

STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

MOLLY CORBETT BROAD, PRESIDENT

BOARD OF TRUSTEES

JOSEPH D. CROCKER, CHAIRMAN

PHILLIP D. WALKER, VICE CHAIRMAN

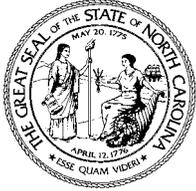
**ROBERT F. BURGIN
GENEVIEVE W. BURDA
RICK CARLISLE
JEANETTE HYDE
JOAN MACNEILL**

**WILLIAM TED PHILLIPS, JR.
J. CLARK PLEXICO
STEVE WARREN
CHARLES R. WORLEY
ROSEMARY WYCHE**

ADMINISTRATIVE OFFICERS

DR. JOHN W. BARDO, CHANCELLOR

GEORGE W. WOOTEN, VICE CHANCELLOR FOR ADMINISTRATION AND FINANCE



Ralph Campbell, Jr.
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet <http://www.osa.state.nc.us>

AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, Western Carolina University

This report presents the results of our financial statement audit of Western Carolina University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, for the year ended June 30, 2003. Our audit was made by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

The accounts and operations of the University are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report*. In those reports, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the audit results on the State's internal controls and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs.

As part of the audit work necessary for the CAFR and the *Single Audit Report*, the accounts and operations of the University were subjected to audit procedures as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to Western Carolina University. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is to present the results of our audit on the accompanying financial statements that relate solely to Western Carolina University. A summary of our reporting objectives and audit results is:

- 1. Objective** – To express an opinion on the accompanying financial statements that relate solely to Western Carolina University.

Results - The accompanying financial statements present fairly, in all material respects, the amounts and disclosures made in accordance with accounting principles generally accepted in the United States of America. These matters are more fully described in the Independent Auditor's Report on the Financial Statements.

AUDITOR'S TRANSMITTAL (CONCLUDED)

2. **Objective** – To present significant deficiencies, if any, in internal control over financial reporting which could adversely affect the University's ability to record, process, summarize, and report financial data in the financial statements and present instances of noncompliance, if any, with laws, regulations, contracts, or grants.

Results - Our tests disclosed no material weaknesses in internal control over financial reporting and no instances of noncompliance which require disclosure herein under *Government Auditing Standards*. These matters are more fully described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting.

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.



Ralph Campbell, Jr.
State Auditor

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR’S REPORT	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
BASIC FINANCIAL STATEMENTS	
Exhibits	
A Statement of Net Assets	18
B Statement of Revenues, Expenses, and Changes in Net Assets	20
C Statement of Cash Flows	21
Notes to the Financial Statement	23
SUPPLEMENTARY INFORMATION	
Schedules	
1 Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures	45
INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	47
DISTRIBUTION OF AUDIT REPORT	49



Ralph Campbell, Jr.
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet <http://www.osa.state.nc.us>

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Western Carolina University
Cullowhee, North Carolina

We have audited the accompanying basic financial statements of Western Carolina University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Western Carolina University as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 5, 2003 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis (MD&A), 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 have applied certain

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ralph Campbell, Jr.
State Auditor

November 5, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS



Introduction

The University's financial report includes three financial statements: the Statement of Net Assets, which 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, which reflects revenues and expenses recognized during the fiscal year; and the Statement of Cash Flows, which provides information on all of the institution's cash inflows and outflows by major category during the fiscal year. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements.

The following discussion and analysis provides an overview of the financial position and activities of Western Carolina University (the "University") for the years ended June 30, 2003 and 2002. 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Net Assets

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

Condensed Summary of Net Assets

	<u>2003</u>	<u>2002</u>	<u>\$ Change</u>	<u>% Change</u>
Assets				
Current Assets	\$ 51,609,855	\$ 50,523,173	\$ 1,086,682	2.15%
Capital Assets, net	125,073,921	98,691,618	26,382,303	26.73%
Other Noncurrent Assets	<u>42,698,793</u>	<u>39,502,008</u>	<u>3,196,785</u>	<u>8.09%</u>
Total Assets	<u>219,382,569</u>	<u>188,716,799</u>	<u>30,665,770</u>	<u>16.25%</u>
Liabilities				
Current Liabilities	10,547,440	8,430,404	2,117,036	25.11%
Noncurrent Liabilities	<u>25,875,498</u>	<u>18,020,319</u>	<u>7,855,179</u>	<u>43.59%</u>
Total Liabilities	<u>36,422,938</u>	<u>26,450,723</u>	<u>9,972,215</u>	<u>37.70%</u>
Net Assets				
Invested in Capital Assets, net of related debt	115,081,132	92,120,396	22,960,736	24.92%
Restricted – Nonexpendable	13,707,454	12,621,595	1,085,859	8.60%
Restricted – Expendable	14,201,420	17,552,465	(3,351,045)	-19.09%
Unrestricted	<u>39,969,625</u>	<u>39,971,620</u>	<u>(1,995)</u>	<u>-</u>
Total Net Assets	<u>\$ 182,959,631</u>	<u>\$ 162,266,076</u>	<u>\$ 20,693,555</u>	<u>12.75%</u>

A review of the University's Statement of Net Assets at June 30, 2003 and 2002 indicates that the University improved its already strong financial position, with Total Net Assets increasing by \$20.7 million (12.8%) over the previous year.

Total assets of the University increased by \$30.7 million. Net capital assets contributed \$26.4 million of this amount, mostly due to a \$19.7 million net increase in Construction in Progress, and a \$6.2 million increase in Buildings and General Infrastructure. The \$3.2 million increase in Other Noncurrent Assets resulted from a \$5.7 million increase in restricted noncurrent cash and cash equivalents offset by a \$2.7 million decrease in the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

amount due from the State of North Carolina for general obligation bond proceeds allotted, but not yet transferred, to the University at year end. The \$5.7 million increase in noncurrent restricted cash is due to unspent proceeds from the University of North Carolina System Pool Revenue Bonds, Series 2002A. The \$1.1 million increase in Current Assets is largely a result of a \$1.6 million increase in restricted current cash related to contract and grant, student loan, and capital improvement activities offset by a decline in unrestricted cash, mostly due to a decrease of over \$400,000 in the carryforward of State funds for use in 2003-04 fiscal year.

Current liabilities increased by \$2.1 million, primarily because of an increase of over \$900,000 in contract retainage and over \$500,000 in amounts payable to vendors for major construction projects. In addition, pending the outcome of a court ruling, the University has recorded an increase of over \$300,000 in library and parking fines under Other Payables.

The issuance of The University of North Carolina System Pool Revenue Bonds, Series 2002A, for major improvements to various athletics facilities (see Note 7C to the financial statements) was largely responsible for the \$7.9 million increase in noncurrent liabilities. The noncurrent portion of compensated absences payable also increased by over \$900,000 as a result of legislation granting State employees a bonus of 80 hours of annual leave.

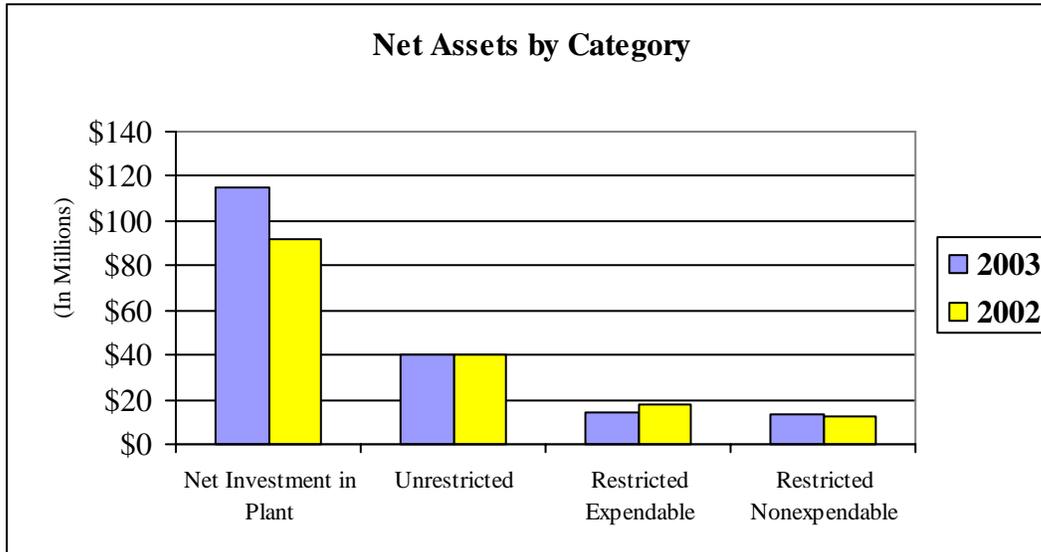
Net assets represent residual interest in the University's assets after all liabilities are deducted. For reporting purposes, they are divided into three major components:

- "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, 2003, \$115 million (62.9%) of the \$183 million in net assets was attributable to the University's investment in capital assets.
- Restricted net assets are subject to externally imposed restrictions governing their use and are further divided into two categories: nonexpendable and expendable. "Restricted – Nonexpendable" net assets primarily include the University's permanent endowment funds received from donors for the purpose of creating present and future income. These funds must be held inviolate and in perpetuity and are, therefore, not expendable. Earnings on these funds support various programs determined by donors. The nonexpendable category makes up approximately \$14 million of the \$183 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, 2003, expendable net assets totaled \$14.2 million, 7.8 percent of total net assets, and included \$4.6 million of funds functioning as endowment.
- "Unrestricted" net assets are not subject to externally imposed stipulations, although management has designated these funds for various academic and research programs and initiatives, as well as capital projects. This year, unrestricted net assets totaling

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

\$40 million represent 21.8 percent of total net assets. Included in this category at June 30, 2003 was \$2.9 million of funds functioning as endowment.

The following chart displays the contribution of each category to the total in both 2003 and 2002:



Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the University, as well as nonoperating revenues and expenses. 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 or expenses are an integral component in determining the increase or decrease in net assets.

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Capital grants and gifts are considered neither operating nor nonoperating revenues and are reported after "Income (Loss) before other revenues, expenses, gains or losses."

The following is a condensed Statement of Revenues, Expenses, and Changes in Net Assets for Western Carolina University as of June 30, 2003, compared with that of 2002.

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

	<u>2003</u>	<u>2002</u>	<u>\$ Change</u>	<u>% Change</u>
Operating Revenues				
Student Tuition and Fees, Net	\$ 19,794,031	\$ 17,305,159	\$2,488,872	14.38%
Grants and Contracts	11,190,031	10,516,661	673,370	6.40%
Sales and Services, Net	16,310,754	14,865,198	1,445,556	9.72%
Other Operating Revenues	<u>688,604</u>	<u>439,100</u>	<u>249,504</u>	<u>56.82%</u>
Total Operating Revenues	47,983,420	43,126,118	4,857,302	11.26%
Operating Expenses	<u>102,496,717</u>	<u>96,950,762</u>	<u>5,545,955</u>	<u>5.73%</u>
Operating Loss	(54,513,297)	(53,824,644)	(688,653)	1.28%
Nonoperating Revenues (Expenses)				
State Appropriations	51,698,881	47,667,671	4,031,210	8.46%
Gifts and Grants	1,585,404	1,712,231	(126,827)	-7.41%
Investment Income (Net of Investment Expense)	3,057,925	1,453,906	1,604,019	110.32%
Other Nonoperating Revenues and Expenses	<u>(657,327)</u>	<u>(414,368)</u>	<u>(242,959)</u>	<u>58.63%</u>
Net Nonoperating Revenues	<u>55,684,883</u>	<u>50,419,440</u>	<u>5,265,443</u>	<u>10.44%</u>
Income (Loss) Before Other Revenues, Expenses, Gains, or Losses	<u>1,171,586</u>	<u>(3,405,204)</u>	<u>4,576,790</u>	<u>-134.40%</u>
Capital Grants	19,208,470	7,825,164	11,383,306	145.47%
Capital Gifts	110,000	29,955	80,045	267.22%
Additions to Permanent Endowments	<u>203,499</u>	<u>400,591</u>	<u>(197,092)</u>	<u>-49.20%</u>
Total Other Revenue	<u>19,521,969</u>	<u>8,255,710</u>	<u>11,266,259</u>	<u>136.47%</u>
Change in Net Assets	<u>20,693,555</u>	<u>4,850,506</u>	<u>15,843,049</u>	<u>326.63%</u>
Beginning Net Assets, as restated	<u>162,266,076</u>	<u>157,415,570</u>	<u>4,850,506</u>	<u>3.08%</u>
Ending Net Assets	<u><u>\$182,959,631</u></u>	<u><u>\$162,266,076</u></u>	<u><u>\$20,693,555</u></u>	<u><u>12.75%</u></u>

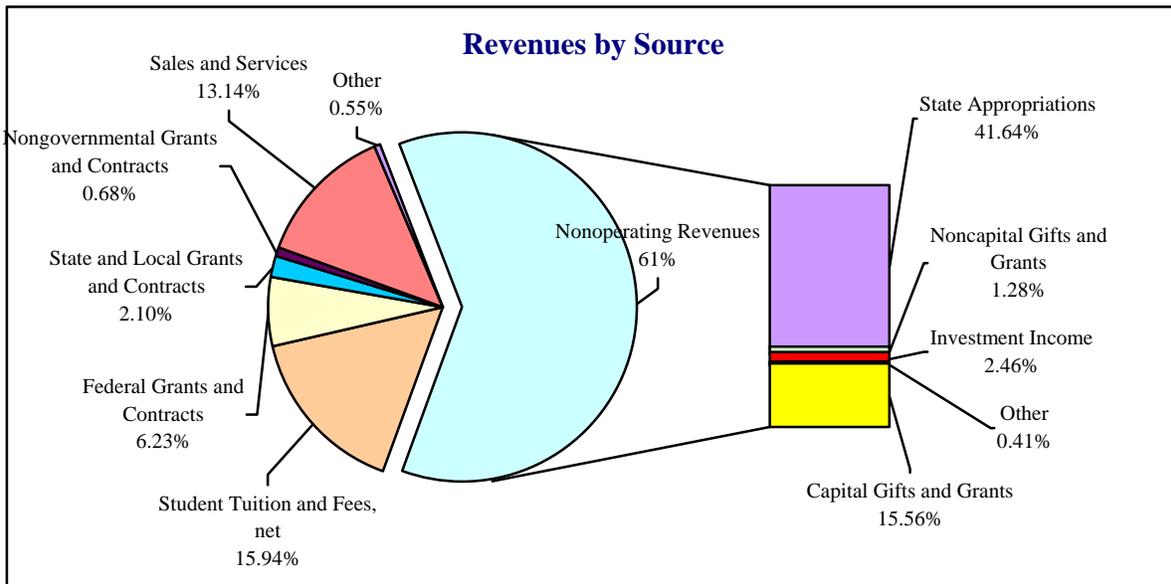
The Statement of Revenues, Expenses, and Changes in Net Assets reflects a positive year with an increase in net assets at year-end of \$20.7 million, a substantial rise from last year's increase of \$4.9 million.

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,

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

along with State appropriations, investment income and federal, State, and private grants and contracts. The University has in the past and will continue to seek funding from available sources that are consistent with its mission and to prudently manage the financial resources realized from these efforts in order to supplement tuition revenues and fund its operating activities.

The following is a graphic illustration of the breakdown of revenues by source (both operating and nonoperating) which are used to fund the University's operating activities for the year ended June 30, 2003. As defined by GASB, significant recurring sources of the University's revenues, such as State appropriations and private gifts, are considered nonoperating.



Operating revenues for 2003 totaled \$48 million compared with \$43 million for 2002. The most significant source of operating revenue for the University was tuition and fees (net of scholarship allowances) totaling \$19.8 and \$17.3 million at June 30, 2003 and June 30, 2002, respectively. This 14% increase primarily reflects an overall increase in tuition and fee rates of approximately 9 percent for in-state students and 14.9 percent for out-of-state students, as well as a modest growth in number of students. Other major revenue sources in 2003 include sales and services of \$16.3 million (\$14.9 million in 2002) and grants and contracts of \$11.2 million (\$10.5 million in 2002). Over \$1 million of the \$1.4 million increase in sales and services was due to revenue increases in residential life, dining and athletics. The rise in housing and dining revenue resulted from rate increases of approximately 5 percent and increased occupancy in the residence halls. The athletics revenue increase occurred because of a substantial football game guarantee received in 2003.

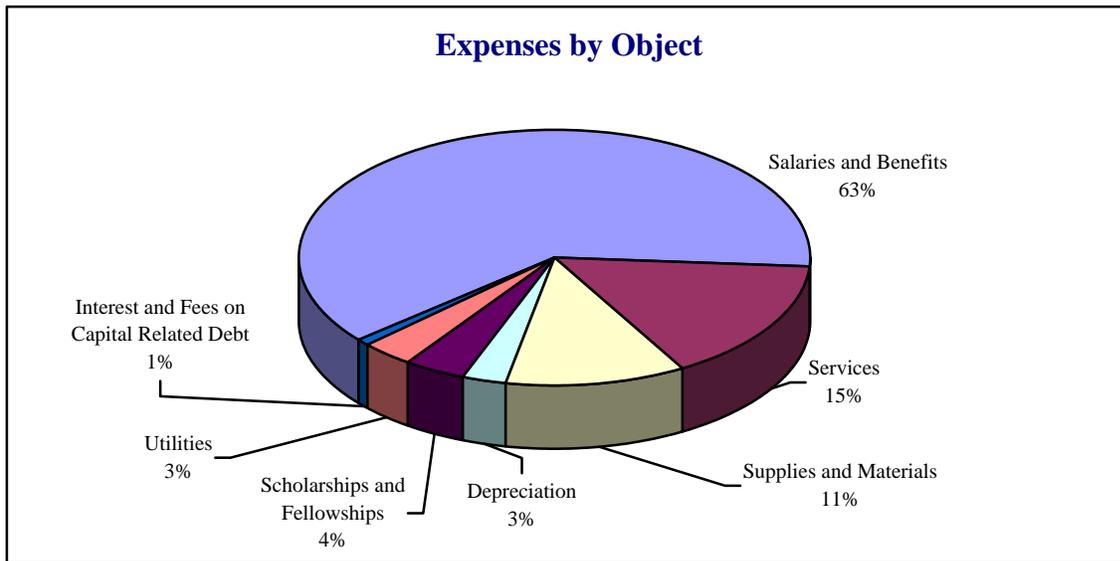
Like most public institutions, the University receives significant nonoperating revenues which offset the loss generated by operating activities. During 2003, the operating loss of \$54.5 million was offset by \$55.7 million in net nonoperating revenues. The primary source

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

of this revenue is State appropriations, which totaled \$51.7 million and accounted for forty-two percent of total revenue. Other major sources of nonoperating revenue in 2003 are investment income of \$3.1 million and noncapital gifts of \$1.4 million. An increase in investment income of over \$1.6 million was attributable to favorable market fluctuations.

Capital grants totaled \$19.2 million and \$7.8 million for the years ended June 30, 2003 and June 30, 2002, respectively. The sources of this revenue are State general obligation bond proceeds of \$16.6 million and \$5 million in 2003 and 2002, respectively and federal capital grant revenue of \$2.6 million and \$2.8 million in 2003 and 2002, respectively. As explained more fully in Note 14C to the financial statements, in 2000 the voters of North Carolina approved the issuance of general obligation bonds to provide funds for capital improvements on the University of North Carolina campuses. The Office of State Budget and Management allots these funds based on the University's projected cash requirements related to the construction projects funded by this bond issue. Increased construction activity on these projects accounts for the increase of over \$11 million in State capital grants in 2003.

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



Operating expenses increased \$5.5 million for the fiscal year ending June 30, 2003. As depicted in the chart above, operating expenses are mainly attributable to salaries and benefits for the faculty and staff of the University. Of the \$102 million in operating expenses, \$64.4 million (63 percent) was used for this purpose in 2003, an increase of \$1.8 million. Over \$1.1 million of this increase was attributable to increases in faculty salaries. The balance of the increase was primarily related to the rise in accrued compensation payable due to the eighty hours of bonus leave granted to State employees by the legislature in 2003. The University is committed to recruiting and retaining an outstanding faculty and staff. Periodic

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

reviews are conducted to compare the University's salaries with those of our peers. Contingent upon availability of funds, adjustments are implemented when salary disparities are identified.

Other elements included in operating expenses are supplies and materials, services, scholarships and fellowships, utilities and depreciation. All categories of expense were consistent with last year in terms of their percent of contribution to total expenses with the exception of salaries and benefits that declined by one percent and scholarships and fellowships that increased by one percent.

Statement of Cash Flows

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. Cash provided or used is categorized based on the following four types of activities: operating, noncapital financing, capital financing, and investing. The statement also provides an assessment of the University's financial flexibility and liquidity, its ability to meet obligations as they come due, and its need for external financing. A comparative summary of the Statement of Cash Flows for the years ended June 30, 2003 and 2002 is as follows:

	Statement of Cash Flows	
	2003	2002
Cash provided (used) by:		
Operating Activities	\$(49,715,433)	\$(48,898,583)
Noncapital Financing Activities	53,986,570	50,249,647
Capital and Related Financing Activities	(20,803)	(10,653,278)
Investing Activities	2,665,801	6,118,557
Net Change in Cash	6,916,135	(3,183,657)
Cash, beginning of year	\$55,083,146	\$58,266,803
Cash, end of year	\$61,999,281	\$55,083,146

Net cash used in operating activities should be viewed in conjunction with net cash provided by noncapital financing activities. State appropriations and gift contributions for operations are significant sources of recurring revenues in support of operating expenses, but are required to be classified as noncapital financing activities under generally accepted accounting principles. Therefore, when considering cash flows related to operating activities, it is important to also consider these noncapital financing activities which support operating expenses. Net cash flow provided by these two activities amounted to \$4.3 million.

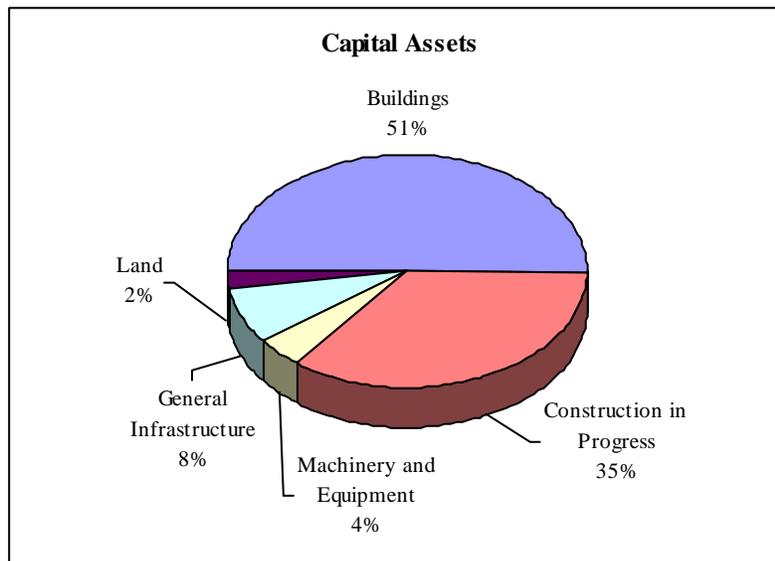
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net cash provided by investing activities of \$2.7 million reflects receipts from sales and maturities of investments less disbursements for purchases of investments. Unrealized losses and gains from the change in fair value of investments is a non-cash transaction for valuation purposes only, and does not affect cash flows from investing activities.

The University's cash and cash equivalents increased \$6.9 million during 2003 due to the positive flow of funds provided by noncapital financing and investing activities.

Capital Asset and Debt Administration

At June 30, 2003, the University had approximately \$177.9 million invested in capital assets, net of accumulated depreciation of \$52.8 million. Depreciation charges for the current year totaled \$2.9 million. The following chart displays the relationship of each category to capital assets as a whole.



A critical factor in achieving quality in the University's academic endeavors and enriching the quality of students' experience here is the development and renewal of its 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 year were funded with federal and State capital grants, debt proceeds, and gifts and unrestricted net assets designated for capital purposes.



Center for Applied Technology, ribbon cutting

Passage of North Carolina's Higher Education Bond Referendum in November 2000 provides Western with over \$100 million in State funds over a six-year period beginning in fiscal year 2001 to fund facility construction projects, infrastructure improvements, land acquisition and technology expansion. Construction projects include two new buildings - the Fine and Performing Arts Center and a 300-bed residence hall – as well as renovation of McKee, Bird, Killian, Killian Annex, Breese Gymnasium, Graham Infirmary, Stillwell and Forsyth buildings. Infrastructure improvements include chiller replacements, electrical distribution improvement and steam / condensate line replacement. Funds were also provided to improve traffic conditions on campus by relocating Centennial Drive and creating a pedestrian only quadrangle between Walker Residence Hall and Dodson Cafeteria. All of these projects, except for Forsyth, are either in construction or nearing completion.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



Fine and Performing Arts Center

Construction projects funded by non-state sources include new facilities for a Center for Applied Technology (formerly called the Regional Labor Force Development Center) which opened in November 2003, a Hospitality Management Studies Center, and a Student Recreation Center. Also funded from such sources are improved and expanded athletic facilities, including the new Jordan-Phillips Fieldhouse and the stadium's west side stands, and an addition to the Hinds University Center, scheduled to open January 2004. Total budgets for these projects exceed \$47 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



A.K. Hinds University Center addition

The University's financial statements indicate \$15,299,000 in bonds payable, \$2,333,080 in notes payable, and \$32,951 in capital leases payable at June 30, 2003. Total annual debt service payments were \$2.1 million in 2003, compared to \$1.5 million in 2002.

During the fiscal year ending June 30, 2003, the University participated in the issuance of The University of North Carolina System Pool Revenue Bonds, Series 2002A. Western Carolina University borrowed \$8,070,000 as part of this issue for the renovation of various University athletic facilities.

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 relates to its ability to recruit and retain high quality students. First-year students applied in record numbers for the third straight year - over 4,600 applications were processed. Just over 73.5% of these students were admitted as the University continues to increase its admission standards for entering freshmen. Of those who were admitted, 1,494 freshmen enrolled to begin the Fall 2003 semester, and their average SAT scores increased to 1023, significantly above the State average of 998 and, for the first time, above the national average of 1020.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

A strong indication of improvement in the quality of education available at Western is the University's continuing emphasis on new, career-focused programs of study. Programs added during FY 2002-2003 included a bachelor's degree program in construction management, the State's only bachelor's degree program in emergency management, a master's degree program in college student personnel, and the State's only master's degree program in entrepreneurship.

Enrollment growth targets for the next 8 - 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. With the total enrollment for Fall 2003 reaching nearly 7,600 students for the first time in the institution's history, the total enrollment target of 10,000 by the year 2009 appears reachable. 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 in serving larger numbers of students.

In addition to recruiting record numbers of students, the University is making a substantial effort to enhance persistence to graduation. Nearly 69% of Fall 2002 freshmen enrolled for Fall 2003, down slightly from the previous year. It is important to note that, while the average graduation rate for all students is 47%, the graduation rate for student-athletes who enrolled in '95-'96 was 65%, an all-time high for Western and five points above the national average, according to NCAA records. Higher retention rates and higher graduation rates are seen as key indicators of success, both for the University and for its 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 and the demand for State appropriations to operate the University. Also, declines in State appropriations generally exert pressure for increased tuition and fees. As an institution targeted for growth in the years ahead, Western will be greatly affected by the availability and levels of State operating funds and capital resources to support that growth.

Private gifts are an important supplement to the University's base revenue from State appropriations and student tuition. Such gifts can provide the support needed to boost programs to higher levels of quality and service. Economic pressures affecting donors, as well as investment returns, may affect future levels of funding that the University can attract from corporate and individual donors. In the face of a national economic downturn and State budget constraints, Western experienced an increase in its core constituency of alumni donors (with a slight decline in overall donors) and remained stable in the total of private gifts received in the fiscal year ended June 30, 2003.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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

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



Western Carolina University
Statement of Net Assets
June 30, 2003

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 36,323,793.50
Restricted Cash and Cash Equivalents	8,401,959.95
Restricted Short-Term Investments	544,302.66
Receivables, Net (Note 4)	2,811,459.47
Inventories	2,682,531.48
Notes Receivable, Net (Note 4)	845,808.19
Total Current Assets	51,609,855.25

Noncurrent Assets:

Restricted Cash and Cash Equivalents	17,273,527.19
Restricted Due from Primary Government	3,569,127.01
Endowment Investments	16,076,515.30
Other Long-Term Investments	1,453,344.75
Notes Receivable, Net (Note 4)	4,326,279.06
Capital Assets - Nondepreciable (Note 5)	47,121,347.54
Capital Assets - Depreciable, Net (Note 5)	77,952,573.18
Total Noncurrent Assets	167,772,714.03

Total Assets	219,382,569.28
---------------------	-----------------------

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	7,552,534.37
Due to Primary Government	36,399.57
Deferred Revenue	1,619,649.14
Interest Payable	202,402.13
Long-Term Liabilities - Current Portion (Note 7)	1,136,455.22
Total Current Liabilities	10,547,440.43

Noncurrent Liabilities:

Deposits Payable	212,699.18
Funds Held for Others	349,582.45
U. S. Government Grants Refundable	5,290,155.91
Long-Term Liabilities (Note 7)	20,023,060.59
Total Noncurrent Liabilities	25,875,498.13

Total Liabilities	36,422,938.56
--------------------------	----------------------

Western Carolina University
Statement of Net Assets
June 30, 2003

Exhibit A
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	115,081,131.57
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	6,746,510.73
Endowed Professorships	6,101,273.38
Loans	859,670.00
Expendable:	
Scholarships and Fellowships	4,987,014.74
Research	134,247.03
Endowed Professorships	256,767.46
Departmental Uses	3,333,247.19
Loans	378,963.17
Capital Projects	1,939,132.85
Debt Service	3,172,047.93
Unrestricted	39,969,624.67
Total Net Assets	\$ 182,959,630.72

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, 2003 **Exhibit B**

REVENUES	
Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 19,794,030.62
Federal Grants and Contracts	7,740,526.48
State and Local Grants and Contracts	2,603,455.52
Nongovernmental Grants and Contracts	846,049.42
Sales and Services, Net (Note 9)	16,310,753.70
Interest Earnings on Loans	75,175.64
Other Operating Revenues	613,428.96
Total Operating Revenues	47,983,420.34
EXPENSES	
Operating Expenses:	
Salaries and Benefits	64,405,229.93
Supplies and Materials	11,832,128.85
Services	16,011,292.66
Scholarships and Fellowships	3,848,446.17
Utilities	3,456,077.33
Depreciation	2,943,542.69
Total Operating Expenses	102,496,717.63
Operating Loss	(54,513,297.29)
NONOPERATING REVENUES (EXPENSES)	
State Appropriations	51,698,881.06
Noncapital Grants	192,590.88
Noncapital Gifts, Net (Note 9)	1,392,813.09
Investment Income (Net of Investment Expense of \$37,244)	3,057,924.39
Interest and Fees on Capital Asset-Related Debt	(957,069.60)
Other Nonoperating Revenues	299,742.77
Net Nonoperating Revenues	55,684,882.59
Income Before Other Revenues, Expenses, Gains, or Losses	1,171,585.30
Capital Grants	19,208,470.29
Capital Gifts, Net (Note 9)	110,000.00
Additions to Endowments	203,498.98
Increase in Net Assets	20,693,554.57
NET ASSETS	
Net Assets - July 1, 2002	162,266,076.15
Net Assets - June 30, 2003	\$ 182,959,630.72

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, 2003

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 47,551,194.96
Payments to Employees and Fringe Benefits	(63,390,744.50)
Payments to Vendors and Suppliers	(30,575,389.76)
Payments for Scholarships and Fellowships	(3,848,446.17)
Loans Issued	(1,427,172.87)
Collection of Loans	1,205,306.22
Interest Earned on Loans	119,508.83
Student Deposits Received	476,159.91
Student Deposits Returned	(440,824.52)
Other Receipts	614,975.43
Net Cash Used by Operating Activities	(49,715,432.47)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	51,698,881.06
Grants for Other than Capital Purposes	198,372.13
Noncapital Gifts	1,567,411.76
Additions to Permanent and Term Endowments	203,498.98
William D. Ford Direct Lending Receipts	15,562,178.00
William D. Ford Direct Lending Disbursements	(15,577,544.00)
Related Activity Agency Receipts	148,982.41
Related Activity Agency Disbursements	(114,953.08)
Other Receipts	299,742.77
Net Cash Provided by Noncapital Financing Activities	53,986,570.03

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	8,085,645.45
Capital Grants	22,200,942.54
Capital Gifts	110,000.00
Acquisition and Construction of Capital Assets	(28,409,813.31)
Principal Paid on Capital Debt and Leases	(1,139,993.51)
Interest and Fees Paid on Capital Debt and Leases	(867,584.43)
Net Cash Used by Capital Financing and Related Financing Activities	(20,803.26)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	1,367,675.34
Interest on Investments	2,770,060.57
Purchase of Investments and Related Fees	(1,471,935.27)
Net Cash Provided by Investing Activities	2,665,800.64

Net Increase in Cash and Cash Equivalents	6,916,134.94
Cash and Cash Equivalents - July 1, 2002	55,083,145.70
Cash and Cash Equivalents - June 30, 2003	\$ 61,999,280.64

Western Carolina University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2003

Exhibit C
Page 2

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

Operating Loss	\$ (54,513,297.29)
Adjustments to Reconcile Operating Loss to Net Cash Provided (Used) by Operating Activities:	
Depreciation Expense	2,943,542.69
Allowances, Write-Offs, and Amortizations	413,653.54
Nonoperating Other Income (Expense)	9,341.00
Changes in Assets and Liabilities:	
Receivables (Net)	(161,868.80)
Inventories	(116,697.22)
Accounts Payable and Accrued Liabilities	1,016,396.89
Due to Primary Government	2,785.99
Deferred Revenue	(49,958.74)
Compensated Absences	927,200.73
Deposits Payable	35,335.39
Note Principal Repayments	1,205,306.22
Notes Issued	(1,427,172.87)
Net Cash Used by Operating Activities	\$ (49,715,432.47)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 36,323,793.50
Restricted Cash and Cash Equivalents	8,401,959.95
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	17,273,527.19
Total Cash and Cash Equivalents - June 30, 2003	\$ 61,999,280.64

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 46,054.61
Change in Fair Value of Investments	340,832.00
Reinvested Distributions	544,497.92

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

NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2003

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. Western Carolina University is a constituent institution of the sixteen-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. Although legally separate, Western Carolina University Foundation, a component unit of the University, is reported as if it were part of the University.

The Foundation is governed by a 28-member board consisting of 4 ex officio directors and 24 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.

Separate financial statements for the Foundation and the Investment Fund may be obtained from the University Controller's Office, HFR 317, Cullowhee, NC 28723, or by calling 828-227-7308. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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 (BTA) and accordingly, is reported within a single column in the basic financial statements.

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

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

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, savings accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - This classification includes long-term fixed income investments, equity investments, mutual funds, limited partnerships, real estate, and other asset holdings by the University. Except for real estate not held by a governmental external investment pool and other asset holdings, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- F. Receivables** – Receivables consist of tuition and fees charges 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.
- 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 expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 75 years for general infrastructure, 10 to 50 years for buildings, and 3 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.

The Hayes and other artifact collections are capitalized at cost or fair value at the date of donation. These collections are considered inexhaustible and are therefore not depreciated.

- I. Restricted Assets** – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

- J. Noncurrent Long-Term Liabilities** – Noncurrent long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, and compensated absences that will not be paid within the next fiscal year.

Bonds payable are reported net of unamortized premiums or discounts and deferred losses on refundings. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method. The deferred losses on refundings are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method. Issuance costs are expensed.

- K. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1st or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30th equals the leave carried forward at the previous December 31st plus the leave earned, less the leave taken between January 1st and June 30th.

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonus awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

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

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

- L. Net Assets** – The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt – This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

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

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

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

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

- 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, State and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

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

- O. Internal Sales Activities** – Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as food, 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 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 General Statute 116-36.1, requires the University to deposit its institutional trust funds with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, and debt service funds with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

Deposits include cash and cash equivalents totaling \$61,999,280.64. At year-end, cash on hand was \$28,449.00. The University's portion of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

State Treasurer's Investment Pool was \$61,717,771.50. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name. The carrying amount of the University's deposits not with the State Treasurer was \$253,060.14 and the bank balance was \$543,619.61. Of the bank balance, \$100,000 was covered by federal depository insurance and \$443,619.61 was collateralized under the pooling method.

North Carolina General Statutes 147-69.1(c), applicable to the State's General Fund, and 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, General Statute 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. General Statute 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.

The financial statements and disclosures for the State Treasurer's Investment Pool 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.osc.state.nc.us/> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to General Statute 116-36.2 and Chapter VI of the Administrative Manual of the University of North Carolina, to invest its special funds in the same manner as the State Treasurer is required to invest, as previously discussed.

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

General Statute 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, Western Carolina University Foundation, are subject to and restricted by General Statute 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the unit value method. Under this method, each participating fund's investment balance is determined on a market 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.

Credit Risk Categories - The University's investments (pooled and non-pooled) are categorized below to give an indication of the level of risk assumed by the entity at year-end. The credit risk categories are concerned with custodial credit risk, which is the risk that a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party if the counterparty to the investment transaction fails. There are three categories of credit risk. Category 1 includes investments that are insured or registered or for which the securities are held by the University or its agent in the University's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the University's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by a counterparty's trust department or agent but not in the University's name.

A summary of the University's investments at June 30, 2003 is presented below:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool

Investments Not Categorized:	Total
Money Market Funds	\$ 17,410,493.13

Non-Pooled Investments

	Fair Value			Total
	Risk Category			
	1	2	3	
Categorized Investments:				
Corporate Stocks	\$ 26,510.00	\$ 0.00	\$ 0.00	\$ 26,510.00
Corporate Bonds	13,159.33			13,159.33
US Government Securities	544,302.66			544,302.66
Total Categorized Investments	\$ 583,971.99	\$ 0.00	\$ 0.00	583,971.99
Investments Not Categorized:				
Real Estate				32,500.00
Collections				47,197.59
Total Investments Not Categorized				79,697.59
Total Non-Pooled Investments				\$ 663,669.58

Total Investments

	Fair Value			Total
	Risk Category			
	1	2	3	
Total Categorized Investments	\$ 583,971.99	\$ 0.00	\$ 0.00	\$ 583,971.99
Total Investments Not Categorized				17,490,190.72
Total Investments				\$ 18,074,162.71

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). The current spending policy for the University's pooled endowment funds provides 5% of a three-year average of market values as of December 31. The Board of Trustees annually reviews the spending policy and makes adjustments accordingly. At June 30, 2003, net appreciation of \$7,582,526.15 was available to be spent, of which \$4,687,901.68 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2003 were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 1,162,691.40	\$ 721,870.40	\$ 440,821.00
Accounts	685,825.40		685,825.40
Intergovernmental	1,049,321.57		1,049,321.57
Pledges	107,489.95	11,524.46	95,965.49
Investment Earnings	181,250.18		181,250.18
Interest on Loans	130,379.42		130,379.42
Other	227,896.41		227,896.41
Total Current Receivables	<u><u>\$ 3,544,854.33</u></u>	<u><u>\$ 733,394.86</u></u>	<u><u>\$ 2,811,459.47</u></u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 825,563.14	\$ 0.00	\$ 825,563.14
Institutional Student Loan Programs	64,001.07	43,756.02	20,245.05
Total Notes Receivable - Current	<u><u>\$ 889,564.21</u></u>	<u><u>\$ 43,756.02</u></u>	<u><u>\$ 845,808.19</u></u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 5,360,433.52	\$ 1,041,368.00	\$ 4,319,065.52
Institutional Student Loan Programs	7,213.54		7,213.54
Total Notes Receivable - Noncurrent	<u><u>\$ 5,367,647.06</u></u>	<u><u>\$ 1,041,368.00</u></u>	<u><u>\$ 4,326,279.06</u></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, 2003, is presented as follows:

	Balance July 1, 2002	Adjustments	Increases	Decreases	Balance June 30, 2003
Capital Assets, Nondepreciable:					
Land	\$ 2,755,590.30	\$ 0.00	\$ 232,470.00	\$ 0.00	\$ 2,988,060.30
Art, Literature, and Artifacts	105,433.00				105,433.00
Construction in Progress	24,333,518.55	(8,246,964.09)	27,941,299.78		44,027,854.24
Total Capital Assets, Nondepreciable	27,194,541.85	(8,246,964.09)	28,173,769.78		47,121,347.54
Capital Assets, Depreciable:					
Buildings	99,010,658.09	6,242,825.01			105,253,483.10
Machinery and Equipment	10,001,667.28		942,878.31	338,081.87	10,606,463.72
Art, Literature, and Artifacts	103,188.00				103,188.00
General Infrastructure	12,604,297.40	2,004,139.08	222,711.86		14,831,148.34
Intangible	1.00				1.00
Total Capital Assets, Depreciable	121,719,811.77	8,246,964.09	1,165,590.17	338,081.87	130,794,284.16
Less Accumulated Depreciation/Amortization for:					
Buildings	40,484,212.51		1,943,011.74		42,427,224.25
Machinery and Equipment	5,096,523.92		637,159.54	324,566.87	5,409,116.59
Art, Literature, and Artifacts	80,383.05		2,334.02		82,717.07
General Infrastructure	4,561,615.68		361,037.39		4,922,653.07
Total Accumulated Depreciation	50,222,735.16		2,943,542.69	324,566.87	52,841,710.98
Total Capital Assets, Depreciable, Net	71,497,076.61	8,246,964.09	(1,777,952.52)	13,515.00	77,952,573.18
Capital Assets, Net	\$ 98,691,618.46	\$ 0.00	\$ 26,395,817.26	\$ 13,515.00	\$ 125,073,920.72

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2003 were as follows:

	<u>Amount</u>
Accounts Payable	\$ 4,118,231.24
Accrued Payroll	926,124.95
Contract Retainage	1,614,123.48
Intergovernmental Payables	<u>894,054.70</u>
Total Accounts Payable and Accrued Liabilities	\$ 7,552,534.37

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2003 is presented as follows:

	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Current Portion
Notes Payable	\$ 2,575,207.56	\$ 0.00	\$ 242,127.14	\$ 2,333,080.42	\$ 253,155.31
Bonds Payable	8,113,000.00	8,070,000.00	884,000.00	15,299,000.00	630,000.00
Total Notes and Bonds Payable	<u>10,688,207.56</u>	<u>8,070,000.00</u>	<u>1,126,127.14</u>	<u>17,632,080.42</u>	<u>883,155.31</u>
Capital Leases Payable	31,172.03	15,645.45	13,866.37	32,951.11	13,443.91
Compensated Absences	2,567,283.55	4,556,191.33	3,628,990.60	3,494,484.28	239,856.00
Total Long-Term Liabilities	<u>\$ 13,286,663.14</u>	<u>\$ 12,641,836.78</u>	<u>\$ 4,768,984.11</u>	<u>\$ 21,159,515.81</u>	<u>\$ 1,136,455.22</u>

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

B. 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 06/30/2003	Principal Outstanding 06/30/2003
UC Renovation	First Union National	6.18	12/01/2010	\$ 3,800,000.00	\$ 1,467,851.89	\$ 2,332,148.11
Purchase Automobile	Ford Motor Credit	3.9	08/06/2003	25,551.66	24,619.35	932.31
Total Notes Payable				<u>\$ 3,825,551.66</u>	<u>\$ 1,492,471.24</u>	<u>\$ 2,333,080.42</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. 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 06/30/2003	Principal Outstanding 06/30/2003
<u>Dormitory System</u>						
Dormitory System Revenue Bonds	C	3.625	05/01/2003	\$ 2,200,000.00	\$ 2,200,000.00	\$ 0.00
Dormitory System Revenue Bonds	D	3.0	05/01/2007	2,394,000.00	2,005,000.00	389,000.00
Dormitory System Revenue Bonds	G	6.2-6.7	05/01/2011	2,865,000.00	2,865,000.00	
UNC System Pool Revenue Bonds (A)	1998B	3.25-5.25	10/01/2013	465,000.00	95,000.00	370,000.00
UNC System - Series 2000 (B)	2000	5.0	10/01/2010	1,370,000.00	20,000.00	1,350,000.00
Total Dormitory System				<u>9,294,000.00</u>	<u>7,185,000.00</u>	<u>2,109,000.00</u>
<u>Student Center</u>						
UNC System - Series 2000	2000	5.00-5.75	10/01/2025	5,355,000.00	215,000.00	5,140,000.00
<u>Faculty Housing</u>						
Faculty Housing Revenue Bonds		3.0	11/01/2007	280,000.00	230,000.00	50,000.00
Faculty Housing Revenue Bonds	A	5.0-7.0	05/01/2003	442,000.00	442,000.00	
Total Faculty Housing				<u>722,000.00</u>	<u>672,000.00</u>	<u>50,000.00</u>
<u>Stadium System</u>						
Stadium System Student Fee Revenue Bonds		5.5-7.5	04/01/2008	865,000.00	865,000.00	
UNC System Pool Revenue Bonds (C)	2002A	4.0-5.375	04/01/2027	8,070,000.00	70,000.00	8,000,000.00
Total Stadium System				<u>8,935,000.00</u>	<u>935,000.00</u>	<u>8,000,000.00</u>
Total Bonds Payable (principal only)				<u>\$ 24,306,000.00</u>	<u>\$ 9,007,000.00</u>	<u>\$ 15,299,000.00</u>

(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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

D. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2003 are as follows:

<u>Fiscal Year</u>	Annual Requirements			
	Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2004	\$ 630,000.00	\$ 772,301.26	\$ 253,155.31	\$ 136,562.10
2005	585,000.00	746,238.76	268,259.57	120,987.67
2006	610,000.00	720,763.76	285,315.74	103,931.50
2007	639,000.00	693,538.76	303,456.37	85,790.87
2008	565,000.00	663,193.76	322,750.39	66,496.85
2009-2013	2,820,000.00	2,880,196.90	900,143.04	72,975.06
2014-2018	2,755,000.00	2,180,943.76		
2019-2023	3,530,000.00	1,360,768.77		
2024-2028	3,165,000.00	358,300.00		
Total Requirements	\$ 15,299,000.00	\$ 10,376,245.73	\$ 2,333,080.42	\$ 586,744.05

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to machinery and equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2003:

<u>Fiscal Year</u>	<u>Amount</u>
2004	\$ 14,505.33
2005	11,634.33
2006	5,255.40
2007	3,129.09
Total Minimum Lease Payments	34,524.15
Amount Representing Interest (7.48% Rate of Interest)	1,573.04
Present Value of Future Lease Payments	\$ 32,951.11

Machinery and equipment acquired under capital lease amounted to \$41,889.04 at June 30, 2003.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Operating Lease Obligations – The University entered into operating leases for automobiles and equipment. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2003:

<u>Fiscal Year</u>	<u>Amount</u>
2004	\$ 105,782.00
2005	<u>36,254.60</u>
Total Minimum Lease Payments	<u>\$ 142,036.60</u>

Rental expense for all operating leases during the year was \$129,195.02.

NOTE 9 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Less Allowance for Uncollectibles</u>	<u>Net Revenues</u>	<u>Net Revenues Pledged as Security for Debt</u>
Operating Revenues:						
Student Tuition and Fees	\$ 23,519,400.97	\$ 26,396.95	\$ 3,342,421.30	\$ 356,552.10	\$ 19,794,030.62	\$ 489,524.91 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 6,212,084.69	\$ 275,029.12	\$ 883,353.82	\$ 100,887.53	\$ 4,952,814.22	\$ 4,952,814.22 (B)
Dining	6,239,003.88	628,103.81	798,927.36	57,964.65	4,754,008.06	
Book Rental	1,002,256.39	894.94	128,891.87	48,080.70	824,388.88	
Bookstore	1,467,480.59	119,159.96		2,161.11	1,346,159.52	
Print Shop	612,681.45	566,584.77			46,096.68	
Athletic	945,879.18	12,650.70			933,228.48	6,060,686.43 (C)
Other	952,753.93	40,764.71		2,644.37	909,344.85	68,890.71 (D)
Sales and Services of Education and Related Activities	2,101,631.99	1,298,020.03		713.36	802,898.60	
Independent Operations	1,811,383.50	69,569.09			1,741,814.41	
Total Sales and Services	<u>\$ 21,345,155.60</u>	<u>\$ 3,010,777.13</u>	<u>\$ 1,811,173.05</u>	<u>\$ 212,451.72</u>	<u>\$ 16,310,753.70</u>	<u>\$ 11,082,391.36</u>
Nonoperating - Noncapital Gifts	<u>\$ 1,392,813.09</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 1,392,813.09</u>	<u>\$ 0.00</u>
Capital Gifts	<u>\$ 110,000.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 110,000.00</u>	<u>\$ 0.00</u>

Revenue Bonds Secured by Pledged Revenues:

- (A) Student Center
- (B) Student Housing
- (C) Stadium System
- (D) Apartment Management

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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	\$ 31,026,021.81	\$ 1,731,148.08	\$ 2,319,074.24	\$ 6,388.67	\$ 966.56	\$ 0.00	\$ 35,083,599.36
Research	830,270.14	94,115.68	186,861.42	2,509.91	19,284.98		1,133,042.13
Public Service	6,284,273.71	622,340.63	1,984,758.19	113,784.01	58,844.71		9,064,001.25
Academic Support	5,053,941.65	1,458,661.33	477,321.38		1,101.97		6,991,026.33
Student Services	2,610,197.07	192,775.71	866,376.99				3,669,349.77
Institutional Support	7,341,624.16	1,141,107.57	1,849,823.33	166,257.89	590.97		10,499,403.92
Operations and Maintenance of Plant	4,529,928.25	2,499,929.74	20,253.32		2,238,171.05		9,288,282.36
Student Financial Aid			360,596.91	2,715,837.55			3,076,434.46
Auxiliary Enterprises	6,552,730.89	2,797,031.64	7,837,837.39	843,668.14	1,137,027.86		19,168,295.92
Independent Operations	176,242.25	1,295,018.47	108,389.49		89.23		1,579,739.44
Depreciation						2,943,542.69	2,943,542.69
Total Operating Expenses	<u>\$ 64,405,229.93</u>	<u>\$ 11,832,128.85</u>	<u>\$ 16,011,292.66</u>	<u>\$ 3,848,446.17</u>	<u>\$ 3,456,077.33</u>	<u>\$ 2,943,542.69</u>	<u>\$ 102,496,717.63</u>

NOTE 11 - PENSION PLANS

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

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, 2003, the General Assembly required no contribution by employers and 6% of covered payroll for members.

For the year ended June 30, 2003, the University had a total payroll of \$53,860,394.89, of which \$28,022,955.73 was covered under the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Teachers' and State Employees' Retirement System. Total employee contributions for pension benefits for the year were \$1,681,377.34. No employer contributions were required. The University made one hundred percent of its annual required contributions for the years ended June 30, 2003, 2002, and 2001, which were \$0.00, \$555,006.36, and \$1,486,034.56, respectively.

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

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

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2003, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2003, the University had a total payroll of \$53,860,394.89, of which \$18,148,927.21 was covered under the Optional Retirement Program. Total employee and employer contributions for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

pension benefits for the year were \$1,088,939.02 and \$1,240,908.82, 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 \$57,914.48 for the year ended June 30, 2003.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2003 were \$20,456.02. The voluntary contributions by employees amounted to \$320,473.00 for the year ended June 30, 2003.

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 \$960,691.89 for the year ended June 30, 2003.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs which provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 2.35% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2003, the University's total contribution to the Plan was \$1,085,039.25. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Long-Term Disability -** The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the fiscal year ended June 30, 2003, the University's total contribution to the DIPNC was \$240,093.79. 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years. Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$11,000,000 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 operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$500 per occurrence deductible. The University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, flood, and "all risks" for buildings and contents. All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses occurring in-State are \$500,000 per claim and \$5,000,000 per occurrence and out-of-State are \$1,000,000 per claim and \$5,000,000 per occurrence. The University pays premiums to the Department of Insurance for the coverage.

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence with a \$50,000 deductible and a 10% participation in each loss above the deductible

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.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and compensation in accordance with the North Carolina Workers' Compensation Act. The University is self-insured for workers' compensation.

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

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$29,577,875.39 and on other purchases were \$2,020,140.53 at June 30, 2003.
- 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.
- C. University Improvement General Obligation Bonds** – The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of two billion five hundred million dollars of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA), establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization \$72,947,710.00 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

NOTE 15 - RELATED PARTIES

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. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of the foundation, except for support from the organization to the University. This support approximated \$98,831.00 for the year ended June 30, 2003.

NOTE 16 - SUBSEQUENT EVENTS

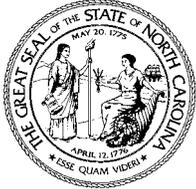
On October 15, 2003, the University of North Carolina Board of Governor's ratified the issuance of bonds for a system-wide tax-exempt bond financing. The University intends to borrow approximately \$13,000,000.00.

**Western Carolina University
Schedule of General Obligation Bond Project Authorizations,
Budgets, and Expenditures
For Project-to-Date as of June 30, 2003**

Schedule 1

Capital Improvement Projects	Projected Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Expected Completion Date
<i>Projects Started</i>							
Humanities and Fine Arts (301 and 315)	Jan 2001	\$ 27,919,644.00	\$ 2,611,056.00	\$ 30,530,700.00	\$ 17,186,806.00	56.29%	Mar 2004
McKee and Bird Renovations (303 and 304)	Nov 2001	10,256,100.00		10,256,100.00	6,082,306.00	59.30%	Nov 2003
New Student Housing (307)	Jan 2001	15,204,600.00	250,000.00	15,454,600.00	3,641,404.00	23.56%	Aug 2004
Steam and Electrical Infrastructure Improvements (309)	Jan 2002	10,639,000.00		10,639,000.00	794,018.00	7.46%	Jan 2006
Chiller Replacement and Retrofit (308)	Apr 2001	1,489,600.00		1,489,600.00	471,781.39	31.67%	May 2004
Breese Gym Conversion (306)	Nov 2001	1,161,300.00		1,161,300.00	56,113.00	4.83%	Dec 2004
Killian and Killian Annex Renovations (310 and 311)	Nov 2001	1,546,300.00		1,546,300.00	254,297.00	16.45%	Nov 2004
Stillwell Lab Renovation (302)	Dec 2002	15,057,500.00		15,057,500.00	241,078.00	1.60%	Jan 2006
Technology Infrastructure Expansion (314)	Apr 2003	5,018,600.00		5,018,600.00	294,531.00	5.87%	Dec 2006
<i>Projects Not Started - To Be Funded in Future Years</i>							
Student Health Center Conversion (305)		1,887,100.00		1,887,100.00			
Forsythe Renovation (312)		7,064,000.00		7,064,000.00			
Land Acquisition (313)		3,093,000.00		3,093,000.00			
Total All Projects		\$ 100,336,744.00	\$ 2,861,056.00	\$ 103,197,800.00	\$ 29,022,334.39		
<p>Note: The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of two billion five hundred million dollars of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina System. The projects listed on this Schedule are those funded or to be funded by bond proceeds from the general obligation bonds authorized by Senate Bill 912.</p>							

[This Page Left Blank Intentionally]



Ralph Campbell, Jr.
State Auditor

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet <http://www.osa.state.nc.us>

**INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE AND ON INTERNAL CONTROL
OVER FINANCIAL REPORTING 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 sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2003, and have issued our report thereon dated November 5, 2003.

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.

Compliance

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 grants, 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 that are required to be reported under Government Auditing Standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being

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

audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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



Ralph Campbell, Jr.
State Auditor

November 5, 2003

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

EXECUTIVE BRANCH

The Honorable Michael F. Easley	Governor of North Carolina
The Honorable Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Ms. Molly Corbett Broad	President, The University of North Carolina
Dr. John W. Bardo	Chancellor, Western Carolina University
Mr. George W. Wooten	Vice Chancellor for Administration and Finance Western Carolina University
Mr. Phillip D. Walker	Chairman, Board of Trustees Western Carolina University

LEGISLATIVE BRANCH

Appointees to the Joint Legislative Commission on Governmental Operations

President Pro Tempore	Speaker of the House
Senator Marc Basnight, Co-Chair	Representative James B. Black, Co-Chair
Senator Charles W. Albertson	Representative Richard T. Morgan, Co-Chair
Senator Patrick J. Ballantine	Representative Martha B. Alexander
Senator Daniel G. Clodfelter	Representative Rex L. Baker
Senator Walter H. Dalton	Representative Bobby H. Barbee, Sr.
Senator Charlie S. Dannelly	Representative Harold J. Brubaker
Senator James Forrester	Representative Debbie A. Clary
Senator Linda Garrou	Representative E. Nelson Cole
Senator Wilbur P. Gulley	Representative James W. Crawford, Jr.
Senator Fletcher L. Hartsell, Jr.	Representative William T. Culpepper, III
Senator David W. Hoyle	Representative W. Pete Cunningham
Senator Ellie Kinnaird	Representative W. Robert Grady
Senator Jeanne H. Lucas	Representative Joe Hackney
Senator Stephen M. Metcalf	Representative Julia C. Howard
Senator Anthony E. Rand	Representative Joe L. Kiser
Senator Eric M. Reeves	Representative Edd Nye
Senator Robert A. Rucho	Representative William C. Owens, Jr.
Senator R. C. Soles, Jr.	Representative Wilma M. Sherrill
Senator Scott Thomas	Representative Thomas E. Wright

Other Legislative Officials

Mr. James D. Johnson	Director, Fiscal Research Division
----------------------	------------------------------------

February 24, 2004

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Internet: <http://www.ncauditor.net>

Telephone: 919/807-7500

Facsimile: 919/807-7647