

STATE OF NORTH CAROLINA

APPALACHIAN STATE UNIVERSITY

BOONE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

APPALACHIAN STATE UNIVERSITY

BOONE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2009

BOARD OF GOVERNORS

THE UNIVERSITY OF NORTH CAROLINA

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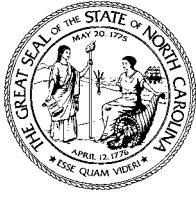
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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly Eaves Perdue, Governor
The General Assembly of North Carolina
Board of Trustees, Appalachian State University

We have completed a financial statement audit of Appalachian State University for the year ended June 30, 2009, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements disclosed certain deficiencies and/or instances of noncompliance that are detailed in the Audit Findings and Responses section of this report. The University's response is included following each finding.

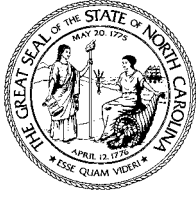
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR’S REPORT	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
BASIC FINANCIAL STATEMENTS	
University Exhibits	
A-1 Statement of Net Assets	10
A-2 Statement of Revenues, Expenses, and Changes in Net Assets	12
A-3 Statement of Cash Flows	13
Component Unit Exhibits	
B-1 Appalachian State University Foundation, Inc., Statement of Position	15
B-2 Appalachian State University Foundation, Inc., Statement of Activities	16
B-3 Appalachian Student Housing Corporation, Statement of Position	17
B-4 Appalachian Student Housing Corporation, Statement of Activities	18
Notes to the Financial Statements	19
INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT</i> <i>AUDITING STANDARDS</i>	49
AUDIT FINDINGS AND RESPONSES	53
ORDERING INFORMATION	55



Beth A. Wood, CPA
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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Appalachian State University
Boone, North Carolina

We have audited the accompanying financial statements of Appalachian State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2009, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Appalachian State University Foundation, Inc. or the Appalachian Student Housing Corporation, the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

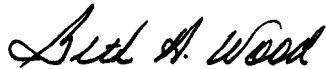
In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of Appalachian State University and its discretely presented component units as of June 30, 2009, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

As discussed in Note 15 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, during the year ended June 30, 2009.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 5, 2010 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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



Beth A. Wood, CPA
State Auditor

January 5, 2010

**APPALACHIAN STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Overview of the Financial Statement Information

Appalachian State University is pleased to present its financial statements for fiscal year 2009. These statements are prepared in accordance with standards issued by the Governmental Accounting Standard's Board (GASB). Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, was implemented in fiscal year 2008-2009 and those requirements are disclosed in Note 15 within the Notes to the Financial Statements.

Statement of Net Assets

The Statement of Net Assets (condensed, comparative table presented within this discussion and analysis) presents the assets, liabilities, and net assets of the University as of the end of the fiscal year. It provides readers with information on the assets available to continue operations, and the amounts owed to vendors, investors, and lending institutions. The change in net assets (assets minus liabilities) from year to year is an indicator of the financial condition of the institution. Restricted nonexpendable net assets consist of loan funds and endowment gifts with specific restrictions on spending the principal. Restricted expendable net assets consist of income from endowment funds, gifts and pledges with specific restrictions, unexpended bond proceeds and grants from third party agencies with expenditure restrictions.

Prominent changes in the Statement of Net Assets include a decrease of \$10,667,187.32 in Total Assets. This net reduction was primarily due to a decrease of \$24,943,366.83 in Current Assets, a decrease of \$29,837,581.36 in Noncurrent Assets-Restricted Cash, a decrease of \$3,502,809.53 in Capital Assets-Nondepreciable and an increase of \$49,142,724.43 in Capital Assets-Depreciable. The decrease in Current Assets was mainly caused by a reduction of \$26,847,958.68 in Cash and Cash Equivalents. Current unrestricted cash of \$21,086,716.81 was borrowed by restricted capital projects cash accounts to cover deficit cash balances in capital projects accounts. The effect of this interfund borrowing is required to be disclosed in the financial statements at year-end by GASB. The deficit cash balances were caused principally by construction costs associated with the Athletic Enhancement Building Campaign and the renovations of Frank Residence Hall. Bonds were issued for both of these projects in July 2009. See Note 17- Subsequent Events for additional information. In addition, Food Services cash decreased due to start up expenses associated with the Central Dining Facility and a \$1,943,439.50 reduction in cash carried forward from 2008 into 2009 because of cash flow and budget constraints.

The decrease in Capital Assets-Nondepreciable was primarily due to the fact that the amount of Construction-in-Progress reclassified to Capital Assets – Depreciable was more than the amount of Construction-in-Progress added during the year. Specifically, the costs were related to the Central Dining Hall, Athletic Facilities, improvements to Frank and other residence halls, and upgrades to the steam distribution system. Art and Artifacts were

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

determined to meet the criteria for inexhaustible assets. The assets were reclassified to Nondepreciable assets and the beginning fund balance for accumulated depreciation was adjusted accordingly. The increase in Capital Assets-Depreciable was caused primarily by capitalization of \$57,802,324.90 in costs for projects moved from Construction in Progress. In addition, there was a \$12,606,773.87 restatement of fully depreciated buildings, buildings that were 80% or greater depreciated, and the fully depreciated fiber optics network. These capital assets were still in service for fiscal year 2009 and will continue to be in service for future periods.

Total Liabilities decreased \$10,613,283.54 from the previous year. The decrease in Current Liabilities of \$2,106,767.51 was due primarily to the reduction in Accounts Payable. Accounts Payables decreased due to budget cuts mandated by the North Carolina Office of State Budget and Management and spending restrictions imposed on the University and all State agencies by the North Carolina General Assembly. Long-Term Liabilities decreased \$7,943,983.57 primarily due to payments made by the University for Bonds and Notes Payables.

The increase in Restricted Nonexpendable Net Assets of \$1,014,046.77 was due largely to the addition of the Kenneth E. Peacock Endowed Professorship of \$500,000.00 and the addition of the Anne Belk Endowed Professorship of \$505,587.39. The decrease in Restricted Expendable Net Assets of \$1,027,599.56 was primarily due to a decrease in the Expendable Endowed Professorship of \$1,705,957.11 due to unfavorable earnings. The decrease in Unrestricted Net Assets of \$23,922,326.63 resulted from the cash used for Capital Projects as explained previously. Overall, Appalachian had a decrease of \$53,903.78 in total Net Assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Net Assets - Restated

	<u>Fiscal Year 2009</u>	<u>Fiscal Year 2008 As Restated</u>	<u>\$ Change</u>	<u>% Change</u>
Assets				
Current Assets	\$ 68,112,428.54	\$ 93,055,795.37	\$ (24,943,366.83)	(26.8)
Noncurrent Assets				
Restricted Cash and Cash Equivalents	1,568,842.05	31,406,423.41	(29,837,581.36)	(95.0)
Restricted Due From Primary Government	105,311.72	301,523.35	(196,211.63)	(65.1)
Capital Assets - Nondepreciable	82,087,916.81	85,590,726.34	(3,502,809.53)	(4.1)
Capital Assets - Depreciable	384,418,367.57	335,275,643.14	49,142,724.43	14.7
Other	<u>18,302,721.04</u>	<u>19,632,663.44</u>	<u>(1,329,942.40)</u>	(6.8)
Total Assets	554,595,587.73	565,262,775.05	(10,667,187.32)	(1.9)
Liabilities				
Current Liabilities	35,499,215.37	37,605,982.88	(2,106,767.51)	(5.6)
Funds Held Others	97,378.29	161,231.32	(63,853.03)	(39.6)
Long-Term Liabilities	174,411,099.71	182,828,406.72	(8,417,307.01)	(4.6)
Other Noncurrent Liabilities	<u>4,051,313.72</u>	<u>4,076,669.71</u>	<u>(25,355.99)</u>	(0.6)
Total Liabilities	214,059,007.09	224,672,290.63	(10,613,283.54)	(4.7)
Net Assets				
Invested in Capital Assets - Net of Related Debt	294,845,978.94	270,964,003.30	23,881,975.64	8.8
Restricted				
Nonexpendable	8,926,852.29	7,912,805.52	1,014,046.77	12.8
Expendable	12,974,920.33	14,002,519.89	(1,027,599.56)	(7.3)
Unrestricted	<u>23,788,829.08</u>	<u>47,711,155.71</u>	<u>(23,922,326.63)</u>	(50.1)
Total Net Assets	<u>\$ 340,536,580.64</u>	<u>\$ 340,590,484.42</u>	<u>\$ (53,903.78)</u>	(0.0)

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets (condensed, comparative table presented on the next page) depicts operating and nonoperating revenues and expenses. Note that State appropriations are considered nonoperating revenues.

In Operating Revenues, Tuition and Fees increased \$3,853,265.85 or 5.6% due to a small increase in Campus Based Tuition of \$42.00, a small increase in Student Fees totaling \$48.00, and a slight increase in the student population. Sales and Services increased \$3,860,232.51 or 5.9% due to rate and population increases.

Operating Expenses grew by \$8,238,257.61 representing an overall increase of 2.7%. Salaries and Benefits increased from \$182,300,477.92 to \$194,971,185.05 or 7.0% due to staff employees receiving a 2.75% increase, increases in EPA Non-teaching and Teaching salaries, and associated fringe benefits. Supplies and Materials expenses totaled \$34,192,918.09 this year as compared to \$41,135,065.99 for the previous year, a decrease of \$6,942,147.90, or 16.9%. This decrease can be mainly attributed to cash flow and budget constraints. Scholarships and Fellowships increased \$3,743,595.40 or 25.2% due primarily to the addition of fifteen new scholarships and fellowships and increases in Pell Awards and the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

UNC Need Based Grant. Finally, Depreciation decreased from \$14,764,893.92 to \$13,190,778.44 or 10.7% due to a reassessment of the useful lives of assets, particularly in Buildings. This was an unprecedented year that did not follow any previous normal trend lines for Operating Expenses. Budget cuts, hiring freezes and spending restrictions made the management and safeguarding of assets time consuming and challenging.

In Nonoperating Revenues, Appalachian State experienced a decrease in State Appropriations of \$15,361,513.36 for an 11.8% decrease, again due to cash flow and budget constraints imposed by the State of North Carolina on State Agencies. However, the University received \$6,221,713.00 in State Aid from the American Recovery Act monies and is reported as State Aid - Federal Recovery Funds. Other Nonoperating Revenues increased \$3,056,527.23 or 8.7%. Federal and State student financial aid revenue is presented as Nonoperating Revenue this fiscal year instead of Operating Revenues as in the previous year. The Condensed Statement of Revenues, Expenses, and Changes in Net Assets was restated to provide a fair comparison. Investment Income decreased \$3,133,095.26 because of an unfavorable economic climate, and Interest and Fees on Debt decreased \$950,611.73 due to the reduction of total debt in 2009.

The Other Revenues section consists of Capital Grants, Capital Appropriations, and Capital Gifts. Other Revenues decreased by a total of \$6,950,999.09 or 59.8%. Capital Appropriations decreased by \$7,596,700.00 as there were no Capital Appropriations allotted for Appalachian during fiscal year 2009 due to cash flow and budget constraints imposed by the North Carolina General Assembly on State Agencies.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

	<u>Fiscal Year 2009</u>	<u>Fiscal Year 2008</u>	<u>\$ Change</u>	<u>% Change</u>
Operating Revenues				
Tuition and Fees, Net	\$ 72,463,672.03	\$ 68,610,406.18	\$ 3,853,265.85	5.6
Nongovernmental Grants and Contracts	1,798,256.80	2,656,436.52	(858,179.72)	(32.3)
Sales and Services, Net	68,821,444.44	64,961,211.93	3,860,232.51	5.9
Interest Earnings on Loans	192.16	13,238.56	(13,046.40)	(98.5)
Other Operating Revenues	887,426.91	1,410,165.23	(522,738.32)	(37.1)
Total Operating Revenues	143,970,992.34	137,651,458.42	6,319,533.92	4.6
Salaries and Benefits	194,971,185.05	182,300,447.92	12,670,737.13	7.0
Supplies and Materials	34,192,918.09	41,135,065.99	(6,942,147.90)	(16.9)
Services	32,745,074.05	32,140,442.50	604,631.55	1.9
Scholarships and Fellowships	18,575,798.75	14,832,203.35	3,743,595.40	25.2
Utilities	14,828,983.01	15,093,426.10	(264,443.09)	(1.8)
Depreciation	13,190,778.43	14,764,893.92	(1,574,115.49)	(10.7)
Operating Expenses	308,504,737.38	300,266,479.78	8,238,257.60	2.7
Operating Loss	(164,533,745.04)	(162,615,021.36)	(1,918,723.68)	(1.2)
Nonoperating Revenues				
State Appropriations	115,211,235.71	130,572,749.07	(15,361,513.36)	(11.8)
State Aid- Federal Recovery Funds	6,221,713.00	0.00	6,221,713.00	100.0
Other Nonoperating Revenues	38,372,616.11	35,316,088.88	3,056,527.23	8.7
Net Nonoperating Revenues	159,805,564.82	165,888,837.95	(6,083,273.13)	(3.7)
Income(Loss) Before Other Revenues	(4,728,180.22)	3,273,816.59	(8,001,996.81)	(244.4)
Capital Grants	1,204,573.19	419,203.42	785,369.77	187.3
Capital Appropriations	0.00	7,596,700.00	(7,596,700.00)	(100.0)
Capital Gifts	2,464,115.86	2,509,372.11	(45,256.25)	(1.8)
Additions to Endowments	1,005,587.39	1,100,000.00	(94,412.61)	(8.6)
Total Other Revenues	4,674,276.44	11,625,275.53	(6,950,999.09)	(59.8)
Total Increase in Net Assets	(53,903.78)	14,899,092.12	(14,952,995.90)	(100.4)
Net Assets				
Net Assets at Beginning of Year, as restated (Note 16)	340,590,484.42	325,691,392.30	14,899,092.12	4.6
Net Assets at End of Year	<u>\$ 340,536,580.64</u>	<u>\$ 340,590,484.42</u>	<u>\$ (53,903.78)</u>	(0.0)

Economic Outlook

The University experienced a decrease in net assets of \$53,903.78 for the year. This slight decrease is a net effect of decreases in both State Appropriations and Capital Appropriations offset by increases in tuition and fees, sales and services, and other nonoperating revenues.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

According to the Fiscal Research Division of the North Carolina General Assembly, the State's decrease in cash flow was caused by unprecedented declines in the State's economy-based taxes. A recession that began in December 2007, spurred by the housing market downturn, spread throughout the economy and worsened when the global financial market collapsed in October 2008. This helped push an already contracting economy into a prolonged and severe recession. For fiscal year 2008-09 General Fund revenues were \$3.22 billion below the \$20.85 budgeted amount. This fall in revenues represents an unprecedented 10.8% decline over the previous year. Many economists believe that the recession is over but also state that economic recovery will occur at a very slow rate, with current economic conditions expected to persist well into 2010. As a result of these conditions economists predict a 1.9% decline in General Fund Revenues for 2009-10, with a slight rebound in revenues of 3.2% predicted for 2010-2011. These rates compare to increases in revenue of 9.2% in 2006-07, 4.2% in 2007-08, and the unprecedented 10.8% decline for 2008-09.

Capital Asset and Debt Administration

Capitalized assets placed into service consisted of the following: \$55,451.11 for Stadium Parking Facilities Improvements, \$8,912,405.11 for the renovation of Residence Facilities, \$18,718,467.38 for new and renovated Athletics Facilities, \$28,472,213.40 for the Central Dining Hall, \$26,236.40 for Rankin Science West, \$445,275.00 for the Carol Belk Library and Information Commons, \$18,418.19 for Camp Broadstone, and \$956,477.58 in General Infrastructure.

Other major capital projects (not funded through the University wide bond issue) to be completed in the near future:

- The Appalachian Athletic Center Field House (Athletic Facility at Kidd Brewer Stadium) is currently under construction and is scheduled to be completed in the Fall of 2009. This total project also includes an indoor practice facility, a baseball facility, a women's softball field, improvements to Varsity Gymnasium, and expansion of the East Stands in Kidd Brewer Stadium. The total Athletic Facilities project has an estimated cost of \$69,000,000.00.
- Frank residence hall renovation is currently under construction and will be completed in 2009-2010 at an approximate cost of \$8,000,000.00. The funding for additional residence hall renovation projects will require external financing of approximately \$25,600,000.00 over the next several years.

Other major capital projects (not funded through the University wide bond issue) currently in the planning phase include:

- The new Student Residential, Learning, and Activity Development Center is currently in the advanced planning stage. This project will renovate an existing 58,800 square foot Cone residence hall, construct a new 110,000 square foot, 350 bed residence hall and expand the adjacent Student Union by adding a 61,000 square-foot addition. The

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

new residence hall will provide a living-learning environment that enhances the student learning experience by co-mingling classrooms, faculty offices, and a computer lab within the traditional residence hall setting. The new Student Union will provide additional student activity and academic space to support the new complex and the campus. This project is estimated to cost \$63,726,000.00, including \$7,360,000.00 for the Academic portion. Advance Planning authorization of \$6,400,000.00 is to be funded from housing receipts.

- The renovation of Cone Hall will begin in the fall of 2009 at an estimated cost of \$12,085,000.00.

Additional bonds are expected to be issued in late fall 2009 or early spring 2010 for additional funds to complete the Athletic facility project (estimated at \$9,000,000.00) and the renovation of Cone Hall (\$10,000,000.00).

Total annual debt service payments were \$15,614,970.63 in 2009 compared to \$14,811,183.74 last year. These payments include bond principal and interest and fees on debt.

Appalachian State University
Statement of Net Assets
June 30, 2009

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 38,453,248.46
Restricted Cash and Cash Equivalents	10,395,142.93
Receivables, Net (Note 4)	8,783,160.00
Due from State of North Carolina Component Units	885,673.00
Due from University Component Units	215,759.61
Inventories	8,670,358.46
Notes Receivable, Net (Note 4)	709,086.08
	<hr/>
Total Current Assets	68,112,428.54

Noncurrent Assets:

Restricted Cash and Cash Equivalents	1,568,842.05
Restricted Due from Primary Government	105,311.72
Endowment Investments	8,453,745.46
Other Investments	6,628,150.08
Notes Receivable, Net (Note 4)	3,220,825.50
Capital Assets - Nondepreciable (Note 5)	82,087,916.81
Capital Assets - Depreciable, Net (Note 5)	384,418,367.57
	<hr/>
Total Noncurrent Assets	486,483,159.19

Total Assets	<hr/> <hr/> 554,595,587.73
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	13,511,698.85
Due to Primary Government	1,340,650.43
Unearned Revenue	8,068,869.68
Interest Payable	2,490,725.27
Long-Term Liabilities - Current Portion (Note 7)	10,087,271.14
	<hr/>
Total Current Liabilities	35,499,215.37

Noncurrent Liabilities:

Deposits Payable	231,576.59
Funds Held for Others	97,378.29
U. S. Government Grants Refundable	3,819,737.13
Long-Term Liabilities (Note 7)	174,411,099.71
	<hr/>
Total Noncurrent Liabilities	178,559,791.72

Total Liabilities	<hr/> <hr/> 214,059,007.09
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Appalachian State University
Statement of Net Assets
June 30, 2009

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	294,845,978.94
Restricted for:	
Nonexpendable:	
Research	20,000.00
Endowed Professorships	8,433,745.46
Loans	473,106.83
Expendable:	
Scholarships and Fellowships	255,967.28
Research	10,251.59
Endowed Professorships	370,193.28
Departmental Uses	2,290,867.13
Debt Service	10,047,641.05
Unrestricted	<u>23,788,829.08</u>
Total Net Assets	<u><u>\$ 340,536,580.64</u></u>

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

Appalachian State University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2009

Exhibit A-2

REVENUES

Operating Revenues:	
Student Tuition and Fees, Net (Note 9)	\$ 72,463,672.03
Nongovernmental Grants and Contracts	1,798,256.80
Sales and Services, Net (Note 9)	68,821,444.44
Interest Earnings on Loans	192.16
Other Operating Revenues	887,426.91
	<hr/>
Total Operating Revenues	143,970,992.34
	<hr/>

EXPENSES

Operating Expenses:	
Salaries and Benefits	194,971,185.05
Supplies and Materials	34,192,918.09
Services	32,745,074.05
Scholarships and Fellowships	18,575,798.75
Utilities	14,828,983.01
Depreciation	13,190,778.43
	<hr/>
Total Operating Expenses	308,504,737.38
	<hr/>
Operating Loss	(164,533,745.04)
	<hr/>

NONOPERATING REVENUES (EXPENSES)

State Appropriations	115,211,235.71
State Aid - Federal Recovery Funds	6,221,713.00
Noncapital Grants - Federal Student Financial Aid	9,786,883.19
Other Noncapital Grants	29,437,669.36
Noncapital Gifts	7,261,537.09
Investment Income	899,573.18
Interest and Fees on Debt	(7,299,260.61)
Other Nonoperating Expenses	(1,713,786.10)
	<hr/>
Net Nonoperating Revenues	159,805,564.82
	<hr/>
Loss Before Other Revenues	(4,728,180.22)
	<hr/>
Capital Grants	1,204,573.19
Capital Gifts	2,464,115.86
Additions to Endowments	1,005,587.39
	<hr/>
Decrease in Net Assets	(53,903.78)
	<hr/>

NET ASSETS

Net Assets - July 1, 2008, as Restated (Note 16)	340,590,484.42
	<hr/>
Net Assets - June 30, 2009	\$ 340,536,580.64
	<hr/> <hr/>

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

Appalachian State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 142,033,798.38
Payments to Employees and Fringe Benefits	(194,238,118.49)
Payments to Vendors and Suppliers	(82,668,790.28)
Payments for Scholarships and Fellowships	(18,575,798.75)
Loans Issued	(544,203.05)
Collection of Loans	543,530.95
Interest Earned on Loans	(878.11)
Other Receipts	1,004,668.03
	<hr/>
Net Cash Used by Operating Activities	(152,445,791.32)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	115,211,235.71
State Aid - Federal Recovery Funds	6,221,713.00
Noncapital Grants - Federal Student Financial Aid	9,786,883.19
Noncapital Grants	30,283,159.02
Noncapital Gifts	7,261,537.09
Additions to Endowments	1,005,587.39
Related Activity Agency Receipts	974,408.65
Related Activity Agency Disbursements	(1,038,261.68)
Other Payments	(1,770,449.91)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	167,935,812.46

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Capital Grants	1,400,784.82
Capital Gifts	904,518.79
Proceeds from Sale of Capital Assets	50,936.72
Acquisition and Construction of Capital Assets	(59,381,130.60)
Principal Paid on Capital Debt and Leases	(8,315,710.02)
Interest and Fees Paid on Capital Debt and Leases	(7,209,651.99)
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(72,550,252.28)

CASH FLOWS FROM INVESTING ACTIVITIES

Investment Income	2,643,665.52
Purchase of Investments and Related Fees	(484,587.39)
	<hr/>
Net Cash Provided by Investing Activities	2,159,078.13
	<hr/>
Net Decrease in Cash and Cash Equivalents	(54,901,153.01)
Cash and Cash Equivalents - July 1, 2008	105,318,386.45
	<hr/>
Cash and Cash Equivalents - June 30, 2009	\$ 50,417,233.44
	<hr/> <hr/>

Appalachian State University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2009

Exhibit A-3

Page 2

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

Operating Loss	\$ (164,533,745.04)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	13,190,778.43
Allowances, Write-Offs, and Amortizations	330,674.37
Changes in Assets and Liabilities:	
Receivables (Net)	(624,735.08)
Due from State of North Carolina Component Units	89,000.00
Inventories	(621,798.50)
Accounts Payable and Accrued Liabilities	(1,331,163.00)
Due to Primary Government	1,234,390.81
Unearned Revenue	(708,714.43)
Arbitrage Rebate Payable	(6,501.37)
Compensated Absences	556,323.49
Deposits Payable	(19,628.90)
Note Principal Repayments	543,530.95
Notes Issued	(544,203.05)
	<u>\$ (152,445,791.32)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 38,453,248.46
Restricted Cash and Cash Equivalents	10,395,142.93
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>1,568,842.05</u>
Total Cash and Cash Equivalents - June 30, 2009	<u>\$ 50,417,233.44</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through Assumption of a Liability	2,049,261.13
Assets Acquired through a Gift	1,498,823.86
Change in Fair Value of Investments	(2,337,136.09)
Reinvested Distributions	407,640.44
Loss on Disposal of Capital Assets	129,482.10
Donated Expendable Supplies	1,379,175.24

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

Appalachian State University Foundation, Inc.
Statement of Financial Position
June 30, 2009

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$	2,121,111
Contributions Receivable		9,568,022
Other Receivables		249,688
Prepaid Expenses		44,447
Investments		60,154,739
Real Estate Held for Resale		10,086,525
Note Receivable		832,808
Contributions Receivable from Trusts		837,830
Contributions Receivable from Irrevocable Bequests		278,308
Cash Surrender Value of Life Insurance		168,242
In-Kind Gifts		41,521
Property and Equipment, Net		1,912,485
		<hr/>
Total Assets		86,295,726
		<hr/>

LIABILITIES

Accounts Payable and Accrued Expenses		39,599
Deferred Revenue - Advance Royalties		54,443
Deposits Payable		4,011
Notes Payable to University		3,900,500
Grants Payable to University		215,760
Split Interest Agreement Obligations		2,549,202
		<hr/>
Total Liabilities		6,763,515
		<hr/>

NET ASSETS

Unrestricted		4,718,582
Temporarily Restricted		21,703,309
Permanently Restricted		53,110,320
		<hr/>
Total Net Assets		79,532,211
		<hr/> <hr/>

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

Appalachian State University Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2009

Exhibit B-2

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, LOSSES AND OTHER SUPPORT				
Contributions	\$ 565,933	\$ 10,748,126	\$ 2,071,318	\$ 13,385,377
Investment Income	1,170,958	389,332	67,759	1,628,049
Auxillary Income	903,232	87,165		990,397
Net Unrealized and Realized Losses on Investments	(3,221,711)	(7,910,340)	(753,316)	(11,885,367)
Net Change in Split Interest Agreement Obligations		(164,276)	(344,089)	(508,365)
Other income	4,572	(1,275)	4,183	7,480
Subtotal	(577,016)	3,148,732	1,045,855	3,617,571
Net Assets Released from Restrictions	8,482,363	(8,482,363)		
Total Revenues, Gains, Losses, and Other Support	7,905,347	(5,333,631)	1,045,855	3,617,571
EXPENSES				
Program Services:				
General University Support	7,913,069			7,913,069
Student Financial Aid	1,781,501			1,781,501
Alumni Affairs	214,086			214,086
Other	381,278			381,278
Total Program Services	10,289,934			10,289,934
Supporting Services:				
General and Administrative	88,674			88,674
Fund Raising	768,920			768,920
Total supporting services	857,594			857,594
Total Expenses	11,147,528			11,147,528
Net (Increase) Decrease in Allowance for Doubtful Contributions Receivable		(289,167)	(25,602)	(314,769)
Increase (Decrease) in Net Assets	(3,242,181)	(5,622,798)	1,020,253	(7,844,726)
NET ASSETS				
Net Assets, beginning	7,960,763	27,326,107	52,090,067	87,376,937
Net Assets, ending	<u>\$ 4,718,582</u>	<u>\$ 21,703,309</u>	<u>\$ 53,110,320</u>	<u>\$ 79,532,211</u>

Appalachian Student Housing Corporation
Statement of Financial Position
June 30, 2009

Exhibit B-3

ASSETS

Current Assets:	
Cash and Cash Equivalents	\$ 2,033,918
Accounts Receivable, Net of allowance for doubtful accounts of \$1,620	13,013
Sales Tax Refund Receivable	16,278
Prepaid Expenses	<u>92,603</u>
Total Current Assets	2,155,812
Property and Equipment, Net	<u>19,344,755</u>
Other Assets:	
Deferred Financing Cost, Net	123,587
Assets Limited as to Use by Bond Order	<u>4,668,345</u>
Total Other Assets	<u>4,791,932</u>
Total Assets	<u><u>\$ 26,292,499</u></u>

LIABILITIES

Current:	
Current Portion of Long-Term Debt	\$ 505,000
Accounts Payable	238,000
Accrued Expenses	59,635
Accrued Interest	6,852
Deferred Income	<u>88,203</u>
Total Current Liabilities	<u>897,690</u>
Long-Term Debt, Less Current Portion	<u>17,975,000</u>
Total Liabilities	<u>18,872,690</u>

NET ASSETS

Unrestricted	<u>7,419,809</u>
Total Liabilities and Net Assets	<u><u>\$ 26,292,499</u></u>

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

Appalachian Student Housing Corporation
Statement of Activities
For the Fiscal Year Ended June 30, 2009

Exhibit B-4

REVENUES AND OTHER SUPPORT

Net Rental Income	\$ 4,088,219
Other Operating Revenues	111,542
	<hr/>
Total Revenues and Other Support	4,199,761
	<hr/>

EXPENSES

Salaries and Benefits	331,034
Purchased Services	95,165
Communications and Service Contracts	53,917
Professional Fees	19,656
Building	149,368
Utilities	514,559
Letter of Credit	169,258
Licenses and Fees	8,340
Insurance	86,815
Renovation	115,200
Depreciation	560,333
Amortization	61,886
Interest	480,938
Bond Remarketing Fees	15,644
Taxes	119,268
Advertising	7,962
Other	201,680
	<hr/>
Total Expenses	2,991,023
	<hr/>

Other Interest Income	98,214
	<hr/>
Increase in Unrestricted Net Assets	1,306,952

Net Assets

Beginning of Year	6,112,857
	<hr/>
End of Year	\$ 7,419,809
	<hr/> <hr/>

APPALACHIAN STATE UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2009

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

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

Discretely Presented Component Units – The Appalachian State University Foundation, Inc. and the Appalachian Student Housing Corporation are legally separate not-for-profit corporations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Appalachian State University Foundation, Inc. is a legally separate, tax-exempt component unit of the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 28 self-perpetuating members of which four ex-officio members are administrative officers of the University and one is an honorary member. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests, are restricted to the activities of the University by the donors. Because these restricted

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

resources held by the Foundation can only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University and is reported in separate financial statements because of the difference in its reporting model, as described below.

The Appalachian Student Housing Corporation is a legally separate, tax-exempt component unit of the University. The Corporation's primary function is to develop, finance, prepare, provide and supervise residential housing facilities for college and University students and employees of Appalachian State University. The Corporation's board consists of six members of which two members are administrative officers of the University. Because the Corporation's sole purpose is to benefit the University, it is considered a component unit of the University and is reported in separate financial statements due to the difference in its reporting model, as described below.

The Appalachian State University Foundation, Inc. and the Appalachian Student Housing Corporation are private not-for-profit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the component units' financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2009, the Foundation distributed \$9,694,570.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Vice Chancellor for University Advancement or the ASU Foundation President. The financial statements of the Corporation may be obtained from the Vice Chancellor for Student Development. The address is: Dougherty Administration Building, 438 Academy Street, Boone, NC 28608.

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

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*, the full scope of the University's

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

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

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

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

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

- E. Investments** - Investments are reported at fair value, as determined by quoted market prices or an estimated amount determined by management if quoted market prices are not available. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity or for a specified period of time, along with any accumulated investment earnings on such amounts. Further, endowment investments also include amounts internally designated by the University for investment in an

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

endowment capacity (i.e. quasi-endowments), along with accumulated investment earnings on such amounts.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded net of estimated uncollectible amounts.
- G. Inventories** - Inventories, consisting of expendable supplies, are valued at cost using first-in, first-out method. Merchandise for resale is valued using the retail inventory method. Rental textbooks are recorded at cost using first-in, first-out method.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 25 years for general infrastructure, 10 to 75 years for buildings, and 5 to 25 years for equipment.

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

- I. Restricted Assets** - Certain resources are reported as restricted assets because restrictions on asset use change the nature or normal understanding of the availability of the asset. Resources that are not available for current operations and are reported as restricted include resources restricted or designated for the acquisition or construction of capital assets and resources legally segregated for the payment of principal and interest as required by debt covenants.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Bonds payable are reported net of deferred losses on refunds. The deferred losses on refunds are amortized over the life of the new debt using the straight-line method. Issuance costs are expensed.

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

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

- O. Internal Sales Activities** - Certain institutional auxiliary operations provide goods and services to University departments, as well as to its customers. These institutional auxiliary operations include activities such as central stores, copy centers, motor pool, postal services, steam plant, electric utility, and telecommunications. In addition, the University has other miscellaneous sales and service units that operated either on a reimbursement or charge basis. All internal sales activities to University departments from auxiliary operations and sales and service units have been eliminated in the accompanying financial statements. These eliminations are recorded by removing the revenue and expense in the auxiliary operations and sales and service units and, if significant, allocating any residual balances to those departments receiving the goods and services during the year.

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2009, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$49,671,607.05, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Cash on hand at June 30, 2009 was \$417,363.87. The carrying amount of the University's deposits not with the State Treasurer was \$328,262.52 and the bank balance was \$975,462.70. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. Pursuant to G.S. 116-36.1, funds received for health care services not deposited with the State Treasurer shall be fully secured in the manner as prescribed by the State Treasurer for the security of public deposits. The University does not have a deposit policy for custodial credit risk. As of June 30, 2009, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	<u>\$ 449,130.01</u>
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B. Investments

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

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

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

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

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

Investments are subject to the following risks.

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

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

Custodial Credit Risk: Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University does not have a formal policy for custodial credit risk.

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The University does not have a formal policy for foreign currency risk.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Long-Term Investment Pool - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the percentage method. Under this method, each participating fund's investment balance is determined on percentage of original investment. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2009, for the Long-Term Investment Pool.

Long-Term Investment Pool

Investment Type	Fair Value	Investment Maturities (in Years)	
		1 to 5	6 to 10
Debt Securities			
Mutual Bond Funds	\$ 4,154,191.28	\$ 2,575,658.66	\$ 1,578,532.62
Other Securities			
International Mutual Funds	1,314,659.70		
Other Mutual Funds	6,854,076.01		
Total Long-Term Investment Pool	\$ 12,322,926.99		

At June 30, 2009, investments in the Long-Term Investment Pool included \$4,154,191.28 in Mutual Bond Funds with credit exposure for which Standard and Poors' credit quality distribution was AA.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturity (in Years) Less Than 1
	Value	Less Than 1
Debt Securities		
Money Market Mutual Funds	\$ 2,692,337.26	\$ 2,692,337.26
Other Securities		
Domestic Stocks	59,000.29	
Foreign Stocks	6,631.00	
Guaranty Capital -Medical Mutual Ins	1,000.00	
Total Non-Pooled Investments	\$ 2,758,968.55	

At June 30, 2009, the University's non-pooled investments included \$2,692,337.26 in money market mutual funds with credit exposure for which Standard and Poors' credit quality distribution was AAAM.

At June 30, 2009, the University's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Counterparty's Trust Dept or Agent not in University's Name
Domestic Stocks	\$ 59,000.29
Foreign Stocks	6,631.00
Total	\$ 65,631.29

Foreign Currency Risk: At June 30, 2009, the University's exposure to foreign currency risk is as follows:

Investment	Currency	Fair Value (U.S. Dollars)
ABB Ltd.	Swiss Franc	\$ 3,156.00
Goldcorp, Inc.	Canadian Dollar	3,475.00
Total		\$ 6,631.00

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Investment Type	<u>Fair Value</u>
Debt Securities	
Mutual Bond Funds	\$ 4,154,191.28
Money Market Mutual Funds	2,692,337.26
Other Securities	
International Mutual Funds	1,314,659.70
Other Mutual Funds	6,854,076.01
Domestic Stocks Held by Counterparty	59,000.29
Foreign Stocks Held by Counterparty	6,631.00
Guaranty Capital-Medical Mutual Insurance	1,000.00
Total Investments	<u>\$ 15,081,895.54</u>

Component Units - Investments of the University's discretely presented component unit, the Foundation, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements. Because the Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments by type:

Short-Term Investment Fund	\$ 15,518,998.00
Money Market Funds	429,524.00
Equity Investments	22,864,972.00
Fixed Income Investments	9,210,704.00
Alternative Investments	12,130,541.00
	<u>60,154,739.00</u>
Real Estate Held for Resale	10,086,525.00
Total Investments	<u>\$ 70,241,264.00</u>

NOTE 3 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, State law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may also appropriate expenditures

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

from eligible nonexpendable balances if deemed prudent and necessary to meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. However, a majority of the University's endowment donor agreements prohibit spending of nonexpendable balances and therefore the related nonexpendable balances are not eligible for expenditure. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which limits spending to 5% of an individual endowment account's net asset value at the end of the previous year. An earnings reserve must be held in each endowment account in an amount equal to 5% of the original contribution. Earnings in excess of the reserve amount as calculated at the end of each fiscal year are eligible for pay out. Realized and unrealized net capital losses that invade the original corpus amounts are recovered from accumulated income before any spending budgets are calculated. Subject to these limitations, the budgeted spending amount will be based on the net asset value of each individual endowment fund. At June 30, 2009, net appreciation was \$356,718.39, of which \$193,719.45 was available to be spent and was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2009, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 4,342,923.10	\$ 796,021.70	\$ 3,546,901.40
Accounts	4,182,798.80	69,865.64	4,112,933.16
Intergovernmental	1,037,704.15		1,037,704.15
Interest on Loans	85,621.29		85,621.29
Total Current Receivables	<u>\$ 9,649,047.34</u>	<u>\$ 865,887.34</u>	<u>\$ 8,783,160.00</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 706,561.08	\$ 0.00	\$ 706,561.08
Institutional Student Loan Programs	2,525.00		2,525.00
Total Notes Receivable - Current	<u>\$ 709,086.08</u>	<u>\$ 0.00</u>	<u>\$ 709,086.08</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	<u>\$ 3,573,923.65</u>	<u>\$ 353,098.15</u>	<u>\$ 3,220,825.50</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - CAPITAL ASSETS

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

	Balance July 1, 2008 (As Restated)	Increases	Decreases	Balance June 30, 2009
Capital Assets, Nondepreciable:				
Land	\$ 20,854,964.88	\$ 99,788.58	\$ 0.00	\$ 20,954,753.46
Art, Literature, and Artifacts	2,080,030.32	146,291.88		2,226,322.20
Construction in Progress	62,655,731.14	54,053,434.91	57,802,324.90	58,906,841.15
Total Capital Assets, Nondepreciable	<u>85,590,726.34</u>	<u>54,299,515.37</u>	<u>57,802,324.90</u>	<u>82,087,916.81</u>
Capital Assets, Depreciable:				
Buildings	396,394,273.42	52,556,258.16	2,872,173.66	446,078,357.92
Machinery and Equipment	41,399,370.63	4,497,333.77	3,906,359.27	41,990,345.13
General Infrastructure	56,181,802.49	5,460,329.75	2,309,011.94	59,333,120.30
Total Capital Assets, Depreciable	<u>493,975,446.54</u>	<u>62,513,921.68</u>	<u>9,087,544.87</u>	<u>547,401,823.35</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	120,684,149.53	8,504,473.28	2,872,173.66	126,316,449.15
Machinery and Equipment	26,223,302.34	2,632,981.88	3,721,478.10	25,134,806.12
General Infrastructure	11,792,351.53	2,053,323.27	2,313,474.29	11,532,200.51
Total Accumulated Depreciation	<u>158,699,803.40</u>	<u>13,190,778.43</u>	<u>8,907,126.05</u>	<u>162,983,455.78</u>
Total Capital Assets, Depreciable, Net	<u>335,275,643.14</u>	<u>49,323,143.25</u>	<u>180,418.82</u>	<u>384,418,367.57</u>
Capital Assets, Net	<u>\$ 420,866,369.48</u>	<u>\$ 103,622,658.62</u>	<u>\$ 57,982,743.72</u>	<u>\$ 466,506,284.38</u>

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 8,673,686.11
Accrued Payroll	2,934,647.02
Contract Retainage	1,851,973.09
Intergovernmental Payables	51,392.63
Total Accounts Payable and Accrued Liabilities	<u>\$ 13,511,698.85</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - LONG-TERM LIABILITIES

UNIVERSITY

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2009, is presented as follows:

	Balance July 1, 2008 (As Restated)	Additions	Reductions	Balance June 30, 2009	Current Portion
Revenue Bonds Payable	\$ 178,115,000.00	\$ 0.00	\$ 6,045,000.00	\$ 172,070,000.00	\$ 7,005,000.00
Deduct Deferred Charge on Refunding	(2,531,276.12)		(161,804.14)	(2,369,471.98)	
Total Bonds Payable	<u>175,583,723.88</u>		<u>5,883,195.86</u>	<u>169,700,528.02</u>	<u>7,005,000.00</u>
Notes Payable	6,668,504.00		2,270,710.02	4,397,793.98	1,944,297.79
Arbitrage Rebate Payable	6,501.37		6,501.37	0.00	
Compensated Absences	9,843,725.36	6,744,970.37	6,188,646.88	10,400,048.85	1,137,973.35
Total Long-Term Liabilities	<u>\$ 192,102,454.61</u>	<u>\$ 6,744,970.37</u>	<u>\$ 14,349,054.13</u>	<u>\$ 184,498,370.85</u>	<u>\$ 10,087,271.14</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2009	Principal Outstanding June 30, 2009	See Table Below
Revenue Bonds Payable							
Housing and Student Center System							
ASU Housing and Student Center System Revenue Bonds	2001	5.23%	07/15/2027	\$ 6,680,000.00	\$ 1,125,000.00	\$ 5,555,000.00	3
ASU Housing and Student Center System Refunding Bonds	2002	4.30%	07/15/2015	13,240,000.00	4,975,000.00	8,265,000.00	3
Total Housing and Student Center System				19,920,000.00	6,100,000.00	13,820,000.00	
Student Union System							
ASU Student Fee Revenue Refunding Bonds Student Union Building	1998	4.87%	05/15/2012	8,050,000.00	5,810,000.00	2,240,000.00	1
Utility System							
ASU Utility System Revenue Refunding Bonds	1998	5.29%	05/15/2024	27,535,000.00	24,320,000.00	3,215,000.00	2
The University of North Carolina System Pool Revenue Bonds							
Doughton Renovation	(A)	5.02%	04/01/2027	4,940,000.00	4,480,000.00	460,000.00	
Broyhill Inn	(B)	3.82%	10/01/2015	990,000.00	195,000.00	795,000.00	
Doughton Renovation	(B)	4.27%	10/01/2026	3,755,000.00	10,000.00	3,745,000.00	
Dining Hall	(B)	4.38%	05/01/2031	23,330,000.00	1,050,000.00	22,280,000.00	
Hoey Hall Renovation	(B)	4.25%	10/01/2026	6,980,000.00	450,000.00	6,530,000.00	
Student Recreation Center	(B)	4.13%	10/01/2021	7,680,000.00		7,680,000.00	
Utility System	(C)	4.28%	10/01/2023	19,230,000.00		19,230,000.00	
Cannon Hall	(C)	4.69%	10/01/2033	8,520,000.00		8,520,000.00	
Parking-Stadium	(C)	4.69%	10/01/2033	3,350,000.00		3,350,000.00	
New Field House Complex	(C)	4.69%	10/01/2033	20,600,000.00		20,600,000.00	
Total The University of North Carolina System Pool Revenue Bonds				99,375,000.00	6,185,000.00	93,190,000.00	
ASU General Revenue Bonds							
ASU General Revenue Bonds-Student Recreation Center	2003A	4.48%	05/01/2028	25,635,000.00	11,795,000.00	13,840,000.00	
ASU General Revenue Bonds-Housing, Athletics, Parking	2005	4.54%	07/15/2030	50,915,000.00	5,150,000.00	45,765,000.00	
Total General Revenue Bonds				76,550,000.00	16,945,000.00	59,605,000.00	
Total Bonds Payable (principal only)				<u>\$ 231,430,000.00</u>	<u>\$ 59,360,000.00</u>	<u>172,070,000.00</u>	
Less: Unamortized Loss on Refunding						<u>2,369,471.98</u>	
Total Bonds Payable						<u>\$ 169,700,528.02</u>	

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

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

(C) The University of North Carolina System Pool Revenue Bonds, Series 2008A

The University has pledged future revenues, net of specific operating expenses, to repay revenue bonds as shown in the table below:

Ref	Revenue Source	Total Future Revenues Pledged	Current Year Revenues Net of Expenses	Current Year Principal & Interest	Estimate of % of Revenues Pledged
(1)	Indebtedness Fee	\$ 2,468,250.00	\$ 1,215,534.34	\$ 810,250.00	67%
(2)	Steam Plant	3,543,250.00	4,054,903.59	1,210,750.00	30%
(3)	Housing Revenues	18,332,000.01	9,086,616.82	1,838,127.50	20%

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Annual Requirements			
	Revenue Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2010	\$ 7,005,000.00	\$ 7,886,241.28	\$ 1,944,297.79	\$ 60,648.56
2011	7,330,000.00	7,596,096.28	1,703,496.19	42,544.37
2012	7,635,000.00	7,295,078.78	200,000.00	30,527.25
2013	7,165,000.00	6,956,530.04	200,000.00	21,557.00
2014	7,445,000.00	6,665,622.54	100,000.00	14,823.12
2015-2019	37,845,000.00	28,074,547.06	250,000.00	17,121.86
2020-2024	44,460,000.00	18,544,515.15		
2025-2029	35,185,000.00	8,464,650.05		
2030-2034	18,000,000.00	1,811,012.50		
Total Requirements	\$ 172,070,000.00	\$ 93,294,293.68	\$ 4,397,793.98	\$ 187,222.16

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

Prior Year Defeasances - During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2009, the outstanding balance of prior year defeased bonds was \$31,640,000.00.

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

Purpose	Financial Institution	Interest Rate/Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2009	Principal Outstanding June 30, 2009
Visual Arts Center	J P Morgan Chase	4.91%	08/01/2008	\$ 2,700,000.00	\$ 2,700,000.00	\$ 0.00
Electric Utility	RBC Centura	4.30%	03/15/2013	1,000,000.00	600,000.00	400,000.00
Electric Utility	BB & T	4.56%	10/12/2016	1,000,000.00	250,000.00	750,000.00
Presbyterian Church Property	Presbyterian Church	0.00%	06/30/2011	4,750,000.00	1,666,666.00	3,083,334.00
Athletics Old Scoreboard	First Bank & Trust	7.52%	10/01/2010	593,063.52	428,603.54	164,459.98
Total Notes Payable				\$ 10,043,063.52	\$ 5,645,269.54	\$ 4,397,793.98

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

F. Component Units

ASU Foundation

On January 5, 2007, the Foundation entered into a revolving line of credit agreement with RBC Bank for up to \$3.5 million. The agreement was amended on August 8, 2007 to increase the line of credit to \$5.0 million. The purpose of the agreement is to assist with costs related to the Athletics facilities enhancement project. The outstanding balance as of June 30, 2009 was \$3,430,000.00. The line of credit is collateralized by outstanding pledge commitments and the amount borrowed may not exceed 95% of the total unpaid pledges. The line of credit is due on January 5, 2012. The interest rate is equal to the 30-day LIBOR plus .49% (.81% at June 30, 2009).

The Foundation entered into a loan agreement with RBC Bank for \$6,241,500.00 on April 14, 2008. The purpose of the loan was to assist with costs related to the athletics facilities east stands project. The Foundation borrowed \$3,467,750.00 as of September 29, 2008. The Foundation paid the loan amount plus interest of \$26,864.00 on September 29, 2008.

The Foundation entered into a loan agreement with RBC Bank on November 15, 2008 for \$470,500.00 to finance the purchase of a new scoreboard at Kidd Brewer Stadium and scorer's tables for the Holmes Convocation Center. The Foundation assigned the rights to marketing revenues to RBC Bank as security for the loan. The outstanding balance as of June 30, 2009 was \$470,500.00. The note is payable in four annual payments beginning July 15, 2009 at an interest rate of 5.83%.

Aggregate maturities required on notes payable as of June 30, 2009 are due in future years as follows:

<u>Fiscal Years Ending June 30,</u>	<u>Amount</u>
2010	\$ 114,557.00
2011	111,992.00
2012	3,548,521.00
2013	125,430.00
	<u>\$ 3,900,500.00</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

ASU Student Housing Corporation

Long-term debt at June 30, 2009 consists of the following:

Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$9,935,000; interest at variable rate calculated weekly due serially from July 1, 2003 to July 1, 2031.	\$ 7,080,000.00
Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$10,000,000; interest at variable rate calculated weekly due serially from July 1, 2002 to July 1, 2031.	6,730,000.00
Student Housing variable rate revenue bonds; dated September 19, 2000; original amount of \$7,000,000; interest at variable rate calculated weekly due serially from July 1, 2003 to July 1, 2031.	<u>4,670,000.00</u>
Total Long-Term Debt	18,480,000.00
Less Current Portion	<u>505,000.00</u>
Long-Term Debt, Less Current Portions	<u><u>\$ 17,975,000.00</u></u>

Principal Maturities over the term of the debt are as follows:

2010	\$ 505,000.00
2011	540,000.00
2012	580,000.00
2013	615,000.00
2014	645,000.00
Thereafter	<u>15,595,000.00</u>
	<u><u>\$ 18,480,000.00</u></u>

The Student Housing Variable Rate Revenue Bonds Series 2000 are secured by a Trust Estate, a letter of credit issued by Wachovia Bank, and a deed of trust and security agreement. Under the terms of the Bond Order, the Corporation is required to make annual principal and interest payments to a trustee, with the principal payments being either for current bond maturities or pursuant to a sinking fund requirement for noncurrent maturities, as set forth in the Bond Order. The trustee will then make principal and interest payments to bondholders when due. Such payments to the trustee are included in assets whose use is limited in the financial statements. The Bond Order requires that the Corporation satisfy certain measures of financial performance as long as the bonds are outstanding.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

On September 1, 2003, the Corporation elected to adjust the interest mode on the bonds from the fixed rates of the long mode to a variable rate under the weekly mode. Under the weekly mode, the variable rate is recalculated each week as the rate which would enable the bonds to be remarketed at par.

Additionally, on March 1, 2008, the Corporation entered into an interest rate swap contract with Wachovia Bank that effectively converts the interest rate on the outstanding bonds to a fixed rate of 2.38%. Under the swap contract, the Corporation pays interest at 2.38% and receives interest at the USD-SIFMA Municipal Swap Index rate each month. The swap is designed to hedge the risk of changes in the variable interest payments on the bonds caused by the change to the weekly interest mode. The swap, which terminates on March 1, 2013, was issued at market terms so that it had no fair value at its inception.

NOTE 8 - LEASE OBLIGATIONS

The University entered into operating leases for equipment and office space. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2009:

<u>Fiscal Year</u>	<u>Amount</u>
2010	\$ 309,238.95
2011	164,519.83
2012	54,489.88
2013	14,848.93
Total Minimum Lease Payments	<u>\$ 543,097.59</u>

Rental expense for all operating leases during the year was \$2,275,907.66.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - REVENUES

A summary of eliminations and allowances by revenue classification is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Change in Allowance for Uncollectibles	Net Revenues
Operating Revenues:					
Student Tuition and Fees	\$ 85,397,113.99	\$ 0.00	\$ 12,729,287.53	\$ 204,154.43	\$ 72,463,672.03
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 20,058,579.34	\$ 1,817.34	\$ 2,709,203.49	\$ 7,571.75	\$ 17,339,986.76
Dining	18,071,182.54	3,505,552.73	1,609,034.84	32,448.13	12,924,146.84
Student Union Services	184,538.97	55,336.01		9,973.95	119,229.01
Health, Physical Education, and Recreation Services	1,573,737.59	87,937.58		5,278.76	1,480,521.25
Bookstore	10,200,743.01	420,765.15	376,194.37	(6,454.99)	9,410,238.48
Parking	2,839,205.57	41,941.25		(10,413.91)	2,807,678.23
Camp Programs	2,316,846.73	87,217.53			2,229,629.20
Steam Utility System	9,219,679.06	9,126,461.06			93,218.00
Athletic	5,519,042.89	12,586.65		24,973.58	5,481,482.66
Other	9,485,575.23	3,748,840.19	410,169.05	32,319.10	5,294,246.89
Sales and Services of Education and Related Activities	1,948,389.00	1,152,597.07		1,779.77	794,012.16
New River Light and Power	15,368,822.86	4,444,741.73		77,026.17	10,847,054.96
Total Sales and Services	\$ 96,786,342.79	\$ 22,685,794.29	\$ 5,104,601.75	\$ 174,502.31	\$ 68,821,444.44

NOTE 10 - OPERATING EXPENSES BY FUNCTION

The University's operating expenses by functional classification are presented as follows:

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$ 95,729,015.21	\$ 1,945,439.29	\$ 4,351,427.72	\$ 105,707.74	\$ 593.70	\$ 0.00	\$ 102,132,183.66
Research	1,202,218.14	394,760.76	800,203.93	32,746.55	775.00		2,430,704.38
Public Service	6,349,479.71	147,334.80	1,618,444.61	1,172,644.22	9,478.40		9,297,381.74
Academic Support	24,349,863.12	5,578,857.72	5,020,823.52	166,698.75	204.44		35,116,447.55
Student Services	6,141,669.18	304,906.98	703,640.92	45,266.31			7,195,483.39
Institutional Support	15,586,556.38	1,554,532.54	2,794,430.16	322,082.46	3,582.30		20,261,183.84
Operations and Maintenance of Plant	13,136,358.29	582,401.94	4,098,050.75		6,363,385.39		24,180,196.37
Student Financial Aid	81,614.03	4,671.13	749.16	15,495,669.69			15,582,704.01
Auxiliary Enterprises	31,424,780.99	17,015,151.64	12,280,030.80	1,234,983.03	8,450,963.78		70,405,910.24
New River Light and Power	969,630.00	6,664,861.29	1,077,272.48				8,711,763.77
Depreciation						13,190,778.43	13,190,778.43
Total Operating Expenses	\$ 194,971,185.05	\$ 34,192,918.09	\$ 32,745,074.05	\$ 18,575,798.75	\$ 14,828,983.01	\$ 13,190,778.43	\$ 308,504,737.38

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - PENSION PLANS

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

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

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

For the current fiscal year, the University had a total payroll of \$162,678,420.89, of which \$78,023,009.92 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$2,621,772.65 and \$4,681,380.60, respectively.

Required employer contribution rates for the years ended June 30, 2008, and 2007, were 3.05% and 2.66%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2009, 2008, and 2007, which were \$2,621,772.65, \$2,163,331.14, and \$1,707,518.20, respectively.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

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

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2009, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of \$162,678,420.89, of which \$63,558,800.65 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$4,347,421.96 and \$3,813,528.04, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan -** The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University. The voluntary contributions by employees amounted to \$177,668.27 for the year ended June 30, 2009.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2009, were \$59,895.40. The voluntary contributions by employees amounted to \$915,428.50 for the year ended June 30, 2009.

IRC Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$1,583,134.41 for the year ended June 30, 2009.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Benefits** - The University participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multiple-employer defined benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

By General Statute, a Retiree Health Benefit Fund (the Fund) has been established as a fund in which accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the Teachers' and State Employees' Retirement System and contributions to the fund are irrevocable. Also by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employers making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year the University contributed 4.1% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. Required contribution rates for the years ended June 30, 2008, and 2007, were 4.1% and 3.8%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2009, 2008, and 2007, which were \$5,804,854.24, \$5,322,128.91, and \$4,498,407.96, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Disability Income** - The University participates in the Disability Income Plan of North Carolina (DIPNC), a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2009, the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University made a statutory contribution of .52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2008, and 2007, were .52% and .52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2009, 2008, and 2007, which were \$736,225.41, \$674,421.86, and \$615,571.62, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

NOTE 13 - RISK MANAGEMENT

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

Tort claims of up to \$1,000,000 are retained under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to \$10,000,000 via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

The University is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium. The University also purchased through the Fund extended coverage for sprinkler leakage, business interruption, vandalism, theft, flood, and "all risks" for buildings and contents.

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are \$1,000,000 per claim and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$10,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage.

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$75,000 deductible.

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. Health care coverage is provided to participants in international educational programs through the Preferred Health Plan for the University of North Carolina System for participants engaged in international educational activities. All exchange students and visitors are required to have medical insurance in effect for themselves and any accompanying spouse and dependents. The maximum coverage for sickness or injury is \$100,000 for the participants and dependents with no medical deductible per injury or sickness.

The University also purchased health care and life insurance for participants in the University camp programs with coverages of \$5,000 for accidental death and dismemberment and \$500 for sickness medical expense benefit. These plans are funded by individual contributions and the coverages were effected and placed by the North Carolina Department of Insurance through the State's agent of record.

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

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

The University retained the following risks as of June 30, 2009:

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 14 - COMMITMENTS AND CONTINGENCIES

A. Commitments - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were \$28,930,011.86 and on other purchases were \$1,694,355.87 at June 30, 2009.

B. Pending Litigation and Claims - As previously reported, the North Carolina School Boards Association, et al., filed a civil action against various State officials in their official capacity seeking a judicial determination as to whether the State Constitution requires certain monetary payments collected by State agencies to be paid to the local county school funds rather than statutorily designated recipients. In part, this civil action included a determination of whether monetary payments collected pursuant to statutory authority by the University for violations of parking traffic regulations and library fines were "civil penalties," which the State Constitution requires to be paid to the school fund in the county where they are collected. On July 1, 2005, the North Carolina Supreme Court held in favor of the school boards with regard to parking fines and held in favor of the University with regards to library fines. The matter was remanded back to trial court for disposition in accordance with the Supreme Court's decision. On August 8, 2008, the trial court entered a judgment against the defendants. The manner and means by which the judgment is satisfied will be determined by the General Assembly. At issue are transportation fines in the amount of \$4,307,434.00 for the period of January 1, 1996 to June 30, 2005.

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.

NOTE 15 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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

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

NOTE 16 - NET ASSET RESTATEMENTS

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

	<u>Amount</u>
July 1, 2008 Net Assets as Previously Reported	\$ 326,928,108.57
Restatements:	
Error in Establishing Useful Lives of Capital Assets	12,606,773.87
Correct Error in Classification of Inexhaustible Art & Artifacts	1,107,564.29
Corrections to Accumulated Depreciation	184,699.41
Correction to Notes Payable	<u>(236,661.72)</u>
July 1, 2008 Net Assets as Restated	<u>\$ 340,590,484.42</u>

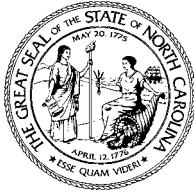
NOTE 17 - SUBSEQUENT EVENTS

On July 9, 2009, the University participated in the University of North Carolina System Pool Revenue Bonds, Series 2009B for \$15,430,000 to provide funds for new athletic facilities (\$8,370,000), and renovation of Frank residence hall (\$7,060,000).

The University is planning to issue bonds in spring 2010 for construction projects. Subject to approval by the University of North Carolina Board of Governors, ASU General Revenue Bonds will be issued for approximately \$19,000,000 to provide funds for the completion of the new athletic facilities (\$9,000,000) and renovation of Cone Residence Hall (\$10,000,000).

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STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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

Board of Trustees
Appalachian State University
Boone, North Carolina

We have audited the financial statements of Appalachian State University, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2009, which collectively comprise the University's basic financial statements and have issued our report thereon dated January 5, 2010. Our report was modified to include a reference to other auditors.

As discussed in Note 15 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* during the year ended June 30, 2009.

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

Internal Control Over Financial Reporting

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the University's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the University's financial statements that is more than inconsequential will not be prevented or detected by the University's internal control. We consider the deficiencies described in findings 1 and 2 in the Audit Findings and Responses section of this report to be significant deficiencies internal control over financial reporting.

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

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

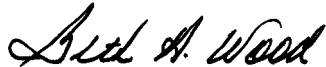
Compliance and Other Matters

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

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

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

This report is intended solely for the information and use of management of the University, the Board of Governors, the Board of Trustees, the Audit Committee, others within the entity, the Governor, the General Assembly, and the State Controller, and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

January 5, 2010

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AUDIT FINDINGS AND RESPONSES

Matters Related to Financial Reporting

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

1. INAPPROPRIATE USEFUL LIVES FOR CAPITAL ASSETS

The University has not periodically compared the estimated useful lives of its capital assets with actual experience. As a result, the financial statements and related notes prepared by the University contained a misstatement that was corrected as a result of our audit. Without this correction, the financial statements could have been misleading to readers.

There were \$30 million in fully-depreciated capital assets reported in the notes to the financial statements. At our request, University personnel determined that a significant number of the assets were still being used and estimated an overstatement of accumulated depreciation, and thus an understatement of the balance reported on the statement of net assets, of \$13.7 million. Further investigation of the fully-depreciated capital assets is to occur during the current fiscal year.

Recommendation: The University should implement additional procedures to ensure that the useful lives of capital assets are periodically re-evaluated and adjusted to match actual experience.

Response: The University is in the process of completing its analysis of its fully-depreciated assets and adjusting where necessary the useful lives to match expected use. This analysis and adjustment will be completed in the current fiscal year. The University has also implemented procedures to analyze and re-evaluate the useful life of assets as they become fully depreciated, further, the University will reassess and adjust useful lives to match expected use for all such assets on an annual basis going forward.

2. INAPPROPRIATE INFORMATION SYSTEM ACCESS

The University has granted information system access rights which do not provide for adequate segregation of duties. As a result, there is an increased risk of error or misappropriation.

We identified an accounting office employee with access rights that were inconsistent with his job duties. This employee could create vendors, create invoices, print batch checks, print online checks, enter journal entries and create electronic funds transactions. We also noted that all personnel in the payroll department could add employees and pay employees.

AUDIT FINDINGS AND RESPONSES (CONCLUDED)

Employees should be granted the minimum access rights needed to perform their job. Duties should be segregated such that one employee cannot process a transaction from beginning to end.

Recommendation: The University should take appropriate steps to strengthen internal controls to limit employees' access rights to those that are only necessary to perform their job duties. Assignment of employees to security classes should be evaluated to ensure adequate segregation of duties.

Response: An unusual set of circumstances led management to temporarily allow additional system access to the accounting office employee. On April 1, 2009, an accounting position within the accounting department was vacated as the result of a retirement. Subsequently, on April 9, 2009 the State of North Carolina enacted a temporary hiring freeze that lasted approximately three months. As a result of this personnel shortage the employee was granted improper access so that normal, daily functions could be completed by the accounting unit until the vacant position could be permanently filled. Management was aware of the inadequate segregation of duties and felt sufficient internal controls were in place to prevent this employee from processing falsified documents. The improper access was immediately removed from the accounting office employee when the vacant position was filled July 2009. The employee's previous, appropriate access levels were re-established at that time.

The system access that allowed Payroll Office staff to add employees to the payroll system was immediately discontinued upon notification from the State Auditors.

The University will take appropriate steps to limit employees' access rights so that employees only have those access rights that are necessary to enable them to perform their daily duties. Security classes will continue to be evaluated in order to ensure adequate segregation of duties and improve internal controls.

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