



STATE OF NORTH CAROLINA

**NORTH CAROLINA AGRICULTURAL AND TECHNICAL
STATE UNIVERSITY**

GREENSBORO, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

**NORTH CAROLINA AGRICULTURAL AND TECHNICAL
STATE UNIVERSITY**

GREENSBORO, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2006

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THE UNIVERSITY OF NORTH CAROLINA

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STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, North Carolina Agricultural and Technical State University

We have completed a financial statement and compliance audit of North Carolina Agricultural and Technical State University for the year ended June 30, 2006, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements and our consideration of the University's administration of federal programs in accordance with applicable laws, regulations, contracts and grants disclosed certain deficiencies and/or instances of noncompliance that are detailed in the Audit Findings and Recommendations section of this report. The University's response is included following each finding.

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

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

August 23, 2007

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
North Carolina Agricultural and Technical State University
Greensboro, North Carolina

We have audited the accompanying financial statements of North Carolina Agricultural and Technical State University, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2006, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the North Carolina Agricultural and Technical State University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of The North Carolina A&T University Foundation, Inc., which represent 100% of the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinions, insofar as they relate to the amounts included for The North Carolina A&T University Foundation, Inc., are based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of The North Carolina A&T University Foundation, Inc., were not audited in accordance with *Government Auditing Standards*. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of North Carolina Agricultural and Technical State University and its discretely presented component unit as of June 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2007, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Leslie W. Merritt, Jr., CPA, CFP
State Auditor

June 30, 2007

**NORTH CAROLINA AGRICULTURAL AND TECHNICAL STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Management's Discussion and Analysis provides an overview of the financial position and operating activities of North Carolina Agricultural and Technical State University for the year ended June 30, 2006, and includes comparative data for the year ended June 30, 2005. Information contained in this section has been prepared by University staff and is designed to complement the financial statements. This discussion and analysis describes important trends and events that have impacted the fiscal health of the University and that may continue to exert influence in future years.

The Financial Statements

The financial statements for North Carolina Agricultural and Technical State University include the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These statements were prepared in accordance with Governmental Accounting Standards Board (GASB) principles and reflect an economic resource measurement focus and the accrual basis of accounting. Management's discussion and analysis will concentrate on the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

The Statement of Net Assets

Condensed Statement of Net Assets

| | <u>2006</u> | <u>2005</u> | <u>Change</u> |
|---|--------------------------|--------------------------|-------------------------|
| Assets | | | |
| Current Assets | \$ 53,407,145.12 | \$ 41,346,755.42 | \$ 12,060,389.70 |
| Noncurrent Capital Assets, Net of Accumulated Depreciation | 250,908,494.90 | 236,164,655.24 | 14,743,839.66 |
| Other Noncurrent Assets | <u>23,971,814.99</u> | <u>31,665,583.61</u> | <u>(7,693,768.62)</u> |
| Total Assets | <u>328,287,455.01</u> | <u>309,176,994.27</u> | <u>19,110,460.74</u> |
| Liabilities | | | |
| Current Liabilities | 19,114,173.04 | 14,703,595.26 | 4,410,577.78 |
| Noncurrent Liabilities | <u>21,652,236.47</u> | <u>21,441,598.43</u> | <u>210,638.04</u> |
| Total Liabilities | <u>40,766,409.51</u> | <u>36,145,193.69</u> | <u>4,621,215.82</u> |
| Net Assets | | | |
| Investment in Capital Assets, Net of Related Debt | 231,723,039.80 | 221,827,473.91 | 9,895,565.89 |
| Restricted - Nonexpendable | 9,797,967.65 | 9,145,957.88 | 652,009.77 |
| Restricted - Expendable | 15,873,064.08 | 21,659,167.37 | (5,786,103.29) |
| Unrestricted | <u>30,126,973.97</u> | <u>20,399,201.42</u> | <u>9,727,772.55</u> |
| Total Net Assets | <u>\$ 287,521,045.50</u> | <u>\$ 273,031,800.58</u> | <u>\$ 14,489,244.92</u> |

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The Statement of Net Assets presents the financial position of the University at June 30, 2006, defined by the balances of assets, liabilities and assets net of liabilities. Assets are classified as current or noncurrent and cash is further identified as unrestricted or restricted. Current assets include those resources available to meet current obligations and operating requirements while noncurrent assets are to be held to meet future needs. Capital assets are shown net of depreciation. Assets, net of liabilities, are grouped into three categories: investment in capital assets net of related debt, restricted net assets, and unrestricted net assets. Restricted net assets are further classified as nonexpendable or expendable. Endowments and loan funds comprise the nonexpendable net assets and expendable net assets are made up primarily of contracts, grants, and restricted gifts.

The change in net assets can be traced to the changes in assets and liabilities described below:

Current assets increased primarily from larger cash balances held in unrestricted and plant funds. Cash balances in unrestricted funds increased by over \$9,281,503.02 due to increases in State appropriations held at year-end and lower expenditures in overhead funds for the fiscal year. Restricted cash held in plant funds increased by \$2,475,943.65.

Noncurrent assets increased by \$7,050,071.04. The increases in capital assets of \$14,743,839.66 and endowment investments of \$2,045,822.94 were offset by a decline of \$8,971,577.11 in the receivable from the State for capital projects funded by grants financed through State bonds.

Current liabilities also experienced an increase of \$4,410,577.78 during the year. The increase was due in large part to short-term temporary financing of \$6,168,000.00 to fund the construction of a 500 car parking deck and a decline in accounts payable of \$1,720,776.00.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets reports the activity of the University during the year and is subdivided into four major components: operating revenues, operating expenses, nonoperating revenues and expenses, and other revenues. Revenues are reported by major source and expenses are reported by natural classification. Intra-departmental sales, services, and transfers are eliminated and depreciation of capital assets is recorded.

During fiscal year 2006, operating revenues contributed 52.1% of total revenues, while nonoperating revenues made up 47.9%. Total University revenues decreased \$32,533,776.51 from \$252,968,291.21 in fiscal year 2005 to \$220,434,514.68 in fiscal year 2006.

Operating revenues increased by \$7,913,826.34. Major operating revenue categories that experienced increases include tuition and fees, and sales and services. The \$8,444,236.16 increase in tuition and fees and sales and services reflects both growth in student enrollment and increases in amounts charged for fees and services. Federal appropriations decreased \$895,036.07 which reveals a decrease in Department of Agriculture funds. Contracts and grants experienced a modest increase of \$254,701.77.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Nonoperating revenues increased by \$10,460,329.28. The University received an increase in State appropriations of approximately \$4,443,928.95 as a result of the rise in student enrollment. Noncapital grants increased by \$2,008,187.98 and the University received noncapital gifts in the amount of \$3,328,765.00. Investment income increased by \$679,447.35.

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

| | <u>2006</u> | <u>2005</u> | <u>Change</u> |
|--|--------------------------|--------------------------|-------------------------|
| Operating Revenues | | | |
| Tuition and Fees | \$ 47,929,884.69 | \$ 42,084,579.61 | \$ 5,845,305.08 |
| Grants and Contracts | 35,704,055.25 | 35,449,353.48 | 254,701.77 |
| Federal Appropriations | 5,023,260.80 | 5,918,296.87 | (895,036.07) |
| Sales and Services | 24,590,908.73 | 21,991,977.65 | 2,598,931.08 |
| Other Operating Revenues | 1,519,962.12 | 1,410,037.64 | 109,924.48 |
| Total Operating Revenues | <u>114,768,071.59</u> | <u>106,854,245.25</u> | <u>7,913,826.34</u> |
| Operating Expenses | <u>204,614,715.70</u> | <u>192,384,219.10</u> | <u>12,230,496.60</u> |
| Operating Loss | <u>(89,846,644.11)</u> | <u>(85,529,973.85)</u> | <u>(4,316,670.26)</u> |
| Nonoperating Revenues (Expenses) | | | |
| State Appropriations | 80,441,591.31 | 75,997,662.36 | 4,443,928.95 |
| Noncapital Grants and Gifts | 14,349,503.38 | 9,012,550.40 | 5,336,952.98 |
| Other Nonoperating Revenues (Expenses) | 716,487.14 | (2,947,229.12) | 3,663,716.26 |
| Net Nonoperating Revenues | <u>95,507,581.83</u> | <u>82,062,983.64</u> | <u>13,444,598.19</u> |
| Income (Loss) Before Other Revenues | 5,660,937.72 | (3,466,990.21) | 9,127,927.93 |
| Capital Appropriations and Grants | 8,111,084.10 | 57,880,739.49 | (49,769,655.39) |
| Capital Gifts | 70,263.00 | 0.00 | 70,263.00 |
| Additions to Permanent Endowments | 646,960.10 | 1,845,499.86 | (1,198,539.76) |
| Total Other Revenues | <u>8,828,307.20</u> | <u>59,726,239.35</u> | <u>(50,897,932.15)</u> |
| Total Increase in Net Assets | 14,489,244.92 | 56,259,249.14 | (41,770,004.22) |
| Net Assets | | | |
| Beginning of the Year | <u>273,031,800.58</u> | <u>216,772,551.44</u> | <u>56,259,249.14</u> |
| End of the Year | <u>\$ 287,521,045.50</u> | <u>\$ 273,031,800.58</u> | <u>\$ 14,489,244.92</u> |

Receipt of State capital grant funds went down by \$51,770,707.00 as a result of the timing of major building projects financed from funds made available to the University through State bond proceeds.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University completed several major projects in 2005 and the next phase of large construction projects were just getting underway by June 30, 2006.

The University presents expenditures by natural classification in the Statement of Revenues, Expenses, and Changes in Net Assets. Personal services accounted for 58.4% of operating expenses, followed by services at 19.3%, supplies and materials at 10.4%, scholarships at 4.8%, depreciation at 4.4%, and utility costs at 2.7%.

The increase in operating costs of \$12,230,496.60 is attributed primarily to increases in payroll charges and expenditures for utilities, depreciation, and supplies and materials. Payroll expenditures increased by \$9,023,320.03 as a result of payroll raises granted by the State legislature. Utilities increased by \$1,072,830.42 due to the rise in prices of natural gas, diesel, and gasoline. Services actually decreased by \$2,097,308.24 during the year because the University did not utilize as much temporary labor as in 2005.

Nonoperating expenses declined by \$2,984,268.91 in large part to the decline in the loss on disposal of assets. During 2005, the University demolished a large dormitory complex causing that figure to be unusually high in the prior year.

Construction

The cost of construction projects continued to exert significant influence on the University's financial statements for 2006 and will continue to do so through 2008. Since the passage in November 2000 of a \$2.5 billion bond package for the improvement and expansion of facilities on the 16 campuses of the University of North Carolina system, the University has received over \$115,102,970.44 in State construction grants financed by the bond proceeds. All twenty-two of the University's bond-funded projects were under design, in the construction phase, or completed at June 30, 2006. During 2006, the University expended \$12,407,221.75 in State grant funds, completing four buildings of a multi-building residence hall complex and a new science laboratory facility while beginning the construction of a new school of education building. In addition, the University completed an extensive renovation of Harrison Auditorium. Originally constructed in 1939, the renovation included Americans with Disabilities Act upgrades and state-of-the-art audio visual systems and stage lighting.



Exterior of Harrison Auditorium

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Other sources of funding for construction projects included auxiliary funds, federal grants and short-term financing. The University expended the following amounts during 2005-2006 on capital projects, land acquisition, and maintenance and repairs:

| | |
|---|-------------------------|
| Construction and Renovation of Buildings and Infrastructure | \$ 18,557,115.38 |
| Maintenance and repairs | <u>1,489,933.20</u> |
| Total | <u>\$ 20,047,048.58</u> |

Forecast

North Carolina A&T State University continues to enhance its academic offerings and commitment to research. The University established two new program areas, the Institute for Public Health and the Division of University Studies. The Institute for Public Health was established to secure research opportunities, develop outreach programs, and to provide educational and training opportunities for individuals in the fields of environmental and public health. The University Studies division was established following an extensive four-year project that revamped the general education program. In addition, North Carolina A&T State University recently became the home of The Negro Educational Review. The University began publication of the 55-year-old academic journal in the spring of 2006.

In August 2005 the University formed an educational partnership agreement with the United States Air Force Research Laboratory Materials and Manufacturing Directorate (AFRL/ML) to engage in research of mutual interest. The partnership with AFRL/ML will provide opportunities for the University's faculty and students to collaborate with Air Force personnel as well as conduct research at AFRL/ML facilities. In addition, AFRL/ML personnel will be able to teach courses related to math, science, and engineering and assist in course development at the University. In 2006 the school was classified as a high research activity institution as classified by the Carnegie Foundation for the Advancement of Teaching. These developments in the academic and research areas will help competitively position the University over the next several years.

North Carolina A&T State University enjoys a strong financial position; however, management recognizes that other resources will need to be secured to continue the move towards its goal of creating an interdisciplinary-centered university. With this vision in mind, the University launched a \$100 million capital campaign in 2002 that has brought in donations and pledges exceeding \$80 million. The funds will play an important role in the growth and development of the University's academic and community offerings, provide scholarships, and purchase state-of-the art classroom equipment. The success of the capital campaign is made more important by the budgetary pressures from the State that will persist as a factor for the University to consider as it meets the needs of students, faculty, staff, and the community. Limited State appropriations will require careful management of all resources, while University personnel continue to raise capital through its campaign effort and to identify other funding opportunities.

North Carolina Agricultural and Technical State University
Statement of Net Assets
June 30, 2006

Exhibit A-1

ASSETS

| | |
|---|------------------|
| Current Assets: | |
| Cash and Cash Equivalents | \$ 36,537,794.24 |
| Restricted Cash and Cash Equivalents | 6,456,038.86 |
| Receivables, Net (Note 4) | 8,320,380.02 |
| Due from State of North Carolina Component Units | 231,000.00 |
| Due from University Component Units | 378,691.26 |
| Inventories | 1,056,039.07 |
| Notes Receivable, Federal Loan Program | 399,665.80 |
| Other Assets | 27,535.87 |
| | <hr/> |
| Total Current Assets | 53,407,145.12 |
| Noncurrent Assets: | |
| Restricted Cash and Cash Equivalents | 7,058,698.64 |
| Receivables, Pledges | 326,226.52 |
| Restricted Due from Primary Government | 5,080,263.09 |
| Endowment Investments | 9,571,482.18 |
| Other Long-Term Investments | 817,749.31 |
| Notes Receivable, Federal Loan Program Net (Note 4) | 1,117,395.25 |
| Capital Assets - Nondepreciable (Note 5) | 25,914,059.59 |
| Capital Assets - Depreciable, Net (Note 5) | 224,994,435.31 |
| | <hr/> |
| Total Noncurrent Assets | 274,880,309.89 |
| | <hr/> |
| Total Assets | 328,287,455.01 |

LIABILITIES

| | |
|---|---------------|
| Current Liabilities: | |
| Accounts Payable and Accrued Liabilities (Note 6) | 7,003,872.61 |
| Due to Primary Government | 25,416.18 |
| Notes Payable (Note 7) | 6,168,000.00 |
| Unearned Revenue | 4,393,525.51 |
| Interest Payable | 226,751.04 |
| Long-Term Liabilities - Current Portion (Note 8) | 1,296,607.70 |
| | <hr/> |
| Total Current Liabilities | 19,114,173.04 |
| Noncurrent Liabilities: | |
| Deposits Payable | 350,762.15 |
| Funds Held for Others | 59,161.92 |
| U. S. Government Grants Refundable | 1,403,997.89 |
| Long-Term Liabilities (Note 8) | 19,838,314.51 |
| | <hr/> |
| Total Noncurrent Liabilities | 21,652,236.47 |
| | <hr/> |
| Total Liabilities | 40,766,409.51 |

North Carolina Agricultural and Technical State University
Statement of Net Assets
June 30, 2006

Exhibit A-1
Page 2

NET ASSETS

| | |
|---|---------------------------------|
| Invested in Capital Assets, Net of Related Debt | 231,723,039.80 |
| Restricted for: | |
| Nonexpendable: | |
| Scholarships and Fellowships | 5,376,461.92 |
| Endowed Professorships | 4,046,986.18 |
| Departmental Uses | 73,079.31 |
| Loans | 301,440.24 |
| Expendable: | |
| Scholarships and Fellowships | 2,188,460.47 |
| Research | 370,339.24 |
| Endowed Professorships | 1,164,757.31 |
| Departmental Uses | 2,952,261.84 |
| Capital Projects | 8,880,968.73 |
| Debt Service | 316,276.49 |
| Unrestricted | <u>30,126,973.97</u> |
| Total Net Assets | <u><u>\$ 287,521,045.50</u></u> |

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

North Carolina Agricultural and Technical State University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2006

Exhibit A-2

REVENUES

Operating Revenues:

| | |
|---|------------------|
| Student Tuition and Fees, Net (Note 10) | \$ 47,929,884.69 |
| Federal Appropriations | 5,023,260.80 |
| Federal Grants and Contracts | 33,940,619.71 |
| State and Local Grants and Contracts | 602,496.35 |
| Nongovernmental Grants and Contracts | 1,160,939.19 |
| Sales and Services, Net (Note 10) | 24,590,908.73 |
| Interest Earnings on Loans | 7,686.69 |
| Other Operating Revenues | 1,512,275.43 |
| | <hr/> |
| Total Operating Revenues | 114,768,071.59 |

EXPENSES

Operating Expenses:

| | |
|------------------------------|-----------------|
| Salaries and Benefits | 119,492,673.27 |
| Supplies and Materials | 21,287,642.56 |
| Services | 39,537,068.00 |
| Scholarships and Fellowships | 9,722,419.78 |
| Utilities | 5,425,558.53 |
| Depreciation | 9,149,353.56 |
| | <hr/> |
| Total Operating Expenses | 204,614,715.70 |
| | <hr/> |
| Operating Loss | (89,846,644.11) |

NONOPERATING REVENUES (EXPENSES)

| | |
|---|---------------|
| State Appropriations | 80,441,591.31 |
| Noncapital Grants | 11,020,738.38 |
| Noncapital Gifts | 3,328,765.00 |
| Investment Income (Net of Investment Expense of \$30,259.93) | 2,047,041.20 |
| Interest and Fees on Debt | (957,922.71) |
| Other Nonoperating Expenses | (372,631.35) |
| | <hr/> |
| Net Nonoperating Revenues | 95,507,581.83 |

Income Before Other Revenues 5,660,937.72

| | |
|-------------------------|--------------|
| Capital Appropriations | 2,916,100.00 |
| Capital Grants | 5,194,984.10 |
| Capital Gifts, Net | 70,263.00 |
| Additions to Endowments | 646,960.10 |
| | <hr/> |

Increase in Net Assets 14,489,244.92

NET ASSETS

Net Assets - July 1, 2005

 273,031,800.58

Net Assets - June 30, 2006

 \$ 287,521,045.50

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

North Carolina Agricultural and Technical State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

| | |
|---|-------------------|
| Received from Customers | \$ 113,462,167.19 |
| Payments to Employees and Fringe Benefits | (118,548,530.51) |
| Payments to Vendors and Suppliers | (67,258,346.98) |
| Payments for Scholarships and Fellowships | (9,722,419.78) |
| Loans Issued | (407,442.00) |
| Collection of Loans | 412,646.51 |
| Interest Earned on Loans | 16,724.19 |
| Other Receipts | 1,512,275.43 |
| | <hr/> |
| Net Cash Used by Operating Activities | (80,532,925.95) |

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

| | |
|--|-----------------|
| State Appropriations | 80,441,591.31 |
| Noncapital Grants | 10,814,395.22 |
| Noncapital Gifts | 3,214,678.32 |
| Additions to Endowments | 646,960.10 |
| William D. Ford Direct Lending Receipts | 45,961,453.00 |
| William D. Ford Direct Lending Disbursements | (45,961,453.00) |
| Related Activity Agency Disbursements | 23,206.61 |
| | <hr/> |
| Net Cash Provided by Noncapital Financing Activities | 95,140,831.56 |

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

| | |
|---|-----------------|
| Proceeds from Capital Debt | 6,168,000.00 |
| State Capital Appropriations | 2,916,100.00 |
| Capital Grants | 14,236,824.21 |
| Proceeds from Sale of Capital Assets | 1,630.22 |
| Acquisition and Construction of Capital Assets | (24,750,022.30) |
| Principal Paid on Capital Debt and Leases | (935,000.00) |
| Interest and Fees Paid on Capital Debt and Leases | (926,880.00) |
| | <hr/> |
| Net Cash Used by Capital Financing and Related Financing Activities | (3,289,347.87) |

CASH FLOWS FROM INVESTING ACTIVITIES

| | |
|---|------------------|
| Proceeds from Sales and Maturities of Investments | 2,743,896.95 |
| Investment Income | 1,883,534.13 |
| Purchase of Investments and Related Fees | (4,673,760.09) |
| | <hr/> |
| Net Cash Used by Investing Activities | (46,329.01) |
| | <hr/> |
| Net Increase in Cash and Cash Equivalents | 11,272,228.73 |
| Cash and Cash Equivalents - July 1, 2005 | 38,780,303.01 |
| | <hr/> |
| Cash and Cash Equivalents - June 30, 2006 | \$ 50,052,531.74 |

North Carolina Agricultural and Technical State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3

Page 2

**RECONCILIATION OF NET OPERATING REVENUES (EXPENSES)
TO NET CASH USED BY OPERATING ACTIVITIES**

| | |
|--|---------------------------|
| Operating Loss | \$ (89,846,644.11) |
| Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities: | |
| Depreciation Expense | 9,149,353.56 |
| Allowances, Write-Offs, and Amortizations | 11,123.02 |
| Changes in Assets and Liabilities: | |
| Receivables (Net) | 73,161.06 |
| Due from State of North Carolina Component Units | 85,681.88 |
| Due from University Component Units | (90,615.93) |
| Inventories | (68,392.41) |
| Accounts Payable and Accrued Liabilities | (1,234,766.51) |
| Due to Primary Government | (33,399.08) |
| U.S. Government Grants Refundable | 7,907.79 |
| Unearned Revenue | 142,512.60 |
| Compensated Absences | 1,188,262.71 |
| Notes Receivable | 82,889.47 |
| | <u>82,889.47</u> |
| Net Cash Used by Operating Activities | <u>\$ (80,532,925.95)</u> |

RECONCILIATION OF CASH AND CASH EQUIVALENTS

| | |
|---|-------------------------|
| Current Assets: | |
| Cash and Cash Equivalents | \$ 36,537,794.24 |
| Restricted Cash and Cash Equivalents | 6,456,038.86 |
| Noncurrent Assets: | |
| Restricted Cash and Cash Equivalents | <u>7,058,698.64</u> |
| Total Cash and Cash Equivalents - June 30, 2006 | <u>\$ 50,052,531.74</u> |

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

| | |
|---|-----------------|
| Assets Acquired through the Assumption of a Liability | \$ 5,823,491.75 |
| Assets Acquired through a Gift | 70,263.00 |
| Change in Fair Value of Investments | 121,112.81 |
| Loss on Disposal of Capital Assets | (372,631.35) |

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

North Carolina A&T University Foundation, Inc.
Statement of Financial Position
June 30, 2006

Exhibit B-1

ASSETS

Current Assets:

| | |
|--|------------|
| Cash and Cash Equivalents | \$ 481,971 |
| Investments | 3,684,264 |
| Unconditional Promises to Give, Less Allowance for Uncollectible Promises of -0- for 2006 | 383,168 |
| Accounts Receivable-NCA&TSU | 135,265 |
| Other Current Assets | 2,768,071 |
| | <hr/> |
| Total Current Assets | 7,452,739 |

Restricted Deposits:

| | |
|----------------------------------|-----------|
| Bond Operating Reserve Fund | 505,258 |
| Bond Interest Fund | 174,247 |
| Bond Surplus Fund | 622,451 |
| Bond Repair and Replacement Fund | 141,588 |
| Bond Taxes and Insurance Fund | 3,116 |
| Bond Construction Fund | 28,351 |
| Bond Debt Service Fund | 3,128,500 |
| Bond Principal Fund | 85,000 |
| Bond QEA Fund | 24,344 |
| | <hr/> |
| Total Restricted Deposits | 4,712,855 |

Endowment Investments:

| | |
|-----------------------------|-----------|
| Investments | 3,418,437 |
| | <hr/> |
| Total Endowment Investments | 3,418,437 |

| | |
|--|---------------|
| Property, Furniture and Equipment, at Cost, Net | 38,821,614 |
| Long-Term Unconditional Promises to Give, Less Allowance for Uncollectible Promises of \$41,250 | 485,908 |
| Other Assets | 4,257,371 |
| | <hr/> |
| Total Assets | \$ 59,148,924 |

LIABILITIES AND NET ASSETS

Current Liabilities:

| | |
|-------------------------------------|--------------|
| Current Maturities of Bonds Payable | \$ 1,020,000 |
| Accounts Payable | 475,890 |
| Other Liabilities | 274,779 |
| | <hr/> |
| Total Current Liabilities | 1,770,669 |

Long-Term Liabilities:

| | |
|---------------------------------------|------------|
| Notes Payable | 1,970,552 |
| Bonds Payable Less Current Maturities | 47,700,000 |
| | <hr/> |
| Total Long-Term Liabilities | 49,670,552 |

| | |
|-------------------|---------------|
| Total Liabilities | \$ 51,441,221 |
|-------------------|---------------|

North Carolina A&T University Foundation, Inc.
Statement of Financial Position
June 30, 2006

Exhibit B-1
Page 2

NET ASSETS

| | |
|----------------------------------|-----------------------------|
| Unrestricted: | |
| Operating | \$ (591,438) |
| Fixed Assets | <u>298,424</u> |
| Total Unrestricted (Deficit) | (293,014) |
| Temporarily Restricted | 4,337,201 |
| Permanently Restricted | <u>3,663,516</u> |
| Total Net Assets | <u>7,707,703</u> |
| Total Liabilities and Net Assets | <u><u>\$ 59,148,924</u></u> |

See Note 1 in the Notes to the Financial Statements

North Carolina A&T University Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2006

Exhibit B-2

| | Restricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---------------------|-----------------------------------|-----------------------------------|---------------------|
| PUBLIC SUPPORT, REVENUES AND RECLASSIFICATIONS | | | | |
| Contributions | | | | |
| Foundations and Corporations | \$ 37,022 | \$ 1,974,540 | \$ 28,941 | \$ 2,040,503 |
| Board of Directors | 12,250 | 3,525 | 3,500 | 19,275 |
| Individuals/Friends | 270,479 | 995,710 | 98,994 | 1,365,183 |
| Interest and Dividends | 366,234 | 65,650 | 91,100 | 522,984 |
| Administrative Fee | 109,286 | | | 109,286 |
| Miscellaneous | 10,623 | 149,083 | | 159,706 |
| Unrealized Gain(Loss) from Investments | 26,456 | 70,758 | 1,886 | 99,100 |
| Satisfaction of Program Restrictions | 3,007,937 | (3,007,937) | | |
| Rental Income | 6,374,674 | | | 6,374,674 |
| Management Fees | 269,366 | | | 269,366 |
| Fundraising | 172,177 | | | 172,177 |
| Total Public Support, Revenues and Reclassifications | 10,656,504 | 251,329 | 224,421 | 11,132,254 |
| EXPENSES | | | | |
| Programs | | | | |
| Scholarships: | | | | |
| Scholarships - Unrestricted | 250,394 | | | 250,394 |
| Scholarships - Departmental | 883,154 | | | 883,154 |
| Total Scholarships | 1,133,548 | | | 1,133,548 |
| Academic Departmental Programs | 2,124,783 | | | 2,124,783 |
| Administration | 944,526 | | | 944,526 |
| Student Housing | 6,512,573 | | | 6,512,573 |
| Total Expenses | 10,715,430 | | | 10,715,430 |
| Changes in Net Assets | (58,926) | 251,329 | 224,421 | 416,824 |
| Net Assets as of Beginning of Year | (234,088) | 4,085,872 | 3,439,095 | 7,290,879 |
| Net Assets as of End of Year | <u>\$ (293,014)</u> | <u>\$ 4,337,201</u> | <u>\$ 3,663,516</u> | <u>\$ 7,707,703</u> |

See Note 1 in the Notes to the Financial Statements

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NORTH CAROLINA AGRICULTURAL AND TECHNICAL STATE UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

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, 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. North Carolina Agricultural and Technical State University is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component unit. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component unit is discretely presented in the University's financial statements. The discretely presented component unit's financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize its legal separateness.

Discretely Presented Component Unit – The North Carolina A&T University Foundation, Inc., (Foundation) is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University.

The Foundation is a tax-exempt component unit and acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 16 elected members. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University and is reported in separate financial statements because of the difference in its reporting model, as described below.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Foundation is a private not-for-profit organization that reports its financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2006, the Foundation distributed \$1,148,969.87 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the North Carolina A&T University Foundation, Inc., located at The Alumni Foundation Events Center, 200 North Benbow Road, Greensboro, NC 27411-0001. The mailing address is P.O. Box 20366, Greensboro, NC 27420.

- 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 Governmental Accounting Standards Board (GASB).

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

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the University does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

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

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

includes State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund 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** - This classification includes long-term fixed income investments, equity investments, mutual funds, money market funds, and real estate. Except for money market funds and real estate not held by a governmental external investment pool, investments are accounted for at fair value, as determined by quoted market prices. The net increase in the fair value of investments is recognized as a component of investment income.

Money market funds and real estate not held by a governmental external investment pool are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

- F. Receivables** – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, 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 expendable supplies, are valued at cost using average cost of last invoice price, using first-in, first-out method or in the case of agricultural supplies inventory, current market value. Merchandise for resale is valued using the first-in, first-out method.
- H. Capital Assets** – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 50 years for general infrastructure, 10 to 50 years for buildings, and 5 to 15 years for equipment.

The Heritage Center and Art Gallery collections are capitalized at cost or fair value at the date of donation. These collections are considered inexhaustible and are therefore not depreciated.

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations. Certain other assets are classified as restricted because their use is limited by external parties or statute.
- J. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refunds. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line or effective interest method. The deferred losses on refunds are amortized over the life of the old debt using the straight-line method. Issuance costs are expensed.

- K. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 for SPA employees and on July 1 for EPA employees. An employee can be paid up to 30 days upon termination of employment. 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 SPA employees 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. The accumulated leave for EPA employees is equal to the balance held at June 30.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method.

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

L. Net Assets – The University’s net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt – This represents the University’s total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted Net Assets – Nonexpendable – Nonexpendable restricted net assets include 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 Assets – Expendable – Expendable restricted net assets include resources for which the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets – Unrestricted net assets include resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

M. Scholarship Discounts – Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the University and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the University has recorded a scholarship discount.

N. Revenue and Expense Recognition – The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

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

O. Internal Sales Activities – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as bookstore, motor pool, postal services, and telecommunications. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** – Unless specifically exempt, the University is required by *North Carolina General Statute* 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

At June 30, 2006, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$49,910,021.41 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.18 years as of June 30, 2006. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2006, was \$35,748.31. The carrying amount of the University's deposits not with the State Treasurer was \$106,762.02 and the bank balance was \$103,701.80. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2006, the University's bank balance was exposed to custodial credit risk as follows:

| | |
|--------------------------------|--------------------|
| Uninsured and Uncollateralized | \$ <u>3,626.80</u> |
|--------------------------------|--------------------|

B. Investments

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

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States; obligations of certain federal agencies; repurchase agreements; obligations of the State of North Carolina; time deposits of specified institutions; prime quality commercial paper, and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

In accordance with the bond resolutions, bond proceeds and debt service funds are invested in obligations that will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investments of the University's component unit, The North Carolina A&T University Foundation, Inc., are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) 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 University utilizes investment pools to manage investments and distribute investment income.

Investments are subject to the following risks.

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

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's Endowment Board's investment policy addresses credit risk by requiring high quality fixed income instruments, evaluating mutual funds on the basis of their standing on the Lipper 500 Index, and by evaluating stocks on their ability to sustain long-term total returns.

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

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributable to the magnitude of an investment in a single issuer. The University does not have a formal policy for concentration of credit risk.

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unit value method. Under this method, each participating fund's investment balance is determined on a market basis. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the Long-Term Investment Pool.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool

| Investment Type | Fair Value | Investment Maturities (in Years) | | | |
|--|------------------------|----------------------------------|------------------------|------------------------|----------------------|
| | | Less Than 1 | 1 to 5 | 6 to 10 | More than 10 |
| Debt Securities | | | | | |
| U.S. Agencies | \$ 436,000.50 | \$ 0.00 | \$ 290,187.50 | \$ 0.00 | \$ 145,813.00 |
| Mutual Bond Funds | 1,061,390.72 | | 730,800.00 | 330,590.72 | |
| Money Market Mutual Funds | 398,395.41 | 145,343.07 | | 253,052.34 | |
| Domestic Corporate Bonds | 966,997.00 | | 98,711.50 | 868,285.50 | |
| | | <u>\$ 145,343.07</u> | <u>\$ 1,119,699.00</u> | <u>\$ 1,451,928.56</u> | <u>\$ 145,813.00</u> |
| Other Securities | | | | | |
| Other Mutual Funds | 2,755,336.17 | | | | |
| Investments in Real Estate | 11,690.00 | | | | |
| Domestic Stocks | 3,623,861.25 | | | | |
| Foreign Stocks | 281,441.60 | | | | |
| Other | 36,369.53 | | | | |
| | <u>36,369.53</u> | | | | |
| Total Long-Term Investment Pool | <u>\$ 9,571,482.18</u> | | | | |

At June 30, 2006, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure:

| | Fair Value | AAA Aaa | AA Aa | A | BBB Baa | Unrated |
|---------------------------|---------------|---------------|------------|------------|------------|------------|
| U.S. Agencies | \$ 436,000.50 | \$ 436,000.50 | \$ 0.00 | \$ 0.00 | \$ 0.00 | \$ 0.00 |
| Mutual Bond Funds | 1,061,390.72 | | 330,590.72 | | | 730,800.00 |
| Money Market Mutual Funds | 398,395.41 | 253,052.34 | | | | 145,343.07 |
| Domestic Corporate Bonds | 966,997.00 | | 613,340.50 | 304,147.50 | 49,509.00 | |

Rating Agency: Moody's and Standard and Poors

Concentration of Credit Risk: The University Endowment Board places no limit on the amount the Board may invest in any one issuer. More than 5% of the long-term investment pool investments are in ISHR Lehman Aggregate Mutual Bond Fund and the Pimco Asset All Authority Fund. These investments are 7.6% and 10.2%, respectively, of the Long-Term Investment Pool's total investments.

Non-Pooled Investments – The University non-pooled investments subject to interest rate risk at June 30, 2006, include money market fund debt securities which mature in less than one year and have a fair value of \$816,402.99 and domestic stocks with a fair value of \$1,346.32. The \$816,402.99 in money market funds were unrated by Standard and Poors for credit quality distribution for securities with credit exposure.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments – The following table presents the fair value of the total investments at June 30, 2006:

| Investment Type | Fair Value |
|----------------------------|------------------|
| Debt Securities | |
| U.S. Agencies | \$ 436,000.50 |
| Mutual Bond Funds | 1,061,390.72 |
| Money Market Funds | 1,214,798.40 |
| Domestic Corporate Bonds | 966,997.00 |
| Other Securities | |
| Other Mutual Funds | 2,755,336.17 |
| Investments in Real Estate | 11,690.00 |
| Domestic Stocks | 3,625,207.57 |
| Foreign Stocks | 281,441.60 |
| Other | 36,369.53 |
| Total Investments | \$ 10,389,231.49 |

Component Units - Investments of the University’s discretely presented component unit, The North Carolina A&T University Foundation, Inc., are subject to and restricted by G.S. 36B “Uniform Management of Institutional Funds Act” (UMIFA) and any requirements placed on them by contract or donor agreements. Because the Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type: The Foundation’s investments include a certificate of deposit in the amount of \$21,380, mutual funds administered by Wachovia National Bank in the amount of \$7,051,321 and stock in the amount of \$30,000. The total amount of investments for the North Carolina A&T University Foundation, Inc., are \$7,102,701.

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the University’s endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, State law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds.

Investment return of the University’s endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University’s endowment funds are based on an adopted spending policy which limits spending to no more than 5% of the endowment principal’s average market value at December 31 for the past three years. To the extent that the total return for the current year exceeds the payout, the excess is added to

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net asset endowment balances to make up the difference. At June 30, 2006, net appreciation of \$387,800.00 was available to be spent, all of which was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

| | <u>Gross Receivables</u> | <u>Less Allowance for Doubtful Accounts</u> | <u>Net Receivables</u> |
|---------------------------------------|------------------------------|---|----------------------------|
| Current Receivables: | | | |
| Students | \$ 1,565,134.36 | \$ 355,954.83 | \$ 1,209,179.53 |
| Accounts | 2,239,573.49 | 1,374,280.89 | 865,292.60 |
| Intergovernmental | 5,605,877.89 | | 5,605,877.89 |
| Pledges | 125,091.76 | | 125,091.76 |
| Investment Earnings | 152,700.42 | | 152,700.42 |
| Interest on Loans | 122,671.92 | | 122,671.92 |
| Other | 239,565.90 | | 239,565.90 |
| Total Current Receivables | <u>\$ 10,050,615.74</u> | <u>\$ 1,730,235.72</u> | <u>\$ 8,320,380.02</u> |
| Notes Receivable - Noncurrent: | | | |
| Federal Loan Programs | <u>\$ 1,631,289.02</u> | <u>\$ 513,893.77</u> | <u>\$ 1,117,395.25</u> |

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2006, is presented as follows:

| | Balance July 1, 2005 | Increases | Decreases | Balance June 30, 2006 |
|---|--------------------------|-------------------------|-------------------------|--------------------------|
| Capital Assets, Nondepreciable: | | | | |
| Land | \$ 8,871,986.09 | \$ 0.00 | \$ 0.00 | \$ 8,871,986.09 |
| Art, Literature, and Artifacts | 2,502,077.00 | | | 2,502,077.00 |
| Construction in Progress | 44,305,387.13 | 10,056,391.82 | 39,821,782.45 | 14,539,996.50 |
| Total Capital Assets, Nondepreciable | 55,679,450.22 | 10,056,391.82 | 39,821,782.45 | 25,914,059.59 |
| Capital Assets, Depreciable: | | | | |
| Buildings | 204,384,619.92 | 43,336,776.40 | 426,397.74 | 247,294,998.58 |
| Machinery and Equipment | 35,488,530.70 | 6,145,359.66 | 1,887,552.11 | 39,746,338.25 |
| General Infrastructure | 10,224,725.93 | 4,550,709.36 | | 14,775,435.29 |
| Total Capital Assets, Depreciable | 250,097,876.55 | 54,032,845.42 | 2,313,949.85 | 301,816,772.12 |
| Less Accumulated Depreciation/Amortization for: | | | | |
| Buildings | 47,276,223.06 | 4,999,982.77 | 195,873.20 | 52,080,332.63 |
| Machinery and Equipment | 20,567,404.20 | 3,718,117.29 | 1,743,815.08 | 22,541,706.41 |
| General Infrastructure | 1,769,044.27 | 431,253.50 | | 2,200,297.77 |
| Total Accumulated Depreciation | 69,612,671.53 | 9,149,353.56 | 1,939,688.28 | 76,822,336.81 |
| Total Capital Assets, Depreciable, Net | 180,485,205.02 | 44,883,491.86 | 374,261.57 | 224,994,435.31 |
| Capital Assets, Net | \$ 236,164,655.24 | \$ 54,939,883.68 | \$ 40,196,044.02 | \$ 250,908,494.90 |

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2006, were as follows:

| | Amount |
|---|------------------------|
| Accounts Payable | \$ 3,148,271.76 |
| Accrued Payroll | 2,471,946.57 |
| Contract Retainage | 1,047,793.92 |
| Intergovernmental Payables | 142,582.30 |
| Other | 193,278.06 |
| Total Accounts Payable and Accrued Liabilities | \$ 7,003,872.61 |

NOTE 7 - SHORT-TERM DEBT – BOND ANTICIPATION NOTES

The University issued bond anticipation notes to secure funds for the construction of a 500 space parking deck. Construction began in the spring of 2006 with an expected completion date of fall 2006.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Short-term debt activity for the year ended June 30, 2006, was as follows:

| | Balance July 1, 2005 | Draws | Repayments | Balance June 30, 2006 |
|-------------------------|-------------------------|-----------------|------------|--------------------------|
| Bond Anticipation Notes | \$ 0.00 | \$ 6,168,000.00 | \$ 0.00 | \$ 6,168,000.00 |

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, 2006, is presented as follows:

| | Balance July 1, 2005 | Additions | Reductions | Balance June 30, 2006 | Current Portion |
|-------------------------------------|-------------------------|-----------------|-----------------|--------------------------|--------------------|
| Bonds Payable | \$ 14,760,000.00 | \$ 0.00 | \$ 935,000.00 | \$ 13,825,000.00 | \$ 985,000.00 |
| Add/Deduct Premium/Discount | 111,882.18 | | 12,294.23 | 99,587.95 | |
| Deduct Deferred Charge on Refunding | (209,610.85) | | (25,913.10) | (183,697.75) | |
| Total Bonds Payable | 14,662,271.33 | | 921,381.13 | 13,740,890.20 | 985,000.00 |
| Compensated Absences | 6,205,769.30 | 4,517,476.21 | 3,329,213.50 | 7,394,032.01 | 311,607.70 |
| Total Long-Term Liabilities | \$ 20,868,040.63 | \$ 4,517,476.21 | \$ 4,250,594.63 | \$ 21,134,922.21 | \$ 1,296,607.70 |

B. Bonds Payable - The University was indebted for bonds payable for the purposes shown in the following table:

| Purpose | Series | Interest Rate/ Ranges | Final Maturity Date | Original Amount of Issue | Principal Paid Through June 30, 2006 | Principal Outstanding June 30, 2006 |
|--|--------|-----------------------------|---------------------------|--------------------------------|--|---|
| UNC System Pool revenue Bonds | | | | | | |
| Student Union (A) | 1998B | 3.25-5.25 | 10/1/2013 | \$ 5,860,000.00 | \$ 4,655,000.00 | \$ 1,205,000.00 |
| Student Union (C) | 2005A | 3.00-4.89 | 4/1/2014 | 2,395,000.00 | 10,000.00 | 2,385,000.00 |
| Parking System (A) | 1998B | 3.25-5.25 | 10/1/2013 | 1,465,000.00 | 565,000.00 | 900,000.00 |
| Dining System (B) | 2000 | 5.00-5.25 | 10/1/2020 | 9,875,000.00 | 1,595,000.00 | 8,280,000.00 |
| Stadium System (B) | 2000 | 5.00-5.25 | 10/1/2020 | 1,555,000.00 | 500,000.00 | 1,055,000.00 |
| Total UNC System Pool Revenue Bonds (Principal Only) | | | | \$ 21,150,000.00 | \$ 7,325,000.00 | 13,825,000.00 |
| Less: Unamortized Loss on Refunding | | | | | | (183,697.75) |
| Less: Unamortized Discount | | | | | | (5,348.21) |
| Plus: Unamortized Premium | | | | | | 104,936.16 |
| Total Bonds Payable | | | | | | \$ 13,740,890.20 |

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

(B) The University of North Carolina System Pool Revenue Bonds, Series 2000

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- C. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2006, are as follows:

| <u>Fiscal Year</u> | Annual Requirements | |
|--------------------|-----------------------|-----------------|
| | Revenue Bonds Payable | |
| | Principal | Interest |
| 2007 | \$ 985,000.00 | \$ 794,150.02 |
| 2008 | 1,030,000.00 | 746,237.52 |
| 2009 | 1,085,000.00 | 637,184.39 |
| 2010 | 1,130,000.00 | 535,006.26 |
| 2011 | 1,180,000.00 | 484,403.13 |
| 2012-2016 | 4,880,000.00 | 1,522,437.50 |
| 2017-2021 | 3,535,000.00 | 483,131.25 |
| Total Requirements | \$ 13,825,000.00 | \$ 5,202,550.07 |

- D. Bond Defeasance** - The University has extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

In April 2005, the University defeased \$2,390,000 of outstanding UNC Pool Revenue Bonds, Series 1998 Student Union. An irrevocable trust was established with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of net Assets. At June 30, 2006, the outstanding balance of the defeased UNC Pool Revenue Bonds, Series 1998 Student Union was 2,390,000.

Component Unit – The North Carolina A&T University Foundation, Inc., entered into a note agreement with A.I. Credit Corporation on July 13, 2001. The note is for a line of credit to fund premium payments for insurance policies purchased in conjunction with the Foundation's "Financed Philanthropy" program. The note balance at June 30, 2006, was \$1,970,552. Bonds payable for the Foundation at June 30, 2006, were \$48,720,000.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for equipment and property. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2006:

| <u>Fiscal Year</u> | <u>Amount</u> |
|------------------------------|----------------------|
| 2007 | \$ 105,536.92 |
| 2008 | 52,100.00 |
| 2009 | 30,800.00 |
| Total Minimum Lease Payments | <u>\$ 188,436.92</u> |

Rental expense for all operating leases during the year was \$655,754.78.

NOTE 10 - REVENUES

A summary of eliminations and allowances by revenue classification and revenues pledged as security for revenue bonds is presented as follows:

| | <u>Gross Revenues</u> | <u>Internal Sales Eliminations</u> | <u>Less Scholarship Discounts</u> | <u>Less Allowance for Uncollectibles</u> | <u>Net Revenues</u> | <u>Revenues Pledged as Security for Debt</u> |
|--|-------------------------|------------------------------------|-----------------------------------|--|-------------------------|--|
| Operating Revenues: | | | | | | |
| Student Tuition and Fees | \$ 59,881,988.83 | \$ 0.00 | \$ 11,679,269.49 | \$ 272,834.65 | \$ 47,929,884.69 | \$ 2,061,515.18 |
| Sales and Services: | | | | | | |
| Sales and Services of Auxiliary Enterprises: | | | | | | |
| Residential Life | \$ 9,918,072.62 | \$ 0.00 | \$ 1,874,035.23 | \$ 43,813.43 | \$ 8,000,223.96 | \$ 0.00 |
| Dining | 9,364,073.07 | | 1,771,940.93 | 41,451.34 | 7,550,680.80 | 7,550,680.80 |
| Student Union Services | 37,492.63 | | | | 37,492.63 | |
| Health, Physical Education, and Recreation Services | 928.00 | | | | 928.00 | |
| Bookstore | 6,234,098.81 | 456,813.42 | | (16.13) | 5,777,301.52 | |
| Parking | 1,032,573.14 | | | | 1,032,573.14 | 1,005,981.93 |
| Athletic | 1,767,484.00 | | | | 1,767,484.00 | |
| Other | 340,656.91 | | | 1,969.97 | 338,686.94 | |
| Sales and Services of Education and Related Activities | 2,186,400.22 | 2,100,862.48 | | | 85,537.74 | |
| Total Sales and Services | <u>\$ 30,881,779.40</u> | <u>\$ 2,557,675.90</u> | <u>\$ 3,645,976.16</u> | <u>\$ 87,218.61</u> | <u>\$ 24,590,908.73</u> | <u>\$ 8,556,662.73</u> |

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - OPERATING EXPENSES BY FUNCTION

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

| | Salaries and Benefits | Supplies and Materials | Services | Scholarships and Fellowships | Utilities | Depreciation | Total |
|-------------------------------------|-----------------------------|------------------------------|-------------------------|------------------------------------|------------------------|------------------------|--------------------------|
| Instruction | \$ 54,451,277.72 | \$ 5,100,712.89 | \$ 1,852,186.40 | \$ 208,234.20 | \$ 0.00 | \$ 0.00 | \$ 61,612,411.21 |
| Research | 12,957,598.99 | 1,987,064.19 | 4,231,577.99 | 1,042,960.12 | 36.68 | | 20,219,237.97 |
| Public Service | 4,393,391.65 | 284,974.89 | 1,310,861.47 | 113,150.95 | 1,415.01 | | 6,103,793.97 |
| Academic Support | 12,747,177.77 | 5,705,931.57 | 4,964,982.65 | 1,348,346.37 | 179.51 | | 24,766,617.87 |
| Student Services | 4,624,003.30 | 297,236.86 | 1,197,142.87 | 49,912.21 | | | 6,168,295.24 |
| Institutional Support | 13,410,341.34 | 733,502.44 | 5,067,283.42 | 27,428.75 | 4,095.16 | | 19,242,651.11 |
| Operations and Maintenance of Plant | 7,608,975.80 | 781,431.08 | 5,916,948.78 | | 3,679,203.10 | | 17,986,558.76 |
| Student Financial Aid | 205,445.34 | 398,039.88 | 503,741.10 | 4,672,679.81 | | | 5,779,906.13 |
| Auxiliary Enterprises | 9,094,461.36 | 5,998,748.76 | 14,492,343.32 | 2,259,707.37 | 1,740,629.07 | | 33,585,889.88 |
| Depreciation | | | | | | 9,149,353.56 | 9,149,353.56 |
| Total Operating Expenses | <u>\$ 119,492,673.27</u> | <u>\$ 21,287,642.56</u> | <u>\$ 39,537,068.00</u> | <u>\$ 9,722,419.78</u> | <u>\$ 5,425,558.53</u> | <u>\$ 9,149,353.56</u> | <u>\$ 204,614,715.70</u> |

NOTE 12 - PENSION PLANS

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

The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2006, these rates were set at 2.34% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2006, the University had a total payroll of \$98,096,331.48, of which \$54,061,899.04 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$3,243,713.94 and \$1,265,048.44, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were \$1,265,048.44, \$1,086,916.00, and \$102,416.00, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.state.nc.us/> and clicking on "Financial Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The Board has authorized the following carriers: Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2006, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2006, the University had a total payroll of \$98,096,331.48, of which \$27,813,351.25 was covered under the Optional

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Retirement Program. Total employee and employer contributions for pension benefits for the year were \$1,668,801.08 and \$1,902,433.23, respectively.

The Federal Retirement System is a multiple-employer system. University extension employees participate in the Civil Service Retirement System (CSRS), a program for participants employed prior to January 1, 1987. Participants contributed approximately 6.6% of their salary to CSRS and the University matched was approximately 8.0%. For the year ended June 30, 2006, covered payroll was \$999,495.00, and the total employee and employer contributions were \$66,186.11 and \$80,242.27, respectively.

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$216,015.74 for the year ended June 30, 2006.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2006, were \$54,886.32. The voluntary contributions by employees amounted to \$357,790.00 for the year ended June 30, 2006.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$1,273,866.35 for the year ended June 30, 2006.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.8% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2006, the University's total contribution to the Plan was \$3,111,259.51. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Long-Term Disability -** The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the year ended June 30, 2006, the University's total contribution to the DIPNC was \$425,751.30. The

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 14 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years. Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$5,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$500 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 occurring in-State are \$500,000 per claim and \$5,000,000 per occurrence and out-of-State are \$1,000,000 per claim and \$5,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence with a \$50,000 deductible and a 10% participation in each loss above the deductible. University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

NOTE 15 - COMMITMENTS AND CONTINGENCIES

- A. **Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$8,496,640.29 and on other purchases were \$5,015,954.33 at June 30, 2006.
- B. **Pending Litigation and Claims** – The University is a party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.
- C. **Federal Grants** – As of June 30, 2006, the University had a \$500,000 contingent liability related to improper business practices and expenditures of the HBCU Future Engineering Faculty Fellowship program funded by federal grants. It is uncertain as to whether the federal funding agency will require refunds for these improper expenditures.

Since June 30, 2005, the University did not maintain documentation required by OMB Circular A-21 to support personnel charges to federal programs. The potential liability to federal funding agencies is not readily determinable.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

Grant accounting deficiencies at the University resulted in over expenditure of grant budgets or excess cash balances for 184 grants. The grant clearing account had a large amount of receipts not identified to a particular program. The questioned cost and potential liability is not readily determinable. The University has implemented collection of time and effort reports beginning November 2006.

NOTE 16 – SUBSEQUENT EVENTS

On November 1, 2006, the University of North Carolina Board of Governors ratified the issuance of bonds for a system-wide tax-exempt bond financing. On November 30, 2006, the University borrowed \$13,490,000 through the financing.

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

Board of Trustees
North Carolina Agricultural and Technical State University
Greensboro, North Carolina

We have audited the financial statements of North Carolina Agricultural and Technical State University, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2006, which collectively comprise the University's basic financial statements and have issued our report thereon dated June 30, 2007. Our report was modified to reference to other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of The North Carolina A&T Foundation, Inc., as described in our report on the University's financial statements. The financial statements of The North Carolina A&T Foundation, Inc., were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Audit Findings and Recommendations section of this report.

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

Finding

1. INSTANCES OF FRAUD/ABUSE
2. DEFICIENCIES IN GRANT MANAGEMENT
3. MISUSE OF VENDING RECEIPTS

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we consider all of the reportable conditions described above to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of 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, which are reported in the Audit Findings and Recommendations section of this report, disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Finding

1. INSTANCES OF FRAUD/ABUSE
2. DEFICIENCIES IN GRANT MANAGEMENT
3. MISUSE OF VENDING RECEIPTS

This report is intended solely for the information and use of the Audit Committee, the Board of Governors, the Board of Trustees, management of the University, the Governor, the State Controller, and the General Assembly, and is not intended to be and should not be used by anyone other than these specified parties.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

June 30, 2007

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

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

1. INSTANCES OF FRAUD/ABUSE

During the course of our audit, there were several allegations of fraud/abuse that were brought to our attention. These allegations were investigated by the University's internal auditors and/or a team of outside consultants hired by the University. Significant findings from those investigations include:

Office of Naval Research Grant

The program manager who administered the HBCU Future Engineering Faculty Fellowship Program funded by the Office of Naval Research was responsible for several improper business practices and expenditures. During the 2005-06 fiscal year, program expenditures for student stipends, travel, tuition and fees, and other payments increased significantly, the same year that the program manager's husband became a student participant in the program. The following items were noted:

- a. Stipends of over \$66,000 were paid to the program manager's husband during 2005-06. The highest yearly stipend payout prior to his entry in the program was less than \$23,000. In many cases, payments made to the program manager's husband exceeded those paid to other students. Stipend payments also exceeded the amount included in the grant proposal.
- b. The program manager hired and supervised her daughter as a student worker in violation of State nepotism policy.
- c. Unreasonable and unnecessary travel expenses were paid. The program manager spent 41 nights in hotels during 2005-06 at program expense, with an average cost of \$328.74 per night. She also approved travel expenses for her husband in excess of the \$1,500 student travel budget. Further, the program manager paid for her daughters, as well as other student workers not enrolled in the program, to attend out-of-State conferences. Finally, lodging and meals for a symposium held in the city where the University is located were paid. Expenditures for the symposium included payments for one room for the program manager and another room for her husband for three nights during the two-day symposium (other participants only stayed two nights). Restaurant/room service charges in the amount of \$369.68 were incurred by the program manager and her husband and paid for by the grant.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- d. Payments were made for tuition that exceeded actual tuition costs, and payments were made for books and supplies even though those costs were supposed to be covered by the base stipend.
- e. Payments were paid to students for reimbursement of personal computer and health insurance costs without requiring proof of purchase.
- f. Equipment purchased by grant funds could not be located. Missing items included computer equipment, a digital camcorder and a digital camera.

In total, approximately \$500,000 of program expenditures were questioned by the consultants. The program manager was terminated from University employment in September 2006.

This finding is applicable to award number N00014-01-1-0987 for the period July 1, 2001, through June 30, 2006, and contract number N00014-01-C-0401.

Natural Resources and Environmental Design Department

An administrative assistant in the Natural Resources and Environmental Design Department misused a total of eleven accounts related to Natural Resources and the School of Agriculture, resulting in a loss to the University of \$101,000. The loss involved unauthorized financial aid awards, stipends, student employment, purchases of goods and travel. The administrative assistant was terminated from University employment in February 2006 and later pled guilty to charges stemming from the misuse of funds.

The grant and award periods affected by this finding are: ACQ-4-33623-07 (7/26/2004-10/26/2007), 2004-33814-15095 (9/1/2004-8/31/2007), 2005-338820-16385 (9/1/2005-8/31/2008), NCX-207-5-06-130-1 (10/1/2005-9/30/2006), 2005-38820-16356 (9/15/2005-9/14/2008), ACQ-4-33623-07 (7/26/2004-7/25/-2006), NCX-171-5-02-130-1 (10/1/2004-9/30/2005), U91619901-0 (8/1/2003-9/30/2005), 68-3A75-3-111 (9/30/2004-9/30/2005), 68-3A75-5-147 (10/18/2005-10/18/2007).

Information Technology and Telecommunications Division

The former Vice Chancellor for Information Technology and Telecommunications misappropriated \$87,000 in university funds during the period May 2004 through February 2006. The majority of the funds came from rebates on computer purchases that were directed to a discretionary account held by the North Carolina A&T Foundation. The Vice Chancellor approved purchases from the fund that appeared to have no business purpose. The Vice Chancellor is no longer employed by the University and has been charged by legal authorities in connection with this matter.

The former Vice Chancellor for Information Technology and Telecommunications also participated in awarding a contract that is questionable. The Purchasing Department bid committee initially ranked a vendor third, but after assistance from the Vice Chancellor

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

in evaluating proposals, the vendor was ranked first. The vendor in question is the mother of the former Vice Chancellor's executive assistant. The \$93,100 contract was for training services and had explicit documentation requirements for the sessions. The vendor submitted invoices totaling \$94,100, which were approved for payment by the former Vice Chancellor. Not only was the contract overpaid by \$1,000, the vendor also did not submit required documentation to indicate that the requirements of the contract were completed.

Recommendation: The University should establish, communicate and reinforce proper ethical and behavioral standards for employees. Further, the University should reevaluate controls over expenditure activity and the delegation of authority at the department level and closely monitor controls to ensure that they are effective. No University accounts should be maintained by the Foundation.

University's Response: We concur with the recommendation. University and State policy prohibits the maintenance of University funds in any non-University account. This policy is communicated to campus annually.

- a. Office of Naval Research Grant: The Office of Naval Research (ONR) and the University have finalized grant amendments in writing, approving \$422,415 of the questioned program expenditures, including stipends, tuition, travel, insurance, and laptop computers. The University recognizes that control over expenditure activity is strengthened by obtaining written agency approvals or amendments before enacting transactions.
- b. The University terminated the program manager's employment and has initiated legal action to recover a major portion of the remaining questioned costs and missing equipment.
- c. Natural Resources and Environmental Design Department: The University has recovered a portion (\$75,851) of the loss from insurance proceeds and legal actions taken against the administrative assistant. The University anticipates some additional restitution from the former employee. The Purchasing Office conducts ongoing campus workshops stressing the proper use and control of the University procurement card, and they audit the monthly departmental procurement card reconciliations.
- d. Information Technology and Telecommunications Division: The University terminated the employment of the Vice Chancellor for Information Technology and Telecommunications and has initiated legal action to recover the misappropriated funds. The University has reinforced its existing ethical and behavioral standards and communicated those standards to the University community through numerous seminars. Additionally, the University and the Foundation have strengthened the policies for establishing accounts in the Foundation and for expenditures from those accounts. The existing policy of the University stipulates that no University funds are to be placed in any accounts outside of the University.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

2. DEFICIENCIES IN GRANTS MANAGEMENT

In January 2007, a team of outside consultants hired by the University identified a number of problems in the management of federal grants, some of which had also been noted by internal auditors. The team's findings included:

- a. Since June 30, 2005, the University has not maintained documentation required by OMB Circular A-21 to support personnel charges to federal programs. As a result, the University has a potential liability for questioned costs associated with personnel charges to federal programs. The amount of potential questioned costs is not readily determinable.
- b. Of the approximately 500 grant fund accounts maintained by the University, 184 accounts have had no recorded activity since July 2005, indicating that the grants were closed. There were 69 inactive accounts with deficit cash balances totaling over \$395,000, which indicates that the budget for the grants was overspent using other funds. The other 115 grant accounts reflected a total cash balance of over \$716,000, which indicates excess federal revenues could have been received. However, the residual balances in these accounts could also be the result of accounting errors. A clearing account managed by the Contracts and Grants Office had a balance of over \$784,000 as of February 14, 2007. The account is used for the deposit of receipts that have not been identified to a particular program. These grant accounting deficiencies could also result in questioned costs in an amount that is not readily determinable.

Recommendation: The University should consult with federal grantor agencies to determine the corrective action to be taken. Also, the University should evaluate its accounting procedures for grant funds and make changes to ensure that receipts are properly applied and that over-expenditures are prevented.

University's Response:

- a. A revised, more efficient time and effort reporting model was in the process of implementation at June 2005. Campus seminars had been conducted and programming was being initiated. However, resources were reprioritized with the implementation of the Banner Finance ERP and the time and effort project was not resumed until November 2006, when certification forms were distributed and informational seminars were conducted with project investigators by the Office of Contracts & Grants. Delinquent reports are now being collected (95% complete) and a policy has been developed that should ensure ongoing compliance.
- b. The University practice is to consult federal or sponsor grantor agencies for guidance with respect to contentious issues or questionable expenditures. The specific grant deficiencies identified will be resolved by October 2007, with procedures put in place by September 2007 to prevent future occurrences. Following newly established procedures final resolution of grants will be completed in a more timely manner.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- c. The clearing account relates to University funds, predominately wired from outside sources that did not have proper documentation for immediate identification but are required to be deposited within 24 hours of receipt. Normally this account is reconciled monthly but the reconciliation was deferred during the Banner Finance ERP implementation. To date, over \$400,000 of the \$784,000 noted has been identified and properly credited. The remaining balance of approximately \$384,000 is being reviewed.

3. MISUSE OF VENDING RECEIPTS

The University inappropriately transferred \$380,000 of vending receipts to the Chancellor's Discretionary Fund maintained by the North Carolina A&T Foundation. These receipts were then primarily used for purposes that are inconsistent with those outlined in University of North Carolina System policy.

The University has a five-year campus vending contract that began in October 2003 that includes exclusive beverage service. The beverage vendor pays the University \$140,000 per year. During 2003 through 2005, \$380,000 of the vending receipts were transferred to the discretionary fund at the Foundation. In 2005, the former Chancellor signed a gift document indicating that the funds were solicited from the vendor for the Foundation; however, there is no mention of the Foundation in the vending contract. Internal auditors and a team of consultants hired by the University both concluded that the moneys should not have been transferred to the Foundation account.

We examined 89% of the expenditures from the Chancellor's Discretionary Fund during the 2006 fiscal year. Since, the majority of the receipts in the fund (85% in the 2006 fiscal year) came from the vending contract, we compared the expenditures to those allowed by University of North Carolina System policy related to vending receipts. The policy provides that vending moneys may be used for scholarships and direct student financial aid programs, debt service on self-liquidating facilities, and other specific student activities as authorized by the chancellor.

We concluded that 87% of the expenditures we examined were for unallowable purposes. Unallowable items included commission for art work, travel for the former Chancellor's wife to accompany him on University-related travel and payments for Foundation/Alumni events.

The largest unallowable expenditure was the payment of \$150,000 to a faculty member exempt from the State Personnel Act for the purchase of an annuity. System policy requires all constituent institutions to have a policy concerning the granting of non-salary compensation for personnel exempt from the State Personnel Act other than the Chancellor. The policy shall either provide specified non-salary compensation to a defined category of employees uniformly or shall require approval by the board of trustees regarding non-salary compensation granted to an individual employee. The

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

University was unable to produce a University policy regarding non-salary compensation or documentation to indicate the payment had been approved by the board of trustees.

Recommendation: The University should account for all of its activity in its own records and should not maintain any additional accounts within the Foundation. The University should adopt policies to ensure that it adheres to University of North Carolina System policy regarding the use of vending receipts and non-salary compensation for employees.

University's Response: University and State policy prohibit the maintenance of University funds in any non-University account. This policy is communicated to campus annually. We concur with the recommendation and are enforcing policies relating to vending receipts and non-salary compensation.

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