



# STATE OF NORTH CAROLINA

**WESTERN CAROLINA UNIVERSITY**

**CULLOWHEE, NORTH CAROLINA**

**FINANCIAL STATEMENT AUDIT REPORT**

**FOR THE YEAR ENDED JUNE 30, 2008**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**WESTERN CAROLINA UNIVERSITY**

**CULLOWHEE, NORTH CAROLINA**

**FINANCIAL STATEMENT AUDIT REPORT**

**FOR THE YEAR ENDED JUNE 30, 2008**

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**THE UNIVERSITY OF NORTH CAROLINA**

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**Beth A. Wood, CPA**  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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**AUDITOR'S TRANSMITTAL**

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The Honorable Beverly E. Perdue, Governor  
The General Assembly of North Carolina  
Board of Trustees, Western Carolina University

We have completed a financial statement audit of Western Carolina University for the year ended June 30, 2008, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

Beth A. Wood, CPA  
State Auditor

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**INDEPENDENT AUDITOR'S REPORT**

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Board of Trustees  
Western Carolina University  
Cullowhee, North Carolina

We have audited the accompanying financial statements of Western Carolina University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2008, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Western Carolina 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 Western Carolina University Foundation, which represent 5 percent, 7 percent, and 2 percent, respectively, of the assets, net assets and revenues of the University; nor the financial statements of Western Carolina University Research and Development Corporation, the University's discretely presented component unit. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of Western Carolina University Foundation and Western Carolina University Research and Development Corporation 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 reports of other auditors provides a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Western Carolina University and its discretely presented component unit as of June 30, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for

## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, Statement 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, and Statement 50, *Pension Disclosures*, during the year ended June 30, 2008.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 10, 2009, 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.



Beth A. Wood, CPA  
State Auditor

June 10, 2009

## WESTERN CAROLINA UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

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### Introduction

The University's financial report includes three financial statements and the *Notes to the Financial Statements*. The *Statement of Net Assets* presents the assets, liabilities, and net assets of the institution as of the end of the fiscal year; the *Statement of Revenues, Expenses, and Changes in Net Assets* reflects revenues and expenses recognized during the fiscal year; and the *Statement of Cash Flows* provides information on all of the institution's cash inflows and outflows during the fiscal year by major category. These financial statements were prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements, which establish standards for external financial reporting for public colleges and universities. GASB standards require that financial statements be presented on a consolidated basis in order to focus on the University as a whole.

Also included in the University's financial report are the *Statement of Financial Position* and *Statement of Activities* for the Western Carolina University Research and Development Corporation, a discretely presented component unit. The following discussion and analysis provides an overview of the financial position and activities only for Western Carolina University (the "University") for the years ended June 30, 2008 and 2007 and not its component unit. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

### Statement of Net Assets

The *Statement of Net Assets* presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The difference between total assets and total liabilities - net assets - is one indicator of the current financial condition of the University. The change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. Assets and liabilities are generally measured using current values; however, one notable exception are capital assets, which are stated at historical cost less an allowance for depreciation.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

### Condensed Statement of Net Assets

	2008	2007	\$ Change	% Change
<b>Assets</b>				
Current Assets	\$ 74,070,145.71	\$ 67,136,615.63	\$ 6,933,530.08	10.33%
Capital Assets, Net	259,848,206.04	234,320,766.19	25,527,439.85	10.89%
Other Noncurrent Assets	64,197,884.37	68,927,466.31	(4,729,581.94)	-6.86%
<b>Total Assets</b>	<u>398,116,236.12</u>	<u>370,384,848.13</u>	<u>27,731,387.99</u>	7.49%
<b>Liabilities</b>				
Current Liabilities	17,018,681.51	17,049,861.07	(31,179.56)	-0.18%
Noncurrent Liabilities	76,352,012.12	55,931,691.97	20,420,320.15	36.51%
<b>Total Liabilities</b>	<u>93,370,693.63</u>	<u>72,981,553.04</u>	<u>20,389,140.59</u>	27.94%
<b>Net Assets</b>				
Invested in Capital Assets, Net of Related Debt	202,573,544.41	196,974,311.32	5,599,233.09	2.84%
Restricted – Nonexpendable	23,093,177.36	18,350,985.93	4,742,191.43	25.84%
Restricted – Expendable	20,658,066.27	32,634,981.03	(11,976,914.76)	-36.70%
Unrestricted	58,420,754.45	49,297,611.09	9,123,143.36	18.51%
<b>Total Net Assets</b>	<u>\$ 304,745,542.49</u>	<u>\$ 297,257,889.37</u>	<u>\$ 7,487,653.12</u>	2.52%

A review of the University's *Statement of Net Assets* at June 30, 2008 and 2007, indicates that the University improved its already strong financial position, with Total Net Assets increasing by nearly \$7.5 million (2.52%).

Total assets of the University increased by \$27.8 million. Net capital assets contributed \$25.5 million of this amount, mostly due to net increases of \$12.7 million in General Infrastructure, \$5.8 million in Buildings, and \$6.2 million in Construction in Progress. The increase in Construction in Progress is primarily due to costs associated with the new Student Recreation Center, Forsyth building renovations and costs associated with the new dining facility, offset by completion of the steam and electric infrastructure project. The General Infrastructure and Buildings increases are mostly attributable to the completion of Steam and Electric Plant improvements and the McKee Building and Killian Building projects during 2009, offset by the current year additions to accumulated depreciation.

The \$4.7 million decrease in Other Noncurrent Assets resulted primarily from a \$7.5 million decrease in the amount due from the State of North Carolina for general obligation bond proceeds allotted, but not yet transferred, to the University at year end. This decrease was offset by an increase in restricted cash of \$1.9 million and \$.7 million increase in investments.

Noncurrent liabilities increased by \$20.4 million, primarily due to bond issuance of \$4.4 million for the Campus Recreation Center and \$17.5 million for the new dining facility, offset by principal repayments of \$1 million.

Net assets represent residual interest in the University's assets after all liabilities are deducted. For reporting purposes, they are divided into three major components:

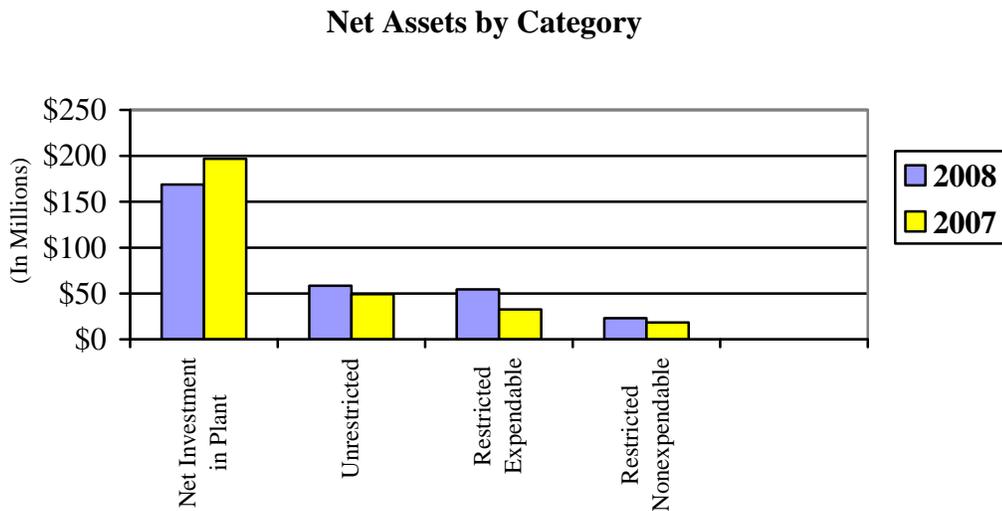
- "Invested in Capital Assets, Net of Related Debt" represents the University's investment in capital assets such as movable equipment, buildings, land,

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

infrastructure, and improvements, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets. At June 30, 2008, \$202.5 million (66.5 %) of the \$304.7 million in net assets was attributable to the University's investment in capital assets.

- Restricted net assets are subject to externally imposed restrictions governing their use and are further divided into two categories: nonexpendable and expendable. "Restricted - Nonexpendable" net assets primarily include the University's permanent endowment funds received from donors for the purpose of creating present and future income. These funds must be held inviolate and in perpetuity and are, therefore, not expendable. Earnings on these funds support various programs determined by donors. The nonexpendable category makes up approximately \$23.1 million (7.6 %) of the \$304.7 million net assets total. "Restricted - Expendable" net assets are available for expenditure in accordance with externally imposed restrictions. Examples include funds for scholarships, debt service, and capital projects. At June 30, 2008, expendable net assets totaled \$20.7 million (6.8% of total net assets).
- "Unrestricted" net assets are not subject to externally imposed restrictions, although management has designated these funds for various academic and research programs and initiatives, as well as capital projects. This year, unrestricted net assets totaling \$58.4 million represent 19.1 % of total net assets.

The following chart displays the contribution of each category to the total in both 2008 and 2007:



## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

The *Statement of Revenues, Expenses, and Changes in Net Assets* presents the revenues earned and the expenses incurred during the year. Activities are reported as either operating or nonoperating. Given a public university's dependency on revenues such as state appropriations, gifts, and investment income, which are prescribed by GASB as nonoperating revenues, operating expenses will exceed operating revenues, resulting in an operating loss. Net nonoperating revenues and expenses are integral components in determining the increase or decrease in net assets.

Generally speaking, operating revenues are generated through the provision of goods and services, and include tuition and fees, contract and grant revenue, interest earnings on student loans, and sales and service revenue generated by student housing, the bookstore, and other enterprises. Operating expenses are the costs incurred to acquire or produce the goods and services provided and to conduct the affairs of the institution.

Nonoperating revenues are revenues received for which goods and services are not provided. For example, state appropriations, while budgeted for operations, are reported as nonoperating revenue because they are provided by the state legislature without the legislature directly receiving commensurate goods and services in return for those revenues. Nonoperating expenses include interest expense, extraordinary items, and other expenses not incurred in the normal operations of the University.

Capital grants and gifts are considered neither operating nor nonoperating revenues and are reported on the statement after "Income Before Other Revenues."

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following is a condensed *Statement of Revenues, Expenses, and Changes in Net Assets* for Western Carolina University as of June 30, 2008, compared with that of 2007.

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

	2008	2007	\$ Change	% Change
<b>Operating Revenues</b>				
Student Tuition and Fees, Net	\$ 32,262,305.01	\$ 31,240,066.21	\$ 1,022,238.80	3.27%
Grants and Contracts	19,006,465.28	16,257,258.07	2,749,207.21	16.91%
Sales and Services, Net	24,412,455.71	24,736,218.22	(323,762.51)	-1.31%
Other Operating Revenues	1,042,849.85	1,164,628.49	(121,778.64)	-10.46%
<b>Total Operating Revenues</b>	<b>76,724,075.85</b>	<b>73,398,170.99</b>	<b>3,325,904.86</b>	<b>4.53%</b>
<b>Operating Expenses</b>				
Salaries and Benefits	103,524,697.44	93,885,045.66	9,639,651.78	10.27%
Supplies and Materials	18,997,635.94	21,885,497.49	(2,887,861.55)	-13.20%
Services	27,198,773.49	25,565,951.01	1,632,822.48	6.39%
Scholarships and Fellowships	7,686,114.18	5,848,751.92	1,837,362.26	31.41%
Utilities	5,168,964.05	5,043,606.23	125,357.82	2.49%
Depreciation	6,782,565.51	6,134,931.06	647,634.45	10.56%
<b>Total Operating Expenses</b>	<b>169,358,750.61</b>	<b>158,363,783.37</b>	<b>10,994,967.24</b>	<b>6.94%</b>
<b>Operating Loss</b>	<b>(92,634,674.76)</b>	<b>(84,965,612.38)</b>	<b>(7,669,062.38)</b>	<b>9.03%</b>
<b>Nonoperating Revenues (Expenses)</b>				
State Appropriations	89,055,512.62	80,794,783.84	8,260,728.78	10.22%
Noncapital Gifts and Grants	3,391,100.28	3,963,000.10	(571,899.82)	-14.43%
Investment Income (Net of Investment Expense)	3,844,485.63	8,418,395.39	(4,573,909.76)	-54.33%
Interest and Fees on Debt	(3,038,489.35)	(2,654,294.92)	(384,194.43)	14.47%
Other Nonoperating Expenses	(320,151.63)	53,523.95	(373,675.58)	-698.15%
<b>Net Nonoperating Revenues</b>	<b>92,932,457.55</b>	<b>90,575,408.36</b>	<b>2,357,049.19</b>	<b>2.60%</b>
<b>Income Before Other Revenues</b>	<b>297,782.79</b>	<b>5,609,795.98</b>	<b>(5,312,013.19)</b>	<b>-94.69%</b>
Capital Appropriations	4,750,400.00	6,223,900.00	(1,473,500.00)	-23.67%
Capital Gifts and Grants	1,631,993.11	16,913,403.86	(15,281,410.75)	-90.35%
Additions to Permanent Endowments	448,780.17	597,540.53	(148,760.36)	-24.90%
<b>Total Other Revenue</b>	<b>6,831,173.28</b>	<b>23,734,844.39</b>	<b>(16,903,671.11)</b>	<b>-71.22%</b>
<b>Change in Net Assets</b>	<b>7,128,956.07</b>	<b>29,344,640.37</b>	<b>(22,215,684.30)</b>	<b>-75.71%</b>
<b>Beginning Net Assets, as restated</b>	<b>297,616,586.42</b>	<b>267,913,249.00</b>	<b>19,703,337.42</b>	
<b>Ending Net Assets</b>	<b>\$ 304,745,542.49</b>	<b>\$ 297,257,889.37</b>	<b>\$ (2,512,346.88)</b>	<b>-0.85%</b>

The *Statement of Revenues, Expenses, and Changes in Net Assets* reflects a positive year ending June 30, 2008, with an increase in ending net assets of \$7.4 million. Revenues exceeding expenses by \$7.1 million along with a prior period adjustment increase to net assets of \$358,697.05 result in the overall increase in total net assets.

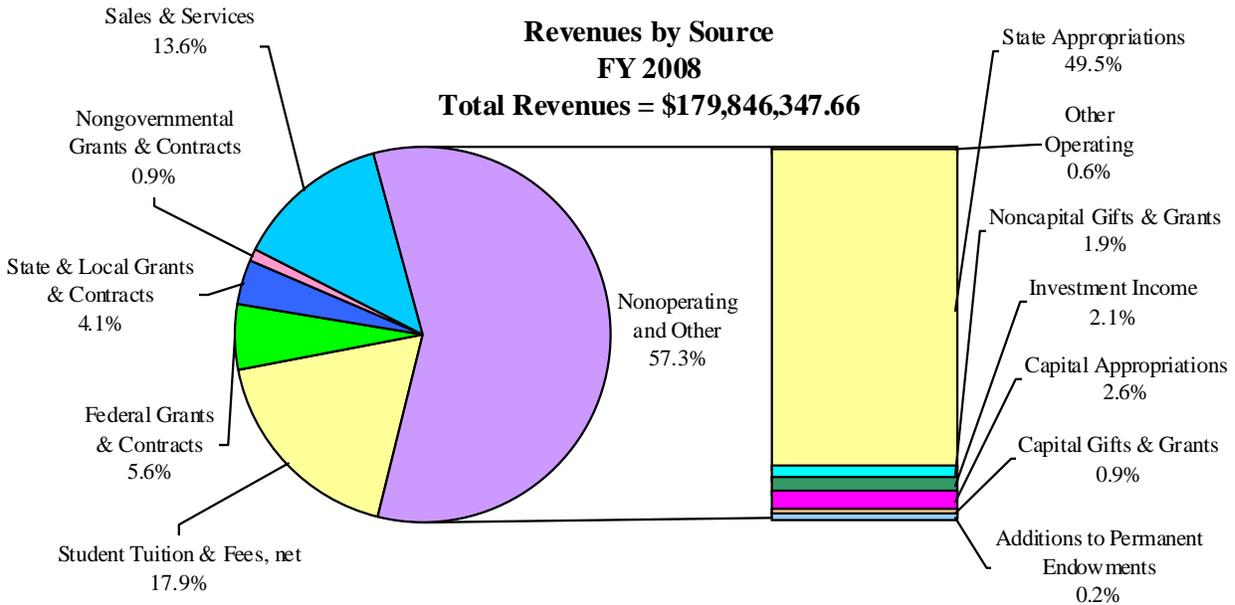
Among the University's greatest strengths are the diverse revenue streams that supplement student tuition and fees. These include gifts from individuals, foundations, and corporations, along with state appropriations, investment income, and federal, state, and private grants and contracts. The University has sought and will continue to seek funding from available

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

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sources that are consistent with its mission and will continue prudently to manage the financial resources realized from these efforts in order to supplement tuition revenues and fund its operating activities.

The following is a graphic illustration of the breakdown of revenues by source (both operating and nonoperating), which are used to fund the University's operating activities for the year ended June 30, 2008. As defined by GASB, significant recurring sources of the University's revenues, such as state appropriations and private gifts, are considered nonoperating.



Operating revenues for 2008 totaled \$76.7 million, compared with \$73.4 million for 2007. The most significant source of operating revenue for the University was tuition and fees (net of scholarship allowances) totaling \$32.3 million at June 30, 2008, and \$31.2 million at June 30, 2007. This 3.5% increase reflects an overall increase in tuition and fee rates. Other major revenue sources in 2008 include sales and services of \$24.4 million (\$24.7 million in 2007) and grants and contracts of \$19 million (\$16.3 million in 2007). The increase in grants and contracts is primarily due to an increase in funds granted by the State of North Carolina for University of North Carolina Need Based Grants and other financial aid programs administered by the North Carolina State Education Assistance Authority.

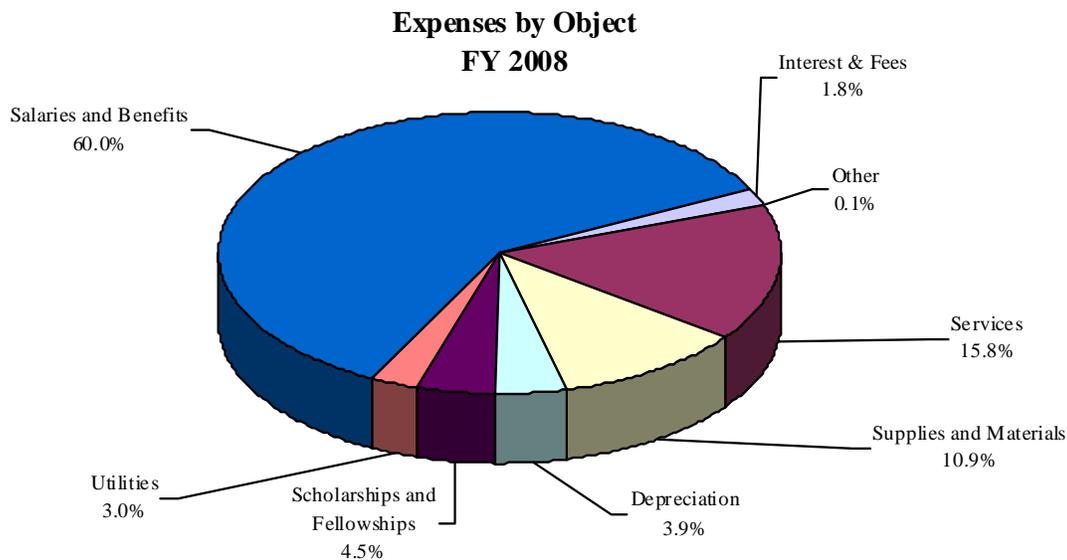
Like most public institutions, the University receives significant nonoperating revenues which offset the loss generated by operating activities. During 2008, the operating loss of \$92.6 million was offset by \$92.9 million in net nonoperating revenues. The primary sources of this revenue are state appropriations, which totaled \$89.1 million and accounted for 49.5% of total revenue. Other sources of nonoperating revenue in 2008 were investment income of

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

\$3.8 million and noncapital gifts and grants of \$3.4 million. A decrease in net investment income in 2008 of \$4.6 million was largely attributable to unfavorable market fluctuations.

Capital grants totaled \$1.6 million and \$16.9 million for the years ended June 30, 2008, and June 30, 2007, respectively. The primary sources of this revenue were state general obligation bond proceeds of \$1.3 million and \$13 million in 2008 and 2007, respectively. In 2000, the voters of North Carolina approved the issuance of general obligation bonds to provide funds for capital improvements on the University of North Carolina campuses. The Office of State Budget and Management allots these funds based on the University's projected cash requirements related to the construction projects funded by this bond issue. The decrease of \$11.7 million in state general obligation proceeds is attributable to the completion of the majority of the bond funded projects.

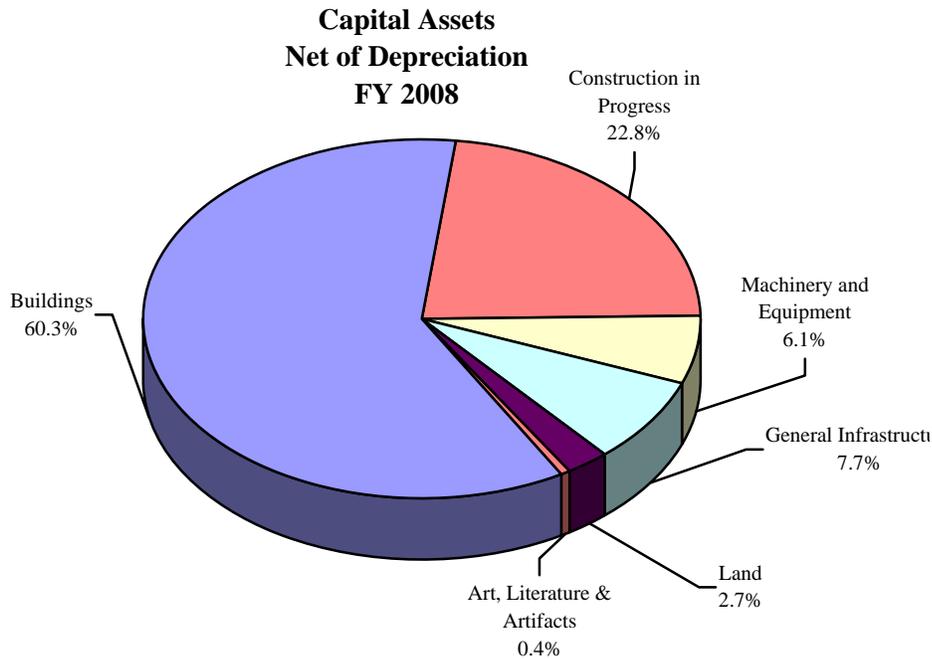
The following is a graphic illustration of expenses (both operating and nonoperating) by their natural (object) classification:



Operating expenses increased \$11 million for the fiscal year ending June 30, 2008. Operating expenses are mainly attributable to salaries and benefits for the faculty and staff of the University. Of the \$169.4 million in operating expenses, \$103.5 million (61.1%) was used for this purpose in 2008. Other elements included in operating expenses are supplies and materials, services, scholarships and fellowships, utilities, and depreciation.

**Capital Asset and Debt Administration**

At June 30, 2008, the University had approximately \$334.9 million invested in capital assets, and accumulated depreciation of \$75.1 million. Depreciation charges for the current year totaled \$6.8 million. The following chart displays the relationship of each category to capital assets as a whole.



A critical factor for achieving quality in the University's academic endeavors, while enriching the quality of all students' campus experience, is the development and renewal of capital assets. The University continues to implement a long-range plan for modernizing its older teaching, research, and student life facilities, balanced with new construction. Capital asset additions and improvements during the current fiscal year were funded with federal and state capital grants, debt proceeds, gifts, and unrestricted net assets designated for capital purposes.

Passage of North Carolina's Higher Education Bond Referendum in November 2000 gave the University more than \$100 million in state funds over a six-year period, beginning in fiscal year 2001, to fund facility construction projects, infrastructure improvements, land acquisitions, and technology expansion.

Of the 2000 Higher Education Bond Referendum, only two projects are remaining. They consist of a comprehensive renovation to Stillwell Laboratory Building and a partial renovation to Forsyth Building. In August 2006, the University obtained occupancy for the Phase I renovation of the Stillwell Laboratory Building (\$26.3 million), which included renovations of classrooms, offices, and support space for many departments within Arts & Sciences. The Phase II renovations of additional classroom and laboratory space obtained

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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occupancy in August 2007. The partial renovation of Forsyth Building includes many upgrades to interior finishes, addresses accessibility, and many other code deficiencies. This renovation is approximately 75% complete with a scheduled completion of November 2008.

The 2000 bond issue also made possible the acquisition of 344 acres of property adjacent to the University's main campus. On May 12, 2006, the University of North Carolina Board of Governors approved *Millennial Campus* designation for the newly acquired property. The Millennial Initiative is an ambitious and comprehensive regional economic improvement strategy that will enable the University to partner with business, industry, and government. A comprehensive master plan was approved by the campus and Board of Trustees to serve as a guide for the development of this property. The 2007 General Assembly approved \$46.2 million in funding for a new 145,200 square foot health and gerontological sciences building that will be the first construction project on the Millennial Initiative property. The new building will house classrooms, offices and laboratories for the University's School of Nursing and programs in social work, physical therapy, athletic training, clinical laboratory sciences, environmental health, health information administration, nutrition and dietetics, emergency medical care, recreational therapy, and communication sciences and disorders. It is expected to become the cornerstone for a mixed-use "neighborhood of interest" focusing on retirement, aging and health, where students and faculty would work with partners from private business and industry. Construction of the new health sciences building is expected to begin in March 2009 with a target completion date of May 2011.

The 2008 General Assembly approved \$4 million in advance planning funds for a new Education and Allied Professions Building. This new 163,000 sf facility will address safety, energy, code/ADA issues while providing the much needed functional space for our College of Education and Allied Professions. The existing facility lacks sufficient space to handle a significant increase in students. The existing space configuration of the education building does not provide adequate space capacity or proper types of configuration for technically sophisticated education and training. This building is to seek a green building rating from the Leadership in Energy and Environmental Design (LEED) of Silver or higher. This project would enhance WCU's efforts to help address the acute shortage of teachers in North Carolina by providing for the expansion of WCU's teacher education programs. The proposed new facility would provide state-of-the-art classrooms to support teaching and learning through the use of new technology and media that are currently unavailable in the existing facility due to its age, size, and configuration. Additionally, WCU has a strong commitment to helping keep teachers in the field once they begin teaching. The proposed facility would be designed to support adult learning to help promote teacher retention.

The University's new \$16.8 million Campus Recreation Center opened to an enthusiastic campus community on August 17, 2008. The building's 73,000 square feet of space includes a 50-foot climbing wall, two multipurpose courts, a wide variety of fitness equipment, two mirror-lined group exercise studios, and a one-eighth mile indoor track.

Helder Residence Hall, a four-story, 400-bed residence hall constructed in 1966, was demolished in Summer 2007, and Dodson Cafeteria and Leatherwood Residence Hall will be

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

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demolished in January, 2009. Demolition of these three buildings was necessary to provide room for construction of a new dining facility and two new residence halls that, together with the Campus Recreation Center, will form a quadrangle arranged around a formal lawn that will be the centerpiece of the University's campus. The new two-story, 53,000 square-foot dining hall is scheduled for completion in February 2009. Ground was broken on April 3, 2008 for the two new residence halls that will be connected by an archway and provide a living and learning community for 801 students enrolled in the Honors College and the North Carolina Teaching Fellows Program. The \$50.2 million residence hall project is being funded through student room fees. The two halls will contain nearly 235,000 square feet, providing modern housing for students, offices for Honors College staff, lobbies, common areas and meeting rooms. One hall is scheduled for completion in July 2009, with the second building expected to be finished by July 2010.

The University acquired a 2.18 acres strip of commercial property that currently houses a number of commercial establishments strategically located in the middle of campus for \$1.6 million. The University plans to maintain it as a business district in keeping with the Millennial Initiative.

The University's financial statements indicate \$45,345,000 in bonds payable, \$985,604 in notes payable, and \$20,283,144 in capital leases payable at June 30, 2008. Total annual debt service payments were \$4.3 million in 2008 and \$4.5 million in 2007.

For additional information on capital assets and debt administration, see Notes 5, 7, and 8 to the financial statements.

### **Enrollment**

A significant factor in the University's capacity to generate resources is the ability to recruit and retain high quality students. Enrollment growth targets for the next 8 to 10 years have been established, and the university continues vigorously to pursue growth in all categories of enrollment - resident credit and distance learning enrollments, at both the undergraduate and graduate levels. Total enrollment for Fall 2007 topped 9,000 for the first time in the institution's history, with significant growth in the number of community college transfers and graduate students. The University's total headcount for the fall of 9,055 represents a 2.2% increase over last fall's enrollment of 8,861 and the total enrollment target of 10,000 by the year 2009 appears to be within reach. Increases in enrollment will generate increases in revenues such as tuition and fees, sales and services, and state appropriations as well as the corresponding operating expenses incurred by serving larger numbers of students.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)**

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### **Economic Outlook**

Looking toward the future, management believes that the University is well positioned to maintain its strong financial condition and to advance both the quality and scope of its services to students, the state, and the region.

A crucial element in the University's future will be our relationships with The University of North Carolina System and the North Carolina General Assembly, as we work to remain competitive in price while providing an outstanding education for our students. There is a direct relationship between the growth of the University's enrollment and facilities and the demand for state appropriations to operate the University. Declines in state appropriations generally exert pressure on institutions to increase tuition and fees. As an institution targeted for growth in the years ahead, the University will be greatly affected by the availability and levels of state operating funds and capital resources to support that growth.

The national economy is currently experiencing turbulent times in the housing and financial markets and Congress is planning unprecedented and extreme measures in an effort to prevent further upheaval. These problems, coupled with rising gas and food prices, are beginning to impact the State of North Carolina's revenue stream. It is unclear at this time what short-term and long-term effects this economic environment will have on the University.

Private gifts are an important supplement to the University's base revenue from state appropriations and student tuition. Such gifts can provide the support needed to boost programs to higher levels of quality and service. The "Campaign for Western: Creating Extraordinary Opportunities", officially launched February 2007, continues to enjoy strong success. Donors to the Campaign are helping the University to enhance institutional quality by making gifts to support current operations and programs, in addition to helping create endowment funds that will provide resources in perpetuity. The economic pressures affecting donors, as well as investment returns, will continue to affect the level of support the University receives from corporate and individual giving.

The University will continue to pursue its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy that is consistent with long-term market results and that insulates operations from temporary market volatility.

While the future cannot be predicted with certainty, management believes that the University's strong financial condition equips it well to weather the economic uncertainties presently known and those that can be reasonably expected.

**Western Carolina University**  
**Statement of Net Assets**  
**June 30, 2008**

**Exhibit A-1**

**ASSETS**

Current Assets:

Cash and Cash Equivalents	\$ 50,900,679.02
Restricted Cash and Cash Equivalents	12,840,383.92
Restricted Short-Term Investments	844,799.83
Receivables, Net (Note 4)	3,672,988.33
Due from State of North Carolina Component Units	40,000.00
Due from University Component Units	1,277,097.21
Inventories	3,797,814.60
Notes Receivable, Net (Note 4)	696,382.80
	<hr/>
Total Current Assets	74,070,145.71

Noncurrent Assets:

Restricted Cash and Cash Equivalents	21,417,837.10
Receivables, Net (Note 4)	155,701.31
Restricted Due from Primary Government	2,598,466.59
Endowment Investments	33,667,327.51
Other Investments	936,399.75
Notes Receivable, Net (Note 4)	5,422,152.11
Capital Assets - Nondepreciable (Note 5)	67,318,940.42
Capital Assets - Depreciable, Net (Note 5)	192,529,265.62
	<hr/>
Total Noncurrent Assets	324,046,090.41

Total Assets	<hr/> <hr/> 398,116,236.12
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**LIABILITIES**

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	9,171,973.10
Due to Primary Government	35,723.33
Funds Held for Others	98,582.25
Unearned Revenue	4,204,196.42
Interest Payable	743,536.52
Long-Term Liabilities - Current Portion (Note 7)	2,764,669.89
	<hr/>

Total Current Liabilities	17,018,681.51
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Noncurrent Liabilities:

Deposits Payable	84,934.15
Funds Held for Others	538,537.35
U. S. Government Grants Refundable	5,538,687.99
Long-Term Liabilities (Note 7)	70,189,852.63
	<hr/>

Total Noncurrent Liabilities	76,352,012.12
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Total Liabilities	<hr/> <hr/> 93,370,693.63
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**Western Carolina University**  
**Statement of Net Assets**  
**June 30, 2008**

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

**NET ASSETS**

Invested in Capital Assets, Net of Related Debt	202,573,544.41
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	10,759,377.83
Endowed Professorships	12,195,911.02
Departmental Uses	137,888.51
Expendable:	
Scholarships and Fellowships	13,496,149.30
Research	377,779.50
Endowed Professorships	1,720,754.85
Departmental Uses	2,160,026.25
Loans	1,413,132.73
Capital Projects	288,266.37
Debt Service	1,201,957.27
Unrestricted	<u>58,420,754.45</u>
Total Net Assets	<u>\$ 304,745,542.49</u>

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

**Western Carolina University**  
**Statement of Revenues, Expenses, and**  
**Changes in Net Assets**  
**For the Fiscal Year Ended June 30, 2008**

**Exhibit A-2**

**REVENUES**

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 32,262,305.01
Federal Grants and Contracts	10,093,693.32
State and Local Grants and Contracts	7,299,946.15
Nongovernmental Grants and Contracts	1,612,825.81
Sales and Services, Net (Note 9)	24,412,455.71
Interest Earnings on Loans	14,574.09
Other Operating Revenues	1,028,275.76
	<hr/>
Total Operating Revenues	76,724,075.85

**EXPENSES**

Operating Expenses:	
Salaries and Benefits	103,524,697.44
Supplies and Materials	18,997,635.94
Services	27,198,773.49
Scholarships and Fellowships	7,686,114.18
Utilities	5,168,964.05
Depreciation	6,782,565.51
	<hr/>
Total Operating Expenses	169,358,750.61
	<hr/>
Operating Loss	(92,634,674.76)

**NONOPERATING REVENUES (EXPENSES)**

State Appropriations	89,055,512.62
Noncapital Grants	77,260.78
Noncapital Gifts	3,313,839.50
Investment Income (Net of Investment Expense of \$166,162.13)	3,844,485.63
Interest and Fees on Debt	(3,038,489.35)
Other Nonoperating Expenses	(320,151.63)
	<hr/>
Net Nonoperating Revenues	92,932,457.55
	<hr/>
Income Before Other Revenues, Expenses, Gains, or Losses	297,782.79
Capital Appropriations	4,750,400.00
Capital Grants	1,631,993.11
Additions to Endowments	448,780.17
	<hr/>
Increase in Net Assets	7,128,956.07

**NET ASSETS**

Net Assets - July 1, 2007, as Restated (Note 17)	<hr/>
	297,616,586.42
Net Assets - June 30, 2008	<hr/>
	\$ 304,745,542.49

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

**Western Carolina University**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended June 30, 2008**

**Exhibit A-3**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Received from Customers	\$ 78,454,099.18
Payments to Employees and Fringe Benefits	(103,155,935.98)
Payments to Vendors and Suppliers	(52,529,885.72)
Payments for Scholarships and Fellowships	(7,686,114.18)
Loans Issued	(1,451,365.29)
Collection of Loans	1,306,951.77
Interest Earned on Loans	14,574.09
Student Deposits Received	731,230.58
Student Deposits Returned	(718,863.07)
Other Receipts	1,028,275.76
	<hr/>
Net Cash Used by Operating Activities	(84,007,032.86)

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

State Appropriations	89,055,512.62
Noncapital Grants	77,260.78
Noncapital Gifts	3,287,315.36
Additions to Endowments	448,780.17
William D. Ford Direct Lending Receipts	31,317,432.00
William D. Ford Direct Lending Disbursements	(31,317,432.00)
Related Activity Agency Receipts	71,782.51
Related Activity Agency Disbursements	(420.00)
Other Payments	51,030.64
	<hr/>
Net Cash Provided by Noncapital Financing Activities	92,991,262.08

**CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES**

Proceeds from Capital Debt	21,910,810.39
State Capital Appropriations	4,750,400.00
Capital Grants	9,134,598.17
Proceeds from Sale of Capital Assets	10,883.03
Acquisition and Construction of Capital Assets	(31,719,441.30)
Principal Paid on Capital Debt and Leases	(2,070,401.18)
Interest and Fees Paid on Capital Debt and Leases	(2,784,630.52)
Other Receipts (Payments)	(4,336.14)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(772,117.55)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Proceeds from Sales and Maturities of Investments	1,334,542.39
Investment Income	5,523,659.23
Purchase of Investments and Related Fees	(3,744,582.83)
	<hr/>
Net Cash Provided by Investing Activities	3,113,618.79
	<hr/>
Net Increase in Cash and Cash Equivalents	11,325,730.46
Cash and Cash Equivalents - July 1, 2007	73,833,169.58
	<hr/>
Cash and Cash Equivalents - June 30, 2008	\$ 85,158,900.04

**Western Carolina University**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended June 30, 2008**

**Exhibit A-3**  
**Page 2**

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

Operating Loss	\$ (92,634,674.76)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	6,782,565.51
Allowances, Write-Offs, and Amortizations	(235,145.21)
Noncash contributed expenses	48,643.05
Changes in Assets and Liabilities:	
Receivables (Net)	2,613,981.49
Due from University Component Units	146,441.79
Inventories	(66,284.94)
Accounts Payable and Accrued Liabilities	(1,147,895.97)
Due to Primary Government	4,781.10
Unearned Revenue	206,755.74
Compensated Absences	386,099.02
Deposits Payable	12,367.51
Note Principal Repayments	1,326,698.10
Notes Issued	(1,451,365.29)
	<hr/>
Net Cash Used by Operating Activities	<u>\$ (84,007,032.86)</u>

**RECONCILIATION OF CASH AND CASH EQUIVALENTS**

Current Assets:	
Cash and Cash Equivalents	\$ 50,900,679.02
Restricted Cash and Cash Equivalents	12,840,383.92
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	21,417,837.10
	<hr/>
Total Cash and Cash Equivalents - June 30, 2008	<u>\$ 85,158,900.04</u>

**NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

Assets Acquired through a Gift	\$ 124,643.61
Change in Fair Value of Investments	(1,296,298.82)
Reinvested Distributions	1,499,512.84
Loss on Disposal of Capital Assets	382,065.31

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

**Western Carolina University Research and Development Corporation**  
**Statement of Financial Position**  
**June 30, 2008**

**Exhibit B-1**

**ASSETS**

Current Assets:	
Cash and Cash Equivalents	\$ 42,861,726.00
Net Investment in Capital Leases, net of unearned interest income	<u>387,734.00</u>
Total Current Assets	<u>43,249,460.00</u>
Property, Plant and Equipment:	
Construction in Progress	7,373,329.00
Other Assets:	
Other Investments	15,000.00
Certificate Issuance Costs, net of accumulated amortization	2,694,467.00
Net Investment in Capital Leases, net of unearned interest income	<u>18,908,513.00</u>
Total Other Assets	<u>21,617,980.00</u>
Total Assets	<u><u>\$ 72,240,769.00</u></u>

**LIABILITIES**

Current Liabilities:	
Current Portion of Long-Term Debt	\$ 535,000.00
Short-Term Note Payable	1,277,097.00
Construction Contracts Payable	3,484,794.00
Construction Retainage Payable	240,830.00
Accrued Interest Payable	<u>244,287.00</u>
Total Current Liabilities	<u>5,782,008.00</u>
Noncurrent Liabilities:	
Certificates of Participation Payable	<u>65,825,000.00</u>
Total Liabilities	<u>71,607,008.00</u>

**NET ASSETS**

Unrestricted	<u>633,761.00</u>
Total Liabilities and Net Assets	<u><u>\$ 72,240,769.00</u></u>

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

**Western Carolina University Research and Development Corporation**  
**Statement of Activities**  
**For the Fiscal Year Ended June 30, 2008**

**Exhibit B-2**

**REVENUES**

Management Fee	\$	104,808.00
Investment Interest Income		71,000.00
Interest Earned from Investments in Capital Leases		<u>1,041,690.00</u>
Total Revenues		<u>1,217,498.00</u>

**EXPENSES**

Interest		924,522.00
Insurance		98,631.00
Professional Fees		52,054.00
Amortization of Certificate Issuance Costs		56,050.00
Other Operating		<u>1,126.00</u>
Total Expenses		<u>1,132,383.00</u>

**CHANGE IN NET ASSETS**

		85,115.00
Net Assets, Beginning of Year		<u>548,646.00</u>
Net Assets, End of Year	\$	<u><u>633,761.00</u></u>

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

**WESTERN CAROLINA UNIVERSITY**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2008**

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

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. The blended component unit, although legally separate, is, in substance, part of the University's operations and therefore, is reported as if it was part of the University. Discretely presented component unit financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize its legal separateness.

**Blended Component Unit** - Although legally separate, Western Carolina University Foundation (Foundation), a component unit of the University, is reported as if it were part of the University.

The Foundation is governed by a 27-member board consisting of 4 ex officio directors and 23 elected directors. The Foundation's purpose is to aid, support and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because the elected directors of the Foundation are appointed by the members of the Western Carolina University Board of Trustees and the Foundation's sole purpose is to benefit Western Carolina University, its financial statements have been blended with those of the University.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Separate financial statements for the Foundation may be obtained from the University Controller's Office, HFR 315, Cullowhee, NC 28723, or by calling 828-227-7323. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

**Discretely Presented Component Unit** - Western Carolina University Research & Development Corporation (Corporation) 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 Corporation 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 Corporation's financial information in the University's financial reporting entity for these differences.

Separate financial statements for the Corporation may be obtained from the University Controller's Office, HFR 315, Cullowhee, NC 28723, or by calling 828-227-7323.

- 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Nonexchange transactions, in which the University receives (or gives) value without directly giving (or receiving) equal value in exchange 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 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** - Investments generally are reported at fair value, as determined by quoted market prices or an estimated amount determined by management if quoted market prices are not available. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

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

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity or for a specified period of time, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the University for investment in an endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 and merchandise for resale, are valued at cost using the last invoice cost.
- 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.

The University capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an estimated 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 15 to 75 years for general infrastructure, 10 to 50 years for buildings, and 3 to 25 years for equipment.

Certain book and art collections are capitalized at cost or fair value at the date of donation. These collections are depreciated over the life of the collection using the straight-line method. The estimated useful lives for the collections are 25 years.

Art 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** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants.
- J. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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obligations, annuity and life income payable, and compensated absences that will not be paid within the next fiscal year.

Bond issuance costs, premiums, and other discounts are considered immaterial and 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 or for which an employee can be paid upon termination of employment. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30.

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

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

- L. 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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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.

- 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*.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 dining, residential, and printing services. 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 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, 2008, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$85,004,331.86 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 2.9 years as of June 30, 2008. Assets and shares of the Short-Term Investment Fund are

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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, 2008 was \$43,734.75. The carrying amount of the University's deposits not with the State Treasurer was \$110,833.43 and the bank balance was \$752,024.74. 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 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, 2008, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Collateral Held by Pledging Bank's Trust Department not in University's Name	\$ <u>588,635.14</u>
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- B. Investments** - 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

Investments of the University's component unit, the Foundation, is 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 has a formal policy that addresses credit risk.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following table presents the fair value of investments by type at June 30, 2008, for the Long-Term Investment Pool.

### *Long-Term Investment Pool*

<b>Investment Type</b>	Fair Value
UNC Investment Fund	\$ 17,617,826.42
Mutual Funds	15,484,643.38
Investments in Real Estate Limited Partnerships	3,220.00
	1,366,962.00
Total Long-Term Investment Pool	\$ 34,472,651.80

**Non-Pooled Investments** - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2008, for the University's non-pooled investments.

### *Non-Pooled Investments*

<b>Investment Type</b>	Fair Value	Investment Maturities Less Than 1 Year
Debt Securities		
Money Market Mutual Funds	\$ 836,827.78	\$ 836,827.78
Other Securities		
Mutual Funds	8,255.46	
Investments in Real Estate	93,800.00	
Domestic Stocks	33,070.05	
Other	3,922.00	
Total Non-Pooled Investments	\$ 975,875.29	

At June 30, 2008, the University's non-pooled investments with credit risk had a fair value of \$836,827.78. The credit quality rating of the money market mutual funds was Aaa and A1+P1 as rated by Moody's Investor Service.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**Total Investments** - The following table presents the fair value of the total investments at June 30, 2008:

	<u>Fair Value</u>
<b>Investment Type</b>	
Debt Securities	
Money Market Mutual Funds	\$ 836,827.78
Other Securities	
UNC Investment Fund	17,617,826.42
Mutual Funds	15,492,898.84
Investments in Real Estate	97,020.00
Limited Partnerships	1,366,962.00
Domestic Stocks	33,070.05
Other	3,922.00
	<u>                    </u>
Total Investments	<u>\$ 35,448,527.09</u>

### 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). The current spending policy for the University's pooled endowment funds provides 5% of a three-year moving average of market values as of December 31. The Board of Trustees annually reviews the spending policy and makes adjustments accordingly. At June 30, 2008, net appreciation of \$15,085,174.67 was available to be spent, of which \$9,664,307.07 was restricted to specific purposes.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 4 - RECEIVABLES

Receivables at June 30, 2008, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
<b>Current Receivables:</b>			
Students	\$ 1,188,966.00	\$ 630,023.15	\$ 558,942.85
Accounts	1,667,794.70		1,667,794.70
Intergovernmental	817,621.05		817,621.05
Pledges	136,418.16	9,748.70	126,669.46
Investment Earnings	100.18		100.18
Interest on Loans	156,955.80		156,955.80
Other	344,904.29		344,904.29
<b>Total Current Receivables</b>	<u>\$ 4,312,760.18</u>	<u>\$ 639,771.85</u>	<u>\$ 3,672,988.33</u>
<b>Noncurrent Receivables:</b>			
Pledges	<u>\$ 170,370.16</u>	<u>\$ 14,668.85</u>	<u>\$ 155,701.31</u>
<b>Notes Receivable:</b>			
<b>Notes Receivable - Current:</b>			
Federal Loan Programs	\$ 683,420.97	\$ 0.00	\$ 683,420.97
Institutional Student Loan Programs	<u>53,579.42</u>	<u>40,617.59</u>	<u>12,961.83</u>
<b>Total Notes Receivable - Current</b>	<u>\$ 737,000.39</u>	<u>\$ 40,617.59</u>	<u>\$ 696,382.80</u>
<b>Notes Receivable - Noncurrent:</b>			
Federal Loan Programs	\$ 6,571,806.62	\$ 1,154,010.00	\$ 5,417,796.62
Institutional Student Loan Programs	<u>4,355.49</u>	<u></u>	<u>4,355.49</u>
<b>Total Notes Receivable - Noncurrent</b>	<u>\$ 6,576,162.11</u>	<u>\$ 1,154,010.00</u>	<u>\$ 5,422,152.11</u>

### NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2008, is presented as follows:

	Balance July 1, 2007 (as restated)	Increases	Decreases	Balance June 30, 2008
Capital Assets, Nondepreciable:				
Land	\$ 6,914,777.75	\$ 0.00	\$ 0.00	\$ 6,914,777.75
Art, Literature, and Artifacts	1,066,236.00			1,066,236.00
Construction in Progress	<u>53,102,871.47</u>	<u>29,906,426.10</u>	<u>23,671,370.90</u>	<u>59,337,926.67</u>
<b>Total Capital Assets, Nondepreciable</b>	<u>61,083,885.22</u>	<u>29,906,426.10</u>	<u>23,671,370.90</u>	<u>67,318,940.42</u>
Capital Assets, Depreciable:				
Buildings	205,764,115.63	10,336,397.71	1,046,177.40	215,054,335.94
Machinery and Equipment	23,122,276.60	2,011,703.74	613,096.55	24,520,883.79
Art, Literature, and Artifacts	108,341.66			108,341.66
General Infrastructure	<u>14,028,345.29</u>	<u>13,895,672.68</u>	<u></u>	<u>27,924,017.97</u>
<b>Total Capital Assets, Depreciable</b>	<u>243,023,079.18</u>	<u>26,243,774.13</u>	<u>1,659,273.95</u>	<u>267,607,579.36</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	55,038,722.15	4,331,160.80	877,403.43	58,492,479.52
Machinery and Equipment	7,949,022.76	1,247,996.18	399,805.21	8,797,213.73
Art, Literature, and Artifacts	72,855.30	2,513.40		75,368.70
General Infrastructure	<u>6,512,356.66</u>	<u>1,200,895.13</u>	<u></u>	<u>7,713,251.79</u>
<b>Total Accumulated Depreciation</b>	<u>69,572,956.87</u>	<u>6,782,565.51</u>	<u>1,277,208.64</u>	<u>75,078,313.74</u>
<b>Total Capital Assets, Depreciable, Net</b>	<u>173,450,122.31</u>	<u>19,461,208.62</u>	<u>382,065.31</u>	<u>192,529,265.62</u>
<b>Capital Assets, Net</b>	<u>\$ 234,534,007.53</u>	<u>\$ 49,367,634.72</u>	<u>\$ 24,053,436.21</u>	<u>\$ 259,848,206.04</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2008, were as follows:

	Amount
Accounts Payable	\$ 4,500,930.49
Accrued Payroll	853,293.47
Contract Retainage	1,982,318.57
Civil Penalty and Forfeiture Fund Payable	1,042,479.93
Other	792,950.64
<b>Total Accounts Payable and Accrued Liabilities</b>	<b>\$ 9,171,973.10</b>

### NOTE 7 - LONG-TERM LIABILITIES

#### UNIVERSITY

**A. Changes in Long-Term Liabilities** - A summary of changes in the long-term liabilities for the year ended June 30, 2008, is presented as follows:

	Balance July 1, 2007	Additions	Reductions	Balance June 30, 2008	Current Portion
Revenue Bonds Payable	\$ 24,479,000.00	\$ 21,900,000.00	\$ 1,034,000.00	\$ 45,345,000.00	\$ 960,000.00
Notes Payable	1,343,920.79		358,316.93	985,603.86	377,499.01
Capital Leases Payable	20,950,418.07	10,810.39	678,084.25	20,283,144.21	734,073.04
Compensated Absences	5,577,091.42	4,909,662.44	4,523,563.42	5,963,190.44	607,053.00
Annuity and Life Income Payable	450,114.44		72,530.43	377,584.01	86,044.84
<b>Total Long-Term Liabilities</b>	<b>\$ 52,800,544.72</b>	<b>\$ 26,820,472.83</b>	<b>\$ 6,666,495.03</b>	<b>\$ 72,954,522.52</b>	<b>\$ 2,764,669.89</b>

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

**B. Revenue Bonds Payable** - The University was indebted for revenue bonds payable:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2008	Principal Outstanding June 30, 2008	See Table Below
<b>The University of North Carolina System Pool Revenue Bonds</b>							
Student Housing I	(A)	4.00*	10/01/2013	465,000.00	240,000.00	225,000.00	(1)
Student Housing II	(B)	5.00*	10/01/2010	1,370,000.00	825,000.00	545,000.00	(1)
Athletic Facilities I	(C)	5.00*	10/01/2012	8,070,000.00	7,100,000.00	970,000.00	
Athletic Facilities II	(D)	2.50*	04/01/2028	1,510,000.00	200,000.00	1,310,000.00	
Student Recreation Center	(D)	2.50*	04/01/2028	11,610,000.00	1,530,000.00	10,080,000.00	
Student Center Refund	(E)	4.00*	10/01/2025	4,335,000.00	150,000.00	4,185,000.00	
Athletic Facility Refund	(E)	4.00*	10/01/2026	6,135,000.00	5,000.00	6,130,000.00	
Student Recreation Center	(F)	5.00*	10/01/2033	4,355,000.00	0.00	4,355,000.00	
Dining Hall Facility	(F)	5.00*	10/01/2033	17,545,000.00	0.00	17,545,000.00	
<b>Total Bonds Payable (principal only)</b>				<b>\$ 55,395,000.00</b>	<b>\$ 10,050,000.00</b>	<b>\$ 45,345,000.00</b>	

(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 2002A

(D) The University of North Carolina System Pool Revenue Bonds, Series 2003A

(E) The University of North Carolina System Pool Revenue Bonds, Series 2006A

(F) The University of North Carolina System Pool Revenue Bonds, Series 2008A

\* For variable rate debt, interest rates in effect at June 30, 2008 are included.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University has pledged future revenues, net of specific operating expenses, to repay revenue bonds and certificates of participation as shown in the table below:

Ref	Revenue Source	Total Future Revenues Pledged	Current Year Revenues Net of Expenses	Current Year Principal & Interest	Estimate of % of Revenues Pledged
(1)	Housing Revenues	847,378.15	4,257,164.70	339,537.61	3%

**C. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2008, are as follows:

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2009	\$ 960,000.00	\$ 2,100,974.24	\$ 377,499.01	\$ 47,345.03
2010	1,505,000.00	2,046,786.28	400,238.18	24,305.86
2011	1,565,000.00	1,987,010.65	195,511.13	3,881.35
2012	1,425,000.00	1,931,638.76	12,355.54	119.18
2013	1,490,000.00	1,865,363.76		
2014-2018	8,300,000.00	8,292,275.04		
2019-2023	10,430,000.00	6,122,996.90		
2024-2028	11,890,000.00	3,393,040.69		
2029-2033	6,315,000.00	1,185,450.00		
2034-2038	1,465,000.00	36,625.00		
Total Requirements	<u>\$ 45,345,000.00</u>	<u>\$ 28,962,161.32</u>	<u>\$ 985,603.86</u>	<u>\$ 75,651.42</u>

**D. Prior Year Defeasances** – During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2008, the outstanding balance of prior year defeased bonds was \$10,530,000.00.

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2008	Principal Outstanding June 30, 2008
University Center Renovation	Wachovia Bank	5.98%	12/01/2010	\$ 3,800,000.00	\$ 2,929,788.17	\$ 870,211.83
Print Shop	BB&T	4.63%	10/26/2011	166,755.00	51,362.97	115,392.03
Total Notes Payable				<u>\$ 3,966,755.00</u>	<u>\$ 2,981,151.14</u>	<u>\$ 985,603.86</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**F. Charitable Gift Annuity Split Interest Agreement** - In October 2003, joint donors entered into a charitable gift annuity agreement with the Foundation. Under the terms of the agreement, the Foundation received property with a fair market value of \$1,082,314.80. In consideration of this property transfer, the annuitants will receive, for their joint lives, an annual annuity of \$86,044.84, payable in quarterly installments. The obligation of the Foundation to make annuity payments, if any remain, shall terminate upon the deaths of the donors. Based on the donors' life expectancy and an expected 5.106% rate of return, the liability at June 30, 2008 was adjusted to its present value as follows:

	Amount
Value of Annuity Liability at June 30, 2007	\$ 450,114.44
Interest Earned on Investment	45,775.52
Sum of Quarterly Payments	(86,045.84)
Present Value Adjustment at Year End	(32,260.11)
Value of Annuity Liability at June 30, 2008	\$ 377,584.01

**G. Component Unit** - The Western Carolina University Research & Development Corporation, a discretely presented component unit of the University, has constructed two dormitories that are recognized as capital leases and is currently replacing two dormitories that will be recognized as capital leases by the University. The long-term debt of the component unit represents the construction cost of the four dormitories.

Long-term debt at June 30, 2008, consists of the following:

2003 certificates of participation with a balance of \$11,080,000, evidenced by undivided interests in the rights to receive certain revenues, including the Base Rentals under the lease with the University for the facility. The maturities and interest rates of the certificates are as follows:

Due June 1	Principal Amount	Interest Rate
2009	\$ 265,000	2.750%
2010	270,000	3.000%
2011	280,000	3.375%
2012	290,000	3.500%
2013	300,000	3.625%
Thereafter	9,675,000	3.625% - 5.000%
	\$ 11,080,000	

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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2005 certificates of participation with a balance of \$10,280,000, evidenced by undivided interests in the rights to receive certain revenues, including the Base Rentals under the lease with the University for the facility. The maturities and interest rates of the certificates are as follows:

<u>Due June 1</u>	<u>Principal Amount</u>	<u>Interest Rate</u>
2009	\$ 270,000	4.000%
2010	280,000	4.000%
2011	295,000	3.000%
2012	300,000	3.125%
2013	310,000	4.000%
Thereafter	<u>8,825,000</u>	3.250% - 4.350%
	<u><u>\$ 10,280,000</u></u>	

2008 certificates of participation with a balance of \$45,000,000, evidenced by undivided interests in the rights to receive certain revenues, including the Base Rentals under the lease with the University for the facility. The maturities and interest rates of the certificates are as follows:

<u>Due June 1</u>	<u>Principal Amount</u>	<u>Interest Rate</u>
2009	\$ 0	0.000%
2010		0.000%
2011	530,000	4.000%
2012	630,000	3.500%
2013	735,000	4.350%
Thereafter	<u>43,105,000</u>	3.500% - 5.250%
	<u><u>\$ 45,000,000</u></u>	

### NOTE 8 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to buildings, machinery and equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2008:

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

<u>Fiscal Year</u>	<u>Amount</u>
2009	\$ 1,824,366.26
2010	1,821,278.76
2011	1,732,114.15
2012	1,447,196.76
2013	1,446,741.68
2014-2018	7,234,087.52
2019-2023	7,235,525.00
2024-2028	7,239,612.30
2028-2033	<u>6,554,470.30</u>
Total Minimum Lease Payments	36,535,392.73
Amount Representing Interest (3.78 - 6.10% Rate of Interest)	<u>16,252,248.52</u>
Present Value of Future Lease Payments	<u><u>\$ 20,283,144.21</u></u>

Buildings acquired under capital lease amounted to \$19,623,569.96 at June 30, 2008. Machinery and equipment acquired under capital lease amounted to \$2,203,416.90 at June 30, 2008.

- B. Operating Lease Obligations** – The University entered into operating leases for automobiles and housing. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2008:

<u>Fiscal Year</u>	<u>Amount</u>
2009	\$ 134,127.12
2010	103,585.52
2011	12,933.75
2012	<u>4,044.00</u>
Total Minimum Lease Payments	<u><u>\$ 254,690.39</u></u>

Rental expense for all operating leases during the year was \$339,261.85.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues
<b>Operating Revenues:</b>					
<b>Student Tuition and Fees</b>	<u>\$ 39,425,519.22</u>	<u>\$ 0.00</u>	<u>\$ 6,886,407.45</u>	<u>\$ 276,806.76</u>	<u>\$ 32,262,305.01</u>
<b>Sales and Services:</b>					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 11,313,998.20	\$ 273,125.75	\$ 1,957,395.48	\$ 158,669.79	\$ 8,924,807.18
Dining	8,867,109.91	623,065.26	1,326,114.91	87,235.67	6,830,694.07
Book Rental	1,557,418.15	1,091.35	230,554.44	57,813.10	1,267,959.26
Bookstore	1,831,169.24	145,151.22		2,807.12	1,683,210.90
Print Shop	755,502.95	630,916.63			124,586.32
Athletic	1,459,206.91				1,459,206.91
Other	1,322,638.48	70,376.57			1,252,261.91
Sales and Services of Education and Related Activities	3,030,598.83	2,238,407.53		28.60	792,162.70
Independent Operations	2,190,068.43	112,501.97			2,077,566.46
<b>Total Sales and Services</b>	<u>\$ 32,327,711.10</u>	<u>\$ 4,094,636.28</u>	<u>\$ 3,514,064.83</u>	<u>\$ 306,554.28</u>	<u>\$ 24,412,455.71</u>

### NOTE 10 - 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	\$ 53,021,953.16	\$ 2,751,827.85	\$ 3,516,381.53	\$ 0.00	\$ 1,049.34	\$ 0.00	\$ 59,291,211.88
Research	1,014,430.68	286,252.53	807,490.55		27,052.20		2,135,225.96
Public Service	7,639,566.08	1,248,601.74	2,779,881.22	70,072.34	111,970.01		11,850,091.39
Academic Support	8,423,176.42	2,118,471.70	1,163,617.55	45,328.79	8,267.43		11,758,861.89
Student Services	4,606,622.44	556,213.00	2,061,165.62	196.47			7,224,197.53
Institutional Support	9,606,761.10	1,052,241.65	3,138,706.43	282,009.82	1,265.76		14,080,984.76
Operations and Maintenance of Plant	8,136,971.91	3,806,210.89	526,400.20		3,118,598.86		15,588,181.86
Student Financial Aid	104,326.47		40,880.76	6,537,681.68			6,682,888.91
Auxiliary Enterprises	10,783,000.78	5,572,136.21	13,082,643.14	750,825.08	1,900,760.45		32,089,365.66
Independent Operations	187,888.40	1,605,680.37	81,606.49				1,875,175.26
Depreciation						6,782,565.51	6,782,565.51
<b>Total Operating Expenses</b>	<u>\$ 103,524,697.44</u>	<u>\$ 18,997,635.94</u>	<u>\$ 27,198,773.49</u>	<u>\$ 7,686,114.18</u>	<u>\$ 5,168,964.05</u>	<u>\$ 6,782,565.51</u>	<u>\$ 169,358,750.61</u>

### NOTE 11 - 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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, 2008, these rates were set at 3.05% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$83,330,513.53, of which \$42,066,615.67 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$1,283,031.78 and \$2,523,996.94, respectively.

Required employer contribution rates for the years ended June 30, 2007, and 2006, were 2.66% and 2.34%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2008, 2007, and 2006, which were \$1,283,031.78, \$1,021,055.41, and \$815,583.73, 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.ncosc.net/> 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 or the trustee

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2008, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$83,330,513.53, of which \$32,241,835.78 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$2,205,341.57 and \$1,934,510.15, 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 \$126,208.46 for the year ended June 30, 2008.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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, 2008, were \$34,979.65. The voluntary contributions by employees amounted to \$395,913.00 for the year ended June 30, 2008.

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 \$1,103,612.08 for the year ended June 30, 2008.

### NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

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

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

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year the University contributed 4.1% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. The required contribution rate for the years ended June 30, 2007, and 2006 was 3.8%. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2008, 2007, and 2006, which were \$3,046,646.51, \$2,576,162.17, and \$2,308,834.74, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available 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.

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

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2008, the University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2007, and 2006 was .52%. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2008, 2007, and 2006, which were \$386,403.95, \$352,527.45, and \$315,945.40, respectively. The University assumes no

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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liability for long-term disability benefits under the Plan other than its contribution.

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

### NOTE 13 - RISK MANAGEMENT

The 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 \$1,000,000 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 \$10,000 per occurrence deductible, except Highlands Biological which still maintains a \$500 per occurrence deductible. Theft losses are subject to a \$1,000 per occurrence deductible. The University also purchased through the Fund extended coverage for most buildings which covers windstorm or hail and "all risk" for selected contents such as high value equipment, computers and fine art. The extended coverage deductible is \$50,000 per occurrence, except for high value equipment losses which are subject to a \$1,000 deductible per occurrence for theft losses and a \$500 deductible per occurrence for all other covered losses.

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are \$1,000,000 per claim and \$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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 \$75,000 deductible and a 10% participation in each loss above the deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. These coverages provide insurance for medical malpractice, accident coverage for students participating in University athletic events, boiler and machinery coverage, general liability, and various other commercial applications. These coverages were affected and placed by the North Carolina Department of Insurance through the State's agent of record.

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.

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 14 - 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 \$13,464,907.78 and on other purchases were \$721,955.39 at June 30, 2008.

**B. Pending Litigation and Claims** - The NC School Boards Association, et. al. filed a civil action against various State officials in their official

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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capacity seeking a judicial determination as to whether the State Constitution requires certain monetary payments collected by State agencies to be paid to the Civil Penalty and Forfeiture Fund (Fund) for distribution to the public schools pursuant to G.S. 115C-457.1. In part, this civil action included a determination of whether monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations and library fines were “civil penalties” requiring remittance to the Fund. On July 1, 2005, the NC Supreme Court held in favor of the school boards with regard to parking fines and held in favor of the University with regards to library fines. The matter was remanded back to the trial court for disposition in accordance with the Supreme Court’s decision. On August 8, 2008, the trial court entered a judgment against the defendants. The manner and means by which the judgment is satisfied will be determined by the General Assembly. Transportation fines in the amount of \$1,042,479.93 have been recorded as a payable by the University for the period January 1, 1996 to June 30, 2005.

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.

### NOTE 15 - RELATED PARTIES

**Foundations** - There are two separately incorporated nonprofit foundations associated with the University. These foundations are The Development Foundation of the North Carolina Center for the Advancement of Teaching, Inc. and The Highlands Biological Foundation, Inc. The University’s financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundations, except for support from each organization to the University.

The Development Foundation of the North Carolina Center for the Advancement of Teaching, Inc. was incorporated in North Carolina on January 31, 1994, for the purpose of supporting the programs of, and providing supplemental funding for, the North Carolina Center for the Advancement of Teaching. This support approximated \$451,574.96 for the year ending June 30, 2008.

The Highlands Biological Foundation, Inc. was incorporated in North Carolina on July 21, 1930, for the purpose of supporting through grants and

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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scholarships the activities of Highlands Biological Station. This support approximated \$63,826.00 for the year ended June 30, 2008.

### NOTE 16 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2008, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*.

GASB Statement No. 50, *Pension Disclosures*.

GASB Statement No. 45, requires cost-sharing employers to recognize OPEB expense for their contractually required contributions to the plan generally consistent with the approach adopted in GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers, with modifications to reflect differences between pension benefits and OPEB*.

GASB Statement No. 48, requires disclosures pertaining to future revenues that have been pledged in order to disclose information about which revenues will be unavailable for other purposes and how long they will continue to do so.

GASB Statement No. 50, aligns the financial reporting requirements for pensions with those of other postemployment benefits, to conform with GASB Statement No. 45. This Statement amends GASB Statement No. 27 to require note disclosure of the employer contribution rates and percentage of the amount contributed for the current and preceding two years and to disclose how the required contribution rates are established.

### NOTE 17 - NET ASSET RESTATEMENT(S)

As of July 1, 2007, net assets as previously reported was restated as follows:

	<u>Amount</u>
July 1, 2007 Net Assets as Previously Reported	\$ 297,257,889.37
Restatement: To add prior omission of capital assets and correct other various recording errors.	<u>358,697.05</u>
July 1, 2007 Net Assets as Restated	<u>\$ 297,616,586.42</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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### NOTE 18 - SUBSEQUENT EVENTS

#### **Fair Value of Investments**

The fair market value of the University's investments owned for the period June 30, 2008 through February 28, 2009 decreased \$7.7 million or 23.6%.

The change is due to the unrealized loss on these investments as a result of the volatile and unstable world-wide financial market. It is expected that this downward trend will continue into the foreseeable future. University management, along with their investment management advisors, plan to continue their efforts of monitoring these investments to minimize any significant losses.

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Beth A. Wood, CPA  
State Auditor

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

---

Board of Trustees  
Western Carolina University  
Cullowhee, North Carolina

We have audited the financial statements of Western Carolina University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2008, which collectively comprise the University's basic financial statements and have issued our report thereon dated June 10, 2009. Our report was modified to include a reference to other auditors.

As discussed in Note 15 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, and Statement No. 50, *Pension Disclosures*, during the year ended June 30, 2008.

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 Western Carolina University Foundation (Foundation) and the discretely presented component unit, as described in our report on the University's financial statements. The financial statements of the Foundation and the discretely presented component unit 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting.

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

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Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the University's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control. We consider the deficiencies described in all of the findings in the Audit Findings and Responses section of this report to be significant deficiencies internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the University's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe that none of the significant deficiencies described above is a material weakness.

**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)**

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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 disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The University's responses to the findings identified in our audit are described in the Audit Findings and Responses section of this report. We did not audit the University's response and, accordingly, we express no opinion on it.

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



Beth A. Wood, CPA  
State Auditor

June 10, 2009

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## AUDIT FINDINGS AND RESPONSES

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### **Matters Related to Financial Reporting**

The following findings and recommendations were identified during the current audit and discuss conditions that represent deficiencies in internal control and/or noncompliance with laws, regulations, contracts, or grants. Finding number 1 was also reported in the prior audit.

1. INAPPROPRIATE INFORMATION SYSTEM ACCESS OVER THE FINANCIAL ACCOUNTING SYSTEM

The University did not maintain adequate internal control over access to its financial accounting system and data. This increases the risk of error or fraud.

The University did not appropriately terminate access rights for all separated employees. We identified 18 former employees whose access to the accounting system and the overall computer network was terminated several days or weeks after separation from the University. Access should be terminated as soon as individuals leave employment.

We identified two computer programmers with access to computer programs used in production, as well as data files. The ability to change programs should be segregated from responsibility for moving programs into production to prevent unauthorized changes.

The issues discussed above were also reported in our prior year audit. However, since the University did not receive the report until late in the fiscal year, the conditions continued to exist through the end of the current audit period. The University revised its procedures in August 2008 to ensure timely termination of access rights. The programmers' inappropriate access rights were removed in July 2008.

We also identified accounting personnel with access rights that were inconsistent with proper segregation of duties. The controller is responsible for approving financial transactions of subordinates and also has access rights to initiate transactions. These responsibilities should be segregated so that no one individual has the ability to control all aspects of a transaction. In addition, the systems accountant shares the user identification and password of the controller. Sharing a user identification and password reduces accountability for any error or misappropriation that may occur.

*Recommendation:* The University should continue to improve internal control over granting and managing access to the financial accounting system and data.

*University's Response:* The University agrees with the context of the recommendation and will work to improve internal control over access to financial data. We acknowledge the unusual access rights for accounting personnel and note it was not a decision taken lightly, but a necessary one for business continuity and financial systems support. In

## **AUDIT FINDINGS AND RESPONSES (CONTINUED)**

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addition, further clarification will show measures were taken to minimize risks to the University.

With respect to access rights and segregation of duties, we agree that managing, monitoring and controlling these are essential. We further contend that integral to this process is managing the integrity of the transactions, processes and systems within which the data is stored. It is within this later context wherein the University had to deviate from the norm with respect to the controller's access rights and roles.

Staff turnover and the realignment of duties subsequent to the Banner implementation left the University in a difficult position. Specifically, detailed knowledge of the Banner Finance System and processes resided almost exclusively with the university controller who previously provided systems accounting support for the University and served as the Banner Finance project lead for the Banner implementation. The University was in a position where the stability, integrity and further resolution of implementation issues of the financial systems upon which the audit itself is based required a careful and deliberate deviation from the norm for the controller. While we do not question there was some risk, we contend that the processes we followed minimized the potential overall risk and consequences to the University that would have resulted from an unstable finance system.

The Controller did not freely release account and password information to the systems accountant for indiscriminate use, but instead maintained full control of the account password through a process external to Banner that he alone controlled. The decision not to grant direct production security access to the new systems accountant during this time was deliberate to assure control and supervision for all production activities. In addition, the Banner systems environment within which we were operating would not accommodate review of all production work done by the systems accountant unless done so under a common access. Upon completion of these tasks, Banner production access was disabled by use of the password change feature, thus minimizing the possibility of errant production transactions during the systems accountant development and transition period.

Significant time and effort have been, and will continue to be, allocated to staff training and development to ensure that security access can be granted commensurate with job duties. It is the University's desire to provide for the segregation of duties to the fullest extent practical.

### **2. DEFICIENCIES IN INTERNAL CONTROL OVER THE RESIDENTIAL MANAGEMENT SYSTEM.**

The University did not maintain adequate internal control over access to its housing system and data. Also, reconciliations were not performed for data transmitted between the housing and financial accounting system to ensure transactions were properly transferred and recorded. This increases the risk of error or fraud.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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We identified three housing personnel with access rights that were inconsistent with proper segregation of duties. These individuals have full system access rights to the housing system, allowing them to enter and change rates, post charges to student accounts and transmit information to the financial accounting system. One of these individuals also has responsibility as the security administrator over access to this system. These functions and related computer access should be segregated so that no one individual has the ability to control all aspects of a transaction. There were no formal procedures in place for granting and managing these access rights. In addition, there was no reconciliation performed of data transmitted between the housing and financial accounting system to ensure transactions were properly transferred and recorded.

*Recommendation:* The University should improve internal control and establish policies and procedures over granting and managing access to the housing system and data and establish controls that ensure data are properly transmitted to the financial accounting system.

*University's Response:* The University agrees with the recommendation and will work to satisfy the recommendation to the fullest extent practical.

Security has been narrowed to align access more closely with primary job functions. We will continue to assess staffing needs and security assignments and will pursue alternative processes and personnel in light of available resources to improve controls and segregation of duties. In addition, the process which was being followed to monitor the transmission of data between the housing and financial systems has been changed to assure all transactions are recorded and accounted for.

### 3. DEFICIENCIES IN FINANCIAL REPORTING

The financial statements prepared by the University contained misstatements that were corrected as a result of our audit. Without these corrections, the financial statements could have been misleading to users. Misstatements noted in our audit included:

- The invested in capital assets, net of related debt net asset balance was understated by \$33,765,411.12. The net asset balance restricted for debt service was overstated by the same amount.
- Current year capital asset disposals of \$613,096.55 and related accumulated depreciation of \$399,805.22 were reported as a prior period adjustment. As a result, current year transactions were omitted from the capital asset disclosure. The amount reported as other nonoperating expense was understated by \$213,291.33, representing the loss on disposal of capital assets that should have been reported in the current year. The net asset restatement was understated by the same amount.

## AUDIT FINDINGS AND RESPONSES (CONTINUED)

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- The pledged future revenues disclosure in the long-term liabilities note did not include all current year revenues net of expenses. As a result, current year revenues net of expenses was understated by \$1,676,634.53 and the estimate of percentage of revenues was overstated by 10 percentage points.
- The University's equity position in the State Treasurer's Short-Term Investment Fund was understated by \$525,219.21 in the deposits and investments disclosure. The carrying amount of the University's deposits not with the State Treasurer was overstated by \$360,127.05. The total investments disclosure was missing from the note.

There is a lack of adequate controls surrounding the financial reporting process to prevent material misstatements in the financial statements. For example, there is no documented evidence the final statements were reviewed and approved, and we noted that 11 percent of the year-end journal entries prepared by the University included no documented evidence of review and approval.

*Recommendation:* The University should implement effective internal controls to ensure the accuracy of the financial statements and related notes.

*University's Response:* The University agrees with the recommendation and will work to strengthen existing processes and provide documented evidence of review. Preparation of the University's financial statements is done with limited staff, to the extent that separation of the preparation and approval process involves to a degree simply an exchange of work. Specifically, it is necessary for staff who under optimum circumstances would be providing only review to assist in the preparation of statements and to provide interim review throughout the preparation process. Resources have been provided and additional personnel have been added to the accounting staff in an effort to provide additional support for daily and yearend financial activities. We will work diligently to develop these resources and provide adequate time for thorough, independent preparation and review of the financial statements and accompanying footnotes.

#### 4. DEFICIENCIES IN BANK RECONCILIATIONS

The University does not have an adequate procedure in place to ensure the complete and accurate reconciliation of individual bank accounts. In addition, there is no documented evidence of review and approval of the reconciliations that were performed. This increases the risk that errors or misappropriations could occur and not be detected.

We attempted to reconcile total cash by individual bank account, however, we were unable to completely reconcile each account. In the process, we identified a misstatement of cash on the financial statements in the amount of \$89,580.

## AUDIT FINDINGS AND RESPONSES (CONCLUDED)

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*Recommendation:* The University should improve internal control to ensure all bank accounts are reconciled to the general ledger completely, accurately, and timely. Any discrepancies should be promptly investigated and resolved. Reconciliations should be reviewed and approved by an appropriate level of management.

*University's Response:* The University agrees with the recommendation and will continue to dedicate resources to ensure bank reconciliations are done both timely and accurately.

During the year, the University dedicated significant resources to redefine the reconciliation process previously in place that had proven to be inadequate for both Banner and the increase in electronic banking applications. The reconciliation process was further complicated by staff turnover and the transition of new staff. The Controller and numerous staff members were significantly involved in this process to the extent that approval of the reconciliations became implied, resulting in documented review and approvals often being overlooked.

We acknowledge that the cash updates and reconciliation between the Banner bank control fund and the individual Banner funds were not working properly and have and will continue to dedicate resources to resolve this issue.

Significant progress has been made and the University will continue to refine the reconciliation process.

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