STATE OF
NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2002

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

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CHAPEL HILL, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2002

STATE OF NORTH CAROLINA
Office of the State Auditor

Ralph Campbell, Jr.
State Auditor

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AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of The University of North Carolina at Chapel Hill, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, for the year ended June 30, 2002. Our audit was made by authority of Article 5A of Chapter 147 of the General Statutes.

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

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

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

1. **Objective –** To express an opinion on the accompanying financial statements that relate solely to The University of North Carolina at Chapel Hill.

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

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

   Results - The following significant deficiency in internal control over financial reporting was noted as a result of our audit:

   Finding

   Bank Reconciliations Not Timely

   These matters are described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting and the Audit Findings and Recommendations section of this report.

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

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the accompanying basic financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the financial position of The University of North Carolina at Chapel Hill as of June 30, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board 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,* and Statement No. 38, *Certain Financial Statement Note Disclosures,* during the year ended June 30, 2002.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2002 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis (MD&A) on pages 3 to 18 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 supplementary information. However, we did not audit the information and express no opinion on it.

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

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

November 22, 2002

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

This discussion and analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year ended June 30, 2002. Selected financial information for the fiscal year ended June 30, 2001, is included in the discussion and analysis. In future years, when prior year information is available, a comprehensive, comparative analysis will be presented. Management has prepared the discussion and analysis, which should be read in conjunction with the financial statements and the accompanying note disclosures.

Financial Statements Overview

The University's Comprehensive Annual Financial Report includes the following three financial statements.

- Statement of Net Assets
- Statement of Revenues, Expenses, and Changes in Net Assets
- Statement of Cash Flows

These financial statements have been prepared in accordance with Governmental Accounting Standards Board (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,* and GASB Statement No. 38, *Certain Financial Statement Note Disclosures.* These GASB standards were effective for the University for the fiscal year ended June 30, 2002, and include significant changes in the presentation of financial information.

Significant changes to the financial statements are as follows:

- The financial statements are presented in a single-column format. Previously, accountability focused on individual fund groups, which were reported in separate columns.

- The term "net assets" replaces "fund balance". Net assets represent the excess of total assets over total liabilities. There are three classes of net assets – unrestricted, restricted (nonexpendable and expendable) and invested in capital assets, net of related debt.

- Assets and liabilities are categorized as either current or noncurrent. Current liabilities are due within one year, and current assets are those assets available to pay current liabilities.

- Revenues and expenses are categorized as either operating or nonoperating, and a net income or loss from operations is displayed. State appropriations, noncapital gifts, and investment income are treated as nonoperating revenues, which results in a net loss from operations for the University.

- Tuition and fees revenues are reported net of scholarships and fellowships that are applied to student accounts. Scholarship discounts reduce tuition and fees revenues and scholarship and fellowship expenses by equal amounts. Scholarships and fellowships paid directly to students continue to be reported as expenses.

- Expenses are reported in the financial statements by natural classification such as salaries and benefits, supplies and materials and other categories. Presentation by program classification such as instruction, research and public service are disclosed in the notes to the financial statements.

- Expenditures for purchases of capital assets are replaced by the recognition of depreciation expense on the capital assets.

- A Statement of Cash Flows using the direct method is now a required presentation.

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University, and segregates the assets and liabilities into current and noncurrent components. Net assets represent the difference between total assets and total liabilities, and are one indicator of the current financial condition of the University. The following table summarizes the University's assets, liabilities and net assets at June 30, 2002.

	2002
Assets:	
Current Assets	$ 677,009,821
Noncurrent Assets:	
Endowment investments	758,987,497
Other long-term investments	300,226,736
Capital assets, net	1,027,884,988
Other noncurrent assets	125,423,197
Total Assets	2,889,532,239
Liabilities:	
Current Liabilities	280,246,736
Noncurrent Liabilities:	
Funds held in trust for pool participants	291,899,328
Long-term liabilities	321,843,654
Other noncurrent liabilities	31,124,475
Total Liabilities	925,114,193
Net Assets	
Invested in capital assets, net of related debt	608,183,275
Restricted:	
Nonexpendable	304,096,632
Expendable	705,592,337
Unrestricted	346,545,802
Total Net Assets	$ 1,964,418,046

The University's financial position remained strong at June 30, 2002, with total assets of $2.9 billion. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were $2 billion at June 30, 2002.

Current Assets and Liabilities

The Statement of Net Assets indicates the University had total assets of $2.9 billion at June 30, 2002. Working capital, which is current assets less current liabilities, was $397 million. Current assets of $677.0 million include cash and cash equivalents of $325.8 million, short-term investments of $202.9 million, receivables of $121.4 million, inventories of $16.7 million, and other current assets of $10.2 million.

- Cash and cash equivalents include cash in bank accounts, cash with fiscal agents, and cash invested through the State Treasurer of North Carolina.
- Short-term investments include funds invested through an investment pool administered by the University.
- Receivables include amounts due from students of the University, patients of the professional health care clinics, governmental and private entities for contract and grant awards, donors for pledges of gifts as well as accrued investment earnings.
- Inventories represent goods for resale by auxiliary operations of the University.
- Other current assets include student loans and amounts due from the State of North Carolina or its component units.

Current liabilities of $280.2 million include accounts payable and accrued liabilities of $70.5 million, deferred revenue of $38.5 million, obligations under reverse repurchase agreements of $35 million, the current portion of long-term liabilities of $124.9 million and other current liabilities of $11.3 million.

- Accounts payable and accrued liabilities include payables to vendors, accrued payroll costs, retainage on construction contracts, and commercial paper.
- Deferred revenue is primarily students' advance payments and gifts through the planned giving program representing the calculated remainder after annuity obligations to beneficiaries are determined.
- Obligations under reverse repurchase agreements are liabilities incurred as part of the University's investment management program.
- The current portion of long-term liabilities includes bonds payable, notes payable, capital leases payable and compensated absences (accrued vacation leave).
- Other current liabilities include amounts due to North Carolina State government or its component units, deposits and interest payable, and funds held for others.

Endowment and Other Long-Term Investments

Endowment investments were $758.9 million at June 30, 2002 and include permanent endowments, funds internally designated as endowments, and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were $716.2 million. The endowment assets are invested with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (the "Investment Fund"), which is reported as a governmental external investment pool in the financial statements. The Investment Fund is a 501(c)(3) nonprofit corporation established to support the University by operating an investment pool for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University.

The net assets of the endowment are categorized as restricted nonexpendable, restricted expendable, or unrestricted.

- Restricted nonexpendable net assets include permanent endowments for which the donor has stipulated that the principal shall remain inviolate and be invested in perpetuity to generate earnings that can be expended consistent with the purposes specified in the gift instrument.

- Restricted expendable net assets include internally designated endowments established by the University with restricted gifts and the undistributed earnings of permanent endowments.

- Unrestricted net assets include internally designated endowments established by the University with unrestricted funds.

The objective of the endowment's earnings distribution policy is to provide a stable source of spending support that is sustainable over the long term while preserving the purchasing power of the endowment. The earnings distribution is generally 5% of the time weighted average market value of the endowment, but may vary between 4% and 7%.

Investment management of the University's endowment provided a positive, albeit small, return for the fiscal year of 1.2%. This return compares favorably with the -2.2% return of the strategic investment policy portfolio, a short-term benchmark that represents a weighted average for each strategic asset class. The return also compares favorably with the -10.4% return of a long-term performance benchmark, a 70% S&P 500 Index/30% Lehman Brothers Government/Corporate Bond Index.

Other long-term investments of $300.2 million include funds of $281 million of affiliated foundations that are not part of the University's financial reporting entity but do invest through the Investment Fund and bond reserves and related funds of $19.2 million.

Capital Assets and Debt Management

Capital assets, net of accumulated depreciation, at June 30, 2002 and 2001 are as follows:

	2002	2001
Capital Assets:		
Construction in Progress	$ 225,022,791	$ 151,638,839
Land and other Nondepreciable Assets	75,465,273	74,075,659
Buildings	491,322,542	449,711,643
General Infrastructure	162,460,694	156,373,495
Machinery and Equipment	73,613,688	74,081,893
Total	$ 1,027,884,988	$ 905,881,529

The University's strategic and capital planning is a long-term process that is continuously reevaluated. The University has adopted a *Facilities Profile and 10-Year Capital Plan*, recognizing the need for additional academic and students life facilities to keep pace with programmatic expansion. One of the critical factors for the University in fulfilling its mission of instruction, research, and public service and for providing a satisfying residential life for its students is investment in its facilities. Maintenance and renewal of its facilities and infrastructure is an important priority for the University, as evidenced by its $1.2 billion capital construction program.

The 48.4% increase in construction in progress to $225 million at June 30, 2002, is one indicator of the University's commitment to the improvement of its capital assets. Projects completed during fiscal year 2001-2002 include construction of new residence halls to house 960 students and Hyde Hall, the new home of the Institute for the Arts and Humanities, as well as renovations to the Robert B. House Undergraduate Library. Many other important projects are under construction. The $64.8 million Medical Biomolecular Research Building is nearing completion, as is a $22.1 million addition, Banks D. Kerr Hall, in the School of Pharmacy. The $14.2 million renovation and addition to the Frank Porter Graham Student Union continues, as does the construction of the $33.7 million Bioinformatics Building. Construction has begun on the $9 million Sonja Haynes Stone Black Cultural Center, and many other capital projects are also underway. Projects related to the general infrastructure of the campus have also been completed or are under construction.

To achieve its capital plan, the University uses a mix of funding sources, including State funds (higher education bonds and appropriations), University bonds, internal reserves and philanthropy. University bonds provide an integral source of funds, and bonds payable were $383.9 million at June 30, 2002. Previous changes in State legislation allowed the University to use a broader stream of revenues for the repayment of its debt obligations, and general revenue bonds were initially issued in fiscal year 2000-2001. The use of general revenue bonds provide a stronger, more flexible financing alternative that captures the strengths of not only our auxiliary and student-related revenues, but also of our research programs.

A commercial paper program was implemented during fiscal year 2001-2002 and provides low cost working capital and bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. The program was implemented as part of a long-term strategy to provide effective and flexible funding for the University's $1.2 billion capital improvement program to renovate and build new facilities.

Many projects are currently underway on campus, including critical bond-funded projects, essential new research buildings, major new cultural facilities that will benefit the local community, undergraduate residence halls, student family housing, and parking facilities. The capital financing program is separated into two five-year phases, the first of which is occurring from fiscal year 2000-2001 through fiscal year 2005-2006, with the projected buildout extending through fiscal year 2007-2008. University debt of $534 million, of which $110 million has been issued, will provide funding for the capital program. State higher education bond proceeds and appropriations will fund $526 million, fund-raising will provide $121 million, and $22 million will come from reserves and other sources. Commercial paper debt was $1 million at June 30, 2002. The commercial paper program and the general revenue bonds allow the University to use a central bank concept for funding capital projects. The University issues fixed and variable rate debt externally, and blends the average borrowing rate to allocate debt costs to individual capital projects and campus divisions. This concept provides a stable and flexible debt-funding source for capital projects.

The University's financial strength allowed it to achieve ratings of AA+/Aa1 by the national rating agencies. The University debt burden ratio, a measure of an entity's dependence on borrowed funds, was only 2.4% at June 30, 2002.

For additional information refer to Note 6, Capital Assets, and Note 8, Long-Term Liabilities.

Other Noncurrent Assets

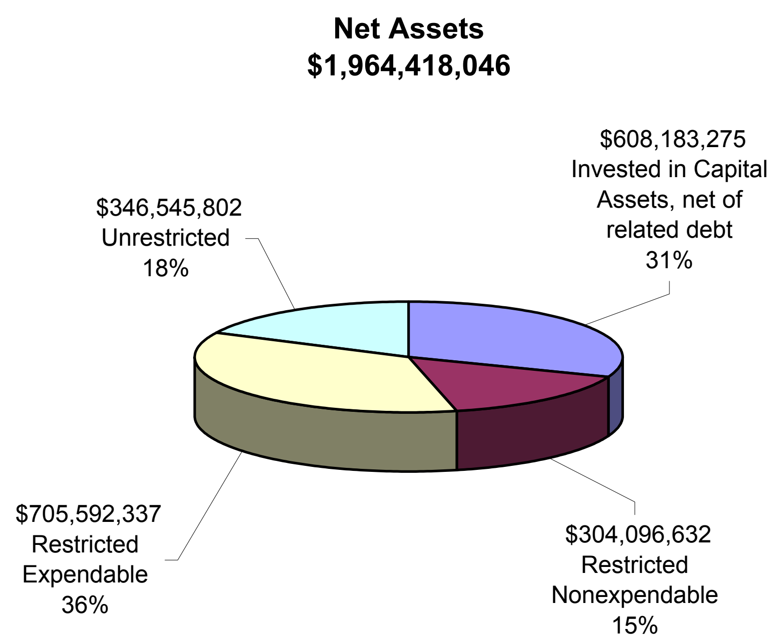
Other noncurrent assets include restricted cash and cash equivalents of $56.5 million, receivables for pledged gifts of $25.4 million, notes receivable for student loans of $26.1 million and a restricted due from the primary government of $17.4 million from statewide higher education bond proceeds.

Noncurrent Liabilities

Noncurrent liabilities of $644.9 million include funds of $291.9 million held for affiliated foundations that are not part of the University's financial reporting entity but that do invest through the Investment Fund. Other noncurrent liabilities of $31.1 million are refundable U.S. government grants that provide resources for student loan programs. Long-term liabilities of $321.9 million are the noncurrent portion of bonds payable, notes payable, capital leases payable, compensated absences, and annuities payable.

Net Assets

Net assets, reported as fund balance in previous years, represent the value of the University's assets after liabilities are deducted. The University's net assets at June 30, 2002, are summarized as follows:



The invested in capital assets, net of related debt category represents the University's land, buildings, general infrastructure, equipment, and other capital assets net of accumulated depreciation and net of the outstanding bonds and other indebtedness on the facilities. The restricted nonexpendable category includes the University's permanent endowments funds. The restricted expendable category primarily includes restricted internally designated endowments, gifts, contract and grant awards and distributed endowment earnings. The unrestricted category includes unrestricted internally designated endowments, gifts, auxiliary operations, facilities and administrative funds (overhead receipts) and other unrestricted funds. While there are no externally imposed restrictions on unrestricted funds, the funds are substantially designated by the University for particular academic programs or capital needs.

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

The Statement of Revenues, Expenses, and Changes in Net Assets presents the University's results of operations. The condensed statement for the fiscal year ended June 30, 2002, is as follows:

	2002
Operating Revenues:	
Student tuition and fees, net	$ 124,661,145
Grants and contracts	479,219,974
Sales and services, net	376,716,731
Other	22,972,089
Total Operating Revenues	1,003,569,939
Operating Expenses	1,477,012,999
Operating Loss	(473,443,060)
Nonoperating Revenues (Expenses):	
State appropriations	368,504,553
Noncapital gifts, net	62,403,802
Investment income, net	52,956,614
Interest and fees on capital asset-related debt	(15,031,104)
Other nonoperating revenues (expenses)	(7,661,489)
Income Before Other Revenues, Expenses, Gains, or Losses	(12,270,684)
State capital grants	27,479,400
Capital gifts, net	8,238,379
Additions to permanent endowments	21,946,491
Increase in Net Assets	45,393,586
Net Assets – July 1, 2001	1,919,024,460
Net Assets – June 30, 2002	$ 1,964,418,046

Despite reductions in State appropriations due to statewide revenue shortfalls, the net loss from operating and nonoperating activities was limited to $12.3 million. Overall, net assets of the University increased by $45.4 million in fiscal year 2001-2002 when capital gifts and endowment additions are included.

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees of $124.7 million are reported net of the scholarship discount of $25.8 million. Gross student tuition and fees of $150.5 million represent an increase 8.1% over the prior year. An approved increase of $300 per student, a 4% inflationary increase, and additional increases for graduate students resulted in the increase in fiscal year 2001-2002.

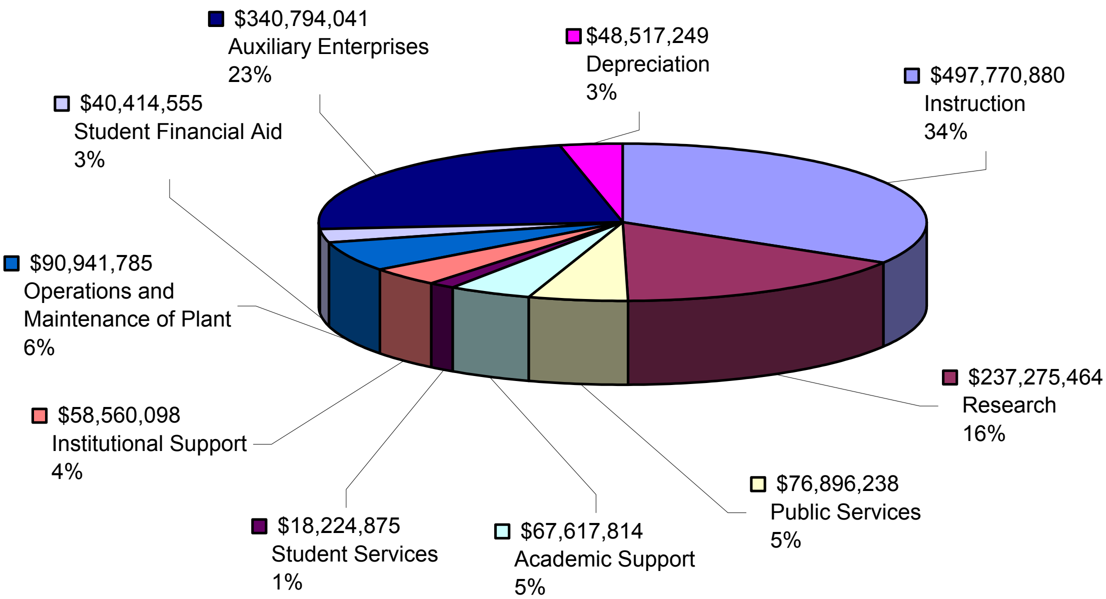
Revenues from grants and contracts totaled $479.2 million and increased 10% over the prior year. The University is among the nation's leading public research universities with a diversified portfolio of research funding. Funding from the National Institutes of Health (NIH) increased 14%, placing the University 12th nationally in overall funding from the NIH. The University also ranks among the top 20 institutions nationally in federal support for science and technology.

Sales and services revenues of $376.7 million, including patient services, represented an increase of 18% over the prior year and included the revenues of campus auxiliary or similar operations such as student housing, student stores, student health services, the utilities system, parking and transportation, the professional health care clinics and others. The increased revenues resulted from rate increases for the utilities system and student housing and dining as well as the inclusion of clinical contracts for the health care operations in sales and services. Other revenues of $22.9 million represent operating resources not separately identified and include, as examples, an assessment to the Investment Fund to support administrative services, funds from the State's program to match gifts for distinguished professorship endowments, library fines and interest on student loans.

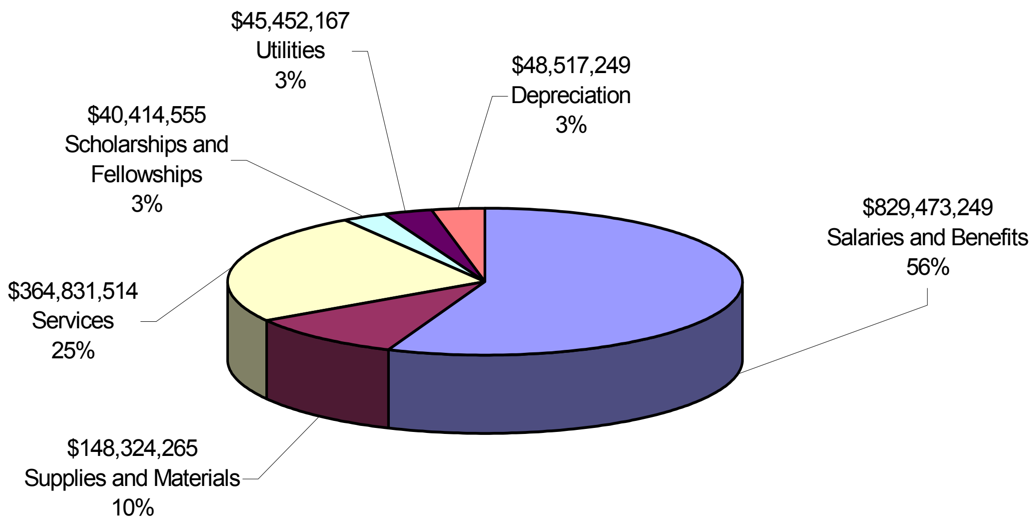
Operating Expenses

The University's operating expenses were $1.5 billion for the fiscal year ended June 30, 2002. The operating expenses are reported by natural classification in the financial statement and by functional classification in the note disclosures. The following charts illustrate the University's operating expenses by the two classifications.

Expenses by Function
$1,477,012,999



Expenses by Nature
$1,477,012,999



Nonoperating Revenues and Expenses
State appropriations of $368.5 million, noncapital gifts of $62.4 million, investment income of $53.0 million, interest and fees on capital assets related debt of -$15.0 million, and other revenues and expenses of -$7.7 million comprise nonoperating revenues and expenses. These revenues are considered nonoperating because they were not generated by the University's principal, ongoing operations. For example, State appropriations were not generated by the University but were provided to help fund operating expenses.

The University's initial budget for State appropriations was $407.9 million for fiscal year 2001-2002. This initial budget for State appropriations included increases of $21.2 million to fund enrollment increases including distance learning and other program enhancements as well as reductions in budgeted State appropriations of $23.2 million. During the fiscal year, it was determined that the State of North Carolina would not meet its budget revenue targets. To ensure that the State ended the fiscal year with a balanced budget, spending limitations were enacted statewide and the carryforward of unspent appropriations was disallowed. These limitations resulted in a loss of State appropriations of $39.4 million when compared to the budget.

Net noncapital gifts of $62.4 million represent expendable gifts received and pledges made and are net of an allowance for uncollectible pledges. Net investment income of $53 million includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. Interest and fees on capital asset-related debt were $15 million. Other nonoperating expenses total $7.7 million and include $6.6 million in capital asset disposals.

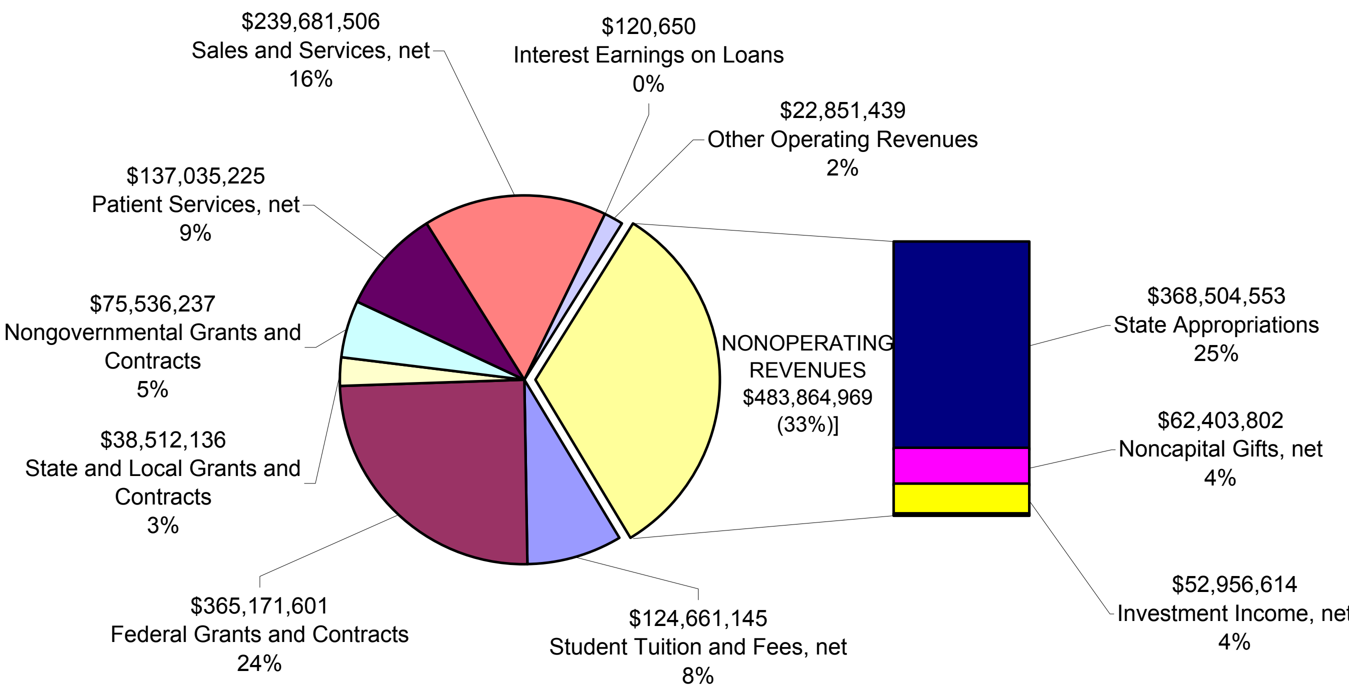
Other Changes in Net Assets

State capital grants of $27.5 million are statewide higher education bond proceeds for capital construction projects. Capital gifts of $8.2 million also provided funding for construction projects. Nonexpendable gifts and other additions to permanent endowments were $21.9 million.

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as State appropriations, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and nonoperating revenues which total $1.5 billion.

TOTAL REVENUES BY SOURCE
$1,487,434,908



Condensed Statement of Cash Flows

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. Cash decreased by $37.8 million during the fiscal year 2001-2002. The condensed statement for the fiscal year ended June 30, 2002 is as follows:

		2002
Cash Flows Provided (Used):		
Operating activities	$	(403,993,881)
Noncapital financing activities		446,775,572
Capital and related financing activities		(171,429,157)
Investing activities		90,827,088
Net Decrease in Cash		(37,820,378)
Cash – July 2, 2001		420,086,283
Cash – June 30, 2002	$	382,265,905

- Cash flows from operating activities include, as examples, cash received for tuition and fees or research grants and salaries paid to faculty or payments of invoices to vendors. Since State appropriations and gifts are not considered an operating revenue, operating activities had a net cash outflow of $404 million.

- Noncapital financing activities include State appropriations received for operations and noncapital gifts, and had a net cash inflow of $446.8 million.

- The cash flows from capital and related financing activities include the proceeds received from short-term and long-term debt obligations, the repayment of debt, and the acquisition of capital assets. Due to the significant expenditure of funds that were received as bond proceeds in prior years, capital and related financing activities had a net cash outflow of $171.4 million.

- The net cash inflows from investing activities of $90.8 million include purchases and sales of equity securities and other investments as well as interest and dividends received.

Economic Outlook

Management believes the University will maintain its solid financial foundation and is well-positioned to continue demonstrating excellence in teaching, discovery and public service. The University's strong debt credit rating, relatively low tuition levels, impressive student body, solid support from the State in difficult economic times, diversified portfolio of research funding, strong investment performance, and outstanding fund-raising capabilities are among the factors indicating a bright future for the University.

Tuition rates increased for fiscal year 2002-2003 by 8% for resident students and 12% for nonresident students. The funds are designated for enrollment growth funding and need-based student financial aid for undergraduate students. A special campus increase of $300 per student was approved to enhance instructional and academic support, provide need-based student aid, and fund more competitive faculty salaries.

The condition of the State economy declined during fiscal year 2001-2002. However, more economic activity is expected for fiscal year 2002-2003 when compared to the prior year. Improvement in the stock market is anticipated as corporate earnings increase. The University was provided a reasonable funding level for State appropriations for 2002-2003. The University's State appropriations budget for 2002-2003 was reduced by $11.6 million to $391.8 million, which represents an increase of 6.3% over fiscal year 2001-2002. The amount of any additional reductions for fiscal year 2002-2003 is unknown. University management may determine the allocation of the budget reductions.

On October 11, 2002, the University announced the $1.8 billion Carolina First fund-raising campaign. The campaign began its quiet phase on July 1, 1999. As of June 30, 2002, gifts, pledges, and deferred commitments of $817 million had been received. Gift receipts were $497 million of that total. Of the $1.8 billion goal, more than half is targeted directly for the University and for the business school, social work, law and UNC foundations, with the remainder for other University related-foundations.

As of June 30, 2002 endowment commitments totaled $328 million toward the overall endowment goal of $700 million. With 37.5 percent of the campaign completed the drive has reached 47% of the endowment goal. We expect that success to continue. While some pledge collections may be delayed because of current economic conditions, we are confident that we will reach both the overall and endowment goals by the end of the campaign on June 30, 2007.

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2002 — *Exhibit A*

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	134,948,413
Restricted Cash and Cash Equivalents		190,843,227
Short-Term Investments		131,039,580
Restricted Short-Term Investments		71,858,492
Receivables, Net (Note 5)		121,372,921
Due from Primary Government		4,663,472
Due from State of North Carolina Component Units		2,799,547
Inventories		16,660,221
Notes Receivable, Net (Note 5)		2,823,948
Total Current Assets		677,009,821
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		56,474,265
Receivables, Net (Note 5)		25,449,474
Restricted Due from Primary Government		17,448,686
Endowment Investments		758,987,497
Other Long-Term Investments		300,226,736
Notes Receivable, Net (Note 5)		26,050,772
Capital Assets, Net (Note 6)		1,027,884,988
Total Noncurrent Assets		2,212,522,418
Total Assets		2,889,532,239
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 7)		70,478,088
Due to Primary Government		198,183
Due to State of North Carolina Component Units		1,843,848
Deferred Revenue		38,517,030
Interest Payable		2,208,906
Deposits Payable		1,135,327
Funds Held for Others		5,934,797
Obligations Under Reverse Repurchase Agreements		34,995,000
Long-Term Liabilities - Current Portion (Note 8)		124,935,557
Total Current Liabilities		280,246,736
Noncurrent Liabilities:		
U. S. Government Grants Refundable		31,124,475
Funds Held in Trust for Pool Participants		291,899,328
Long-Term Liabilities (Note 8)		321,843,654
Total Noncurrent Liabilities		644,867,457
Total Liabilities		925,114,193

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2002

Exhibit A
Page 2

NET ASSETS		
Invested in Capital Assets, Net of Related Debt		608,183,275
Restricted for:		
Nonexpendable:		
Scholarships and Fellowships		76,426,182
Research		9,971,833
Endowed Professorships		107,759,463
Departmental Uses		47,584,886
Loans		13,214,353
Library Acquisitions		18,926,206
Other		30,213,709
Expendable:		
Scholarships and Fellowships		103,039,482
Research		26,973,584
Endowed Professorships		170,169,791
Departmental Uses		198,961,418
Plant Improvements		21,471,111
Capital Projects		118,810,804
Debt Service		10,722,820
Library Acquisitions		28,674,617
Instruction and Educational Service Agreements		26,768,710
Unrestricted		346,545,802
Total Net Assets	$	1,964,418,046

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

The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2002

Exhibit B

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 10)	$	124,661,145
Federal Grants and Contracts		365,171,601
State and Local Grants and Contracts		38,512,136
Nongovernmental Grants and Contracts		75,536,237
Patient Services, Net (Note 10)		137,035,225
Sales and Services, Net (Note 10)		239,681,506
Interest Earnings on Loans		120,650
Other Operating Revenues		22,851,439
Total Operating Revenues		1,003,569,939
EXPENSES		
Operating Expenses:		
Salaries and Benefits		829,473,249
Supplies and Materials		148,324,265
Services		364,831,514
Scholarships and Fellowships		40,414,555
Utilities		45,452,167
Depreciation		48,517,249
Total Operating Expenses		1,477,012,999
Operating Loss		(473,443,060)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		368,504,553
Noncapital Gifts, Net (Note 10)		62,403,802
Investment Income (Net of Investment Expense of $2,220,237)		52,956,614
Interest and Fees on Capital Asset-Related Debt		(15,031,104)
Other Nonoperating Revenues (Expenses)		(7,661,489)
Net Nonoperating Revenues		461,172,376
Loss Before Other Revenues, Expenses, Gains, or Losses		(12,270,684)
Capital Grants		27,479,400
Capital Gifts, Net (Note 10)		8,238,379
Additions to Permanent Endowments		21,946,491
Increase in Net Assets		45,393,586
NET ASSETS		
Net Assets - July 1, 2001, as Restated (Note 18)		1,919,024,460
Net Assets - June 30, 2002	$	1,964,418,046

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

The University of North Carolina at Chapel Hill
Statement of Cash Flows
Year Ended June 30, 2002

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	994,354,800
Payments to Employees and Fringe Benefits		(827,166,001)
Payments to Vendors and Suppliers		(555,090,010)
Payments for Scholarships and Fellowships		(40,414,555)
Loans Issued to Students		(3,562,402)
Collection of Loans to Students		5,751,046
Other Receipts (Payments)		22,133,241
Net Cash Used by Operating Activities		(403,993,881)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Appropriations		368,504,553
Grants for Other than Capital Purposes		3,890,817
Noncapital Gifts		53,150,901
Additions to Permanent and Term Endowments		21,946,491
Related Activity Agency Receipts		4,971,473
Related Activity Agency Disbursements		(5,688,663)
Net Cash Provided by Noncapital Financing Activities		446,775,572
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Proceeds from Capital Debt		1,000,000
Proceeds from Capital Refunding Debt		66,965,201
Capital Grants		34,539,226
Capital Gifts		6,898,069
Acquisition and Construction of Capital Assets		(175,519,351)
Principal Paid on Capital Debt and Leases		(14,130,000)
Defeasance of Capital Debt		(70,065,001)
Interest and Fees Paid on Capital Debt and Leases		(21,117,301)
Net Cash Used by Capital Financing Activities		(171,429,157)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		732,646,620
Interest on Investments		60,629,791
Purchase of Investments and Related Fees		(702,449,323)
Net Cash Provided by Investing Activities		90,827,088
Net Decrease in Cash and Cash Equivalents		(37,820,378)
Cash and Cash Equivalents - July 1, 2001		420,086,283
Cash and Cash Equivalents - June 30, 2002	$	382,265,905

The University of North Carolina at Chapel Hill
Statement of Cash Flows
Year Ended June 30, 2002

Exhibit C
Page 2

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

Operating Loss	$	(473,443,060)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		48,517,249
Allowances, Write-Offs, and Amortizations		(863,712)
Nonoperating Other Income (Expense)		(1,097,034)
Changes in Assets and Liabilities		
Receivables, Net		17,880,346
Notes Receivables, Net		2,106,858
Inventories		(573,956)
Accounts Payable and Accrued Liabilities		1,746,007
Due to Primary Government		91,629
Deferred Revenue		95,873
Compensated Absences		5,425,219
U.S. Government Grants Refundable		1,581,612
Funds Held for Others		(5,460,912)
Net Cash Used by Operating Activities	$	(403,993,881)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	134,948,413
Restricted Cash and Cash Equivalents		190,843,227
Noncurrent Assets		56,474,265
Total Cash and Cash Equivalent Balances	$	382,265,905

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	$	9,857,223
Assets Acquired through a Gift		1,008,188
Change in Fair Value of Investments		(17,465,914)
Increase in Receivable Related to Nonoperating Income		9,585,023

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

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NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have both delegated and statutory responsibilities for financial accountability of the University's funds. Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-CH Foundation), The Kenan-Flagler Business School Foundation (Business School Foundation), The School of Social Work Foundation, Inc. (School of Social Work Foundation), and UNC Law Foundation, Inc. (Law Foundation), are reported as if they were part of the University.

The Investment Fund is governed by a board consisting of 11 ex officio directors and one or two elected directors. Ex officio directors include all of the members of the Board of Trustees of the Endowment Fund of the University of North Carolina at Chapel Hill, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement. The UNC-CH Foundation Board may, in its discretion, elect one or two of its at-large members to the Investment Fund Board. The Investment Fund's purpose is to support the University by operating an investment fund for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. The Investment Fund is a governmental external investment pool. Because the members of the Board of Directors of the Investment Fund are officials or appointed by officials of the University and the Investment Fund's primary purpose is to benefit the University of North Carolina at Chapel Hill and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The UNC-CH Foundation is governed by a 17-member board consisting of nine ex officio directors and eight elected directors. Ex officio directors include the Chairman of the Board of Trustees of the University of North Carolina at Chapel Hill, the Chancellor, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement (nonvoting). In addition, two ex officio directors are elected by the Board of Trustees from the membership of that board and three ex officio directors are elected by the Board of Trustees from the membership of the Board of Trustees of the Endowment Fund of the University of North Carolina at Chapel Hill who have not otherwise been selected. The eight remaining directors are elected to membership on the UNC-CH Foundation Board of Directors by action of the ex officio directors. The UNC-CH 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 members of the Board of Directors of the UNC-CH Foundation are officials or appointed by officials of the University and the UNC-CH Foundation's sole purpose is to benefit the University of North Carolina at Chapel Hill, its financial statements have been blended with those of the University.

The Business School Foundation is governed by a board consisting of four ex officio directors and four or more elected directors. Ex officio directors include the Dean of the Kenan-Flagler Business School (Business School), the Chief Financial Officer of the Business School, the Assistant Dean of Academic Affairs, and the Associate Dean for MBA Programs of the Business School. The remaining directors are elected to membership on the Business School Foundation Board of Directors by action of the ex officio directors. The Business School Foundation's purpose is to aid, promote, and support the Business School at the University of North Carolina at Chapel Hill. Because the members of the Board of Directors of the Business School Foundation are officials or appointed by officials of the University, the financial statements of the Business School Foundation have been blended with those of the University.

The Social Work Foundation is governed by a board consisting of three ex officio directors and 10 elected directors. Ex officio directors include the Dean of the School of Social Work, the Chairman of the Board of Advisors to the School of Social Work, and the Assistant Dean for External Affairs. The remaining 10 board of directors are elected to membership on the Social Work Foundation by action of the ex officio directors. The Social Work Foundation's purpose is to foster and promote the growth, progress and general welfare of social work practice and research at the School of Social Work of the University of North Carolina at Chapel Hill. Because the members of the Board of Directors of the Social Work Foundation are officials or appointed by officials of the University, the financial statements of the Social Work Foundation have been blended with those of the University.

The Law Foundation is governed by a board consisting of one ex officio director, six appointed directors and six elected directors. The ex officio director is the Dean of the School of Law of the University of North Carolina at Chapel Hill. The ex officio director appoints six directors, while the Board of Directors of the Law Alumni Association of the UNC, Inc. elects the other six directors. The Law Foundation's purpose is to provide support, foster, and encourage the study and teaching of law at the Law School of the University of North Carolina at Chapel Hill. Because a majority of the members of the Board of Directors of the Law Foundation are officials or appointed by officials of the University, the financial statements of the Law Foundation have been blended with those of the University.

Separate financial statements for the Investment Fund and blended foundations may be obtained from the University Controller's Office, Campus Box 1279, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370. Other related foundations and similar non-profit corporations for which the University is not financially accountable are not part of the accompanying financial statements except for their participation in the Investment Fund and Temporary Pool as presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. The University's financial statements include the financial activities of the clinical patient care programs. These clinical patient care programs established or maintained by the School of Medicine of the University of North Carolina at Chapel Hill are a component unit of the University of North Carolina Health Care System, which is a component unit of the University of North Carolina System.

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,* effective for the University's year ended June 30, 2002, the full scope of the University's activities is considered to be a single business-type activity (BTA) and accordingly, is reported within a single column in the basic financial statements.

C. Basis of Accounting - The financial statements of the University have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred. Non-exchange transactions, in which the University receives value without directly giving equal value in exchange, include grants, State appropriations, and private donations. On an accrual basis, revenues from these transactions are recognized in the fiscal year in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection.

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, for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

D. Cash and Cash Equivalents – This classification appears on the Statement of Net Assets and the Statement of Cash Flows and includes cash on deposit with private bank accounts, petty cash, undeposited receipts, savings accounts, cash on deposit with fiscal agents and deposits with the State Treasurer's Cash and Investment Pool (a governmental external investment pool).

E. Investments - This classification includes long-term fixed income investments, repurchase agreements, equity investments, mutual funds, money market funds, certificates of deposit, limited partnerships, real estate investment trusts, and other asset holdings by the University. Except for money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings, these investments are reported at fair value for year-end financial reporting purposes. Fair value is the amount at which an investment could be exchanged between two willing parties. Fair value for financial reporting purposes is based on quoted market prices. The net increase (decrease) in the fair value of investments is recognized as a part 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.

Short-term investments include marketable securities representing the investment of cash that is available for current operations. A majority of this available cash is invested in the University's Temporary Pool, a governmental external investment pool.

F. **Receivables** – The receivables consist of tuition and fees charges to students, and charges to patients for services provided by the UNC Physicians & Associates and the Dental Faculty Practices. 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, pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource providers conditions have been satisfied, and notes receivable from loans to students. Patients, pledges and notes receivables are recorded net of allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.

G. **Inventories** – Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost of market. The inventories consist of expendable supplies, postage, fuel held for consumption, textbooks, and other merchandise for resale.

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 University capitalizes assets that have a value or cost in excess of $5,000 at the date of acquisition and an expected useful life of one or more years. Library books are expensed.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 40 years for general infrastructure, 10 to 50 years for buildings, and 4 to 10 years for equipment.

The University's historic property, artworks and literary collections are capitalized at cost or fair value at the date of donation. These property and collections are considered inexhaustible and are therefore not depreciated.

I. **Restricted Assets** – Restricted assets represent assets whose use is restricted by external parties or by law through constitutional provisions or enabling legislation.

J. **Funds Held in Trust for Pool Participants** – Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 3.

K. **Funds Held in Trust by Others -** Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2002, is approximately $26,589,426.

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

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

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

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

The University has the policy of recording the cost of sick leave when taken and paid rather than when the leave is earned. The policy provides for unlimited accumulation of sick leave, but the employee cannot be compensated for any unused sick leave upon termination of employment.

N. 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. 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 University would generally first apply restricted funds, although individual departments have authority to use either restricted or unrestricted funds as appropriate.

O. 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.

P. **Revenue and Expense Recognition** – The University presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.* Operating activities are those activities that are necessary and essential to the mission of the University. Operating revenues include all charges to customers, grants received for student financial assistance, research contracts and grants, and interest earned on loans. Grants received for student financial assistance are considered operating revenues because they provide resources for student charges and such programs are necessary and essential to the mission of the University. 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. Operating expenses are all expense transactions incurred other than those related to investing, capital or noncapital financing activities. Revenues received for capital financing activities, as well as related expenses, are considered neither operating nor nonoperating activities and are presented after nonoperating activities on the accompanying Statement of Revenues, Expenses, and Changes in Net Assets.

Q. **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 utility services, telecommunications, central stores, printing and copy centers, postal services, repairs and maintenance 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 - BUDGETING AND BUDGETARY CONTROL

The State of North Carolina operates on a biennial budget cycle with separate annual departmental and institutional certified budgets adopted by the General Assembly.

Chapter 116, Article 1, Part 2A of the North Carolina General Statutes authorizes the universities within the sixteen-campus University of North Carolina System to apply for special responsibility status, which sets the legal level of budgetary control at the institution's budget code level. A budget code is a convention used in the State's accounting system to distinguish the type of fund and the responsible department or institution. Budget codes are also used to segregate certain purposes within departments or institutions. Institutions with special responsibility status must still have certain budget revisions, primarily those associated with unanticipated revenues, approved by the Office of State Budget and Management. Additionally, universities must maintain programs and services in accordance with the guidelines established by the Board of Governors of the consolidated University of North Carolina System. The University of North Carolina at Chapel Hill has applied for and received special responsibility status.

After the budget is approved by the General Assembly and adopted by the Board of Governors, the University follows an established system of budgetary controls. Periodic interim budget statements to department heads guide them in managing budget allocations. Monthly financial reports, which include budget and actual data, are provided for each fund to individual managers responsible for the fund. When actual conditions require changes to the budget, revisions are prepared and communicated to those affected. Changes to the budget are reviewed and approved at the University or State level as required. The University maintains an encumbrance accounting system as another method to ensure that imposed expenditure constraints are observed. The State budgetary control is maintained on a cash basis of accounting.

NOTE 3 - DEPOSITS AND INVESTMENTS

A. **Deposits** - The University is required by General Statute 147-77 to deposit its budget code cash, as defined in Note 2, and by the University of North Carolina Board of Governors pursuant to General Statute 116-36.1 to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, in the State Treasurer's Cash and Investment Pool. In addition, 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's Cash and Investment

Pool. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

Deposits include cash and cash equivalents and certificates of deposit totaling $382,124,912. At year-end, cash on hand was $140,993. The University's portion of the State Treasurer's Cash and Investment Pool was $354,919,311. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name. The carrying amount of the University's deposits not with the State Treasurer was $27,346,594 and the bank balance was $5,976,150. Of the bank balance, $1,557,248 was covered by federal depository insurance or by collateral held by the University's agent in the University's name, and $4,418,902 was uninsured and uncollateralized.

North Carolina General Statute 147-69.1(c), applicable to the State's General Fund, and General Statute 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. General Statute 147-69.1(c) also authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. General Statute 147-69.2 also authorizes the following: general obligations of other states; general obligations of North Carolina local governments; certain venture capital limited partnerships; and the obligations or securities of the North Carolina Enterprise Corporation.

The financial statements and disclosures for the State Treasurer's Cash and Investment Pool are included in the State of North Carolina's *Comprehensive Annual Financial Report.* An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.osc.state.nc.us/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

B. **Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to General Statute 116-36.2 to invest its special funds and funds received for services rendered by health care professionals pursuant to General Statute 116-36.1(h) in the same manner as the State Treasurer is required to invest, as previously discussed.

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

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

Investments of the University's component units, the UNC-CH Foundation, the Investment Fund, the Business School Foundation, the Social Work Foundation and the Law Foundation are subject to General Statute 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

Temporary Investment Pool (Temporary Pool) - This is a fixed income portfolio managed by the University's Investment Office and Wachovia Asset Management. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. The Temporary Pool is not registered with the SEC and the University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Northern Trust Company is the custodian for the Temporary Pool and provides the University's Director of Accounting Services with monthly statements defining income and market value information. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, corporate bonds, mutual funds and money market funds. In June 2002 the

University elected to invest a portion of the Temporary Pool assets into the University's Investment Fund.

Through written request to Accounting Services, participants may purchase and sell shares in the Temporary Pool at a fixed value of $1 per share. Generally, the purchase and sale of participation shares occur only at the beginning of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are sent to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund balance. The rates are set in coordination between the University's Investment Office and the Vice Chancellor for Finance and Administration.

UNC-CH Foundation Investment Fund Inc. (Investment Fund) - This is a North Carolina nonprofit corporation exempt from income tax pursuant to Section 501(c)3 established in January, 1997 by the University and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, nonprofit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. The University's Endowment, the UNC-CH Foundation, the Business School Foundation, the Social Work Foundation, and the Law Foundation are included in the University's reporting entity (internal portion). Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants.

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Board of Directors (See Note 1 A). The Investment Fund Board is responsible for adopting investment objectives and policies, for hiring investment advisors, and for monitoring policy implementation and investment performance. The Board has generally chosen not to make individual security selection decisions. The Board's primary role is to oversee the allocation of the Investment Fund Portfolio among asset classes, investment vehicles, and investment managers.

The Northern Trust Company is the custodian for the Investment Fund and provides the University with monthly statements defining income and market value information. The Investment Fund uses a unit basis to determine each participant's market value and to distribute the Fund's earnings according to the Fund's spending policy. There are no involuntary participants in the Investment Fund pool. The University has not provided or obtained any legally binding guarantees during the period to support the value for the pool's investments. The audited financial statements for the Investment Fund pool may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

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

A summary of the University's investments at June 30, 2002 is presented below:

Temporary Pool Investments

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U. S. Government Securities	$ 85,505,183	$ 0	$ 0	$ 85,505,183
Collateralized Mortgage Obligations	49,737,227			49,737,227
State and Municipal Securities	4,640,640			4,640,640
Corporate Bonds	44,111,103			44,111,103
Corporate Stock	30,000			30,000
Total Categorized Investments	$ 184,024,153	$ 0	$ 0	$ 184,024,153
Investments Not Categorized:				
Investments Held by Broker-Dealers				
Under Reverse Repurchase Agreements				
U. S. Government Securities				15,133,500
Money Market Funds				7,859,537
Mutual Funds				22,142,135
Total Investments Not Categorized				45,135,172
Total Temporary Pool Investments				$ 229,159,325

Investment Fund Pool Investments

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U. S. Government Securities	$ 8,280,031	$ 0	$ 0	$ 8,280,031
Collateralized Mortgage Obligations	11,925,245			11,925,245
Corporate Bonds	8,197,210			8,197,210
Corporate Stocks	88,440,413			88,440,413
Total Categorized Investments	$ 116,842,899	$ 0	$ 0	$ 116,842,899
Investments Not Categorized:				
Investments Held by Broker-Dealers				
Under Reverse Repurchase Agreements				
U. S. Government Securities				19,352,433
Money Market Funds				14,509,031
Mutual Funds				363,546,415
Limited Partnerships				409,112,030
Real Estate Investment Trusts				12,633,966
Other Investments				69,600
Total Investments Not Categorized				819,223,475
Total Investment Fund Pool Investments				$ 936,066,374

Non-Pooled Investments

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U. S. Government Securities	$ 4,664,437	$ 843,571	$ 0	$ 5,508,008
State and Municipal Securities	672,194			672,194
Corporate Bonds	6,523,990			6,523,990
Corporate Stocks	10,610,402	1,196,518		11,806,920
Total Categorized Investments	$ 22,471,023	$ 2,040,089	$ 0	$ 24,511,112
Investments Not Categorized:				
Money Market Funds				33,184,162
Mutual Funds				24,671,204
Real Estate				10,778,788
Other Investments				3,741,340
Total Investments Not Categorized				72,375,494
Total Non-Pooled Investments				$ 96,886,606

Total Investments

	Fair Value			
	Risk Category			
	1	2	3	Total
Total Categorized Investments	$ 323,338,075	$ 2,040,089	$ 0	$ 325,378,164
Total Investments Not Categorized				936,734,141
Total Investments				$ 1,262,112,305

Since a separate annual financial report on the Temporary Investment Pool has not and is not planned to be issued, the following additional disclosures are being provided in the University's financial statements.

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2002 are as follows:

Statement of Net Assets
June 30, 2002

Assets	
State Treasurer Investment Fund	$ 22,000,000
Accrued Investment Income	1,427,530
Investment Fund Equity	24,574,434
Investments	229,159,325
Total Assets	$ 277,161,289
Liabilities	
Obligations Under Reverse Repurchase Agreements	$ 15,075,000
Deferred Income	556,301
Total Liabilities	15,631,301
Net Assets	
Internal Portion	169,628,350
External Portion	91,901,638
Total Net Assets	261,529,988
Total Liabilities and Net Assets	$ 277,161,289

Statement of Operations and Changes in Net Assets
For the Fiscal Year Ended June 30, 2002

Increase in Net Assets From Operations	
Revenues:	
Investment Income	$ 16,133,440
Expenses:	
Investment Management	263,330
Net Increase in Net Assets Resulting from Operations	15,870,110
Distributions to Participants	
Distributions Paid and Payable	15,870,110
Share Transactions	
Net Share Purchases	51,174,558
Total Increase in Net Assets	51,174,558
Net Assets	
Beginning of Year	210,355,430
End of Year	$ 261,529,988

The major investment classifications of the Temporary Pool had the following attributes at June 30, 2002:

Investment Classification	Fair Value	Principal Amount	Range of Interest Rates	Range of Maturities
U.S. Government Securities:	$ 85,505,183	$ 82,293,379	2.5% - 11.5%	2003 - 2030
Collateralized Mortgage Obligations	49,737,227	44,287,212	2.8% - 19.0%	2002 - 2032
State and Municipal Securities	4,640,640	4,396,640	2.7% - 4.0%	2009
Corporate Bonds	44,111,103	43,219,384	2.5% - 8.7%	2003 - 2011
Corporate Stocks	30,000	30,000	N/A	N/A
Mutual Funds	22,142,135	20,380,659	N/A	N/A
Money Market Funds	7,859,537	7,859,537	1.8%	1 day
Reverse Repurchase Agreements	15,133,500	15,010,222	1.8%	1 day
Total Temporary Pool Investments	$ 229,159,325	$ 217,477,033		

C. **Reverse Repurchase Agreements** - Under the University's authority to purchase and sell securities, it has entered into fixed coupon reverse repurchase (reverse repurchase) agreements; that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers default on their obligations to resell these securities to the University or provide securities or cash of equal value, the University would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. This credit exposure at year-end was $324,396.

At June 30, 2002 reverse repurchase agreements are open (on-demand) agreements and have no specified maturity date. The amount and interest rate of the agreement may be changed daily and either party may terminate the transaction at any time. In investing the proceeds of reverse repurchase agreements, the University's practice is for the term to maturity of the investment to be the same as the term of the reverse repurchase agreement. The University's investments in the underlying securities and the securities purchased with proceeds from the reverse repurchase agreements are in accordance with the statutory requirements as noted. The interest earnings and interest cost arising from reverse repurchase agreement transactions are reported at gross amounts on the accompanying financial statements.

D. **Derivative and Similar Transactions** - A derivative is a financial instrument created from, or whose value depends on (is derived from), the value of one or more underlying assets, reference rates, or indexes of asset values. These instruments may include forwards, futures, currency and interest rate swaps, options, floaters/inverse floaters, and caps/floors/collars. Investment transactions similar to a derivative may include securitized assets, such as mortgage-backed securities and other asset-backed securities. As required by accounting principles generally accepted in the United States of America, the nature of derivative or similar transactions entered into by the University, and the reasons for entering into those transactions follow:

Mortgage-Backed Securities - The University invests in mortgage-backed securities issued by the Government National Mortgage Association (GNMA), an agency of the United States government, government sponsored enterprises including the Federal Home Loan Mortgage Corporation (FHLMC) or the Federal National Mortgage Association (FNMA), and private trusts or corporations. The University invests in these securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The values of mortgage-backed securities are generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities may include mortgage pass-through securities and collateralized mortgage obligations (CMOs). Mortgage pass-through securities pay the holder of the security the principal and interest amounts received from the underlying pool of mortgages as these amounts are collected from the mortgage holders. In a CMO, the cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple security classes with different priority claims and payment streams (commonly referred to as tranches.) A holder of the CMO security thus chooses the class of security that best meets its risk and return objectives. Both pass-through securities and CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets.

The mortgage pass-through securities issued by GNMA, FNMA, and FHLMC are classified by the University as U.S. government securities. The mortgage pools underlying the GNMA pass-through securities are backed by the full faith and credit of the U.S. government by the Federal Housing Administration (FHA), Veterans Administration (VA), and the Farmers Home Administration (FHA). The FNMA and FHLMC securities are collateralized by underlying pools of mortgages primarily issued by GNMA, FNMA, or FHLMC which guarantee full and timely payment of principal and interest.

The CMOs held by the University include mortgage-backed securities issued by FNMA, FHLMC, certain trusts, and private corporations (including REMIC issuers). In addition, non-traditional mortgage pass-through securities, such "interest-only strips" and "principal-only strips", if held by the University, are classified as CMOs. The University held non-traditional pass-through securities during the year.

As of June 30, 2002 the University was holding $142,482,521 in mortgage-backed securities valued at fair value representing approximately 11.3% of its total investments. Of this amount $61,662,473 represent investments in CMOs.

Other Asset-Backed Securities - The University invests in various asset-backed securities such as automobile loan securitizations, credit card securitizations, and home equity loans. The University invests in the various asset-backed securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The values of these other asset-backed securities are generally based on the cash flows to be received from the underlying pools of assets. Accordingly, these securities are subject to market risk due to fluctuations in interest rates, prepayment rates, and various liquidity factors related to their specific markets. The market risk is reduced by the University's preference to invest in the shorter average life securities.

These security holdings are subject to credit-related losses in the event of non-performance by the issuers or counterparties to these instruments. However, the University does not expect any issuers or counterparties to fail to meet their obligation given their high credit ratings. The assets that collateralize these securities, which could be liquidated at market values at the time of non-performance, reduce the credit risk.

As of June 30, 2002 the University was holding $17,113,221 in asset-backed securities valued at fair value representing approximately 1.4% of its total investments.

Futures - The University purchases and sells equity index futures and futures on domestic and foreign securities and currencies. The University uses the futures market to securitize excess cash holdings, to gain exposure to non-U.S. markets, to exploit foreign interest rate yield opportunities, to diversify its overall investment portfolio, to lower its transaction costs and to improve its liquidity.

Futures contracts are traded on margin on various futures and options exchanges. Since there is no direct cost in establishing any given futures position, the book value of these securities is recorded at $0. The margin amounts remitted by the University to the brokerage houses are reflected in the University's cash and cash equivalent or government securities holdings. Gains or losses from trading the futures are recognized in income when the futures positions are closed or liquidated. Unlike most securities investments, the losses on futures contracts can exceed their cost (of $0).

The market value of a futures contract is dependent on the value of its underlying cash market security or securities. Accordingly, the futures contracts held by the University are sensitive to changes in their respective foreign currency rates or security values. They are also sensitive to changes in the level of interest rates. The University trades futures on organized exchanges, which mitigates its credit risk of default by a counterparty.

As of June 30, 2002 the futures contracts held by the University had expiration dates not exceeding September 2002.

Options - The University purchases and sells options on futures of U.S. and foreign securities. All options are traded through domestic and foreign exchanges.

The University uses the options to hedge certain of its futures positions, to gain exposure to non-U.S. markets, to exploit foreign interest rate yield opportunities, and to further diversify its overall investment portfolio.

The University records the book values of long and short call and put option contracts at the option premium paid (if the option is purchased) or collected (if the option is written.) The University records the book value of the options in an investment account at an amount equal to the quantity of contracts purchased (sold) at the respective option premium price paid (collected.) When the option contract expires, or is repurchased or is exercised, the University records any resulting gain or loss in related income accounts. Unlike purchased options and most securities investments, losses on written options can exceed their cost.

During the year ending June 30, 2002, the option contracts held by the University vary with changes in the market price of their underlying futures contracts and accordingly also fluctuate with changes in their respective foreign currency rates or security values. The University's option contracts are traded on organized exchanges which mitigate its credit risk of default by a counterparty.

As of June 30, 2002 the University had no outstanding option transactions.

Indirect Derivative Holdings - The University identifies various external investment funds (mutual funds, external investment pools, and limited partnerships) that meet asset allocation and investment management objectives. The University invests in these funds to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. Fund investments generally include equity and bond funds. Certain funds expose the University to significant amounts of market risk by trading or holding derivative instruments and by leveraging the securities in the fund.

The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes. The investment funds that utilized derivative securities for the fiscal year ending June 30, 2002 are summarized in the chart below. The amounts shown in the chart represent the market value of the University's (including affiliated external foundations who participate in the Investment Fund) investment in the various asset classes and the market value and percent of holdings held in derivatives in those classifications. The University's reporting entity comprises 75.54% of these totals.

The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc., Indirect Derivative Analysis, for fiscal year ending June 30, 2002 is as follows:

Asset Class	Total Market Value	% Invested Derivatives	Amount
Domestic Equity	$ 99,801,698	11.80%	$ 11,776,600
International Equity	154,624,478	4.53%	7,004,489
Opportunistic Equity	77,942,370	15.56%	12,127,833
Absolute Return	119,411,857	6.80%	8,120,006
Fixed Income			
Domestic Fixed Income	54,650,106	8.00%	4,372,008
Enhanced Fixed Income	102,767,539	2.37%	2,435,591
Total	609,198,048		$ 45,836,527
Total Market Value of Investments in the Investment Fund	$ 936,006,374		
Total % of Market Value for Indirect Derivative Exposure		4.90%	

The market values reported for each asset class do not include accrued income, reverse repurchase liabilities, or investments in the State Treasurer's Investment Fund.

The market risk associated with these indirect derivative holdings by fund type follows:

Domestic Equity - From time-to-time domestic equity managers will utilize equity index futures, options on equity index futures, and specific stock options. These are used mainly to hedge their portfolio or to take advantage of an options mispricing on a security they own.

International Equity - International equity managers will utilize foreign equity index futures and options to hedge their exposure to their respective markets.

Opportunistic Equity - Opportunistic equity managers will utilize a wide range of currency, equity, and fixed income futures and options. These are used to gain exposure to specific markets in the most cost-effective and liquid manner possible.

Absolute Return - Absolute return managers utilize fixed income and equity futures both as a hedging tool and to gain exposure to specific markets.

Fixed Income - Fixed income funds utilize futures and options on global fixed income and currency markets. These vehicles are used purely to hedge exposure to a given market or to gain exposure to an illiquid market. Domestic and enhanced are two subasset classes of this fund type. Domestic fixed income focuses upon U.S. Treasury securities, quasi-government securities and high-grade U.S. corporate bonds. Enhanced fixed income can include non-U.S. investments and non-high-grade securities, and are generally intended to provide a higher total return than traditional fixed income.

The Fund’s holdings in indirect derivatives (i.e., derivatives held by external investment managers) are primarily used to decrease risk. This is because the indirect derivatives are used by the fund’s hedge fund managers primarily to hedge underlying positions, or to gain exposure to specific markets in an efficient, inexpensive, liquid, and diversified manner. In the former case, risk is actually reduced by the use of derivatives because the derivative is directly offsetting market exposure. In the latter case, the derivatives are merely substituting for what would otherwise be a more traditional (individual security) array. Hence there would be no greater risk and often less risk than the traditional array that would exist in place of such derivatives. In limited cases, select managers are allowed to use derivatives to lever specific holdings or market positions. In aggregate, the Fund’s 4.90% exposure to indirect derivative holdings reflects a smaller degree of risk than there would be without such derivatives in the portfolio. The University considers the risk associated with these holdings to be prudent and within acceptable bounds.

NOTE 4 - ENDOWMENT INVESTMENTS RETURN

Substantially all of the investments of the University's endowment funds are pooled in the Investment Fund. Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual distributions from the Investment Fund to the University's pooled endowment funds are based on an adopted spending policy. Under this policy, the prior year distribution is increased by the rate of inflation as measured by the Consumer Price Index (CPI). Each year's distribution, however, is subject to a minimum of 4% and a maximum of 7% of the pooled endowment fund's average market value for the previous year.

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2002 accumulated income and appreciation of $288,274,274 was available in the University's pooled endowment funds of which $254,345,358 was restricted to specific purposes.

NOTE 5 - RECEIVABLES

Receivables at June 30, 2002 were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	$ 2,362,079	$ 0	$ 2,362,079
Patients	68,969,330	(52,366,054)	16,603,276
Accounts	45,709,279		45,709,279
Intergovernmental	38,526,001		38,526,001
Pledges	13,834,244	(271,074)	13,563,170
Investment Earnings	4,002,618		4,002,618
Interest on Loans	606,498		606,498
Total Current Receivables	$ 174,010,049	$ (52,637,128)	$ 121,372,921
Noncurrent Receivables:			
Pledges	$ 25,837,029	$ (387,555)	$ 25,449,474
Notes Receivables			
Notes Receivable - Current:			
Federal Loan Programs	$ 2,532,901	$ (208,706)	$ 2,324,195
Institutional Student Loan Programs	523,824	(24,071)	499,753
Total Notes Receivable - Current	$ 3,056,725	$ (232,777)	$ 2,823,948
Notes Receivable - Noncurrent:			
Federal Loan Programs	$ 23,365,886	$ (1,925,301)	$ 21,440,585
Institutional Student Loan Programs	4,832,248	(222,061)	4,610,187
Total Notes Receivable - Noncurrent	$ 28,198,134	$ (2,147,362)	$ 26,050,772

Pledges are receivable over varying time periods ranging from 1 to 10 years, and have been discounted based on a projected interest rate of 3.58% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

Scheduled receipts, the discounted amount under these pledge commitments, and allowances for uncollectible pledges are as follows:

Fiscal Year	Amount
2003	$ 13,929,249
2004	10,758,017
2005	8,607,217
2006	6,152,851
2007	1,155,278
2008-2011	1,860,844
Total Pledge Receipts Expected	42,463,456
Discount Amount Representing Interest (3.58% Rate of Interest)	(2,792,183)
Present Value of Pledge Receipts Expected Less Allowance for Uncollectible	(658,629)
Pledges Receivable	$ 39,012,644

NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets is presented as follows:

	Balance July 1, 2001	Adjustments	Increases	Decreases	Balance June 30, 2002
Capital Assets, Non-Depreciable:					
Land	$ 22,093,860	$ 0	$ 0	$ 0	$ 22,093,860
Art, Literature, and Artifacts	50,981,799		1,390,094	480	52,371,413
Construction in Progress	151,638,839	(59,737,439)	144,509,838	11,388,447	225,022,791
Intangible	1,000,000				1,000,000
Total Capital Assets, Non-Depreciable	225,714,498	(59,737,439)	145,899,932	11,388,927	300,488,064
Capital Assets, Depreciable:					
Buildings	760,607,088	44,326,346	18,866,929	59,957	823,740,406
Machinery and Equipment	189,578,631		21,468,172	17,847,750	193,199,053
General Infrastructure	267,687,586	15,411,093	2,238,577		285,337,256
Total Capital Assets, Depreciable	1,217,873,305	59,737,439	42,573,678	17,907,707	1,302,276,715
Less Accumulated Depreciation/Amortization for:					
Buildings	310,895,445		21,530,253	7,834	332,417,864
Machinery and Equipment	115,496,738		15,424,524	11,335,897	119,585,365
General Infrastructure	111,314,091		11,562,471		122,876,562
Total Accumulated Depreciation/Amortization	537,706,274		48,517,248	11,343,731	574,879,791
Total Capital Assets, Depreciable, Net	680,167,031	59,737,439	(5,943,570)	6,563,976	727,396,924
Capital Assets, Net	$ 905,881,529	$ 0	$ 139,956,362	$ 17,952,903	$ 1,027,884,988

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2002 were as follows:

	Amount
Accounts Payable	$ 43,334,804
Accrued Payroll	17,729,070
Contract Retainage	8,228,702
Commercial Paper	1,000,000
Other	185,512
Total Accounts Payable and Accrued Liabilities	$ 70,478,088

On March 5, 2002, the University issued University of North Carolina at Chapel Hill General Revenue Bonds, Series 2002A with a maximum issue amount of $75,000,000. The issue is the University's portion of the University of North Carolina System Board of Governors Tax-Exempt Commercial Paper Bonds (UNC at Chapel Hill/NC State 2002 Issue), with a maximum issue amount of $100,000,000. On March 5, 2002 the University sold $1,000,000 of Series 2002A with a final maturity date of November 12, 2002. The proceeds of this issuance were used to provide interim financing for the construction related to the University's Dormitory System.

NOTE 8 - LONG-TERM LIABILITIES

A. **Changes in Long-Term Liabilities** - A summary of changes in the long-term liabilities is presented as follows:

	Balance July 1, 2001	Additions	Reductions	Balance June 30, 2002	Current Portion
Notes, Bonds, and Capital Leases Payable					
Notes Payable	$ 0	$ 3,800,229	$ 0	$ 3,800,229	$ 3,800,229
Bonds Payable	459,900,000	66,555,000	84,025,000	442,430,000	116,312,178
Add/Deduct Premium/Discount	(62,822,379)	3,667,455	(3,936,816)	(55,218,108)	
Deduct Deferred Charge on Refunding		(3,257,254)		(3,257,254)	
Total Bonds Payable	397,077,621	66,965,201	80,088,184	383,954,638	116,312,178
Capital Leases Payable	335,760	1,318,939	1,048,999	605,700	294,252
Total Notes, Bonds, and Capital Leases Payable	397,413,381	72,084,369	81,137,183	388,360,567	120,406,659
Compensated Absences	47,050,200	39,485,312	34,060,092	52,475,420	3,836,481
Annuity Payable	11,631,887		5,688,663	5,943,224	692,417
Total Long-Term Liabilities	$ 456,095,468	$ 111,569,681	$ 120,885,938	$ 446,779,211	$ 124,935,557

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

On January 7, 2002 the UNC-CH Foundation (which is part of the University's financial reporting entity) signed a promissory note with First Union National Bank in the amount of $3,534,971. On April 30, 2002 a second advance was received in the amount of $265,258 for a total note amount of $3,800,229. The final maturity date is January 7, 2003. The proceeds were used to acquire, equip and furnish an office building used by the University's Development Office.

The University plans to refinance the notes maturing on January 7, 2003 with other long-term financing.

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue Plus Capital Appreciation	Principal Paid Through 6/30/2002	Discount on Capital Appreciation Bonds	Principal Outstanding 6/30/2002
Dormitory System							
	1997	4.500%-5.100%	11/01/2017	$ 9,170,000	$ 965,000	$ 0	$ 8,205,000
	1997	4.000%-5.0000%	11/01/2017	7,210,000	260,000		6,950,000
Total Dormitory System				16,380,000	1,225,000		15,155,000
Utility System							
	1997	5.250%-5.500%	08/01/2021	84,135,000		(45,148,385)	38,986,615
	1992	3.000%-6.000%	08/01/2007	3,490,000	2,065,000		1,425,000
Total Utility System				87,625,000	2,065,000	(45,148,385)	40,411,615
Parking System							
	1997	4.350%-5.700%	05/15/2027	11,750,000	615,000		11,135,000
	1997	3.900%-5.150%	05/15/2009	8,245,000	2,845,000		5,400,000
Total Parking System				19,995,000	3,460,000		16,535,000
General Revenue 2001							
	2001	2.900%-5.125%	12/01/2025	89,930,000	1,580,000		88,350,000
	2001	Variable	12/01/2025	54,970,000	1,240,000		53,730,000
	2001	Variable	12/01/2025	54,970,000	1,240,000		53,730,000
Total General Revenue 2001				199,870,000	4,060,000		195,810,000
General Revenue 2002 Series	2002	3.500%-5.000%	12/01/2011	66,555,000			66,555,000
Student Union	2000	4.550%-5.659%	06/01/2022	12,465,000	335,000		12,130,000
Student Recreation Center	1997	3.900%-5.000%	06/01/2011	3,545,000	485,000		3,060,000
U.S. EPA Project, Series 1991	1991	8.250%-9.050%	02/15/2015	58,125,000	11,695,000	(15,034,035)	31,395,965
U.S. EPA Project, Series 1996	1996	6.72%	02/15/2006	2,400,000	1,205,000		1,195,000
Total Bonds Payable (principal only)				$ 466,960,000	$ 24,530,000	$ (60,182,420)	382,247,580
Less: Unamortized Loss on Refunding							(3,257,254)
Less: Unamortized Discount							(919,548)
Plus: Unamortized Premium							5,883,860
Total Bonds Payable							$ 383,954,638

C. Demand Bonds - Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a "put" feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the University's remarketing or paying agents.

With regards to the following demand bonds, the University has not entered into take out agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

General Revenue, Series 2001B and 2001C - In 2001 the University issued two series of variable rate demand bonds in the amount of $54,970,000 (2001B) and $54,970,000 (2001C) that each have a final maturity date of December 1, 2025, and are repaid from Available Funds. Available Funds are defined as any Unrestricted Net Assets remaining after satisfying obligations of the University under trust indentures, trust agreements or bond resolutions (Specific Revenue Bonds), but excluding State Appropriations, Tuition, and certain special facilities revenues. The bonds are subject to mandatory sinking fund redemption that began on December 1, 2001. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Housing System, Series 2000; Kenan Stadium, Series 1996; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days' notice and delivery to the University's remarketing agents, Lehman Brothers, Inc. (2001B) and UBS Paine Webber, Incorporated (2001C).

Under an irrevocable letter of credit issued by Toronto-Dominion Bank and Chase Manhattan Bank, the trustee is entitled to draw amounts sufficient to pay principal, and while the bonds are bearing interest at the daily or weekly rate, accrued interest on bonds delivered for purchase. The University is required to pay a quarterly commitment fee for the letter of credit of .08% per annum of the amount of bonds then currently outstanding.

Under the letter of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the letter of credit. Interest at the rate of prime plus 1.0% (prime plus 2.0% after 60 days) is payable quarterly and upon draw repayment. At June 30, 2002, no purchase drawings had been made under the letter of credit.

The letter of credit terminates on February 6, 2003, subject to extension by the agreement of both parties.

In 2000 the University entered into an interest rate swap contractual agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) on $22,000,000 of University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Bonds, Series 2001B and 2001C, and the interest swap agreement was amended to reflect the refunding. Under this amended agreement, Lehman Brothers pays the University interest on the notational amount based on the Bond Market Association (BMA) Municipal Bond Index on a quarterly basis. For the fiscal year ended June 30, 2002, Lehman Brothers paid the University $431,597 under this agreement. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24%. For the fiscal year ended June 30, 2002, the University paid Lehman Brothers $1,152,800 under this agreement.

D. **Capital Appreciation Bonds** – The University's Series 1997 Utility System and the Series 1991 U.S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of $30,379,142 and $3,828,921, respectively. These bonds are recorded in the amounts of $38,986,615 ($84,135,000 ultimate maturity less $45,148,385 discount) and $10,240,965 ($25,275,000 ultimate maturity less $15,034,035 discount) respectively, which are the accreted values at June 30, 2002. These bonds mature in the years from 2010 to 2021.

E. **Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2002 are as follows:

	Annual Requirements			
	Bonds Payable		Notes Payable	
Fiscal Year	Principal	Interest	Principal	Interest
2003	$ 12,365,000	$ 10,003,190	$ 3,800,229	$ 75,766
2004	17,305,000	9,517,077		
2005	18,165,000	8,991,294		
2006	19,120,000	8,419,403		
2007	19,885,000	7,832,293		
2008-2012	111,165,000	30,385,784		
2013-2017	106,275,000	21,127,434		
2018-2022	94,315,000	12,300,684		
2023-2027	43,835,000	3,324,255		
Total Requirements	$ 442,430,000	$ 111,901,414	$ 3,800,229	$ 75,766

Interest on the variable rate General Revenue Bonds 2001B is calculated at 1.000% at June 30, 2002.
Interest on the variable rate General Revenue Bonds 2001C is calculated at 1.100% at June 30, 2002.
For UNC-CH General Revenue Bonds, Series 2001B and 2001C, interest rates change weekly.

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

Utilities System: On May 7, 2002 the University issued $66,555,000 in The University of North Carolina at Chapel Hill General Revenue

Refunding Bonds, Series 2002B, with an average interest rate of 3.50%. The refunding was used to defease $69,895,000 of outstanding University of North Carolina at Chapel Hill Utility System Revenue Bonds, Series 1993, with a combined average interest rate of 5.34%. The net proceeds amount was used to purchase U.S. Government securities. The purchased securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. The University reduced its debt service requirements by $3,340,000 over the next 10 years and obtained an economic gain of $1,700,902. At June 30, 2002, the outstanding balance was $69,895,000 for defeased outstanding Utility System Revenue Bonds, Series 1993.

Dining System: On February 7, 2001 the University defeased $13,205,000 of outstanding Dining System Revenue Bonds, Series 1997. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's balance sheet. At June 30, 2002 the outstanding balance of the defeased Dining System bonds was $12,155,000.

Dormitory System: On December 1, 1999 the University defeased $1,225,000 of outstanding Dormitory System Revenue Bonds, Series E, F & G (1963). Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. At June 30, 2002, the outstanding balance was $673,000 for the defeased outstanding Dormitory System Revenue Bonds, Series E, F & G (1963).

Student Apartments: On December 1, 1999 the University defeased $128,000 of outstanding Student Apartment Revenue Bonds, Series A (1961). Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. At June 30, 2002, the outstanding balance was $40,000 for the defeased outstanding Student Apartment Revenue Bonds, Series A (1961).

Student Union: On December 1, 1999 the University defeased $620,000 of outstanding Student Union Revenue Bonds, Series 1967. Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the balance sheet. At June 30, 2002, the outstanding balance was $480,000 for the defeased outstanding Student Union Revenue Bonds, Series 1967.

Housing System: On October 30, 1997 the University defeased $6,630,000 of outstanding Housing System Revenue Bonds, Series 1991. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds through November 1, 2001, at which time all the outstanding bonds were redeemed. At June 30, 2002 the outstanding balance of the defeased Housing System bonds was $0.

Utility System: On October 30, 1997 the University defeased $19,337,000 of outstanding Utility System Revenue Bonds, Series 1992. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's balance sheet. At June 30, 2002 the outstanding balance of the defeased Utility System bonds was $19,337,370.

NOTE 9 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to medical and research 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, 2002:

Fiscal Year	Amount
2003	$ 341,776
2004	285,649
2005	49,584
2006	10,038
Total Minimum Lease Payments	687,047
Amount Representing Interest (8.2% - 14.9% Rate of Interest)	81,347
Present Value of Future Lease Payments	$ 605,700

Leased assets amounted to $1,609,480 at June 30, 2002.

B. Operating Lease Obligations - Future minimum lease payments under non-cancelable operating leases consist of the following at June 30, 2002:

Fiscal Year	Amount
2003	$ 4,537,897
2004	3,295,273
2005	2,958,522
2006	2,077,741
2007	32,099
Total Minimum Lease Payments	$ 12,901,532

Rental expense for all operating leases during the year was $11,625,340.

C. Other Lease Obligations – The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-CH Foundation) issued certificates of participation to provide for construction of Alumni facilities. The University constructed the facilities as an agent for the UNC-CH Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-CH Foundation and simultaneously entered into a sublease agreement with the General Alumni Association, an affiliated organization, for the same time period for the use of alumni facilities.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the Alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2002 the aggregate principal amount of the certificates was $9,950,000.

If the University complies with all the terms of the lease agreement, title to the Alumni facilities will be conveyed to the University.

NOTE 10 - 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	Less Indigent Care and Contractual Adjustments	Net Revenues	Revenues Pledged as Security for Debt	
Operating Revenues:								
Student Tuition and Fees	$ 150,537,311	$ 0	$ 25,876,166	$ 0	$ 0	$ 124,661,145	$ 0	
Patient Services	$ 311,760,599	$ 0	$ 0	$ (4,949,060)	$ 179,674,434	$ 137,035,225	$ 0	
Sales and Services:								
Sales and Services of Auxiliary Enterprises:								
Residential Life	$ 22,578,714	$ 0	$ 3,905,806	$ 0	$ 0	$ 18,672,908	$ 17,200,826	(A)
Dining	15,968,058		180,931			15,787,127		
Student Union Services	1,835,757		1,016,666			819,091		
Health, Physical Education, and Recreation Services	13,099,556		1,795,273	740		11,303,543	11,304,283	(B)
Bookstore	33,389,738					33,389,738		
Parking	12,408,017					12,408,017	12,408,017	(C)
Athletic	31,722,630		390,845			31,331,785		
Utilities	60,595,890	43,624,502				16,971,388	16,971,388	(D)
Other Professional Income	49,754,020					49,754,020		
Other	113,799,033	64,523,372		31,772		49,243,889	4,581,720	(E)
Total Sales and Services	$ 355,151,413	$ 108,147,874	$ 7,289,521	$ 32,512	$ 0	$ 239,681,506	$ 62,466,234	
Nonoperating - Noncapital Gifts	$ 65,854,614	$ 0	$ 0	$ 3,450,812 *	$ 0	$ 62,403,802	$ 0	
Capital Gifts	$ 8,238,379	$ 0	$ 0	$ 0	$ 0	$ 8,238,379	$ 0	

Revenue bonds secured by pledged revenues:
(A) Housing System Revenue Bonds, Series 1997 A & B
(B) Student Fee Revenue Bonds, Series 1997 & 2000
(C) Parking System Revenue Bonds, Series 1997 A & B
(D) Utility System Revenue Bonds, Series 1992 & 1997
(E) US EPA Project, Series 1991 & 1996

*Includes $2,792,183 PV discount on pledges receivable

NOTE 11 - 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	$ 377,733,925	$ 29,723,404	$ 90,283,674	$ 0	$ 29,877	$ 0	$ 497,770,880
Research	140,283,583	37,007,721	59,970,636		13,524		237,275,464
Public Service	26,891,751	1,272,686	48,695,946		35,855		76,896,238
Academic Support	44,094,982	13,861,680	9,661,152				67,617,814
Student Services	9,380,825	810,404	8,030,748		2,898		18,224,875
Institutional Support	40,625,131	4,164,940	13,746,601		23,426		58,560,098
Operations and Maintenance of Plant	27,207,188	2,410,214	26,218,791		35,105,592		90,941,785
Student Financial Aid				40,414,555			40,414,555
Auxiliary Enterprises	163,255,864	59,073,216	108,223,966		10,240,995		340,794,041
Depreciation						48,517,249	48,517,249
Total Operating Expenses	$ 829,473,249	$ 148,324,265	$ 364,831,514	$ 40,414,555	$ 45,452,167	$ 48,517,249	$ 1,477,012,999

NOTE 12 - 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. The Teachers' and State Employees' Retirement System (System) is a multiple-employer cost sharing defined benefit pension plan administered by the North Carolina State Treasurer.

After five years of creditable service, members of the Teachers' and State Employees' Retirement System qualify for a vested deferred benefit. Employees who retire on or after age 65 and complete 5 years of membership service (age 55 and 5 years of creditable service for law enforcement officers), reach age 60 with 25 years of membership service, or complete 30 years of creditable service receive a retirement allowance of 1.81% of an average final compensation (based on the 4 consecutive years that produce the highest average) multiplied by the number of years of creditable service. Employees may retire with reduced benefits if they reach age 50 with 20 years of creditable service or reach age 60 with 5 years of creditable service (age 50 with 15 years creditable service for law enforcement officers).

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, 2002 these rates were set at 1.97% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2002 the University had a total payroll of $690,345,877 of which $313,456,885 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $18,807,413 and $6,175,101, respectively. The University made one hundred percent of its annual required contributions for the years ended June 30, 2002, 2001, and 2000, which were $6,175,101, $16,111,000, and $24,505,000, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.osc.state.nc.us/ and clicking on "Financial

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

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

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, 2002 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.

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.

For the year ended June 30, 2002 the University had a total payroll of $690,345,877 of which $264,414,349 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were $15,864,860 and $18,085,942, 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 permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to $279,942 for the year ended June 30, 2002.

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, 2002 were $86,326. The voluntary contributions by employees amounted to $2,159,498 for the year ended June 30, 2002.

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 non-profit 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 $19,084,246 for the year ended June 30, 2002.

NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

A. **Health Care for Long-Term Disability Beneficiaries and Retirees** - The University participates in State-administered programs which provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 2.35% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2002 the University's total contribution to the Plan was $13,579,974. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report.*

B. **Long-Term Disability** - The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The University contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. For the fiscal year ended June 30, 2002 the University's total contribution to the DIPNC was $3,004,930. 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 14 - RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to, and the 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 risk pools, 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.

Public Officers' and Employees' Liability Insurance - Tort claims of up to $500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides an additional $11,000,000 public officers' and employees' liability insurance via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

Fire and Other Property Loss - The State Property Fire Insurance Fund (Fund), an internal service fund of the State, insures all State-owned buildings and contents for fire and various other property losses up to $2,500,000 per occurrence. The Fund purchases excess insurance from private insurers to cover losses over the amounts insured by the fund. Coverage for fire losses for all operations supported by the State's General Fund is provided at no cost to the University. Other operations not supported by the State's General Fund are charged for fire coverage. The University also purchased through the Fund extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft and "all risks" for buildings and contents. Wind coverage is provided by the Fund and its reinsurer. For losses involving a named storm, such as a hurricane, the University's deductible is 1% of the total value of a building and contents replacement value for each building, including contents, with a minimum of $100,000 per building and $2,500,000 per occurrence.

Automobile Liability Insurance - All State-owned vehicles are covered by liability insurance handled by the North Carolina Department of Insurance. The State is self-insured for the first $500,000 of any loss through a retrospective rated plan. Excess insurance coverage is purchased through a private insurer to cover losses greater than $500,000. The liability limits for losses incurring in-State are $500,000 per claimant and $5,000,000 per occurrence. The University is charged premiums to cover the cost of excess insurance and to pay for those losses falling under the self-insured retention.

Employee and Computer Fraud - The University is protected for losses from employee dishonesty and computer fraud. The blanket honesty bond is with a private insurance company and is handled by the North Carolina Department of Insurance with coverage of $5,000,000 per occurrence with a $50,000 deductible.

Other coverage not handled by the North Carolina Department of Insurance is purchased through the State's insurance agent of record.

Comprehensive Major Medical Plan - Employees and retirees are provided health care coverage by the Comprehensive Major Medical Plan, a component unit of the State. The Plan is funded by employer and employee contributions and is administered by a third-party contractor. Beginning October 1, 2001 the plan no longer offers health coverage through HMO plans. 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.

Liability Insurance Trust Fund – The University participates in the Liability Insurance Trust Fund (the Fund), a claims-servicing public entity risk pool for healthcare professional liability protection. The Fund acts as a servicer of professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Fund.

The Fund was created by Chapter 116, Article 26, of the General Statutes and The University of North Carolina Board of Governors Resolution of June 9, 1978 to provide professional liability protection for program participants and individual health care practitioners working as employees, agents, or officers of The University of North Carolina Hospitals at Chapel Hill (the Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (University Physicians and Associates). The Fund is exempt from federal and State income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

Participation in the Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the Hospitals, and any health care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the Hospitals. Only the University Physicians and Associates and the Hospitals have participated in the Fund to date. Participants provide management and administrative services to the Fund at no cost.

The Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of thirteen members as follows: one member each appointed by the State Attorney General, the State Auditor, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and eight members appointed to three year terms (with no limit on the number of terms) by the Board of Governors of the University of North Carolina.

The Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation, and other factors. Participant assessments are determined at a level to fund claim liabilities, discounted for future investment earnings. Each participant is required by statute to maintain a fund balance of $100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

The Fund provides occurrence coverage for participants as a corporate entity, as well as for the employees and professional staff of the participants. The Fund provides coverage of $3,500,000 per occurrence and $12,000,000 annual aggregate for the negligence of individual employees of the participants within the course and scope of their employment. Commercial excess insurance of $25,000,000 per occurrence and $50,000,000 annual aggregate is provided above the self-insurance retention limits. The Fund provides coverage of $500,000 per occurrence, in accordance with the limited waiver of sovereign immunity afforded by the State Tort Claims Act, for any recovery against the participants for the negligence of its employees. To assure that both existing and future claims will be paid, the Board of Governors of the University of North Carolina is authorized by law to borrow up to $30,000,000 to replenish the Trust Fund. No borrowings have been made under this line of credit to date. The Council believes adequate funds are on deposit in the Fund to meet estimated losses based upon the results of the independent actuary's report.

The Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs. The likelihood that the Fund will be required to make future payments on these claims is considered remote.

The Council may choose to terminate the Fund, or the respective participants may choose to terminate their participation. In the event of such termination by either the Council or a participant, an updated actuarial study will be performed to determine amounts due to or from the participants based on loss experience up to the date of termination.

At June 30, 2002 the University assets in the Fund totaled $15,945,529 while the University liabilities totaled $15,328,949, resulting in net assets of $616,580.

Additional disclosures relative to the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund for the years ended June 30, 2002 and 2001. Copies of this report may be obtained from The University of North Carolina Liability

Insurance Trust Fund, 6001 East Wing, University of North Carolina Hospitals, 101 Manning Drive, Chapel Hill, North Carolina 27514, or by calling (919) 966-3041.

Term Life Insurance - Term life insurance of $25,000 to $50,000 is provided to eligible workers. This self-insured death benefit is administered by the State Treasurer's Office and funded via employer contributions.

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

NOTE 15 - COMMITMENTS AND CONTINGENCIES

A. Commitments - The University had commitments of $25,775,290 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

B. Pending Litigation and Claims – Litigation is still pending between NC School Boards Association, et. al. v. Harlan Boyles, et. al. which involves 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. The complaint alleges in part that the monetary payments collected pursuant to statutory authority by the University for violations of parking and traffic regulations and library fines are "civil penalties" which the State constitution requires to be paid to the School fund in the county where they are collected. The lawsuit seeks declaratory judgment that the State Civil Penalty and Forfeiture Fund, the State School Technology Fund, and the Public Settlement Reserve Fund are unconstitutional. On December 14, 2001 the Wake County Superior Court ruled in favor of the Plaintiffs but has stayed enforcement of the ruling, pending appeal. The Defendants did appeal this judgment. It is still too soon to identify what effect this litigation will have on the University's financial statements. At issue is approximately $6.7 million collected from December 1995 through June 2002 and $1.3 million annually thereafter representing fines, penalties, and forfeitures from the Public Safety department and the University libraries.

A claim related to the construction of the Alumni Center, which was completed in January 1993, had been submitted for extra costs allegedly associated with numerous changes throughout the life of the project. The initial judgment, awarded in May of 2000 and currently under appeal, is for $1,400,000 plus yet to be determined costs and attorney fees.

The University is undertaking environmental remediation efforts on the Old Sanitary Landfill. The amount of the liability associated with this site cannot reasonably be estimated at this time.

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

C. **University Improvement General Obligation Bonds –** The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of $2.5 billion general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – General Administration (UNC-GA) establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization of $458,621,100 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions, the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

D. **Other Contingent Receivables –** The University has received notification of other gifts and grants for which funds have not been disbursed by the resource provider and for which conditions attached to the gift or grant have not been satisfied, or in the case of permanent endowments, cannot begin to be satisfied. In accordance with accounting principles generally accepted in the United States of America these amounts have not been recorded on the accompanying financial statements. The purpose and amount of other contingent receivables at year-end is as follows:

Purpose	Amount
Pledges to Permanent Endowments	$ 12,888,481

NOTE 16 - RELATED PARTIES

Foundations - There are 17 separately incorporated non-profit organizations associated with the University. These organizations are The Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The Golden Fleece Foundation, Inc., The Institute of Government Foundation, Inc., The Law Alumni Association of N.C., Inc., The Medical Foundation of North Carolina, Inc., The North Caroliniana Society, Inc., The Order of the Grail Valkyries, The Pharmacy Foundation of North Carolina, Inc., The School of Education Foundation, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., and The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc.

These organizations were established to assist and provide support to University programs by funding scholarships, fellowships, professorships, and other needs of specific schools as well as the University's overall academic endeavors. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support approximated $16,949,101 for the year ended June 30, 2002.

Carolina Student Legal Services, Inc. – Carolina Student Legal Services, Inc. is an incorporated entity created as a function of the Student Government at the University of North Carolina at Chapel Hill. Its purpose is to provide legal consultation and workshops for student groups and students enrolled at the University. Carolina Student Legal Services is funded from student fees from University of North Carolina Student Government that are a predetermined amount per student as established by a student referendum.

NOTE 17 - ACCOUNTING CHANGES

Effective July 1, 2001 the University implemented 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 financial statement presentation required by these Statements is a single-column enterprise activity rather than the fund-group perspective previously reported. Significant accounting changes in order to comply with the new requirements include adopting depreciation on capital assets, reporting revenues net of discounts and allowances, eliminating interfund activities, classifying activities as operating or nonoperating, classifying assets and liabilities as current or noncurrent, and prorating summer school activities to periods earned.

In addition, the University implemented GASB Statement No. 38, *Certain Financial Statement Note Disclosures.* Changes in existing disclosures include more detailed information on debt service requirements, obligations under leases, and short-term debt. New disclosures include variable debt interest information and the major components of receivable and payable balances.

NOTE 18 - NET ASSET RESTATEMENTS

As of July 1, 2001 the net assets as previously reported were restated as a result of the implementation of GASB Statements Nos. 34, 35, and 38 (Note 17), and correction of errors in the reported balances of the fiscal year ended June 30, 2001.

July 1, 2001 Fund Equity as previously reported	$ 2,690,444,020
Implementation of GASB 34/35	(755,617,471)
Restatement due to corrections related to prior year implementation of GASB Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*	(15,802,089)
July 1, 2001 Net Assets as Restated	$ 1,919,024,460

The University of North Carolina at Chapel Hill
Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures
For Project-to-Date as of June 30, 2002

Schedule 1

Capital Improvement Projects	Projected Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Expected Completion Date
Projects Started							
Medical Biomolecular Research Bldg	Dec 2000	$ 26,718,000	$ 38,847,748	$ 65,565,748	$ 16,879,737	25.74%	May 2003
RB House Library-Renovations	Apr 2001	9,898,700	11,162,729	21,061,429	21,061,429	100.00%	Sep 2002
Murphey Hall Classroom Bldg Comp Renovation	Jun 2001	6,723,500	300,000	7,023,500	1,818,585	25.89%	Nov 2002
Memorial Hall-Comp Renovation and Addition	Jun 2001	9,000,000	1,200,000	10,200,000	525,036	5.15%	Dec 2003
Memorial Hall-Comp Renovation and Addition	Jun 2001	200,000		200,000	200,000	100.00%	Dec 2003
Renovate Health Sciences Library	Jun 2001	11,000,000	400,000	11,400,000	479,798	4.21%	Aug 2004
Teaching Research Bldg-Sch of Public Health Proj Supp	Jun 2001	13,382,900	25,598,300	38,981,200	1,654,739	4.24%	May 2005
Sch of Dentistry Bldg Renovation & Conversion fr. Operatory	Jun 2001	8,397,100		8,397,100	199,375	2.37%	Jul 2003
Carrington Hall-Addn for Sch of Nursing Proj Supp	Jun 2001	10,082,100	7,904,000	17,986,100	892,829	4.96%	Nov 2004
Peabody Hall-Classroom Bldg Comp Renovation	Jun 2001	8,509,800	368,008	8,877,808	375,847	4.23%	Dec 2003
Inst Marine Sciences-Morehead City Comp Renovation	Jun 2001	1,833,300		1,833,300	35,200	1.92%	May 2003
Science Complex Phase I	Jun 2001	55,012,500		55,012,500	805,617	1.46%	Nov 2005
Burnett Womack Bldg Research Lab Comp Renovation	Jun 2001	24,848,000		24,848,000	21,737	0.09%	Nov 2004
Medical Research Bldg-Comp. Renov. of Classrooms	Jun 2001	12,895,000	500,000	13,395,000	266,047	1.99%	Sep 2005
Carolina Living & Learning Center	Jun 2001	1,154,275	1,495,111	2,649,386	2,649,386	100.00%	Sep 2002
Sch of Med-Bioinformatics Bldg-Supplement	Feb 2001	2,000,000	33,585,234	35,585,234	9,045,880	25.42%	May 2003
Campus Fiber Optics Network	Nov 2001	17,533,500		17,533,500	244,317	1.39%	Dec 2007
Steam Distribution System Replacement	Apr 2002	6,300,000		6,300,000	23,567	0.37%	Oct 2003
Phillips Hall-Comp Classroom & Lecture Renovation	Jul 2002	1,450,000		1,450,000	70,572	4.87%	Nov 2005
Hill & Davie Halls-Classroom & Lecture Renovation	Aug 2002	1,949,000		1,949,000	1,000	0.05%	Oct 2006
Infrastructure Improvements	Sep 2002	32,298,000	1,170,000	33,468,000	83,329	0.25%	Feb 2006
Storm Drainage Improvements	Oct 2002	10,500,000		10,500,000	208,678	1.99%	Jan 2007
Beard Hall & Lab Bldg Comp Renovation	Nov 2002	3,500,000	21,829,600	25,329,600	13,052,693	51.53%	Oct 2004
Berryhill Hall Lab Bldg Comp Renovation	Apr 2004	10,700,000		10,700,000	213,150	1.99%	Mar 2006
Arts & Sciences-Digital Multimedia Inst Ctr & Music Lib	Mar 2005	20,150,000		20,150,000	142,382	0.71%	Aug 2007
Projects Not Started - To Be Funded in Future Years							
Land Acquisition	Sep 2001	8,000,000		8,000,000			Feb 2006
Caldwell & Howell Hall Class and Lecture Halls Renovation	Jan 2002	1,732,000		1,732,000			Nov 2002
Gerard Hall Classroom Bldg Comp Renovation	Jul 2002	1,350,000		1,350,000			Jul 2005
Community Health Bldg-Consolid of Programs	Aug 2002	18,340,000		18,340,000			Dec 2004
Electrical Systems Improvement	Sep 2002	8,400,000		8,400,000			Jan 2005
Technology Infrastructure Expansion	Sep 2002	9,165,000		9,165,000			Feb 2006
Physical Plant Support Facilities	Oct 2002	7,875,000		7,875,000			Apr 2004
Upgrade Campus Energy Mgt and Control System	Oct 2002	3,682,600		3,682,600			Mar 2005
Saunders Hall Classroom Bldg- Comp Renovation	Nov 2002	4,194,100		4,194,100			Sep 2004
440 W Franklin St. Renovation & Conversion for Info Tech	May 2003	9,170,000		9,170,000			Jun 2005

The University of North Carolina at Chapel Hill
Schedule of General Obligation Bond Project Authorizations, Budgets, and Expenditures
For Project-to-Date as of June 30, 2002

Schedule 1

Capital Improvement Projects	Projected Start Date	General Obligation Bonds Authorized	Other Sources	Total Project Budget	Amount Expended	Percent Completed	Expected Completion Date
Projects Not Started - To Be Funded in Future Years (continued)							
Wollen & Fetzer Gyms Comp Renovation of Classrooms	Jul 2003	1,598,000		1,598,000			Oct 2007
Brauer Hall Comp. Renovation of Dental Clinic	Dec 2003	13,415,400		13,415,400			Nov 2005
Coker & Mitchell Hall-Comp Renovation of Classrooms	Jan 2004	1,718,000		1,718,000			Nov 2009
Rosenau Hall Lab Bldg Comprehensive Renovation	Mar 2004	9,000,000		9,000,000			Oct 2005
Academic Facilities to Consolidate Int'l Educ. Programs	Mar 2004	20,000,000		20,000,000			Jul 2006
Hanes & Manning Halls & Alumni Bldg-Renovation of Class	May 2004	2,233,000		2,233,000			Oct 2005
Student Services Bldg-Consolid of Services	Jun 2004	27,000,000		27,000,000			Apr 2006
Cogeneration Facility-Back Pressure Turbine Generator	Jul 2004	2,625,000		2,625,000			Dec 2005
New West Classroom Bldg-Comp Renovation	Jul 2004	4,500,000		4,500,000			Aug 2006
Steele Bldg-Comp Renovation & Conversion of Admin Office	Jul 2004	3,428,600		3,428,600			Sep 2007
Greenlaw Hall-Comp Renovation of Classrooms	May 2005	1,825,000		1,825,000			Oct 2008
Wilson Hall Lab-Comp Renovation	May 2005	8,920,000		8,920,000			Dec 2006
Smith Hall-Comp Renovation	Aug 2005	1,355,200		1,355,200			Jan 2007
Science Complex Phase II	Oct 2005	33,437,500		33,437,500			Jan 2009
Hamilton Hall-Comp Renovation of Classrooms	Jul 2006	1,539,000		1,539,000			Nov 2007
Total All Projects		$ 510,539,075	$ 144,360,730	$ 654,899,805	$ 70,950,930		

Note: The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of two billion dollars of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina System. The projects listed on this schedule are those funded or to be funded by bond proceeds from the general obligation bonds authorized by Senate Bill 912.

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

Board of Trustees
The University of North Carolina at Chapel Hill
Chapel Hill, North Carolina

We have audited the financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, as of and for the year ended June 30, 2002, and have issued our report thereon dated November 22, 2002.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board 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,* and Statement No. 38, *Certain Financial Statement Note Disclosures,* during the year ended June 30, 2002.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

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

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the University's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition noted as a result of our audit is described in the Audit Findings and Recommendations section of this report.

Finding

Bank Reconciliations Not Timely

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However we consider this finding to be a material weakness.

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

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

November 22, 2002

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting or Federal Compliance Objectives

Current Year Finding and Recommendation - The following finding and recommendation was identified during the current audit and represents significant deficiencies in internal controls or noncompliance with laws, regulations, contracts, or grants.

BANK RECONCILIATIONS NOT TIMELY

Certain bank reconciliations, including nine University Institutional Trust Fund bank account reconciliations and four Student Stores Institutional Trust Fund bank account reconciliations, were not timely completed. Supervisory review and approval of bank reconciliations was not documented for each month. Although the Health Care Funds bank account was reconciled timely, the reconciliation was not complete. Health Care Funds reconciliations did not include verifying actual deposits to bank reported amounts. These conditions increase the risk of unrecorded transactions and transactions recorded in error.

Recommendation: The University should strengthen internal controls to ensure that bank reconciliations are completed timely, all relevant reconciliations are performed, and appropriate review and approval is documented.

University Response: Management concurs with the finding and recommendation. Action necessary to correct the issues noted has either been completed or will be completed in the near future. The University Institutional Trust Fund (ITF) bank account reconciliation performed by Accounting Services is now current. The performance of the reconciliation and supervisory approval are important responsibilities and will be performed timely. In addition to the control provided by supervisory review and approval, the department head will also approve bank account reconciliations. Although the September 2001 through May 2002 reconciliations were not performed timely, the June 2002 reconciliation was completed timely. Contributing factors were a vacancy in a position that performs other bank reconciliations; the additional, time-consuming duties resulting from the State's cash flow issues; workload in the department; and the increased cash management tasks due to the high-level of construction.

The Student Stores ITF bank account reconciliation is now current. Vacancies in two Student Stores positions caused the delay in the completion of the reconciliations for March 2002 through June 2002. A vacancy in the position that performs the reconciliations and a vacancy in a supervisory position necessitated that the duties be temporarily reassigned. The reconciliation is current, and supervisory review and approval is documented each month.

UNC Health Care will be in current status for reconciliation issues by the end of this fiscal year. Planned enhancements to the reconciliation process will ensure the reconciliations are performed timely. Each of the clinics enters receipt information into the Patient Accounting

System (PAS), and PAS reports identify receipt transactions that do not balance to a deposit total. Due to staff turnover, a significant backlog in researching and resolving discrepancies developed. UNC Health Care staff resources have been assigned to this issue, and current status for reconciliation will be attained by the end of this fiscal year. A system process improvement is currently being piloted with one clinic. A unique identifier will be assigned to each deposit transaction and will provide for electronic reconciliation. The identifier will be part of the deposit transaction as recorded by the bank and as recorded in PAS. Full implementation of this enhancement is planned for April 2003.

DISTRIBUTION OF AUDIT REPORT

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

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The Honorable Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Ms. Molly Corbett Broad	President, The University of North Carolina
Dr. James Moeser	Chancellor The University of North Carolina at Chapel Hill
Ms. Nancy D. Suttenfield	Vice Chancellor for Finance and Administration The University of North Carolina at Chapel Hill
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Representative Joe Hackney	N. C. House Speaker Pro-Tem
Mr. James D. Johnson	Director, Fiscal Research Division

April 2, 2003

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