

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



UNIVERSITY OF NORTH CAROLINA SCHOOL OF THE ARTS

WINSTON-SALEM, NORTH CAROLINA
FINANCIAL STATEMENT AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2015

A CONSTITUENT INSTITUTION OF THE UNIVERSITY OF NORTH CAROLINA
SYSTEM AND A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA



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STATE OF NORTH CAROLINA
Office of the State Auditor



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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Board of Trustees, University of North Carolina School of the Arts

We have completed a financial statement audit of the University of North Carolina School of the Arts for the year ended June 30, 2015, 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.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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



Beth A. Wood, CPA
State Auditor

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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency. The Auditor also has the power to summon people to produce records and to answer questions under oath.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



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State Auditor

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
University of North Carolina School of the Arts
Winston-Salem, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of the University of North Carolina School of the Arts, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the University's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the University of North Carolina School of the Arts Housing Corporation, which represent 3.14 percent, 0.01 percent, and 1.45 percent, respectively, of the assets, net position, and revenues of the University; nor the financial statements of the University of North Carolina School of the Arts Program Support Corporation, which represent less than one percent of the respective assets, net position, and revenues of the University. In addition, we did not audit the financial statements of the University of North Carolina School of the Arts Foundation, Inc., the University's discretely presented component unit. Those statements were audited by other auditors, whose reports have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based solely 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 from material misstatement. The financial statements of the University of North Carolina School of the Arts Housing Corporation, the University of North Carolina School of the Arts Program Support Corporation, and the University of North Carolina School of the Arts Foundation, Inc. were not audited in accordance with *Government Auditing Standards*.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the University's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of University of North Carolina School of the Arts and its discretely presented component unit, as of June 30, 2015, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 16 to the financial statements, during the year ended June 30, 2015, the University of North Carolina School of the Arts adopted new accounting guidance, Governmental Accounting Standards Board Statement No. 68 – *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and Statement No. 71 – *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*. Our opinion is not modified with respect to this matter.

Other Matters – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis and other required supplementary information, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's

responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 2, 2015 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control over financial reporting and compliance.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

November 2, 2015



MANAGEMENT'S DISCUSSION AND ANALYSIS



Introduction

This section of the University of North Carolina School of the Arts financial report provides an overview of the financial position and activities for the year ended June 30, 2015. This discussion has been prepared by management along with the financial statements and related notes to the financial statements and should be read in conjunction with the financial statements and the notes thereto, which follow this section. This discussion and analysis is designed to focus on current activities, resulting change, and current known facts.

Using the Financial Statements

This annual report consists of a series of financial statements, prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). These financial statements focus on the financial condition of the University, the results of operations, and cash flows of the University as a whole. The three financial statements presented include: the Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows.

The Statement of Cash Flows provides information relative to the University's sources and uses of cash for operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The statement provides a reconciliation of beginning cash balances to ending cash balances and is representative of the activity reported on the Statement of Revenues, Expenses, and Changes in Net Position as adjusted for changes in the beginning and ending balances of noncash accounts on the Statement of Net Position. For the purpose of this discussion, we will address the Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position.

The Notes to the Financial Statements provide information regarding the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on deposits and investments, long-term liabilities, accounts receivable, accounts payable, revenues, expenses, required information on pension plans, other post employment benefits, insurance against losses, commitments and contingencies, and if necessary, a discussion of accounting changes, adjustments to prior periods, and events subsequent to the University's financial statement period. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Statement of Net Position

The Statement of Net Position presents the assets, liabilities, and net position of the University as of the end of the fiscal year. The purpose of the Statement of Net Position is to present the readers of the financial statements a fiscal snapshot of the University of North Carolina School of the Arts. The Statement of Net Position presents end-of-year data

concerning assets (current and noncurrent), liabilities (current and noncurrent), and net position (assets plus deferred outflows minus liabilities plus deferred inflows).

From the data presented, readers of the Statement of Net Position are able to determine the assets available to continue the operations of the University. They are also able to determine how much the University owes vendors, investors and lending institutions. Finally, the Statement of Net Position provides a picture of the net position and their availability for expenditure by the University.

Net Position is divided into three major categories. The first category, net investment in capital assets provides the University's equity in property, plant and equipment owned by the University. The next net position category is restricted net position, which is divided into two categories, nonexpendable and expendable. Nonexpendable restricted net position includes endowment investments, which are only available for investment purposes, and student loan funds. Expendable restricted net position is available for expenditure by the University, but must be spent for purposes as determined by donors and/or external entities that have placed certain restrictions on the use of the assets. This category includes restricted funds for endowment investments, capital projects, debt service, and other expendable restricted resources. The final category is unrestricted net position, which is available to the University for any lawful purpose of the University. The University uses available resources to acquire and improve all areas of the University to better serve the instructional and public service missions of the University. Please refer to the financial statements and notes to the financial statements for more detail.

Condensed Statement of Net Position

	Year Ended June 30,		
	2015	2014 (Restated)	Change
Assets			
Current Assets	\$ 24,373,229.53	\$ 22,788,063.01	\$ 1,585,166.52
Capital Assets, Net	125,898,326.33	123,684,401.01	2,213,925.32
Other Noncurrent Assets	23,642,979.68	19,214,344.75	4,428,634.93
Total Assets	<u>173,914,535.54</u>	<u>165,686,808.77</u>	<u>8,227,726.77</u>
Deferred Outflows of Resources			
Deferred Outflows for Pensions	<u>1,210,474.00</u>	<u>1,118,878.00</u>	<u>91,596.00</u>
Liabilities			
Current Liabilities	4,770,320.59	7,477,744.25	(2,707,423.66)
Long-Term Liabilities	10,967,624.47	13,605,966.82	(2,638,342.35)
Other Noncurrent Liabilities	504,977.32	499,460.05	5,517.27
Total Liabilities	<u>16,242,922.38</u>	<u>21,583,171.12</u>	<u>(5,340,248.74)</u>
Deferred Inflows of Resources			
Deferred Inflows for Pensions	<u>3,441,775.00</u>	<u>0.00</u>	<u>3,441,775.00</u>
Net Position			
Net Investment in Capital Assets	119,145,456.19	116,424,401.01	2,721,055.18
Restricted:			
Nonexpendable	15,051,935.97	13,807,496.99	1,244,438.98
Expendable	9,018,786.67	7,064,252.02	1,954,534.65
Unrestricted	12,224,133.33	7,926,365.63	4,297,767.70
Total Net Position	<u>\$ 155,440,312.16</u>	<u>\$ 145,222,515.65</u>	<u>\$ 10,217,796.51</u>

The total assets of the University increased by \$8,227,726.77 for the year, with increases in current assets, capital assets, net and other noncurrent assets of \$1,585,166.52, \$2,213,925.32 and \$4,428,634.93, respectively. Of the \$1,585,166.52 change in current assets, the majority of the increase was attributable to an increase of \$1,881,813.30 in unrestricted cash and cash equivalents, offset with a decrease in restricted cash and cash equivalents of \$274,924.77 and other small changes in receivables and inventories. Related to the change in the unrestricted cash balance, approximately, \$1,006,000.00 represents an increase in housing services as a result of increased fees and food services experienced increased cash of approximately \$465,000.00 compared to prior year. The decrease in restricted cash was the result of a reclassification of noncurrent restricted cash of \$2.3 million to current restricted cash to cover related current plant liabilities in the prior year compared to \$1.6 million this year, which is a decrease of approximately \$673,000.00. This decrease was offset by an increase of restricted cash of approximately \$399,000.00 attributable to increase in departmental fees. The increase of \$2,213,925.32 in capital assets primarily represents the net effect of an increase in buildings and decrease in construction in progress. The University completed and capitalized four buildings (Library, Film, Central Storage, and Campus Police) that were in construction in progress in the prior year. These increases in capital assets were offset by a reduction of depreciable capital assets mainly due to the annual depreciation charge. Of the \$4,428,634.93 increase in noncurrent assets, the majority of this increase represents increases in noncurrent restricted cash and other investments of \$2,973,464.39 and \$1,614,607.79, respectively. Noncurrent restricted cash increased approximately \$2,300,000.00 as a result of a new \$1.25 million gift received for an existing endowment and increased funding of repair and renovations monies received from the state. Other investments increased primarily as a result of new investments related to the new notes payable issued for the energy savings lighting project.

The total liabilities of the University decreased \$5,340,248.74, with a decrease in both current liabilities and remaining liabilities of \$2,707,423.66 and \$2,632,825.08, respectively. The decrease in current liabilities was attributable to a decrease in accounts payable, accrued payroll, and accrued retainage of \$2,749,070.83, offset by small increases and decreases in other current liabilities. The decrease in accounts payable primarily consists of a decrease of \$3.1 million in capital accounts payable and contract retainage payable related to the completion of the Library, Central Storage, Campus Police and Film buildings, offset by an increase of approximately \$385,000.00 in other University regular accounts payables compared to prior year. The decrease in long-term liabilities resulted from the University recording the net pension liability due to implementation of GASB Statement No. 68 – *Accounting and Financial Reporting for Pensions* (GASB 68) and the University continuing to pay down its capital debt for revenue bonds and refinancing of the UNCSCA Housing Corporation 2015 certificate of participation debt. These decreases were offset with a new notes payable issued for \$1,929,618.00 for the energy savings lighting project.

The University recorded deferred inflows for pensions in the amount of \$3,441,775.00. This amount represents the net amount of the University's pension deferrals that will decrease pension expense in fiscal years 2016 to 2019. For more information about the University's deferred outflows and inflows related to pensions, refer to Note 11 of the Notes to the Financial Statements.

The University's net position was \$155,440,312.16 at June 30, 2015, an increase of \$10,217,796.51 from the prior year as restated (refer to Note 16 of the Notes to Financial Statements for details). The significant increases in net assets are in the categories of net investment in capital assets of \$2.7 million, restricted for nonexpendable for departmental

uses of \$1.2 million, restricted for expendable for capital projects of \$1.2 million, and unrestricted of \$4.3 million. The increase in net investment of capital assets is primarily the result of an increase in capital assets, offset by the current year depreciation charge and reduction in capital debt for revenue bond, notes payable, and certificate of participation debt. The increase in restricted for nonexpendable for department uses is as a result of the new gifts received for existing endowments. The increase in restricted for expendable capital projects is primarily the result of additional repairs and renovations monies received from the state and the impact of the prior year unrestricted net position reflecting the deficit in capital assets due to the construction expenses related to the four new capitalized buildings. The increase in unrestricted net position was due primarily to the restatement of net position related to the implementation of GASB 68 as well as in the prior year unrestricted net position impacted by the capital projects net position deficit.

Statement of Revenues, Expenses, and Changes in Net Position

The Statement of Revenues, Expenses, and Changes in Net Position reports the University's results of operation for the fiscal year. Changes in total net position presented on the Statement of Net Position are based on the activity presented in the Statement of Revenues, Expenses, and Changes in Net Position. The purpose of this statement is to present the revenues received by the University and expenses paid by the University, both operating and nonoperating, and any other revenues, expenses, gains and losses received or spent by the University.

Generally speaking, operating revenues are received for providing instruction, goods, or services to the various customers of the University. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University. Nonoperating revenues are revenues received for which goods and services are not provided. For example, the state appropriations are nonoperating because they are provided by the state legislature which receives no goods or services in return for those revenues.

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

	Year Ended June 30,		
	2015	2014 *	Change
Operating Revenues			
Student Tuition and Fees, Net	\$ 13,865,106.86	\$ 12,323,195.30	\$ 1,541,911.56
Sales and Services, Net	7,805,592.31	6,717,351.23	1,088,241.08
Other Operating Revenues	478,427.27	552,993.12	(74,565.85)
Total Operating Revenues	22,149,126.44	19,593,539.65	2,555,586.79
Operating Expenses:			
Salaries and Benefits	33,695,619.90	32,577,776.49	1,117,843.41
Supplies and Materials	7,512,662.80	7,097,507.51	415,155.29
Services	10,681,097.79	7,715,764.65	2,965,333.14
Scholarships and Fellowships	1,491,369.64	1,307,234.55	184,135.09
Utilities	2,081,566.94	2,013,003.38	68,563.56
Depreciation	3,457,969.78	2,906,397.04	551,572.74
Total Operating Expenses	58,920,286.85	53,617,683.62	5,302,603.23
Operating Loss	(36,771,160.41)	(34,024,143.97)	(2,747,016.44)
Nonoperating Revenues (Expenses)			
State Appropriations	28,886,987.00	31,868,375.27	(2,981,388.27)
Noncapital Grants - Student Financial Aid	1,807,879.27	1,624,320.46	183,558.81
Other Noncapital Grants	55,900.00	9,000.00	46,900.00
Noncapital Gifts	1,924,921.38	1,719,934.71	204,986.67
Investment Income, Net	1,739,490.54	2,517,410.60	(777,920.06)
Interest and Fees on Debt	(607,027.63)	(331,144.59)	(275,883.04)
Other Nonoperating Expenses	(32,205.34)	(34,478.40)	2,273.06
Net Nonoperating Revenues	33,775,945.22	37,373,418.05	(3,597,472.83)
Income (Loss) Before Other Revenues	(2,995,215.19)	3,349,274.08	(6,344,489.27)
Capital Appropriations	1,788,627.00	305,900.00	1,482,727.00
Capital Grants	10,172,844.70	23,435,999.79	(13,263,155.09)
Capital Gifts		55,000.00	(55,000.00)
Additions to Endowments	1,251,540.00	253,250.00	998,290.00
Net Other Revenues	13,213,011.70	24,050,149.79	(10,837,138.09)
Increase in Net Position	10,217,796.51	27,399,423.87	(17,181,627.36)
Beginning Net Position (As Restated)	145,222,515.65	121,676,378.78	23,546,136.87
Ending Net Position	\$ 155,440,312.16	\$ 149,075,802.65	\$ 6,364,509.51

*Note: The year ended June 30, 2014 column is not presented "as restated" above because actuarial calculations performed relative to the implementation of GASB 68 do not provide sufficient information to restate these amounts.

The Statement of Revenues, Expenses, and Changes in Net Position reflects an increase in the net position at the end of the year. Total revenues for the fiscal year were \$69,777,316.33 compared to \$81,382,730.48 from the previous year, a decrease of \$11,605,414.15. Some of the highlights of the revenue accounts presented on the Statement of Revenues, Expenses, and Changes in Net Position are as follows:

- Student tuition and fees, net increased by \$1,541,911.56. This increase was primarily the result of an increase in tuition and fees during the year. The tuition rate

increase per student ranged from \$600.00 to \$2,225.00, and the fee rates increase per student ranged from \$12.00 to \$40.00.

- Sales and Services, net increased by \$1,088,241.08. This change was the result of an increase in summer workshops revenue, school productions revenue and other auxiliaries' revenues, offset by a decrease in allowance in the scholarship discounts for sales and services.
- State appropriations decreased \$2,981,388.27. This change was the result of one time additional funding awarded in the prior year of approximately \$4,466,330.00 for furniture and equipment and other one-time costs associated with bringing the four buildings that were under construction on-line, offset by additional funding given for state funded salary increases and recurring monies for operation and maintenance of the buildings.
- Investment income, net decreased by \$777,920.06 as a result of decline in unrealized gains recognized compared to prior year.
- Capital appropriations increased \$1,482,727.00 due to increased state funding related to repairs and renovation projects.
- Capital grants decreased \$13,263,155.09 as a result of the final completion stages of the Library, Central Storage Facility, Campus Police, and Film School Production Design Facility buildings during the fiscal year.
- Additions to endowments increased \$998,290.00. In fiscal year 2015, no new endowments were created; however, the University did receive \$1,251,540.00 of additional funding for existing endowments. In fiscal year 2014, the University received \$253,250.00 in additional funding for existing endowments.

Total expenses were \$59,559,519.82 for fiscal year ended June 30, 2015 and \$53,983,306.61 for 2014. Operating expenses totaled \$58,920,286.85 for the year compared to \$53,617,683.62 from the previous year, an increase of \$5,302,603.23. The significant changes include:

- Salaries and benefits increased \$1,117,843.41 primarily due to legislative salary increases for fiscal year, filling new positions for the newly constructed buildings, increases in faculty and staff due to organizational/departmental changes, offset against recording of pension expense and reduction of Teachers and State Employees retirement contributions due to implementation of GASB 68.
- Services increased by \$2,965,333.14. This increase was primarily attributed to several factors which include increases in facility and campus repairs (\$548,000.00), various information technology ongoing projects (\$738,000.00), one-card upgrade project (\$747,000.00) and other contracted services and other costs relating to University productions and academic services (\$247,000.00).
- Depreciation increased by \$551,572.74. This increase was a result of additional depreciation expense primarily attributable to four buildings capitalized during the year that were in construction in progress in prior year.

Capital Asset and Debt Administration

The University's capital assets, net of accumulated depreciation at June 30, 2015, were \$125,898,326.33. Construction projects in progress for the 2014-2015 fiscal year totaled

\$447,870.14. For more information about the University's asset holdings, refer to Note 5 of the Notes to the Financial Statements.

The University had \$11,511,169.38 in outstanding long-term debt at June 30, 2015, and continues to make all of its debt payments in a timely manner. The University refunded its certificates of participation in the amount of \$5.4 million during the 2014-2015 fiscal year. Refer to Note 7 of the Notes to the Financial Statements for more detailed information about the University's debt obligations.

Some other changes to highlight over the 2014-2015 fiscal year were the numerous construction and renovation projects. We received the certificate of occupancy on the new Library, Film School Production Design Facility, Central Storage Building, and Campus Police Operations Center. This generated an increase to our permanent budget that included support staff positions. We completed a total renovation of our dining hall over the summer of 2015 and started the design to renovate the Pickle Jar. When we awarded Aramark a renewed food services contract, we planned to renovate our existing food service spaces as well as expand by opening the Library Café. Our goal is to provide fresh, healthy, and sustainable food options to the community of elite artists.

There was considerable focus on residential housing for the 2014-2015 fiscal year. We made significant improvements over the winter break in the residence halls to improve the communal bathrooms and individual rooms. Improvements were made to our Campus One Card System. This involved upgrading the system to a newer platform to allow for technology enhancements and replaced and rewired all the campus door access readers. We also refinanced the debt on the Center Stage Apartments that lowered our interest rate and reduced the payback period by six years.

Economic Outlook

The State of North Carolina experienced strong steady growth in the second part of the fiscal year 2015. The North Carolina unemployment rate increase over the last few months are not a true indication of the state's economic performance. The private sector has indicated a strong growth in the number of new jobs, an increase in factory expansions and construction, and even an increase in housing. The state is expected to grow in 2016. Job growth is expected in the Raleigh and Charlotte areas. Oil prices continue to fall which should indicate a possible increase in household spending for both housing and larger consumables. Overall, the state's economic outlook appears to be positive.

The UNC School of the Arts welcomed a new Chancellor in August 2014, Lindsay Bierman. Chancellor Bierman was embraced by the campus community due to his wealth of business management experience, innovation, and creativity. His success during his first year consisted of leading the school towards the completion of a new Strategic Plan, rebranding the school with a new logo, and the launch of a new website in fiscal year 2015-2016.

UNC School of the Arts students continue to distinguish themselves in competitions and contests, winning honors and accolades for themselves and our school. Two Dance students competed in the Semifinals and Finals of the prestigious Youth America Grand Prix. Two Design & Production students received Young Designer and Technician Awards (the Master Craftsmanship Award and the Makeup Design Award) from the U.S. Institute for Theatre Technology. Two short films created by students in the School of Filmmaking were among only 25 films nationwide to compete in the 2015 PBS Online Film Festival. Student ensemble Trio Dionysis competed through the semifinals of the Fischhoff National Chamber Music

Competition, commonly regarded as the most prestigious chamber music competition in the United States.

Our operations continued to support the instructional mission. Tuition rates were increased a flat \$600.00 per year for high school non-resident, and graduate students. This revenue was used to offset financial aid for students and faculty retention. The NC General Assembly increased undergraduate non-resident student tuition by \$2,225.00 per year. The revenue generated from the increased rate was returned to the state to help balance the state budget. Enrollment continues to remain steady and grow according to the strategic direction of the school.



FINANCIAL STATEMENTS

University of North Carolina School of the Arts
Statement of Net Position
June 30, 2015

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 19,957,887.15
Restricted Cash and Cash Equivalents	3,942,831.93
Receivables, Net (Note 4)	114,692.40
Due from University Component Unit	109,178.00
Inventories	165,447.54
Notes Receivable, Net (Note 4)	83,192.51
	<hr/>
Total Current Assets	24,373,229.53

Noncurrent Assets:

Restricted Cash and Cash Equivalents	3,005,612.68
Endowment Investments	18,646,265.61
Restricted Investments	1,667,103.23
Notes Receivable, Net (Note 4)	323,998.16
Capital Assets - Nondepreciable (Note 5)	6,600,531.59
Capital Assets - Depreciable, Net (Note 5)	119,297,794.74
	<hr/>
Total Noncurrent Assets	149,541,306.01
	<hr/>
Total Assets	173,914,535.54

DEFERRED OUTFLOWS OF RESOURCES

Deferred Outflows Related to Pensions	1,210,474.00
	<hr/>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	2,436,754.71
Due to Primary Government	15,120.67
Unearned Revenue	1,749,121.81
Interest Payable	25,778.49
Long-Term Liabilities - Current Portion (Note 7)	543,544.91
	<hr/>
Total Current Liabilities	4,770,320.59

Noncurrent Liabilities:

Funds Held for Others	33,733.83
U. S. Government Grants Refundable	471,243.49
Long-Term Liabilities, Net (Note 7)	10,967,624.47
	<hr/>
Total Noncurrent Liabilities	11,472,601.79
	<hr/>
Total Liabilities	16,242,922.38

DEFERRED INFLOWS OF RESOURCES

Deferred Inflows Related to Pensions	3,441,775.00
	<hr/>

University of North Carolina School of the Arts
Statement of Net Position
June 30, 2015

Exhibit A-1
Page 2 of 2

NET POSITION

Net Investment in Capital Assets	119,145,456.19
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	322,503.20
Endowed Professorships	10,010,167.91
Departmental Uses	4,638,625.21
Loans	80,639.65
Expendable:	
Scholarships and Fellowships	280,285.82
Endowed Professorships	3,664,430.66
Departmental Uses	3,174,566.14
Capital Projects	1,217,160.79
Debt Service	682,343.26
Unrestricted	<u>12,224,133.33</u>
Total Net Position	<u><u>\$ 155,440,312.16</u></u>

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

**University of North Carolina School of the Arts
Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2015**

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 9)	\$ 13,865,106.86
Federal Grants and Contracts	1,549.00
Sales and Services, Net (Note 9)	7,805,592.31
Interest Earnings on Loans	1,515.06
Other Operating Revenues	475,363.21

Total Operating Revenues	22,149,126.44
--------------------------	---------------

EXPENSES

Operating Expenses:

Salaries and Benefits	33,695,619.90
Supplies and Materials	7,512,662.80
Services	10,681,097.79
Scholarships and Fellowships	1,491,369.64
Utilities	2,081,566.94
Depreciation	3,457,969.78

Total Operating Expenses	58,920,286.85
--------------------------	---------------

Operating Loss	(36,771,160.41)
----------------	-----------------

NONOPERATING REVENUES (EXPENSES)

State Appropriations	28,886,987.00
Noncapital Grants - Student Financial Aid	1,807,879.27
Noncapital Grants	55,900.00
Noncapital Gifts	1,924,921.38
Investment Income (Net of Investment Expense of \$89,674.70)	1,739,490.54
Interest and Fees on Debt	(607,027.63)
Other Nonoperating Expenses	(32,205.34)

Net Nonoperating Revenues	33,775,945.22
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Income Before Other Revenues	(2,995,215.19)
------------------------------	----------------

Capital Appropriations	1,788,627.00
Capital Grants	10,172,844.70
Additions to Endowments	1,251,540.00

Increase in Net Position	10,217,796.51
--------------------------	---------------

NET POSITION

Net Position - July 1, 2014, as Restated (Note 16)	145,222,515.65
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Net Position - June 30, 2015	\$ 155,440,312.16
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The accompanying notes to the financial statements are an integral part of this statement.

University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2015

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 22,309,557.60
Payments to Employees and Fringe Benefits	(34,104,497.63)
Payments to Vendors and Suppliers	(19,845,575.09)
Payments for Scholarships and Fellowships	(1,491,369.64)
Loans Issued	(94,057.00)
Collection of Loans	101,713.05
Interest Earned on Loans	(1,889.21)
	<hr/>
Net Cash Used by Operating Activities	(33,126,117.92)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	28,886,987.00
Noncapital Grants - Student Financial Aid	1,807,879.27
Noncapital Grants	55,900.00
Noncapital Gifts	1,932,931.38
Additions to Endowments	1,251,540.00
William D. Ford Direct Lending Receipts	7,198,007.00
William D. Ford Direct Lending Disbursements	(7,198,007.00)
Related Activity Agency Receipts	4,557.03
Other Receipts	13,549.08
	<hr/>
Net Cash Provided by Noncapital Financing Activities	33,953,343.76

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	7,329,618.00
State Capital Appropriations	1,788,627.00
Capital Grants	10,172,844.70
Proceeds from Sale of Capital Assets	28,784.03
Acquisition and Construction of Capital Assets	(8,833,890.03)
Principal Paid on Capital Debt and Leases	(6,355,000.00)
Interest and Fees Paid on Capital Debt and Leases	(355,140.32)
	<hr/>
Net Cash Provided by Capital Financing and Related Financing Activities	3,775,843.38

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	1,713,376.79
Investment Income	192,507.02
Purchase of Investments and Related Fees	(1,928,600.11)
	<hr/>
Net Cash Provided by Investing Activities	(22,716.30)

Net Increase in Cash and Cash Equivalents	4,580,352.92
Cash and Cash Equivalents - July 1, 2014	22,325,978.84
	<hr/>
Cash and Cash Equivalents - June 30, 2015	\$ 26,906,331.76

**University of North Carolina School of the Arts
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2015**

**Exhibit A-3
Page 2 of 2**

**RECONCILIATION OF NET OPERATING LOSS
TO NET CASH USED BY OPERATING ACTIVITIES**

Operating Loss	\$ (36,771,160.41)
Adjustments to Reconcile Loss to Net Cash Used by Operating Activities:	
Depreciation Expense	3,457,969.78
Write-Offs	6,807.15
Pension Expense	435,784.00
Changes in Assets and Liabilities:	
Receivables (Net)	(12,193.20)
Inventories	33,965.58
Notes Receivable (Net)	7,316.67
Accounts Payable and Accrued Liabilities	361,734.52
Due to Primary Government	907.38
Unearned Revenue	174,235.15
Deferred Outflows for Contributions Subsequent to the Measurement Date	(1,104,826.00)
U.S. Government Grants Refundable	4,460.24
Compensated Absences	282,381.22
Deposits Payable	(3,500.00)
	<u>(3,500.00)</u>
Net Cash Used by Operating Activities	<u>\$ (33,126,117.92)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 19,957,887.15
Restricted Cash and Cash Equivalents	3,942,831.93
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	<u>3,005,612.68</u>
Total Cash and Cash Equivalents - June 30, 2015	<u>\$ 26,906,331.76</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	\$ 1,595,799.08
Change in Fair Value of Investments	1,350,310.36
Loss on Disposal of Capital Assets	(45,754.42)

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Financial Position
June 30, 2015

Exhibit B-1

ASSETS

Cash and Cash Equivalents	\$ 7,136,509
Investments	33,532,301
Annuity Investments	457,102
Prepaid Expenses and Other Current Assets	38,809
Pledges Receivable, Net	1,175,071
Beneficial Interest in Perpetual Trusts	819,513
Property and Equipment	72,525
Other Long-Term Assets	97,896
	<hr/>
Total Assets	<u>\$ 43,329,726</u>

LIABILITIES

Accounts Payable and Accrued Expenses	\$ 218,790
Agency Funds Payable	778,659
Annuity Obligations	129,196
	<hr/>
Total Liabilities	<u>1,126,645</u>

NET ASSETS

Unrestricted	
Unappropriated	464,808
Board Appropriated	101,676
Temporarily Restricted	11,781,428
Permanently Restricted	29,855,169
	<hr/>
Total Net Assets	<u>42,203,081</u>
	<hr/>
Total Liabilities and Net Assets	<u>\$ 43,329,726</u>

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

University of North Carolina School of the Arts Foundation, Inc.
Statement of Activities
For the Fiscal Year Ended June 30, 2015

Exhibit B-2

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
REVENUES AND SUPPORT				
Gifts and Grants	\$ 543,253	\$ 3,251,362	\$ 1,543,522	\$ 5,338,137
Interest and Dividend Income	553	3,001		3,554
Change In Fair value of:				
Annuity Investments			(32,068)	(32,068)
Perpetual Trusts			13,501	13,501
Annuity Obligations			(7,060)	(7,060)
Other Long-Term Assets			(46,349)	(46,349)
Net Gain (Loss) on Other Investments Reported at Fair Value	(11,431)	2,871,188	82,158	2,941,915
Other Income	30,758	239,459		270,217
Net Assets Released from Restrictions	<u>2,722,176</u>	<u>(2,722,176)</u>		
Total Revenues and Support	<u>3,285,309</u>	<u>3,642,834</u>	<u>1,553,704</u>	<u>8,481,847</u>
EXPENDITURES				
Program Services:				
School Programs	1,317,767			1,317,767
Scholarships and Awards	<u>1,001,649</u>			<u>1,001,649</u>
Total Program Services	<u>2,319,416</u>			<u>2,319,416</u>
Supporting Services:				
Development Costs	418,185			418,185
Administrative Costs	328,600			328,600
Investment Management Fees	<u>163,148</u>			<u>163,148</u>
Total Supporting Services	<u>909,933</u>			<u>909,933</u>
Total Expenditures	<u>3,229,349</u>			<u>3,229,349</u>
Change in Net Assets	55,960	3,642,834	1,553,704	5,252,498
NET ASSETS				
Net Assets - Beginning of Year	<u>510,524</u>	<u>8,138,594</u>	<u>28,301,465</u>	<u>36,950,583</u>
Net Assets - End of Year	<u>\$ 566,484</u>	<u>\$ 11,781,428</u>	<u>\$ 29,855,169</u>	<u>\$ 42,203,081</u>

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



NOTES TO THE FINANCIAL STATEMENTS

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. The University of North Carolina School of the Arts is a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the University and its component units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. See below for further discussion of the University's component units.

Blended Component Units - Although legally separate, the University of North Carolina School of the Arts Housing Corporation (Housing Corporation) and the University of North Carolina School of the Arts Program Support Corporation (Program Support Corporation), component units of the University, are reported as if they were part of the University.

The Housing Corporation is governed by a five-member board. Its purpose is to aid, support, and promote the University, specifically by the ownership of the Center Stage apartment complex at 900 Center Stage Court, Winston-Salem, NC 27127. Because the directors are appointed by the Chancellor and its primary purpose is to benefit the University of North Carolina School of the Arts, its financial statements have been blended with those of the University.

The Program Support Corporation board consists of at least three and no more than 12 appointed directors. Its purpose is to foster, promote, manage, assist, and support the schools of Dance, Design and Production, Drama, Filmmaking, and Music, and any other related activity of the University of North Carolina School of the Arts. Because the directors are appointed by the Chancellor and its primary purpose is to benefit the University of North Carolina School of the Arts, its financial statements have been blended with those of the University.

Separate financial statements for the Housing Corporation and Program Support Corporation may be obtained from the University Controller's Office, P.O. Box 12189, Winston-Salem, NC 27117, or by calling (336) 770-3304.

Condensed combining information regarding the blended component units is provided in Note 15.

Discretely Presented Component Unit – The University of North Carolina School of the Arts Foundation, Inc. (Foundation) is a legally separate nonprofit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to 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 not less than 12, nor more than 21 members. 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 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 University of North Carolina School of the Arts Foundation, Inc. reports its financial results under the Financial Accounting Standards Board (FASB) Codification. As such, certain revenue recognition criteria and presentation features are different from the Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the Foundation's financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2015, the Foundation distributed \$1,852,876.08 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University of North Carolina School of the Arts Foundation, Inc., P.O. Box 12189, Winston-Salem, NC 27117.

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 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.

- 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, include 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, and deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF 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 generally are reported at fair value, as determined by quoted market prices or estimated amounts determined by management if quoted market prices are not available. The fair value for investments in the UNC Investment Fund was based on amounts reported to the University by UNC Management Company, Inc. University management reviews and evaluates the values provided by UNC Management Company, Inc. as well as the valuation methods and assumptions used in determining the fair value of such investments. 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 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.

- 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, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts

and grants. Receivables are recorded net of estimated uncollectible amounts.

- G. Inventories** - Inventories, consisting of expendable supplies, are valued at cost using the last invoice cost method. Merchandise for resale is valued using the retail inventory 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 of \$5,000 or greater at the date of acquisition and an estimated useful life of more than one year.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets in the following manner:

<u>Asset Class</u>	<u>Estimated Useful Life</u>
Buildings	50 years
Machinery & Equipment	5-25 years
Specialized Musical Instruments	25-50 years
General Infrastructure	50 years

The Regis Film collection is capitalized at cost or fair value at the date of donation. This collection is considered inexhaustible and is therefore not depreciated.

- 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 for the acquisition or construction of capital assets, resources legally segregated for the payment of principal and interest as required by debt covenants, unspent debt proceeds, and endowment and other restricted investments.
- J. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of revenue bonds payable, certificates of participation, net pension liability, notes payable, and compensated absences that will not be paid within the next fiscal year.

Deferred charges on refundings are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method, and are included as Deferred Outflows or Deferred Inflows of Resources on the Statement of Net Position. Issuance costs are expensed.

The net pension liability represents the University's proportionate share of the collective net pension liability reported in the State of North

Carolina's 2014 *Comprehensive Annual Financial Report*. This liability represents the University's portion of the collective total pension liability less the fiduciary net position of the Teachers' and State Employees' Retirement System. See Note 11 for further information regarding the University's policies for recognizing liabilities, expenses, and deferred outflows and inflows related to pensions.

- 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 Position** - The University's net position is classified as follows:

Net Investment in Capital Assets - 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 Net Investment in Capital Assets. Additionally, deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of capital assets or related debt are also included in this component of net position.

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

Restricted Net Position - Expendable - Expendable restricted net position includes resources for which the University is legally or

contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Position - Unrestricted net position includes 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. Both restricted and unrestricted net position include consideration of deferred outflows and inflows of resources.

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 Position. 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 nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Position. 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 Position. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, (3) certain federal, state, and local grants and contracts that are essentially contracts for services, and (4) interest earned on loans. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9 – *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions 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** - The University has 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. However, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, may authorize the University to deposit its institutional trust funds in interest-bearing accounts and other investments authorized by the Board of Governors, without regard to any statute or rule of law relating to the investment of funds by fiduciaries. Although specifically exempted, the University may voluntarily deposit institutional trust funds, endowment funds, special funds, revenue bond proceeds, and debt service funds with the State Treasurer. Special funds consist of moneys for agency funds held directly by the University.

At June 30, 2015, the amount shown on the Statement of Net Position as cash and cash equivalents includes \$26,904,201.76 which represents the University's equity position in the State Treasurer's STIF. The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.5 years as of June 30, 2015. Assets and shares of the STIF 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 STIF) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Cash on hand at June 30, 2015, was \$2,130.00. As of June 30, 2015, the University did not have any cash outside the State Treasurer's STIF; therefore, the University was not exposed to custodial credit risk. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk.

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; certificates of deposit and other deposit accounts of specified financial institutions; prime quality commercial paper; asset-backed securities with specified ratings, specified bills of exchange or time drafts, and corporate bonds/notes with specified ratings; 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 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.

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.

UNC Investment Fund, LLC - At June 30, 2015, the University's investments include \$18,646,265.61 which represents the University's equity position in the UNC Investment Fund, LLC (UNC Investment Fund). The UNC Investment Fund is an external investment pool that is not registered with the Securities and Exchange Commission, does not have a credit rating, and is not subject to any regulatory oversight. Asset and ownership interests of the UNC Investment Fund are determined on a market unit valuation basis each month. Investment risks associated with the UNC Investment Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2015, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years) <u>Less Than 1</u>
Debt Securities		
Money Market Mutual Funds	<u>\$ 1,667,103.23</u>	<u>\$ 1,667,103.23</u>

At June 30, 2015, the Money Market Mutual Funds, with a fair value of \$1,667,103.23, were rated AAAM by Standard and Poor's.

Total Investments - The following table presents the fair value of the total investments at June 30, 2015:

Investment Type	Fair Value
Debt Securities	
Money Market Mutual Funds	\$ 1,667,103.23
Other Securities	
UNC Investment Fund	<u>18,646,265.61</u>
Total Investments	<u><u>\$ 20,313,368.84</u></u>

Component Unit - 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:

Investment Type	Fair Value
UNC Investment Fund	\$ 33,532,301.00

C. Reconciliation of Deposits and Investments - A reconciliation of deposits and investments for the University as of June 30, 2015, is as follows:

Cash on Hand	\$ 2,130.00
Deposits in the Short-Term Investment Fund	26,904,201.76
External Investment Pool	18,646,265.61
Non-Pooled Investments	<u>1,667,103.23</u>
Total Deposits and Investments	<u>\$ 47,219,700.60</u>
Deposits	
Current:	
Cash and Cash Equivalents	\$ 19,957,887.15
Restricted Cash and Cash Equivalents	3,942,831.93
Noncurrent:	
Restricted Cash and Cash Equivalents	<u>3,005,612.68</u>
Total Deposits	<u>26,906,331.76</u>
Investments	
Noncurrent:	
Endowment Investments	18,646,265.61
Restricted Investments	<u>1,667,103.23</u>
Total Investments	<u>20,313,368.84</u>
Total Deposits and Investments	<u>\$ 47,219,700.60</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 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 by which the rate of spending for a fiscal year is calculated at 5% of the trailing three year average, if applicable. To the extent that the total return for the current year exceeds the payout, the excess is added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net position endowment balances to make up the difference. At June 30, 2015, net appreciation of \$5,287,942.95 was available to be spent and was classified in net position as restricted expendable for scholarships and fellowships, endowed professorships, and departmental uses as it is restricted for specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2015, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
	<u> </u>	<u> </u>	<u> </u>
Current Receivables:			
Students	\$ 15,263.85	\$ 5,194.75	\$ 10,069.10
Accounts	61,371.29		61,371.29
Interest on Loans	43,252.01		43,252.01
	<u> </u>	<u> </u>	<u> </u>
Total Current Receivables	<u>\$ 119,887.15</u>	<u>\$ 5,194.75</u>	<u>\$ 114,692.40</u>
Notes Receivable:			
Notes Receivable - Current:			
Federal Loan Programs	\$ 111,034.55	\$ 27,980.29	\$ 83,054.26
Institutional Student Loan Programs	3,865.75	3,727.50	138.25
	<u> </u>	<u> </u>	<u> </u>
Total Notes Receivable - Current	<u>\$ 114,900.30</u>	<u>\$ 31,707.79</u>	<u>\$ 83,192.51</u>
Notes Receivable - Noncurrent:			
Federal Loan Programs	\$ 481,277.06	\$ 157,278.90	\$ 323,998.16
	<u> </u>	<u> </u>	<u> </u>

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2015, is presented as follows:

	Balance July 1, 2014	Increases	Decreases	Balance June 30, 2015
Capital Assets, Nondepreciable:				
Land and Permanent Easements	\$ 4,313,652.83	\$ 0.00	\$ 0.00	\$ 4,313,652.83
Art, Literature, and Artifacts	1,839,008.62			1,839,008.62
Construction in Progress	35,727,661.45	4,551,692.50	39,831,483.81	447,870.14
Total Capital Assets, Nondepreciable	41,880,322.90	4,551,692.50	39,831,483.81	6,600,531.59
Capital Assets, Depreciable:				
Buildings	107,357,342.19	39,831,483.81		147,188,826.00
Machinery and Equipment	13,765,884.19	1,194,741.05	627,486.72	14,333,138.52
General Infrastructure	5,107,656.50			5,107,656.50
Total Capital Assets, Depreciable	126,230,882.88	41,026,224.86	627,486.72	166,629,621.02
Less Accumulated Depreciation for:				
Buildings	36,963,954.93	2,566,120.64		39,530,075.57
Machinery and Equipment	6,154,393.96	789,696.01	552,948.27	6,391,141.70
General Infrastructure	1,308,455.88	102,153.13		1,410,609.01
Total Accumulated Depreciation	44,426,804.77	3,457,969.78	552,948.27	47,331,826.28
Total Capital Assets, Depreciable, Net	81,804,078.11	37,568,255.08	74,538.45	119,297,794.74
Capital Assets, Net	\$ 123,684,401.01	\$ 42,119,947.58	\$ 39,906,022.26	\$ 125,898,326.33

During the year ended June 30, 2015, the University incurred \$337,106.14 in interest costs related to the acquisition and construction of capital assets. Of this total, \$312,739.38 was charged in interest expense, and \$24,366.76 was capitalized.

The University has pledged the energy savings improvements installed in its buildings and other structures financed through the UNC System Guaranteed Energy Savings Installment Financing Agreement (agreement) dated September 1, 2014. The value of the energy savings improvement assets associated with the agreement is \$1,876,980.84 and is subject to security provisions in the agreement to ensure timely debt service payments. The value of the energy savings improvement assets includes \$447,870.15 which has been completed as of June 30, 2015 and \$1,429,110.69 which is remaining to be completed by the ESCO provider. Additional information regarding the agreement can be found in Note 7.

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2015, were as follows:

	Amount
Current Accounts Payable and Accrued Liabilities	
Accounts Payable	\$ 928,777.36
Accrued Payroll	113,971.00
Contract Retainage	1,394,006.35
	<u>2,436,754.71</u>
Total Current Accounts Payable and Accrued Liabilities	\$ 2,436,754.71

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2015, is presented as follows:

	Balance July 1, 2014 (As Restated)	Additions	Reductions	Balance June 30, 2015	Current Portion
Revenue Bonds Payable	\$ 1,265,000.00	\$ 0.00	\$ 360,000.00	\$ 905,000.00	\$ 0.00
Certificates of Participation	5,995,000.00	5,400,000.00	5,995,000.00	5,400,000.00	295,000.00
Total Revenue Bonds and Certificates of Participation	<u>7,260,000.00</u>	<u>5,400,000.00</u>	<u>6,355,000.00</u>	<u>6,305,000.00</u>	<u>295,000.00</u>
Net Pension Liability	4,972,165.00		4,019,221.00	952,944.00	
Notes Payable		1,929,618.00		1,929,618.00	60,810.86
Compensated Absences	2,041,226.16	1,399,872.93	1,117,491.71	2,323,607.38	187,734.05
Total Long-Term Liabilities	\$ 14,273,391.16	\$ 8,729,490.93	\$ 11,491,712.71	\$ 11,511,169.38	\$ 543,544.91

Additional information regarding the net pension liability is included in Note 11.

B. Revenue Bonds Payable and Certificates of Participation - The University was indebted for revenue bonds payable and certificates of participation 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, 2015	Principal Outstanding June 30, 2015	See Table Below
Revenue Bonds Payable							
<u>The University of North Carolina System Pool Revenue Bonds</u>							
Fitness and Student Center Project	A	3.25%-5.25%	10/01/2018	\$ 2,650,000.00	\$ 1,745,000.00	\$ 905,000.00	(1)
Refunding 1998B and 2000 UNC System Pool Revenue Bonds	B	3.00%-4.25%	04/01/2019	1,900,000.00	1,900,000.00		
Total UNC System Pool Revenue Bonds				<u>4,550,000.00</u>	<u>3,645,000.00</u>	<u>905,000.00</u>	
<u>Certificates of Participation</u>							
Student Housing Project, Series 2015	C	3.50%-4.50%	06/01/2030	5,400,000.00		5,400,000.00	(2)
Student Housing Project, Series 2005	D	3.50%-4.50%	06/01/2036	7,200,000.00	7,200,000.00		
Total Certificates of Participation				<u>12,600,000.00</u>	<u>7,200,000.00</u>	<u>5,400,000.00</u>	
Total Revenue Bonds Payable and Certificates of Participation				\$ 17,150,000.00	\$ 10,845,000.00	\$ 6,305,000.00	

- (A) The University of North Carolina System Pool Revenue Bonds, Series 1998B
- (B) The University of North Carolina System Pool Revenue Bonds, Series 2000
- (C) University of North Carolina School of the Arts Student Housing Project, Series 2015 (Refunding of 2005 COPs)
- (D) University of North Carolina School of the Arts Student Housing Project, Series 2005

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year			Estimate of % of Revenues Pledged
			Revenues Net of Expenses	Principal	Interest	
(1)	Facility Debt Fee Revenues	\$ 1,047,537.50	\$ 244,294.84	\$ 0.00	\$ 40,725.00	72%
(2)	Housing Revenues	6,774,233.90	422,639.03	170,000.00	257,226.87	95%

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2015, are as follows:

Fiscal Year	Annual Requirements					
	Revenue Bonds Payable		Certificates of Participation		Notes Payable	
	Principal	Interest	Principal	Interest	Principal	Interest
2016	\$ 0.00	\$ 40,725.00	\$ 295,000.00	\$ 156,526.50	\$ 60,810.86	\$ 8,885.89
2017		40,725.00	299,000.00	152,639.50	246,981.11	32,730.30
2018		40,725.00	308,000.00	143,699.40	255,828.46	28,123.77
2019	905,000.00	20,362.50	317,000.00	134,490.20	266,513.73	23,338.08
2020			327,000.00	125,011.90	277,515.44	18,353.41
2021-2025			1,785,000.00	472,599.40	821,968.40	23,072.98
2026-2030			2,069,000.00	189,267.00		
Total Requirements	\$ 905,000.00	\$ 142,537.50	\$ 5,400,000.00	\$ 1,374,233.90	\$ 1,929,618.00	\$ 134,504.43

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

On June 12, 2015, the University of North Carolina School of the Arts issued \$5,400,000.00 in University of North Carolina School of the Arts Housing Corporation, Series 2015 Certificate of Participation refunding bonds with an average interest rate of 2.99%. The bonds were issued for a current refunding of \$5,825,000.00 of outstanding University of North Carolina School of the Arts Housing Corporation, Series 2005 Certificate of Participation bonds with an average interest rate of 3.50%. The refunding was undertaken to reduce total debt service payments by \$2,270,191.22 over the next 15 years and resulted in a net present value savings of \$771,181.38.

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

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2015	Principal Outstanding June 30, 2015
UNC System Guaranteed Energy Savings Project	Banc of America Public Capital Corp	1.84%	02/14/2023	\$ 1,929,618.00	\$ 0.00	\$ 1,929,618.00

NOTE 8 - OPERATING LEASE OBLIGATIONS

The University entered into operating leases for copiers and rental of storage buildings. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2015:

<u>Fiscal Year</u>	<u>Amount</u>
2016	\$ 66,185.33
2017	53,468.04
2018	50,384.33
2019	42,746.34
2020	16,725.72
Total Minimum Lease Payments	\$ 229,509.76

Rental expense for all operating leases during the year was \$351,458.80.

NOTE 9 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Less Allowance for Uncollectibles</u>	<u>Net Revenues</u>
Operating Revenues:					
Student Tuition and Fees	\$ 18,504,945.87	\$ 0.00	\$ 4,646,085.60	\$ (6,246.59)	\$ 13,865,106.86
Sales and Services:					
Sales and Services of Auxiliary Enterprises:					
Residential Life	\$ 4,218,151.30	\$ 0.00	\$ 1,064,281.91	\$ 0.00	\$ 3,153,869.39
Dining	2,950,335.85		727,804.09		2,222,531.76
Health, Physical Education, and Recreation Services	287,831.57	8,587.20			279,244.37
Bookstore	1,157.90				1,157.90
Parking	80,260.01	2,645.00			77,615.01
Other	60,586.53				60,586.53
Sales and Services of Education and Related Activities					
University Production Revenues	825,948.45	57,158.93			768,789.52
Other	1,252,776.83	10,979.00			1,241,797.83
Total Sales and Services	\$ 9,677,048.44	\$ 79,370.13	\$ 1,792,086.00	\$ 0.00	\$ 7,805,592.31

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	\$ 13,236,366.29	\$ 1,290,044.35	\$ 1,051,623.99	\$ 0.00	\$ 0.00	\$ 0.00	\$ 15,578,034.63
Research			418.00				418.00
Public Service	336,527.75	140,250.57	555,596.12				1,032,374.44
Academic Support	4,571,379.17	358,432.87	326,409.26				5,256,221.30
Student Services	988,719.98	23,111.55	487,041.19				1,498,872.72
Institutional Support	6,666,843.50	4,348,777.09	2,699,594.72				13,715,215.31
Operations and Maintenance of Plant	4,533,466.16	765,494.07	1,539,794.14		1,600,219.48		8,438,973.85
Student Financial Aid				1,491,369.64			1,491,369.64
Auxiliary Enterprises	3,362,317.05	586,552.30	4,020,620.37		481,347.46		8,450,837.18
Depreciation						3,457,969.78	3,457,969.78
Total Operating Expenses	\$ 33,695,619.90	\$ 7,512,662.80	\$ 10,681,097.79	\$ 1,491,369.64	\$ 2,081,566.94	\$ 3,457,969.78	\$ 58,920,286.85

NOTE 11 - PENSION PLANS

A. Defined Benefit Plan

Plan Administration: The State of North Carolina administers the Teachers' and State Employees' Retirement System (TSERS) plan. This plan is a cost-sharing, multiple-employer, defined benefit pension plan established by the State to provide pension benefits for general employees and law enforcement officers (LEOs) of the State, general employees and LEOs of its component units, and employees of Local Education Agencies (LEAs) and charter schools not in the reporting entity. Membership is comprised of employees of the State (state agencies and institutions), universities, community colleges, and certain proprietary component units along with the LEAs and charter schools. Benefit provisions are established by General Statute 135-5 and may be amended only by the North Carolina General Assembly.

Benefits Provided: TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of general members who die while in active service or within 180 days of their last day of service and who also have either completed 20 years of creditable service regardless of age, or have completed five years of service and have reached age 60.

Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

Contributions: Contribution provisions are established by General Statute 135-8 and may be amended only by the North Carolina General Assembly. Employees are required to contribute 6% of their compensation. The contribution rate for employers is set each year by the NC General Assembly in the Appropriations Act based on the actuarially-determined rate recommended by the actuary. The University's contractually-required contribution rate for the year ended June 30, 2015 was 9.15% of covered payroll. The University's contributions to the pension plan were \$1,104,825.70, and employee contributions were \$724,475.87 for the year ended June 30, 2015.

The TSERS Plan's financial information, including all information about the plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, is included in the State of North Carolina's fiscal year 2014 *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.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

TSERS Basis of Accounting: The financial statements of the TSERS plan were prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. Employer contributions are recognized when due and the employer has a legal requirement to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan. The plan's fiduciary net position was determined on the same basis used by the pension plan.

Methods Used to Value TSERS Investment: Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The pension trust funds are the primary participants in the Long-term Investment portfolio and the sole participants in the External Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Credit Investment, and Inflation Protection Investment portfolios. The investment balance of each pension trust fund represents its share of the fair market value of the net position of the various portfolios within the pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2014 *Comprehensive Annual Financial Report*.

Net Pension Liability: At June 30, 2015, the University reported a liability of \$952,944.00 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2014. The

total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2013, and update procedures were used to roll forward the total pension liability to June 30, 2014. The University's proportion of the net pension liability was based on the present value of future salaries for the University relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2014, the University's proportion was 0.08128%, which was a decrease of 0.00062% from its proportion measured as of June 30, 2013.

Actuarial Assumptions: The following table presents the actuarial assumptions used to determine the total pension liability for the TSERS plan at the actuarial valuation date:

Valuation Date	12/31/2013
Inflation	3%
Salary Increases*	4.25% - 9.10%
Investment Rate of Return**	7.25%

* Salary increases include 3.5% inflation and productivity factor.

** Investment rate of return is net of pension plan investment expense, including inflation.

TSERS currently uses mortality tables that vary by age, gender, employee group (i.e. teacher, general, law enforcement officer), and health status (i.e. disabled and healthy). The current mortality rates are based on published tables and based on studies that cover significant portions of the U.S. population. The healthy mortality rates also contain a provision to reflect future mortality improvements.

The actuarial assumptions used in the December 31, 2013 valuations were based on the results of an actuarial experience study for the period January 1, 2005 through December 31, 2009.

Future ad hoc Cost of Living Adjustment (COLA) amounts are not considered to be substantively automatic and are therefore not included in the measurement.

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the U.S. Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected

inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan’s target asset allocation as of June 30, 2014 (the valuation date) are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>
Fixed Income	2.5%
Global Equity	6.1%
Real Estate	5.7%
Alternatives	10.5%
Credit	6.8%
Inflation Protection	3.7%

The information above is based on 30-year expectations developed with the consulting actuary for the 2013 asset, liability, and investment policy study for the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.19%. All rates of return and inflation are annualized.

Discount Rate: The discount rate used to measure the total pension liability was 7.25%. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of the current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability to Changes in the Discount Rate: The following presents the net pension liability of the plan calculated using the discount rate of 7.25%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.25%) or 1-percentage point higher (8.25%) than the current rate:

<u>Net Pension Liability (Asset)</u>		
<u>1% Decrease (6.25%)</u>	<u>Current Discount Rate (7.25%)</u>	<u>1% Increase (8.25%)</u>
\$6,840,891.37	\$952,944.00	(\$4,018,570.17)

Deferred Inflows of Resources and Deferred Outflows of Resources Related to Pensions: For the year ended June 30, 2015, the University

recognized pension expense of \$435,784.00. At June 30, 2015, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Employer Balances of Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions by Classification:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference Between Actual and Expected Experience	\$ 0.00	\$ 222,126.00
Changes of Assumptions		
Net Difference Between Projected and Actual Earnings on Pension Plan Investments		3,219,649.00
Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions	105,648.00	
Contributions Subsequent to the Measurement Date	1,104,826.00	
Total	\$ 1,210,474.00	\$ 3,441,775.00

The amount of \$1,104,826.00 reported as deferred outflows of resources related to pensions will be included as a reduction of the net pension liability in the fiscal year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Schedule of the Net Amount of the Employer's Balances of Deferred Outflows of Resources and Deferred Inflows of Resources That will be Recognized in Pension Expense:

Year ended June 30:	Amount
2016	\$ (835,647.00)
2017	(835,647.00)
2018	(835,647.00)
2019	(829,186.00)
Total	\$ (3,336,127.00)

B. Defined Contribution Plan - The Optional Retirement Program (Program) is a defined contribution pension 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 TSERS. 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, 2015, 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 \$26,547,440.05, of which \$10,279,414.44 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$703,111.95 and \$616,764.87, respectively. The amount of pension expense recognized in the current year related to ORP is equal to the employer contributions.

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 (TSERS) or the Optional Retirement Program (ORP). 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 Chapter 135, Article 3B, 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.

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 TSERS 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 established by the General Assembly.

For the current fiscal year the University contributed 5.49% of the covered payroll under TSERS and ORP to the Fund. Required contribution rates for the years ended June 30, 2014, and 2013, were 5.40% and 5.30%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2015, 2014, and 2013, which were \$1,227,235.27, \$1,176,662.93, and \$1,118,610.09, 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.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

- 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 TSERS and ORP. 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 by the General Assembly. For the fiscal year ended June 30, 2015, the University made a statutory contribution of .41% of covered payroll under TSERS and ORP to the DIPNC. Required contribution rates for the years ended June 30, 2014, and 2013, was .44% in both years. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2015, 2014, and 2013, which were \$91,651.45, \$95,876.24, and \$92,865.74, 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.

A. Employee Benefit Plans

1. State Health Plan

University employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a discretely presented component unit of the State of North Carolina. The Plan has contracted with third parties to process claims.

2. Death Benefit Plan of North Carolina

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.

B. Other Risk Management and Insurance Activities

1. Automobile, Fire, and Other Property Losses

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.

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

2. Public Officers' and Employees' Liability Insurance

The risk of tort claims of up to \$1,000,000 per claimant is 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.

3. Employee Dishonesty and Computer Fraud

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.

4. Statewide Workers' Compensation Program

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.

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.

5. Other Insurance Held by the University

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance. The insurance purchased included general and professional liability insurance for the School of Filmmaking student interns, student accident and health insurance, and accident and health insurance for students who study abroad.

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 \$1,784,953.98 and on other purchases were \$1,410,401.60 at June 30, 2015.
- B. 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.

NOTE 15 - BLENDED COMPONENT UNITS

Condensed combining information for the University's blended component units for the year ended June 30, 2015, is presented as follows:

*Condensed Statement of Net Position
June 30, 2015*

	University	Housing Corporation	Program Support Corporation	Total
ASSETS				
Current Assets	\$ 23,374,677.53	\$ 889,282.00	\$ 109,270.00	\$ 24,373,229.53
Capital Assets	120,242,538.33	4,573,163.00	1,082,625.00	125,898,326.33
Other Noncurrent Assets	23,642,979.68			23,642,979.68
Total Assets	<u>167,260,195.54</u>	<u>5,462,445.00</u>	<u>1,191,895.00</u>	<u>173,914,535.54</u>
TOTAL DEFERRED OUTFLOWS OF RESOURCES	<u>1,210,474.00</u>	<u>0.00</u>	<u>0.00</u>	<u>1,210,474.00</u>
LIABILITIES				
Current Liabilities	4,438,851.59	330,182.00	1,287.00	4,770,320.59
Long-Term Liabilities	5,856,467.47	5,105,000.00		10,961,467.47
Other Noncurrent Liabilities	504,977.32	6,157.00		511,134.32
Total Liabilities	<u>10,800,296.38</u>	<u>5,441,339.00</u>	<u>1,287.00</u>	<u>16,242,922.38</u>
TOTAL DEFERRED INFLOWS OF RESOURCES	<u>3,441,775.00</u>	<u>0.00</u>	<u>0.00</u>	<u>3,441,775.00</u>
NET POSITION				
Net Investment in Capital Assets	118,389,668.19	(326,837.00)	1,082,625.00	119,145,456.19
Restricted - Nonexpendable	15,051,935.97			15,051,935.97
Restricted - Expendable	9,018,786.67			9,018,786.67
Unrestricted	11,768,207.33	347,943.00	107,983.00	12,224,133.33
Total Net Position	<u>\$ 154,228,598.16</u>	<u>\$ 21,106.00</u>	<u>\$ 1,190,608.00</u>	<u>\$ 155,440,312.16</u>

*Condensed Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2015*

	University	Housing Corporation	Program Support Corporation	Eliminations	Total
OPERATING REVENUES					
Operating Revenues	\$ 14,423,907.13	\$ 0.00	\$ 21,613.00	\$ (101,986.00)	\$ 14,343,534.13
Sales and Service, Net	6,798,954.31	1,006,638.00			7,805,592.31
Total Operating Revenues	<u>21,222,861.44</u>	<u>1,006,638.00</u>	<u>21,613.00</u>	<u>(101,986.00)</u>	<u>22,149,126.44</u>
OPERATING EXPENSES					
Operating Expenses	54,974,324.07	576,666.00	13,313.00	(101,986.00)	55,462,317.07
Depreciation	3,348,053.78	109,916.00			3,457,969.78
Total Operating Expenses	<u>58,322,377.85</u>	<u>686,582.00</u>	<u>13,313.00</u>	<u>(101,986.00)</u>	<u>58,920,286.85</u>
Operating Income (Loss)	<u>(37,099,516.41)</u>	<u>320,056.00</u>	<u>8,300.00</u>		<u>(36,771,160.41)</u>
NONOPERATING REVENUES (EXPENSES)					
Investment Income, Net	1,735,748.54	3,742.00			1,739,490.54
Interest and Fees on Capital Asset Related Debt	(56,374.63)	(550,653.00)			(607,027.63)
Other Nonoperating Revenues	32,643,482.31				32,643,482.31
Net Nonoperating Revenues (Expenses)	<u>34,322,856.22</u>	<u>(546,911.00)</u>			<u>33,775,945.22</u>
Capital Contributions	11,961,471.70				11,961,471.70
Additions to Endowments	1,251,540.00				1,251,540.00
Increase (Decrease) in Net Position	<u>10,436,351.51</u>	<u>(226,855.00)</u>	<u>8,300.00</u>		<u>10,217,796.51</u>
NET POSITION					
Net Position, July 1, 2014 (As Restated)	<u>143,792,246.65</u>	<u>247,961.00</u>	<u>1,182,308.00</u>		<u>145,222,515.65</u>
Net Position, June 30, 2015	<u>\$ 154,228,598.16</u>	<u>\$ 21,106.00</u>	<u>\$ 1,190,608.00</u>	<u>\$ 0.00</u>	<u>\$ 155,440,312.16</u>

Condensed Statement of Cash Flows
June 30, 2015

	University	Housing Corporation	Program Support Corporation	Total
Net Cash Provided (Used) by Operating Activities	\$ (33,547,244.92)	\$ 418,920.00	\$ 2,207.00	\$ (33,126,117.92)
Net Cash Provided by Noncapital Financing Activities	33,953,343.76			33,953,343.76
Net Cash Provided (Used) by Capital and Related Financing Activities	4,644,532.38	(868,689.00)		3,775,843.38
Net Cash Provided (Used) by Investing Activities	(795,092.30)	772,376.00		(22,716.30)
Net Increase in Cash and Cash Equivalents	4,255,538.92	322,607.00	2,207.00	4,580,352.92
Cash and Cash Equivalents, July 1, 2014	21,677,348.84	544,242.00	104,388.00	22,325,978.84
Cash and Cash Equivalents, June 30, 2015	<u>\$ 25,932,887.76</u>	<u>\$ 866,849.00</u>	<u>\$ 106,595.00</u>	<u>\$ 26,906,331.76</u>

NOTE 16 - NET POSITION RESTATEMENT

As of July 1, 2014, net position as previously reported was restated as follows:

	Amount
July 1, 2014 Net Position as Previously Reported	\$ 149,075,802.65
Restatement:	
Record the University's Net Pension Liability and Pension Related Deferred Outflows of Resources Per GASB 68 Requirements	<u>(3,853,287.00)</u>
July 1, 2014 Net Position as Restated	<u>\$ 145,222,515.65</u>

NOTE 17 - SUBSEQUENT EVENT

On August 27, 2015, the University of North Carolina School of the Arts redeemed the outstanding balance of the University of North Carolina (UNC) System Pool Revenue Bonds, Series 1998B, which would have matured on October 1, 2018. The original issue amount was \$2,650,000.00 and at June 30, 2015, the outstanding balance of the UNC System Pool Revenue Bonds, 1998B was \$905,000.00. As a result of the redemption of these bonds, the University has reduced its debt service requirements by \$1,047,537.50 over the next four years.



REQUIRED SUPPLEMENTARY INFORMATION

**University of North Carolina School of the Arts
 Required Supplementary Information
 Schedule of the Proportionate Net Pension Liability
 Teachers' and State Employees' Retirement System
 Last Two Fiscal Years**

Exhibit C-1

	<u>2014</u>	<u>2013</u>
Proportionate Share Percentage of Collective Net Pension Liability	0.08128%	0.08190%
Proportionate Share of TSERS Collective Net Pension Liability	\$ 952,944.00	\$ 4,972,165.00
Covered-Employee Payroll	\$ 12,111,613.34	\$ 12,300,093.04
Net Pension Liability as a Percentage of Covered-Employee Payroll	7.87%	40.42%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	98.24%	90.60%

**University of North Carolina School of the Arts
Required Supplementary Information
Schedule of University Contributions
Teachers' and State Employees' Retirement System
Last Ten Fiscal Years**

Exhibit C-2

	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>
Contractually Required Contribution	\$ 1,104,825.70	\$ 1,052,499.20	\$ 1,024,597.75	\$ 881,137.64	\$ 607,338.98
Contributions in Relation to the					
Contractually Determined Contribution	<u>1,104,825.70</u>	<u>1,052,499.20</u>	<u>1,024,597.75</u>	<u>881,137.64</u>	<u>607,338.98</u>
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered-Employee Payroll	\$ 12,074,597.76	\$ 12,111,613.34	\$ 12,300,093.04	\$ 11,843,247.87	\$ 12,319,249.00
Contributions as a Percentage of					
Covered-Employee Payroll	9.15%	8.69%	8.33%	7.44%	4.93%

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
Contractually Required Contribution	\$ 419,387.66	\$ 415,060.57	\$ 344,977.74	\$ 278,587.53	\$ 234,153.32
Contributions in Relation to the					
Contractually Determined Contribution	<u>419,387.66</u>	<u>415,060.57</u>	<u>344,977.74</u>	<u>278,587.53</u>	<u>234,153.32</u>
Contribution Deficiency (Excess)	<u>\$ -</u>				
Covered-Employee Payroll	\$ 11,747,553.49	\$ 12,352,993.12	\$ 11,310,745.72	\$ 10,473,215.41	\$ 10,006,551.95
Contributions as a Percentage of					
Covered-Employee Payroll	3.57%	3.36%	3.05%	2.66%	2.34%

**University of North Carolina School of the Arts
Notes to Required Supplementary Information
Schedule of University Contributions
Teachers' and State Employees' Retirement System
For the Fiscal Year Ended June 30, 2015**

Changes of Benefit Terms:

									<u>Cost of Living Increase</u>
<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	
N/A	1.00%	N/A	N/A	N/A	2.20%	2.20%	3.00%	2.00%	

Changes of assumptions. In 2008, and again in 2012, the rates of withdrawal, mortality, service retirement and salary increase for active members and the rates of mortality for beneficiaries were adjusted to more closely reflect actual experience. Assumptions for leave conversions and loads were also revised in 2012.



INDEPENDENT AUDITOR'S REPORT

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
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
University of North Carolina School of the Arts
Winston-Salem, North Carolina

We have audited, in accordance with the 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, the financial statements of the University of North Carolina School of the Arts, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated November 2, 2015. Our report includes a reference to other auditors who audited the financial statements of the University of North Carolina School of the Arts Housing Corporation, the University of North Carolina School of the Arts Program Support Corporation, and the discretely presented component unit, the University of North Carolina School of the Arts Foundation, Inc., as described in our report on the University's financial statements. The financial statements of the University of North Carolina School of the Arts Housing Corporation, the University of North Carolina School of the Arts Program Support Corporation, and the discretely presented component unit were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with those entities.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

A *deficiency in internal control* 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 and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free from 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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

November 2, 2015

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