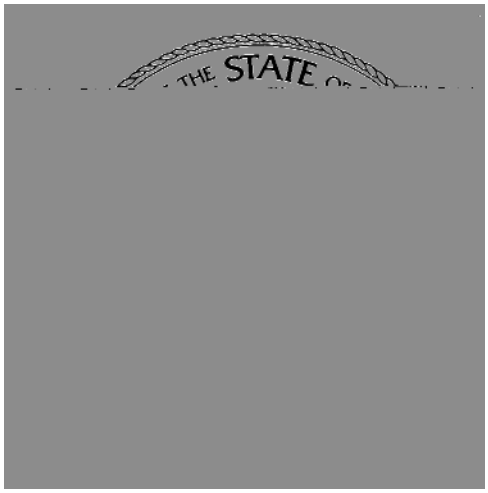

STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

STATE OF NORTH CAROLINA
Office of the State Auditor

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AUDITOR'S TRANSMITTAL

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

We have completed a f

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WESTERN CAROLINA UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The University's financial report includes three fi

A review of the University's *Statement of Net Assets* at June 30, 2005 and 2004, indicates that the University improved its already strong financial position, with Total Net Assets increasing by $24.6 million (11.2%) over the previous year.

Total assets of the University increased by $32.6 million. Net capital assets contributed $29.3 million of this amount, mostly due to a $41.3 million net increase in Buildings and Infrastructure, offset by a decrease of $18.7 million in Construction In Progress due to the capitalization of completed capital projects. In addition, there was a $3.2 million increase in Land resulting from the purchase of property for the University's Millennial Initiative.

The $2.7 million decrease in Current Assets was mainly attributable to a $2.4 million decrease in restricted current cash related to contract and grant, student loan, and capital improvement activities. Noncurrent restricted cash and cash equivalents increased by $3.7 million, resulting in a net increase in restricted cash of $1.4 million. Changes in the level of the current portion of restricted cash and cash equivalents are related to changes in the noncurrent portion of restricted cash and cash equivalents and to changes in the level of current liabilities. This relationship exists because current restricted cash and cash equivalents is that portion of restricted cash and cash equivalents needed to satisfy the current portion of liabilities in restricted accounts.

The $5.9 million increase in Other Noncurrent Assets resulted primarily from the $3.7 million increase in noncurrent cash and cash equivalents and a $1.7 million increase in endowment investments, more than half of which was due to f 0 12 151.75977 38n36 l9 0 6 0 12 151.75977 389.382 Tw 12

- Restricted net assets are subject to externally im

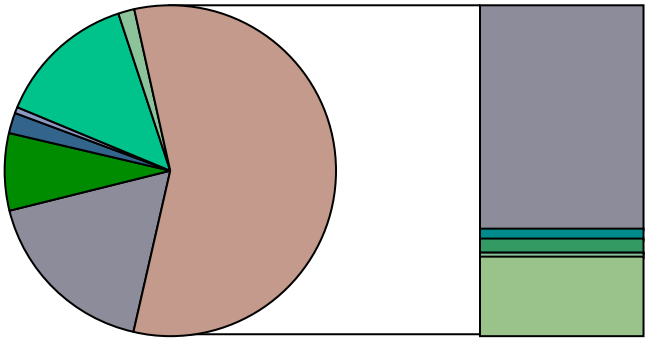
Statement of Revenues, Expenses, and Changes in Net Assets

The *Statement of Revenues, Expenses, and Changes in Net Assets* presents the revenues earned and the expenses incurred during the year. Activities are reported as either operating or nonoperating. Given a public university's dependency on revenues such as state

sources that are consistent with its mission and will continue prudently to manage the financial resources realized from these efforts in order to supplement tuition revenues and fund its operating activities.

The following is a graphic illustration of the breakdown of revenues by source (both operating and nonoperating), which are used to fund the University's operating activities for the year ended June 30, 2005. As defined by GASB, significant recurring sources of the University's revenues, such as state appropriations and private gifts, are considered nonoperating.

Revenues by Source



Like most public institutions, the University receives significant nonoperating revenues which offset the loss generated by operating activities. During 2004, the operating loss of $60 million was offset by $63 million in net nonoperating revenues. The primary source of this revenue is state appropriations, which totaled $59.3 million and accounted for 39% of total revenue. Other major sources of nonoperating revenue in 2005 are investment income of $3.4 million and noncapital gifts and grants of $2.5 million. A decrease in investment income in 2005 of $1.4 million was largely attributable to ma

expense were consistent with last year in terms of their percent of contribution to total expenses with the exception of supplies and materials that decreased by 3%. A $1.6 million decrease in supplies and materials in 2005 was mostly due to a decline in expenditures related to construction or sponsored research projects.

Statement of Cash Flows

The *Statement of Cash Flows* provides additional information about the University's financial results by reporting the major sources and uses of cash. Cash provided or used is categorized based on the following four types of activities: operating, noncapital financing, capital financing, and investing. The statement also provides an assessment of the University's financial flexibility and liquidity, its ability to meet obligations as they come due, and its need for external financing. A comparative summary of the *Statement of Cash Flows* for the years ended June 30, 2005 and 2004, is as follows:

Statement of Cash Flows

	2005	2004
Cash provided (used) by:		
Operating Activities	$ (59,341,515)	$ (50,512,804)
Noncapital Financing Activities	63,748,815	56,026,252
Capital and Related Financing Activities	(4,371,825)	(2,404,120)
Investing Activities	1,591,804	1,248,497
Net Change in Cash	**1,627,279**	**4,357,825**
Cash, Beginning of Year	**66,357,106**	**61,999,281**
Cash, End of Year	**$ 67,984,385**	$ **66,357,106**

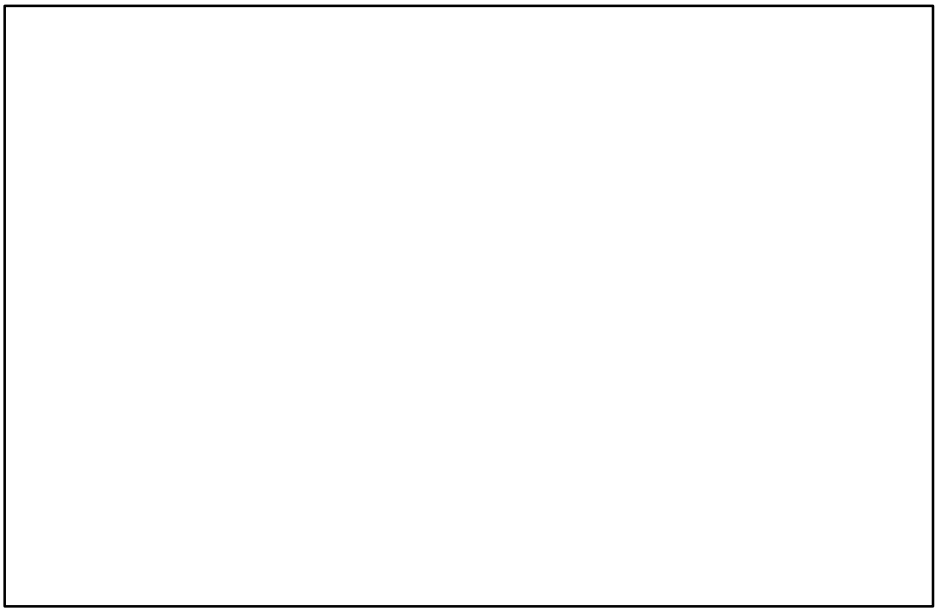
Net cash used in operating activities should be viewed in conjunction with net cash provided by noncapital financing activities. State appropriations and gifts are significant sources of recurring revenues in support of operating expenses, but are required to be classified as noncapital financing activities under generally accepted accounting principles. Therefore, when considering cash flows related to operating activities, it is important also to consider these noncapital financing activities, which support operating expenses. Net cash flow provided by these two activities amounted to $4.4 million in the year ended June 30, 2005.

Net cash provided by investing activities of $1.6 million reflects receipts from sales and maturities of investments less disbursements for purchases of investments. Unrealized losses and gains from the change in fair value of investments are non-cash transactions for valuation purposes only, and do not affect cash flows from investing activities.

The University's cash and cash equivalents increased $1.6 million during 2005 due to the positive flow of funds provided by noncapital financing and investing activities.

Capital Asset and Debt Administration

At June 30, 2005, the University had approximately $253.2 million invested in capital assets, and accumulated depreciation of $59.1 million. Depreciation charges for the current year totaled $4 million. The following chart displays the relationship of each category to capital assets as a whole.



The $30 million Fine and Performing Arts Center, an exciting new cultural arts and art education destination for Western North Carolina and the surrounding region, is in the final stages of completion with a grand opening scheduled for October 22, 2005. The center combines state-of-the-art educational opportunities for students and instructors with a fresh and inspiring venue for world-class performers and artists. Other capital projects funded by the 2000 bond issue are renovations recently begun on the Stillwell Laboratory Building ($16.8 million); completed renovations to Breese Gymnasium, including conversion of the old gymnasium area to physical education and dance program usage, as well as energy upgrades ($1.3 million); and completed construction of a 300-bed residence hall on Central Drive ($21.5 million).

The 2000 bond issue also made possible the acquisition of 344 acres of property adjacent to the University's main campus that will be home to a mix of academic buildings, research facilities, business, industry and housing as part of the University's Millennial Initiative. The Millennial Initiative is designed to enable the University to engage in public-private partnerships that enhance educational opportunities for students in high-tech programs and increase the ability of faculty to conduct cutting-edge research, while simultaneously promoting economic development. A comprehensive master plan is being developed to determine the most logical building sites for the different types of structures to be located on the property.

Construction projects funded from a0<5 T5xsu4 424.98145 Tm(the property.)C /P/ÞN5.05063 ssI7n

Enrollment growth targets for the next 8 - 10 years have been established, and the University continues vigorously to pursue growth in all categories of enrollment: resident credit and distance learning enrollments at both the undergraduate and graduate levels. With the total enrollment for Fall 2005 reaching an all-time high of nearly 8,700 students, a 3.4% increase over last fall's enrollment of 8,396, the total enrollment target of 10,000 by the year 2009 appears reachable. Increases in enrollment will generate increases in revenues such as tuition and fees, sales and services, and State appropriations, as well as the corresponding operating expenses incurred in serving larger numbers of students.

Economic Outlook

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

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

Private gifts are an important supplement to the University's base revenue from State appropriations and student tuition. Such gifts can provide the support needed to boost programs to higher levels of quality and service. Reflecting national positive trends in philanthropy, Western experienced an increase of over $233,000 (10%) in total (noncapital and capital) gifts in 2005. Though some indicators suggest that the overall state of the economy will continue to improve moderately in the months to come, local, State and national economies remain susceptible to political and market uncertainties. The economic pressures affecting donors, as well as investment returns, will continue to affect the level of support the University receives from corporate and individual giving. Other factors that could have an impact on fundraising at Western are the increased competition for discretionary dollars represented by the growing number of charitable entities (which now total more than 1.5 million organizations in the United States) and the philanthropic response to natural disasters like the recent hurricanes, Katrina and Rita.

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

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

Western Carolina University
Statement of Net Assets
June 30, 2005

Exhibit A-1

ASSETS

NET ASSETS	
Invested in Capital Assets, Net of Related Debt	167,156,112.78
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	7,270,623.69
Endowed Professorships	6,570,683.83
Loans	929,012.00
Expendable:	
Scholarships and Fellowships	6,856,971.71
Research	224,928.27
Endowed Professorships	1,078,378.71
Departmental Uses	4,380,030.55
Loans	434,352.40
Capital Projects	988,176.61
Debt Service	12,507,569.09
Unrestricted	35,111,323.83
Total Net Assets	$ 243,508,163.47

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

Western Carolina University
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2005

Exhibit A-2

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 9)	$	26,662,394.03
Federal Grants and Contracts		12,008,901.65
State and Local Grants and Contracts		2,842,825.55
Nongovernmental Grants and Contracts		1,137,899.83
Sales and Services, Net (Note 9)		20,962,142.41
Interest Earnings on Loans		14,813.59
Other Operating Revenues		2,633,379.78
Total Operating Revenues		66,262,356.84
EXPENSES		
Operating Expenses:		
Salaries and Benefits		77,231,433.95
Supplies and Materials		15,750,661.89
Services		20,616,072.82
Scholarships and Fellowships		4,815,087.41
Utilities		4,121,653.13
Depreciation		3,999,855.86
Total Operating Expenses		126,534,765.06
Operating Loss		(60,272,408.22)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations		59,294,420.63
Noncapital Grants		184,001.44
Noncapital Gifts		2,277,981.25
Investment Income (Net of Investment Expense of $36,948.59)		3,422,638.05
Interest and Fees on Capital Asset-Related Debt		(1,749,325.46)
Other Nonoperating Expenses		(411,001.51)
Net Nonoperating Revenues		63,018,714.40
Income Before Other Revenues		2,746,306.18
Capital Appropriations		1,226,900.00
Capital Grants		20,132,820.02
Capital Gifts		300,000.00
Additions to Endowments		206,991.05
Increase in Net Assets		24,613,017.25
NET ASSETS		
Net Assets - July 1, 2004		218,895,146.22
Net Assets - June 30, 2005	$	243,508,163.47

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

Western Carolina University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2005

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	64,821,165.71
Payments to Employees and Fringe Benefits		(77,149,179.01)
Payments to Vendors and Suppliers		(44,509,406.22)
Payments for Scholarships and Fellowships		(4,815,087.41)
Loans Issued		(1,486,049.80)
Collection of Loans		1,147,015.75
Interest Earned on Loans		14,813.59
Other Receipts		2,635,212.54
Net Cash Used by Operating Activities		(59,341,514.85)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Appropriations		59,294,420.63
Noncapital Grants		150,703.83
Noncapital Gifts		4,476,388.97
Additions to Endowments		206,991.05
William D. Ford Direct Lending Receipts		23,159,156.00
William D. Ford Direct Lending Disbursements		(23,262,963.00)
Related Activity Agency Receipts		339,758.99
Related Activity Agency Disbursements		(204,639.79)
Other Payments		(411,001.51)
Net Cash Provided by Noncapital Financing Activities		63,748,815.17
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
State Capital Appropriations		1,226,900.00
Capital Grants		20,244,126.50
Capital Gifts		300,000.00
Acquisition and Construction of Capital Assets		(22,923,910.39)
Principal Paid on Capital Debt and Leases		(1,460,716.21)
Interest and Fees Paid on Capital Debt and Leases		(1,758,225.67)
Net Cash Used by Capital Financing and Related Financing Activities		(4,371,825.77)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		970,865.61
Investment Income		2,062,009.70
Purchase of Investments and Related Fees		(1,441,071.01)
Net Cash Provided by Investing Activities		1,591,804.30
Net Increase in Cash and Cash Equivalents		1,627,278.85
Cash and Cash Equivalents - July 1, 2004		66,357,105.87
Cash and Cash Equivalents - June 30, 2005	$	67,984,384.72

RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	$	(60,272,408.22)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		3,999,855.86
Allowances, Write-Offs, and Amortizations		(246,265.08)
Changes in Assets and Liabilities:		
Receivables (Net)		1,004,168.19
Inventories		(212,714.49)
Accounts Payable and Accrued Liabilities		(3,581,378.81)
Due to Primary Government		(2,803.24)
Deferred Revenue		98,926.00
Compensated Absences		185,807.88
Deposits Payable		9,432.68
Note Principle Repayments		1,161,914.18
Notes Issued		(1,486,049.80)
Net Cash Used by Operating Activities	$	(59,341,514.85)
RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Current Assets:		
Cash and Cash Equivalents	$	38,214,138.07
Restricted Cash and Cash Equivalents		8,719,031.64
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		21,051,215.01
Total Cash and Cash Equivalents - June 30, 2005	$	67,984,384.72
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired through a Gift	$	371,738.97
Change in Fair Value of Investments		908,311.51
Reinvested Distributions		720,292.43

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

Western Carolina University Research and Development Corporation
Statement of Financial Position
June 30, 2005 *Exhibit B-1*

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	6,671,792
Net Investment in Direct Financing Lease		146,467
Property and Equipment:		
Construction in Progress		7,244,920
Other Assets:		
Certificate Issuance Costs, net of accumulated amortization		1,159,371
Net Investment in Direct Financing Lease		10,067,123
Total Assets		25,289,673
LIABILITIES		
Current Liabilities:		
Current Portion of Long Term Debt	$	500,000
Construction Contracts Payable		1,847,611
Construction Retainage Payable		643,147
Accrued Expenses		75,344
Total Current Liabilities		3,066,102
Noncurrent Liabilities:		
Certificates of Participation Payable		22,395,000
Total Liabilities		25,461,102
NET ASSETS		
Unrestricted Net Assets		(171,429)
Total Liabilities and Net Assets	$	25,289,673

Western Carolina University Research and Development Corporation
Statement of Activities
For the Fiscal Year Ended June 30, 2005 *Exhibit B-2*

REVENUES		
Management Fee	$	109,045
Interest Income		376,420
Total Revenues		485,465
EXPENSES		
Trustee Fees		5,250
Interest Expense		522,174
Insurance		70,649
Bank Charges		19
Annual Filing Fee		200
Amortization of Certificate Issuance Costs		40,499
Total Expenses		638,791
CHANGE IN NET ASSETS		(153,326)
Net Assets at Beginning of Year		(18,103)
Net Assets at End of Year	$	(171,429)

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity – The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. Western Carolina University is a constituent institution of the 16-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

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

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

The Corporation reports its financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the University's financial reporting entity for these differences.

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

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 Governm

C. Basis of Accounting – The financial statements of the University have been prepared using the economic resource measurement focus and the

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

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

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

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

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

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

The carrying amount of the University's deposits not with the State Treasurer was $89,859.62 and the bank balance was $468,029.76. 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, 2005, the University's bank balance was exposed to custodial credit risk as follows:

Uninsured and Collateral Held by Pledging Bank's Trust Department not in University's Name	$ 356,218.98

B. Investments – The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received for services rendered by health care professionals in the same manner as the State Treasurer is required to invest, as discussed below.

G.S. 147-69.1(c), applicable to the State's General Fund, and G.S. 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the f

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

Investments of the University's component unit, the Western Carolina University Foundation, are subject to and restricted by G.S. 36B "Uniform Manageme

a bond issuer will fail to pay interest or principal in a timely manner, or that negative perceptions of the issuer's ability to make these payments will cause security prices to decline. The circumstances may arise due to a variety of factors such as financial weakness, bankruptcy, litigation and/or adverse political developments.

A bond's credit quality is an assessment of the issuer's ability to pay interest on the bond, and ultimately pay the principal. Credit quality is evaluated by Moody's Investors Service, or comparable by Standard and Poor's (S&P). A lower rating will result in a greater chance, in the rating agency's opinion, that the bond issuer will default or fail to meet its payment obligations. The University's investment policy states that no more than 10% of each fund, at cost, may be invested in securities rated Baa or below.

Certain fixed income securities, including obligations of the U.S. government or those explicitly guaranteed by the U.S. government, are not considered to have credit risk.

As of June 30, 2005, the University had no investments in the Long-Term Investment Pool subject to credit risk.

The University Endowment Board places no limit on the amount the Board may invest in any one issuer. More than 5% of the long-term investment pool investments are in the following funds:

Fund Name	Percent Invested
Artisan Mid-Cap Fund	7.15%
Common Fund High Quality Bond Fund	16.28%
TCW Funds	8.03%
Dodge & Cox Stock Fund	18.55%

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NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2005, is presented as follows:

	Balance July 1, 2004	Adjustments	Increases	Decreases	Balance June 30, 2005
Capital Assets, Nondepreciable:					
Land	$ 2,988,060.30	$ 0.00	$ 3,184,646.45	$ 0.00	$ 6,172,706.75
Art, Literature, and Artifacts	105,433.00				105,433.00
Construction in Progress	76,831,601.79	(34,861,458.96)	16,124,113.99		58,094,256.82
Total Capital Assets, Nondepreciable	79,925,095.09	(34,861,458.96)	19,308,760.44		64,372,396.57
Capital Assets, Depreciable:					
Buildings	112,775,561.76	33,340,701.53	9,844,262.67		155,960,525.96
Machinery and Equipment	12,883,637.41		4,537,612.42	648,075.26	16,773,174.57
Art, Literature, and Artifacts	103,188.00		50,000.00		153,188.00
General Infrastructure	14,941,042.23	1,520,757.43	364,372.29	852,251.10	15,973,920.85
Intangible	1.00				1.00
Total Capital Assets, Depreciable	140,703,430.40	34,861,458.96	14,796,247.38	1,500,326.36	188,860,810.38
Less Accumulated Depreciation/Amortization for:					
Buildings	44,552,245.81		2,593,805.65		47,146,051.46
Machinery and Equipment	5,809,577.26		1,013,791.29	520,246.19	6,303,122.36
Art, Literature, and Artifacts	84,851.09		1,869.91		86,721.00
General Infrastructure	5,328,885.93		390,389.01	160,507.27	5,558,767.67
Intangible					
Total Accumulated Depreciation	55,775,560.09		3,999,855.86	680,753.46	59,094,662.49
Total Capital Assets, Depreciable, Net	84,927,870.31	34,861,458.96	10,796,391.52	819,572.90	129,766,147.89
Capital Assets, Net	$ 164,852,965.40	$ 0.00	$ 30,105,151.96	$ 819,572.90	$ 194,138,544.46

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2005, were as follows:

	Amount
Accounts Payable	$ 2,434,143.67
Accrued Payroll	829,705.60
Contract Retainage	1,439,136.18
Other	1,807,438.19
Total Accounts Payable and Accrued Liabilities	$ 6,510,423.64

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities – A summa

NOTE 8 - LEASE OBLIGATIONS

A. Capital Lease Obligations – Capital lease obligations relating to machinery and equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2005:

Fiscal Year	Amount
2006	$ 775,632.90
2007	773,506.59
2008	768,240.50
2009	766,387.50
2010	764,100.00
2011-2015	3,827,987.50
2016-2020	3,829,423

NOTE 9 - REVENUES

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

	Gross Revenues	Internal Sales Eliminations	Less Scholarship Discounts	Less Allowance for Uncollectibles	Net Revenues	Revenues Pledged as Security for Debt	
Operating Revenues:							
Student Tuition and Fees	$ 31,536,067.93	$ 23,978.25	$ 4,617,463.54	$ 232,232.11	$ 26,662,394.03	$ 481,932.25	(A)
Sales and Services:							
Sales and Services of Auxiliary Enterprises:							
Residential Life	$ 9,014,566.11	$ 474,528.01	$ 1,326,653.56	$ 86,757.51	$ 7,126,627.03	$ 7,126,627.03	(B)
Dining	7,842,133.81	623,208.37	1,045,139.81	33,265.06	6,140,520.57		
Book Rental	1,263,555.62	1,147.75	164,828.65	38,401.51	1,059,177.71		
Bookstore	1,738,738.37	135,152.62		1,511.21	1,602,074.54		
Print Shop	630,529.37	542,940.59			87,588.78		
Athletic	1,060,729.79				1,060,729.79	1,060,729.79	(C)
Other	996,365.81	29,614.34		902.91	965,848.56	65,854.00	(D)
Sales and Services of Education and Related Activities	2,540,310.69	1,502,566.34		615.05	1,037,129.30		
Independent Operations	1,964,036.43	81,590.30			1,882,446.13		
Total Sales and Services	$ 27,050,966.00	$ 3,390,748.32	$ 2,536,622.02	$ 161,453.25	$ 20,962,142.41	$ 8,253,210.82	

Revenue Bonds Secured by Pledged Revenues:
(A) Housing and Student Center System
(B) Student Housing
(C) Stadium System
(D) Apartment Management

NOTE 10 - OPERATING EXPENSES BY FUNCTION

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

Salaries and	Supplies a	Scholarships

Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North 996 Tm(ent)TvTo

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to $130,832.48 for the year ended June 30, 2005.

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).

$1,779,828.28. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed inform

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 $20,280,408.48 and on other purchases were $2,700,961.27 at June 30, 2005.

B. Capital Lease Commitment – The University entered into a thirty-two year lease agreement on February 9, 2005 with Affinity Housing, LLC, a sole member and manager of the Western Carolina University Research and Development Corporation. Under the agreement, Affinity Housing, LLC will lease the Norton Road Residence Hall to the University. The Norton Road residence facility was under construction at June 30, 2005 with an occupancy date of August 31, 2005. The University will begin capital lease payments during the June 30, 2006 fiscal year that will total $18,407,955.10 during the life of the lease.

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

D. University Improvement General Obligation Bonds – The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of $2.5 billion of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for eachj12 0 0 12 e 407.74088 184.8029 7 th 174.96g

exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-GA notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within

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STATE OF NORTH CAROLINA
Office of the State Auditor

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

Board of Trustees
Western Carolina University
Cullowhee, North Carolina

We have audited the financial statements of Western Carolina University, a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2005, which collectively comprise the University's basic financial statements and have issued our report thereon dated May 12, 2006. We did not audit the financial statements of Western Carolina University Foundation, which represent 5 percent, 6 percent, and 2 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of Western Ca

INDEPENDENT AUDITOR’S REPORT

ORDERING INFORMATION

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

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