLOWS OF RESOURCES

| | |
|---|----------------------|
| Deferred State Aid | 54,840,000.00 |
| Deferred Inflows for Irrevocable Split-Interest Agreements | 718,123.19 |
| Deferred Inflows Related to Pensions | 355,239.00 |
| Deferred Inflows Related to Other Postemployment Benefits (Note 14) | 28,293,198.00 |
| Total Deferred Inflows of Resources | <u>84,206,560.19</u> |

***The University of North Carolina System Office
Statement of Net Position
June 30, 2019***

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

NET POSITION

| | |
|----------------------------------|---------------------------------|
| Net Investment in Capital Assets | 53,373,340.94 |
| Restricted for: | |
| Nonexpendable: | |
| Scholarships and Fellowships | 13,432,785.42 |
| Departmental Uses | 48,813.30 |
| Other | 1,315,388.70 |
| Expendable: | |
| Scholarships and Fellowships | 48,554,959.05 |
| Endowed Professorships | 111,930.09 |
| Departmental Uses | 38,516,802.64 |
| Capital Projects | 12,201,956.23 |
| Other | 1,121,825.30 |
| Unrestricted | <u>(42,112,319.14)</u> |
| Total Net Position | <u><u>\$ 126,565,482.53</u></u> |

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

***The University of North Carolina System Office
Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2019***

Exhibit A-2

OPERATING REVENUES

| | |
|--------------------------|----------------------|
| Sales and Services | \$ 11,765,406.22 |
| Other Operating Revenues | 30,485.01 |
| Total Operating Revenues | <u>11,795,891.23</u> |

OPERATING EXPENSES

| | |
|--------------------------|------------------------|
| Salaries and Benefits | 37,420,022.47 |
| Supplies and Materials | 3,378,586.32 |
| Services | 37,059,756.17 |
| Utilities | 1,612,794.00 |
| Depreciation | 2,809,662.90 |
| Total Operating Expenses | <u>82,280,821.86</u> |
| Operating Loss | <u>(70,484,930.63)</u> |

NONOPERATING REVENUES (EXPENSES)

| | |
|---|----------------------|
| State Appropriations | 342,026,381.04 |
| Noncapital Grants | 57,348,064.58 |
| Noncapital Gifts, Net (Note 11) | 13,700,648.59 |
| Investment Income (Net of Investment Expense of \$339,681.44) | 8,776,614.15 |
| Interest and Fees on Debt | (7,392.85) |
| Grants, Aid and Subsidies | (330,428,929.00) |
| Gain on Sale of Capital Assets | 114,547.06 |
| Other Nonoperating Expenses | (897,991.64) |
| Net Nonoperating Revenues | <u>90,631,941.93</u> |
| Income Before Other Revenues | 20,147,011.30 |
| Capital Contributions | <u>22,519,741.66</u> |
| Increase in Net Position | 42,666,752.96 |

NET POSITION

| | |
|--|--------------------------|
| Net Position - July 1, 2018, as Restated (Note 19) | <u>83,898,729.57</u> |
| Net Position - June 30, 2019 | <u>\$ 126,565,482.53</u> |

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

The University of North Carolina System Office
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2019

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

| | |
|---|------------------|
| Received from Customers | \$ 11,018,776.52 |
| Payments to Employees and Fringe Benefits | (40,220,912.62) |
| Payments to Vendors and Suppliers | (40,646,543.81) |
| Other Receipts | 629,808.90 |
| | <hr/> |
| Net Cash Used by Operating Activities | (69,218,871.01) |

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

| | |
|--|------------------|
| State Appropriations | 352,026,381.04 |
| Noncapital Grants | 55,709,597.06 |
| Noncapital Gifts | 13,115,377.59 |
| Grants, Aid and Subsidies | (330,428,929.00) |
| Annuity Gifts for Others Received | 2,853,644.67 |
| Payments to Annuity Beneficiaries | (140,123.44) |
| | <hr/> |
| Net Cash Provided by Noncapital Financing Activities | 93,135,947.92 |

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

| | |
|---|-----------------|
| Capital Contributions | 15,783,155.89 |
| Proceeds from Sale of Capital Assets | 117,605.09 |
| Proceeds from Insurance on Capital Assets | 13,890.00 |
| Acquisition and Construction of Capital Assets | (17,780,947.08) |
| Principal Paid on Capital Debt | (83,907.21) |
| Interest and Fees Paid on Capital Debt | (7,282.25) |
| | <hr/> |
| Net Cash Used by Capital Financing and Related Financing Activities | (1,957,485.56) |

CASH FLOWS FROM INVESTING ACTIVITIES

| | |
|---|----------------|
| Proceeds from Sales and Maturities of Investments | 9,097,186.44 |
| Investment Income | 2,399,963.89 |
| Purchase of Investments and Related Fees | (4,129,889.11) |
| | <hr/> |
| Net Cash Provided by Investing Activities | 7,367,261.22 |

| | |
|---|-------------------|
| Net Increase in Cash and Cash Equivalents | 29,326,852.57 |
| Cash and Cash Equivalents - July 1, 2018 | 92,128,884.31 |
| | <hr/> |
| Cash and Cash Equivalents - June 30, 2019 | \$ 121,455,736.88 |

The University of North Carolina System Office
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2019

Exhibit A-3
Page 2 of 2

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

| | |
|--|---------------------------|
| Operating Loss | \$ (70,484,930.63) |
| Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities: | |
| Depreciation Expense | 2,809,662.90 |
| Changes in Assets and Deferred Outflows of Resources: | |
| Receivables, Net | 1,242,121.67 |
| Inventories | (3,967.01) |
| Prepaid Items | 144,320.42 |
| Net Other Postemployment Benefits Asset | 58,120.00 |
| Deferred Outflows Related to Pensions | (997,520.00) |
| Deferred Outflows Related to Other Postemployment Benefits | (38,901.00) |
| Changes in Liabilities and Deferred Inflows of Resources: | |
| Accounts Payable and Accrued Liabilities | 1,072,488.04 |
| Unearned Revenue | (1,988,751.37) |
| Funds Held for Others | 599,323.89 |
| Net Pension Liability | 1,466,497.00 |
| Net Other Postemployment Benefits Liability | (9,849,139.00) |
| Workers' Compensation Liability | 118,860.07 |
| Compensated Absences | 395,594.01 |
| Deferred Inflows Related to Pensions | (11,531.00) |
| Deferred Inflows Related to Other Postemployment Benefits | 6,248,881.00 |
| Net Cash Used by Operating Activities | <u>\$ (69,218,871.01)</u> |

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

| | |
|--|-----------------|
| Assets Acquired through the Assumption of a Liability | \$ 4,309,084.54 |
| Change in Fair Value of Investments | 6,716,331.70 |
| Increase in Receivables Related to Nonoperating Income | 7,651,802.16 |

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



NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina System Office (UNC System Office) is the administrative body 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 UNC System Office and its component unit. The UNC System Office is the organizational structure established, pursuant to *North Carolina General Statutes* 116-3 through 116-22, to support and assist the President of the University System in fulfilling responsibilities to the Board of Governors in meeting the overall responsibilities for administering the University System. The President, as chief administrative and executive officer, is responsible for (1) communication between the Board and persons inside and outside the University System, (2) preparation, presentation, and execution of the budget for the University System, and (3) establishment and supervision of administrative divisions to comply with policies of the Board. These responsibilities are accomplished through offices which address academic affairs, financial administration, long-range planning, student services and special programs, research, communications, and public affairs. The UNC System Office's component unit is blended in the UNC System Office's financial statements. Other related foundations and similar nonprofit corporations for which the UNC System Office is not financially accountable are not part of the accompanying financial statements. See below for further discussion of the UNC System Office's component unit.

Blended Component Unit - Although legally separate, The University of North Carolina Foundation, Inc. (Foundation), a component unit of the UNC System Office, is reported as if it was part of the UNC System Office.

The Foundation is governed by a board consisting of ten voting ex-officio directors. The Foundation's purpose is to aid, support, and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the multi-campus University System. The ten ex-officio directors are the Chair of the Board of Governors of the University System, the President of the University System, the Senior Vice President for Finance and Budget of the University System, the Senior Vice President for Academic Affairs of the University System, the Senior Vice President for External Affairs of the University System, the Senior Vice President for Strategy and Policy for the University System, the Senior Vice President and Chief of Staff of the

University System, the Senior Vice President for Legal Affairs and General Counsel of the University System, the Chair of the Committee on University Governance of the Board of Governors of the University System, and the Chair of the Committee on Budget and Finance of the Board of Governors of the University System. Because the Foundation's sole purpose is to benefit the University System, its financial statements have been blended with those of the UNC System Office.

Separate financial statements for the Foundation may be obtained from the UNC System Office, 140 Friday Center Drive, Chapel Hill, or by calling 919-962-3992.

Condensed combining information regarding the blended component unit is provided in Note 17.

- 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 UNC System Office'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 UNC System Office 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 UNC System Office 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, 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. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net change in the value of investments is recognized as a component of investment income.

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity or for a specified period of time, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the UNC System Office for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts. Land and other real estate held as investments by endowments are reported at fair value, consistent with how investments are generally reported.

- F. Receivables** - Receivables consist of amounts due from the federal government, state and local governments, constituent universities, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, Teachers' Insurance and Annuity Association and the College Retirement Equities Fund (TIAA/CREF) as the trustees of the Optional Retirement Program (ORP) in connection with reimbursement of expenses related to the administration of the ORP, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** - Inventories, consisting of postage, are valued at cost using the last invoice cost method.
- H. Beneficial Interest in Assets Held by Others** - Resources held by a trustee in an irrevocable trust that will benefit the UNC System Office upon the end of the predetermined period are reported as Beneficial Interest in Assets Held by Others.
- I. Capital Assets** - Capital assets are stated at cost at date of acquisition or acquisition value at date of donation in the case of gifts. Donated capital assets acquired prior to July 1, 2015 are stated at fair value as of the date of donation. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The UNC System Office 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 | 15-100 years |
| Machinery and Equipment | 5-25 years |
| General Infrastructure | 5-50 years |

The UNC System Office does not capitalize its art and historical treasures. These collections adhere to the UNC System Office’s policy to maintain for public exhibition or education; protect, keep unencumbered, care for, and preserve; and are required not to be sold. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized.

- J. **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, endowment and other restricted investments, and resources whose use is limited by external parties or statute.
- K. **Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of long-term debt and other long-term liabilities that will not be paid within the next fiscal year. Debt is defined as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established. Long-term debt includes notes from direct borrowings. Other long-term liabilities include compensated absences, annuities and life income payable, net pension liability, net other postemployment benefits (OPEB) liability, and workers’ compensation.

The net pension liability represents the UNC System Office’s proportionate share of the collective net pension liability reported in the State of North Carolina’s 2018 *Comprehensive Annual Financial Report*. This liability represents the UNC System Office’s portion of the collective total pension liability less the fiduciary net position of the Teachers’ and State Employees’ Retirement System. See Note 13 for further information regarding the UNC System Office’s policies for recognizing liabilities, expenses, deferred outflows of resources, and deferred inflows of resources related to pensions.

The net OPEB liability represents the UNC System Office’s proportionate share of the collective net OPEB liability reported in the State of North Carolina’s 2018 *Comprehensive Annual Financial Report*. This liability represents the UNC System Office’s portion of the collective total OPEB liability less the fiduciary net position of the Retiree Health Benefit Fund. See Note 14 for further information regarding the UNC System Office’s

policies for recognizing liabilities, expenses, deferred outflows of resources, and deferred inflows of resources related to OPEB.

- L. Compensated Absences** - The UNC System Office'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 UNC System Office 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.

- M. 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 UNC System Office has the following items that qualify for reporting in this category: deferred outflows related to pensions and deferred outflows related to other postemployment benefits.

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 UNC System Office has the following items that qualify for reporting in this category: deferred state aid, deferred inflows for irrevocable split-interest agreements, deferred inflows related to pensions, and deferred inflows related to other postemployment benefits.

- N. Net Position** - The UNC System Office's net position is classified as follows:

Net Investment in Capital Assets - This represents the UNC System Office's total investment in capital assets, net of outstanding liabilities related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of net investment in capital assets.

Restricted Net Position - Nonexpendable - Nonexpendable restricted net position includes endowments and similar type assets whose use is limited by donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

Restricted Net Position - Expendable - Expendable restricted net position includes resources for which the UNC System Office is legally or contractually obligated to spend in accordance with restrictions imposed by external parties. It also includes the net position of accrued employee benefits such as certain other postemployment benefits.

Unrestricted Net Position - Unrestricted net position includes resources derived from sales and services, unrestricted gifts, and interest income. It also includes the net position of accrued employee benefits such as compensated absences, pension plans, and other postemployment benefits.

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 UNC System Office. Both restricted and unrestricted net position include consideration of deferred outflows of resources and deferred inflows of resources. See Note 10 for further information regarding deferred outflows of resources and deferred inflows of resources that had a significant effect on unrestricted net position.

- O. Revenue and Expense Recognition** - The UNC System Office 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 UNC System Office's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as sales and services related to shared 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 UNC System Office, as well as investment income, are considered nonoperating since these are either investing, capital, or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - Unless specifically exempt, the UNC System Office 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 UNC System Office 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 UNC System Office may voluntarily deposit institutional trust funds, endowment funds, special funds, revenue bond proceeds, and debt service funds with the State Treasurer. Special funds consist of moneys for agency funds held directly by the UNC System Office.

At June 30, 2019, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$118,403,970.60, which represents the UNC System Office'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 1.3 years as of June 30, 2019. 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.

The carrying amount of the UNC System Office's deposits not with the State Treasurer was \$3,051,766.28, and the bank balance was \$3,051,766.28. Custodial credit risk is the risk that in the event of a bank failure, the UNC System Office's deposits may not be returned to it. The UNC System Office does not have a deposit policy for custodial credit risk. As of June 30, 2019, \$2,713,261.02 of the UNC System Office's bank balance was exposed to custodial credit risk because it is uninsured and uncollateralized.

- B. Investments** - The UNC System Office 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.

Additionally, the UNC System Office has also been delegated authority by the President of the University of North Carolina pursuant to G.S. 116-36.1 and Section 600.2.4.1 of the Policy Manual of the University of North Carolina to invest its trust 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.

G.S. 116-36(e) provides that the trustees of the Endowment Fund shall be responsible for the prudent investment of the Fund in the exercise of their sound discretion, without regard to any statute or rule of law relating to the investment of funds by fiduciaries but in compliance with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the UNC System Office's component unit, the Foundation, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks as defined by GASB Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*.

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

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

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of the failure of the counterparty, the UNC System Office will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The UNC System Office does not have a formal policy for custodial credit risk.

UNC Investment Fund, LLC - At June 30, 2019, the UNC System Office's investments include \$88,190,907.33, which represents the UNC System Office's equity position in the UNC Investment Fund, LLC (UNC Investment Fund). The UNC Investment Fund is an external investment pool that is not registered with the Securities and Exchange Commission, does not have a credit rating, and is not subject to any regulatory oversight. Investment risks associated with the UNC Investment Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

Non-Pooled Investments - The following table presents investments by type and investments subject to interest rate risk at June 30, 2019, for the UNC System Office's non-pooled investments.

Non-Pooled Investments

| Investment Type | Amount | Investment Maturities (in Years) | | |
|-------------------------------------|------------------------|----------------------------------|----------------------|------------------------|
| | | Less Than 1 | 1 to 5 | 6 to 10 |
| Debt Securities | | | | |
| Debt Mutual Funds | \$ 1,247,647.54 | \$ 0.00 | \$ 205,986.16 | \$ 1,041,661.38 |
| Money Market Mutual Funds | 11,964.34 | 11,964.34 | | |
| Total Debt Securities | 1,259,611.88 | \$ 11,964.34 | \$ 205,986.16 | \$ 1,041,661.38 |
| Other Securities | | | | |
| Equity Mutual Funds | 2,022,876.97 | | | |
| Investments in Real Estate | 27,050.00 | | | |
| Total Non-Pooled Investments | \$ 3,309,538.85 | | | |

At June 30, 2019, the UNC System Office's non-pooled investments had the following credit quality distribution for securities with credit exposure:

| | Amount | AAA Aaa | BB/Ba and below | Unrated |
|---------------------------|------------------------|----------------------|-----------------------|----------------------|
| Debt Mutual Funds | \$ 1,247,647.54 | \$ 331,367.33 | \$ 205,986.16 | \$ 710,294.05 |
| Money Market Mutual Funds | 11,964.34 | 11,964.34 | | |
| Totals | \$ 1,259,611.88 | \$ 343,331.67 | \$ 205,986.16 | \$ 710,294.05 |

Rating Agency: Morningstar

At June 30, 2019, the UNC System Office's non-pooled investments were exposed to custodial credit risk, as all non-pooled investments are held by a counterparty in the name of the UNC System Office.

Total Investments - The following table presents the total investments at June 30, 2019:

| Investment Type | Amount |
|----------------------------|-------------------------|
| Debt Securities | |
| Debt Mutual Funds | \$ 1,247,647.54 |
| Money Market Mutual Funds | 11,964.34 |
| Other Securities | |
| UNC Investment Fund | 88,190,907.33 |
| Equity Mutual Funds | 2,022,876.97 |
| Investments in Real Estate | 27,050.00 |
| Total Investments | <u>\$ 91,500,446.18</u> |

NOTE 3 - FAIR VALUE MEASUREMENTS

To the extent available, the UNC System Office's investments are recorded at fair value as of June 30, 2019. GASB Statement No. 72, *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

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

- Level 1 Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.
- Level 2 Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset, either directly or indirectly.

Level 3 Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

The following table summarizes the UNC System Office's investments, including deposits in the Short-Term Investment Fund, within the fair value hierarchy at June 30, 2019:

| | Fair Value | Fair Value Measurements Using | | |
|--|-------------------|-------------------------------|----------------|----------------|
| | | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| Investments by Fair Value Level | | | | |
| Debt Securities | | | | |
| Debt Mutual Funds | \$ 1,247,647.54 | \$ 1,247,647.54 | \$ 0.00 | \$ 0.00 |
| Money Market Mutual Funds | 11,964.34 | 11,964.34 | | |
| Total Debt Securities | 1,259,611.88 | 1,259,611.88 | | |
| Other Securities | | | | |
| Equity Mutual Funds | 2,022,876.97 | 2,022,876.97 | | |
| Investments in Real Estate | 27,050.00 | | | 27,050.00 |
| Total Investments by Fair Value Level | 3,309,538.85 | \$ 3,282,488.85 | \$ 0.00 | \$ 27,050.00 |
| Investments as a Position in an External Investment Pool | | | | |
| Short-Term Investment Fund | 118,403,970.60 | | | |
| UNC Investment Fund | 88,190,907.33 | | | |
| Total Investments as a Position in an External Investment Pool | 206,594,877.93 | | | |
| Total Investments Measured at Fair Value | \$ 209,904,416.78 | | | |

Short-Term Investment Fund - Ownership interests of the STIF are 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. Pool investments are measured at fair value in accordance with GASB 72. The UNC System Office's position in the pool is measured and reported at fair value and the STIF is not required to be categorized within the fair value hierarchy.

UNC Investment Fund - Ownership interests of the UNC Investment Fund are determined on a market unit valuation basis each month and in accordance with the UNC Investment Fund's operating procedures. Valuation of the underlying assets is performed by the custodian. Pool investments are measured at fair value in accordance with GASB 72. The UNC System Office's position in the pool is measured and reported at fair value and the UNC Investment Fund is not required to be categorized within the fair value hierarchy.

Debt and Equity Securities - Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

Investments in Real Estate - These investments of donated real estate held for profit are valued at fair market value. The fair market values were estimated using recent appraisals, tax values, and purchase price.

NOTE 4 - ENDOWMENT INVESTMENTS

Investments of the UNC System Office's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, state law permits the Board of Governors to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may also appropriate expenditures from eligible nonexpendable balances if deemed prudent and necessary to meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. However, several of the UNC System Office's endowment donor agreements prohibit spending of nonexpendable balances and therefore the related nonexpendable balances are not eligible for expenditure. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds.

Investment return of the UNC System Office's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the UNC System Office's endowment funds are based on an adopted spending policy which limits spending to 5% of the endowment funds market value at the end of the previous fiscal year. Under this policy, annual distributions are calculated by comparing cash associated with the endowment fund to projected expenses for programs associated with the fund. To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the UNC System Office uses accumulated income and appreciation from restricted, expendable net position endowment balances to make up the difference. At June 30, 2019, net appreciation of \$24,409,979.17 was available to be spent, of which \$21,378,105.49 was classified in net position as restricted: expendable: scholarships and fellowships, \$127,681.86 was classified in net position as restricted: expendable: departmental uses, and \$825,658.37 was classified in net position as restricted: expendable: other as these amounts are restricted for specific purposes. The remaining portion of net appreciation available to be spent is classified as unrestricted net position.

NOTE 5 - RECEIVABLES

Receivables at June 30, 2019, were as follows:

| | Gross Receivables | Less Allowance for Doubtful Accounts | Net Receivables |
|-------------------|-------------------------|--|-------------------------|
| Receivables: | | | |
| Accounts | \$ 3,389,416.71 | \$ 0.00 | \$ 3,389,416.71 |
| Intergovernmental | 8,343,999.74 | | 8,343,999.74 |
| Pledges | 2,746,892.00 | 1,105,495.00 | 1,641,397.00 |
| Total Receivables | <u>\$ 14,480,308.45</u> | <u>\$ 1,105,495.00</u> | <u>\$ 13,374,813.45</u> |

NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2019, is presented as follows:

| | Balance July 1, 2018 | Increases | Decreases | Balance June 30, 2019 |
|---|-------------------------|-------------------------|----------------------|--------------------------|
| Capital Assets, Nondepreciable: | | | | |
| Land | \$ 802,658.00 | \$ 0.00 | \$ 0.00 | \$ 802,658.00 |
| Construction in Progress | 457,698.30 | 20,658,714.62 | 320,106.37 | 20,796,306.55 |
| Total Capital Assets, Nondepreciable | 1,260,356.30 | 20,658,714.62 | 320,106.37 | 21,598,964.55 |
| Capital Assets, Depreciable: | | | | |
| Buildings | 93,552,780.53 | 365,315.05 | 1,166,259.34 | 92,751,836.24 |
| Machinery and Equipment | 13,527,458.28 | 1,213,410.05 | 381,011.87 | 14,359,856.46 |
| General Infrastructure | 21,364,111.94 | 172,696.83 | | 21,536,808.77 |
| Total Capital Assets, Depreciable | 128,444,350.75 | 1,751,421.93 | 1,547,271.21 | 128,648,501.47 |
| Less Accumulated Depreciation for: | | | | |
| Buildings | 69,450,416.97 | 1,362,409.26 | 1,166,260.78 | 69,646,565.45 |
| Machinery and Equipment | 9,734,852.96 | 974,735.52 | 377,953.84 | 10,331,634.64 |
| General Infrastructure | 11,545,660.23 | 472,518.12 | | 12,018,178.35 |
| Total Accumulated Depreciation | 90,730,930.16 | 2,809,662.90 | 1,544,214.62 | 91,996,378.44 |
| Total Capital Assets, Depreciable, Net | 37,713,420.59 | (1,058,240.97) | 3,056.59 | 36,652,123.03 |
| Capital Assets, Net | \$ 38,973,776.89 | \$ 19,600,473.65 | \$ 323,162.96 | \$ 58,251,087.58 |

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2019, were as follows:

| | Amount |
|---|------------------------|
| Accounts Payable and Accrued Liabilities | |
| Accounts Payable | \$ 2,417,549.92 |
| Accounts Payable - Capital Assets | 4,304,844.14 |
| Accrued Payroll | 1,126,414.55 |
| Contract Retainage | 226,748.05 |
| Total Accounts Payable and Accrued Liabilities | \$ 8,075,556.66 |

NOTE 8 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2019, is presented as follows:

| | Balance July 1, 2018 (as Restated) | Additions | Reductions | Balance June 30, 2019 | Current Portion |
|---|--|-----------------|------------------|--------------------------|--------------------|
| Long-Term Debt | | | | | |
| Notes from Direct Borrowings | \$ 430,061.66 | \$ 0.00 | \$ 83,907.21 | \$ 346,154.45 | \$ 87,370.97 |
| Other Long-Term Liabilities | | | | | |
| Annuities and Life Income Payable | 316,137.96 | 1,564,338.77 | 69,924.68 | 1,810,552.05 | 204,503.86 |
| Employee Benefits | | | | | |
| Compensated Absences | 3,999,720.96 | 3,171,553.98 | 2,775,959.97 | 4,395,314.97 | 119,667.83 |
| Net Pension Liability | 9,440,398.00 | 1,466,497.00 | | 10,906,895.00 | |
| Net Other Postemployment Benefits Liability | 54,765,104.00 | | 9,849,139.00 | 44,915,965.00 | |
| Workers' Compensation | 329,003.82 | 260,012.00 | 141,151.93 | 447,863.89 | 103,652.77 |
| Total Other Long-Term Liabilities | 68,850,364.74 | 6,462,401.75 | 12,836,175.58 | 62,476,590.91 | 427,824.46 |
| Total Long-Term Liabilities | \$ 69,280,426.40 | \$ 6,462,401.75 | \$ 12,920,082.79 | \$ 62,822,745.36 | \$ 515,195.43 |

Additional information regarding the net pension liability is included in Note 13.

Additional information regarding the net other postemployment benefits liability is included in Note 14.

B. Terms of Debt Agreements - The UNC System Office's debt agreements are subject to the following collateral requirements and terms with finance-related consequences:

Notes from Direct Borrowings - The UNC System Office has pledged the energy savings improvements installed in its buildings and other structures as collateral for the UNC System Guaranteed Energy Savings Installment Financing Agreement dated September 1, 2014. This agreement also contains provisions related to events of default and remedies. Significant to these provisions, an event of default occurs when: (1) the UNC System Office fails to pay an installment payment when due, (2) an event of nonappropriation from the State occurs, (3) insurance coverage on the asset is not maintained, or (4) the UNC System Office fails to perform any warranty, covenant, condition, or agreement within thirty days of receiving written notice by the lender or fails to diligently pursue corrective action for matters that cannot be reasonably corrected within thirty days.

Upon the occurrence of any event of default, the lender may, without any further demand or notice, declare the unpaid principal amount plus any accrued and unpaid interest be due and payable immediately. The lender may also exercise all remedies available by law or in the equity provided under the agreement, including sale of the secured assets, and apply the proceeds of any such sale to the amounts due after deducting all costs and expenses related to the recovery, repair, storage, and sale of the secured assets, including court costs and reasonable attorneys' fees incurred.

- C. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2019, are as follows:

| Fiscal Year | Annual Requirements | |
|--------------------|------------------------------|--------------|
| | Notes from Direct Borrowings | |
| | Principal | Interest |
| 2020 | \$ 87,370.97 | \$ 5,778.26 |
| 2021 | 90,936.84 | 4,144.47 |
| 2022 | 94,607.72 | 2,444.14 |
| 2023 | 73,238.92 | 675.53 |
| Total Requirements | \$ 346,154.45 | \$ 13,042.40 |

- D. Notes from Direct Borrowings** - The UNC System Office was indebted for notes from direct borrowings 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, 2019 | Principal Outstanding June 30, 2019 |
|---------------------------|--|---------------|---------------------|--------------------------|--------------------------------------|-------------------------------------|
| Energy Services Agreement | Banc of America Public Capital Corp | 1.84% | 2/14/2023 | \$ 607,508.00 | \$ 261,353.55 | \$ 346,154.45 |

- E. Annuities Payable** - The UNC System Office serves as the intermediary for split-interest agreements that require benefits payments to the donors for a specified period to a designated beneficiary out of assets held in trust for this purpose. At the end of the predetermined period (e.g. the lifetime of the beneficiary specified by the donor), the remaining assets of the trust revert to one of the UNC System universities for their use as designated by the donor. At the end of the fiscal year, annuities payable to the beneficiaries are calculated using the 2000 CM mortality table, thus taking into consideration beneficiary's age and the amount of the gift.

NOTE 9 - OPERATING LEASE OBLIGATIONS

The UNC System Office entered into operating leases for tower sites and office and storage facilities. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2019:

| Fiscal Year | Amount |
|------------------------------|---------------|
| 2020 | \$ 158,012.10 |
| 2021 | 104,506.94 |
| 2022 | 90,345.44 |
| 2023 | 80,863.51 |
| 2024 | 77,157.67 |
| 2025-2029 | 109,370.09 |
| 2030-2034 | 10,809.13 |
| Total Minimum Lease Payments | \$ 631,064.88 |

Rental expense for all operating leases during the year was \$263,152.87.

NOTE 10 - NET POSITION

The deficit in unrestricted net position of \$42,112,319.14 has been significantly affected by transactions that resulted in the recognition of deferred outflows of resources and deferred inflows of resources. A summary of the balances reported within unrestricted net position relating to the reporting of net pension liability and net other postemployment benefits (OPEB) liability, and the related deferred outflows of resources and deferred inflows of resources is presented as follows:

| | TSERS | Retiree Health Benefit Fund | Total |
|---|--------------------------|--------------------------------|---------------------------|
| Deferred Outflows Related to Pensions | \$ 6,311,686.00 | \$ 0.00 | \$ 6,311,686.00 |
| Deferred Outflows Related to OPEB | | 1,820,237.00 | 1,820,237.00 |
| Noncurrent Liabilities: | | | |
| Long-Term Liabilities: | | | |
| Net Pension Liability | 10,906,895.00 | | 10,906,895.00 |
| Net OPEB Liability | | 44,915,965.00 | 44,915,965.00 |
| Deferred Inflows Related to Pensions | 355,239.00 | | 355,239.00 |
| Deferred Inflows Related to OPEB | | 28,290,378.00 | 28,290,378.00 |
| Net Effect on Unrestricted Net Position | <u>\$ (4,950,448.00)</u> | <u>\$ (71,386,106.00)</u> | <u>\$ (76,336,554.00)</u> |

See Notes 13 and 14 for detailed information regarding the amortization of the deferred outflows of resources and deferred inflows of resources relating to pensions and OPEB, respectively.

NOTE 11 - REVENUES

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

| | Gross Revenues | Less Allowance for Uncollectibles | Net Revenues |
|-----------------------|-------------------------|---|-------------------------|
| Noncapital Gifts, Net | <u>\$ 13,714,289.59</u> | <u>\$ 13,641.00</u> | <u>\$ 13,700,648.59</u> |

NOTE 12 - OPERATING EXPENSES BY FUNCTION

The UNC System Office's operating expenses by functional classification are presented as follows:

| | Salaries and Benefits | Supplies and Materials | Services | Utilities | Depreciation | Total |
|-------------------------------------|-----------------------------|------------------------------|-------------------------|------------------------|------------------------|-------------------------|
| Instruction | \$ 852,759.17 | \$ 124,525.86 | \$ 2,814,320.28 | \$ 0.00 | \$ 0.00 | \$ 3,791,605.31 |
| Research | 56,518.06 | | 267.92 | | | 56,785.98 |
| Public Service | 11,759,614.67 | 1,875,853.20 | 17,289,790.79 | 1,278,372.70 | | 32,203,631.36 |
| Institutional Support | 24,751,130.57 | 1,378,207.26 | 16,150,461.36 | 334,421.30 | | 42,614,220.49 |
| Operations and Maintenance of Plant | | | 599,918.82 | | | 599,918.82 |
| Student Financial Aid | | | 204,997.00 | | | 204,997.00 |
| Depreciation | | | | | 2,809,662.90 | 2,809,662.90 |
| Total Operating Expenses | \$ 37,420,022.47 | \$ 3,378,586.32 | \$ 37,059,756.17 | \$ 1,612,794.00 | \$ 2,809,662.90 | \$ 82,280,821.86 |

NOTE 13 - 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.

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 UNC System Office's contractually-required contribution rate for the year ended June 30, 2019 was 12.29% of covered payroll. Employee contributions to the pension plan were \$1,043,937.19, and the UNC System Office's contributions were \$2,138,331.34 for the year ended June 30, 2019.

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 2018 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <https://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. For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the TSERS plan, and additions to/deductions from the TSERS plan's fiduciary net position have been determined on the same basis as they are reported by TSERS.

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 External Investment Pool. TSERS and other pension plans of the State of North Carolina are the sole participants in the Long-Term Investment, Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Opportunistic Fixed Income Investment, and Inflation Sensitive Investment Portfolios. The Fixed Income Asset Class includes the Long-Term Investment and 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 value of the net position of the various portfolios within the External Investment Pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2018 *Comprehensive Annual Financial Report*.

Net Pension Liability: At June 30, 2019, the UNC System Office reported a liability of \$10,906,895.00 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2018. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2017, and update procedures were used to roll forward the total pension liability to June 30, 2018. The UNC System Office's proportion of the net pension liability was based on the present value of future salaries for the UNC System Office relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2018, the UNC System Office's proportion was 0.10955%, which was a decrease of 0.00943 from its proportion measured as of June 30, 2017, which was 0.11898%.

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 | 12/31/2017 |
| Inflation | 3% |
| Salary Increases* | 3.50% - 8.10% |
| Investment Rate of Return** | 7.00% |

* Salary increases include 3.5% inflation and productivity factor.

** Investment rate of return includes inflation assumption and is net of pension plan investment expense.

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 mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2017 valuations were based on the results of an actuarial experience review for the period January 1, 2010 through December 31, 2014.

Future ad hoc Cost of Living Adjustment 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, 2018 (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% |
| Opportunistic Fixed Income | 6.0% |
| Inflation Sensitive | 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. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2018 is 1.5%.

Discount Rate: The discount rate used to measure the total pension liability was lowered from 7.20% to 7.00% for the December 31, 2017 valuation. The discount rate is in line with the long-term nominal expected return on pension plan investments. The calculation of the net pension liability is a present value calculation of the future net pension payments. These net pension payments assume that contributions from plan members will be made at the current statutory contribution rate and that contributions from employers will be made at the contractually 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, 2018 calculated using the discount rate of 7.00%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.00%) or 1-percentage point higher (8.00%) than the current rate:

| Net Pension Liability | | |
|-----------------------|-------------------------------|---------------------|
| 1% Decrease (6.00%) | Current Discount Rate (7.00%) | 1% Increase (8.00%) |
| \$ 20,801,297.18 | \$ 10,906,895.00 | \$ 2,604,511.69 |

Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: For the year ended June 30, 2019, the UNC System Office recognized pension expense of \$2,539,383.00. At June 30, 2019, the UNC System Office 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 | \$ 795,992.00 | \$ 109,458.00 |
| Changes of Assumptions | 2,188,733.00 | |
| Net Difference Between Projected and Actual Earnings on Plan Investments | 1,039,429.00 | |
| Change in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions | 149,200.66 | 245,781.00 |
| Contributions Subsequent to the Measurement Date | 2,138,331.34 | |
| Total | \$ 6,311,686.00 | \$ 355,239.00 |

The amount of \$2,138,331.34 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be included as a reduction of the net pension liability in the fiscal year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as 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 |
|---------------------|------------------------|
| 2020 | \$ 2,314,257.00 |
| 2021 | 1,411,253.00 |
| 2022 | 111,692.00 |
| 2023 | (19,086.34) |
| Total | \$ 3,818,115.66 |

- 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. Staff of the UNC System Office may join ORP instead of TSERS. The Board of Governors of the University of North Carolina is responsible for the administration of ORP and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under ORP and approves the form and contents of the contracts and trust agreements.

Participants in ORP are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in 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. Member and employer contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2019, these rates were set at 6% of covered payroll for members and 6.84% of covered payroll for employers. The UNC System Office assumes no liability other than its contribution.

For the current fiscal year, the UNC System Office had a total payroll of \$31,710,876.17, of which \$11,554,911.09 was covered under ORP. Total employee and employer contributions for pension benefits for the year were \$693,294.67 and \$790,355.92, respectively. The amount of expense recognized in the current year related to ORP is equal to the employer contributions. The UNC System Office had forfeitures reflected in pension expense for the current fiscal year of \$768,566.00.

NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS

The UNC System Office participates in two postemployment benefit plans, the Retiree Health Benefit Fund and the Disability Income Plan of North Carolina, that are administered by the State of North Carolina as pension and other employee benefit trust funds. Each plan's financial information, including all information about the plans' 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 2018 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at <https://www.osc.nc.gov/> or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

A. Summary of Significant Accounting Policies and Plan Asset Matters

Basis of Accounting: The financial statements of these plans were prepared using the accrual basis of accounting. Employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits are recognized when due and payable in accordance with the terms of each plan. For purposes of measuring the

net OPEB liability, deferred outflows of resources and deferred inflows of resources related to OPEB, and OPEB expense, information about the fiduciary net position of each plan, and additions to/deductions from each plans' fiduciary net position have been determined on the same basis as they are reported by the plans.

Methods Used to Value Plan Investments: Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the other postemployment benefits funds. The State Treasurer maintains various investment portfolios in its External Investment Pool. The Retiree Health Benefit Fund participates in the External Investment Pool. The Disability Income Plan of North Carolina is invested in the Short-Term Investment Portfolio of the External Investment Pool and the Bond Index External Investment Pool. The investment balance of each other employee benefit trust fund represents its share of the fair 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 2018 *Comprehensive Annual Financial Report*.

B. Plan Descriptions

1. Health Benefits

Plan Administration: The State of North Carolina administers the North Carolina State Health Plan for Teachers and State Employees, referred to as the State Health Plan (the Plan), a healthcare plan exclusively for the benefit of employees of the State, the University of North Carolina System, community colleges, and certain other component units. In addition, Local Education Agencies (LEAs), charter schools, and some select local governments that are not part of the State's financial reporting entity also participate. Health benefit programs and premium rates are determined by the State Treasurer upon approval of the Plan Board of Trustees.

The Retiree Health Benefit Fund (RHBF) has been established as a fund to provide health benefits to retired and disabled employees and their applicable beneficiaries. RHBF is established by General Statute 135-7, Article 1. RHBF is a cost-sharing, multiple-employer, defined benefit healthcare plan, exclusively for the benefit of eligible former employees of the State, the University of North Carolina System, and community colleges. In addition, LEAs, charter schools, and some select local governments that are not part of the State's financial reporting entity also participate.

By statute, RHBF is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System (TSERS). RHBF is supported by a percent of payroll contribution from participating employing units. Each year the percentage is set in legislation, as are the maximum per retiree contributions from RHBF to the Plan. The State Treasurer, with the approval of the Plan Board of Trustees, then

sets the employer contributions (subject to the legislative cap) and the premiums to be paid by retirees, as well as the health benefits to be provided through the Plan.

Benefits Provided: Plan benefits received by retired employees and disabled employees from RHBF are OPEB. The healthcare benefits for retired and disabled employees who are not eligible for Medicare are the same as for active employees as described in Note 15. The plan options change when former employees become eligible for Medicare. Medicare retirees have the option of selecting one of two fully-insured Medicare Advantage/Prescription Drug Plan options or the self-funded Traditional 70/30 Preferred Provider Organization plan option that is also offered to non-Medicare members. If the Traditional 70/30 Plan is selected by a Medicare retiree, the self-funded State Health Plan coverage is secondary to Medicare.

Those former employees who are eligible to receive medical benefits from RHBF are long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of TSERS, the Consolidated Judicial Retirement System, the Legislative Retirement System, the Optional Retirement Program (ORP), and a small number of local governments, with five or more years of contributory membership service in their retirement system prior to disability or retirement, with the following exceptions: for employees first hired on or after October 1, 2006, and members of the North Carolina General Assembly first taking office on or after February 1, 2007, future coverage as retired employees and retired members of the North Carolina General Assembly is subject to the requirement that the future retiree have 20 or more years of retirement service credit in order to receive coverage on a noncontributory basis. Employees first hired on or after October 1, 2006 and members of the North Carolina General Assembly first taking office on or after February 1, 2007 with 10 but less than 20 years of retirement service credit are eligible for coverage on a partially contributory basis. For such future retirees, the State will pay 50% of the State Health Plan's total noncontributory premium.

The Plan's and RHBF's benefit and contribution provisions are established by Chapter 135-7, Article 1, and Chapter 135, Article 3B of the General Statutes and may be amended only by the North Carolina General Assembly. RHBF does not provide for automatic post-retirement benefit increases.

Contributions: Contribution rates to RHBF, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the North Carolina General Assembly in the Appropriations Bill. The UNC System Office's contractually-required contribution rate for the year ended June 30, 2019 was 6.27% of covered payroll. The UNC System Office's contributions to the RHBF were \$1,815,407.29 for the year ended June 30, 2019.

2. Disability Income

Plan Administration: As discussed in Note 15, short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer, defined benefit plan, to the eligible members of TSERS which includes employees of the State, the University of North Carolina System, community colleges, certain participating component units, LEAs which are not part of the reporting entity, and the ORP. By statute, DIPNC is administered by the Department of State Treasurer and the Board of Trustees of TSERS.

Benefits Provided: Long-term disability benefits are payable as an OPEB from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided the following requirements are met: (1) the employee has five or more years of contributing membership service in TSERS or the ORP, earned within 96 months prior to the end of the short-term disability period or cessation of salary continuation payments, whichever is later; (2) the employee must make application to receive long-term benefits within 180 days after the conclusion of the short-term disability period or after salary continuation payments cease or after monthly payments for Workers' Compensation cease (excluding monthly payments for permanent partial benefits), whichever is later; (3) the employee must be certified by the Medical Board to be mentally or physically disabled for the further performance of his/her usual occupation; (4) the disability must have been continuous, likely to be permanent, and incurred at the time of active employment; (5) the employee must not be eligible to receive an unreduced retirement benefit from TSERS; and (6) the employee must terminate employment as a permanent, full-time employee. An employee is eligible to receive an unreduced retirement benefit from TSERS after (1) reaching the age of 65 and completing five years of membership service, or (2) reaching the age of 60 and completing 25 years of creditable service, or (3) completing 30 years of creditable service, at any age.

For employees who had five or more years of membership service as of July 31, 2007, during the first 36 months of the long-term disability period, the monthly long-term disability benefit is equal to 65% of one-twelfth of an employee's annual base rate of compensation last payable to the participant or beneficiary prior to the beginning of the short-term disability period, plus the like percentage of one-twelfth of the annual longevity payment and local supplements to which the participant or beneficiary would be eligible. The monthly benefits are subject to a maximum of \$3,900 per month reduced by any primary Social Security disability benefits and by monthly payments for Workers' Compensation to which the participant or beneficiary may be entitled, but the benefits payable shall be no less than \$10 a month. After the first 36 months of the long-term disability, the long-term

benefit is calculated in the same manner as described above except the monthly benefit is reduced by an amount equal to a monthly primary Social Security disability benefit to which the participant or beneficiary might be entitled had Social Security disability benefits been awarded. When an employee qualifies for an unreduced service retirement allowance from TSERS, the benefits payable from DIPNC will cease, and the employee will commence retirement under TSERS or the ORP.

For employees who had less than five years of membership service as of July 31, 2007, and meet the requirements for long-term disability on or after August 1, 2007, during the first 36 months of the long-term disability period, the monthly long-term benefit shall be reduced by an amount equal to the monthly primary Social Security retirement benefit to which the employee might be entitled should the employee become age 62 during the first 36 months. This reduction becomes effective as of the first day of the month following the month of initial entitlement to Social Security benefits. After the first 36 months of the long-term disability, no further benefits are payable under the terms of this section unless the employee has been approved and is in receipt of primary Social Security disability benefits.

Contributions: Although DIPNC operates on a calendar year, disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the North Carolina General Assembly and coincide with the State's fiscal year. The UNC System Office's contractually-required contribution rate for the year ended June 30, 2019 was 0.14% of covered payroll. The UNC System Office's contributions to DIPNC were \$40,535.41 for the year ended June 30, 2019.

C. Net OPEB Liability (Asset)

Net OPEB Liability: At June 30, 2019, the UNC System Office reported a liability of \$44,915,965.00 for its proportionate share of the collective net OPEB liability for RHBF. The net OPEB liability was measured as of June 30, 2018. The total OPEB liability used to calculate the net OPEB liability was determined by an actuarial valuation as of December 31, 2017, and update procedures were used to roll forward the total OPEB liability to June 30, 2018. The UNC System Office's proportion of the net OPEB liability was based on the present value of future salaries for the UNC System Office relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2018, the UNC System Office's proportion was 0.15767%, which was a decrease of 0.00936 from its proportion measured as of June 30, 2017, which was 0.16703%.

Net OPEB Asset: At June 30, 2019, the UNC System Office reported an asset of \$49,671.00 for its proportionate share of the collective net OPEB asset for DIPNC. The net OPEB asset was measured as of June 30, 2018. The total OPEB asset used to calculate the net OPEB asset

was determined by an actuarial valuation as of December 31, 2017, and update procedures were used to roll forward the total OPEB asset to June 30, 2018. The UNC System Office's proportion of the net OPEB asset was based on the present value of future salaries for the UNC System Office relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2018, the UNC System Office's proportion was 0.16352%, which was a decrease of 0.01284 from its proportion measured as of June 30, 2017, which was 0.17636%.

Actuarial Assumptions: The total OPEB liabilities (assets) for RHBF and DIPNC were determined by actuarial valuations as of December 31, 2017, using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified. The total OPEB liabilities (assets) were then rolled forward to June 30, 2018 utilizing update procedures incorporating the actuarial assumptions.

| | Retiree Health Benefit Fund | Disability Income Plan of N. C. |
|---|---|--|
| Valuation Date | 12/31/2017 | 12/31/2017 |
| Inflation | 3.00% | 3.00% |
| Salary Increases* | 8.10% grading down to 3.50% depending on employee class | 3.50% - 8.10% |
| Investment Rate of Return** | 7.00% | 3.75% |
| Healthcare Cost Trend Rate - Medical | 6.50% grading down to 5.00% by 2024 | 6.50% grading down to 5.00% by 2024 |
| Healthcare Cost Trend Rate - Prescription Drug | 7.25% grading down to 5.00% by 2027 | N/A |
| Healthcare Cost Trend Rate - Medicare Advantage | 5.00% | N/A |
| Healthcare Cost Trend Rate - Administrative | 3.00% | N/A |

* Salary increases include 3.5% inflation and productivity factor.

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

N/A - Not Applicable

The OPEB plans currently use 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 studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The projected long-term investment returns and inflation assumptions are developed through a 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 projects 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. DIPNC is primarily invested in the Bond Index Investment Pool as of June 30, 2018.

Best estimates of real rates of return for each major asset class included in RHBF's target asset allocation as of June 30, 2018 (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% |
| Opportunistic Fixed Income | 6.0% |
| Inflation Sensitive | 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. The long-term expected real rate of return for the Bond Index Investment Pool as of June 30, 2018 is 1.5%.

Actuarial valuations of the plans involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

The actuarial assumptions used for RHBF are consistent with those used to value the pension benefits of TSERS where appropriate. These assumptions are based on the most recent pension valuations available. The discount rate used for RHBF reflects a pay-as-you-go approach.

Projections of benefits for financial reporting purposes of the plans are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and historical pattern of sharing of benefit costs between the employer and plan members to that point. Historically, the benefits funded solely by employer contributions applied equally to all retirees.

Currently, as described earlier in the note, benefits are dependent on membership requirements.

The actuarial methods and assumptions used for DIPNC include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

The actuarial assumptions used in the December 31, 2017 valuations were generally based on the results of an actuarial experience study prepared as of December 31, 2014, as amended for updates to certain assumptions (such as the long-term investment return, medical claims, and medical trend rate assumptions) implemented based on annual reviews that have occurred since that experience study.

Discount Rate: The discount rate used to measure the total OPEB liability for RHBF was 3.87%. The projection of cash flows used to determine the discount rate assumed that contributions from employers will be made at the current statutorily determined contribution rate. Based on the above assumptions, the plan's fiduciary net position was not projected to be available to make projected future benefit payments of current plan members. As a result, a municipal bond rate of 3.87% was used as the discount rate used to measure the total OPEB liability. The 3.87% rate is based on the Bond Buyer 20-year General Obligation Index as of June 30, 2018.

The discount rate used to measure the total OPEB asset for DIPNC was 3.75%. 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 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 plan investments was applied to all periods of projected benefit payments to determine the total OPEB asset.

Sensitivity of the Net OPEB Liability (Asset) to Changes in the Discount Rate: The following presents the UNC System Office's proportionate share of the net OPEB liability (asset) of the plans, as well as what the plans' net OPEB liability (asset) would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current discount rate:

| Net OPEB Liability (Asset) | | | | | |
|----------------------------|---------------------|-------------------------------|---------------------|--|--|
| | 1% Decrease (2.87%) | Current Discount Rate (3.87%) | 1% Increase (4.87%) | | |
| RHBF | \$ 53,068,667.39 | \$ 44,915,965.00 | \$ 38,380,701.42 | | |
| | 1% Decrease (2.75%) | Current Discount Rate (3.75%) | 1% Increase (4.75%) | | |
| DIPNC | \$ (38,059.41) | \$ (49,671.00) | \$ (60,810.02) | | |

NOTES TO THE FINANCIAL STATEMENTS

Sensitivity of the Net OPEB Liability (Asset) to Changes in the Healthcare Cost Trend Rates: The following presents the net OPEB liability (asset) of the plans, as well as what the plans' net OPEB liability (asset) would be if it were calculated using healthcare cost trend rates that are 1-percentage point lower or 1-percentage point higher than the current healthcare cost trend rates:

| | 1% Decrease (Medical - 4.00% - 5.50%, Pharmacy - 4.00% - 6.25%, Med. Advantage - 4.00%, Administrative - 2.00%) | Current Healthcare Cost Trend Rates (Medical - 5.00% - 6.50%, Pharmacy - 5.00% - 7.25%, Med. Advantage - 5.00%, Administrative - 3.00%) | 1% Increase (Medical - 6.00% - 7.50%, Pharmacy - 6.00% - 8.25%, Med. Advantage - 6.00%, Administrative - 4.00%) |
|-------------------------|---|--|---|
| RHBF Net OPEB Liability | \$ 37,054,501.84 | \$ 44,915,965.00 | \$ 55,236,526.59 |
| | 1% Decrease (5.50% grading down to 4.00% in 2024) | Current Healthcare Cost Trend Rates (6.50% grading down to 5.00% in 2024) | 1% Increase (7.50% grading down to 6.00% in 2024) |
| DIPNC Net OPEB Asset | \$ (49,814.90) | \$ (49,671.00) | \$ (49,535.28) |

Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB: For the year ended June 30, 2019, the UNC System Office recognized OPEB contra-expense of \$1,880,062.00 for RHBF and expense of \$3,609.00 for DIPNC. At June 30, 2019, the UNC System Office reported deferred outflows of resources and deferred inflows of resources related to OPEB from the following sources:

| Employer Balances of Deferred Outflows of Resources Related to OPEB by Classification: | | | |
|---|------------------------|----------------------|------------------------|
| | RHBF | DIPNC | Total |
| Differences Between Actual and Expected Experience | \$ 0.00 | \$ 86,646.00 | \$ 86,646.00 |
| Changes of Assumptions | | 9,380.00 | 9,380.00 |
| Net Difference Between Projected and Actual Earnings on Plan Investments | 4,829.71 | 38,684.00 | 43,513.71 |
| Changes in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions | | 11,458.59 | 11,458.59 |
| Contributions Subsequent to the Measurement Date | 1,815,407.29 | 40,535.41 | 1,855,942.70 |
| Total | \$ 1,820,237.00 | \$ 186,704.00 | \$ 2,006,941.00 |

Employer Balances of Deferred Inflows of Resources
Related to OPEB by Classification:

| | RHB | DIPNC | Total |
|---|-------------------------|--------------------|-------------------------|
| Differences Between Actual and Expected Experience | \$ 3,071,552.00 | \$ 0.00 | \$ 3,071,552.00 |
| Changes of Assumptions | 19,458,633.00 | | 19,458,633.00 |
| Changes in Proportion and Differences Between Employer's Contributions and Proportionate Share of Contributions | 5,760,193.00 | 2,820.00 | 5,763,013.00 |
| Total | \$ 28,290,378.00 | \$ 2,820.00 | \$ 28,293,198.00 |

Amounts reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net OPEB liability related to RHB and an increase of the net OPEB asset related to DIPNC in the fiscal year ended June 30, 2020. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB 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 OPEB Expense:

| Year Ended June 30: | RHB | DIPNC |
|---------------------|---------------------------|----------------------|
| 2020 | \$ (6,496,207.00) | \$ 33,637.00 |
| 2021 | (6,496,207.00) | 33,632.00 |
| 2022 | (6,496,207.00) | 25,906.00 |
| 2023 | (6,491,404.00) | 20,436.00 |
| 2024 | (2,305,523.29) | 14,870.00 |
| Thereafter | | 14,867.59 |
| Total | \$ (28,285,548.29) | \$ 143,348.59 |

NOTE 15 - RISK MANAGEMENT

The UNC System Office 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

UNC System Office employees 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 contributions. Certain plans also require contributions from employees. The Plan has contracted with third parties to process claims. See Note 14, Other Postemployment Benefits, for additional information regarding retiree health benefits.

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 0.16% for the current fiscal year.

3. Disability Income Plan

Short-term and long-term disability benefits are provided to UNC System Office employees through the Disability Income Plan of North Carolina (DIPNC), part of the State's Pension and Other Employee Benefit Trust Funds. Short-term benefits are paid by the UNC System Office up to the first six months of benefits and reimbursed by DIPNC for any additional short-term benefits. As discussed in Note 14, long-term disability benefits are payable as other postemployment benefits from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled.

B. Other Risk Management and Insurance Activities

1. Automobile, Fire, and Other Property Losses

The UNC System Office 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 UNC System Office 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.

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 UNC System Office

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 \$2,000,000 per claim and \$10,000,000 in the aggregate per fiscal year via contract with a private insurance company. The UNC System Office pays the premium, based on a composite rate, directly to the private insurer.

3. Employee Dishonesty and Computer Fraud

The UNC System Office is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$100,000 deductible.

4. Statewide Workers' Compensation Program

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

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

5. Other Insurance Held by the UNC System Office

The UNC System Office purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. These purchased coverages include: boiler, auto comprehensive and collision, leased computer equipment, and fine art.

NOTE 16 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The UNC System Office has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$16,580,916.35 at June 30, 2019.
- B. Pending Litigation and Claims** - The UNC System Office is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. The UNC System Office management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the UNC System Office.

NOTE 17 - BLENDED COMPONENT UNIT

Condensed combining information for the UNC System Office's blended component unit for the year ended June 30, 2019, is presented as follows:

*Condensed Statement of Net Position
June 30, 2019*

| | The University of North Carolina System Office | The University of North Carolina Foundation, Inc. | Eliminations | Total |
|---|--|---|--------------|-------------------|
| ASSETS | | | | |
| Current Assets | \$ 125,664,396.27 | \$ 822,573.03 | \$ 0.00 | \$ 126,486,969.30 |
| Capital Assets, Net | 58,251,087.58 | | | 58,251,087.58 |
| Other Noncurrent Assets | 99,163,856.30 | 3,154,525.91 | | 102,318,382.21 |
| Total Assets | 283,079,340.15 | 3,977,098.94 | | 287,056,439.09 |
| TOTAL DEFERRED OUTFLOWS OF RESOURCES | 8,318,627.00 | | | 8,318,627.00 |
| LIABILITIES | | | | |
| Current Liabilities | 21,085,114.73 | 222,703.85 | | 21,307,818.58 |
| Long-Term Liabilities | 60,701,501.74 | 1,606,048.19 | | 62,307,549.93 |
| Other Noncurrent Liabilities | | 1,560,442.06 | (572,787.20) | 987,654.86 |
| Total Liabilities | 81,786,616.47 | 3,389,194.10 | (572,787.20) | 84,603,023.37 |
| TOTAL DEFERRED INFLOWS OF RESOURCES | 83,633,772.99 | | 572,787.20 | 84,206,560.19 |
| NET POSITION | | | | |
| Net Investment in Capital Assets | 53,373,340.94 | | | 53,373,340.94 |
| Restricted - Nonexpendable | 14,796,987.42 | | | 14,796,987.42 |
| Restricted - Expendable | 100,061,249.10 | 446,224.21 | | 100,507,473.31 |
| Unrestricted | (42,253,999.77) | 141,680.63 | | (42,112,319.14) |
| Total Net Position | \$ 125,977,577.69 | \$ 587,904.84 | \$ 0.00 | \$ 126,565,482.53 |

*Condensed Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2019*

| | The University of North Carolina System Office | The University of North Carolina Foundation, Inc. | Total |
|---|--|---|--------------------------|
| OPERATING REVENUES | | | |
| Sales and Services | \$ 11,765,406.22 | \$ 0.00 | \$ 11,765,406.22 |
| Other | 30,485.01 | | 30,485.01 |
| Total Operating Revenues | 11,795,891.23 | | 11,795,891.23 |
| OPERATING EXPENSES | | | |
| Operating Expenses | 79,265,796.39 | 205,362.57 | 79,471,158.96 |
| Depreciation | 2,809,662.90 | | 2,809,662.90 |
| Total Operating Expenses | 82,075,459.29 | 205,362.57 | 82,280,821.86 |
| Operating Loss | (70,279,568.06) | (205,362.57) | (70,484,930.63) |
| NONOPERATING REVENUES (EXPENSES) | | | |
| State Appropriations | 342,026,381.04 | | 342,026,381.04 |
| Noncapital Grants | 57,348,064.58 | | 57,348,064.58 |
| Noncapital Gifts, Net | 13,397,298.74 | 303,349.85 | 13,700,648.59 |
| Investment Income, Net | 8,773,560.18 | 3,053.97 | 8,776,614.15 |
| Grants, Aid and Subsidies | (329,236,160.59) | (1,192,768.41) | (330,428,929.00) |
| Other Nonoperating Expenses | (790,837.43) | | (790,837.43) |
| Net Nonoperating Revenues (Expenses) | 91,518,306.52 | (886,364.59) | 90,631,941.93 |
| Capital Contributions | 22,519,741.66 | | 22,519,741.66 |
| Increase (Decrease) in Net Position | 43,758,480.12 | (1,091,727.16) | 42,666,752.96 |
| NET POSITION | | | |
| Net Position, July 1, 2018, as Restated | 82,219,097.57 | 1,679,632.00 | 83,898,729.57 |
| Net Position, June 30, 2019 | <u>\$ 125,977,577.69</u> | <u>\$ 587,904.84</u> | <u>\$ 126,565,482.53</u> |

*Condensed Statement of Cash Flows
June 30, 2019*

| | The University of North Carolina System Office | The University of North Carolina Foundation, Inc. | Total |
|---|--|---|--------------------------|
| Net Cash Used by Operating Activities | \$ (69,023,094.06) | \$ (195,776.95) | \$ (69,218,871.01) |
| Net Cash Provided (Used) by Noncapital Financing Activities | 94,025,366.48 | (889,418.56) | 93,135,947.92 |
| Net Cash Used by Capital and Related Financing Activities | (1,957,485.56) | | (1,957,485.56) |
| Net Cash Provided by Investing Activities | 7,364,207.25 | 3,053.97 | 7,367,261.22 |
| Net Increase (Decrease) in Cash and Cash Equivalents | 30,408,994.11 | (1,082,141.54) | 29,326,852.57 |
| Cash and Cash Equivalents, July 1, 2018 | 90,690,637.94 | 1,438,246.37 | 92,128,884.31 |
| Cash and Cash Equivalents, June 30, 2019 | <u>\$ 121,099,632.05</u> | <u>\$ 356,104.83</u> | <u>\$ 121,455,736.88</u> |

NOTE 18 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2019, the UNC System Office implemented the following pronouncement issued by the Governmental Accounting Standards Board (GASB):

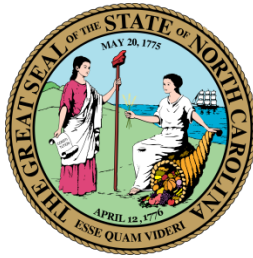
GASB Statement No. 88, Certain Disclosures Related to Debt, including Direct Borrowings and Direct Placements

GASB Statement No. 88 improves the information that is disclosed in the notes to government financial statements related to debt, including direct borrowings and direct placements. It defines debt for purposes of disclosure in notes to financial statements and requires disclosure of additional essential information, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events with finance-related consequences or significant subjective acceleration clauses. Additionally, this Statement requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt.

NOTE 19 - NET POSITION RESTATEMENT

As of July 1, 2018, net position as previously reported was restated as follows:

| | Amount |
|--|-------------------------|
| July 1, 2018 Net Position as Previously Reported | \$ 84,227,733.39 |
| Restatement: | |
| Record the UNC System Office's Workers' Compensation Liability | (329,003.82) |
| July 1, 2018 Net Position as Restated | <u>\$ 83,898,729.57</u> |



REQUIRED SUPPLEMENTARY INFORMATION

**The University of North Carolina System Office
Required Supplementary Information
Schedule of the Proportionate Share of the Net Pension Liability
Cost-Sharing, Multiple-Employer, Defined Benefit Pension Plan
Last Six Fiscal Years***

Exhibit B-1

| Teachers' and State Employees' Retirement System | 2019 | 2018 | 2017 |
|--|------------------|------------------|------------------|
| Proportionate Share Percentage of Collective Net Pension Liability | 0.10955% | 0.11898% | 0.12384% |
| Proportionate Share of TSERS Collective Net Pension Liability | \$ 10,906,895.00 | \$ 9,440,398.00 | \$ 11,382,175.00 |
| Covered Payroll | \$ 19,074,221.00 | \$ 21,022,422.00 | \$ 19,582,919.00 |
| Proportionate Share of the Net Pension Liability as a Percentage of Covered Payroll | 57.18% | 44.91% | 58.12% |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 87.61% | 89.51% | 87.32% |
| | 2016 | 2015 | 2014 |
| Proportionate Share Percentage of Collective Net Pension Liability | 0.11855% | 0.12394% | 0.12468% |
| Proportionate Share of TSERS Collective Net Pension Liability | \$ 4,368,986.00 | \$ 1,453,102.00 | \$ 7,569,190.00 |
| Covered Payroll | \$ 19,305,120.00 | \$ 19,638,164.00 | \$ 19,499,999.00 |
| Proportionate Share of the Net Pension Liability as a Percentage of Covered Payroll | 22.63% | 7.40% | 38.82% |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 94.64% | 98.24% | 90.60% |

Note: Information is presented for all years that were measured in accordance with the requirements of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions - An Amendment of GASB Statement No. 27*, as amended.

* The amounts presented for each fiscal year were determined as of the prior fiscal year ending June 30.

The University of North Carolina System Office
Required Supplementary Information
Schedule of UNC System Office Contributions
Cost-Sharing, Multiple-Employer, Defined Benefit Pension Plan
Last Ten Fiscal Years

Exhibit B-2

| Teachers' and State Employees' Retirement System | 2019 | 2018 | 2017 | 2016 | 2015 |
|---|------------------|------------------|------------------|------------------|------------------|
| Contractually Required Contribution | \$ 2,138,331.34 | \$ 2,056,201.02 | \$ 2,098,037.72 | \$ 1,791,837.09 | \$ 1,766,418.48 |
| Contributions in Relation to the Contractually Determined Contribution | 2,138,331.34 | 2,056,201.02 | 2,098,037.72 | 1,791,837.09 | 1,766,418.48 |
| 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 | \$ 17,398,953.00 | \$ 19,074,221.00 | \$ 21,022,422.00 | \$ 19,582,919.00 | \$ 19,305,120.00 |
| Contributions as a Percentage of Covered Payroll | 12.29% | 10.78% | 9.98% | 9.15% | 9.15% |
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| Contractually Required Contribution | \$ 1,706,556.45 | \$ 1,624,349.92 | \$ 1,440,219.87 | \$ 982,192.41 | \$ 699,297.03 |
| Contributions in Relation to the Contractually Determined Contribution | 1,706,556.45 | 1,624,349.92 | 1,440,219.87 | 982,192.41 | 699,297.03 |
| 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 | \$ 19,638,164.00 | \$ 19,499,999.00 | \$ 19,357,794.00 | \$ 19,922,767.00 | \$ 19,588,152.00 |
| Contributions as a Percentage of Covered Payroll | 8.69% | 8.33% | 7.44% | 4.93% | 3.57% |

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

The University of North Carolina System Office
Notes to Required Supplementary Information
Schedule of UNC System Office Contributions
Cost-Sharing, Multiple-Employer, Defined Benefit Pension Plan
Last Ten Fiscal Years

Changes of Benefit Terms:

| | <u>Cost of Living Increase</u> | | | | | | | | | |
|---|--------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Teachers' and State Employees' Retirement System | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 |
| | 1.00% | N/A | N/A | N/A | 1.00% | N/A | N/A | N/A | 2.20% | 2.20% |

Changes of Assumptions: In 2015, the North Carolina Retirement Systems' consulting actuaries performed the quinquennial investigation of each retirement system's 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 discount rate for the Teachers' and State Employees' Retirement System was lowered from 7.25% to 7.20% for the December 31, 2016 valuation. For the December 31, 2017 valuation, the discount rate was lowered to 7.00%.

The Board of Trustees also adopted a new asset valuation method for the Teachers' and State Employees' Retirement System. For determining plan funding requirements, the plan now uses a five-year smoothing method with a reset of the actuarial value of assets to market value as of December 31, 2014.

The Notes to Required Supplementary Information reflect information included in the State of North Carolina's 2018 *Comprehensive Annual Financial Report*.

N/A - Not Applicable

The University of North Carolina System Office
Required Supplementary Information
Schedule of the Proportionate Share of the Net OPEB Liability or Asset
Cost-Sharing, Multiple-Employer, Defined Benefit OPEB Plans
Last Three Fiscal Years*

Exhibit B-3

| Retiree Health Benefit Fund | 2019 | 2018 | 2017 |
|--|------------------|------------------|------------------|
| Proportionate Share Percentage of Collective Net OPEB Liability | 0.15767% | 0.16703% | 0.17553% |
| Proportionate Share of Collective Net OPEB Liability | \$ 44,915,965.00 | \$ 54,765,104.00 | \$ 76,361,516.00 |
| Covered Payroll | \$ 30,934,718.00 | \$ 31,691,990.00 | \$ 28,657,706.00 |
| Proportionate Share of the Net OPEB Liability as a Percentage of Covered Payroll | 145.20% | 172.80% | 266.46% |
| Plan Fiduciary Net Position as a Percentage of the Total OPEB Liability | 4.40% | 3.52% | 2.41% |
| Disability Income Plan of North Carolina | | | |
| Proportionate Share Percentage of Collective Net OPEB Asset | 0.16352% | 0.17636% | 0.16638% |
| Proportionate Share of Collective Net OPEB Asset | \$ 49,671.00 | \$ 107,791.00 | \$ 103,322.00 |
| Covered Payroll | \$ 30,934,718.00 | \$ 31,691,990.00 | \$ 28,657,706.00 |
| Proportionate Share of the Net OPEB Asset as a Percentage of Covered Payroll | 0.16% | 0.34% | 0.36% |
| Plan Fiduciary Net Position as a Percentage of the Total OPEB Asset | 108.47% | 116.23% | 116.06% |

Note: Information is presented for all years that were measured in accordance with the requirements of GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, as amended.

* The amounts presented for each fiscal year were determined as of the prior fiscal year ending June 30.

The University of North Carolina System Office
Required Supplementary Information
Schedule of UNC System Office Contributions
Cost-Sharing, Multiple-Employer, Defined Benefit OPEB Plans
Last Ten Fiscal Years

Exhibit B-4

| Retiree Health Benefit Fund | 2019 | 2018 | 2017 | 2016 | 2015 |
|--|------------------|------------------|------------------|------------------|------------------|
| Contractually Required Contribution | \$ 1,815,407.29 | \$ 1,871,550.44 | \$ 1,841,304.62 | \$ 1,604,831.54 | \$ 1,484,191.03 |
| Contributions in Relation to the Contractually Determined Contribution | 1,815,407.29 | 1,871,550.44 | 1,841,304.62 | 1,604,831.54 | 1,484,191.03 |
| Contribution Deficiency (Excess) | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Covered Payroll | \$ 28,953,864.00 | \$ 30,934,718.00 | \$ 31,691,990.00 | \$ 28,657,706.00 | \$ 27,034,445.00 |
| Contributions as a Percentage of Covered Payroll | 6.27% | 6.05% | 5.81% | 5.60% | 5.49% |
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| Contractually Required Contribution | \$ 1,414,713.01 | \$ 1,259,452.99 | \$ 1,126,145.20 | \$ 1,122,713.77 | \$ 1,025,186.90 |
| Contributions in Relation to the Contractually Determined Contribution | 1,414,713.01 | 1,259,452.99 | 1,126,145.20 | 1,122,713.77 | 1,025,186.90 |
| Contribution Deficiency (Excess) | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Covered Payroll | \$ 26,198,389.00 | \$ 23,763,264.00 | \$ 22,522,904.00 | \$ 22,912,526.00 | \$ 22,781,931.00 |
| Contributions as a Percentage of Covered Payroll | 5.40% | 5.30% | 5.00% | 4.90% | 4.50% |
| Disability Income Plan of North Carolina | 2019 | 2018 | 2017 | 2016 | 2015 |
| Contractually Required Contribution | \$ 40,535.41 | \$ 43,308.61 | \$ 120,429.56 | \$ 117,496.59 | \$ 110,841.22 |
| Contributions in Relation to the Contractually Determined Contribution | 40,535.41 | 43,308.61 | 120,429.56 | 117,496.59 | 110,841.22 |
| Contribution Deficiency (Excess) | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Covered Payroll | \$ 28,953,864.00 | \$ 30,934,718.00 | \$ 31,691,990.00 | \$ 28,657,706.00 | \$ 27,034,445.00 |
| Contributions as a Percentage of Covered Payroll | 0.14% | 0.14% | 0.38% | 0.41% | 0.41% |
| | 2014 | 2013 | 2012 | 2011 | 2010 |
| Contractually Required Contribution | \$ 115,272.91 | \$ 104,558.36 | \$ 117,119.10 | \$ 119,145.14 | \$ 118,466.04 |
| Contributions in Relation to the Contractually Determined Contribution | 115,272.91 | 104,558.36 | 117,119.10 | 119,145.14 | 118,466.04 |
| Contribution Deficiency (Excess) | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Covered Payroll | \$ 26,198,389.00 | \$ 23,763,264.00 | \$ 22,522,904.00 | \$ 22,912,526.00 | \$ 22,781,931.00 |
| Contributions as a Percentage of Covered Payroll | 0.44% | 0.44% | 0.52% | 0.52% | 0.52% |

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

***The University of North Carolina System Office
Notes to Required Supplementary Information
Schedule of UNC System Office Contributions
Cost-Sharing, Multiple-Employer, Defined Benefit OPEB Plans
Last Ten Fiscal Years***

Changes of Benefit Terms: Effective January 1, 2016, benefit terms related to copays, out-of-pocket maximums, and deductibles were changed for three of four options of the Retiree Health Benefit Fund (RHBF). Most of the changes were an increase in the amount from the previous year.

Effective January 1, 2017, benefit terms related to copays, coinsurance maximums, out-of-pocket maximums, and deductibles were changed for two of four options of the RHBF. Most of the changes were an increase in the amount from the previous year.

Method and Assumptions Used in Calculations of Actuarially Determined Contributions: An actuarial valuation is performed for each plan each year. The actuarially determined contribution rates in the Schedule of Employer Contributions are calculated by the actuary as a projection of the required employer contribution for the fiscal year beginning six months following the date of the valuation results for the RHBF. The actuarially determined contribution rates in the Schedule of UNC System Office Contributions are calculated by the actuary as a projection of the required employer contribution for the fiscal year beginning 18 months following the date of the valuation results for the Disability Income Plan of North Carolina (DIPNC). See Note 14 for more information on the specific assumptions for each plan. The actuarially determined contributions for those items with covered payroll were determined using the actuarially determined contribution rate from the actuary and covered payroll as adjusted for timing differences and other factors such as differences in employee class. Other actuarially determined contributions are disclosed in the schedule as expressed by the actuary in reports to the plans.

Changes of Assumptions: In 2015, the North Carolina Retirement Systems' consulting actuaries performed the quinquennial investigation of each retirement system's 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 Boards of Trustees of the Teachers' and State Employees' Retirement System and the State Health Plan adopted a number of new actuarial assumptions and methods for the RHBF and the DIPNC. 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 and rates of termination from active employment were reduced to more closely reflect actual experience.

In 2018, for the December 31, 2017 actuarial valuation, the discount rate for the RHBF was updated to 3.87% and the medical and prescription drug claims cost were changed based on most recent experience. Enrollment assumptions were updated to model expected migrations among RHBF plan options and trend assumptions for the RHBF include contribution changes for the 2019 period as those amounts have been finalized.

Additionally, the December 31, 2017 DIPNC actuarial valuation includes a liability for the State's potential reimbursement of health insurance premiums paid by employers during the second six months of the short-term disability benefit period.

The Notes to Required Supplementary Information reflect information included in the State of North Carolina's 2018 *Comprehensive Annual Financial Report*.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

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**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 Governors
University of North Carolina System
Chapel Hill, North Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of The University of North Carolina System Office (UNC System Office), the administrative body of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2019, and the related notes to the financial statements, which collectively comprise the UNC System Office's basic financial statements, and have issued our report thereon dated February 18, 2020.

As discussed in Note 1, the financial statements of The University of North Carolina System Office are intended to present the financial position, changes in financial position, and cash flows that are only attributable to the transactions of The University of North Carolina System Office. They do not purport to, and do not, present fairly the financial position of the University of North Carolina System as of June 30, 2019, the changes in its financial position, or its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the UNC System Office's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the UNC System Office's internal control. Accordingly, we do not express an opinion on the effectiveness of the UNC System Office'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 UNC System Office'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 UNC System Office'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 UNC System Office'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 UNC System Office's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

February 18, 2020

ORDERING INFORMATION

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For additional information, contact the
North Carolina Office of the State Auditor at 919-807-7666.



This audit required 408 hours at an approximate cost of \$42,432.