



STATE OF NORTH CAROLINA

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

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, 2009

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THE UNIVERSITY OF NORTH CAROLINA

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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

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, 2009, 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 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

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, 2009, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the 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, 6 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 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, 2009, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, during the year ended June 30, 2009.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 2, 2010 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, 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

September 2, 2010

WESTERN CAROLINA UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2009 and 2008 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 classified as either current or noncurrent. This statement is a point in time financial statement and provides a fiscal snapshot of the University at June 30, 2009. The difference between total assets and total liabilities - net assets - is one measure 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.

Data presented in the *Statement of Net Assets* helps readers determine the assets available to continue the operations of the University and how much the University owes vendors, investors, and lending institutions. In addition, the Net Assets section of the statement reflects the residual value of the University's assets after liabilities are deducted and their availability for expenditure.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Net Assets

	2009	2008	\$ Change	% Change
Assets				
Current Assets	\$ 72,244,548.54	\$ 74,070,145.71	\$ (1,825,597.17)	-2.46%
Capital Assets, Net	269,850,199.64	259,848,206.04	10,001,993.60	3.85%
Other Noncurrent Assets	42,717,826.59	64,197,884.37	(21,480,057.78)	-33.46%
Total Assets	<u>384,812,574.77</u>	<u>398,116,236.12</u>	<u>(13,303,661.35)</u>	-3.34%
Liabilities				
Current Liabilities	12,842,069.69	17,018,681.51	(4,176,611.82)	-24.54%
Noncurrent Liabilities	75,037,645.08	76,352,012.12	(1,314,367.04)	-1.72%
Total Liabilities	<u>87,879,714.77</u>	<u>93,370,693.63</u>	<u>(5,490,978.86)</u>	-5.88%
Net Assets				
Invested in Capital Assets, Net of Related Debt	206,156,665.47	202,573,544.41	3,583,121.06	1.77%
Restricted – Nonexpendable	25,259,949.45	23,093,177.36	2,166,772.09	9.38%
Restricted – Expendable	20,925,847.93	20,658,066.27	267,781.66	1.30%
Unrestricted	44,590,397.15	58,420,754.45	(13,830,357.30)	-23.67%
Total Net Assets	<u>\$ 296,932,860.00</u>	<u>\$ 304,745,542.49</u>	<u>\$ (7,812,682.49)</u>	-2.56%

Assets

Current assets, which consist primarily of cash, short-term investments, accounts and notes receivable, and operating inventories, decreased by \$1.8 million. During fiscal year 2007-2008, the University paid the design costs of \$1.3 million for two planned residence halls on behalf of the Western Carolina University Research and Development Corporation (WCU R&D), a legally separate not-for-profit corporation reported as a discretely presented component unit in the University's financial statements. This amount was reflected on the June 30, 2008 Statement of Net Assets as \$1.3 million due from University component unit. During fiscal year 2009-2010, the University and WCU R&D agreed that this \$1.3 million and interest payments made by the University on the WCU R&D Corporation's bonds payable would not be repaid and, therefore, should be reported as construction in progress cost for the two residence halls under construction. When the two residence halls are placed in service, the University will record these residence halls as capital assets and amounts owed to the WCU R&D as a capital lease payable. This reclassification resulted in a decrease of \$1.3 million in amounts due from component units. Other significant changes in current assets include a \$0.5 million decrease in cash and cash equivalents and a \$1 million increase in restricted short-term investments due to normal fluctuations in operating cash needs, and a \$1 million decrease in receivables, mostly due to a decrease in amounts due the University on federal and state grants.

Net capital assets increased \$10 million. A net decrease in nondepreciable construction in progress of \$33.5 million was offset by a \$48.9 million increase in depreciable buildings. The biggest factor in this change was the completion of the new Campus Recreation Center (\$17.5 million) and major renovations to the Stillwell Laboratory (\$26.1 million) and Forsyth Building (\$5.3 million). General infrastructure increased by \$.3 million. Machinery and equipment also increased by \$2 million due to purchases of \$2.6 million, net of disposals of

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

\$0.6 million. Current year depreciation of \$7.7 million, net of the decrease in accumulated depreciation on disposals of \$1.4 million, offset these net additions totaling \$17.2 million.

Other noncurrent assets decreased \$21.5 million. Restricted noncurrent cash decreased \$12.8 million, largely attributable to the use of bond proceeds for capital projects completed or nearing completion at June 30, 2009. Realized and unrealized losses of \$1 million and \$4.9 million, respectively, resulted in a decrease of \$5.9 million in endowment investments. In addition, restricted amounts due from the State of North Carolina for general obligation proceeds allotted, but not yet transferred to the University at year end, decreased by \$1.8 million, directly attributable to the completion of construction projects funded by these statewide higher education bonds.

Liabilities

Current liabilities decreased by \$4.2 million. Accounts payable and accrued liabilities decreased by \$6 million due to decreases of \$2.9 million in construction payables and \$1.6 million in construction contract retainages because of less construction activity at June 30, 2009. In addition, the University reclassified \$1 million of parking fines to be paid to the Civil Penalty and Forfeiture Fund for distribution to public schools as required by G.S. 115C-457.1 from Accrued Liabilities to Due to Primary Government. This caused an increase in Due to Primary Government of \$1 million. In addition, the current portion of bonds payable and notes payable increased by \$0.5 million and \$0.4 million, respectively.

Noncurrent liabilities decreased by \$1.3 million. The only long-term debt issued by the University this past fiscal year was a \$1.8 million capital lease for the purchase of copy and print equipment. Principal payments of \$2.2 million for existing bonds, notes, and capital leases payable, along with the \$0.9 million increase in the current portion of long term debt, resulted in the overall decrease of \$1.3 million in long-term liabilities.

Net Assets

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, 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, 2009, \$206 million (69.3%) of the \$297 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The nonexpendable category makes up approximately \$25.2 million (8.5%) of the \$297 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, 2009, expendable net assets totaled \$21 million (7.0% 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 totaled \$44.6 million (15.2% of total net assets).

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, interest earnings on student loans, and sales and service revenue generated by student housing, the bookstore, and other enterprises. Also included are certain types of contracts and grants where value is received by the University and a good or service is provided in return. 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 revenues also include nonexchange grants and contracts which occur when value is received by the University without providing a good or service in return. 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, 2009, compared with that of 2008.

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

	<u>2009</u>	<u>2008</u>	<u>\$ Change</u>	<u>% Change</u>
Operating Revenues				
Student Tuition and Fees, Net	\$ 30,405,994.79	\$ 32,262,305.01	\$ (1,856,310.22)	-5.75%
Grants and Contracts	6,163,363.31	19,006,465.28	(12,843,101.97)	-67.57%
Sales and Services, Net	24,116,599.12	24,412,455.71	(295,856.59)	-1.21%
Other Operating Revenues	<u>1,396,054.09</u>	<u>1,042,849.85</u>	<u>353,204.24</u>	33.87%
Total Operating Revenues	<u>62,082,011.31</u>	<u>76,724,075.85</u>	<u>(14,642,064.54)</u>	-19.08%
Operating Expenses				
Salaries and Benefits	108,902,141.19	103,524,697.44	5,377,443.75	5.19%
Supplies and Materials	16,311,432.19	18,997,635.94	(2,686,203.75)	-14.14%
Services	25,573,875.36	27,198,773.49	(1,624,898.13)	-5.97%
Scholarships and Fellowships	9,398,196.40	7,686,114.18	1,712,082.22	22.28%
Utilities	5,115,944.78	5,168,964.05	(53,019.27)	-1.03%
Depreciation	<u>7,724,282.47</u>	<u>6,782,565.51</u>	<u>941,716.96</u>	13.88%
Total Operating Expenses	<u>173,025,872.39</u>	<u>169,358,750.61</u>	<u>3,667,121.78</u>	2.17%
Operating Loss	<u>(110,943,861.08)</u>	<u>(92,634,674.76)</u>	<u>(18,309,186.32)</u>	-21.25%
Nonoperating Revenues (Expenses)				
State Appropriations	84,000,003.86	89,055,512.62	(5,055,508.76)	-5.68%
State Aid - Federal Recovery Funds	3,563,974.00		3,563,974.00	100.00%
Noncapital Grants - Student Financial Aid	16,272,839.77		16,272,839.77	100.00%
Noncapital Gifts and Grants	3,536,954.47	3,391,100.28	145,854.19	4.30%
Investment Income (Includes Investment Expenses)	(4,549,479.72)	3,844,485.63	(8,393,965.35)	-218.34%
Interest and Fees on Debt	(2,322,567.70)	(3,038,489.35)	715,921.65	-23.56%
Other Nonoperating Revenues (Expenses)	<u>(360,096.05)</u>	<u>(320,151.63)</u>	<u>(39,944.42)</u>	12.48%
Net Nonoperating Revenues	<u>100,141,628.63</u>	<u>92,932,457.55</u>	<u>7,209,171.08</u>	7.76%
Loss Before Other Revenues	(10,802,232.45)	297,782.79	(11,100,015.24)	-3727.55%
Capital Appropriations		4,750,400.00	(4,750,400.00)	-100.00%
Refund of Prior Years Capital Appropriations	(1,010,694.90)		(1,010,694.90)	-100.00%
Capital Gifts and Grants	1,565,695.38	1,631,993.11	(66,297.73)	-4.06%
Additions to Permanent Endowments	<u>2,730,603.60</u>	<u>448,780.17</u>	<u>2,281,823.43</u>	508.45%
Total Other Revenue	<u>3,285,604.08</u>	<u>6,831,173.28</u>	<u>(3,545,569.20)</u>	-51.90%
Change in Net Assets	(7,516,628.37)	7,128,956.07	(14,645,584.44)	-205.44%
Beginning Net Assets, as Restated	<u>304,449,488.37</u>	<u>297,616,586.42</u>	<u>6,832,901.95</u>	2.30%
Ending Net Assets	<u>\$ 296,932,860.00</u>	<u>\$ 304,745,542.49</u>	<u>\$ (7,812,682.49)</u>	-2.56%

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating Revenues

Operating revenues decreased \$14.2 million, based on the following:

- Student tuition and fees decreased by \$1.9 million largely as a result of an increase in the scholarship discount adjustment applied to these revenues. The University records a scholarship discount which reduces student tuition and fees and certain sales and services revenues to the extent that revenues from student financial assistance are used to satisfy tuition, fees, and other charges assessed to students. Total institutional resources provided as financial aid increased by \$3.8 million, which resulted in a corresponding increase of \$1.3 million in the scholarship discount and decrease in that same amount to net tuition and fees. Another contributing factor to the decrease in student tuition and fees was a decrease of \$0.8 million in fees charged to participants in various educational outreach activities. Approximately half of this decrease was due to the transfer of the NC Teachers Academy summer program to contracts and grants in accordance with the handling by the sponsoring agency.
- Grants and contracts revenues decreased \$12.8 million. This is mainly because revenue from federal grants and contracts and state and local grants and contracts totaling \$15.7 million was reclassified due to a change effective this fiscal year to report student financial revenue as nonoperating revenue, rather than operating revenue as reported in prior fiscal years.
- Sales and services revenues decreased less than \$0.5 million. As discussed above, the scholarship discount adjustment increased this fiscal year, resulting in a reduction in both tuition and fees revenues and sales and services revenues. The increase in the scholarship discount applied to sales and services revenues in residential live, dining and book rental totaled \$0.8 million, resulting in a reduction to net sales and services revenue of auxiliary enterprises of that amount.
- Other operating revenues increased by less than \$0.5 million due to increases in orientation registration fees, admission fees to musical events, and other similar activities.

Nonoperating revenues increased by \$7.2 million, based on the following:

- State appropriations decreased by \$5 million. In response to serious economic and financial adversity experienced by the State, the North Carolina Office of State Budget and Management, at the direction of the Governor, imposed stringent expenditure restrictions and allotment reductions on all state agencies to ensure a balanced budget on June 30, 2009. These actions resulted in a reversion of \$5.9 million of the University's appropriations in fiscal year 2008-2009.
- State aid - federal recovery funds increased by \$3.6 million due to the State's decision to utilize a portion of the federal funds available through the State Fiscal Stabilization Fund, a new one-time appropriation under the American Recovery and Reinvestment Act (ARRA), to partially offset faculty salary and benefits in the 2008-2009 fiscal year.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

- Noncapital grants for student financial aid increased by \$16.2 million due entirely to the change implemented this fiscal year to report student financial aid program revenue as nonoperating revenue, rather than operating federal grants and contracts or state and local grants and contracts revenue as reported in prior fiscal years.
- Noncapital gifts and grants remained substantially the same, with only a \$0.2 million increase.
- Investment income decreased by \$8.4 million. Realized losses accounted for \$1.1 million of this decrease and unrealized losses the other \$6.4 million. These deepening losses are a reflection of market fluctuations due to the national and state economic struggles and recessionary conditions.
- Interest and fees on debt decreased by \$0.7 million. Interest payments decreased on bonds, notes, and capital leases by \$0.1 million, \$0.2 million, and \$0.2 million, respectively. In addition, bond issuance costs of \$0.2 million were paid on bonds payable for construction of the new dining hall and campus recreation center in fiscal year 2007-2008. There were no new bonds issued by the University in fiscal year 2008-2009.

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 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.

Operating Expenses

Operating expenses increased \$3.7 million, based on the following:

- Salaries and benefits for the faculty and staff of the University increased by \$5.4 million. Factors contributing to this increase were legislative salary increases of approximately 3.1%, increases in retirement rates of 4%, and filling of vacant faculty positions. Faculty salaries increased by \$2.7 million, staff salaries increased by \$1.2 million, and employee benefit costs increased by \$1.1 million.
- Supplies and materials decreased by \$2.6 million, largely due to a decrease in purchases of office and educational equipment not meeting the capitalization threshold of \$5,000. This decrease is primarily attributable to the budget restrictions imposed on the University in the spring, which prohibited the purchase of all equipment.
- Services decreased by \$1.6 million. Contracts for academic services such as guest artists and visiting lecturers decreased \$0.1 million and other contracted personal services decreased by \$0.7 million. Other decreases in services occurred in travel expenses (\$0.6 million), marketing (\$0.2 million), and printing (\$0.5 million). These

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

decreases were offset by modest increases in some services such as insurance and maintenance agreements.

- Scholarships and fellowships, net of scholarship discount, increased by \$1.7 million. Before application of the \$12.5 million discount, scholarships increased by \$3.7 million, partly due to increases of \$2.2 million in funds granted by the State of North Carolina for University of North Carolina Need Based Grants and \$0.3 in other financial aid programs administered by the North Carolina State Education Assistance Authority. As discussed in the tuition and fees and sales and services revenue sections, the scholarship discount increased by a total of \$2.1 million this fiscal year offsetting the \$3.7 million increase.
- Utilities expense decreased only slightly by \$53 thousand.
- Depreciation expense increased \$1 million due to the increase in the depreciable base.

Capital appropriations decreased by \$4.8 million because the state appropriated this amount for capital projects in fiscal year 2007-2008, but due to budget constraints no capital appropriations were made in fiscal year 2008-2009. In addition, the State required the University to revert \$1 million in prior year appropriations.

Capital gifts and grants remained substantially the same as in the prior year with only a \$66 thousand decrease.

The \$2.3 million increase in additions to permanent endowments was largely a result of the receipt of matching funds on endowed professorships in the amount of \$1.8 million.

Capital Asset and Debt Administration

At June 30, 2009, the University had approximately \$351.5 million invested in capital assets, and accumulated depreciation of \$81.5 million. Depreciation charges for the current year totaled \$7.7 million.

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. The final two projects funded by this bond issue consisted 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 (\$26.2 million), which included renovations of classrooms, offices, and support space for many departments within Arts &

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Sciences. The Phase II renovations of additional classroom and laboratory space obtained occupancy in August 2008. The partial renovation of Forsyth Building includes many upgrades to interior finishes, addresses accessibility, and many other code deficiencies. This renovation is complete and obtained occupancy in January 2009.

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 began in May 2009 with a target completion date of July 2011.

The University's new \$17.2 million Campus Recreation Center opened to an enthusiastic campus community on August 17, 2009. 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, Leatherwood Residence Hall in March 2009, and Dodson Cafeteria in Summer 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 was completed in July 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, Balsam Hall, was completed in August 2009, with the second building, Blue Ridge Hall, 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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

\$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 \$44,385,000 in bonds payable, \$608,363 in notes payable, and \$21,283,689 in capital leases payable at June 30, 2009. Total annual debt service payments were \$4.4 million in 2009 and \$4.8 million in 2008.

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 2009 was 9,429 - the largest total student enrollment in the University's history, a 4 percent increase from last year. 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.

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 has implemented unprecedented and extreme measures in an effort to prevent further upheaval. After several consecutive years of job growth that topped 2.0%, North Carolina's labor market slowed significantly in 2008. The North Carolina unemployment rate soared to 9.7% in January 2009.

Significant losses have occurred in professional and business services, with only the education and health services reporting positive growth in 2008. Job losses in the manufacturing sector continue to deteriorate, registering a decline of 7.4% in December 2008 as compared to December 2007. While home prices in North Carolina remain marginally

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

positive, construction jobs have declined by 7% compared to the prior year as a result of a decline of over 35% in housing starts.

The North Carolina economy is expected to remain stagnant in 2009, with economic recovery beginning to recover in 2010 as construction rebounds and losses in the manufacturing sector stabilize. The unemployment rate could reach just under 10% in 2010 before it begins to fall again in 2011. There are some signs that jobs in the professional and business services sector may register solid growth in 2010 and 2011. Construction employment will be slower to recover.

As a result of these economic struggles, the budget for fiscal year 2008-2009 allocated permanent flexibility reductions of approximately 3.6% to the University of North Carolina campuses. In addition, the State is requiring an appropriation holdback of 5% of each agency's budget.

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, 2009

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 48,063,969.32
Restricted Cash and Cash Equivalents	15,143,300.94
Restricted Short-Term Investments	1,885,171.88
Receivables, Net (Note 4)	2,733,098.06
Due from State of North Carolina Component Units	40,000.00
Inventories	3,485,983.01
Notes Receivable, Net (Note 4)	893,025.33
	<hr/>
Total Current Assets	72,244,548.54
	<hr/>

Noncurrent Assets:

Restricted Cash and Cash Equivalents	8,647,508.48
Receivables, Net (Note 4)	102,579.91
Restricted Due from Primary Government	803,034.73
Endowment Investments	26,760,671.32
Other Investments	1,589,906.00
Notes Receivable, Net (Note 4)	4,814,126.15
Capital Assets - Nondepreciable (Note 5)	32,710,460.81
Capital Assets - Depreciable, Net (Note 5)	237,139,738.83
	<hr/>
Total Noncurrent Assets	312,568,026.23
	<hr/>

Total Assets	384,812,574.77
	<hr/>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	3,107,675.24
Due to Primary Government	1,092,807.29
Funds Held for Others	37,130.94
Unearned Revenue	4,259,758.74
Interest Payable	584,729.44
Long-Term Liabilities - Current Portion (Note 7)	3,759,968.04
	<hr/>
Total Current Liabilities	12,842,069.69
	<hr/>

Noncurrent Liabilities:

Deposits Payable	86,982.45
Funds Held for Others	571,207.60
U. S. Government Grants Refundable	5,442,371.89
Long-Term Liabilities (Note 7)	68,937,083.14
	<hr/>

Total Noncurrent Liabilities	75,037,645.08
	<hr/>

Total Liabilities	87,879,714.77
	<hr/>

Western Carolina University
Statement of Net Assets
June 30, 2009

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	206,156,665.47
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	11,544,483.74
Endowed Professorships	13,315,542.56
Departmental Uses	399,923.15
Expendable:	
Scholarships and Fellowships	10,532,149.80
Research	350,769.99
Endowed Professorships	1,324,809.03
Departmental Uses	1,475,214.75
Loans	1,370,467.39
Capital Projects	2,160,768.60
Debt Service	3,237,882.27
Other	473,786.10
Unrestricted	<u>44,590,397.15</u>
Total Net Assets	<u><u>\$ 296,932,860.00</u></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, 2009

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 30,405,994.79
Federal Grants and Contracts	3,847,930.05
State and Local Grants and Contracts	1,006,013.20
Nongovernmental Grants and Contracts	1,309,420.06
Sales and Services, Net (Note 9)	24,146,453.74
Interest Earnings on Loans	17,777.60
Other Operating Revenues	1,348,421.87
	<hr/>
Total Operating Revenues	62,082,011.31

EXPENSES

Operating Expenses:	
Salaries and Benefits	108,902,141.19
Supplies and Materials	16,311,432.19
Services	25,573,875.36
Scholarships and Fellowships	9,398,196.40
Utilities	5,115,944.78
Depreciation	7,724,282.47
	<hr/>
Total Operating Expenses	173,025,872.39
	<hr/>
Operating Loss	(110,943,861.08)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	84,000,003.86
State Aid - Federal Recovery Funds	3,563,974.00
Noncapital Grants - Student Financial Aid	16,272,839.77
Other Noncapital Grants	227,191.95
Noncapital Gifts, Net (Note 9)	3,309,762.52
Investment Loss (Includes Investment Expense of \$167,406.93)	(4,549,479.72)
Interest and Fees on Debt	(2,322,567.70)
Other Nonoperating Expenses	(360,096.05)
	<hr/>
Net Nonoperating Revenues	100,141,628.63
	<hr/>
Loss Before Other Revenues or Expenses	(10,802,232.45)
Refund of Prior Years Capital Appropriations	(1,010,694.90)
Capital Grants	1,227,195.38
Capital Gifts	338,500.00
Additions to Endowments	2,730,603.60
	<hr/>
Decrease in Net Assets	(7,516,628.37)

NET ASSETS

Net Assets - July 1, 2008, as Restated (Note 17)	304,449,488.37
	<hr/>
Net Assets - June 30, 2009	\$ 296,932,860.00

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, 2009

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 60,968,602.10
Payments to Employees and Fringe Benefits	(108,983,890.93)
Payments to Vendors and Suppliers	(48,062,159.09)
Payments for Scholarships and Fellowships	(9,398,196.40)
Loans Issued	(1,584,875.59)
Collection of Loans	700,500.36
Interest Earned on Loans	97,737.12
Student Deposits Received	748,675.57
Student Deposits Returned	(754,579.50)
Other Receipts	1,348,421.87
	<hr/>
Net Cash Used by Operating Activities	(104,919,764.49)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	84,000,003.86
State Aid - Federal Recovery Funds	3,563,974.00
Noncapital Grants - Student Financial Aid	16,272,839.77
Noncapital Grants	227,191.95
Noncapital Gifts	1,645,413.36
Additions to Endowments	2,730,603.60
William D. Ford Direct Lending Receipts	29,305,203.50
William D. Ford Direct Lending Disbursements	(29,305,203.50)
Related Activity Agency Receipts	56,604.97
Related Activity Agency Disbursements	(98,977.50)
Other Receipts	69,287.09
	<hr/>
Net Cash Provided by Noncapital Financing Activities	108,466,941.10

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	1,822,766.82
Refund of Prior Years Capital Appropriations	(1,010,694.90)
Capital Grants	3,022,627.24
Capital Gifts	638,500.00
Proceeds from Sale of Capital Assets	13,779.26
Acquisition and Construction of Capital Assets	(18,744,509.22)
Principal Paid on Capital Debt and Leases	(2,159,462.75)
Interest and Fees Paid on Capital Debt and Leases	(2,464,859.17)
Other Payments	(16,515.61)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(18,898,368.33)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	2,041,396.73
Investment Income	2,018,632.66
Purchase of Investments and Related Fees	(2,012,958.97)
	<hr/>
Net Cash Provided by Investing Activities	2,047,070.42

Net Decrease in Cash and Cash Equivalents	(13,304,121.30)
Cash and Cash Equivalents - July 1, 2008	85,158,900.04
	<hr/>
Cash and Cash Equivalents - June 30, 2009	\$ 71,854,778.74

Western Carolina University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3

Page 2

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

Operating Loss	\$ (110,943,861.08)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	7,724,282.47
Allowances, Write-Offs, and Amortizations	1,051,888.98
Noncash Contributed Expenses	6,643.57
Changes in Assets and Liabilities:	
Receivables (Net)	999,284.30
Inventories	311,831.59
Accounts Payable and Accrued Liabilities	(4,437,444.02)
Due to Primary Government	1,057,083.96
Unearned Revenue	(45,386.78)
Compensated Absences	137,390.57
Deposits Payable	(5,903.93)
Note Principal Repayments	809,301.47
Notes Issued	<u>(1,584,875.59)</u>
Net Cash Used by Operating Activities	<u>\$ (104,919,764.49)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 48,063,969.32
Restricted Cash and Cash Equivalents	15,143,300.94
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>8,647,508.48</u>
Total Cash and Cash Equivalents - June 30, 2009	<u>\$ 71,854,778.74</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 1,822,766.82
Assets Acquired through a Gift	123,110.17
Change in Fair Value of Investments	(6,400,605.27)
Reinvested Distributions	(387,006.21)
Loss on Disposal of Capital Assets	426,111.93

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, 2009

Exhibit B-1

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 23,477,704.00
Net Investment in Capital Leases, Net of Unearned Interest Income	406,006.00
Accounts Receivable	111,022.00
	<hr/>
Total Current Assets	23,994,732.00
	<hr/>
Property, Plant and Equipment:	
Construction in Progress	24,953,962.00
Other Assets:	
Other Investments	15,000.00
Certificate Issuance Costs, Net of Accumulated Amortization	2,597,739.00
Net Investment in Capital Leases, Net of Unearned Interest Income	18,502,508.00
	<hr/>
Total Other Assets	21,115,247.00
	<hr/>
Total Assets	<u><u>\$ 70,063,941.00</u></u>

LIABILITIES

Current Liabilities:	
Current Portion of Long-Term Debt	\$ 550,000.00
Construction Contracts Payable	1,652,969.00
Construction Retainage Payable	1,242,160.00
Accrued Interest Payable	242,854.00
	<hr/>
Total Current Liabilities	3,687,983.00
	<hr/>
Noncurrent Liabilities:	
Certificates of Participation Payable	65,275,000.00
	<hr/>
Total Liabilities	68,962,983.00
	<hr/>

NET ASSETS

Unrestricted	1,100,958.00
	<hr/>
Total Liabilities and Net Assets	<u><u>\$ 70,063,941.00</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, 2009

Exhibit B-2

REVENUES

Management Fee	\$	298,123.00
Investment Interest Income		18,214.00
Interest Earned from Investments in Capital Leases		1,038,532.00
Sales Tax Refund		234,371.00
		<hr/>
Total Revenues		1,589,240.00

EXPENSES

Interest		910,083.00
Insurance		84,241.00
Professional Fees		30,487.00
Amortization of Certificate Issuance Costs		96,728.00
Other Operating		504.00
		<hr/>
Total Expenses		1,122,043.00

Change in Net Assets		467,197.00
Net Assets, Beginning of Year		633,761.00
		<hr/>
Net Assets, End of Year	\$	1,100,958.00

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

WESTERN CAROLINA UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. 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 were 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 31-member board consisting of 4 ex officio directors and 27 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)

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.

Financial statements for the University and its blended and discretely presented component units are presented as of and for the fiscal year ended June 30, 2009.

Complete 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

after November 30, 1989, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

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

Real estate not held by a governmental external investment pool and investments in limited partnerships 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are valued at cost using the last invoice cost method.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or 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 25 years for general infrastructure, 50 years for buildings, and 10 to 15 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- J. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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*

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.

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

- O. Internal Sales Activities** - Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as 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, 2009, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$71,572,739.66 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.8 years as of June 30, 2009. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2009 was \$40,169.75. The carrying amount of the University's deposits not with the State Treasurer was \$241,869.33 and the bank balance was \$441,662.42. 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, 2009, 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>\$ 179,750.51</u>
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B. Investments

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

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

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

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

Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. The 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 and investments subject to interest rate risk at June 30, 2009, for the Long-Term Investment Pool.

Long-Term Investment Pool

	Fair Value
Investment Type	
UNC Investment Fund	\$ 13,629,263.74
Mutual Funds	11,985,298.55
Investments in Real Estate	3,220.00
Limited Partnerships	1,620,442.00
Total Long-Term Investment Pool	\$ 27,238,224.29

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2009, for the University's non-pooled investments.

Non-Pooled Investments

	Fair Value	Investment Maturities (in Years) Less Than 1
Investment Type		
Debt Securities		
Money Market Mutual Funds	\$ 1,885,171.88	\$ 1,885,171.88
Other Securities		
Mutual Funds	991,933.03	
Investments in Real Estate	93,800.00	
Domestic Stocks	22,698.00	
Other	3,922.00	
Total Non-Pooled Investments	\$ 2,997,524.91	

At June 30, 2009, the University's non-pooled investments with credit risk had a fair value of \$1,885,171.88. The credit quality rating of the money market mutual funds was AAAM and A-1+ as rated by Standard & Poor's.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments - The following table presents the fair value of the total investments at June 30, 2009:

Investment Type	Fair Value
Money Market Mutual Funds	\$ 1,885,171.88
Other Securities	
UNC Investment Fund	13,629,263.74
Other Mutual Funds	12,977,231.58
Investments in Real Estate	97,020.00
Limited Partnerships	1,620,442.00
Domestic Stocks	22,698.00
Other	3,922.00
Total Investments	\$ 30,235,749.20

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. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may also appropriate expenditures from eligible nonexpendable balances if deemed prudent and necessary to meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. However, a majority of the University's endowment donor agreements prohibit spending of nonexpendable balances and therefore the related nonexpendable balances are not eligible for expenditure. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). 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, 2009, endowment net assets of \$11,653,147.65 were available to be spent, of which \$7,772,413.66 was restricted to specific purposes.

During the current year, the university incurred investment losses that exceeded the related endowment's available accumulated income and net appreciation. These losses resulted in a reduction to the specific nonexpendable endowment balance. At June 30, 2009 the amount of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

investment losses reported against the nonexpendable endowment balances were \$1,063,196.31.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2009, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 1,276,864.62	\$ 591,270.68	\$ 685,593.94
Accounts	1,079,245.45		1,079,245.45
Intergovernmental	534,942.17		534,942.17
Pledges	166,309.91	40,442.41	125,867.50
Interest on Loans	185,797.39		185,797.39
Other	121,651.61		121,651.61
Total Current Receivables	<u>\$ 3,364,811.15</u>	<u>\$ 631,713.09</u>	<u>\$ 2,733,098.06</u>
Noncurrent Receivables:			
Pledges	<u>\$ 239,972.95</u>	<u>\$ 137,393.04</u>	<u>\$ 102,579.91</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 891,176.93	\$ 0.00	\$ 891,176.93
Institutional Student Loan Programs	42,302.44	40,454.04	1,848.40
Total Notes Receivable - Current	<u>\$ 933,479.37</u>	<u>\$ 40,454.04</u>	<u>\$ 893,025.33</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 6,177,604.66	\$ 1,367,834.00	\$ 4,809,770.66
Institutional Student Loan Programs	4,355.49		4,355.49
Total Notes Receivable - Noncurrent	<u>\$ 6,181,960.15</u>	<u>\$ 1,367,834.00</u>	<u>\$ 4,814,126.15</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2009, is presented as follows:

	Balance July 1, 2008 (as restated)	Increases	Decreases	Balance June 30, 2009
Capital Assets, Nondepreciable:				
Land	\$ 6,801,272.65	\$ 0.00	\$ 0.00	\$ 6,801,272.65
Art, Literature, and Artifacts	1,066,236.00	15,040.00		1,081,276.00
Construction in Progress	58,254,600.77	15,591,910.82	49,018,599.43	24,827,912.16
Total Capital Assets, Nondepreciable	66,122,109.42	15,606,950.82	49,018,599.43	32,710,460.81
Capital Assets, Depreciable:				
Buildings	215,065,535.91	48,937,551.43	1,084,220.13	262,918,867.21
Machinery and Equipment	24,179,219.95	2,692,359.42	683,941.43	26,187,637.94
Art, Literature, and Artifacts	108,341.66			108,341.66
General Infrastructure	29,169,251.76	250,089.50		29,419,341.26
Total Capital Assets, Depreciable	268,522,349.28	51,880,000.35	1,768,161.56	318,634,188.07
Less Accumulated Depreciation for:				
Buildings	58,456,901.28	4,876,945.97	862,914.00	62,470,933.25
Machinery and Equipment	9,159,443.75	1,931,238.74	479,135.63	10,611,546.86
Art, Literature, and Artifacts	75,368.70	2,513.40		77,882.10
General Infrastructure	7,420,502.67	913,584.36		8,334,087.03
Total Accumulated Depreciation	75,112,216.40	7,724,282.47	1,342,049.63	81,494,449.24
Total Capital Assets, Depreciable, Net	193,410,132.88	44,155,717.88	426,111.93	237,139,738.83
Capital Assets, Net	\$ 259,532,242.30	\$ 59,762,668.70	\$ 49,444,711.36	\$ 269,850,199.64

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2009, were as follows:

	Amount
Accounts Payable	\$ 1,536,713.30
Accrued Payroll	651,248.88
Contract Retainage	355,464.73
Intergovernmental Payables	564,248.33
Total Accounts Payable and Accrued Liabilities	\$ 3,107,675.24

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2009, is presented as follows:

	Balance July 1, 2008	Additions	Reductions	Balance June 30, 2009	Current Portion
Bonds Payable	\$ 45,345,000.00	\$ 0.00	\$ 960,000.00	\$ 44,385,000.00	\$ 1,505,000.00
Notes Payable	985,603.86		377,240.72	608,363.14	400,222.29
Capital Leases Payable	20,283,144.21	1,822,766.82	822,222.03	21,283,689.00	1,098,856.94
Compensated Absences	5,963,190.44	6,861,215.56	6,723,824.99	6,100,581.01	669,843.97
Annuity and Life Income Payable	377,584.01		58,165.98	319,418.03	86,044.84
Total Long-Term Liabilities	\$ 72,954,522.52	\$ 8,683,982.38	\$ 8,941,453.72	\$ 72,697,051.18	\$ 3,759,968.04

Additional information regarding capital lease obligations is included in Note 9.

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2009	Principal Outstanding June 30, 2009	See Table Below
<u>The University of North Carolina System Pool Revenue Bonds</u>							
Student Housing I	(A)	4.00*	10/01/2013	465,000.00	275,000.00	190,000.00	(1)
Student Housing II	(B)	5.00*	10/01/2010	1,370,000.00	995,000.00	375,000.00	(1)
Athletic Facilities I	(C)	5.00*	10/01/2012	8,070,000.00	7,325,000.00	745,000.00	
Athletic Facilities II	(D)	5.00*	04/01/2028	1,510,000.00	240,000.00	1,270,000.00	
Student Recreation Center	(D)	5.00*	04/01/2028	11,610,000.00	1,855,000.00	9,755,000.00	
Student Center Refund	(E)	5.00*	10/01/2025	4,335,000.00	310,000.00	4,025,000.00	
Athletic Facility Refund	(E)	4.00*	10/01/2026	6,135,000.00	10,000.00	6,125,000.00	
Student Recreation Center	(F)	5.00*	10/01/2033	4,355,000.00		4,355,000.00	
Dining Hall Facility	(F)	5.00*	10/01/2033	17,545,000.00		17,545,000.00	
Total Bonds Payable (principal only)				\$ 55,395,000.00	\$ 11,010,000.00	\$ 44,385,000.00	

(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, 2009 are included.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University has pledged future revenues, net of specific operating expenses, to repay revenue bonds 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	\$ 609,096.89	\$ 3,893,626.98	\$ 235,846.84	3.21%

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2009, are as follows:

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2010	\$ 1,505,000.00	\$ 2,046,786.28	\$ 400,222.29	\$ 24,305.86
2011	1,565,000.00	1,987,010.65	195,785.31	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	1,550,000.00	1,807,028.76		
2015-2019	8,650,000.00	7,894,801.28		
2020-2024	10,920,000.00	5,628,823.16		
2025-2029	10,640,000.00	2,836,734.43		
2030-2034	6,640,000.00	863,000.00		
Total Requirements	\$ 44,385,000.00	\$ 26,861,187.08	\$ 608,363.14	\$ 28,306.39

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, 2009, the outstanding balance of prior year defeased bonds was \$10,375,000.00.

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, 2009	Principal Outstanding June 30, 2009
University Center Renovation	Wachovia Bank	5.98%	12/01/2010	\$ 3,800,000.00	\$ 3,274,257.74	\$ 525,742.26
Print Shop	BB&T	4.63%	10/26/2011	166,755.00	84,134.12	82,620.88
Total Notes Payable				\$ 3,966,755.00	\$ 3,358,391.86	\$ 608,363.14

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, 2009 was adjusted to its present value as follows:

	Amount
Value of Annuity Liability at June 30, 2008	\$ 377,584.01
Interest Earned on Investment	30,864.31
Sum of Quarterly Payments	(86,044.84)
Present Value Adjustment at Year End	(2,985.45)
Value of Annuity Liability at June 30, 2009	\$ 319,418.03

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, 2009, consists of the following:

2003 certificates of participation with a balance of \$10,815,000, 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
2010	\$ 270,000	3.000%
2011	280,000	3.375%
2012	290,000	3.500%
2013	300,000	3.625%
2014	310,000	3.875%
Thereafter	9,365,000	4.500%
	\$ 10,815,000	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

2005 certificates of participation with a balance of \$10,010,000, 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>
2010	\$ 280,000	4.000%
2011	295,000	3.000%
2012	300,000	3.125%
2013	310,000	4.000%
2014	325,000	3.250%
Thereafter	<u>8,500,000</u>	3.750% - 4.350%
	<u>\$ 10,010,000</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>
2010	\$ 0	0.000%
2011	530,000	4.000%
2012	630,000	4.000%
2013	735,000	3.500%
2014	840,000	3.500%
Thereafter	<u>42,265,000</u>	3.500% - 5.250%
	<u>\$ 45,000,000</u>	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to buildings, equipment and machinery 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, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 2,230,732.56
2011	2,141,567.95
2012	1,856,650.56
2013	1,859,195.48
2014	1,755,119.11
2015-2019	7,235,268.76
2020-2024	7,235,245.00
2025-2029	7,237,049.80
2030-2033	<u>5,108,102.79</u>
Total Minimum Lease Payments	36,658,932.01
Amount Representing Interest (3.78 - 6.10% Rate of Interest)	<u>15,375,243.01</u>
Present Value of Future Lease Payments	<u><u>\$ 21,283,689.00</u></u>

Buildings acquired under capital lease amounted to \$19,623,569.96 at June 30, 2009. Machinery and equipment acquired under capital lease amounted to \$4,026,183.72 at June 30, 2009.

- B. Operating Lease Obligations** - The University entered into operating leases for automobiles, equipment and housing. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 67,967.85
2011	17,079.99
2012	<u>11,046.74</u>
Total Minimum Lease Payments	<u><u>\$ 96,094.58</u></u>

Rental expense for all operating leases during the year was \$601,034.04.

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
Operating Revenues:					
Student Tuition and Fees	\$ 38,907,811.20	\$ 26,214.20	\$ 8,186,626.88	\$ 288,975.33	\$ 30,405,994.79
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 11,316,832.06	\$ 313,126.26	\$ 2,367,169.53	\$ 121,474.58	\$ 8,515,061.69
Dining	9,614,402.35	839,358.39	1,657,678.11	69,938.18	7,047,427.67
Book Rental	1,497,299.61	2,012.72	274,767.98	53,611.86	1,166,907.05
Bookstore	1,857,063.48	159,191.49		2,252.08	1,695,619.91
Print Shop	604,224.91	482,178.17			122,046.74
Athletic	1,463,374.17				1,463,374.17
Other	2,006,555.64	457,631.59		16,479.62	1,532,444.43
Sales and Services of Education and Related Activities	2,086,986.51	1,677,433.50			409,553.01
Independent Operations	2,303,055.15	109,036.08			2,194,019.07
Total Sales and Services	\$ 32,749,793.88	\$ 4,039,968.20	\$ 4,299,615.62	\$ 263,756.32	\$ 24,146,453.74
Nonoperating - Noncapital Gifts	\$ 3,487,597.97	\$ 0.00	\$ 0.00	\$ 177,835.45	\$ 3,309,762.52

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	\$ 56,678,285.93	\$ 2,107,329.05	\$ 3,563,757.21	\$ 13,234.32	\$ 1,358.59	\$ 0.00	\$ 62,363,965.10
Research	1,110,753.18	197,539.07	571,593.51		22,586.18		1,902,471.94
Public Service	6,960,881.46	1,018,275.34	3,040,794.92	101,681.06	119,757.90		11,241,390.68
Academic Support	8,498,102.34	2,040,553.66	1,231,548.57	55,895.92	9,788.99		11,835,889.48
Student Services	5,191,323.10	443,407.50	2,329,436.69	10,736.70	55,807.08		8,030,711.07
Institutional Support	10,474,409.02	549,002.56	2,507,060.13	446,207.79	1,112.71		13,977,792.21
Operations and Maintenance of Plant	8,374,538.06	3,273,249.07	667,952.48		3,087,741.17		15,403,480.78
Student Financial Aid	87,521.29		151.39	7,781,085.62			7,868,758.30
Auxiliary Enterprises	11,273,403.33	4,836,875.44	11,576,900.26	989,354.99	1,817,792.16		30,494,326.18
Independent Operations	252,923.48	1,845,200.50	84,680.20				2,182,804.18
Depreciation						7,724,282.47	7,724,282.47
Total Operating Expenses	\$ 108,902,141.19	\$ 16,311,432.19	\$ 25,573,875.36	\$ 9,398,196.40	\$ 5,115,944.78	\$ 7,724,282.47	\$ 173,025,872.39

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the time of employment, otherwise they are automatically enrolled in the Teachers' and State Employees' Retirement System.

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2009, these rates were set at 3.36% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$88,406,021.93, of which \$46,146,823.92 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$1,550,533.28 and \$2,768,809.44, respectively.

Required employer contribution rates for the years ended June 30, 2008, and 2007, were 3.05% and 2.66%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2009, 2008, and 2007, which were \$1,550,533.28, \$1,283,031.78, and \$1,021,055.41, 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 "Proceed directly to OSC's index page," then "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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

responsible for the administration of the Program and designates the companies authorized to offer investment products or the trustee 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, 2009, 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 \$88,406,021.93, of which \$34,181,282.64 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$2,337,999.73 and \$2,050,876.96, 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 \$217,972.44 for the year ended June 30, 2009.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2009, were \$36,053.06. The voluntary contributions by employees amounted to \$408,007.00 for the year ended June 30, 2009.

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 \$1,048,253.01 for the year ended June 30, 2009.

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 *North Carolina General Statute* 135-7 and Chapter 135, Article 3A, of the General Statutes and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are 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. Required contribution rates for the years ended June 30, 2008, and 2007, were 4.1% and 3.8%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2009, 2008, and 2007, which were \$3,293,452.37, \$3,046,646.51, and \$2,576,162.17, 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 "Proceed directly to OSC's index page," then "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, 2009, 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, 2008, and 2007, was .52% for both years. The University made 100% of its annual required contributions to the DIPNC

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

for the years ended June 30, 2009, 2008, and 2007, which were \$417,706.15, \$386,403.95, and \$352,527.45, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 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 retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

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 for Highlands Biological which still maintains a \$5,000 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, computer, and fine art. The extended coverage deductible is \$50,000 per occurrence, except for high value equipment losses were subject to a \$5,000 deductible per occurrence for theft losses and all other 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 \$10,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$75,000 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 retains the risk 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 \$34,910,336.50 and on other purchases were \$463,025.64 at June 30, 2009.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Pending Litigation and Claims - The University is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. University management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the University.

NOTE 15 - RELATED PARTIES

Foundations - There are three 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., The Highlands Biological Foundation, Inc. and the Forest Stewards, Inc.

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 \$558,081.00 for the year ending June 30, 2009.

The Highlands Biological Foundation, Inc. was incorporated in North Carolina on July 21, 1930, for the purpose of supporting through grants and scholarships the activities of Highlands Biological Station. This support approximated \$63,092.95 for the year ended June 30, 2009.

Forest Stewards, Inc. was incorporated in North Carolina on May 5, 2008 for the purpose of providing educational and charitable support to Western Carolina University. This support approximated \$300.00 for the year ended June 30, 2009.

NOTE 16 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2009, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*.

GASB Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

GASB Statement No. 49, requires reporting pollution remediation obligations, including reporting pollution remediation obligations that previously may not have been reported.

GASB Statement No. 52, requires reporting land and other real estate held as investments at fair value. This statement amends GASB Statement No. 31, which required endowments to report land and other real estate investments at historical cost.

In addition, beginning with the year ended June 30, 2009, the University reports student aid as nonoperating revenue instead of operating revenue. This change was the result of a clarification in the GASB *Comprehensive Implementation Guide*.

NOTE 17 - NET ASSET RESTATEMENT

As of July 1, 2008, net assets as previously reported was restated as follows:

	<u>Amount</u>
July 1, 2008 Net Assets as Previously Reported	\$ 304,745,542.49
Restatements:	
Capital Assets Capitalization and Reconciliation Errors	(313,104.59)
Various Other Misstatements	<u>17,050.47</u>
July 1, 2008 Net Assets as Restated	<u><u>\$ 304,449,488.37</u></u>

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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, 2009, which collectively comprise the University's basic financial statements and have issued our report thereon dated September 2, 2010. Our report was modified to include a reference to other auditors.

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* and Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*, during the year ended June 30, 2009.

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 and the discretely presented component unit, as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. The financial statements of 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. Accordingly, we do not express 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)**

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 all deficiencies described in the Audit Findings and Responses section of this report to be significant deficiencies in 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 consider all the findings to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests 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.

**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)**

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

September 2, 2010

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

The following audit findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control.

Management's responses are presented after each audit finding. We did not audit the responses, and accordingly, we express no opinion on them. However, *Government Auditing Standards* require that we add explanatory comments to the report whenever we disagree with an audit finding response. In accordance with this requirement and to ensure that the nature and seriousness of the findings are not minimized or misrepresented, we have provided comments to the University's responses when appropriate.

1. INAPPROPRIATE INFORMATION SYSTEM ACCESS TO 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 37 former employees whose access to the accounting system and the overall computer network was terminated several days or weeks after separation from the University. Of these, 19 former employees had access rights with update capability within the financial accounting system. Access should be terminated as soon as individuals leave employment.

We further identified users that had access rights that were incompatible with their job functions. The controller is responsible for approving financial transactions of subordinates and also has access rights to initiate and execute accounting transactions. Also, there are two systems accountants who have access rights to initiate and execute accounting transactions. One of these systems accountants shared the user identification and password of the controller. Finally, we identified employees with access rights to modify tuition and fee tables who also maintain student accounts. One user account with this access was shared by three employees. Personnel should only be granted the minimum access needed to perform their job. Sharing a user identification and password reduces accountability for any error or misappropriation that may occur.

Significant aspects of this finding were also reported in the two prior audits. In response to this issue, access rights for the controller were revised in April, 2009.

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

AUDIT FINDINGS AND RESPONSES (CONTINUED)

University's Response: The University agrees with the context of the recommendation and will continue to work to improve internal control over access to financial data. In so doing, it is incumbent upon the University to assess the cost/benefits and practicality associated with these controls in conjunction with associated risks for deviation from the theoretical model of full separation of duties while assuring the operational needs of the University can be met. The University offers the following specific responses to the above items.

The University has devoted significant effort within the past two years to address a more automated process for terminating user access rights to the network and Banner data and is currently in the final phase of implementing a University Policy that addresses access rights and timelines for these rights. Unfortunately, the complexities of the academic environment and access needs, accompanied with coordinating and integrating timely departmental notifications for employee separations into the Human Resources and Information Technology business processes have precluded automation at this point. Termination of network access and termination of Banner access are two independent processes. To a great degree, the delay in Banner account terminations can be attributed to a breakdown in communication and understanding of the manual process used to terminate the accounts. Originally, the understanding was that the termination of network access also terminated Banner access; however, this is not the case. This situation was corrected prior to the end of the 2009 fiscal year. It should also be noted that in the WCU Banner Finance centralized environment, update access by campus departments to Banner Finance is restricted only to the purchase requisition create function. We will reemphasize to campus the importance of timely notification of separations to assure access to the requisition create process is disabled immediately upon separation from the University.

With respect to access rights incompatible with job functions, as noted in the prior year response, the University evaluated the Controller's security and associated risks for choosing an alternative access path and maintains the overall risks to the University and its financial processes were minimized under the approach we took. With control processes in place, it is highly unlikely an unauthorized or unapproved transaction would go unnoticed in Banner Finance. In addition, all transactions entered in Banner Finance store the user id in the transaction table, providing an audit trail of all financial transactions processed. When the University became satisfied that staff skill sets supported restricting the Controller's access, actions were taken to do so as noted in the finding above. Indicative of the University's consideration of the risks and desire to restrict the Controller's access as soon as operationally feasible, it should be noted the change to the Controller's access in April of 2009 was made prior to the issuance of the fiscal 2008 audit report and related finding.

Further to the Controller's access, the finding suggests the Controller shared both his password and Banner account with one of the Systems Accountants. Consistent with the prior year's response, access to the password was not released, though transactions or reports were processed under the Controller's account within controlled, mentoring events. It should be noted that a unique account for the Systems Accountant was created

AUDIT FINDINGS AND RESPONSES (CONTINUED)

in March 2009, when he had acquired the appropriate skill sets to support full independence. This change was made in conjunction with restricting the Controller's access and as noted, was done prior to the release of the 2008 audit finding.

With respect to access to the tuition and fee tables and maintenance of student accounts, access was in place to provide back-up functionality. Dual access has now been revoked so that no one individual has access to both processes. In addition, the shared account which essentially was a shared process to drop students for non-payment has been addressed. Individual user accounts to execute this process have been created for each of the three employees referenced.

Auditor Comment: Management is responsible for adopting sound internal control policies and procedures. The timing of the audit or the release of the audit report does not relieve the University management of this responsibility, nor should the audit be management's sole source for evaluating the effectiveness of its internal control. Further, although management has the responsibility for assessing the cost/benefits and practicality associated with controls, the auditor's responsibility to communicate internal control deficiencies exists regardless of management's decisions.

With respect to the University's statement that the update access by campus departments to Banner Finance being limited to the ability to create purchase requisitions, our audit indicated that the ability to create purchase requisitions was equal to the authorization of purchases and was applicable to 16 of the 19. The remaining three had additional rights including two with "finance all" rights. Further, while adequate communication of policy is desirable, communication alone may not be sufficient to ensure separations are timely executed.

With respect to the University's assertion that sufficient controls exists to detect unauthorized or unapproved transactions in Banner Finance, our consideration of these controls, for example bank reconciliations and the reconciliation of Banner to NCAS, during the audit process was that these controls alone were not sufficient to detect unauthorized transactions.

With respect to sharing of passwords, regardless of the environment it would be impossible to determine the responsible party if an error or misappropriation occurred.

With respect to access to the tuition and fee tables, a total of four user accounts had update capabilities. Of these four, one account was shared by three individuals. Exception was not taken to the individual that served as a back-up function.

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, nor did it maintain adequate internal control to ensure data were transferred from the housing system to the financial system completely and accurately. This increases the risk of error or fraud.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

We identified two housing personnel with access rights that were inconsistent with proper segregation of duties. These individuals have full 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 the 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. In addition, there was no reconciliation performed of data transmitted between the housing and financial accounting systems to ensure transactions were properly transferred and recorded.

This finding was also reported in the prior audit. In response to this issue, the University implemented reconciliation procedures for the daily transfer of data transmitted between the housing and financial accounting systems effective December 2008.

Recommendation: The University should continue to improve internal control and establish policies and procedures over granting and managing access to the housing system and data.

University's Response: The University agrees with the recommendation and will work to satisfy the recommendation to the fullest extent practical. The University offers the following specific responses to the above items.

With respect to the housing personnel access rights, security was changed on July 16, 2009 to remove conflicting access to the rate tables for one of these individuals listed in the 2008 Audit Comments, dated June 10, 2009. Unfortunately, the late issuance date for the 2008 audit prevented the University from making timely adjustments to eliminate this deficiency in the 2009 fiscal year since 11 months of the 2009 year had lapsed when the internal control weaknesses was noted. The University took action within 45 days following the issuance of the 2008 audit finding to address this finding. Unfortunately, the adjustment was not made until July 16, 2009; however, we are hopeful that our action will eliminate the need to include this finding again in the 2010 audit. In addition, the University is currently exploring options which will allow a separation of the security administration function by adding additional staff or reassigning the responsibility for table maintenance to a department outside of Residential Living.

With respect to the data transfer reconciliation, as noted in the finding the University implemented a formal reconciliation and data review process in December, 2008 to address the prior year finding. These processes continue to be followed.

Auditor Comment: Management is responsible for adopting sound internal control policies and procedures. The timing of the audit or the timing of the release of the audit report does not relieve the University management of this responsibility, nor should the audit be management's sole source for evaluating the effectiveness of its internal control. Weaknesses identified during the audit are communicated throughout the process.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

3. DEFICIENCIES IN FINANCIAL REPORTING

The financial statements prepared by the University contained misstatements that were corrected as a result of our audit. These misstatements indicate that the University's internal control over financial reporting was not effective, and without the corrections, the financial statements could have been misleading to users. Misstatements noted in our audit included:

- a. The University failed to record the effects of borrowing unrestricted cash to cover deficit balances in restricted funds. As a result, current unrestricted cash was overstated by \$1,936,477, restricted current cash was understated by \$1,910,377, and restricted noncurrent cash was understated by \$26,100.
- b. The restricted expendable capital projects net asset balance was overstated by \$2,578,186, the restricted expendable debt service net asset balance was overstated by \$75,746, unrestricted net assets were understated by \$2,334,647, and invested in capital assets, net of related debt net assets were understated by \$319,286 as a result of classification errors. The restricted nonexpendable scholarships and fellowships net asset balance was overstated by \$999,139 and the restricted nonexpendable endowed professorships net asset balance was understated by the same amount due to the classification errors.
- c. Nonexpendable net asset balances were overstated as a result of the University's failure to record investment losses that exceeded the related endowment's available accumulated income and net appreciation. Nonexpendable net asset balances were overstated by \$1,063,196 and expendable net asset balances were understated by the same amount. The note disclosure of endowment balances available to be spent and those restricted for specific purposes were also understated.
- d. The beginning balance for construction-in-progress was overstated by \$902,598 and the beginning balance for machinery and equipment was understated by \$902,598. This is a result of the University failing to capitalize completed assets in the appropriate year. Current year additions were also overstated as a result of this error.
- e. Capital asset purchases were reported as expenses rather than capitalized as assets. As a result, depreciable capital assets were understated by \$97,186, supplies and materials expense was overstated by the same amount, and depreciation expense was understated by \$2,390.
- f. Machinery and equipment was understated by \$86,695 and related accumulated depreciation was understated by \$14,449 due to the University incorrectly showing an asset as a disposal in the financial accounting system that was actually still in use. Depreciation expense was also understated by \$5,779.

This finding was also reported in the prior audit.

AUDIT FINDINGS AND RESPONSES (CONTINUED)

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

University's Response: The University will continue to work to increase the level of internal control over financial reporting in order to produce annual financial statements with the highest level of accuracy, completeness, and compliance with generally accepted accounting principles possible. Tremendous strides have been made in the last two years to develop systems and procedures to meet the challenges associated with the implementation of the Banner Finance, Student, and Fixed Assets systems without the benefit of additional resources. This has been facilitated by the recent hiring of highly qualified staff to assist with the preparation of the annual financial report in addition to their other duties in the Controller's Office. The University offers the following specific responses to the above items reported as financial reporting deficiencies:

- a. As part of the cash to accrual conversion performed each fiscal year, the University records an accounts receivable amount equal to the amount of cash expended but not reimbursed under cost reimbursable grants and certain student loan programs. We have not, however, recorded a reclassification from unrestricted to restricted cash and cash equivalents to reflect this borrowing of unrestricted cash to cover restricted cash deficits. Failure to make this adjustment has not been an audit issue in the past. The University does, however, agree with this adjustment and a similar reclassification was made for the fiscal year ended June 30, 2010. In addition, this adjustment is now listed on our financial reporting checklist to ensure it will be made in all subsequent years.
- b. The University did not concur with the original adjustment proposed by the Office of State Auditors but does agree that there were net asset classification errors on the University's financial statements as originally prepared. The University recalculated the net asset breakdown on the Statement of Net Assets and this calculation was reviewed by the auditors and accepted as the corrected amounts to be reported on the University's Statement of Net Assets. This same methodology was used for the financial statements for the fiscal year ended June 30, 2010 and will be used in future years.
- c. This net asset classification error was a result of the University's recording of the market value adjustment on "underwater" permanent endowment funds in the expendable rather than nonexpendable net assets classification. The University concurs with this adjustment and made a similar adjustment on the financial report for the fiscal year ended June 30, 2010. This adjustment has also been added to the University's financial reporting checklist to ensure it will be made in all subsequent years, if applicable.

Findings 3.d. through 3.f. are all related to the recording of fixed assets transactions and balances. Both the implementation of Banner Fixed Assets in fiscal year 2007 and staff turnover in the fixed asset accountant position presented significant challenges to the University. The University has devoted substantial time and effort to

AUDIT FINDINGS AND RESPONSES (CONTINUED)

overcoming these challenges and feels that we have made tremendous improvements in the accuracy and completeness of the fixed assets records and the internal controls over fixed assets. Given the high volume of equipment purchases and construction activity on a university campus and the necessary dependence of the Fixed Asset Accountant on campus departments for accurate and complete information, it is highly unlikely that 100% accuracy can ever be achieved. The University feels, however, that the fixed asset controls currently in place are highly effective in ensuring that a material misstatement would not go undetected.

Though the University did not restate the June 30, 2008 beginning balance affected by Finding 3.d. nor the June 30, 2009 ending balance affected by Finding 3.e., as explained in more detail below, both of these items were correctly reported in the financial statements in the year following the error and prior to the audit of the June 30, 2009 financial statements or discovery by the auditors. In our opinion, the net effect of these adjustments neither individually nor combined, resulted in a material misstatement of the financial statements. Neither do we believe they are an indication of a control deficiency that could result in a material misstatement that will go undetected.

The University offers the following specific comments to items 3. d. - f.:

- d. As part of the annual financial reporting process, the Capital Improvements Accountant sends a listing of all amounts accumulated as “construction in progress” on capital projects to the Facilities Management department to verify if any projects listed were completed as of the end of the fiscal year. Based on this response, the accumulated cost of completed projects is then reclassified out of construction in progress and into the appropriate fixed asset category. This procedure was followed in fiscal year ended June 30, 2008 and reclassifications were made based on this confirmation. The Facilities Management employee completing the verification form indicated that a capital project was still in progress at year end because funds were remaining in the project and it appeared additional costs would be incurred. In reality, the project had been completed by year end and, therefore, should have been reclassified to Machinery and Equipment, rather than included in Construction in Progress. This resulted in the beginning balances in these two categories in the capital asset footnote being misstated in offsetting amounts (\$902,598) and since it was reclassified by the University correctly in the fiscal year ended June 30, 2009, had no effect on the June 30 2009, Statement of Net Assets or on depreciation expense for that year.

For fiscal year ended June 30, 2010, the University Controller and Associate Vice Chancellor for Financial Services met with the Associate Vice Chancellor for Facilities Management and the Director of Facilities Planning, Design and Construction to review the status of all capital projects at year end to ensure proper reclassification of all completed projects. This practice will continue in future years. In addition, the Fixed Asset Accountant will be provided access to

AUDIT FINDINGS AND RESPONSES (CONTINUED)

CAPSTAT, UNC's capital project status system, so he can review completion dates and other pertinent information about the status of capital projects.

- e. The University has in place a chart of accounts and reports to provide a means to identify equipment, furnishings, and other purchases that require capitalization in accordance with the University and state policies. The Fixed Asset Accountant, however, relies on the accuracy of account coding by campus departments in order to ensure that additions can be identified for entry into the fixed asset system. The assets that were identified in this finding were not capitalized as a result of campus departments using incorrect account codes on purchase requisitions that resulted in these purchases being omitted from the reports used by the Fixed Asset Accountant. As a result of this, the reports have been expanded to include accounts that would not typically include assets that should be capitalized to ensure that items entered with incorrect account codes can be captured for capitalization. In addition, the Fixed Asset Accountant is now reviewing all daily checks issued for the purchase of goods and services, along with supporting documentation, to ensure that the University's fixed assets records are as complete and accurate as possible. While the University does not feel that a 100% review of all transactions is a reasonable use of State resources, we do feel it is necessary to ensure that a similar error and resulting audit finding do not occur in future years.
- f. This understatement in Machinery and Equipment was a result of an incorrect tag number on a list of items that were sold at a surplus yard sale. The list was submitted to the Fixed Asset accountant and all items were recorded as disposals in fiscal year ended June 30, 2009, including this particular piece of equipment that was removed in error. Subsequent to year end, the Fixed Asset Accountant was reviewing the fixed assets records and noticed that this item flagged as "disposed" had remaining useful life and a fairly significant cost so he asked the department the reason for its disposal. The department responded that they still had the equipment and it was at that time the Fixed Asset Accountant determined what had happened and took immediate steps to enter the item back in the system and to prepare the journal entry to record the correction in the finance system in the 2009-2010 fiscal year. Based on the immateriality of this error, the University did not consider it necessary to restate the June 30, 2009 balances. The fact that the University detected this error as a result of careful review and follow up by the Fixed Asset Accountant is an indication that controls are in place to detect errors and to prevent misstatements, not a deficiency in financial reporting as presented in the audit report. Unfortunately, in this particular situation, the error was discovered shortly after the 2009 year end was closed, resulting in an understatement of \$72,246 (.03%) of Net Capital Assets and \$5,779 (.07%) of total Depreciation Expense on the June 30 2009 financial report.

Auditor Comment: While some of the misstatements noted in items (d) through (f) may not be considered material misstatements individually, the cumulative effect of the misstatements, when combined with the other items included in the finding, indicates that the University did not have adequate controls in place to prevent or

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

detect errors to the financial statements prior to their issuance. The University is responsible for fair presentation of their financial statements and previous audit results should not be considered a primary control for accurate financial reporting.

With respect to the University's specific response to finding 3b, upon reviewing the auditor's initial corrections to the net assets classification, the University identified additional errors in the net assets classifications in the statements as originally presented. This resulted from incomplete evidence provided to the auditors. The net effect of the additional evidence and subsequent adjustment did not result in a material variation from the original proposed correction.

With respect to the University's response to findings 3d - 3f, an adequate internal control structure includes, in addition to preventing or detecting errors, processes to correct errors identified and to timely evaluate the impact of errors identified on the financial statements. Also, while some of the assets identified in 3e were not capitalized due to incorrect account coding, this was not the sole reason for all errors described in the finding.

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