



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

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, 2004

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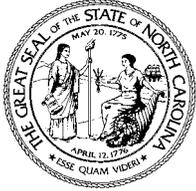
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Ralph Campbell, Jr.
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AUDITOR'S TRANSMITTAL

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, 2004. 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

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Western Carolina University
Cullowhee, North Carolina

We have audited the accompanying financial statements of Western Carolina University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2004, which collectively comprise the Western Carolina University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Western Carolina University Foundation, which represents 5 percent, 6 percent, and 2 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of Western Carolina University Research and Development Corporation which represents 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, and the reports of other auditors, provides a reasonable basis for our opinions.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Western Carolina University and its discretely presented component units, as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 2004.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2004 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis (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. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise Western Carolina University's basic financial statements. 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 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

October 26, 2004

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 during the fiscal year by major category. 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, 2004 and 2003. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The difference between total assets and total liabilities - net assets - is one indicator of the current financial condition of the University, 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

	2004	2003	\$ Change	% Change
Assets				
Current Assets	\$ 58,171,163	\$ 51,609,855	6,561,308	12.71%
Capital Assets, net	164,852,965	125,073,921	39,779,044	31.80%
Other Noncurrent Assets	48,835,032	42,698,793	6,136,239	14.37%
Total Assets	271,859,160	219,382,569	52,476,591	23.92%
Liabilities				
Current Liabilities	14,048,037	10,547,440	3,500,597	33.19%
Noncurrent Liabilities	38,915,977	25,875,498	13,040,479	50.40%
Total Liabilities	52,964,014	36,422,938	16,541,076	45.41%
Net Assets				
Invested in Capital Assets, net of related debt	148,893,781	115,081,132	33,812,649	29.38%
Restricted – Nonexpendable	14,428,685	13,707,454	721,231	5.26%
Restricted – Expendable	14,674,298	14,201,420	472,878	3.33%
Unrestricted	40,898,382	39,969,625	928,757	2.32%
Total Net Assets	\$ 218,895,146	\$ 182,959,631	\$35,935,515	19.64%

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

A review of the University's Statement of Net Assets at June 30, 2004, and 2003 indicates that the University improved its already strong financial position, with Total Net Assets increasing by \$35.9 million (19.6%) over the previous year.

Total assets of the University increased by \$52.5 million. Net capital assets contributed \$39.8 million of this amount, mostly due to a \$32.8 million net increase in Construction in Progress, and a \$7.6 million increase in Buildings and General Infrastructure.

The \$6.6 million increase in Current Assets is mainly attributable to a \$1.7 million increase in unrestricted current cash and a \$2.6 million increase in restricted current cash related to contract and grant, student loan, and capital improvement activities. In addition, net receivables increased by \$1.8 million largely due to an accounts receivable of \$1.4 million from National Fire Insurance Company of Hartford as partial satisfaction of their responsibility as surety in accordance with the terms of a Performance and Labor and Material Payment Bond they issued to the University for construction of the Central Drive Residence Hall. The \$6.1 million increase in Other Noncurrent Assets resulted primarily from a \$4.8 million increase in endowment investments, \$2.9 million of which was due to favorable market fluctuations.

An increase of \$2 million in amounts payable to vendors for major construction projects contributed to the increase of \$3.5 million in current liabilities. The primary factor in the \$13 million increase in noncurrent liabilities was the issuance of The University of North Carolina System Pool Revenue Bonds, Series 2003A, for construction of a new Student Recreation Center and a softball facility (see Notes 7A and B to the financial statements).

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:

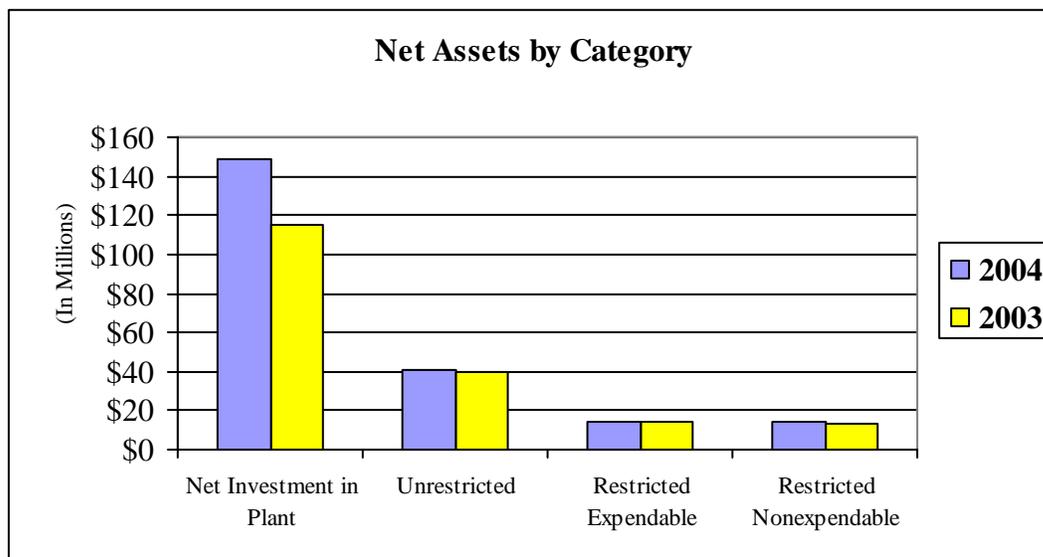
- "Invested in Capital Assets, Net of Related Debt" represents the University's investment in capital assets such as movable equipment, buildings, land, infrastructure, and improvements, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets. At June 30, 2004, \$148.9 million (68%) of the \$218.9 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 \$14.4 million of the \$218.9 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, 2004,

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

expendable net assets totaled \$14.7 million (6.7% of total net assets) and included \$6.5 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 \$40.9 million represent 18.7 % of total net assets. Included in this category at June 30, 2004, was \$1.1 million of funds functioning as endowment.

The following chart displays the contribution of each category to the total in both 2004 and 2003:



Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and the expenses incurred during the year. Activities are reported as either operating or nonoperating. Given a public university's dependency on revenues such as State appropriations, gifts, and investment income, which are prescribed by GASB as nonoperating revenues, operating expenses will exceed operating revenues, resulting in an operating loss. Net nonoperating revenues 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, the bookstore, and other enterprises. Operating expenses are the costs incurred to acquire or produce the goods and services provided and to conduct the affairs of the institution.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

Capital grants and gifts are considered neither operating nor nonoperating revenues and are reported 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, 2004, compared with that of 2003.

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

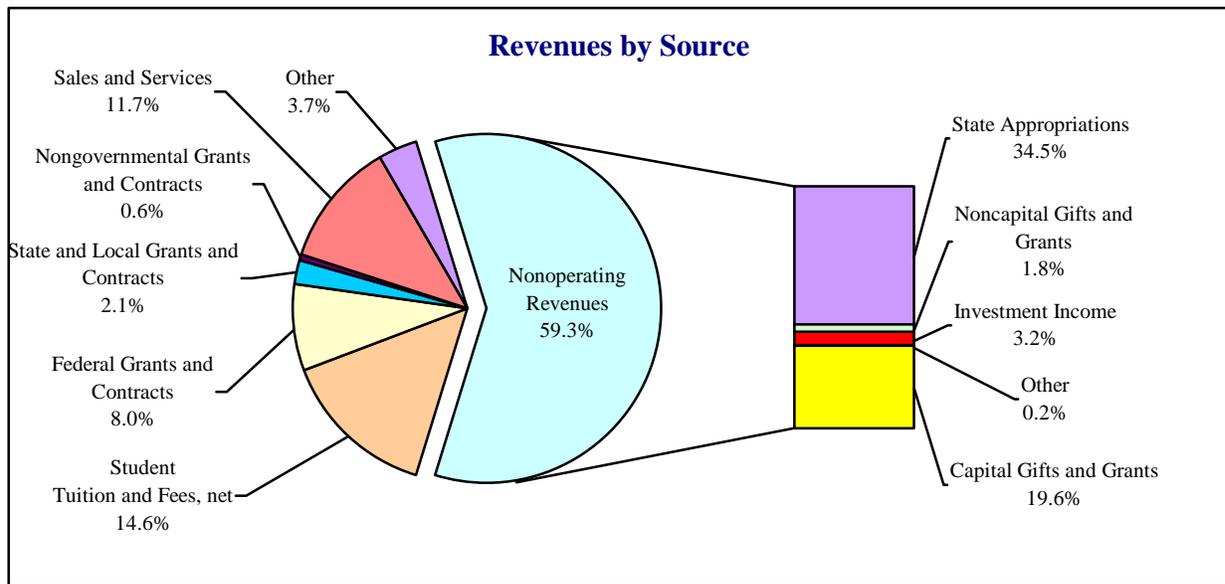
	<u>2004</u>	<u>2003</u>	<u>\$ Change</u>	<u>% Change</u>
Operating Revenues				
Student Tuition and Fees, Net	\$ 22,401,622	\$ 19,794,031	2,607,591	13.17%
Grants and Contracts	16,404,243	11,190,031	5,214,212	46.60%
Sales and Services, Net	18,047,805	16,310,754	1,737,051	10.65%
Other Operating Revenues	<u>5,725,464</u>	<u>688,604</u>	<u>5,036,860</u>	<u>731.46%</u>
Total Operating Revenues	62,579,134	47,983,420	14,595,714	30.42%
Operating Expenses	<u>116,559,161</u>	<u>102,496,717</u>	<u>14,062,444</u>	<u>13.72%</u>
Operating Income/(Loss)	<u>(53,980,027)</u>	<u>(54,513,297)</u>	533,270	0.98%
Nonoperating Revenues (Expenses)				
State Appropriations	53,144,187	51,698,881	1,445,306	2.80%
Gifts and Grants	2,767,827	1,585,404	1,182,423	74.58%
Investment Income (net of investment expense)	4,857,098	3,057,925	1,799,173	58.84%
Other Nonoperating Revenues and Expenses	<u>(1,324,914)</u>	<u>(657,327)</u>	<u>(667,587)</u>	<u>101.56%</u>
Net Nonoperating Revenues	<u>59,444,198</u>	<u>55,684,883</u>	<u>3,759,315</u>	<u>6.75%</u>
Income Before Other Revenues, Expenses, Gains, or Losses	<u>5,464,171</u>	<u>1,171,586</u>	<u>4,292,585</u>	<u>366.39%</u>
Capital Grants	30,180,854	19,208,470	10,972,384	57.12%
Capital Gifts	909	110,000	(109,091)	-99.17%
Additions to Permanent Endowments	<u>289,581</u>	<u>203,499</u>	<u>86,082</u>	<u>42.30%</u>
Total Other Revenue	<u>30,471,344</u>	<u>19,521,969</u>	<u>10,949,375</u>	<u>56.09%</u>
Change in Net Assets	<u>35,935,515</u>	<u>20,693,555</u>	<u>15,241,960</u>	<u>73.66%</u>
Beginning Net Assets, as restated	<u>182,959,631</u>	<u>162,266,076</u>	<u>20,693,555</u>	<u>12.75%</u>
Ending Net Assets	<u>\$218,895,146</u>	<u>\$182,959,631</u>	<u>\$35,935,515</u>	<u>19.64%</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The Statement of Revenues, Expenses, and Changes in Net Assets reflects a positive year ending June 30, 2004, with an increase in net assets of \$35.9 million, a substantial rise from last year's increase of \$20.7 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, along with State appropriations, investment income, and federal, State, and private grants and contracts. The University has sought and will continue to seek funding from available sources that are consistent with its mission and will continue prudently to manage the financial resources realized from these efforts in order to supplement tuition revenues and fund its operating activities.

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, 2004. 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 2004 totaled \$62.6 million, compared with \$48 million for 2003. The most significant source of operating revenue for the University was tuition and fees (net of scholarship allowances) totaling \$22.4 million at June 30, 2004, and \$19.8 million at June 30, 2003. This 13% increase primarily reflects an overall increase in tuition and fee rates of approximately 7% for in-State students and 5% for out-of-State students, as well as a 7.5% growth in number of students. Other major revenue sources in 2004 include sales and services of \$18 million (\$16.3 million in 2003) and grants and contracts of \$16.4 million (\$11.2 million in 2003). Approximately \$1.4 million of the \$1.7 million increase in sales and

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

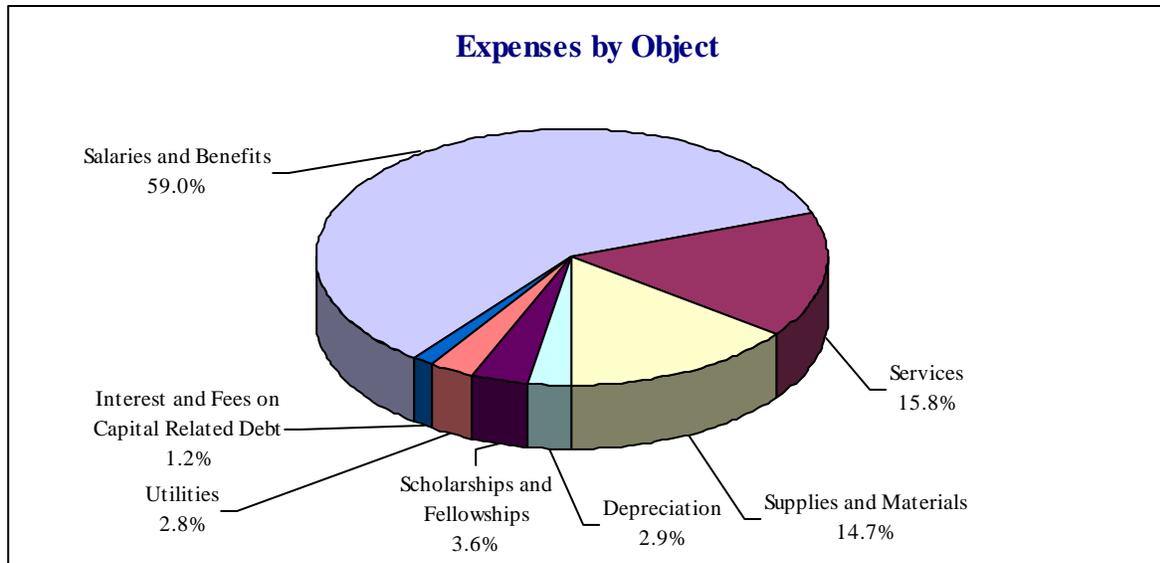
services resulted from increases in revenue from residential life and dining services. Rate increases of approximately 7% in housing services and 5% in student meal plans along with increased occupancy in the residence halls were responsible for these revenue increases. The \$5.2 million increase in grants and contracts revenue is primarily attributable to \$3.7 million in federal grants revenue from a US Department of Defense grant. The substantial increase of over \$5 million in Other Operating Revenues is due to \$4.9 million of surety payments remitted to the University by National Fire Insurance Company of Hartford for construction work necessary to complete the Central Drive Residence Hall after the original contractor was declared to be in default.

Like most public institutions, the University receives significant nonoperating revenues which offset the loss generated by operating activities. During 2004, the operating loss of \$54 million was offset by \$59.4 million in net nonoperating revenues. The primary source of this revenue is State appropriations, which totaled \$53.1 million and accounted for 35% of total revenue. Other major sources of nonoperating revenue in 2004 are investment income of \$4.9 million and noncapital gifts and grants of \$2.8 million. An increase in investment income in 2004 of \$1.8 million was attributable to favorable market fluctuations.

Capital grants totaled \$30.2 million and \$19.2 million for the years ended June 30, 2004, and June 30, 2003, respectively. The primary sources of this revenue are State general obligation bond proceeds of \$27.9 million in 2004 (\$16.6 million in 2003) and federal capital grant revenue of \$2 million in 2004 (\$2.6 million in 2003). 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 \$11 million in State capital grants in 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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



Operating expenses increased \$14.1 million for the fiscal year ending June 30, 2004. Operating expenses are mainly attributable to salaries and benefits for the faculty and staff of the University. Of the \$116.6 million in operating expenses, \$69.6 million (60%) was used for this purpose in 2004. 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 3.3% and supplies and materials that increased by 3.3%. A \$5.5 million increase in supplies and materials in 2004 was mostly due to equipment purchases funded as part of construction or sponsored research projects that did not meet the University's capitalization criteria.

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, 2004 and 2003, is as follows:

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Cash Flows

	<u>2004</u>	<u>2003</u>
Cash provided (used) by:		
Operating Activities	\$ (50,512,804)	\$ (49,715,433)
Noncapital Financing Activities	56,026,252	53,986,570
Capital and Related Financing Activities	(2,404,120)	(20,803)
Investing Activities	<u>1,248,497</u>	<u>2,665,801</u>
Net Change in Cash	4,357,825	6,916,135
Cash, beginning of year	<u>61,999,281</u>	<u>55,083,146</u>
Cash, end of year	<u><u>\$ 66,357,106</u></u>	<u><u>\$ 61,999,281</u></u>

Net cash used in operating activities should be viewed in conjunction with net cash provided by noncapital financing activities. State appropriations and gifts 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 also to consider these noncapital financing activities, which support operating expenses. Net cash flow provided by these two activities amounted to \$5.5 million in the year ended June 30, 2004.

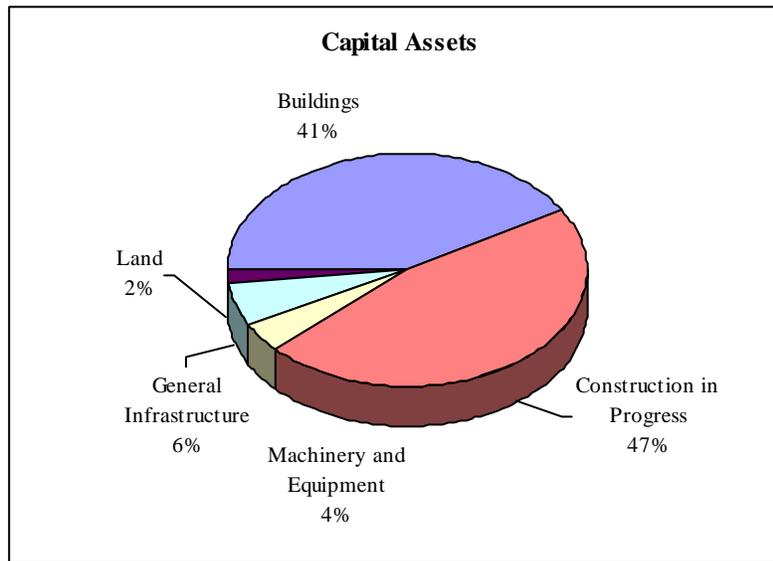
Net cash provided by investing activities of \$1.2 million reflects receipts from sales and maturities of investments less disbursements for purchases of investments. Unrealized losses and gains from the change in fair value of investments are non-cash transactions for valuation purposes only, and do not affect cash flows from investing activities.

The University's cash and cash equivalents increased \$4.4 million during 2004 due to the positive flow of funds provided by noncapital financing and investing activities.

Capital Asset and Debt Administration

At June 30, 2004, the University had approximately \$220.6 million invested in capital assets, net of accumulated depreciation of \$55.8 million. Depreciation charges for the current year totaled \$3.4 million. The following chart displays the relationship of each category to capital assets as a whole.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)



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 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.

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

In November, the University celebrated the completion of \$1.8 million in renovations on the Bird Building, which was redesigned for use as a state-of-the-art Student Health Center and Counseling and Psychological Services office, and \$5.2 million in renovations on the McKee Building, which included modernizing classrooms and faculty offices, improving access and eliminating water intrusion on the ground floor.

The new \$30 million Fine and Performing Arts Center, a new 300-bed residence hall on Central Drive, and renovations to Breese Gymnasium are nearing completion. Renovations have begun or are planned for Forsyth, Graham, Killian, Killian Annex, and Stillwell buildings. Work has begun on improving traffic conditions by relocating Centennial Drive and creating a pedestrian-only quadrangle between Walker Residence Hall and Dodson Cafeteria.

Construction projects funded from a variety of other sources include new facilities for a Center for Applied Technology (formerly called the Regional Labor Force Development Center), which opened in November 2003; expanded athletic facilities including the new

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Jordan-Phillips Fieldhouse and the stadium's west side stands; and a \$6.8 million expansion of the A.K. Hinds University Center, which was completed with a grand opening in January 2004. The UC expansion features a 160-seat multipurpose room, 170-seat auditorium for movies and lectures, a new student mail center, an expanded food court, and 3,500 square feet of retail space for the new Catamount Clothing and Gift Store. Currently in design are a new Student Recreation Center and a planned Hospitality Management Studies Center with total combined budgets of \$23 million.

The University's financial statements indicate \$27,434,000 in bonds payable, \$2,080,239 in notes payable, and \$27,643 in capital leases payable at June 30, 2004. Total annual debt service payments were \$2.7 million in 2004, compared to \$2.1 million in 2003.

During the fiscal year ending June 30, 2004, the University participated in the issuance of The University of North Carolina System Pool Revenue Bonds, Series 2003A. Western Carolina University borrowed \$13,120,000 as part of this issue for the construction of a new Student Recreation Center (\$11,610,000) and for construction of a softball facility (\$1,510,000).

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 fourth straight year - over 4,911 (up from 4,600 last year) applications were processed. Just over 76.2% (up from 73.5% last year) of these students were admitted. Of those who were admitted, 1,578 (up from 1,494) freshmen enrolled to begin the Fall 2004 semester, and their average SAT scores increased to 1027 (up from 1023 last year), significantly above the State average of 1006 and above the national average of 1026.

In an effort to boost enrollment and to improve the quality of education available at Western, the University continues its emphasis on new, career-focused programs of study. Programs added during FY 2003-2004 included programs in athletic training and Cherokee studies, a joint degree program in electrical engineering with UNC Charlotte, and a new concentration in forensic anthropology - all at the undergraduate level, and a new master's degree program in fine arts.

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 2004 reaching nearly 8,400 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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

In addition to recruiting record numbers of students, the University is making a substantial effort to enhance persistence to graduation. Nearly 74% of Fall 2003 freshmen enrolled for Fall 2004, up five percentage points from the previous year. It is important to note that, while the average graduation rate for all students is 49%, the graduation rate for student-athletes who enrolled in the '97-'98 academic year was 59%. 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. In the face of a national economic downturn and State budget constraints, Western experienced an increase of nearly \$1 million (68.3%) in noncapital gifts in 2004 with the overall number of donors remaining stable. Though some indicators suggest that the overall State of the economy will continue to improve moderately in the months to come, local, State and national economies remain susceptible to political and market uncertainties. The economic pressures affecting donors, as well as investment returns, will continue to affect the level of support the University receives from corporate and individual giving.

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

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

Western Carolina University
Statement of Net Assets
June 30, 2004

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$	38,005,844.94
Restricted Cash and Cash Equivalents		10,983,540.23
Restricted Short-Term Investments		530,616.69
Receivables, Net (Note 4)		4,598,695.54
Inventories		3,016,273.11
Notes Receivable, Net (Note 4)		1,036,192.81

Total Current Assets 58,171,163.32

Noncurrent Assets:

Restricted Cash and Cash Equivalents		17,367,720.70
Restricted Due from Primary Government		3,923,467.72
Endowment Investments		20,882,364.36
Other Long-Term Investments		1,655,872.50
Notes Receivable, Net (Note 4)		5,005,606.61
Capital Assets - Nondepreciable (Note 5)		79,925,095.09
Capital Assets - Depreciable, Net (Note 5)		84,927,870.31

Total Noncurrent Assets 213,687,997.29

Total Assets 271,859,160.61

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)		10,132,688.08
Due to Primary Government		47,761.34
Deferred Revenue		1,775,448.58
Interest Payable		331,715.31
Long-Term Liabilities - Current Portion (Note 7)		1,760,424.08

Total Current Liabilities 14,048,037.39

Noncurrent Liabilities:

Deposits Payable		231,673.70
Funds Held for Others		351,317.99
U. S. Government Grants Refundable		5,531,072.77
Long-Term Liabilities (Note 7)		32,801,912.54

Total Noncurrent Liabilities 38,915,977.00

Total Liabilities 52,964,014.39

Western Carolina University**Statement of Net Assets****June 30, 2004****Exhibit A-1****Page 2****NET ASSETS**

Invested in Capital Assets, Net of Related Debt	148,893,781.30
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	6,963,660.48
Endowed Professorships	6,570,683.83
Loans	894,341.00
Expendable:	
Scholarships and Fellowships	6,359,793.98
Research	116,932.27
Endowed Professorships	863,086.46
Departmental Uses	3,623,651.24
Loans	416,981.98
Capital Projects	162,261.52
Debt Service	3,131,590.55
Unrestricted	40,898,381.61
Total Net Assets	\$ 218,895,146.22

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, 2004

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 22,401,622.22
Federal Grants and Contracts	12,340,106.67
State and Local Grants and Contracts	3,157,740.52
Nongovernmental Grants and Contracts	906,396.36
Sales and Services, Net (Note 9)	18,047,804.88
Interest Earnings on Loans	12,592.77
Other Operating Revenues	5,712,870.67
Total Operating Revenues	62,579,134.09

EXPENSES

Operating Expenses:

Salaries and Benefits	69,557,805.27
Supplies and Materials	17,379,569.26
Services	18,683,029.75
Scholarships and Fellowships	4,211,892.59
Utilities	3,329,828.62
Depreciation	3,397,035.79
Total Operating Expenses	116,559,161.28

Operating Loss (53,980,027.19)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	53,144,187.17
Noncapital Grants	424,400.66
Noncapital Gifts, Net (Note 9)	2,343,426.30
Investment Income (Net of Investment Expense of \$45,250.24)	4,857,097.60
Interest and Fees on Capital Asset-Related Debt	(1,416,600.31)
Other Nonoperating Revenues	91,686.70
Net Nonoperating Revenues	59,444,198.12

Income Before Other Revenues, Expenses, Gains, or Losses 5,464,170.93

Capital Grants	30,180,853.87
Capital Gifts, Net (Note 9)	909.25
Additions to Endowments	289,581.45
Increase in Net Assets	35,935,515.50

NET ASSETS

Net Assets - July 1, 2003	182,959,630.72
Net Assets - June 30, 2004	\$ 218,895,146.22

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, 2004

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 54,890,016.46
Payments to Employees and Fringe Benefits	(68,680,390.48)
Payments to Vendors and Suppliers	(37,338,005.63)
Payments for Scholarships and Fellowships	(4,211,892.59)
Loans Issued	(1,691,742.36)
Collection of Loans	768,813.33
Interest Earned on Loans	22,862.79
Student Deposits Received	1,225,606.66
Student Deposits Returned	(1,206,632.14)
Other Receipts	5,708,559.62
Net Cash Used by Operating Activities	(50,512,804.34)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	53,144,187.17
Noncapital Grants	424,400.66
Noncapital Gifts	1,832,115.25
Additions to Permanent and Term Endowments	289,581.45
William D. Ford Direct Lending Receipts	19,683,865.00
William D. Ford Direct Lending Disbursements	(19,682,236.00)
Related Activity Agency Receipts	438,319.11
Related Activity Agency Disbursements	(195,666.71)
Other Receipts	91,686.70
Net Cash Provided by Noncapital Financing Activities	56,026,252.63

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	13,127,179.00
Capital Grants	30,379,884.10
Capital Gifts	909.25
Acquisition and Construction of Capital Assets	(43,310,182.14)
Principal Paid on Capital Debt and Leases	(1,314,623.41)
Interest and Fees Paid on Capital Debt and Leases	(1,287,287.13)
Net Cash Used by Capital Financing and Related Financing Activities	(2,404,120.33)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	1,796,054.39
Investment Income	2,382,294.22
Purchase of Investments and Related Fees	(2,929,851.34)
Net Cash Provided by Investing Activities	1,248,497.27

Net Increase in Cash and Cash Equivalents	4,357,825.23
Cash and Cash Equivalents - July 1, 2003	61,999,280.64
Cash and Cash Equivalents - June 30, 2004	\$ 66,357,105.87

Western Carolina University**Statement of Cash Flows****For the Fiscal Year Ended June 30, 2004****Exhibit A-3****Page 2****RECONCILIATION OF NET OPERATING REVENUES (EXPENSES)
TO NET CASH USED BY OPERATING ACTIVITIES**

Operating Loss	\$	(53,980,027.19)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		3,397,035.79
Allowances, Write-Offs, and Amortizations		164,684.09
Nonoperating Other Income		11,118.00
Changes in Assets and Liabilities:		
Receivables (Net)		(2,603,119.00)
Inventories		(333,741.63)
Accounts Payable and Accrued Liabilities		2,714,255.38
Due to Primary Government		11,361.77
Deferred Revenue		139,301.76
Compensated Absences		870,281.20
Deposits Payable		18,974.52
Note Principle Repayments		768,813.33
Notes Issued		(1,691,742.36)
Net Cash Used by Operating Activities	\$	<u>(50,512,804.34)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	\$	38,005,844.94
Restricted Cash and Cash Equivalents		10,983,540.23
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		17,367,720.70
Total Cash and Cash Equivalents - June 30, 2004	\$	<u>66,357,105.87</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$	591,955.00
Change in Fair Value of Investments		3,224,370.62
Reinvested Distributions		392,416.17

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

Western Carolina University Research and Development Corporation			
Statement of Financial Position			
June 30, 2004			Exhibit B-1
ASSETS			
Cash and Cash Equivalents		\$	4,800,266.00
Deferred Charges			664,524.00
Property and Equipment, Net			9,238,750.00
Total Assets			<u>14,703,540.00</u>
LIABILITIES			
Accounts Payable and Accrued Expenses			2,262,185.00
Interest Payable			369,458.00
Bonds Payable			12,090,000.00
Total Liabilities			<u>14,721,643.00</u>
NET ASSETS			
Unrestricted			(18,103.00)
Total Net Assets		\$	<u>(18,103.00)</u>
See Note 1 in the Notes to the Financial Statements			

<i>Western Carolina University Research and Development Corporation</i>				
<i>Statement of Activities</i>				
<i>For the Fiscal Year Ended June 30, 2004</i>				<i>Exhibit B-2</i>
EXPENSES				
Operating Expenses:				
	Trustee Fees		\$	3,000.00
	Amortization of Certificate Issuance Costs			15,103.00
	Total Expenses			18,103.00
	Change in Net Assets			(18,103.00)
NET ASSETS				
	Net Assets - End of Year		\$	(18,103.00)
	See Note 1 in the Notes to the Financial Statements			

WESTERN CAROLINA UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

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. The University's component units are either blended or discretely presented in the University's financial statements. The blended component unit, although legally separate, is in substance, part of the University's operations and therefore, is reported as if it were part of the University. The discretely presented component unit's financial data is reported in separate financial statements because of its use of different GAAP reporting models and to emphasize its legal separateness.

Blended Component Unit – 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 31-member board consisting of 4 ex officio directors and 27 appointed 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 directors of the Foundation are appointed by the members of the Western Carolina University Board of Trustees and the Foundation's sole purpose is to benefit Western Carolina University, its financial statements have been blended with those of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Separate financial statements for the Foundation may be obtained from the University Controller's Office, HFR 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.

Discretely Presented Component Unit – The Western Carolina University Research and Development Corporation is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University.

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

Separate financial statements for the Corporation may be obtained from the University Controller's Office, HFR 317, Cullowhee, NC 28723, or by calling 828-227-7308.

- 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.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, 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, 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.

Real estate not held by the 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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.

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 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, annuities 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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 bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002 and as of July 1, 2003. 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 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 \$66,326,951.87. At year-end, cash on hand was \$30,154.00. The University's portion of the State Treasurer's Investment Pool was \$64,720,826.16. 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 \$1,606,125.71 and the bank balance was \$2,039,578.43. Of the bank balance, \$109,225.00 was covered by federal depository insurance and \$1,930,353.43 was collateralized under the pooling method.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds in the same manner as the State Treasurer is required to invest, as previously discussed.

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

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 with any lawful condition placed by the donor upon that part of the Endowment Fund to be invested.

Investments of the University's component unit, the 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 pool:

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, 2004 is presented below:

Long-Term Investment Pool

	Total
Investments Not Categorized:	
Mutual Funds	22,051,013.86

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Non-Pooled Investments

	Fair Value			Total
	Risk Category			
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 530,616.69	\$ 0.00	\$ 0.00	\$ 530,616.69
Corporate Bonds	14,233.13			14,233.13
Corporate Stocks	30,417.00			30,417.00
Total Categorized Investments	<u>\$ 575,266.82</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	575,266.82
Investments Not Categorized:				
Real Estate				32,500.00
Limited Partnerships				393,441.58
Collections				16,631.29
Total Investments Not Categorized				<u>442,572.87</u>
Total Non-Pooled Investments				<u>\$ 1,017,839.69</u>

Total Investments

	Fair Value			Total
	Risk Category			
	1	2	3	
Total Categorized Investments	<u>\$ 575,266.82</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	\$ 575,266.82
Total Investments Not Categorized				
Pooled Investments				22,051,013.86
Non Pooled Investments				442,572.87
Total Investments Not Categorized				<u>22,493,586.73</u>
Total Investments				<u>\$ 23,068,853.55</u>

NOTE 3 - ENDOWMENT INVESTMENTS

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

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). The current spending policy for

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the University's pooled endowment funds provides 4.5% 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, 2004, net appreciation of \$9,745,706.16 was available to be spent, of which \$6,527,554.06 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2004 were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 1,191,645.71	\$ 833,337.63	\$ 358,308.08
Accounts	2,429,432.48		2,429,432.48
Intergovernmental	1,230,990.00		1,230,990.00
Pledges	138,984.06	11,242.84	127,741.22
Investment Earnings	58.69		58.69
Interest on Loans	120,109.40		120,109.40
Other	332,055.67		332,055.67
Total Current Receivables	<u>\$ 5,443,276.01</u>	<u>\$ 844,580.47</u>	<u>\$ 4,598,695.54</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 985,734.18	\$ 0.00	\$ 985,734.18
Institutional Student Loan Programs	94,378.53	43,919.90	50,458.63
Total Notes Receivable - Current	<u>\$ 1,080,112.71</u>	<u>\$ 43,919.90</u>	<u>\$ 1,036,192.81</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 5,898,144.93	\$ 898,478.00	\$ 4,999,666.93
Institutional Student Loan Programs	5,939.68		5,939.68
Total Notes Receivable - Noncurrent	<u>\$ 5,904,084.61</u>	<u>\$ 898,478.00</u>	<u>\$ 5,005,606.61</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, 2004, is presented as follows:

	Balance July 1, 2003	Adjustments	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:					
Land	\$ 2,988,060.30	\$ 0.00	\$ 0.00	\$ 0.00	\$ 2,988,060.30
Art, Literature, and Artifacts	105,433.00				105,433.00
Construction in Progress	44,027,854.24	(7,444,578.66)	40,248,326.21		76,831,601.79
Total Capital Assets, Nondepreciable	47,121,347.54	(7,444,578.66)	40,248,326.21		79,925,095.09
Capital Assets, Depreciable:					
Buildings	105,253,483.10	7,444,578.66	77,500.00		112,775,561.76
Machinery and Equipment	10,606,463.72		2,729,635.76	452,462.07	12,883,637.41
Art, Literature, and Artifacts	103,188.00				103,188.00
General Infrastructure	14,831,148.34		120,618.50	10,724.61	14,941,042.23
Intangible	1.00				1.00
Total Capital Assets, Depreciable	130,794,284.16	7,444,578.66	2,927,754.26	463,186.68	140,703,430.40
Less Accumulated Depreciation/Amortization for:					
Buildings	42,427,224.25		2,125,021.56		44,552,245.81
Machinery and Equipment	5,409,116.59		852,922.74	452,462.07	5,809,577.26
Art, Literature, and Artifacts	82,717.07		2,134.02		84,851.09
General Infrastructure	4,922,653.07		416,957.47	10,724.61	5,328,885.93
Total Accumulated Depreciation	52,841,710.98		3,397,035.79	463,186.68	55,775,560.09
Total Capital Assets, Depreciable, Net	77,952,573.18	7,444,578.66	(469,281.53)		84,927,870.31
Capital Assets, Net	\$ 125,073,920.72	\$ 0.00	\$ 39,779,044.68	\$ 0.00	\$ 164,852,965.40

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2004 were as follows:

	Amount
Accounts Payable	\$ 6,078,663.82
Accrued Payroll	933,258.54
Contract Retainage	1,480,021.81
Other	1,640,743.91
Total Accounts Payable and Accrued Liabilities	\$ 10,132,688.08

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, 2004 is presented as follows:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	\$ 15,299,000.00	\$ 13,120,000.00	\$ 985,000.00	\$ 27,434,000.00	\$ 920,000.00
Notes Payable	2,333,080.42		252,841.28	2,080,239.14	268,259.57
Capital Leases Payable	32,951.11	7,179.00	12,487.03	27,643.08	13,860.67
Compensated Absences	3,494,484.28	4,503,602.85	3,633,321.65	4,364,765.48	472,259.00
Annuity Payable		719,983.54	64,294.62	655,688.92	86,044.84
Total Long-Term Liabilities	\$ 21,159,515.81	\$ 18,350,765.39	\$ 4,947,944.58	\$ 34,562,336.62	\$ 1,760,424.08

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

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 6/30/2004	Principal Outstanding 6/30/2004
Dormitory System						
Dormitory System Revenue Bonds - Series D		3.0	5/1/2007	\$ 2,394,000.00	\$ 2,095,000.00	\$ 299,000.00
UNC System Pool Revenue Bonds	(A)	3.25-5.25	10/1/2013	465,000.00	120,000.00	345,000.00
UNC System Pool Revenue Bonds	(B)	5.00-5.50	10/1/2010	1,370,000.00	225,000.00	1,145,000.00
Total Dormitory System				4,229,000.00	2,440,000.00	1,789,000.00
Student Center						
UNC System Pool Revenue Bonds	(B)	5.00-5.75	10/1/2025	5,355,000.00	335,000.00	5,020,000.00
Faculty Housing						
Faculty Housing Revenue Bonds		3.0	11/1/2007	280,000.00	240,000.00	40,000.00
Stadium System						
UNC System Pool Revenue Bonds	(C)	4.0-5.375	4/1/2027	8,070,000.00	250,000.00	7,820,000.00
UNC System Pool Revenue Bonds	(D)	2.0-5.25	4/1/2028	1,510,000.00	40,000.00	1,470,000.00
Total Stadium System				9,580,000.00	290,000.00	9,290,000.00
Student Recreation Center						
UNC System Pool Revenue Bonds	(D)	2.0-5.25	4/1/2028	11,610,000.00	315,000.00	11,295,000.00
Total Bonds Payable (principal only)				\$ 31,054,000.00	\$ 3,620,000.00	\$ 27,434,000.00

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

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

(C) The University of North Carolina System Pool Revenue Bonds, Series 2002A

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. 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 6/30/2004	Principal Outstanding 6/30/2004
UC Renovation	First Union National	6.18	12/1/2010	\$ 3,800,000.00	\$ 1,719,760.86	\$ 2,080,239.14
Purchase Automobile	Ford Motor Credit	3.9	8/6/2003	25,551.66	25,551.66	
Total Notes Payable				\$ 3,825,551.66	\$ 1,745,312.52	\$ 2,080,239.14

D. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2004 are as follows:

Fiscal Year	Annual Requirements			
	Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2005	\$ 920,000.00	\$ 1,302,306.28	\$ 268,259.57	\$ 120,987.67
2006	950,000.00	1,270,131.28	285,315.74	103,931.50
2007	984,000.00	1,236,106.28	303,456.37	85,790.87
2008	920,000.00	1,197,136.28	322,750.39	66,496.85
2009	950,000.00	1,159,411.28	343,271.15	45,976.09
2010-2014	4,830,000.00	5,128,959.46	557,185.92	26,684.94
2015-2019	5,425,000.00	3,910,657.54		
2020-2024	6,940,000.00	2,401,551.27		
2025-2029	5,515,000.00	589,700.00		
Total Requirements	\$ 27,434,000.00	\$ 18,195,959.67	\$ 2,080,239.14	\$ 449,867.92

E. Charitable Gift Annuity Split Interest Agreement – In October 2003, joint donors entered into a charitable gift annuity agreement with the Foundation. Under the terms of the agreement, the Foundation received property with a fair market value of \$1,082,315.06. In consideration of this property transfer, the annuitants will receive for their joint lives, an annual annuity of \$86,044.80, payable in quarterly installments. The obligation of the Foundation to make annuity payments, if any remain, shall terminate upon the deaths of the donors. The value of the annuity liability at the date of the contribution was \$597,400.00. Noncapital gift revenue was recorded in the amount of \$484,915.07. Based on the donors' life expectancy and an expected 3.146% rate of return, the liability at June 30, 2004 was adjusted to its present value as follows:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

		Amount
Value of annuity liability at date of contribution	\$	597,400.00
Interest earned on investment		23,533.65
Quarterly payments		(64,294.62)
Present value adjustment at year end		99,049.89
Value of annuity liability at June 30, 2004	\$	655,688.92

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, 2004:

<u>Fiscal Year</u>		Amount
2005	\$	14,346.09
2006		7,967.40
2007		5,841.09
Total Minimum Lease Payments		28,154.58
Amount Representing Interest (7.48% Rate of Interest)		511.50
Present Value of Future Lease Payments	\$	27,643.08

Machinery and equipment acquired under capital lease amounted to \$54,642.25 at June 30, 2004.

- B. Operating Lease Obligations** – The University entered into operating leases for automobiles and housing. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2004:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Fiscal Year	Amount
2005	\$ 1,001,654.67
2006	1,024,429.15
2007	1,007,654.57
2008	991,419.12
2009	969,627.82
2010-2014	4,687,200.00
2015-2019	4,687,200.00
2020-2024	4,687,200.00
2025-2029	4,687,200.00
Total Minimum Lease Payments	\$ 23,743,585.33

Rental expense for all operating leases during the year was \$174,566,74.

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	Revenues Pledged as Security for Debt
Operating Revenues:						
Student Tuition and Fees	\$ 26,813,896.65	\$ 21,324.29	\$ 3,967,647.41	\$ 423,302.73	\$ 22,401,622.22	\$ 545,633.66 (A)
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 6,972,683.06	\$ 257,887.19	\$ 1,033,109.22	\$ 108,166.47	\$ 5,573,520.18	\$ 5,573,520.18 (B)
Dining	6,825,467.50	606,322.70	933,339.39	54,697.45	5,231,107.96	
Book Rental	1,053,612.27	3,383.81	142,394.94	57,781.70	850,051.82	
Bookstore	1,686,921.58	138,800.63		2,467.53	1,545,653.42	
Print Shop	558,064.08	203,980.24			354,083.84	
Athletic	838,245.38				838,245.38	838,245.38 (C)
Other	997,960.92	24,846.45		760.94	972,353.53	67,644.02 (D)
and Related Activities	2,214,342.54	1,309,529.85		583.20	904,229.49	
Independent Operations	1,851,440.91	72,881.65			1,778,559.26	
Total Sales and Services	\$ 22,998,738.24	\$ 2,617,632.52	\$ 2,108,843.55	\$ 224,457.29	\$ 18,047,804.88	\$ 6,479,409.58
Nonoperating - Noncapital Gifts	\$ 2,343,426.30	\$ 0.00	\$ 0.00	\$ 0.00	\$ 2,343,426.30	\$ 0.00
Capital Gifts	\$ 909.25	\$ 0.00	\$ 0.00	\$ 0.00	\$ 909.25	\$ 0.00

Revenue Bonds Secured by Pledged Revenues:

(A) Housing and Student Center System, (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	\$ 33,820,274.90	\$ 1,336,478.31	\$ 2,595,916.96	\$ 11,431.18	\$ 2,210.19	\$ 0.00	\$ 37,766,311.54
Research	873,956.28	1,721,683.57	869,914.11	2,476.05	18,402.32		3,486,432.33
Public Service	6,563,970.55	722,341.84	2,285,665.12	129,662.47	56,698.82		9,758,338.80
Academic Support	5,274,824.83	1,391,257.13	607,678.18		992.25		7,274,752.39
Student Services	2,782,027.39	136,259.75	922,974.97				3,841,262.11
Institutional Support	8,206,565.52	1,154,042.57	2,359,075.07	192,464.97	560.94		11,912,709.07
Operations and Maintenance of Plant	4,826,117.80	5,374,866.65	325,548.53		2,132,410.59		12,658,943.57
Student Financial Aid		1,599.65	11,854.97	3,002,202.35			3,015,656.97
Auxiliary Operations	7,037,834.73	4,229,367.40	8,555,351.85	873,655.57	1,118,553.51		21,814,763.06
Independent Operations	172,233.27	1,311,672.39	149,049.99				1,632,955.65
Depreciation						3,397,035.79	3,397,035.79
Total Operating Expenses	<u>\$ 69,557,805.27</u>	<u>\$ 17,379,569.26</u>	<u>\$ 18,683,029.75</u>	<u>\$ 4,211,892.59</u>	<u>\$ 3,329,828.62</u>	<u>\$ 3,397,035.79</u>	<u>\$ 116,559,161.28</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, 2004, these rates were set at .22% of covered payroll for employers and 6% of covered payroll for members.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended June 30, 2004, the University had a total payroll of \$57,533,707.46, of which \$29,924,315.57 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$1,795,458.93 and \$65,833.49, respectively. The University made one hundred percent of its annual required contributions for the years ended June 30, 2004, 2003, and 2002, which were \$65,833.49, \$0.00, and \$555,006.36, 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, 2004, 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

For the year ended June 30, 2004, the University had a total payroll of \$57,533,707.46, of which \$20,702,241.74 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$1,242,134.50 and \$1,416,033.34, 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 \$55,269.48 for the year ended June 30, 2004.

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, 2004 were \$21,109.67. The voluntary contributions by employees amounted to \$331,286.00 for the year ended June 30, 2004.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$905,398.50 for the year ended June 30, 2004.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2% 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, 2004, the University's total contribution to the Plan was \$1,620,049.83. 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. Employer contributions are established in the Appropriations Bill by the General Assembly. The University was not required to contribute to the DIPNC for the fiscal year ended June 30, 2004. 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*.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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. Except for a reduction in the public officers' and employees' liability insurance from \$11,000,000 to \$5,000,000, there have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$5,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to 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 buildings that covers windstorm or hail and "all risk" for selected contents such as high value equipment, computers, and fine art.

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses occurring in-State are \$500,000 per claim and \$5,000,000 per occurrence and out-of-State are \$1,000,000 per claim and \$5,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

students participating in University athletic events, boiler and machinery coverage, general liability, and various other commercial applications. These coverages were affected and placed by the North Carolina Department of Insurance through the State's agent of record.

University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

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

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. There were no employer contributions required 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 \$16,236,424.26 and on other purchases were \$1,245,897.73 at June 30, 2004.
- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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 of \$45,027,219.00 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

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

The Development Foundation of the North Carolina Center for the Advancement of Teaching, Inc., was incorporated in North Carolina on January 31, 1994, for the purpose of supporting the programs of, and providing supplemental funding for, the North Carolina Center for the Advancement of Teaching. This support approximated \$86,684.03 for the year ended June 30, 2004.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

The Highlands Biological Foundation, Inc., was incorporated in North Carolina on January July 21, 1930, for the purpose of supporting through grants and scholarships the activities of the Highlands Biological Station. This support approximated \$61,662.90 for the year ended June 30, 2004.

NOTE 16 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2004, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

NOTE 17 - SUBSEQUENT EVENTS

On August 20, 2004, the Foundation purchased land identified as the "Killian Tract" at a contract price of \$900,000. This property is located in Cullowhee, North Carolina. It is the intent of the Foundation to sell this property to the State of North Carolina within a three-month period.

Western Carolina University
Schedule of General Obligation Bond Project Authorizations,
Budgets, and Expenditures
For Project-to-Date as of June 30, 2004

Schedule 1

Capital Improvement Projects	Original Projected Start Date	Revised/ Actual Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Original Expected Completion Date	Revised/ Actual Completion Date
Projects Started									
McKee and Bird Renovations (3003 and 304)	Jun 2001	Jun 2001	\$ 6,769,890.00	\$	\$ 6,769,890.00	\$ 5,937,205.00	87.70%	Jul 2003	Jul 2004
New Student Housing (307)	May 2001	Jan 2001	14,444,370.00	250,000.00	14,694,370.00	13,680,692.00	93.10%	Oct 2003	Aug 2004
Breese Gym Conversion (306)	Nov 2001	Nov 2001	1,258,235.00		1,258,235.00	903,122.00	71.78%	Aug 2003	Aug 2004
Chiller Replacement and Retrofit (308)	Apr 2001	Apr 2001	1,060,120.00		1,060,120.00	492,371.00	46.44%	Apr 2004	Sep 2004
Humanities and Fine Arts (301 and 315)	Jan 2001	Jan 2001	26,618,109.00	2,611,056.00	29,229,165.00	24,899,471.00	85.19%	Jul 2004	Feb 2005
Student Health Center Conversion (305)	Mar 2003	Apr 2003	1,792,745.00		1,792,745.00	124,345.00	6.94%	Aug 2005	Dec 2005
Stillwell Lab Renovations (302)	Apr 2003	Apr 2003	16,804,625.00		16,804,625.00	1,017,974.00	6.06%	Dec 2005	Jun 2006
Killian and Killian Annex Renovations (310 and 311)	Jan 2001	Jan 2001	4,442,390.00		4,442,390.00	1,872,579.00	42.15%	Aug 2006	Aug 2006
Steam and Electrical Infrastructure Improvements (309)	Jan 2002	Jan 2002	10,752,050.00	1,385,858.00	12,137,908.00	5,038,888.00	41.51%	Sep 2006	Sep 2006
Forsythe Renovation	Jun 2004	Jun 2004	7,210,800.00		7,210,800.00	364.00	0.01%	Jun 2007	Jun 2007
Land Acquisition (313)	Nov 2003	Nov 2003	3,093,000.00		3,093,000.00	253,888.00	8.21%	Dec 2007	Dec 2007
Technology Infrastructure Expansion (314)	Apr 2003	Apr 2003	4,122,670.00		4,122,670.00	927,238.00	22.49%	Dec 2007	Dec 2007
Reserve for Effective Project Management (350)	Nov 2001	Nov 2001	1,767,740.00		1,767,740.00	551,739.00	31.21%	Dec 2007	Dec 2007
Total All Projects			\$ 100,136,744.00	\$ 4,246,914.00	\$ 104,383,658.00	\$ 55,699,876.00			
<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. 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>									

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Ralph Campbell, Jr.
State Auditor

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

Board of Trustees
Western Carolina University
Cullowhee, North Carolina

We have audited the financial statements of Western Carolina University, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2004, which collectively comprise the University's basic financial statements, and have issued our report thereon dated October 26, 2004. We did not audit the financial statements of Western Carolina University Foundation, which represent 5 percent, 6 percent, and 2 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of the Western Carolina University Research and Development Corporation which represents 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

As discussed in Note 16 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 2004.

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.

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 an opinion 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 over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the

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

design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

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

October 26, 2004

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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.

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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
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Mr. George W. Wooten	Vice Chancellor for Administration and Finance, Western Carolina University
Mr. Phillip D. Walker	Chairman, Board of Trustees, Western Carolina University

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Mr. James D. Johnson	Director, Fiscal Research Division
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December 10, 2004

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