



STATE OF NORTH CAROLINA

WESTERN CAROLINA UNIVERSITY

CULLOWHEE, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30,

WESTERN C



STATE OF NORTH CAROLINA
Office of the State Auditor

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

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AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of Western Carolina University for the year ended June 30, 2006, 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 resulted in no audit findings.

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

Leslie W. Merritt, Jr.

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

December 19, 2006

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

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 13, 2006, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*

**WESTERN CAROLINA UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Introduction

The University's financial report includes three financial statements: the *Statement of Net Assets*, which presents the assets, liabilities, and net assets of the institution as of the end of the fiscal year; the *Statement of Revenues, Expenses, and Changes in Net Assets*, which reflects revenues and expenses recognized during the fiscal year; and the *Statement of Cash Flows*, which provides information on all of the institution's cash inflows and outflows during the fiscal year by major category. These financial statements were prepared in accordance with Governmental Accounting Standards Board (GASB) pronouncements.

The following discussion and analysis provides an overview of the financial position and activities of Western Carolina University (the "University") for the years ended June 30, 2006 and 2005. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

Statement of Net Assets

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

Condensed Summary of Net Assets

	<u>2006</u>	<u>2005</u>	<u>\$ Change</u>	<u>% Change</u>
Assets				
Current Assets	\$ 66,592,904.50	\$ 55,504,650.24	\$ 11,088,254.26	19.98%
Capital Assets, Net	219,595,688.89	194,138,544.46	25,457,144.43	13.11%
Other Noncurrent Assets	<u>53,207,113.52</u>	<u>54,781,889.47</u>	<u>(1,574,775.95)</u>	-2.87%
Total Assets	<u>339,395,706.91</u>	<u>304,425,084.17</u>	<u>34,970,622.74</u>	11.49%
Liabilities				
Current Liabilities	13,404,152.23	12,781,282.86	622,869.37	4.87%
Noncurrent Liabilities	<u>58,078,305.68</u>	<u>48,135,637.84</u>	<u>9,942,667.84</u>	20.66%
Total Liabilities	<u>71,482,457.91</u>	<u>60,916,920.70</u>	<u>10,565,537.21</u>	17.34%
Net Assets				
Invested in Capital Assets, Net of Related Debt	182,065,630.91	167,993,723.92	14,071,906.99	8.38%
Restricted – Nonexpendable	17,046,677.72	14,770,319.52	2,276,358.20	15.41%
Restricted – Expendable	24,757,619.12	19,390,800.82	5,366,818.30	27.68%
Unrestricted	<u>44,043,321.25</u>	<u>41,353,319.21</u>	<u>2,690,002.04</u>	6.50%
Total Net Assets	<u>\$ 267,913,249.00</u>	<u>\$ 243,508,163.47</u>	<u>\$ 24,405,085.53</u>	10.02%

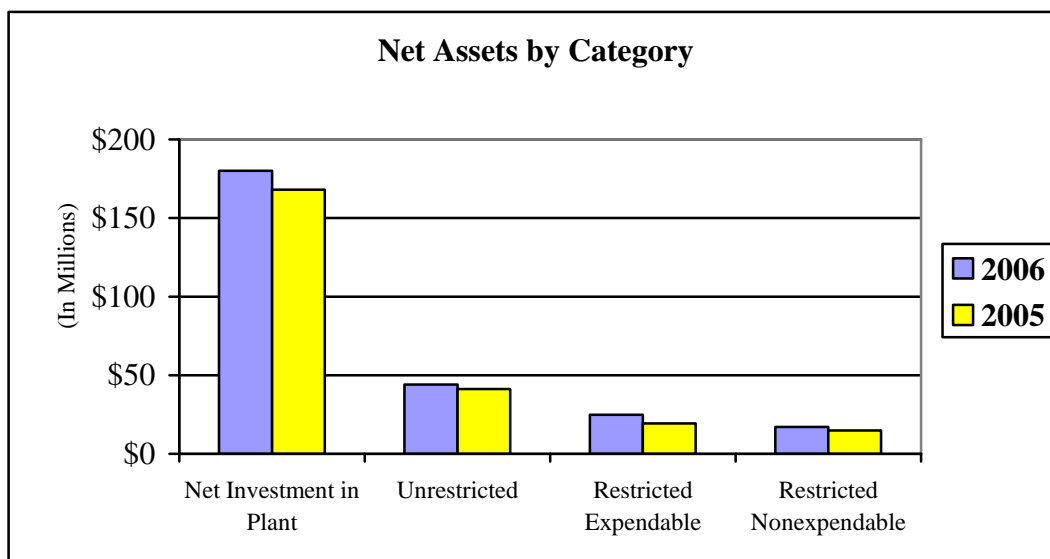
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net assets represent residual interest in the University's assets after all liabilities are deducted. For reporting purposes, they are divided into three major components:

- "Invested in Capital Assets, Net of Related Debt" represents the University's investment in capital assets such as movable equipment, buildings, land, infrastructure, and improvements, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets. At June 30, 2006, \$182.1 million (68 %) of the \$267.9 million in net assets was attributable to the University's investment in capital assets.
- Restricted net assets are subject to externally imposed restrictions governing their use and are further divided into two categories: nonexpendable and expendable. "Restricted - Nonexpendable" net assets primarily include the University's permanent endowment funds received from donors for the purpose of creating present and future income. These funds must be held inviolate and in perpetuity and are, therefore, not expendable. Earnings on these funds support various programs determined by donors. The nonexpendable category makes up approximately \$17 million (6.4%) of the \$267.9 million net assets total. "Restricted - Expendable" net assets are available for expenditure in accordance with externally imposed restrictions. Examples include funds for scholarships, debt service, and capital projects. At June 30, 2006, expendable net assets totaled \$24.8 million (9.2% of total net assets).
- "Unrestricted" net assets are not subject to externally imposed restrictions, although management has designated these funds for various academic and research programs and initiatives, as well as capital projects. This year, unrestricted net assets totaling \$44 million represent 16.4 % of total net assets.

The following chart displays the contribution of each category to the total in both 2006 and 2005:



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Statement of Revenues, Expenses, and Changes in Net Assets

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

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following is a condensed *Statement of Revenues, Expenses, and Changes in Net Assets* for Western Carolina University as of June 30, 2006, compared with that of 2005.

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

	2006	2005	\$ Change	% Change
Operating Revenues				
Student Tuition and Fees, Net	\$ 28,692,604.02	\$ 26,662,394.03	\$ 2,030,209.99	7.61%
Grants and Contracts	16,784,061.78	15,989,627.03	794,434.75	4.97%
Sales and Services, Net	23,621,945.29	20,962,142.41	2,659,802.88	12.69%
Other Operating Revenues	1,208,860.99	2,648,193.37	(1,439,332.38)	-54.35%
Total Operating Revenues	70,307,472.08	66,262,356.84	4,045,115.24	6.10%
Operating Expenses	144,944,442.66	126,534,765.06	18,409,677.60	14.55%
Operating Income/(Loss)	(74,636,970.58)	(60,272,408.22)	(14,364,562.36)	23.83%
Nonoperating Revenues (Expenses)				
State Appropriations	74,579,645.56	59,294,420.63	15,285,224.93	25.78%
Noncapital Gifts and Grants	4,037,736.56	2,461,982.69	1,575,753.87	64.00%
Investment Income (Net of Investment Expense)	4,709,304.44	3,422,638.05	1,286,666.39	37.59%
Other Nonoperating Expenses	(3,287,981.96)	(2,160,326.97)	(1,127,654.99)	52.20%
Net Nonoperating Revenues	80,038,704.60	63,018,714.40	17,019,990.20	27.01%
Income Before Other Revenues	5,401,734.02	2,746,306.18	2,655,427.84	96.69%
Capital Appropriations	1,818,000.00	1,226,900.00	591,100.00	48.18%
Capital Gifts and Grants	14,668,696.19	20,432,820.02	(5,764,123.83)	-28.21%
Additions to Permanent Endowments	2,516,655.32	206,991.05	2,309,664.27	1115.83%
Total Other Revenue	19,003,351.51	21,866,711.07	(2,863,359.56)	-13.09%
Change in Net Assets	24,405,085.53	24,613,017.25	(207,931.72)	-0.84%
Beginning Net Assets, as Restated	243,508,163.47	218,895,146.22	24,613,017.25	11.24%
Ending Net Assets	<u>\$ 267,913,249.00</u>	<u>\$ 243,508,163.47</u>	<u>\$ 24,405,085.53</u>	10.02%

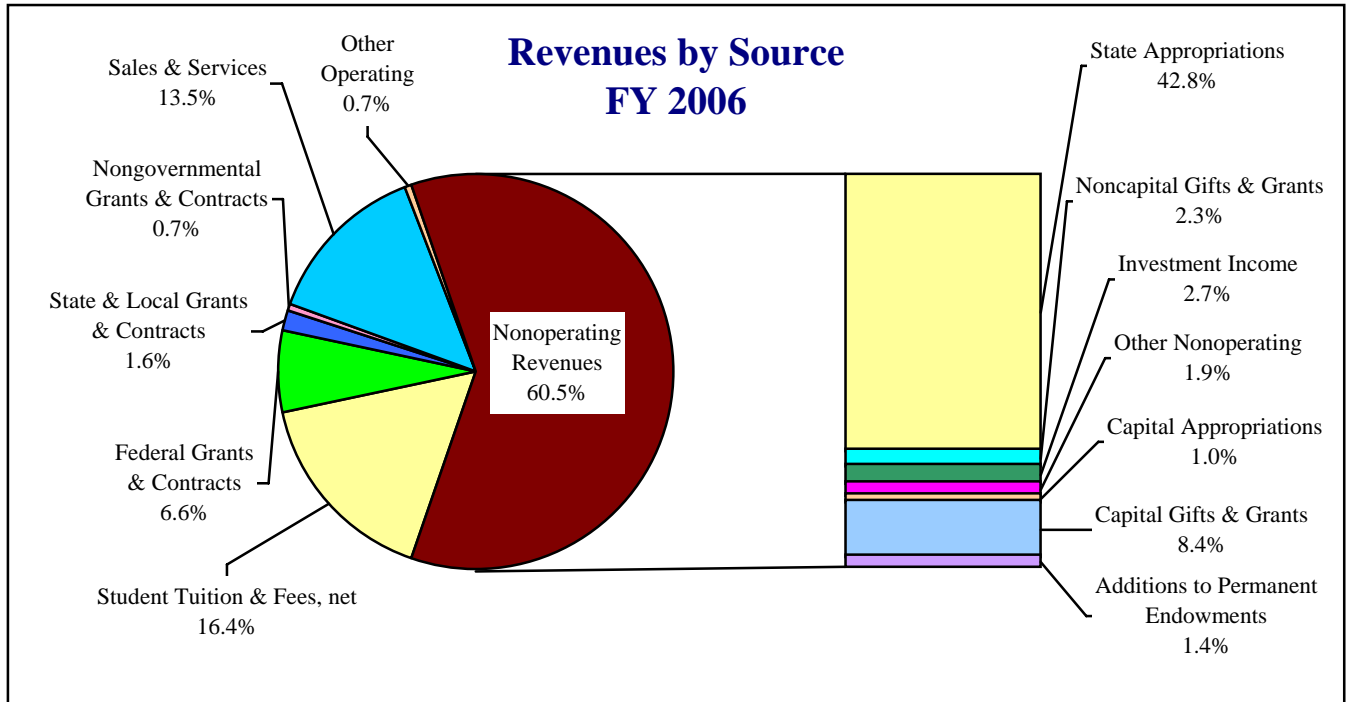
The *Statement of Revenues, Expenses and Changes in Net Assets* reflects a positive year ending June 30, 2006, with an increase in ending net assets of \$24.4 million.

Among the University's greatest strengths are the diverse revenue streams that supplement student tuition and fees. These include gifts from individuals, foundations, and corporations, along with state appropriations, investment income, and federal, state, and private grants and contracts. The University has sought and will continue to seek funding from available sources that are consistent with its mission and will continue prudently to manage the

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

financial resources realized from these efforts in order to supplement tuition revenues and fund its operating activities.

The following is a graphic illustration of the breakdown of revenues by source (both operating and nonoperating), which are used to fund the University's operating activities for the year ended June 30, 2006. As defined by GASB, significant recurring sources of the University's revenues, such as state appropriations and private gifts, are considered nonoperating.



Operating revenues for 2006 totaled \$70.3 million, compared with \$66.3 million for 2005. The most significant source of operating revenue for the University was tuition and fees (net of scholarship allowances) totaling \$28.7 million at June 30, 2006, and \$26.7 million at June 30, 2005. This 7.6% increase primarily reflects an overall increase in tuition and fee rates of approximately 5.1% for in-state and 1.4% for out-of-state undergraduate students, and 13.1% for in-state and 3.4% for out-of-state graduate students. In addition, the University experienced a 2.3% growth in number of students. Other major revenue sources in 2006 include sales and services of \$23.6 million (\$21 million in 2005) and grants and contracts of \$16.8 million (\$16 million in 2005). Approximately \$2.3 million of the \$2.7 million increase in sales and services resulted from increases in revenue generated from residential living facilities. Rate increases of approximately 14% in residential living facilities fees, along with increased occupancy in the residence halls in general, and the new higher-priced residence halls in particular, were responsible for the 32.8% housing revenue increases. Rates for the three new residence halls placed in service over the last two years range from 25% - 65% higher than the older residence halls. The decrease of over \$1.4 million in Other Operating Revenues is mostly due to final surety payments totaling \$1.8 million remitted to the

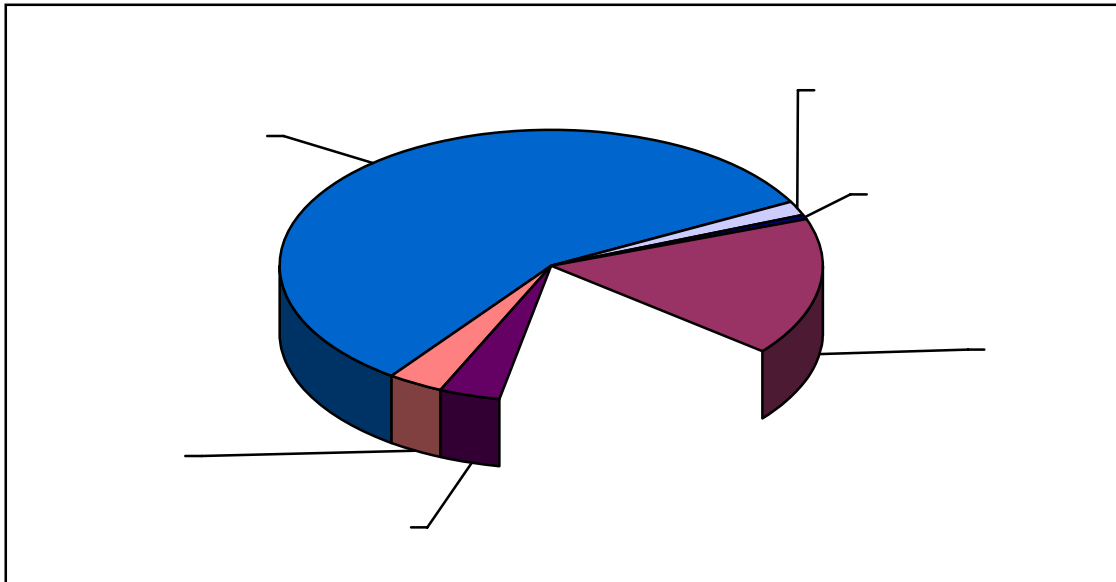
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

University in the prior fiscal year (2005) by National Fire Insurance Company of Hartford for construction work necessary to complete the Central Drive Residence Hall after the original contractor was declared to be in default.

Like most public institutions, the University receives significant nonoperating revenues which offset the loss generated by operating activities. During 2006, the operating loss of \$74.6 million was offset by \$80 million in net nonoperating revenues. The primary sources of this revenue are state appropriations, which totaled \$74.6 million and accounted for 42.8% of total revenue. Other major sources of nonoperating revenue in 2006 were investment income of \$4.7 million and noncapital gifts and grants of \$4 million. An increase in investment income in 2006 of \$1.3 million was largely attributable to favorable market fluctuations.

Capital grants totaled \$14.4 million and \$20.1 million for the years ended June 30, 2006, and June 30, 2005, respectively. The primary sources of this revenue were state general obligation bond proceeds of \$13 million in 2006 (\$18.2 million in 2005). In 2000, the voters of North Carolina approved the issuance of general obligation bonds to provide funds for capital improvements on the University of North Carolina campuses. The Office of State Budget and Management allots these funds based on the University's projected cash requirements related to the construction projects funded by this bond issue. Decreased construction activity on these projects in 2006, due to completion of several major projects in 2005, is the primary reason for the decrease of \$5.2 million in state capital grants.

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



MANAGEMENT

Operating expenses increase
Operating expenses are main
the University. Of the \$144.
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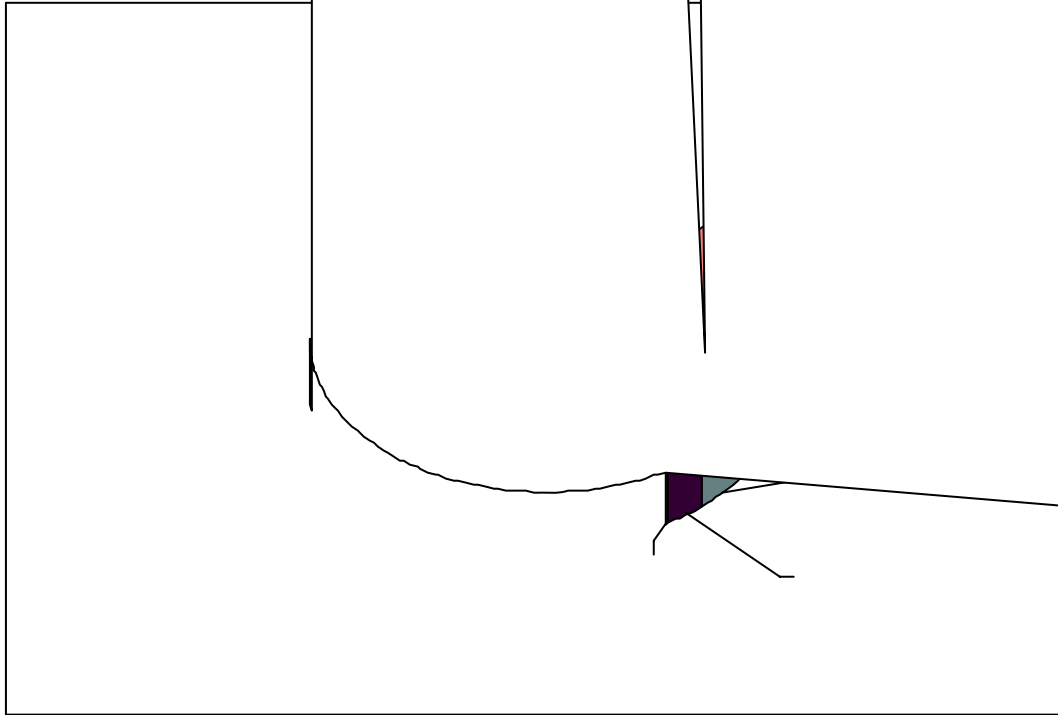
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At June 30, 2006, the Univer
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MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

year 2001, to fund facility construction projects, infrastructure improvements, land acquisitions, and technology expansion.

In September 2005, the University held a ribbon-cutting ceremony to celebrate the completion of the \$2.9 million renovation to the Killian Annex Building. This facility includes the University's new One Stop Student Support Center, which is designed to enable students to conduct a wide range of university-related business in a single location, instead of traveling to offices spread across campus.

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, officially opened the weekend of October 22-23, 2005 with a series of gala events. The Center includes a 1,000-seat auditorium capable of hosting Broadway-quality productions, four separate art galleries, atrium space comprising nearly 10,000 square feet to house and display the University's permanent collection and rotating displays of contemporary art and student work.

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

The 2000 bond issue also made possible the acquisition of 344 acres of property adjacent to the University's main campus. On May 12, 2006, the University of North Carolina Board of Governors approved *Millennial Campus* designation for the newly acquired property. A comprehensive master plan was approved by the campus and Board of Trustees to serve as a guide for the development of this property. The 2006 General Assembly approved advance planning funds for the design of a new 145,200 square foot Health and Gerontological Science Building (\$46.2 million). This building will be the first building on the University's west campus and will house expanded programs in nursing and health-related programming, while providing the opportunity to develop degree programs in occupational therapy, gerontology, and a masters degree in social work with specializations in rural and gerontological social work.

Projects currently in design, with total combined budgets of \$95.2 million, are: a new student recreation center; a pedestrian quadrangle; a dining facility to replace Dodson Cafeteria; two new residence halls to replace Helder and Leatherwood Residence Halls; a partial renovation of the Forsyth Building; and a planned Hospitality Management Studies Center.

The University's financial statements indicate \$25,664,000 in bonds payable, \$1,525,347 in notes payable, and \$21,626,069 in capital leases payable at June 30, 2006. Total annual debt service payments were \$4.2 million in 2006 and \$3.2 million in 2005.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Enrollment

A significant factor in the University's capacity to generate resources is the ability to recruit and retain high quality students. In an effort to boost enrollment and to improve the quality of

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Though some indicators suggest that the overall state of the economy will continue to improve moderately in the months to come, local, state and national economies remain susceptible to political and market uncertainties. The economic pressures affecting donors, as well as investment returns, will continue to affect the level of support the University receives from corporate and individual giving.

The University will continue to pursue its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending rate policy that is consistent with long-term market results and that insulates operations from temporary market volatility. While the future cannot be predicted with certainty, management believes that the University's strong financial condition equips it well to weather the economic uncertainties presently known and those that can be reasonably expected.

Western Carolina University
Statement of Net Assets
June 30, 2006

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$	44,068,511.32
Restricted Cash and Cash Equivalents		9,645,045.81
Restricted Short-Term Investments		3,476,807.10
Receivables, Net (Note 4)		5,250,255.45
Due from State of North Carolina Component Units		200,000.00
Inventories		3,488,934.70
Notes Receivable, Net (Note 4)		463,350.12
Total Current Assets		66,592,904.50

Noncurrent Assets:

Restricted Cash and Cash Equivalents		14,559,814.74
Receivables, Net (Note 4)		184,435.55
Restricted Due from Primary Government		4,451,083.14
Endowment Investments		27,423,862.44
Other Long-Term Investments		1,161,415.41

Western Carolina University
Statement of Net Assets
June 30, 2006

Exhibit A-1
Page 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	182,065,630.91
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	7,475,993.89
Endowed Professorships	9,570,683.83
Expendable:	
Scholarships and Fellowships	11,311,969.62
Research	1,221,167.54
Endowed Professorships	1,604,285.63
Departmental Uses	1,501,355.17
Loans	1,380,671.46
Capital Projects	4,494,641.68
Debt Service	3,243,528.02
Unrestricted	<u>44,043,321.25</u>
Total Net Assets	<u><u>\$ 267,913,249.00</u></u>

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

***Western Carolina University
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2006***

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$	28,692,604.02
Federal Grants and Contracts		11,451,405.06
State and Local Grants and Contracts		4,044,204.15
Nongovernmental Grants and Contracts		1,288,452.57
Sales and Services, Net (Note 9)		23,621,945.29
Interest Earnings on Loans		14,809.42
Other Operating Revenues		1,194,051.57

***Western Carolina University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006***

Exhibit A-3

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers

\$ 68,402,247.00

Western Carolina University
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2006

Exhibit A-3
Page 2

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

Operating Loss	\$ (74,636,970.58)
Adjustments to Reconcile Operating (Loss) to Net Cash Provided Used by Operating Activities:	
Depreciation Expense	5,328,682.95
Allowances, Write-Offs, and Amortizations	579,266.17
Nonoperating Other Income	21,013.05
Changes in Assets and Liabilities:	
Receivables (Net)	(495,577.81)
Due from State of North Carolina Component Units	(200,000.00)
Inventories	(259,947.10)
Accounts Payable and Accrued Liabilities	337,118.28
Due to Primary Government	4,883.49
Unearned Revenue	17,742.61
Compensated Absences	646,713.30
Deposits Payable	48,910.19
Note Principal Repayments	1,433,244.93
Notes Issued	(1,317,093.66)
	<u>(68,492,014.18)</u>
Net Cash Used by Operating Activities	<u>\$ (68,492,014.18)</u>
Current Assets:	
Cash and Cash Equivalents	\$ 44,068,511.32
Restricted Cash and Cash Equivalents	9,645,045.81
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>14,559,814.74</u>
Total Cash and Cash Equivalents - June 30, 2006	<u>\$ 68,273,371.87</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 10,137,750.82
Assets Acquired through a Gift	622,718.05
Change in Fair Value of Investments	72,559.81
Reinvested Distributions	2,355,375.53

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, 2006

Exhibit B-1

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 1,659,015.00
Net Investment in Capital Leases, net of unearned interest income	349,859.00
	<hr/>
Total Current Assets	2,008,874.00

Other Assets:

Certificate Issuance Costs, net of accumulated amortization	1,118,872.00
Net Investment in Capital Leases, net of unearned interest income	19,667,094.00
	<hr/>
Total Other Assets	20,785,966.00

Total Assets	<u>\$ 22,794,840.00</u>
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LIABILITIES

Current Liabilities:

Current Portion of Long-Term Debt	\$ 510,000.00
Accrued Expenses	74,354.00
	<hr/>
Total Current Liabilities	584,354.00

Noncurrent Liabilities:

Certificates of Participation Payable	21,885,000.00
	<hr/>

Total Liabilities	<hr/> 22,469,354.00
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NET ASSETS

Unrestricted	<hr/> 325,486.00
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Total Liabilities and Net Assets	<u>\$ 22,794,840.00</u>
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The accompanying notes to the financial statements are an integral part of this statement.

Western Carolina University Research and Development Corporation
Statement of Activities
For the Fiscal Year Ended June 30, 2006

Exhibit B-2

REVENUES

Management Fee	\$ 329,135.00
Investment Interest Income	68,482.00
Interest Earned from Investments in Capital Leases	<u>1,116,504.00</u>
Total Revenues	<u>1,514,121.00</u>

EXPENSES

Amortization of Certificate Issuance Costs	40,499.00
Insurance	89,443.00
Interest	875,921.00
Professional Fees	10,818.00
Other Operating	<u>525.00</u>
Total Expenses	<u>1,017,206.00</u>

CHANGE IN NET ASSETS

496,915.00

Net Assets, Beginning of Year (171,429.00)

Net Assets, End of Year \$ 325,486.00

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

WESTERN CAROLINA UNIVERSITY
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006

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 Endowment Fund have delegated responsibilities for financial accountability of the University’s funds. The University’s component units are either blended or discretely presented in the University’s financial statements. The blended component units, although legally separate, are, in substance, part of the University’s operations and therefore, are reported as if they were part of the University. Discretely presented component units’ financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

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

The Foundation is governed by a 26-member board consisting of 4 ex officio directors and 22 elected directors. The Foundation’s purpose is to aid, support and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University. Because the elected directors of the Foundation are appointed by the members of the Western Carolina University Board of Trustees and the Foundation’s sole purpose is to benefit Western Carolina University, its financial statements have been blended with those of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Separate financial statements for the Foundation may be obtained from the University Controller's Office, HFR 317, Cullowhee, NC 28723, or by calling 828-227-7323. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

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

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

Separate financial statements for the Corporation may be obtained from Western Carolina University's Controller's Office, HFR 317, Cullowhee, NC 28723 or by calling 828-227-7323.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

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

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

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

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

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

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

Bond issuance costs 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 2 - DEPOSITS AND INVESTMENTS

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

At June 30, 2006, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$68,167,758.06 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.18 years as of June 30, 2006. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.ncosc.net/> and clicking on "Financial Reports", or

NOTES TO THE FINANCIAL STATEMENTS (

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 unit, the Western Carolina University Foundation are subject to and restricted by G.S. 36B "Uniform Management of Institutional Funds Act" (UMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks.

Interest Rate Risk: Interest rate risk is the risk the University may face

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the Long-Term Investment Pool.

Long-Term Investment Pool

	Fair Value
Investment Type	
Mutual Funds	\$ 26,662,349.40
Investments in Real Estate	3,220.00
Limited Partnerships	843,320.00
	<hr/>
Total Long-Term Investment Pool	<u>\$ 27,508,889.40</u>

Non-Pooled Investments – The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2006, for the University's non-pooled investments.

Non-Pooled Investments

Investment

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments – The following table presents the fair value of the total investments at June 30, 2006:

	Fair Value
Investment Type	
Debt Securities	
Money Market	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2006, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
Current Receivables:			
Students	\$ 1,153,989.21	\$ 806,407.31	\$ 347,581.90
Accounts	1,525,927.26		1,525,927.26
Intergovernmental	1,545,001.16		1,545,001.16
Pledges	137,723.77	11,386.46	126,337.31
Investment Earnings	54.32		54.32
Interest on Loans	151,150.16		151,150.16
Other	1,554,203.34		1,554,203.34
	<u>\$ 6,068,049.22</u>	<u>\$ 817,793.77</u>	<u>\$ 5,250,255.45</u>
Total Current Receivables			
Noncurrent Receivables:			
Pledges	<u>\$ 206,373.00</u>	<u>\$ 21,937.45</u>	<u>\$ 184,435.55</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 459,784.94	\$ 0.00	\$ 459,784.94
Institutional Student Loan Programs	49,054.99	45,489.81	3,565.18
	<u>\$ 508,839.93</u>	<u>\$ 45,489.81</u>	<u>\$ 463,350.12</u>
Total Notes Receivable - Current			
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 6,379,140.64	\$ 957,052.00	\$ 5,422,088.64
Institutional Student Loan Programs	4,413.60		4,413.60
	<u>\$ 6,383,554.24</u>	<u>\$ 957,052.00</u>	<u>\$ 5,426,502.24</u>
Total Notes Receivable - Noncurrent			

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Balance

Balance

Current

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

COMPONENT UNITS

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

Long-term debt at June 30, 2006, consists of the following:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2006:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 1,797,982.85
2008	1,826,313.26
2009	1,821,510.26
2010	1,818,422.76
2011	1,730,374.16
2012-2016	7,231,962.54
2017-2021	7,239,467.50
2022-2026	7,237,454.80
2027-2031	7,230,700.00
2032-2036	2,216,242.80
Total Minimum Lease Payments	40,150,430.93
Amount Representing Interest (3.78% - 6.10% Rate of Interest)	18,524,361.66
Present Value of Future Lease Payments	\$ 21,626,069.27

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE

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, 2006, these rates were set at 2.34% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2006, the University had a total payroll of \$69,095,382.53, of which \$34,854,005.36 was covered under the Teachers’ and State Employees’ Retirement System. Total employee and employer contributions for pension benefits for the year were \$2,091,240.32 and \$815,583.73, respectively. The University made 100% of its annual required contributions for the years ended June 30, 2006, 2005, and 2004, which were \$815,583.73, \$704,822.44, and \$65,833.49, respectively.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$140,120.48 for the year ended June 30, 2006.

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, 2006, were \$27,170.91. The voluntary contributions by employees amounted to \$385,253.00 for the year ended June 30, 2006.

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 \$1,136,443.22 for the year ended June 30, 2006.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees –** The University participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

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

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance co

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 15 - RELATED PARTIES

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

The Development Foundation of the North Carolina Center for the Advancement of Teaching, Inc. was incorporated in North Carolina on January 31, 1994, for the purpose of supporting the programs of, and providing supplemental funding for, the North Carolina Center for the Advancement of

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**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

ORDERING INFORMATION

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Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919/807-7500

Facsimile: 919/807-7647