



STATE OF NORTH CAROLINA

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2007

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2007

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THE UNIVERSITY OF NORTH CAROLINA

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STATE OF NORTH CAROLINA
Office of the State Auditor

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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

We have completed a financial statement and compliance audit of Western Carolina University for the year ended June 30, 2007, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

Leslie W. Merritt, Jr.

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

May 8, 2008

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Western Carolina University
Cullowhee, North Carolina

We have audited the accompanying financial statements of Western Carolina University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2007, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Western Carolina University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Western Carolina University Foundation, which represent 5 percent, 7 percent, and 3 percent, respectively, of the assets, net assets and revenues of the University; nor the financial statements of Western Carolina University Research and Development Corporation, the University's discretely presented component unit. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinions, insofar as they relate to the amounts included for that entity, are based on the report of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Western Carolina University and its discretely presented component unit as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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

In accordance with *Government Auditing Standards*, we have also issued our report dated April 22, 2008, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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



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

April 22, 2008

WESTERN CAROLINA UNIVERSITY MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

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

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

Statement of Net Assets

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Summary of Net Assets				
	2007	2006	\$ Change	% Change
Assets				
Current Assets	\$ 67,136,615.63	\$ 66,592,904.50	\$ 543,711.13	0.82%
Capital Assets, Net	234,175,360.47	219,595,688.89	14,579,671.58	6.64%
Other Noncurrent Assets	68,927,466.31	53,207,113.52	15,720,352.79	29.55%
Total Assets	370,239,442.41	339,395,706.91	30,843,735.50	9.09%
Liabilities				
Current Liabilities	17,049,861.07	13,404,152.23	3,645,708.84	27.20%
Noncurrent Liabilities	55,931,691.97	58,078,305.68	(2,146,613.71)	-3.70%
Total Liabilities	72,981,553.04	71,482,457.91	1,499,095.13	2.10%
Net Assets				
Invested in Capital Assets, Net of Related Debt	196,974,311.32	182,065,630.91	14,908,680.41	8.19%
Restricted – Nonexpendable	18,350,985.93	17,046,677.72	1,304,308.21	7.65%
Restricted – Expendable	32,634,981.03	24,757,619.12	7,877,361.91	31.82%
Unrestricted	49,297,611.09	44,043,321.25	5,254,289.84	11.93%
Total Net Assets	\$ 297,257,889.37	\$ 267,913,249.00	\$ 29,344,640.37	10.95%

A review of the University's *Statement of Net Assets* at June 30, 2007 and 2006 indicates that the University improved its already strong financial position, with Total Net Assets increasing by \$29.3 million (11%).

Total assets of the University increased by \$30.8 million. Net capital assets contributed \$14.6 million of this amount, mostly due to increases of \$15.4 million in Construction in Progress and \$4.3 million in depreciable assets, offset by current depreciation of \$6.1 million. The increase in Construction in Progress is primarily due to costs associated with Phase II of the Stillwell Laboratory Building renovations of classroom and laboratory space that is due for completion in December 2007, and the new Student Recreation Center with an estimated completion date of July 2008.

The \$15.7 million increase in Other Noncurrent Assets resulted primarily from a \$5.7 million increase in the amount due from the State of North Carolina for general obligation bond proceeds allotted, but not yet transferred, to the University at year end. In addition, endowment investments increased by \$4.9 million, \$3.3 million of which was due to favorable market fluctuations and noncurrent restricted cash increased by \$4.9 million.

Current Liabilities increased by \$3.6 million, \$3.2 million of which was in Accounts Payable and Accrued Liabilities. Amounts payable to vendors for the Stillwell Laboratory Renovation project contributed \$2.3 million to this increase in Accounts Payable. Noncurrent liabilities decreased by \$2.1 million, primarily due to repayments on long-term bonds, notes, and capital leases payable.

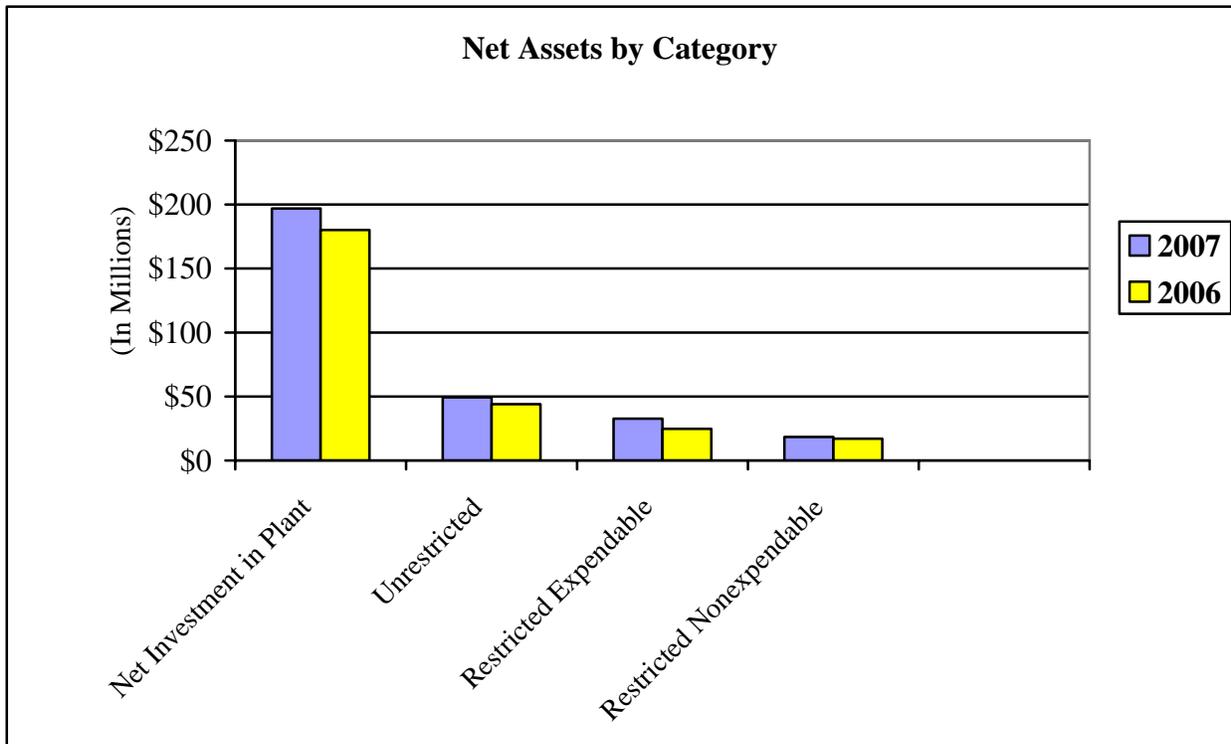
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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, 2007, \$197 million (66.3 %) of the \$297.3 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 \$18.3 million (6.15%) of the \$297.3 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, 2007, expendable net assets totaled \$32.6 million (10.96% of total net assets).
- “Unrestricted” net assets are not subject to externally imposed restrictions, although management has designated these funds for various academic and research programs and initiatives, as well as capital projects. This year, unrestricted net assets totaling \$49.3 million represent 16.5 % of total net assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following chart displays the contribution of each category to the total in both 2007 and 2006:



Statement of Revenues, Expenses, and Changes in Net Assets

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

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

Nonoperating revenues are revenues received for which goods and services are not provided. For example, state appropriations, while budgeted for operations, are reported as nonoperating revenue because they are provided by the state legislature without the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

legislature directly receiving commensurate goods and services in return for those revenues. Nonoperating expenses include interest expense and other expenses not incurred in the normal operations of the University.

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

The following is a condensed *Statement of Revenues, Expenses, and Changes in Net Assets* for Western Carolina University as of June 30, 2007, compared with that of 2006.

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

	2007	2006	\$ Change	% Change
Operating Revenues				
Student Tuition and Fees, Net	\$ 31,240,066.21	\$ 28,692,604.02	\$ 2,547,462.19	8.88%
Grants and Contracts	16,257,258.07	16,784,061.78	(526,803.71)	-3.14%
Sales and Services, Net	24,736,218.22	23,621,945.29	1,114,272.93	4.72%
Other Operating Revenues	1,164,628.49	1,208,860.99	(44,232.50)	-3.66%
Total Operating Revenues	<u>73,398,170.99</u>	<u>70,307,472.08</u>	<u>3,090,698.91</u>	<u>4.40%</u>
Operating Expenses	<u>158,363,783.37</u>	<u>144,944,442.66</u>	<u>13,419,340.71</u>	<u>9.26%</u>
Operating Loss	<u>(84,965,612.38)</u>	<u>(74,636,970.58)</u>	<u>(10,328,641.80)</u>	<u>13.84%</u>
Nonoperating Revenues (Expenses)				
State Appropriations	80,794,783.84	74,579,645.56	6,215,138.28	8.33%
Noncapital Gifts and Grants	3,963,000.10	4,037,736.56	(74,736.46)	-1.85%
Investment Income (Net of Investment Expense)	8,418,395.39	4,709,304.44	3,709,090.95	78.76%
Other Nonoperating Expenses	(2,600,770.97)	(3,287,981.96)	687,210.99	-20.90%
Net Nonoperating Revenues	<u>90,575,408.36</u>	<u>80,038,704.60</u>	<u>10,536,703.76</u>	<u>13.16%</u>
Income Before Other Revenues	<u>5,609,795.98</u>	<u>5,401,734.02</u>	<u>208,061.96</u>	<u>3.85%</u>
Capital Appropriations	6,223,900.00	1,818,000.00	4,405,900.00	242.35%
Capital Gifts and Grants	16,913,403.86	14,668,696.19	2,244,707.67	15.30%
Additions to Permanent Endowments	597,540.53	2,516,655.32	(1,919,114.79)	76.26%
Total Other Revenue	<u>23,734,844.39</u>	<u>19,003,351.51</u>	<u>4,731,492.88</u>	<u>24.90%</u>
Change in Net Assets	<u>29,344,640.37</u>	<u>24,405,085.53</u>	<u>4,939,554.84</u>	<u>20.24%</u>
Beginning Net Assets	<u>267,913,249.00</u>	<u>243,508,163.47</u>	<u>24,405,085.53</u>	<u>10.02%</u>
Ending Net Assets	<u>\$ 297,257,889.37</u>	<u>\$ 267,913,249.00</u>	<u>\$ 29,344,640.37</u>	<u>10.95%</u>

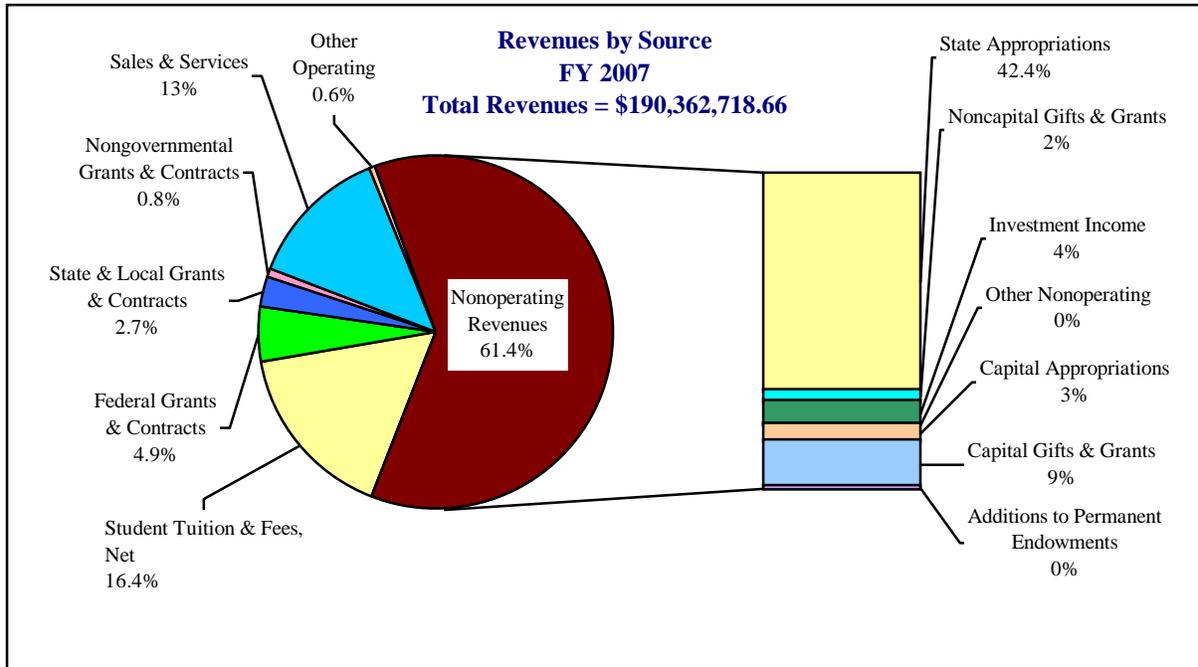
The *Statement of Revenues, Expenses and Changes in Net Assets* reflects a positive year ending June 30, 2007, with an increase in ending net assets of \$29.3 million.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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, 2007. 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 2007 totaled \$73.3 million, compared with \$70.3 million for 2006. The most significant source of operating revenue for the University was tuition and fees (net of scholarship allowances) totaling \$31.2 million at June 30, 2007, and \$28.7 million at June 30, 2006. This 8.9% increase reflects an overall increase in tuition and fee rates and a 2.3% growth in number of students. Other major revenue sources in 2007 include sales and services of \$24.7 million (\$23.6 million in 2006) and grants and contracts of \$16.3 million (\$16.8 million in 2006).

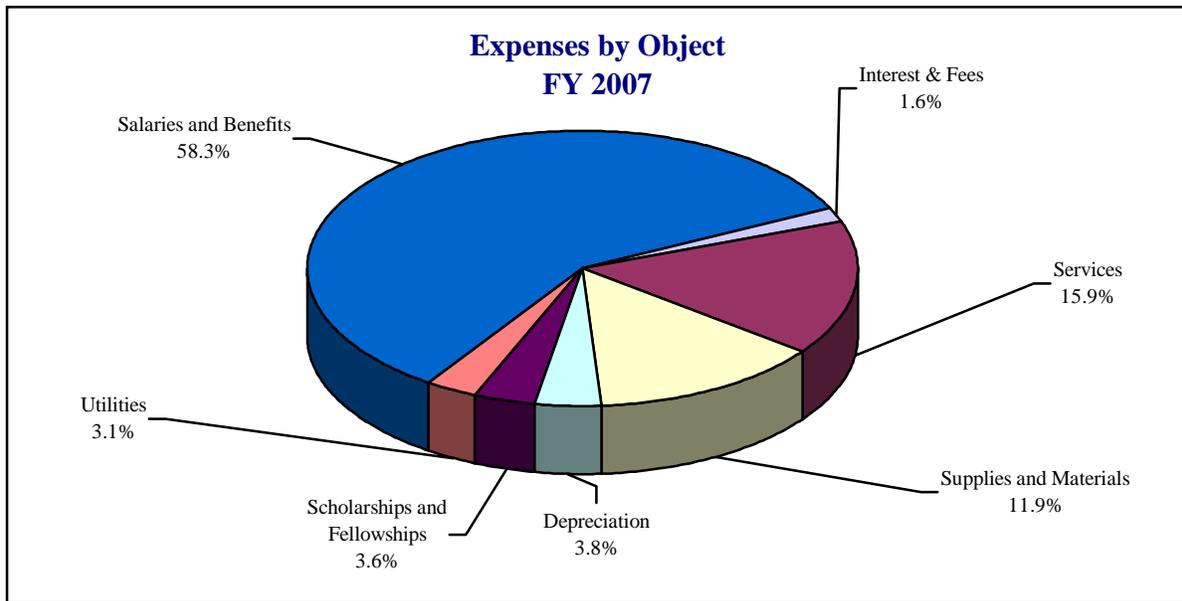
Like most public institutions, the University receives significant nonoperating revenues which offset the loss generated by operating activities. During 2007, the operating loss of \$85 million was offset by \$90.6 million in net nonoperating revenues. The primary sources of this revenue are state appropriations, which totaled \$80.8 million and accounted for 42.4% of total revenue. Other major sources of nonoperating revenue in 2007 were investment income of \$8.4 million and noncapital gifts and grants of \$4 million. An increase

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

in investment income in 2007 of \$3.7 million was largely attributable to favorable market fluctuations.

Capital grants totaled \$16.9 million and \$14.6 million for the years ended June 30, 2007, and June 30, 2006, respectively. The primary sources of this revenue were state general obligation bond proceeds of \$13 million in both 2007 and 2006. In 2000, the voters of North Carolina approved the issuance of general obligation bonds to provide funds for capital improvements on the University of North Carolina campuses. The Office of State Budget and Management allots these funds based on the University's projected cash requirements related to the construction projects funded by this bond issue.

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



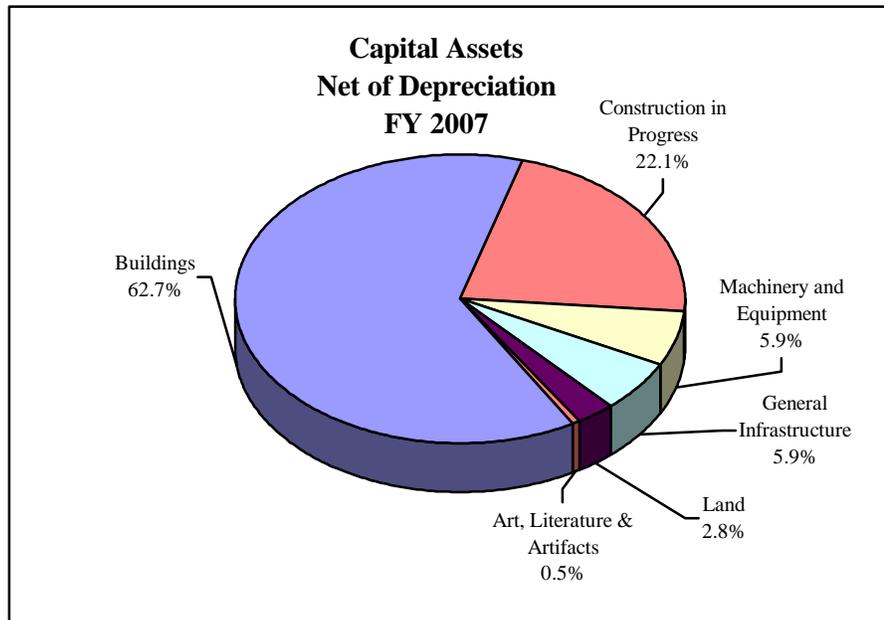
Operating expenses increased \$13.4 million for the fiscal year ending June 30, 2007. Operating expenses are primarily attributable to salaries and benefits for the faculty and staff of the University. Of the \$158.3 million in operating expenses, \$93.9 million (59.3%) was used for this purpose in 2007. Other elements included in operating expenses are supplies and materials, services, scholarships and fellowships, utilities, and depreciation. All categories of expense were fairly consistent with last year in terms of their percent of contribution to total expenses.

Capital Asset and Debt Administration

At June 30, 2007, the University had approximately \$304.1 million invested in capital assets, and accumulated depreciation of \$69.9 million. Depreciation charges for the current year

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

totaled \$6.1 million. The following chart displays the relationship of each category to capital assets as a whole.



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

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

In August 2006, the University obtained occupancy after the Phase I renovation of the Stillwell Laboratory Building (\$24.3 million), which included renovations of classrooms, offices, and support space for many departments within Arts & Sciences. Phase II renovations of additional classroom and laboratory space are underway with a scheduled completion date of December 2007.

The 2000 bond issue also made possible the acquisition of 344 acres of property adjacent to the University's main campus. On May 12, 2006, the University of North Carolina Board of Governors approved *Millennial Campus* designation for the newly acquired property. The Millennial Initiative is an ambitious and comprehensive regional economic improvement strategy that will enable the University to partner with business, industry, and government. A

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

comprehensive master plan was approved by the campus and Board of Trustees to serve as a guide for the development of this property. The 2007 General Assembly approved \$46.2 million in funding for a new 145,200 square foot health and gerontological sciences building that will be the first construction project on the Millennial Initiative property. The new building will house classrooms, offices and laboratories for the University's School of Nursing and programs in social work, physical therapy, athletic training, clinical laboratory sciences, environmental health, health information administration, nutrition and dietetics, emergency medical care, recreational therapy, and communication sciences and disorders. It is expected to become the cornerstone for a mixed-use "neighborhood of interest" focusing on retirement, aging and health, where students and faculty would work with partners from private business and industry. The target completion date for the new health sciences building is June 2010.

Helder Residence Hall, a four-story, 400-bed residence hall constructed in 1966, was demolished in Summer 2007 as part of a group of construction and renovation projects designed to create more of a "college quad" feel on campus with green space and a pedestrian-friendly environment. A new two-story, 53,000 square-foot dining hall will be constructed on this site, with construction expected to be completed in Fall 2008. At that time Dodson Cafeteria and Leatherwood Residence Hall will be taken down to make way for a new residence hall.

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

The University's financial statements indicate \$24.4 million in bonds payable, \$1.3 million in notes payable, and \$20.9 million in capital leases payable at June 30, 2007. Total annual debt service payments were \$4 million in 2007 and \$4.2 million in 2006.

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

Enrollment

A significant factor in the University's capacity to generate resources is the ability to recruit and retain high quality students. In an effort to boost enrollment and to improve the quality of education available at Western, the University is emphasizing continued as well as new career-focused programs of study. The University enrolled its first class in the new master's degree program in nurse anesthesia in the Spring 2007 semester. The 28-month Certified Registered Nurse Anesthetist program integrates research, physiology, pharmacology, pathophysiology and anesthesia principles and prepares students to take a national certification examination. The University has also added a two-year master's degree program in science and entrepreneurship designed to prepare scientists for careers in the "business" of the science and technology industry and a new Graduate Certificate Program in Project

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Management, which is available fully online or through a combination of online work and regular class meetings.

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

Economic Outlook

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

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

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. On February 20, 2007, the University officially launched the first comprehensive fundraising campaign in the University's 118-year history. The goal of the campaign, whose theme is "Creating Extraordinary Opportunities", is to raise at least \$40 million in private support to enhance institutional quality.

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.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

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, 2007

Exhibit A-1

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 41,014,816.99
Restricted Cash and Cash Equivalents	13,313,639.61
Restricted Short-Term Investments	682,676.12
Receivables, Net (Note 4)	6,504,165.32
Due from State of North Carolina Component Units	40,000.00
Due from University Component Units	1,423,539.00
Inventories	3,731,529.66
Notes Receivable, Net (Note 4)	397,326.93
Other Assets	28,922.00
	<hr/>
Total Current Assets	67,136,615.63
	<hr/>
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	19,504,712.98
Receivables, Net (Note 4)	321,369.26
Restricted Due from Primary Government	10,101,171.70
Endowment Investments	32,279,530.87
Other Investments	1,536,630.41
Notes Receivable, Net (Note 4)	5,184,051.09
Capital Assets - Nondepreciable (Note 5)	61,000,814.22
Capital Assets - Depreciable, Net (Note 5)	173,174,546.25
	<hr/>
Total Noncurrent Assets	303,102,826.78
	<hr/>
Total Assets	370,239,442.41
	<hr/>

LIABILITIES

Current Liabilities:	
Accounts Payable and Accrued Liabilities (Note 6)	9,589,453.04
Due to Primary Government	30,942.23
Funds Held for Others	61,656.00
Unearned Revenue	4,062,673.61
Interest Payable	494,013.83
Long-Term Liabilities - Current Portion (Note 7)	2,811,122.36
	<hr/>
Total Current Liabilities	17,049,861.07
	<hr/>
Noncurrent Liabilities:	
Deposits Payable	73,159.49
Funds Held for Others	503,508.24
U. S. Government Grants Refundable	5,365,601.88
Long-Term Liabilities (Note 7)	49,989,422.36
	<hr/>
Total Noncurrent Liabilities	55,931,691.97
	<hr/>
Total Liabilities	72,981,553.04
	<hr/>

Western Carolina University
Statement of Net Assets
June 30, 2007

Exhibit A-1

Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	196,974,311.32
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	8,648,043.02
Endowed Professorships	9,702,942.91
Expendable:	
Scholarships and Fellowships	14,780,799.23
Research	1,474,960.63
Endowed Professorships	3,162,081.60
Departmental Uses	1,831,277.41
Loans	1,463,089.60
Capital Projects	6,494,809.57
Debt Service	3,427,962.99
Unrestricted	<u>49,297,611.09</u>
Total Net Assets	<u>\$ 297,257,889.37</u>

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

Western Carolina University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2007

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 31,240,066.21
Federal Grants and Contracts	9,467,754.25
State and Local Grants and Contracts	5,199,593.11
Nongovernmental Grants and Contracts	1,589,910.71
Sales and Services, Net (Note 9)	24,736,218.22
Interest Earnings on Loans	9,826.48
Other Operating Revenues	1,154,802.01
	<hr/>
Total Operating Revenues	73,398,170.99

EXPENSES

Operating Expenses:

Salaries and Benefits	93,885,045.66
Supplies and Materials	21,885,497.49
Services	25,565,951.01
Scholarships and Fellowships	5,848,751.92
Utilities	5,043,606.23
Depreciation	6,134,931.06
	<hr/>
Total Operating Expenses	158,363,783.37

Operating Loss	<hr/> (84,965,612.38)
----------------	------------------------------

NONOPERATING REVENUES (EXPENSES)

State Appropriations	80,794,783.84
Noncapital Grants	212,517.23
Noncapital Gifts	3,750,482.87
Investment Income (Net of Investment Expense of \$86,601.16)	8,418,395.39
Interest and Fees on Debt	(2,654,294.92)
Other Nonoperating Revenues	53,523.95
	<hr/>
Net Nonoperating Revenues	90,575,408.36
	<hr/>
Income Before Other Revenues	5,609,795.98

Capital Appropriations	6,223,900.00
Capital Grants	16,913,403.86
Additions to Endowments	597,540.53
	<hr/>
Increase in Net Assets	29,344,640.37

NET ASSETS

Net Assets - July 1, 2006	<hr/> 267,913,249.00
Net Assets - June 30, 2007	<hr/> \$ 297,257,889.37

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, 2007

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 72,005,429.43
Payments to Employees and Fringe Benefits	(93,468,347.20)
Payments to Vendors and Suppliers	(50,526,363.23)
Payments for Scholarships and Fellowships	(5,848,751.92)
Loans Issued	(1,929,131.13)
Collection of Loans	1,502,453.89
Interest Earned on Loans	23,767.17
Student Deposits Received	687,603.89
Student Deposits Returned	(667,364.30)
	<hr/>
Net Cash Used by Operating Activities	(78,220,703.40)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	80,794,783.84
Noncapital Grants	229,027.09
Noncapital Gifts	3,278,671.99
Additions to Endowments	597,540.53
William D. Ford Direct Lending Receipts	28,724,288.00
William D. Ford Direct Lending Disbursements	(28,724,288.00)
Related Activity Agency Receipts	110,995.35
Related Activity Agency Disbursements	(10,241.00)
Other Receipts	83,598.14
	<hr/>
Net Cash Provided by Noncapital Financing Activities	85,084,375.94

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	10,636,755.00
State Capital Appropriations	6,223,900.00
Capital Grants	11,267,997.36
Proceeds from Sale of Capital Assets	9,831.27
Acquisition and Construction of Capital Assets	(20,157,768.26)
Principal Paid on Capital Debt and Leases	(12,678,832.55)
Interest and Fees Paid on Capital Debt and Leases	(2,574,642.26)
Payment to Bond Escrow Agent	(7,683.75)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(7,280,443.19)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	5,346,983.18
Investment Income	5,089,148.14
Purchase of Investments and Related Fees	(4,459,562.96)
	<hr/>
Net Cash Provided by Investing Activities	5,976,568.36

Net Increase in Cash and Cash Equivalents	5,559,797.71
Cash and Cash Equivalents - July 1, 2006	68,273,371.87
	<hr/>
Cash and Cash Equivalents - June 30, 2007	\$ 73,833,169.58

Western Carolina University Research and Development Corporation
Statement of Financial Position
June 30, 2007

Exhibit B-1

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 1,760,938.00
Net Investment in Capital Leases, Net of Unearned Interest Income	371,430.00
Total Current Assets	<u>2,132,368.00</u>
Property, Plant and Equipment:	
Construction in Progress	2,062,512.00
Other Assets:	
Certificate Issuance Costs, Net of Accumulated Amortization	1,078,373.00
Net Investment in Capital Leases, Net of Unearned Interest Income	19,296,248.00
Total Other Assets	<u>20,374,621.00</u>
Total Assets	<u>\$ 24,569,501.00</u>

LIABILITIES

Current Liabilities:	
Current Portion of Long-Term Debt	\$ 525,000.00
Short-Term Note Payable	1,423,539.00
Construction Contracts Payable	638,973.00
Accrued Interest Payable	73,343.00
Total Current Liabilities	<u>2,660,855.00</u>
Noncurrent Liabilities:	
Certificates of Participation Payable	<u>21,360,000.00</u>
Total Liabilities	24,020,855.00

NET ASSETS

Unrestricted	<u>548,646.00</u>
Total Liabilities and Net Assets	<u>\$ 24,569,501.00</u>

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

Western Carolina University Research and Development Corporation
Statement of Activities
For the Fiscal Year Ended June 30, 2007

Exhibit B-2

REVENUES

Management Fee	\$ 149,331.00
Investment Interest Income	78,817.00
Interest Earned from Investments in Capital Leases	<u>1,095,532.00</u>
Total Revenues	<u>1,323,680.00</u>

EXPENSES

Amortization of Certificate Issuance Costs	40,499.00
Insurance	98,924.00
Interest	937,382.00
Professional Fees	23,490.00
Other Operating	<u>225.00</u>
Total Expenses	<u>1,100,520.00</u>

CHANGE IN NET ASSETS

	223,160.00
Net Assets, Beginning of Year	<u>325,486.00</u>
Net Assets, End of Year	<u><u>\$ 548,646.00</u></u>

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

WESTERN CAROLINA UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. Western Carolina University is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

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

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

The Foundation is governed by a 28-member board consisting of 4 ex officio directors and 24 elected directors. The Foundation's purpose is to aid, support and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because the elected directors of the Foundation are appointed by the members of the Western Carolina University Board of Trustees and the Foundation's sole purpose is to benefit Western Carolina University, its financial statements have been blended with those of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Discretely Presented Component Unit – Western Carolina University Research and Development Corporation (Corporation) is a legally separate not-for-profit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. The Corporation's purpose is to aid and promote education and charitable functions of the University.

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

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

- B. Basis of Presentation** - The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

- D. Cash and Cash Equivalents** – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts and deposits held by the State Treasurer in the short-term investment fund. The short-term investment fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

- E. Investments** - This classification includes equity investments, mutual funds, money market funds, limited partnerships, real estate, and other asset holdings by the University. Except for money market funds, 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.

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

- F. Receivables** – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

G. Inventories – Inventories, consisting of expendable supplies and merchandise for resale, are valued at the last invoice cost.

H. Capital Assets – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 75 years for general infrastructure, 10 to 50 years for buildings, and 3 to 25 years for equipment.

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

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

I. Restricted Assets – Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. These assets are also classified as noncurrent since they cannot be used for current operations. Certain other assets are classified as restricted because their use is limited by external parties or statute.

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

Bond issuance costs, premiums, and discounts are considered immaterial and are expensed.

K. Compensated Absences - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

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

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

At June 30, 2007, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$73,777,138.27 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2007. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports," or

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

by calling the State Controller's Financial Reporting Section at (919) 981-5454.

Cash on hand at June 30, 2007 was \$46,837.81. The carrying amount of the University's deposits not with the State Treasurer was \$9,193.50 and the bank balance was \$274,917.11. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2007, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Collateral Held by Pledging Bank's Trust Department not in University's Name	<u>\$ 174,917.11</u>
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- B. Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

G.S. 116-36(e) provides that the trustees of the Endowment Fund shall be responsible for the prudent investment of the Fund in the exercise of their

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

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

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University has a formal policy that addresses credit risk.

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. 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.

The following table presents the fair value of investments by type at June 30, 2007, for the Long-Term Investment Pool.

Long-Term Investment Pool

	Fair Value
Investment Type	
UNC Investment Fund	\$ 17,127,936.70
Mutual Funds	15,259,573.35
Investments in Real Estate	3,220.00
Limited Partnerships	1,282,608.00
	<hr/>
Total Long-Term Investment Pool	<u>\$ 33,673,338.05</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2007, for the University's non-pooled investments.

Non-Pooled Investments

	Fair Value	Investment Maturities Less Than 1 Year
Investment Type		
Debt Securities		
Money Market Mutual Funds	\$ 682,676.12	\$ 682,676.12
Other Securities		
Mutual Funds	93,800.00	
Investments in Real Estate	19,027.48	
Domestic Stocks	27,873.75	
Other	2,122.00	
Total Non-Pooled Investments	\$ 825,499.35	

At June 30, 2007, the University's non-pooled investments with credit risk had a fair value of \$682,676.13. The credit quality rating of the money market mutual funds was Aaa and A1+P1 as rated by Moody's Investor Service.

Total Investments – The following table presents the fair value of the total investments at June 30, 2007:

	Fair Value
Investment Type	
Debt Securities	
Money Market Mutual Funds	\$ 682,676.12
Other Securities	
UNC Investment Fund	17,127,936.70
Mutual Funds	15,278,600.83
Investments in Real Estate	97,020.00
Limited Partnerships	1,282,608.00
Domestic Stocks	27,873.75
Other	2,122.00
Total Investments	\$ 34,498,837.40

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). The current spending policy for the University's pooled endowment funds provides 4.5% of a three-year average of market values as of December 31. The Board of Trustees reviews the spending policy annually and makes adjustments accordingly. At June 30, 2007, net appreciation of \$17,954,795.65 was available to be spent, of which \$11,949,056.94 was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2007, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$ 891,860.06	\$ 625,764.77	\$ 266,095.29
Accounts	1,968,312.52		1,968,312.52
Intergovernmental	2,342,739.36		2,342,739.36
Pledges	136,870.22	13,426.24	123,443.98
Investment Earnings	216,362.83		216,362.83
Interest on Loans	137,209.47		137,209.47
Other	1,450,001.87		1,450,001.87
Total Current Receivables	\$ 7,143,356.33	\$ 639,191.01	\$ 6,504,165.32
Noncurrent Receivables:			
Pledges	\$ 359,594.11	\$ 38,224.85	\$ 321,369.26
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 384,654.25	\$ 0.00	\$ 384,654.25
Institutional Student Loan Programs	54,592.84	41,920.16	12,672.68
Total Notes Receivable - Current	\$ 439,247.09	\$ 41,920.16	\$ 397,326.93
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 6,343,461.60	\$ 1,163,766.00	\$ 5,179,695.60
Institutional Student Loan Programs	4,355.49		4,355.49
Total Notes Receivable - Noncurrent	\$ 6,347,817.09	\$ 1,163,766.00	\$ 5,184,051.09

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2007, is presented as follows:

	Balance July 1, 2006	Increases	Decreases	Balance June 30, 2007
Capital Assets, Nondepreciable:				
Land	\$ 6,172,706.75	\$ 659,000.00	\$ 0.00	\$ 6,831,706.75
Art, Literature, and Artifacts	695,488.00	370,748.00		1,066,236.00
Construction in Progress	37,673,174.31	15,429,697.16		53,102,871.47
Total Capital Assets, Nondepreciable	44,541,369.06	16,459,445.16		61,000,814.22
Capital Assets, Depreciable:				
Buildings	204,702,136.23	963,916.00	5,736.60	205,660,315.63
Machinery and Equipment	19,634,871.98	3,114,795.08	275,183.47	22,474,483.59
Art, Literature, and Artifacts	153,188.00	22,685.06	50,000.00	125,873.06
General Infrastructure	14,595,535.58	241,839.98		14,837,375.56
Total Capital Assets, Depreciable	239,085,731.79	4,343,236.12	330,920.07	243,098,047.84
Less Accumulated Depreciation for:				
Buildings	50,771,899.00	4,150,712.28	401.56	54,922,209.72
Machinery and Equipment	7,033,790.44	1,429,599.58	242,439.87	8,220,950.15
Art, Literature, and Artifacts	88,327.00	2,059.70		90,386.70
General Infrastructure	6,137,395.52	552,559.50		6,689,955.02
Total Accumulated Depreciation	64,031,411.96	6,134,931.06	242,841.43	69,923,501.59
Total Capital Assets, Depreciable, Net	175,054,319.83	(1,791,694.94)	88,078.64	173,174,546.25
Capital Assets, Net	\$ 219,595,688.89	\$ 14,667,750.22	\$ 88,078.64	\$ 234,175,360.47

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2007, were as follows:

	Amount
Accounts Payable	\$ 5,601,646.11
Accrued Payroll	878,133.19
Contract Retainage	1,251,902.54
Civil Penalty and Forfeiture Fund Payable	1,042,479.93
Other	815,291.27
Total Accounts Payable and Accrued Liabilities	\$ 9,589,453.04

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, 2007, is presented as follows:

	Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Current Portion
Bonds Payable	25,664,000.00	10,470,000.00	11,655,000.00	24,479,000.00	1,034,000.00
Notes Payable	1,525,347.14	166,755.00	348,181.35	1,343,920.79	330,296.49
Capital Leases Payable	21,626,069.27		675,651.20	20,950,418.07	704,357.03
Compensated Absences	5,197,286.66	6,026,878.79	5,647,074.03	5,577,091.42	656,424.00
Annuity and Life Income Payable	533,153.60		83,039.16	450,114.44	86,044.84
Total Long-Term Liabilities	\$ 54,545,856.67	\$ 16,663,633.79	\$ 18,408,945.74	\$ 52,800,544.72	\$ 2,811,122.36

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

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2007	Principal Outstanding June 30, 2007
Dormitory System						
Dormitory System Revenue Bonds - Series D		3.00	05/01/2007	\$ 2,394,000.00	\$ 2,290,000.00	\$ 104,000.00
Faculty Housing						
Faculty Housing Revenue Bonds		3.00	11/01/2007	280,000.00	270,000.00	10,000.00
The University of North Carolina System Pool Revenue Bonds						
Student Housing I	(A)	3.25-5.25	10/01/2013	465,000.00	210,000.00	255,000.00
Student Housing II	(B)	5.00-5.50	10/01/2010	1,370,000.00	660,000.00	710,000.00
University Center Expansion	(B)	5.00-5.75	10/01/2025	5,355,000.00	5,355,000.00	0.00
Athletic Facilities I	(C)	4.00-5.375	04/01/2027	8,070,000.00	6,885,000.00	1,185,000.00
Athletic Facilities II	(D)	2.00-5.25	04/01/2028	1,510,000.00	160,000.00	1,350,000.00
Student Recreation Center	(D)	2.00-5.25	04/01/2028	11,610,000.00	1,215,000.00	10,395,000.00
Student Center Refund	(E)	4.00-5.00	10/01/2025	4,335,000.00		4,335,000.00
Athletic Facility Refund	(E)	4.00-5.00	10/01/2026	6,135,000.00		6,135,000.00
Total The University of North Carolina System Pool				38,850,000.00	14,485,000.00	24,365,000.00
Total Bonds Payable				\$ 41,524,000.00	\$ 17,045,000.00	\$ 24,479,000.00

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2007, are as follows:

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2008	\$ 1,034,000.00	\$ 1,127,711.28	\$ 330,296.49	\$ 65,381.24
2009	960,000.00	1,091,448.78	376,042.30	48,801.74
2010	1,005,000.00	1,044,448.78	399,417.70	25,426.34
2011	1,050,000.00	1,005,398.15	225,808.76	5,325.34
2012	895,000.00	962,701.26	12,355.54	119.18
2013-2017	4,995,000.00	4,143,691.30		
2018-2022	6,195,000.00	2,855,922.50		
2023-2027	7,495,000.00	1,205,737.50		
2028-2032	850,000.00	40,375.00		
Total Requirements	\$ 24,479,000.00	\$ 13,477,434.55	\$ 1,343,920.79	\$ 145,053.84

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

On November 30, 2006, the University issued \$4,335,000.00 in WCU Student Center System Refunding Revenue Bonds, Series 2006A with an average interest rate of 4.794%. The bonds were issued to advance refund \$4,630,000.00 of outstanding WCU Student Center System Revenue Bonds, Series 2000 bonds with an average interest rate of 5.433%. The net proceeds of the refunding bonds along with other resources were used to purchase U.S. government securities. These securities were deposited in an irrevocable trust to provide for all future debt service on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the Statement of Net Assets. This advance refunding was undertaken to reduce total debt service payments by \$883,562.57 over the next 11.19 years and resulted in an economic gain of \$228,860.74. At June 30, 2007, the outstanding balance was \$4,630,000.00 for the defeased WCU Student Center System Revenue Bonds, Series 2000.

On November 30, 2006, the University issued \$6,135,000.00 in WCU Athletic Facility Systems Refunding Revenue Bonds, Series 2006A with an average interest rate of 4.851%. The bonds were issued to advance refund \$6,045,000.00 of outstanding WCU Athletic Facility System Revenue Bonds, Series 2002 bonds with an average interest rate of 5.161%. The net proceeds of the refunding bonds were used to purchase U.S. government securities. These securities were deposited into an

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

irrevocable trust to provide for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the University's Statement of Net Assets. This advance refunding was undertaken to reduce total debt service payments by \$350,552.46 over the next 13.663 years and resulted in an economic gain of \$181,528.81. At June 30, 2007, the outstanding balance was \$6,045,000.00 for the defeased WCU Athletic Facility System Revenue Bonds, Series 2002.

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2007	Principal Outstanding June 30, 2007
University Center Renovation	Wachovia Bank	5.98%	12/01/2010	\$ 3,800,000.00	\$ 2,605,305.37	\$ 1,194,694.63
Print Shop	BB&T	4.63%	10/01/2011	166,725.00	17,498.84	149,226.16
Total Notes Payable				<u>\$ 3,966,725.00</u>	<u>\$ 2,622,804.21</u>	<u>\$ 1,343,920.79</u>

F. Charitable Gift Annuity Split Interest Agreement – In October 2003, joint donors entered into a charitable gift annuity agreement with the Foundation. Under the terms of the agreement, the Foundation received property with a fair market value of \$1,082,314.80. In consideration of this property transfer, the annuitants will receive, for their joint lives, an annual annuity of \$86,044.84, payable in quarterly installments. The obligation of the Foundation to make annuity payments, if any remain, shall terminate upon the deaths of the donors. Based on the donors' life expectancy and an expected 4.509% rate of return, the liability at June 30, 2007, was adjusted to its present value as follows:

	<u>Amount</u>
Value of Annuity Liability at June 30, 2006	\$ 533,153.60
Interest Earned on Investment	41,522.62
Sum of Quarterly Payments	(86,044.84)
Present Value Adjustment at Year End	<u>(38,516.94)</u>
Value of Annuity Liability at June 30, 2007	<u>\$ 450,114.44</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Component Unit

The Western Carolina University Research & Development Corporation, a discretely presented component unit of the University, has constructed two dormitories that are recognized as capital leases by the University. The long-term debt of the component unit represents the construction cost of the two dormitories.

Long-term debt at June 30, 2007, consists of the following:

2003 certificates of participation with a balance of \$11,340,000, evidenced by undivided interests in the rights to receive certain revenues, including the Base Rentals under the lease with the University for the facility. The maturities and interest rates of the certificates are as follows:

Due June 1	Principal Amount	Interest Rate
2008	\$ 260,000.00	2.375%
2009	265,000.00	2.750%
2010	270,000.00	3.000%
2011	280,000.00	3.375%
2012	290,000.00	3.500%
Thereafter	9,975,000.00	3.625% - 5.000%
	\$ 11,340,000.00	

2005 certificates of participation with a balance of \$10,545,000, evidenced by undivided interests in the rights to receive certain revenues, including the Base Rentals under the lease with the University for the facility. The maturities and interest rates of the certificates are as follows:

Due June 1	Principal Amount	Interest Rate
2008	\$ 265,000.00	3.000%
2009	270,000.00	4.000%
2010	280,000.00	4.000%
2011	295,000.00	3.000%
2012	300,000.00	3.125%
Thereafter	9,135,000.00	3.250% - 4.350%
	\$ 10,545,000.00	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - LEASE OBLIGATIONS

- A. Capital Lease Obligations** - Capital lease obligations relating to buildings, machinery and equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2007:

<u>Fiscal Year</u>	<u>Amount</u>
2008	\$ 1,826,311.26
2009	1,821,510.26
2010	1,818,422.76
2011	1,699,124.66
2012	1,445,828.76
2013-2017	7,237,006.28
2018-2022	7,230,160.00
2023-2027	7,241,332.30
2028-2032	7,235,000.10
2033	766,500.20
Total Minimum Lease Payments	<u>38,321,196.58</u>
Amount Representing Interest (3.78% - 6.10% Rate of Interest)	<u>17,370,778.51</u>
Present Value of Future Lease Payments	<u><u>\$ 20,950,418.07</u></u>

Buildings acquired under capital lease amounted to \$19,623,569.96. Equipment acquired under capital lease amounted to \$957,287.02 at June 30, 2007.

- B. Operating Lease Obligations** – The University entered into operating leases for automobiles and equipment. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2007:

<u>Fiscal Year</u>	<u>Amount</u>
2008	\$ 167,497.80
2009	158,754.00
2010	68,486.61
2011	16,227.36
Total Minimum Lease Payments	<u><u>\$ 410,965.77</u></u>

Rental expense for all operating leases during the year was \$350,673.16.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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	\$ 37,189,848.82	\$ 7,216.06	\$ 5,721,096.83	\$ 221,469.72	\$ 31,240,066.21	\$ 0.00
Sales and Services:						
Sales and Services of Auxiliary Enterprises:						
Residential Life	\$ 11,872,612.45	\$ 498,541.59	\$ 1,852,555.98	\$ 189,781.43	\$ 9,331,733.45	\$ 9,331,733.45 (A)
Dining	8,704,147.49	842,234.36	1,187,912.92	76,152.76	6,597,847.45	
Book Rental	1,625,285.99	3,465.99	216,024.12	71,438.93	1,334,356.95	
Bookstore	1,814,205.48	109,322.59		4,143.93	1,700,738.96	
Print Shop	757,159.33	632,670.37			124,488.96	
Athletic	1,361,344.48				1,361,344.48	
Other	1,299,210.01	36,493.93		33.30	1,262,682.78	78,930.92 (B)
Sales and Services of Education and Related Activities	3,052,793.68	2,042,403.83		155.40	1,010,234.45	
Independent Operations	2,116,529.92	103,739.18			2,012,790.74	
Total Sales and Services	\$ 32,603,288.83	\$ 4,268,871.84	\$ 3,256,493.02	\$ 341,705.75	\$ 24,736,218.22	\$ 9,410,664.37

(A) Student Housing

(B) Rental Property

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	\$ 47,934,995.33	\$ 2,938,962.36	\$ 3,536,759.50	\$ 40,192.57	\$ 2,012.28	\$ 0.00	\$ 54,452,922.04
Research	707,678.05	313,654.71	303,509.76		24,045.74		1,348,888.26
Public Service	7,273,832.21	1,405,391.82	3,118,106.84	89,820.60	66,002.37		11,953,153.84
Academic Support	7,331,475.51	3,039,533.20	1,185,550.38	11,999.98	2,280.56		11,570,839.63
Student Services	4,040,100.34	408,570.42	2,797,328.03	183.57			7,246,182.36
Institutional Support	9,070,067.24	1,308,112.92	3,388,354.53	289,864.79	1,348.21		14,057,747.69
Operations and Maintenance of Plant	7,144,475.35	6,952,129.17	593,486.11		3,045,485.31		17,735,575.94
Student Financial Aid	70,624.23		1,240.05	4,467,405.30			4,539,269.58
Auxiliary Enterprises	10,089,974.12	3,874,471.07	10,550,083.72	949,285.11	1,902,051.76		27,365,865.78
Independent Operations	221,823.28	1,644,671.82	91,532.09		380.00		1,958,407.19
Depreciation						6,134,931.06	6,134,931.06
Total Operating Expenses	\$ 93,885,045.66	\$ 21,885,497.49	\$ 25,565,951.01	\$ 5,848,751.92	\$ 5,043,606.23	\$ 6,134,931.06	\$ 158,363,783.37

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2007, these rates were set at 2.66% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2007, the University had a total payroll of \$76,807,145.73, of which \$38,385,541.58 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$2,303,132.49 and \$1,021,055.41, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2007, 2006, and 2005, which were \$1,021,055.41, \$815,583.73, and \$704,822.44, respectively.

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

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2007, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2007, the University had a total payroll of \$76,807,145.73, of which \$29,408,199.64 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$1,764,491.98 and \$2,011,520.86, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$139,977.44 for the year ended June 30, 2007.

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, 2007, were \$28,863.01. The voluntary contributions by employees amounted to \$367,256.00 for the year ended June 30, 2007.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$1,112,238.83 for the year ended June 30, 2007.

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 3.8% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2007, the University's total contribution to the Plan was

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$2,576,162.17. 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. Disability Income - The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the year ended June 30, 2007, the University's total contribution to the DIPNC was \$352,527.45. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 13 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

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

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$10,000 per occurrence

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses 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 \$75,000 deductible and a 10% participation in each loss above the deductible.

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

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

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

Term life insurance (death benefits) of \$25,000 to \$50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

A. Commitments - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$33,900,244.07 and on other purchases were \$1,304,113.15 at June 30, 2007.

B. Pending Litigation and Claims – The NC School Boards Association, et. al. filed a civil action against various State officials in their official capacity seeking a judicial determination as to whether the State Constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. In part, this civil action includes a determination of whether monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations are “civil penalties” which the State Constitution requires to be paid to the school fund in the county where they are collected. On July 1, 2005, the NC Supreme Court held in favor of the school boards with regard to parking fines. The matter has been remanded back to the trial court for disposition in accordance with the Supreme Court’s decision. At issue are transportation fines in the amount of \$1,042,479.93 for the period December 1995 to June 30, 2005. A liability has been recorded by the University.

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

NOTE 15 - RELATED PARTIES

Foundations - There are two separately incorporated nonprofit foundations associated with the University. These foundations are The Development

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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 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 \$435,016.63 for the year ending June 30, 2007.

The Highlands Biological Foundation, Inc. was incorporated in North Carolina on July 21, 1930, for the purpose of supporting through grants and scholarships the activities of the Highlands Biological Station. This support approximated \$51,349.38 for the year ended June 30, 2007.

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

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

Board of Trustees
Western Carolina University
Cullowhee, North Carolina

We have audited the financial statements of Western Carolina University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2007, which collectively comprise the University's basic financial statements and have issued our report thereon dated April 22, 2008. Our report was modified to include a reference to other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Other auditors audited the financial statements of Western Carolina University Foundation and the discretely presented component unit, as described in our report on the University's financial statements. The financial statements of the discretely presented component unit was not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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GOVERNMENT AUDITING STANDARDS (CONTINUED)**

weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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

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

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

Compliance and Other Matters

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

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

This report is intended solely for the information and use of management of the University, the Board of Governors, the Board of Trustees, the Audit Committee, the Governor, the

**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
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General Assembly, and the State Controller, and is not intended to be and should not be used by anyone other than these specified parties.

Leslie W. Merritt, Jr.

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

April 22, 2008

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

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

1. INAPPROPRIATE INFORMATION SYSTEM ACCESS

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

We identified three computer programmers with access to computer programs used in production, as well as data files. The ability to change programs should be segregated from responsibility for moving programs into production to prevent unauthorized changes. Also, access to data files should be limited to the greatest extent possible.

We also identified accounting personnel with access rights that were inconsistent with their job duties. Personnel should only be granted the minimum access rights needed to perform their job.

Finally, the University did not appropriately terminate access rights for all separated employees. We identified 5 former employees whose access to the accounting system and the overall computer network was terminated several weeks or months after they left the University and 13 other former employees who still had access at the time of our audit. Access should be terminated as soon as individuals leave employment.

Recommendation: The University should improve internal control over computer system and data access.

University Response: We agree with this finding. Security procedures and processes will be put in place to remedy this situation. Security and data access will be reviewed on at least an annual basis to assure access is appropriate to job responsibilities. Additionally, employee and account terminations will be addressed as part of the University's Identity Management and Human Resources system implementations. Interim processes and controls will be implemented prior to full implementation of these systems.

2. NO PHYSICAL INVENTORY OF MACHINERY AND EQUIPMENT

The University did not perform a physical inventory of machinery and equipment. This increases the risk that an error or misappropriation could occur and not be detected in a timely manner.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

The University's Business and Financial Policies and Procedures state that "... an annual inventory is taken to verify the existence, condition, and location of the University's fixed assets. Each department should complete their inventory within the yearly quarter they have been assigned, and return the completed inventory sheets to the Purchasing Fixed Asset Coordinator. This inventory is then used to update property records and to provide documentation for annual financial reporting."

Recommendation: The University should improve internal control to ensure that policies and procedures are followed and fixed assets are properly accounted for and reported.

University Response: We agree with this finding. Implementation of Banner required some critical decisions relative to balancing of resources to meet daily and yearend operational needs. Foregoing the annual physical inventory was a necessary, though difficult, decision. For the fiscal year ending June 30, 2008, the University will resume its practice of conducting an annual physical inventory for machinery and equipment.

ORDERING INFORMATION

Audit reports issued by the Office of the State Auditor can be obtained from the web site at www.ncauditor.net. Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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