



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

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



FISCAL YEAR ENDED JUNE 30, 2004 · CHAPEL HILL, NORTH CAROLINA

2004

COMPREHENSIVE
A N N U A L
F I N A N C I A L
R E P O R T



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OFFICE OF THE VICE CHANCELLOR FOR FINANCE AND ADMINISTRATION

FISCAL YEAR ENDED JUNE 30, 2004 · CHAPEL HILL, NORTH CAROLINA

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Introductory S e c t i o n

Chapel Hill, North Carolina
Fiscal Year Ended June 30, 2004



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

Message from the Chancellor

Great things are happening at Carolina, and the past year only added to the positive momentum driving successful results. We enrolled our first class of Carolina Covenant Scholars and the most academically prepared freshman class in the University's history. We made progress in a multi-year construction program that is bringing our campus master plan to life. Faculty research funding grew stronger. And alumni and friends demonstrated an extraordinary commitment to Chapel Hill by contributing generously to the Carolina First campaign.

These exciting developments help show why this is a university that is on the move and poised for continued future excellence. Our vision is to become the nation's leading public university. Such a bold aspiration is consistent with Carolina's history as the birthplace of American public higher education. We want the University to be the best that it can be for the people of North Carolina and beyond.

Carolina Covenant Expands

In 2003, we launched the Carolina Covenant, a first for a major public U.S. university, because we recognized that access to higher education is the key to opportunity for a better life in a knowledge-based economy. The Carolina Covenant promises admitted students from low-income families that we will provide the full cost of their education so that they can graduate debt-free.

Following Carolina's lead, other universities created similar programs, including Virginia, Maryland, Nebraska, Harvard, and Brown.

This fall, 225 Carolina Covenant Scholars arrived. I met some of these

students and their parents over the summer. They are outstanding students who impressed me with their academic credentials, their passions, and their interests. More than half of them are first-generation college students. They came well prepared – with an average 4.2 grade-point average and a 1,209 Scholastic Aptitude Test score.

We are extending the Carolina Covenant's reach. Next fall, we will expand it for families from 150 percent of the federal poverty level to 200 percent. That will cover a family of four with an annual income of about \$37,000 or a single parent with a child who makes about \$24,000. This adjustment will add another 120 Covenant Scholars.

These young people and their families need our help. Recognizing that our tuition accounts for only a third of the total cost of attendance, the Covenant goes further to cover room and board, books, and other expenses. Our increased financial commitment to the Covenant is possible because of our Board of Trustees policies emphasizing need-based aid and strong support from the State of North Carolina in funding financial aid as the cost of education rises. Increasingly, donors are pledging gifts to support the Carolina Covenant through the Carolina First campaign.

We hope the Carolina Covenant challenges other forward-thinking universities to give qualified students across America the chance they deserve to graduate debt-free.

'Carolina Connects' Spotlights Engagement With State

A leading public university is an engaged university that always puts its state first. We are enhancing that Carolina tradition. I have visited every corner of North Carolina as part of an initiative called "Carolina Connects" to spotlight the work of faculty, staff, and students. This University serves North Carolina each day in meaningful, relevant ways. In short, Carolina connects.

My visits have been well received. Conversations with community leaders, elected officials, alumni, and parents have been invaluable. Let me share three examples of Carolina people I have met:

□ Jill Fitzgerald, an education professor, taught a year at Siler City



Elementary School, which, in many ways, mirrors our state. The school is dealing with an influx of immigrants who do not speak English as a first language. Jill's experience in the Siler City classroom changed about 80 percent of what she had been teaching her own UNC students.

- ❑ Stuart Gold, a pediatric oncology specialist, illustrates the roles that the Area Health Education Centers Program and UNC Health Care play across our state. Stuart's work at Wilmington's AHEC clinic helps save families the hardship of traveling to Chapel Hill for specialized care for their children that the local hospital cannot provide.
- ❑ Rick Leuttich and faculty at the Institute of Marine Sciences directly benefit the Carteret County economy. Their work with other public-private partners contributes \$127 million and more than 3,100 jobs to the county's economy. Their research informs us about our coast, considered the "world's largest wet lab" for marine and environmental sciences.

Carolina will continue defining its research and public service agendas around the state's needs. We work on real-world problems, and we address local, as well as global, needs.

General Assembly Approves New Cancer Hospital

This past session of the General Assembly was highly successful. Budget cuts were minimal and offset by funding for enrollment growth and employee salary increases. Legislators authorized \$180 million to build a world-class hospital in Chapel Hill for cancer patients and their families. We have seen a 23 percent increase in the number of cancer patients coming to us for care in the last five years. Over the next 30 years, the number of cancer cases in North Carolina alone is expected to double. When completed, the new hospital will become the largest freestanding university cancer hospital in the Southeast and the clinical home for the UNC Lineberger Comprehensive Cancer Center, one of only 38 National Cancer Institute-designated centers.

Carolina First Strengthens Faculty Support – Our Top Priority

Our number one priority at Carolina is strengthening faculty recruitment, retention, and development. We have made great progress on this front, thanks to strong support from the General Assembly, modest increases in campus-based tuition, and gifts through the Carolina First Campaign.

At this writing, Carolina First has secured about \$211 million for faculty support – more than half of our \$400 million goal in this part of the campaign. These funds support key faculty retention and recruitment initia-

tives – research stipends, summer programs, graduate support and course development, as well as endowed professorships. Donors have created 127 endowed professorships toward our goal of 200. And the Legislature increased the state matching funds for distinguished endowed professorships.

We have exceeded more than \$1.32 billion toward our overall campaign goal of \$1.8 billion. That is great progress. Private dollars are critical as we compete with the finest private universities for faculty and students.

Learning Environment, Student Experience Among Priorities

The University and our trustees have set other key priorities to guide the future. One is to create the richest possible learning environment for undergraduate, graduate, and professional students. What sets Carolina apart from the other great research universities is a culture for learning that rivals the finest private liberal arts colleges for undergraduates, and the finest graduate and professional school environments.

Last year, we increased the percentage of classes with fewer than 20 students and reduced the percentage of classes with more than 50 students. This is one of our own measures of excellence, as well as a number used by U.S. News & World Report magazine. Our gains helped us move up 21 places in the magazine's ranking of faculty resources among all universities. During tough state budget cuts, we invested strategically to support our priority for student learning.

Our priorities also focus on strengthening the student experience. We want to increase the percentage of undergraduate

classes with fewer than 20 students by doubling the size of the Honors Program. We want to improve our six-year graduation rate, now at more than 82 percent, and raise it to at least 92 percent, the highest level of any of our top public university peers. And we want to make graduate teaching assistant stipends nationally competitive.

Faculty Research Funding Up Again

This past year, our faculty secured \$577 million in research grants – up 7.5 percent from the previous year. That continued the steady rise in research funding we have seen for more than two decades. Such success continued this fall.

We were the only university to receive three of 21 grants awarded through the National Institutes of Health's "Roadmap for Medical Research" initiatives, designed to transform our country's medical research capacity and speed research discoveries from the bench to the bedside. More than \$5 million over three years will support planning for new centers focusing on obesity, inflammation, and genetic abnormalities and will position us for national leadership in these fields.

The School of Education received a \$10 million grant from the U.S. Department of Education to improve teaching, learning, and student achievement in America's rural schools. Through our new National Research Center on Rural Education Support, researchers will train teachers and provide academic and social programs for students. UNC's is one of only three new federally funded centers and the only one focused on rural education. North Carolina's rural schools will benefit from this research.

Ambitious Construction Program Makes Progress

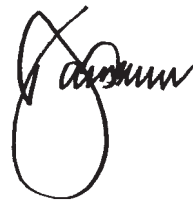
The prevalence of construction cranes in Chapel Hill is a sign of progress. We are in the midst of a \$1.3 billion construction and renovation program that is among the largest at any U.S. campus. The people of North Carolina who voted to approve the 2000 Higher Education Bond Referendum made this transformation possible. We are leveraging those bond dollars through private gifts to the Carolina First Campaign, overhead receipts generated by faculty research, and other investments using campus-generated funds.

These projects balance the needs of undergraduate education and teaching with major health and medical facilities dedicated to teaching and research. More than 80 projects are putting thousands of North Carolinians to work, with daily payments to contractors currently exceeding \$1 million. Recently completed projects include the School of Government's Knapp-Sanders Building, the Sonja Haynes Stone Center for Black Culture and History, the Bioinformatics and Medical Biomolecular Research Buildings, and Murphey Hall, a classroom building.

Conclusion

2003–2004 was one of our best years in recent University history. Our positive momentum is growing stronger. We enjoyed a highly successful short session of the North Carolina General Assembly. We have set clear priorities for the near term. Our faculty remain among the nation's research leaders, and the capital construction program is taking shape. Alumni and friends are making generous gifts to the Carolina First campaign. We are sharply focused on ambitious but attainable long-range goals and are exceptionally confident about the University's prospects for future success.

Sincerely,



James Moeser

Letter of Transmittal



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

OFFICE OF THE VICE CHANCELLOR
FOR FINANCE AND ADMINISTRATION

300 SOUTH BUILDING
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CHAPEL HILL, N.C. 27599-1000

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November 12, 2004

To Chancellor Moeser, Members of the Board of Trustees,
and Friends of The University of North Carolina at
Chapel Hill:

INTRODUCTION

This Comprehensive Annual Financial Report includes the financial statements for the year ended June 30, 2004, as well as other useful information that helps ensure the University's accountability to the public. Responsibility for the accuracy of the information and for the completeness and fairness of its presentation, including all disclosures, rests with the University's management. We believe the information is accurate in all material respects and fairly presents the University's financial position, revenues, expenses, and other changes in net assets. We believe our system of internal controls is sound and sufficient to disclose material deficiencies in controls to the auditors and the audit committee. The Comprehensive Annual Financial Report includes all disclosures necessary for the reader to gain a broad understanding of the University's financial position and results of operations for the fiscal year ended June 30, 2004. The report is organized into three sections.

The **Introductory Section** includes a message from the chancellor, the transmittal letter, a listing of the University's Board of Trustees, Chancellor's Cabinet, and an organization chart. This section also features the University's major recent initiatives, priorities, and progress. Overall, this section provides background about the organization and structure of the University, the scope of its operations, significant factors contributing to the current fiscal environment, and expected factors influencing the future.

The **Financial Section** presents management's discussion and analysis, basic financial statements and a report of the Office of the State Auditor. Management's discussion

and analysis provides an objective review of the University's financial activities. The basic financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board.

The **Statistical Section** contains selected financial, statistical, and demographic information. This information provides a broad overview of trends in the University's financial affairs. Also included is historical statistical information reproduced from the 2001 Comprehensive Annual Financial Report. The Statistical Section includes, for the first time, information on the Cost of College Project of the National Association of College and University Business Officers.

The accompanying financial statements present all funds belonging to the University and its component units. While the 16-campus University of North Carolina System's Board of Governors has ultimate responsibility, the chancellor, the University's Board of Trustees, and the Board of Trustees of the Endowment Fund have both delegated and statutory responsibilities for financial accountability of the University's funds. For the fiscal year ended June 30, 2004, the University implemented Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This statement



amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine if certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

The Financial Reporting Entity for the financial statements is comprised of the University and ten component units. Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Investment Fund), UNC Investment Fund, LLC (System Fund), UNC Management Company, Inc. (Management Company), The University of North Carolina at Chapel Hill Foundation, Inc., The Kenan-Flagler Business School Foundation, The School of Social Work Foundation Inc., and U.N.C. Law Foundation Inc., are reported as if they were part of the University.

The Investment Fund supports the University by operating an investment fund for charitable, non-profit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. The System Fund was organized to allow the University, the University of North Carolina and its constituent institutions (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System to pool their resources and invest collectively in investment opportunities identified, structured and arranged by the Management Company. The Investment Fund contributed and assigned all of its assets to the System Fund in exchange for membership interest in the System Fund. At year end, the Investment Fund membership interest was approximately 92 percent of the System Fund total membership interest.

The Management Company is organized and operated exclusively to support the educational mission of the University. The Management Company also provides investment management services to the University, UNC System, and affiliated tax-exempt organizations. The purpose of UNC-CH Foundation, Business School Foundation, Social Work Foundation, and Law Foundation is to aid, support and promote teaching, research, and service in the various educational, scientific, scholarly, professional, artistic, and creative endeavors of the University.

The financial statements of the Investment Fund, System Fund, Management Company, UNC-CH Foundation, Business School Foundation, Social Work Foundation, and U.N.C. Law Foundation have been blended with those of the University.

Separate financial statements for three other component units are reported based on GASB Statement No. 39. The Medical Foundation of North Carolina, Inc., The

Educational Foundation Scholarship Endowment Trust, and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. are legally separate, non-profit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

Other related foundations and similar non-profit corporations for which the University is not financially accountable are not part of the accompanying financial statements. The University of North Carolina at Chapel Hill is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

ECONOMIC CONDITION AND OUTLOOK

In the typical post-World War II recession, the North Carolina economy declined much more steeply than the national average and then rebounded more quickly to new record heights. That development was primarily due to the fact that the share of jobs in manufacturing and the share of manufacturing in the gross state product were both much higher than the national average.

That pattern was shattered with the 2001 recession, which began in March and ended in November. For some parts of 2000 and 2001, North Carolina had the highest unemployment rate in the United States. That had never happened before. One of the reasons, especially in the Triangle (the Raleigh-Durham-Chapel Hill Metropolitan Statistical Area (MSA)) was an over-concentration of "bubble" industries, such as telecommunications. Another part was an over-concentration in textiles and furniture, especially in sectors of those industries that were no longer globally competitive. North Carolina sank faster and took far longer to come back than in any other recession since World War II. This was despite the fact that on a national basis, the 2001 recession was the mildest one ever recorded, with a peak-to-trough decline in real GDP of only 0.05 percent.

It now appears that the North Carolina economy is back on track to outperform the national average as it usually has in the past 50 years. In July 2004, the unemployment rate in North Carolina was 5 percent, well below the national average of 5.5 percent on a seasonally adjusted basis. This was a huge drop in the unemployment rate from 6.6 percent in July 2003. There were 4.2 million people in the labor force in North Carolina in July and 211,200 of them were unemployed. That was a decline of 71,200 in the ranks of the unemployed in one year. The total number

of nonfarm payroll jobs in July 2004 in North Carolina was 3.9 million. This was an increase of 40,200 jobs or 1.1 percent from July 2003.

Among MSAs in the state in July 2004, the lowest unemployment rates were in Asheville (3.3 percent), Raleigh-Durham-Chapel Hill (3.6 percent), Wilmington (3.9 percent) and Jacksonville (4.4 percent). The biggest improvement over the 12 months ending in July 2004 was the Hickory-Morganton-Lenoir MSA, which saw its unemployment rate fall from 10.1 to 7.6 percent. The Rocky Mount MSA had a fall from 9.3 to 8 percent over the same period. About one-third of the total statewide gain in nonfarm payroll employment in the year to July 2004 occurred in the Raleigh-Durham-Chapel Hill MSA. Another 23.6 percent was in the Charlotte-Gastonia-Rock Hill (SC) MSA. This meant these two MSAs accounted for more than half the statewide gain.

On September 28, 2004, the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce released revised personal income data for all states from the first quarter of 2001 through the first quarter of 2004. This data showed that total personal income in North Carolina in the second quarter of 2004 was \$249.1 billion at a seasonally adjusted annual rate, up 5.8 percent from the second quarter of 2003. The national average increase was 5.2 percent, so North Carolina was back in its normal position of outperforming the national average. For calendar year 2003, total personal income in North Carolina was \$237.9 billion, up 3.1 percent from 2002. This was just below the national average increase of 3.2 percent.

PROGRESS AND MAJOR INITIATIVES

Carolina's progress, priorities, and major initiatives during fiscal year 2003-2004 reflected the University's vision of becoming the nation's leading public university. Following this letter are highlights from fiscal year 2003-2004.

FINANCIAL INFORMATION

INTERNAL CONTROL STRUCTURE

The University's Finance and Administration Division establishes and maintains an effective system of internal control. One objective of an internal control structure is to provide management with reasonable, although not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition. Another objective is to ensure that transactions are executed in accordance with appropriate authorization and recorded properly in the financial records to permit the preparation of financial statements in accordance with generally accepted account-

ing principles. Organizational structure, policies, and procedures have been established to safeguard assets, ensure the reliability of accounting data, promote efficient operations, and ensure compliance with established governmental laws, regulations and policies, University policies, and other requirements of sponsors to whom the University is accountable.

As a recipient of federal financial awards, the University is responsible for ensuring compliance with all applicable laws and regulations. A combination of state and University policies and procedures, integrated with the University's system of internal controls, provides for this compliance. As an integral part of the State of North Carolina's Single Audit, the University is subject to an annual examination by the Office of the State Auditor of its federal financial assistance programs and federal cost-reimbursement contracts in accordance with U.S. Office of Management and Budget Circular A-133, *Audits of State and Local Governments, and Non-Profit Organizations*.

BUDGETARY CONTROLS

The University is responsible for controlling its budget and using the funds to fulfill its educational, research, and public service missions. It is also responsible for planning, developing, and controlling budgets and expenditures within authorized allocations in accordance with University, state, and federal policies and procedures. The University maintains budgetary controls to ensure compliance with provisions embodied in the annual appropriated budget approved by the North Carolina General Assembly, and as further directed by the Board of Governors. Project-length financial plans are adopted for capital projects.

After the budget has been approved by the chancellor and the Board of Governors, the University follows an established system of budgetary controls. Finance and Administration issues periodic interim budget statements to department heads to guide them in managing their budget allocations. Monthly financial reports are provided on each fund to individual managers responsible for the fund. Financial reports are also provided to the state. When actual conditions require changes to the budget, revisions are prepared, and these revisions are appropriately approved and communicated to those affected. Changes to the budget are approved at the University level and/or the state level as required. Based on the state's management flexibility legislation, the University has received delegated authority for designated budget changes. The University maintains an encumbrance accounting system as another method to ensure that imposed expenditure constraints are observed.

DEBT ADMINISTRATION

To ensure the appropriate mix of funding sources is utilized, the University established a debt policy, which is continuously used by management as a tool to evaluate the University's organizational and capital funding structure, the appropriate use of leverage, and internal lending mechanisms.

To fulfill its mission, the University will need to make capital investments, driving capital decisions that affect the University's credit. Appropriate financial leverage serves a useful role and should be considered a long-term component of the University's balance sheet. Just as investments represent an integral component of the University's assets, debt is viewed to be a continuing component of the University's liabilities. Debt, especially tax-exempt debt, provides a low-cost source of capital for the University to fund capital investments and achieve its mission and strategic objectives.

The debt strategies, combined with management judgment, provide the framework by which decisions will be made regarding the use and management of debt. The objectives of the debt policy are:

- ❑ *Identify projects eligible for debt financing.* Using debt to fund mission-critical projects will ensure that debt capacity is optimally used to fulfill Carolina's mission. Projects that relate to the core mission will be given priority for debt financing; projects with associated revenues will receive priority consideration as well.
- ❑ *Maintain Carolina's favorable access to capital.* Management's determination of the timing of capital projects will not be compromised by the University's access to capital sources, including debt. Management will use and issue debt to ensure timely access to capital.
- ❑ *Limit risk of University debt portfolio.* The University will manage debt on a portfolio basis. The University's continuing objective to achieve the lowest cost of capital will be balanced with the goal of limiting exposure to market shifts.
- ❑ *Manage the University's credit to maintain the highest acceptable credit.* This practice will permit the University to continue to issue debt and finance capital projects at favorable interest rates while meeting strategic objectives. The University will limit its overall debt to a level that will maintain an acceptable credit with the bond rating agencies.

In meeting these objectives, the University has adopted strategies and procedures relating to both the external and the internal management of debt and interest. These strategies include the following:

- ❑ *Mission-Based Capital Planning.* Provide framework with a link to mission to evaluate and prioritize debt-eligible projects.
- ❑ *Core Ratios.* Adopt a set of core ratios to guide capital planning and ensure central oversight of University-wide leverage levels.
- ❑ *Financial Instruments.* Provide management with appropriate debt vehicles based on borrowing needs.
- ❑ *External and Internal Debt Repayment.* Delink external and internal debt repayment, including adoption of internal lending policies.

The University has \$471.7 million of revenue bonds outstanding at June 30, 2004. The bonds were issued to finance the construction and/or renovation of many facilities including essential new research buildings, major new cultural facilities that will benefit the local community and state, undergraduate residence halls, student family housing, and parking facilities. The bonds are payable both as to principal and interest from the general revenues of the University and net revenues generated by the operations of those facilities.

The UNC-CH Foundation, which is part of the University's financial reporting entity, also adheres to a debt policy that levers the foundation's financial resources to continue to provide current and future support to the University.

CASH MANAGEMENT

The cash management plan of the University addresses control of receipts, management of disbursements, and investment of funds to maximize earnings on the investment of cash. State law requires that state-appropriated funds be deposited with the State Treasurer with investment earnings accruing to the state. Other resources, such as gifts, contract and grant awards, auxiliary revenues, and student activity fees are not appropriated by the state. Some of these funds must be deposited with the State Treasurer with investment earnings accruing to the University. Endowment, debt service, and other designated funds are invested by the University in accordance with its investment policies.

The University administers a short-term investment pool for funds not required to be on deposit with the State Treasurer. The investment pool is administered in conjunction with cash receipts and disbursing requirements to minimize idle cash and to generate current income without loss of capital at a rate of return comparable to the State Treasurer. The University uses the state's cash management control system to improve cash flow by electronically recording cash receipts and disbursements for funds deposited with the State Treasurer.

RISK MANAGEMENT

Risk has traditionally been viewed as something to be avoided or eliminated with only a negative outcome. Increasingly in today's environment, risk is more broadly defined as any issue that affects an organization's ability to meet its objectives. There is also greater awareness that responsible risk taking leads to a competitive advantage and can maximize stakeholder value.

To optimize the benefits of risk and minimize their costs, the University has taken a more enterprise-wide approach to its risk management programs by holistically addressing its operational, financial, compliance, strategic, and reputation risks. This enterprise risk management framework ensures that decisions that trade value and risk are made on an informed basis and are aligned with our risk tolerance and strategy. Addressing our full portfolio of risks is also a critical element of our strategic planning process.

Insurable risks are addressed in several ways, including participation in various state-administered risk pools, purchase of commercial insurance, and self retention of certain risks. Refer to Note 14 of the Notes to the Financial Statements for more detailed information concerning the University's insurance programs.

OTHER INFORMATION

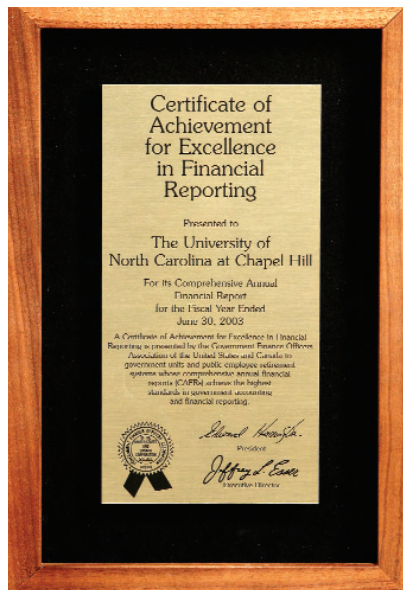
AUDITS

State law, federal guidelines, and certain bond covenants require that the University's accounting and financial records be audited by the Office of the State Auditor each year. The University's Internal Auditors also perform fiscal, compliance and performance audits. The reports resulting from these audits are shared with University management.

The audit of the University's federal financial assistance programs is performed by the Office of the State Auditor in conjunction with the statewide Single Audit. The accounting and financial records of The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc., The University of North Carolina at Chapel Hill Foundation, Inc., UNC Investment Fund, LLC, UNC Management Company, Inc., The Kenan-Flagler Business School Foundation, The School of Social Work Foundations, Inc., The U.N.C. Law Foundation, Inc., the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., The Medical Foundation of

North Carolina, Inc., the Educational Foundation Scholarship Endowment Trust, WUNC Radio, and the Athletic Department are each audited by a public accounting firm in addition to the State Auditor review. All audit reports are available for public inspection.

CERTIFICATE OF ACHIEVEMENT



The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the University for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the ninth consecutive year that the University has been honored with this prestigious award. To receive a Certificate of Achievement, a government unit must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for one year. We believe our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

Preparation of this Comprehensive Annual Financial Report in a timely manner would not have been possible without the coordinated efforts of the University community, with special assistance from the Chancellor's Office, the Office of the Executive Vice Chancellor and Provost, Research and Economic Development, Student Affairs, Information Technology Services, University Advancement, University Relations, Institutional Research, the Office of Scholarships and Student Aid, the Department of Athletics, and Dr. James F. Smith, Adjunct Professor of Business Administration in the Kenan-Flagler Business School. In addition, the Office of the State Auditor provided invaluable assistance.

Nancy D. Sattenfield
Vice Chancellor for Finance and Administration

Progress and Major Initiatives

Fiscal 2003–2004

Carolina's progress and major initiatives during fiscal 2003–2004 reflected the University's vision of becoming the leading public university in the United States. Following are a sampling of recent highlights demonstrating significant progress across many areas of the University:

INNOVATIVE LEADERSHIP: EXPANDING THE CAROLINA COVENANT

Carolina has expanded its nationally recognized Carolina Covenant initiative to make a debt-free college education possible for more low-income students. The changes, announced by Chancellor James Moeser during his 2004 State of the University address, send an even stronger message about accessibility and the traditional commitment to opportunity in Chapel Hill for qualified students – regardless of their ability to pay.

Launched in fall 2004, the Carolina Covenant now covers 225 freshmen who can graduate without debt. Instead, they agree to work on campus 10 to 12 hours weekly in a federal work-study job, and Carolina meets the rest of their needs through a combination of federal, state, University, and other privately funded grants and scholarships.

Now the University is increasing the financial eligibility requirements for the program to cover an estimated 120 new students. Starting next fall, students and their families must be at or below 200 percent of the federal poverty level – up from 150 percent. That raises the threshold to cover a family of four with an annual income of about \$37,000 or a single parent with a child who makes about \$24,000. This year, those income levels were at about \$28,000 and \$18,000, respectively.

Carolina became the first major public U.S. university to announce plans for such a program in fall 2004. Since then, several universities, including Virginia, Maryland, Nebraska, Harvard, and Brown have created or announced plans for similar programs. Financial criteria vary by campus. Virginia, for example, uses the 150 percent poverty level standard.

UNC consistently ranks among the national leaders in making education financially accessible to students. Carolina also meets the full need of middle-income students, with financial aid packages comprised of two-thirds grants and scholarships and one-third loans and work-study. (Most aid packages are closer to two-thirds loans and one-third grants.)

In recent years, when UNC has enacted a campus-based tuition increase, it has dedicated 35 percent of the revenue to aid for needy students, and every needy student received a grant to cover a campus-

based tuition increase. The average cumulative indebtedness of a graduating senior who borrowed dropped from \$13,700 in 2000 to \$11,519 in 2003.

Carolina Covenant scholars were admitted under the University's rigorous admissions standards. More than half of this year's class are first-generation college students. Covenant students posted an average 4.21 grade-point average and 1,209 Scholastic Aptitude Test (SAT) score.

The average annual income for a Carolina Covenant Scholar last year was \$13,400, or \$400 less than what North Carolinians now pay to attend the University. Since tuition accounts for only about a third of the total cost of attendance, the Carolina Covenant covers room and board, books, and other related educational expenses.

Carolina's initiative comes when the cost of college is rising steadily. Nationally, the

**"We hope our leadership
in establishing the
Carolina Covenant,
and our increased commitment
to the Covenant,
will challenge other universities
to make similar investments
to ensure affordability and access
for deserving students."**

~ Chancellor James Moeser ~

carolina covenant

UNC HOME DIRECTORIES SEARCH DEPARTMENTS UNC

FAQ

Testimonials

Tawf Ahmed
Gretchen Brown
Cris Collier
Alicia Dyer
Tasha Farris
Tina Hester
Lashonda Johnson
Michele Miller
Jocelyn Moore
Shirley Ort
Shirley Patton
Diana Ponder
Pamela Wood

Video Clips

Give to the Covenant

THE UNIVERSITY OF NORTH CAROLINA - CHAPEL HILL

You could attend the University of North Carolina at Chapel Hill without borrowing a penny.

UNC-Chapel Hill's Carolina Covenant will enable eligible students from historically low-income families to attend the University and graduate debt-free if they:

- work on campus 10 to 12 hours weekly in a federal work-study job throughout their four years here, instead of borrowing.
- agree to have the University meet the rest of the student's financial need through a combination of federal, state, university, and private grants and scholarships.

Carolina leads by making college accessible

With the Carolina Covenant, the University leads American public universities in a commitment to make college more accessible to all people. University Chancellor James Mooser announced the innovative initiative in September 2003.

"A covenant is a promise," Mooser said. "College should be possible for everyone who can make the grade, regardless of family income. With the Carolina Covenant, we are telling students that college is affordable, no matter how much money your family makes."

Mooser credits two university administrators for their vision in creating the Carolina Covenant. They are Shirley Ort, associate general and director of scholarships and student aid, and Jerry Lucile, vice president for enrollment management and director of undergraduate admissions.

Calling the Covenant "an expression of our values at this university," Mooser has said that Carolina's place in history as the nation's oldest public university accounts for why "this idea of access is deeply embedded in our genetic code, in our DNA."

Chancellor Mooser announced on September 29, 2004 that the University will extend the reach of the Carolina Covenant by expanding the program for families from 150 percent of the federal poverty level to 200 percent. This move will cover a family of four with an annual income of about \$37,000 or a single parent with a child who makes about \$24,000. These changes strengthen an already solid message about accessibility and the traditional commitment to opportunity in Chapel Hill for qualified students, regardless of their ability to pay. The adjustment begins with the fall 2005 freshman class, and will add an estimated 120 new Carolina Covenant Scholars for a total of approximately 345. [Learn more.](#)

The University considers all admitted and enrolled students, based on their completed financial aid applications (FAFSA and the PROFILE). No separate application is required. [Learn more.](#)

In fall 2004, 225 Carolina Covenant Scholars enrolled at UNC-Chapel Hill.

Carolina welcomed 225 Carolina Covenant Scholars to Chapel Hill in fall 2004. More than half of them are first-generation college students. They came well prepared – with an average 4.2 GPA and a 1,209 SAT score. To meet some of these students and learn more about the Carolina Covenant, visit www.unc.edu/carolinacovenant.

average student loan debt doubled to about \$17,000 in just a decade. Approximately one-fifth of the full-time students working log 35 or more hours a week. As a result, many low-income youth abandon plans for college – or drop out – because the burden of that debt and workload is too much. Research shows that low-income families need more information – and greater predictability – about the availability of financial aid.

The Carolina Covenant responds to such concerns. The University's increased commitment to this program is made possible because of its policies emphasizing need-based financial aid and strong support from the North Carolina General Assembly and state leaders in providing financial aid funding as the cost of education rises. Private donors have committed nearly \$2.7 million in private gifts.

The Carolina Covenant is more than just a financial-aid program. Beginning in 2005, the Office of Scholarships and Student Aid will tap the enthusiasm of Carolina faculty and staff volunteering to serve as mentors to small groups of Covenant Scholars. Mentors in the privately funded program will participate in training sessions and meetings with students. In exchange, mentors will receive a modest stipend and budget for social and cultural activities for their group.

National research and UNC's experiences show that many low-income students face challenges other students do not. Few have had the travel or cultural enrichment experiences enjoyed by their more affluent peers. Many, particularly those from rural communities, find a major university to be a large place. Some are expected to send money

home to help with the family's support.

Carolina aims to ensure that Covenant students have access to the support network and resources they need to successfully complete their Carolina education. The University has excellent academic advising and student academic counseling programs, as well as units that offer help with various academic skills. Covenant Scholars, like all other Carolina students, are encouraged to take advantage of these services. The mentoring program will provide Covenant Scholars with easy access to a person familiar with the academic life and traditions of Carolina.

The Carolina Covenant is the second major national initiative the University has launched in recent years to benefit students. Starting with freshmen applying for admission in fall 2003, Carolina became the nation's first major American public university to eliminate its binding early decision admissions plan.

SUPPORTING FACULTY THROUGH CAROLINA FIRST

The Carolina First Campaign is a comprehensive, multi-year private fund-raising campaign – the largest in the University's history – to support the vision of Carolina becoming the nation's leading public university. The ultimate beneficiaries of reaching that goal will be the people of North Carolina, whom Carolina is dedicated to serve.



CAROLINA FIRST

The University exceeded the \$1 billion mark for the campaign during fiscal 2002–2003. In all, the campaign has raised more than \$1.32 billion toward its \$1.8 billion goal. During the quiet phase of the campaign, which began July 1, 1999, the University raised \$866 million. The public kick-off came October 11, 2002.



As Chancellor's Eminent Professor, Daniel Reed holds one of Carolina's endowed professorships. Reed, a key architect in national high-performance computing initiatives, joined UNC in 2004 and also has been appointed vice chancellor for information technology. He is founding director of the new interdisciplinary Renaissance Computing Institute.

The University's number one priority is strengthening faculty recruitment, retention and development. Carolina made progress toward that goal this past year, thanks to strong support from the General Assembly, modest increases in campus-based tuition, and generous gifts through the Carolina First Campaign.

Carolina First has secured about \$211 million for faculty support – more than half of its \$400 million goal in this part of the campaign. These funds support key faculty retention and recruitment initiatives – research stipends, summer programs, graduate support, and course development, as well as endowed professorships. Donors have created 127 endowed professorships toward a goal of 200. And the Legislature increased the state matching funds for distinguished endowed professorships.

Other campaign priorities include student support, with a goal of raising \$300 million and creating 1,000 new undergraduate scholarships and graduate fellowships. The campaign has reached nearly two-thirds of its total goal in this category.

The University made excellent progress toward the campaign's other priorities, which include providing the means to pursue strategic initiatives to enrich the academic experi-

ence; conduct research that improves the health and the economic, social, and cultural well being of citizens; redouble the commitment to public service and engagement; and implement a campus master plan to create 21st Century teaching and learning environments.

Total giving in fiscal 2004 was \$190 million in gifts and private grants – the largest single amount received in a single year in the University's history. The campaign counts gifts, pledges, and deferred gifts, bringing the campaign total to \$237 million for fiscal 2004. The \$190 million figure counts only gifts received outright.

Major gifts and pledges announced in fiscal 2003–2004 included:

- ❑ For faculty support, \$3 million from an anonymous donor to create the Richard Cole Eminent Professorship in the School of Journalism and Mass Communication; \$1.2 million from Miriam McFadden of Nashville, Tenn., to the School of Social Work to recruit and retain faculty; and \$3 million from the William R. Kenan Jr. Charitable Trust and Julian and Josie Robertson of New York to create the Nannerl O. Keohane Professorship in honor of Duke's retiring president.
- ❑ Other major gifts included \$3 million from Carolina First steering committee member Lowry Caudill and his wife Suzi to name the largest of the planned green spaces for the Carolina Physical Science Complex after UNC chemistry professor Royce Murray; \$1 million from the estate of Gladys Hall Coates to establish the Albert and Gladys Coates Endowment Fund benefiting the North Carolina Collection; and \$5 million from steering committee members Vaughn and Nancy Bryson of Vero Beach, Fla., to establish a clinical genetics research center at UNC, as well as another \$2 million from the couple in support of Carolina's baseball stadium renovation project.
- ❑ Corporate and foundation gifts include \$2 million from the Wachovia Foundation supporting the Kenan-Flagler Business School, the School of Law and the School of Medicine; \$3.5 million from the Ewing Marion Kauffman Foundation of Kansas City, Mo., to create the Carolina Entrepreneurial Initiative; and \$1 million from Harris Teeter and the Dickson Foundation to create a scholarship fund for study abroad by in-state students.

Carolina First is the private complement to the generous public support that North Carolina's voters and legislators have shown for the University. In 2000 North Carolina voters approved \$510 million in bond funding for repair, renovations, utilities, infrastructure, and new buildings at Carolina. Carolina First is helping leverage that bond money by making good on Chancellor Moeser's pledge to state citizens to triple it through private gifts. In all, the University plans to invest another \$800 million in non-state funds for additional buildings essential to continued excellence.

Since its beginning, Carolina has benefited from a public-private partnership. With continued support from both the state and from private sources, the University will return to its partners, the people, great teaching, path-breaking research, and inspired public service.

BRINGING THE CAMPUS MASTER PLAN TO LIFE

The campus master plan is guiding the next several decades of an aggressive renovation and building program at Carolina. The plan shows where and how to place future buildings. It identifies transportation and utility corridors and suggests ways to protect open space and meet important environmental standards including no net increase in storm water runoff. The plan also recognizes the importance of enhancing the intellectual climate and the valuable University culture of collegiality and collaboration.

Photo by Dan Sears



The Rams Head Center is among the most significant construction projects now under way at Carolina. When completed, the center will advance major components of the campus master plan. It will provide recreation, dining, and parking facilities on South Campus.

Fiscal 2003–2004 marked the third year of master plan implementation. The Board of Trustees approved the plan in 2001 after three years of work involving the University, consultants and Town of Chapel Hill representatives. Later joint town–gown discussions led to a new zoning ordinance and category as well as the rezoning of the main campus. A town–approved development plan in 2001 included details on proposed development and strategies to mitigate community impacts in areas

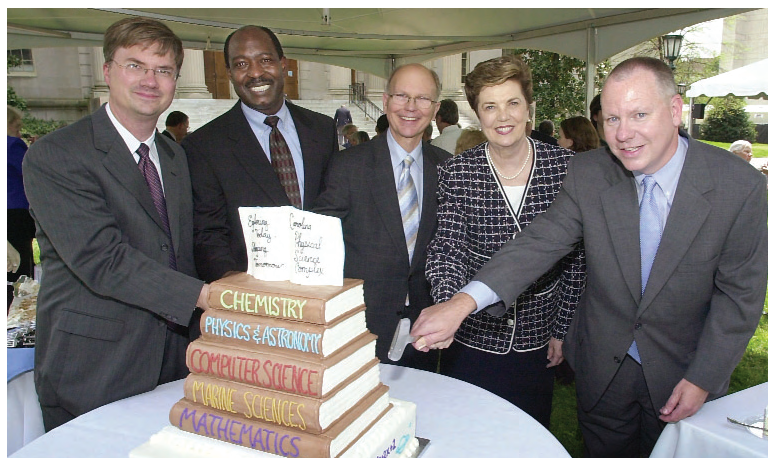
such as traffic, storm water, and noise. The University reached agreements with the town about two separate modifications to the development plan in 2003–2004.

The University advanced its bond referendum project schedule to achieve completion six months ahead of the Office of the President's target. More than 70 major capital projects are underway. Current construction, exceeding \$1.3 billion, represents the equivalent of combining the entire existing campuses of UNC–Charlotte and UNC–Wilmington; the renovation program is the equivalent of refurbishing the entire East Carolina campus. Carolina's expenditure rate for contractors – currently about \$1 million daily – and participation in the Historically Underutilized Business program leads the UNC System.

Related accomplishments include:

- ☐ Emphasis on historical preservation and landscape heritage.
- ☐ Innovative transportation strategies, including more park-and-ride lots, fare-free transit, Zip Cars, and a nationally recognized commuter alternative program. Also helped launch Smart Commute initiative, a Fannie Mae partnership to aid prospective homebuyers including UNC employees with homes near public transportation.
- ☐ Newly completed buildings or renovation projects, including Knapp Building addition and renovation (School of Government); Old Dental Building and Peabody Hall renovations (Schools of Dentistry and Education); Frank Porter Graham Student Union addition and renovation; Sonja Haynes Stone Center for Black Culture and History; Alexander–Connor–Winston student residence hall renovations; the Institute of Marine Sciences in Morehead City; and the Administrative Office Building.

Photo by Dan Sears



Professor Holden Thorp, Trustee Chair Richard "Stick" Williams, Chancellor James Moeser, UNC President Molly Broad and Donor W. Lowry Caudill pose with a cake helping celebrate the formal groundbreaking of the Carolina Physical Science Complex. The \$205 million complex will enhance Carolina's longtime interdisciplinary strengths by bringing together faculty and students in high-technology laboratories, classrooms, lecture halls, and libraries.



Photo by Dan Sears

The privately funded Sonja Haynes Stone Center for Black Culture and History was among several major new construction projects completed in 2003-04. The center's new home is one of the few such facilities nationwide to house educational and cultural programs, research, community service, and learning under one roof.



Photo by Dan Sears

Bill Roper, chief executive officer of the UNC Health Care System and dean of the School of Medicine, gestures toward a model of the new North Carolina Cancer Hospital, authorized in 2004 by the N.C. General Assembly. When completed, the \$180 million hospital will become the largest freestanding university cancer hospital in the Southeast.

- ❑ New projects, including the first phases of the Carolina Physical Science Complex and the Rams Head Center, as well as the demolition and renovation of Burnett-Womack (School of Medicine). Renovation projects under way include the Medical Sciences Research Building (School of Medicine), as well as Saunders and Phillips Halls (College of Arts and Sciences). Also noteworthy were infrastructure projects begun including steam and chiller plants on South Campus and a new utilities tunnel.
- ❑ Full participation in community deliberations about creating new partnerships to help redevelop downtown Chapel Hill.

BUILDING UPON THE ACADEMIC PLAN

The University's strategic focus and priorities build upon the academic plan completed and endorsed by the Board of Trustees in 2003. The plan, developed through a campus task force, guides the University's decisions about investments in the academic enterprise in the short term. It is tied with parallel efforts to develop a rolling five-year financial plan that will make possible execution of the academic plan as well as other non-academic strategic goals.

The academic plan's six key priorities are:

- ❑ Provide the strongest possible academic experiences for undergraduate, graduate, and professional students.
- ❑ Further integrate interdisciplinary research, education and public service.
- ❑ Improve faculty recruitment, retention, and development.
- ❑ Increase diversity among faculty, students, and staff.
- ❑ Enhance public engagement.
- ❑ Extend Carolina's global presence, research, and teaching.

The plan is dynamic and will be reviewed and revised as new opportunities and challenges emerge.

GROWING RESEARCH FUNDING AND EXCELLENCE

Carolina faculty conduct research that creates new knowledge and useful technologies as well as pumps hundreds of millions of dollars into the North Carolina economy. These advances, combined with teaching and public service, make the University an educational and economic beacon for the state.

Faculty are leading a partnership with Brunswick County's schools and community college to improve science education and help attract new businesses. They are working with community leaders in Spindale, where the former Stonecutter Mills closed. They are monitoring water quality in the Neuse River. And they are training the state's future leaders and workforce.

Research funding has risen steadily at Carolina for more than two decades, making Chapel Hill one of the top U.S. public universities in research support. Faculty secured \$577 million in research funds in 2004, ranking among the leaders in grants from the National Institutes of Health and the National Science Foundation. That total represented a 7.5 percent increase over the previous year.

Positive growth in the University's overall research funding corresponds with a decision made in mid-1998 by the North Carolina General Assembly to permit the University to retain all overhead receipts generated by research.

Outside research funding supports science vital to the public interest. For example, Chapel Hill was the only university to receive three of 21 grants awarded in the past year as part of the National Institutes of Health's "Roadmap for Medical Research" initiatives, which are designed to transform the nation's medical research capacity and speed research discoveries from the bench to the bedside. More than \$5 million over three years will support planning for new centers focusing on obesity, inflammation, and genetic abnormalities.

The School of Education received a \$10 million grant from the

U.S. Department of Education to improve teaching, learning, and student achievement in America's rural schools. Through the new National Research Center on Rural Education Support, researchers will train teachers and provide academic and social programs for students. The needs of North Carolina's rural schools will remain an important focus, and the state's schools are expected to benefit significantly from this new center.

Ongoing research initiatives include efforts to tackle challenges such as the emerging field of genome sciences, which is unraveling the mysteries of DNA and the human genome. Carolina has committed at least \$245 million over the next decade to be at the forefront of the genomics revolution. Led by renowned genetics scientist Terry Magnuson, the initiative represents a public-private investment that includes a \$25 million anonymous gift creating the Michael Hooker Center for Proteomics to study a specialized area of genetics. One result of the initiative is the School of Public Health's selection by the U.S. Centers for Disease Control and Prevention to house one of three U.S. centers for excellence for genomics and public health.

Fiscal 2004 also saw the dedication of the Southern Astrophysical Research (SOAR) Telescope in Chile's Andes Mountains. The telescope will produce the sharpest images of any observatory in its class in the world at a location that is ideal for viewing the Milky Way, our home galaxy and other planets in our solar system. Thanks to the computer programming skills of a Carolina undergraduate, the Internet will help bring those images back to faculty and students in Chapel Hill, as well as public school classrooms across North Carolina. Faculty and students including undergraduates are now traveling to Chile to learn first-hand from SOAR, which was made possible by federal funding and private donors.

Photo by Dan Sears



Terry Magnuson, one of the world's leading experts in mammalian genetics, founded the Department of Genetics at Carolina. Magnuson and his team anchor a campuswide genome sciences initiative that is helping unravel the mysteries of DNA and the human genome.

NURTURING TECHNOLOGY-TRANSFER, ECONOMIC DEVELOPMENT

Among the University's goals in the research arena are to transfer new technologies into the consumer marketplace, resulting in increased economic value for North Carolinians as well as income for inventors and the university.

Key accomplishments included the following:

- ❑ Faculty filed 124 inventions with the campus Office of Technology Development.
- ❑ 105 patent applications were filed, and 28 new U.S. patents were issued to the University. That brought the total of U.S. and foreign patents held by Carolina to 889.
- ❑ 34 inventions were licensed.
- ❑ Licensing income to the University totaled \$3.94 million, an increase of almost 300 percent.

Such work also has helped make possible the discoveries and innovations to create 25 UNC spin-off companies now employing state residents. Examples of commercialization include therapeutic agents for Parkinson's Disease, technologies for drug delivery to treat cancer, contrast media for medical imaging, industrial applications for carbon nanotubes, and gene therapy treatment for diseases like muscular dystrophy.

The University's most successful spin-off is Inspire Pharmaceuticals, one of North Carolina's leading biotechnology companies. In the early 1990s, Richard Boucher and colleagues at UNC's renowned Cystic Fibrosis Research Center discovered the potential of the molecule Uridine triphosphate (UTP) to act like a natural hormone in cystic fibrosis cells, which cannot produce the moisture required to line a normal person's airways with mucus.

They learned that UTP could increase moisture in airway surfaces and improve how the cilia keep surfaces in the lungs and sinuses clear from dust and viruses. That made UTP a candidate for a new drug therapy for patients with diseases including cystic fibrosis, the most common fatal genetic lung disease among whites in the United States.

Boucher could not advance the work by himself. He turned to UNC's Office of Technology Development to bring the science from the laboratory to the commercial marketplace to benefit the public and

North Carolina's economy.

Technology licensed from the University led to Inspire's incorporation in 1993 and its opening two years later. Inspire is developing breakthrough drugs to treat dry eye, retinal disease and respiratory disorders including cystic fibrosis. Inspire successfully completed an Initial Public Offering in 2000 and a follow-on offering in 2003. NASDAQ invited Chief Executive Officer Christy Shaffer to open a trading session in New York City – a first for a North Carolina biotechnology company.

Last year, Inspire was recognized by *The Scientist* magazine as first among U.S. businesses with less than 500 employees as the best place to work for scientists in industry. Inspire, which has 150 employees, has attracted venture capital investments from the Northeast and West Coast.

Other new University efforts aim to strengthen the North Carolina economy. Daniel Reed, a nationally recognized high-performance computing expert, is founding director of the interdisciplinary Renaissance Computing Institute, which is based at Carolina in partnership with Duke and N.C. State universities. The institute explores the interactions of computing technology with the arts, humanities, sciences, and engineering. It is partnering with business leaders to enhance the competitiveness of North Carolina industries. Jesse White, Jr., who has headed the Appalachian Regional Commission and the Southern Growth Policies Board, is leading a new Office of Economic and Business Development, which matches faculty and campus resources with statewide needs.

ADVANCING PLANS FOR CAROLINA NORTH

The University's future contributions to the North Carolina economy one day will include Carolina North, a mixed-use development located on a 900-plus acre tract of UNC-owned property one mile north of the main campus. That property, previously called the Horace Williams tract, was part of a bequest by an esteemed philosopher years ago.

The 50-year vision for Carolina North is to become a living and learning community advancing UNC's mission of teaching,

Photo by Dan Sears



Christy Shaffer, chief executive officer, and UNC Professor Richard Boucher, founding scientist, have shaped Inspire Pharmaceuticals in Durham. Inspire is UNC-Chapel Hill's most successful spin-off company. The idea that led to the company was born in Boucher's laboratory.



Students from Steven Ross' class at High Point Central High School leave Destiny, Carolina's traveling science laboratory. Destiny, which stands for Delivering Edge-cutting Science and Technology in North Carolina, launched in 2000. A second bus, Discovery, began operating in 2004 because demand for Destiny is so strong across the state. Both buses are full of state-of-the-art science and technology equipment for wet-lab experiments, Internet exploration, and classroom materials. The buses bring the latest science and technology to students who otherwise would not see a high-technology laboratory or what a science career can offer.

research, and public service. Goals include creating a vibrant setting for business innovation and economic development, for service, and for engaging citizens of all ages in the life of the University.

Last year's efforts to advance the project included engaging the University and local communities, as well as appropriate state officials such as the Department of Transportation, in dialogue about new and revised 50-year concept proposals.

POSITIONING ACADEMIC REPUTATION WITH LEADING RANKINGS AND RATINGS

Several national publications and reports published rankings in 2003 and 2004 that list Carolina prominently in categories ranging from academic quality to affordability to diversity to entrepreneurship to international presence.

Highlights included the following:

- ❑ 5th best public university in U.S. News & World Report's annual "Best Colleges" guidebook. Affirmation as a national leader in student accessibility; 2nd among public campuses and 19th overall in "Great Schools, Great Prices," based on academic quality, net cost of attendance and average student debt. Also 6th among publics for "least debt." Kenan-Flagler Business School: tied for 6th among undergraduate programs.
- ❑ 4th among public universities in "The Top American Research Universities," produced by Lombardi Program on Measuring University Performance at the University of Florida. Based on categories such as research, endowment assets, private giving, faculty, and advanced training.
- ❑ 1st among the 100 best public colleges combining great academics and affordable tuitions as ranked by Kiplinger's Personal Finance. Carolina has been first four consecutive times.
- ❑ Number one "best value" among 77 schools chosen by The Princeton Review for outstanding academics, low-to-moderate

tuition and fees, and generous financial aid packages.

- ❑ Among the 20 very "best buy" public universities in the U.S. and Canada as judged by the 2005 Fiske Guide to Colleges based on the quality of the academic programs in relation to the cost of attendance.
- ❑ "Hottest" for health careers, according to the Kaplan/Newsweek 2005 "How to Get into College" guide, based on admissions trends and interviews with educators, admissions officers, students and other longtime observers of the admissions process. An article in the guide says UNC's diverse offerings in the health disciplines – all in the same place – are helping attract prospective students.
- ❑ 1st for the top entrepreneurial campus and 5th "most connected," according to The Princeton Review and Forbes.com. UNC has an undergraduate business degree offering with a concentration in entrepreneurship in the Kenan-Flagler Business School, a new minor in entrepreneurship in the



Morehead Scholar Elizabeth Kistin of Corrales, N.M., was chosen to receive a 2004 Rhodes Scholarship to Oxford University. She became the 37th winner from Carolina since 1902. UNC ranks second among U.S. public universities in numbers of Rhodes Scholars produced. 2004 was one of the University's most successful years ever for undergraduates awarded prestigious national and international scholarships.



Photo by Dan Sears

A trio of new Carolina graduates smile during the May 2004 Commencement ceremony in Kenan Stadium.

College of Arts and Sciences, and a new campuswide Carolina Entrepreneurial Initiative. In 2000, UNC became the nation's largest university requiring undergraduates to own laptop computers. With more than 850 wireless access points, UNC provides wireless connectivity in classrooms, libraries, residence halls and quadrangles.

- ❑ 1st among public research universities recording the highest rate of undergraduates studying abroad in 2001-2002; 17th among all major research universities, according to an annual report published by the Institute of International Education.
- ❑ 13th among top U.S. colleges and universities for the number of alumni volunteering to serve in the Peace Corps in 2003.
- ❑ 14th – the highest ranking for any major public research university – in the 2004 “Black Enterprise-DayStar Top 50 Colleges and Universities for African Americans” list. This ranking was based on responses to questions about which schools were both a good academic and social fit for African-Americans.
- ❑ Degree programs or specialty areas from the schools of business, education, government, law, medicine, public health, and social work as well as the College of Arts and Sciences appeared prominently in the Spring 2004 edition of U.S. News & World Report’s “American’s Best Graduate Schools” issue. Highlights included medicine, overall primary care, tied for 5th, overall research, tied for 20th; social work, master’s program, tied for 7th; master’s of public administration program, tied for 10th, Kenan-Flagler Business School’s MBA program, tied for 21st, School of Law, tied for 27th; and School of Education, 30th.
- ❑ Kenan-Flagler appeared in several other best MBA program lists. They included Business Week, 16th, Forbes, 8th for return on investment to graduates; The Wall Street Journal, 11th based on a survey of corporate recruiters; The Financial Times, 7th; and Hispanic Business, 5th, among top business schools for Hispanics.

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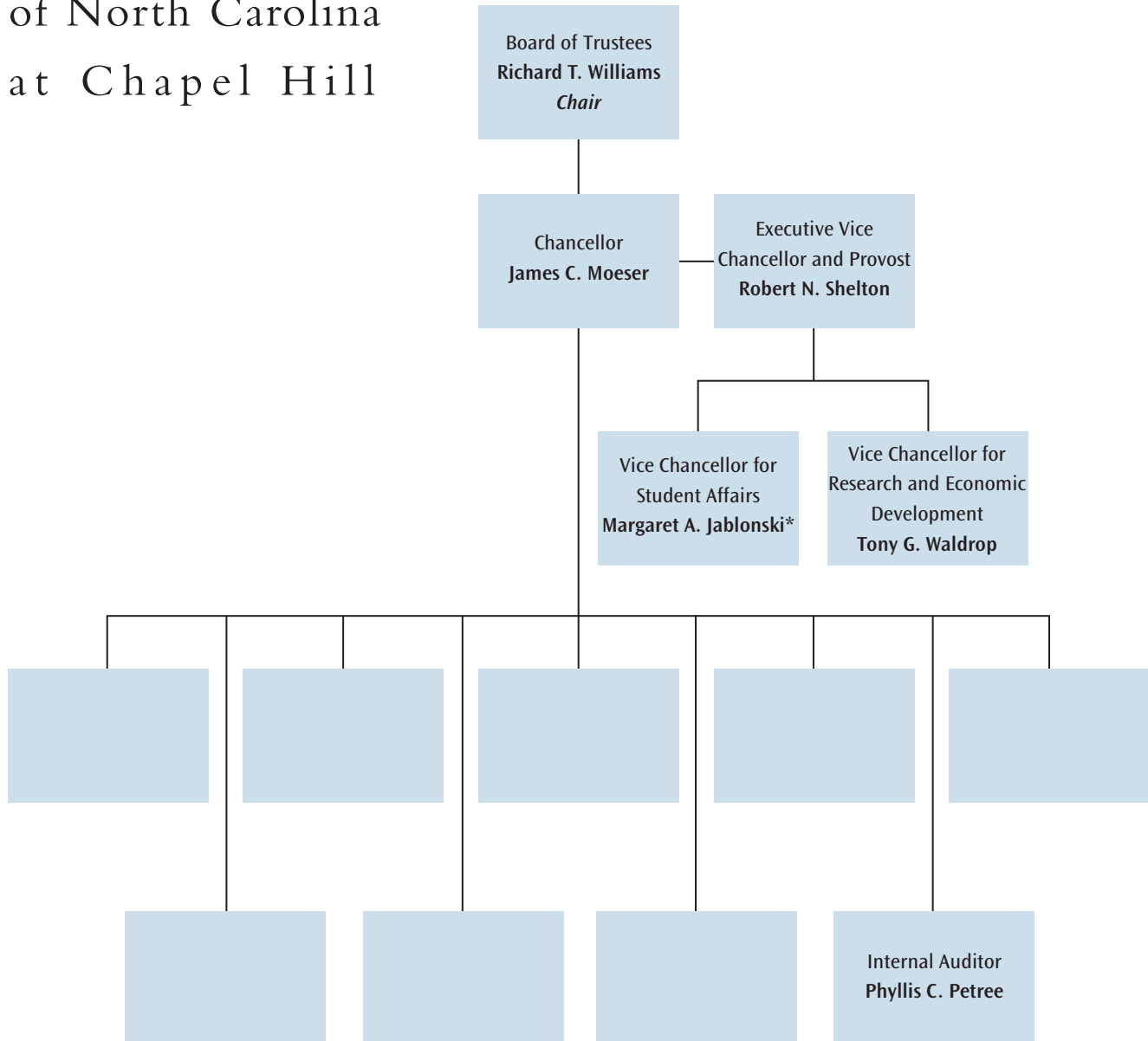
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Economic Development

Organization Chart

The University
of North Carolina
at Chapel Hill



*Appointment effective August 19, 2004

Financial Section

Chapel Hill, North Carolina
Fiscal Year Ended June 30, 2004



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL



RALPH CAMPBELL, JR.
STATE AUDITOR

STATE OF NORTH CAROLINA
Office of the State Auditor

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20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the sixteen-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2004, which collectively comprise The University of North Carolina at Chapel Hill's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., which represent 100% of the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those entities, is based on the reports of the other auditors.

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

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units,

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 17 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, during the year ended June 30, 2004.

In accordance with *Government Auditing Standards*, we will also issue our report dated November 12, 2004 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit. The report on internal control and compliance will be issued under separate cover in the Financial Statement Audit Report of The University of North Carolina at Chapel Hill published by this Office.

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

The introductory and statistical sections, identified in the table of contents, were not audited by us, and accordingly, we do not express an opinion thereon.



Ralph Campbell, Jr.
State Auditor

November 12, 2004

Management's Discussion and Analysis

(unaudited)

INTRODUCTION

Management's discussion and analysis provides an introduction and overview of the financial position and activities of The University of North Carolina at Chapel Hill (the University) for the fiscal year ended June 30, 2004, with comparative information for the fiscal year ended June 30, 2003. Certain prior year amounts have been reclassified to conform to current year presentations. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying note disclosures.

The University is a constituent institution of the 16-campus University of North Carolina System (UNC System), a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*. Established in 1789, the University was the first state university to open its doors and the only public university in America to award degrees to students in the 18th Century. Through its teaching, research, and public service, the University is an educational and economic beacon for the people of North Carolina and beyond. Now in its third century, Carolina offers bachelor's, master's, doctoral, and professional degrees in academic areas critical to North Carolina's future: business, dentistry, education, law, medicine, nursing, pharmacy, public health, and social work, among others. The health sciences are well integrated with the liberal arts, basic sciences, and high-tech programs. Patient outreach programs affiliated with Carolina and the UNC Health Care System serve citizens in all 100 North Carolina counties.

For the fiscal year ended June 30, 2004, the University implemented Governmental Accounting Standards Board (GASB) Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and signifi-

cance of their relationship to the University. Note 1A of the financial statements describes the Financial Reporting Entity which is comprised of the University and its component units.

The Financial Reporting Entity for the financial statements is comprised of the University and ten component units. Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc., UNC Investment Fund, LLC, UNC Management Company, Inc., The University of North Carolina at Chapel Hill Foundation, Inc., The Kenan-Flagler Business School Foundation, The School of Social Work Foundation, Inc., and U.N.C. Law Foundation, Inc. are reported as if they were part of the University.

Separate financial statements for three other component units are reported based on GASB Statement No. 39. The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. are legally separate, non-profit, tax-exempt organizations that are reported as discretely presented component units based on the nature and significance of their relationship to the University.

Management's discussion and analysis includes a separate section regarding the three component units that are discretely reported in the financial statements. The rest of management's discussion and analysis pertains to the University and the seven component units reported as part of the University.

FINANCIAL HIGHLIGHTS

The University's financial position at June 30, 2004, remained solid with total assets of \$3.6 billion. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were \$2.2 billion at June 30, 2004. The University's net assets increased by \$216 million in fiscal year 2003-2004, when operating, non-operating, and other changes are included.

Changes in net assets and total assets are summarized below:

	2004	2003	% Change
Net assets – July 1	\$2,025,185,600	\$1,964,418,046	3.1
Increase in net assets	<u>216,013,557</u>	<u>60,767,554</u>	255.5
Net assets – June 30	2,241,199,157	2,025,185,600	10.7
Total liabilities	<u>1,357,712,327</u>	<u>1,112,017,605</u>	22.1
Total assets	<u>\$3,598,911,484</u>	<u>\$3,137,203,205</u>	14.7

The significant increase in net assets included a modest increase in state appropriations. State appropriations continue to provide essential resources to support the University's mission. Continued capital funding through the North Carolina Higher Education Bond Referendum of 2000, controlled enrollment growth, a robust research program, the continuing success of the Carolina First fund-raising campaign, and the successful investments made through the management program were among the other factors resulting in the noteworthy financial results for the fiscal year.

USING THE FINANCIAL STATEMENTS

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

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

These financial statements have been prepared in accordance with Governmental Accounting Standards Board (GASB) statements. The GASB sets standards for external financial reporting for public colleges and universities and requires that financial statements be presented on a consolidated basis to focus on the entire University.

Other important characteristics of the financial statements include the following:

- ☐ Net assets represent the excess of total assets over total liabilities. There are three classes of net assets – unrestricted, restricted (non-expendable and expendable), and invested in capital assets net of related debt.
- ☐ Assets and liabilities are categorized as either current or non-current. Current liabilities are due within

one year, and current assets are those assets available to pay current liabilities.

- ☐ Revenues and expenses are categorized as either operating or non-operating, and a net income or loss from operations is displayed. State appropriations, non-capital gifts and grants, and investment income are non-operating revenues, which results in a net loss from operations.
- ☐ Tuition and fees revenues are reported net of scholarships and fellowships that are applied to student accounts. The "scholarship discounts" reduce the tuition and fees revenues and the scholarship and fellowship expenses by equal amounts. Scholarships and fellowships paid directly to students continue to be reported as expenses.
- ☐ Expenses are reported in the financial statements by natural classification such as salaries and benefits, supplies and materials, and other categories. Presentation by program classification such as instruction, research, and public service are disclosed in the notes to the financial statements.
- ☐ Purchases of capital assets are expensed over the asset's useful life by the recognition of depreciation expense on the capital assets.
- ☐ A Statement of Cash Flows using the direct method is reported.

CONDENSED STATEMENT OF NET ASSETS

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and non-current components. Net assets represent the difference between total assets and total liabilities, and are one indicator of the University's current financial condition.

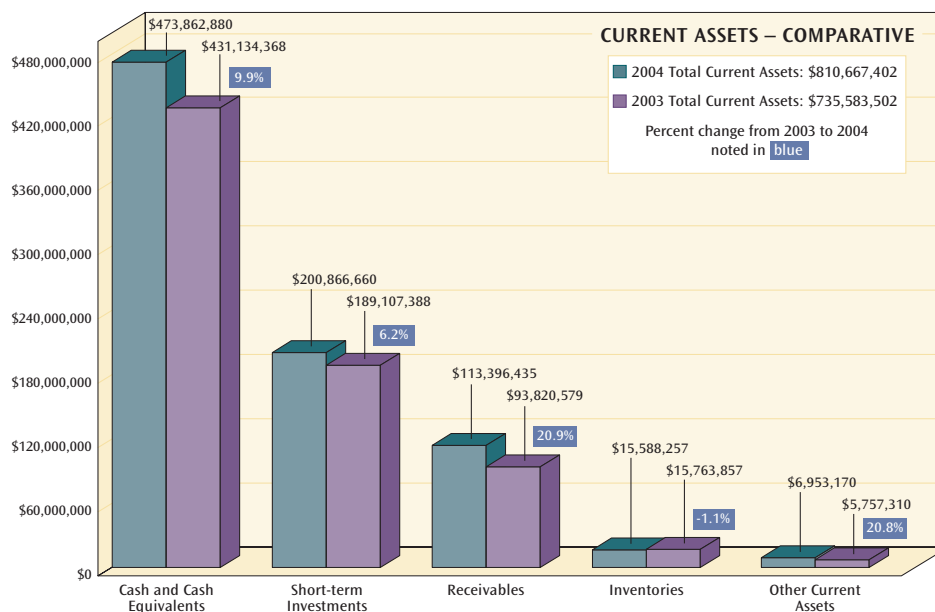
The following table summarizes the University's assets, liabilities, and net assets at June 30, 2004 and 2003.

	2004	2003	% Change
Assets:			
Current assets	\$810,667,402	\$735,583,502	10.2
Non-current assets:			
Endowment investments	848,469,859	754,623,099	12.4
Other long-term investments	505,076,807	377,744,985	33.7
Capital assets, net	1,276,669,341	1,134,221,485	12.6
Other non-current assets	<u>158,028,075</u>	<u>135,030,134</u>	17.0
Total Assets	<u>3,598,911,484</u>	<u>3,137,203,205</u>	14.7
Liabilities:			
Current liabilities	401,819,861	367,955,960	9.2
Non-current liabilities:			
Funds held in trust for pool participants	440,811,149	345,883,384	27.4
Long-term liabilities	482,557,455	366,628,262	31.6
Other non-current liabilities	<u>32,523,862</u>	<u>31,549,999</u>	3.1
Total Liabilities	<u>1,357,712,327</u>	<u>1,112,017,605</u>	22.1
Net Assets:			
Invested in capital assets, net of related debt	855,739,608	771,280,637	11.0
Restricted:			
Non-expendable	328,735,341	323,961,205	1.5
Expendable	648,019,434	559,127,937	15.9
Unrestricted	<u>408,704,774</u>	<u>370,815,821</u>	10.2
Total Net Assets	<u>\$2,241,199,157</u>	<u>\$2,025,185,600</u>	10.7

CURRENT ASSETS AND LIABILITIES

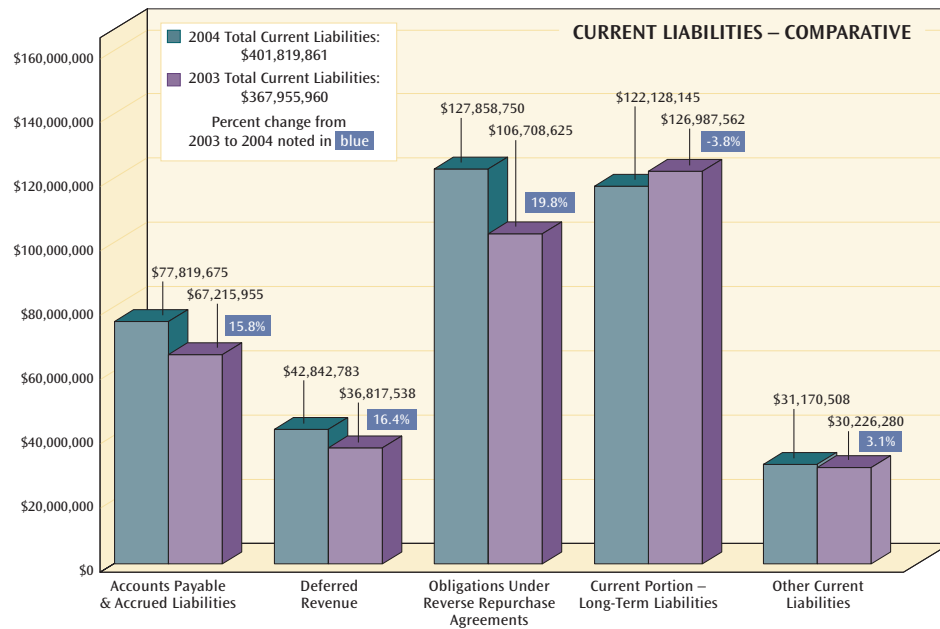
The Statement of Net Assets shows the University had total assets of \$3.6 billion at June 30, 2004, an increase of 14.7 percent over the prior year. Working capital, which is current assets less current liabilities, was \$408.8 million at June 30, 2004, an increase of 11.2 percent over the previous year. Factors causing the working capital increase include a decline in the liability for temporary financing for capital construction through the commercial paper program and an increase in patient accounts receivables resulting from adjustments for uncollectible billings.

Current assets are represented graphically below:



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

Current liabilities are represented graphically below:



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

ENDOWMENT AND OTHER LONG-TERM INVESTMENTS

Endowment investments were \$848.5 million at June 30, 2004 and include permanent endowments, funds internally designated as endowments, and similar funds such as gift annuities and charitable trusts. Net assets of endowment and similar funds were \$801.3 million at June 30, 2004.

The endowment assets are invested with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (the "Investment Fund"), which is reported as a governmental external investment pool in the financial statements. The Investment Fund is a 501(c)(3) non-profit corporation established to support the University by operating an investment pool for charitable, non-profit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University.

During the prior fiscal year (effective January 1, 2003), the assets of the Investment Fund were contributed to the UNC Investment Fund, LLC ("System Fund"), a North Carolina limited liability company organized and operated to invest assets contributed to it from time to time by the Investment Fund and by The University of North Carolina and its constituent institutions and their related endowments and tax-exempt foundations. All or substantially all of the assets of the Investment Fund are expected to be invested in the System Fund. Separate, audited financial statements for the Investment Fund and System Fund are available. The investment returns noted below refer to the pooled investment fund in existence for that time period.

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

- ❑ Restricted non-expendable net assets include permanent endowments for which the donor has stipulated that the principal shall remain inviolate and be invested in perpetuity to generate earnings that can be expended consistent with the purposes specified in the gift instrument.
- ❑ Restricted expendable net assets include internally designated endowments established by the University with restricted gifts and the undistributed earnings of permanent endowments.
- ❑ Unrestricted net assets include internally designated endowments established by the University with unrestricted funds.

The investment objective is to earn an average real total return of at least 5.5 percent per year, net of all fees, over rolling five and ten year periods. The earnings distribution policy is to provide a stable source of spending support that is sustainable over the long term while preserving the purchasing power of the endowment. The earnings distribution rate was established at 5 percent of the previous year's market value, with annual increases based on inflationary factors. Each year's distribution is subject to a 4 percent floor and a 7 percent cap based on estimated fiscal year-end market value.

Other long-term investments of \$505.1 million include funds of \$422.6 million of affiliated entities that

are not part of the University's financial reporting entity but do invest through the System Fund, and bond reserves and related funds of \$82.5 million.

Most of the University's endowment assets are managed within the System Fund, a pooled investment fund vehicle. The System Fund is designed to provide long-term, stable rates of return on the invested assets through the use of a highly diversified portfolio strategy. The nominal return on the endowment assets invested in the System Fund for fiscal year 2003-2004 was 16 percent, with a real return of 12.8 percent after inflation. The System Fund return of 16 percent was above the Strategic Investment Policy Portfolio ("SIPP") return of 15.4 percent and above the 70 percent S&P 500/30 percent Lehman Brothers Bond Index ("70/30") return of 13.3 percent for the year. The strong performance follows on the heels of superior performance over prior periods. For the three-year period ended June 30, 2004; the System Fund returned 6.3 percent versus the SIPP return of 3.3 percent and the 70/30 return of 1.7 percent. For the five-year period ended June 30, 2004; the System Fund returned 8.1 percent versus the SIPP return of 4 percent and the 70/30 return of 0.8 percent.

The noted returns were achieved while assuming less overall risk than the benchmark indexes. The volatility of performance metric, as measured by the standard deviation of returns, is a useful measure (lower volatility is better). For the fiscal year 2003-2004, the System's Fund's monthly volatility was 1.0 percent versus the S&P's volatility of 2.3 percent and the 70/30 index volatility of 1.7 percent. For the three-year period ended June 30, 2003, the System Fund's volatility was 1.3 percent versus the S&P's volatility of 4.8 percent and the 70/30 volatility of 3.3 percent. For the five-year period ended June 30, 2003, the System Fund's volatility was 2.3 percent versus the S&P's volatility of 4.8 percent and the 70/30 volatility of 3.4 percent. The System Fund is very well positioned in the current environment, and remains invested according to the approved investment policy that provides excellent diversification in both bull and bear markets.

CAPITAL ASSETS AND DEBT MANAGEMENT

Capital assets, net of accumulated depreciation, at June 30, 2004 and June 30, 2003 were as follows:

	2004	2003	% Change
Capital Assets:			
Construction in progress	\$219,339,291	\$226,958,080	-3.4
Land and other non-depreciable assets	85,103,216	81,080,269	5.0
Buildings	703,546,321	546,453,143	28.7
General Infrastructure	187,589,810	198,911,507	-5.7
Machinery and equipment	<u>81,090,703</u>	<u>80,818,486</u>	0.3
Total	<u>\$1,276,669,341</u>	<u>\$1,134,221,485</u>	12.6

A summary of changes in capital assets is disclosed in Note 5.

The University's method of capital planning is a long-term process that is continuously reevaluated. The University Board of Trustees approved the campus master plan in March 2001 to guide the University's physical development in the 21st Century. The master plan meshes the critical pieces needed for smart growth in the 21st Century – transportation, parking, housing, utilities and environmental sustainability – with the program needs of a growing campus. The master plan combines the practical requirements of a research university with the beauty that inspired its founders. The University will grow dramatically in the coming years. With the master plan, that growth will improve the way campus works and extend the University's historic legacy of beautiful buildings and grounds to every corner of campus.

The University is engaged in a \$1.3 billion capital construction program that began in 2000 and will continue through the next four years. This program includes major capital renewal of existing buildings and infrastructure to address both deferred maintenance and programmatic needs. Additionally, expansion of campus facilities will allow the University to accommodate the enrollment growth projected over the next decade.

Major projects completed in fiscal year 2003–2004 include:

New Construction:

Frank Porter Graham	
Student Union Addition	\$14,153,300
Administrative Office Building	10,500,000
Sonja Haynes Stone	
Black Cultural Center	9,000,000

Major Renovations of Academic Buildings:

Knapp Building –	
School of Government	\$21,151,200
Peabody Hall	8,509,800
Original School of Dentistry Building	8,400,000

Completed projects represent 24 percent of the \$1.3 billion capital construction program, 28 percent of the projects are under construction, and 48 percent are in the design phase.

The Higher Education Bond Referendum, overwhelmingly approved in 2000 by North Carolina's voters, is providing nearly \$510 million for this program. The University is investing in its capital construction program using a variety of other funding sources including University bonds, cost reimbursements from research grants, internal reserves,

and private gifts. Previous changes in state legislation allowed the University to pledge a broader stream of revenues as security for its debt obligations, and general revenue bonds were initially issued in fiscal year 2000–2001. In December 2003, the University issued \$108 million in fixed-rate bonds to finance certain capital construction projects. The general revenue pledge results in a stronger, more flexible security that captures the strengths of not only the University's auxiliary and student-related revenues, but also its research programs.

The University continues to use its commercial paper program that provides low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was \$8.8 million at June 30, 2004. The commercial paper program and the general revenue bonds allow the University to use a central bank concept for funding capital projects. The University issues fixed and variable rate debt externally, and blends the average borrowing rate to allocate debt costs to individual capital projects and campus divisions. This concept provides a stable and flexible debt-funding source for capital projects.

The interest rate on the commercial paper program for fiscal year 2003–2004 was 0.98 percent. Interest rates on the University's variable rate, long-term bonds were 1.0 percent for fiscal year 2003–2004. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements.

The University's financial strength allowed it to achieve ratings of AA+/Aa1 by the national rating agencies. The University debt burden ratio, a measure of an entity's dependence on borrowed funds, was only 2.7 percent at June 30, 2004 and 2.1 percent for the prior year.

OTHER NON-CURRENT ASSETS

Other non-current assets were \$158 million at June 30, 2004, a 17 percent increase over the prior year. Included in this category are restricted cash and cash equivalents of \$70.8 million, receivables for pledged gifts of \$29.5 million, notes receivable for student loans of \$29.3 million, investment in a joint venture of \$8.3 million, and restricted resources due from the primary government of \$20.1 million.

The increase over the prior year resulted from several factors. Restricted resources due from the primary government increased 27.1 percent and represent receivables for designated capital construction projects funded from proceeds from statewide higher education bonds. Notes receivable for student loans increased 16.1 percent based on additional loan advances under federal loan programs and a decrease in borrowers in repayment status. Pledged gifts

increased 7.7 percent as the fund-raising campaign continues. The investment in a joint venture represents the construction of the Southern Astrophysical Research Telescope (SOAR), situated in Cerro Pachon, Chile in South America, as part of an international consortium including the UNC-Chapel Hill.

NON-CURRENT LIABILITIES

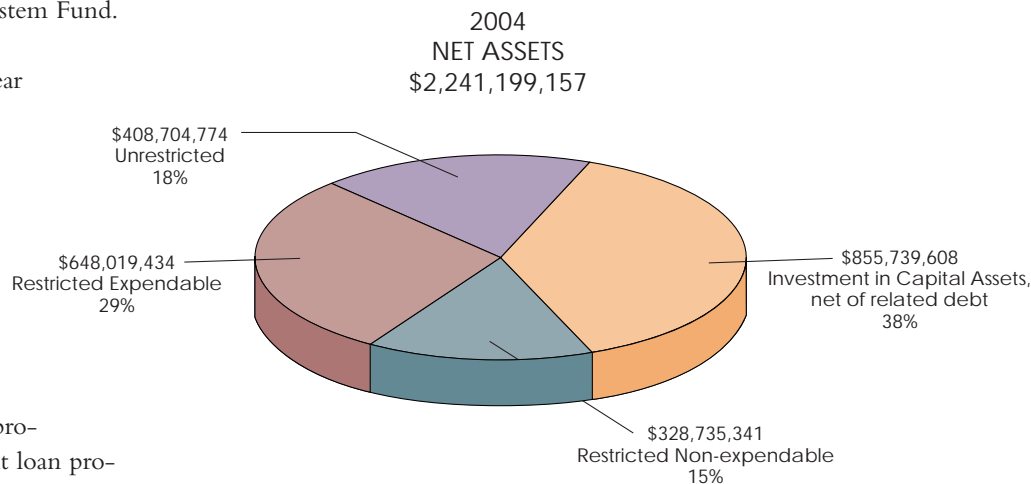
Non-current liabilities were \$955.9 million at June 30, 2004 and include funds of \$440.8 million held for the University's affiliated foundations and other campuses in the UNC System and their affiliates. These entities are not part of the University's financial reporting entity but do invest through the System Fund.

The increase in 27.4 percent over the prior year resulted from improved investment performance, participant contributions, and the addition of additional, qualifying entities. Other non-current liabilities of \$32.5 million are refundable U.S. government grants that provide resources for student loan programs.

Long-term liabilities of \$482.6 million are the non-current portion of bonds payable, notes payable, capital leases payable, compensated absences, and annuities payable. The increase of 31.6 percent over the prior year resulted from University's issuance of \$108 million in fixed-rate general revenue bonds to finance certain capital construction projects. A second factor was the increase of \$16.1 million in non-current compensated absences as State of North Carolina employees were awarded two weeks of bonus leave for the second consecutive fiscal year. The reader may refer to Note 8 for summary of changes in long-term liabilities.

NET ASSETS

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets at June 30, 2004 were \$2.2 billion and are presented graphically below:



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

CONDENSED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses, and Changes in Net Assets presents the University's results of operations. The statement for the fiscal year ended June 30, 2004 and the prior year is summarized as follows:

	2004	2003	% Change
Operating Revenues:			
Student tuition and fees, net	\$153,943,215	\$146,961,417	4.8
Grants and contracts	499,798,678	455,680,436	9.7
Sales and services, net	443,227,663	393,361,966	12.7
Other	<u>5,667,765</u>	<u>7,563,970</u>	-25.1
Total Operating Revenues	1,102,637,321	1,003,567,789	9.9
Operating Expenses:			
Salaries and benefits	917,840,235	876,265,477	4.7
Supplies and materials	151,196,308	146,986,272	2.9
Services	380,125,640	377,855,970	0.6
Scholarships and fellowships	47,427,018	45,618,092	4.0
Utilities	46,207,389	43,914,948	5.2
Depreciation	<u>60,589,122</u>	<u>53,075,830</u>	14.2
	1,603,385,712	1,543,716,589	3.9
Operating Loss	(500,748,391)	(540,148,800)	-7.3
Non-operating Revenues (Expenses):			
State appropriations	380,446,327	368,024,036	3.4
Non-capital grants	53,153,741	40,994,829	29.7
Non-capital gifts, net	68,517,192	60,887,596	12.5
Investment income, net	135,369,198	47,398,174	185.6
Interest and fees on capital asset related debt	(18,339,114)	(15,680,788)	17.0
Other non-operating revenues (expenses)	<u>(8,132,036)</u>	<u>(1,899,072)</u>	328.2
Income (Loss) Before Other Changes	110,266,917	(40,424,025)	372.8
Capital grant	74,392,000	72,486,349	2.6
Capital appropriations	897,387	0	n/a
Capital gifts, net	6,358,879	7,552,718	-15.8
Additions to permanent endowments	<u>24,098,374</u>	<u>21,152,512</u>	13.9
Increase in Net Assets	216,013,557	60,767,554	255.5
Net Assets – July 1	<u>2,025,185,600</u>	<u>1,964,418,046</u>	3.1
Net Assets – June 30	<u>\$2,241,199,157</u>	<u>\$2,025,185,600</u>	10.7

OPERATING REVENUES

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was \$33.3 million for fiscal year 2003-2004 and \$31.5 million for the prior year. Total revenues from student tuition and fees increased 4.8 percent over the prior year. Factors increasing revenues from

tuition and fees were an inflationary rate increase of 5 percent for undergraduate students and for resident graduate students, an inflationary rate increase of 3.4 percent for non-resident graduate students, and an additional rate increase for one of the professional schools. The revenue growth from the rate increases was offset by a shift in residency status among graduate students from non-resident to resident.

Revenues from contracts and grants increased 9.7 percent over the prior year. Discussion of contracts and grants in terms of awards also provides a useful perspective. The University remains among the nation's leading public research universities, with a diversified portfolio of research that attracted more than \$577 million in sponsored program funding during fiscal year 2003–2004, a 7.5 percent increase over the previous year. During the same period, funding from the Department of Health and Human Services increased more than 8 percent to \$324 million. During the federal Fiscal Year 2003 (the latest available numbers), the University placed 20th nationally in overall funding from the National Institutes of Health (NIH). The University continues to rank in the top 20 educational institutions nationally in federal support for science and technology.

Substantial improvements to the physical infrastructure supporting research were made during fiscal year 2003–2004. The Administrative Office Building, which opened in January 2004, greatly improved the University's ability to provide the services that will help sustain the research enterprise. Several key research facilities were renovated, including the entire Health Sciences Library, the 11th floor of Mary Ellen Jones, and the Dental Building. Renovations were begun in Beard Hall, Molecular Biology, Burnett Womack, and the Medical Research Building. The School of Nursing addition, the new School of Public Health Teaching and Research Center, and the Carolina Physical Science Complex are well under way. The new Kerr Hall (School of Pharmacy), the Medical Biomolecular Building, the Neurosciences Research Building, and the Bioinformatics Building are fully occupied, equipped, and on line for research.

A central factor in the University's efforts to support

research is the ability to recover facilities and administrative (F&A) costs associated with sponsored research. Two innovations will help ensure recovery of F&A costs. First, new space-survey software has been developed to more accurately identify the space used for research in campus facilities. Second, a year-long study has begun of library use, to more fully understand and document how the library organization supports research.

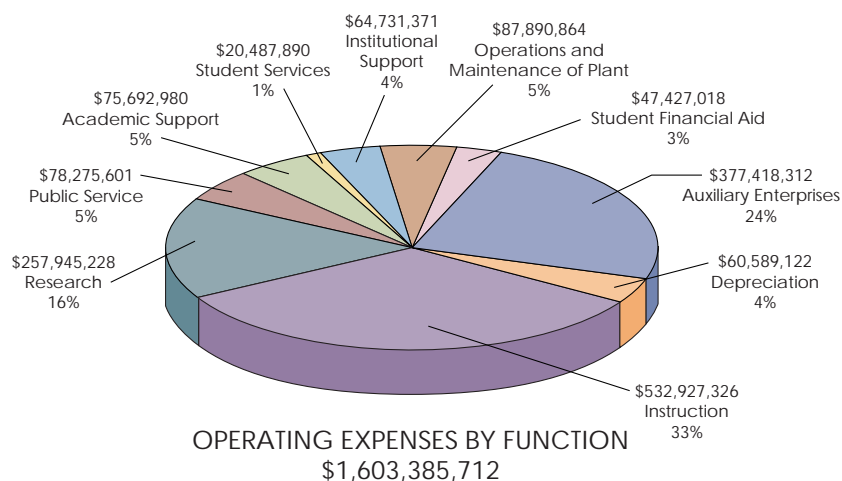
Sales and services revenues of \$443.2 million for fiscal year 2003–2004 represent an increase of 12.7 percent over the prior year and include the revenues of campus auxiliary or similar operations such as student housing, student stores, student health services, the utilities system, parking and transportation, the professional healthcare clinics, and others. Sales and services revenues are from the operations of the University's auxiliary enterprises and from operations of the patient health care clinics. Auxiliary enterprise revenues increased 3.2 percent. The revenues generated by the health clinic increased 31.7 percent, driven in large part by a reduction in the allowance for uncollectible patient accounts based on historical collection rates. Other revenues of \$5.7 million for fiscal year 2003–2004 represent operating resources not separately identified and include, as examples, an assessment to the Investment Fund to support administrative services, library fines, and interest income from student loans.

OPERATING EXPENSES

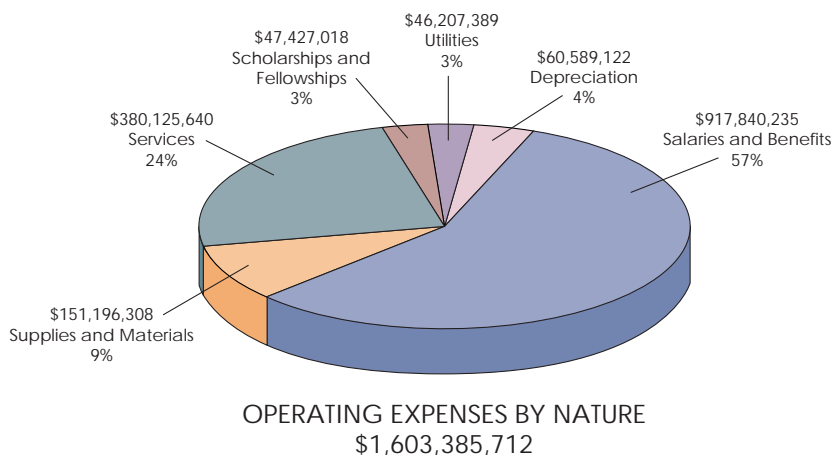
The University's operating expenses were \$1.6 billion for the fiscal year ended June 30, 2004, an increase of 3.9 percent over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in the note disclosures (Note 11). The following table illustrates the University's operating expenses by the functional classification:

	2004	2003	% Change
Operating Expenses by Function:			
Instruction	\$532,927,326	\$531,123,250	0.3
Research	257,945,228	247,434,085	4.2
Public Service	78,275,601	75,409,910	3.8
Academic Support	75,692,980	70,888,224	6.8
Student Services	20,487,890	19,490,736	5.1
Institutional Support	64,731,371	63,460,504	2.0
Operations and Maintenance of Plant	87,890,864	86,451,422	1.7
Student Financial Aid	47,427,018	45,618,092	4.0
Auxiliary Enterprises	377,418,312	350,764,536	7.6
Depreciation	<u>60,589,122</u>	<u>53,075,830</u>	14.2
Total Operating Expenses by Function:	<u>\$1,603,385,712</u>	<u>\$1,543,716,589</u>	3.9

The following chart illustrates the University's operating expenses by function.



The following graph illustrates the University's operating expenses by the natural classification.



Operating expense categories reported by natural classification generally increased at a comparable rate to total operating expenses. The one outlier was depreciation expense. Depreciation increased 14.2 percent over the prior year. The increase was anticipated based on the ongoing, major capital construction program.

NON-OPERATING REVENUES AND EXPENSES

State appropriations of \$380.4 million, non-capital grants of \$53.2 million, non-capital gifts of \$68.5 million, investment income of \$135.4 million, interest and fees on capital asset-related debt of (\$18.3) million, fixed asset writedowns of (\$4.9 million), and other revenues and expenses of (\$3.2) million comprise non-operating revenues and expenses. These revenues are considered non-operating

because they were not generated by the University's principal, ongoing operations. For example, state appropriations were not generated by the University but were provided to help fund operating expenses.

The University's initial budget for state appropriations was \$396 million for fiscal year 2003-2004. Budget increases of \$5.5 million to fund a salary bonus of \$550 per employee and enrollment increases including distance learning and other program enhancements as well as reductions in budgeted state appropriations of (\$13.9) million resulted in an operating budget for state appropriations of \$387.6 million. During the fiscal year 2003-2004, the University was required to reserve \$7.2 million in appropriations for reversion at the end of the year. There was no mid-year reduction for fiscal year 2003-

2004, and the state allowed the carry forward of advance tuition and other deferred revenues at the end of fiscal year 2003-2004. For the prior year, mid-year reductions and limitations on the carry forward of receipts reduced appropriations.

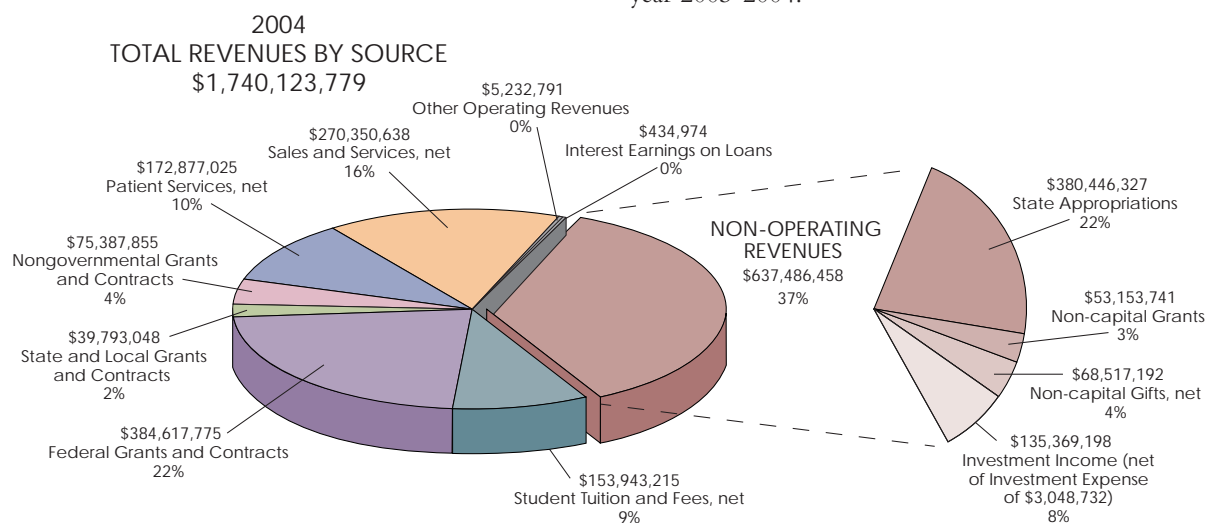
The University uses an annual budget planning and hearing process with all deans and vice chancellors. The review process provides a framework to implement differential budget reductions; the across-the-board approach for budget reductions is not used. The approach in administering flat or marginal increases in state appropriations is to protect the classroom as much as possible, while streamlining administration and eliminating programs. The University has increased its reliance on alternative funding sources, such as clinical income, research awards, indirect cost reimbursements of facilities and administrative expenses, and gifts.

Non-capital grants increased by 29.7 percent to \$53.2 million in fiscal year 2003-2004 and represent federal

awards that are not considered to be exchange transactions. Net non-capital gifts of \$68.5 million represent expendable gifts received and pledges made and are net of an allowance for uncollectible pledges. Net investment income of \$135.4 million includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For detail discussion, the reader may refer to the Endowment and Other Long-term Investments section of Management's Discussion and Analysis. Interest and fees on capital asset-related debt were (\$18.3) million. Other non-operating expenses total (\$8.1) million and include capital asset disposals. The increase in fiscal year 2003-2004 over the prior year resulted in part from increased disposals due to technology and other capital equipment upgrades.

TOTAL OPERATING AND NON-OPERATING REVENUES

Operating and non-operating revenues such as state appropriations, non-capital grants, non-capital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and non-operating revenues, which total \$1.8 billion for fiscal year 2003-2004.



OTHER CHANGES IN NET ASSETS

Capital grant of \$74.4 million came from statewide higher education bond proceeds for capital construction projects. Capital appropriations of \$0.9 million were received from the state for repairs and replacements. Net capital gifts of \$6.4 million also provided funding for construction projects. Non-expendable gifts and funds from the state's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of \$24.1 million during fiscal year 2003-2004.

CONDENSED STATEMENT OF CASH FLOWS

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. Cash increased by \$46.9 million during the fiscal year 2003–2004, compared with an increase of \$115.5 million during fiscal year 2002–2003. One factor which caused \$90 million of the increase in the cash position at June 30, 2003 was the additional use of the State Treasurer's short-term investment fund, which is classified as a cash equivalent, for the University's temporary investment pool. The statements for the fiscal year ended June 30, 2004 and the prior year are summarized as follows:

	2004	2003	% Change
Cash Flows Provided (Used):			
Operating activities	(\$348,742,031)	(\$382,265,470)	8.8
Non-capital financing activities	530,971,166	488,584,930	8.7
Capital and related financing activities	(107,595,259)	(55,707,534)	93.1
Investing activities	<u>(27,684,390)</u>	<u>64,860,649</u>	-142.7
Net Increase (Decrease) in Cash	46,949,486	115,472,575	-59.3
Cash – July 1	<u>497,738,480</u>	<u>382,265,905</u>	30.2
Cash – June 30	<u><u>\$544,687,966</u></u>	<u><u>\$497,738,480</u></u>	9.4

- ❑ Cash flows from operating activities include, as examples, cash received for tuition and fees or research grants and salaries paid to faculty or payments of invoices to vendors. Since state appropriations, gifts, and certain other revenues are not considered operating revenue, operating activities had a net cash outflow for both fiscal years.
- ❑ Non-capital financing activities include state appropriations received for operations and non-capital gifts, and had a net cash inflow for both fiscal years.
- ❑ The cash flows from capital and related financing activities include the proceeds received from short-term and long-term debt obligations, the repayment of debt, and the acquisition of capital assets.
- ❑ The net cash inflows from investing activities include purchases and sales of equity securities and other investments as well as interest and dividends received. The significant change in the cash flows from investing activities resulted from additional investment purchases due to increased levels of gifts and other funds available for investment.

Discrete presentation provides readers with complete information regarding the financial activities of the component units. The reader may refer to Notes 1A and 17 for additional information regarding the three affiliated foundations.

Summary information regarding the financial activities of the three affiliated foundations follows:

	2004
Total assets	\$389,576,735
Total liabilities	<u>2,387,485</u>
Total net assets	<u><u>\$387,189,250</u></u>
Net Assets Composition:	
Unrestricted	\$17,723,823
Temporarily restricted	209,029,695
Permanently restricted	<u>160,435,732</u>
Total Net Assets	<u><u>\$387,189,250</u></u>

Unrestricted net assets are expendable and do not have external restrictions regarding use of the resources, temporarily restricted net assets are expendable but are subject to restrictions regarding allowable uses and the timing for availability, and permanently restricted net assets are not expendable and the related earnings are subject to restrictions regarding allowable uses.

COMPONENT UNITS REPORTED USING DISCRETE PRESENTATION

Potential component units of the University, primarily the affiliated fundraising foundations, are evaluated to determine if the financial statements of the potential component unit should be:

- a) combined with those of the University in the Comprehensive Annual Financial Report (CAFR),
- b) reported separately (that is, discretely) along with the University's financial statements in the CAFR, or
- c) not reported in the CAFR.

Three affiliated foundations were categorized as compo-

	2004
Total revenues	\$73,909,097
Total expenses	<u>25,359,735</u>
Increase in net assets	48,549,362
Net assets – July 1	<u>338,639,888</u>
Net assets – June 30	<u><u>\$387,189,250</u></u>

Expenses included \$20.5 million provided to the University.

ECONOMIC OUTLOOK

Management's view is that the University is well positioned to continue demonstrating excellence in teaching, discovery, and public service. Management believes that, although national and state economic conditions have affected resources in prior years, fiscal year 2003–2004 demonstrated an improved financial condition. The University will maintain its solid financial foundation and enhance its financial outlook. The University's strong debt credit rating allows it to obtain competitive financing for capital construction. The University's comparatively low tuition levels enhance its appeal to prospective students and provide a possible source of additional resources, should tuition increases be enacted.

Tuition rates increased for fiscal year 2004–2005 by 8.5 percent for undergraduate residents, 10.1 percent for undergraduate non-residents, 7.9 percent for graduate residents, and 9.9 percent for graduate non-residents. There were also limited tuition increases for the professional schools. The University's academic standing allows it to continuously attract top students. Student application levels, enrollment levels of students including cross admits, applicants' exam scores and other admission criteria, and other factors illustrate the substantial appeal of the University to prospective students. Carolina's tuition levels remain low compared with its national peer group of institutions. The University has launched the Carolina Covenant, which provides qualified students from low income families with a Carolina education debt-free. Carolina Covenant Scholars agree to work on campus 10 to 12 hours weekly in a federal work-study job, and the University meets the rest of their needs through a combination of federal, state, university and other privately funded grants and scholarships. Carolina became the first major public U.S. university to announce plans for such a program. Since then, several universities, including Virginia, Maryland, Nebraska, Harvard, and Brown have created or announced plans for similar programs.

The University's relationship with the State of North Carolina continues to be a vital success factor. Given the many needs of the state and the recent economic challenges it has faced, the governor and the General Assembly have continued to demonstrate strong financial support for higher education in North Carolina. The budgeted funding level for state appropriations for 2004–2005 totals \$408.5 million, which represents an increase of 7.4 percent over fiscal year 2003–2004 actual state appropriations. This level of funding includes base salary increases for all employees for the first time in over three years. It also includes a 1.5 percent permanent budget reduction, the smallest level of reduction in recent years.

While additional budget reductions or reversions are not anticipated for fiscal year 2004–2005, it is not certain.

The North Carolina economy is back on track to outperform the national average as it usually has over the past 50 years. In July 2004, the unemployment rate in North Carolina was 5 percent, well below the national average of 5.5 percent on a seasonally adjusted basis. On September 28, 2004, the Bureau of Economic Analysis (BEA) of the U.S. Department of Commerce released revised personal income data for all states from the first quarter of 2001 through the first quarter of 2004. These data showed that total personal income in North Carolina in the second quarter of 2004 was \$249.1 billion at a seasonally adjusted annual rate, up 5.8 percent from the second quarter of 2003. The national average increase was 5.2 percent, so North Carolina was back in its normal position of outperforming the national average.

The University must continue to address competitive pressures related to recruiting and retaining faculty and staff. The University's programs for health, retirement, and other benefits have cost and coverage issues that are of concern and require resolution, working in conjunction with UNC System and state officials. The University is progressing on these benefits issues by pursuing additional flexibility in allowing benefits and other enhancements to the benefits programs. However, the University's diverse revenue base, its strategic planning processes, and its proactive approach in addressing budgetary issues help alleviate the significance of the impacts.

Research efforts will continue to provide impetus to the financial condition of the University and the state. The University has created a new Renaissance Computing Institute based in Chapel Hill in partnership with Duke and North Carolina State universities. The University has taken steps to develop new research opportunities by forming a seed-funding program to support interdisciplinary activities and by successfully competing for three of only 21 planning grants awarded across the country as part of a new National Institutes of Health "Roadmap for Medical Research" initiative. The University also established an ongoing mechanism to continue competing successfully for NIH "Roadmap" funding opportunities.

As research activity grows, so do the challenges of complying with state and federal regulations. During the year, the University took major steps to ensure a strong campus-wide program of compliance including the reorganization of all institutional review boards under one office – the Office of Human Research Ethics. This move will help ensure uniform standards of compliance in research with human subjects. During the fiscal year 2003–2004, the University addressed a second undercover investigation by

People for the Ethical Treatment of Animals (PETA) in a facility housing laboratory animals. After careful internal and external reviews, which found only minor violations in an otherwise well-managed program of animal care, the University's lab-animal program retained its national accreditation and demonstrated its ability to comply with federal standards.

The University's research enterprise creates jobs for the state's economy. Expenses resulting from research funding at the University cycle through the state and local economies, transforming federal funds into revenue for North Carolina residents and businesses. The University is the largest employer in the state with 20,637 employees, and about 6,200 of these employees conduct or support research. Using a U.S. government multiplier of 1.7, Carolina's \$577 million in research funding generated an estimated \$982 million in economic impact. The University continues its commitment to transfer new technologies developed by faculty to the marketplace. Planning continued for Carolina North, a nearly 1,000-acre tract of land envisioned for mixed-use development to support the research, teaching, and public service missions of the University. A master plan for Carolina North was developed and presented to the local community in an extensive series of meetings. Resulting feedback is helping shape a revised plan for proposed development.

Two new activities will enhance Carolina's ability to stimulate economic activity. During the year, the University became one of eight campuses nationally to receive funding under the Kauffman Entrepreneurial Initiative, which will promote entrepreneurship on the campus. The Office of Economic and Business Development was formed to coordinate efforts on campus and to enable all to work more effectively with external entities.

Management believes the investment performance of its endowment fund will continue to earn attractive returns and provide important resources for University operations. The organizational changes implemented in fiscal year 2002-2003 will continue to strengthen investment management. The University's investment management operation was separately organized as the UNC Management Company, Inc. (UNC-MC), a non-profit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated non-profit foundations as appropriate. Management believes this structure will continue to enhance the ability to attract and retain investment professionals and increase the pool of funds and resulting investment returns.

The University's fund-raising efforts continue to achieve a high level of success and provide critical resources for the

present and for future generations. Initially announced on October 11, 2002, the \$1.8 billion Carolina First Campaign began its quiet phase on July 1, 1999. Of the \$1.8 billion goal, \$850 million will provide expendable resources, \$700 million will be used to increase endowment assets, and \$250 million will support the capital construction program.

As of June 30, 2004, gifts, pledges and deferred commitments of \$1.3 billion had been recorded. The commitments represent more than 70 percent of the goal. Gift receipts were \$847 million of that total. Of the \$1.8 billion goal, over half is targeted directly for the University and for the business school, social work, law and UNC-CH foundations, with the remainder for the other University affiliated foundations. As of June 30, 2004, endowment commitments totaled \$524 million toward the overall endowment goal of \$700 million. With 63 percent of the campaign time period elapsed, the fund-raising drive has reached 75 percent of the endowment goal. The campaign will conclude on June 30, 2007, and management anticipates the goal will be attained.

The capital planning process continues to benefit the University as the construction program has and will continue to improve academic and administrative facilities. The new and renovated facilities continue to enhance the teaching environment, improve research opportunities, and provide a better infrastructure. The operational planning process is a critical success factor as well. The strategic, mission-driven financial decision processes combined with the framework of the academic plan that considers mission-critical goals and resource needs ensures sound resource development and allocation decisions. Management believes the academic and financial planning processes result in a strategic use of resources.

The University's solid support from the state in difficult economic times, its widespread appeal to top prospective students, its diversified portfolio of research funding, its strong investment performance, its capital construction program, and its outstanding fund-raising campaign are among the factors indicating a positive and successful future for the University. The University's commitment to strategic and balanced operating budgets, protection and enhancement of its endowed and physical assets, and adherence to compliance and control standards all support a continuing strong financial position for the University.

Statement of Net Assets

June 30, 2004

ASSETS

Current Assets

Cash and cash equivalents	\$229,145,462
Restricted cash and cash equivalents	244,717,418
Short-term investments	124,311,551
Restricted short-term investments	76,555,109
Receivables, net (Note 4)	113,396,435
Due from primary government	1,073,935
Due from State of North Carolina component units	1,622,498
Inventories (Note 1G)	15,588,257
Notes receivable, net (Note 4)	<u>4,256,737</u>
Total current assets	<u>810,667,402</u>

Non-current Assets

Restricted cash and cash equivalents	70,825,086
Receivables, net (Note 4)	29,543,833
Restricted due from primary government	20,072,186
Endowment investments	848,469,859
Other long-term investments	505,076,807
Notes receivable, net (Note 4)	29,268,053
Investment in joint venture	8,318,917
Capital assets, non-depreciable (Note 5)	304,442,507
Capital assets, depreciable, net (Note 5)	<u>972,226,834</u>
Total non-current assets	<u>2,788,244,082</u>
Total assets	<u>\$3,598,911,484</u>

LIABILITIES

Current Liabilities

Accounts payable and accrued liabilities (Note 6)	\$77,819,675
Due to primary government	91,968
Due to State of North Carolina component units	4,156,524
Deposits payable	5,051,920
Funds held for others	10,928,432
Deferred revenue	42,842,783
Interest payable	2,100,664
Obligations under reverse repurchase agreements	127,858,750
Short-term debt (Note 7)	8,841,000
Long-term liabilities-current portion (Note 8)	<u>122,128,145</u>
Total current liabilities	<u>401,819,861</u>

Non-current Liabilities

US government grants refundable	32,523,862
Funds held in trust for pool participants	440,811,149
Long-term liabilities (Note 8)	<u>482,557,455</u>
Total non-current liabilities	<u>955,892,466</u>
Total liabilities	<u>\$1,357,712,327</u>
Total assets less liabilities	<u>\$2,241,199,157</u>

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

Statement of Net Assets *(continued)*

June 30, 2004

NET ASSETS

Invested in capital assets, net of related debt	<u>\$855,739,608</u>
Restricted for	
Non-expendable	
Professorships and lectureships	121,273,813
Scholarships and fellowships	81,210,043
Research	10,689,000
Library acquisitions	21,265,812
Departmental uses	50,278,694
Loans	14,005,878
Other	<u>30,012,101</u>
Total restricted non-expendable	<u>328,735,341</u>
Expendable	
Professorships and lectureships	202,055,745
Scholarships and fellowships	120,737,336
Research	11,403,638
Library acquisitions	32,922,567
Departmental uses	214,057,017
Instruction and educational service agreements	18,213,465
Plant improvements	11,814,358
Capital projects	27,910,308
Debt service	<u>8,905,000</u>
Total restricted expendable	<u>648,019,434</u>
Unrestricted	<u>408,704,774</u>
Total net assets	<u>\$2,241,199,157</u>

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

Statement of Revenues, Expenses, and Changes in Net Assets

For the Year Ended June 30, 2004

REVENUES

Operating Revenues:

Student tuition and fees, net (Note 10)	\$153,943,215
Federal grants and contracts	384,617,775
State and local grants and contracts	39,793,048
Non-governmental grants and contracts	75,387,855
Patient services, net (Note 10)	172,877,025
Sales and services, net (Note 10)	270,350,638
Interest earnings on loans	434,974
Other operating revenues	<u>5,232,791</u>
Total operating revenues	<u>\$1,102,637,321</u>

EXPENSES

Operating expenses:

Salaries and benefits	917,840,235
Supplies and materials	151,196,308
Services	380,125,640
Scholarships and fellowships	47,427,018
Utilities	46,207,389
Depreciation	<u>60,589,122</u>
Total operating expenses	<u>1,603,385,712</u>
Operating loss	<u>(\$500,748,391)</u>

NON-OPERATING REVENUES (EXPENSES)

State appropriations	380,446,327
Non-capital grants	53,153,741
Non-capital gifts, net (Note 10)	68,517,192
Investment income (net of investment expense of \$3,048,732)	135,369,198
Interest and fees on capital asset related debt	(18,339,114)
Other non-operating revenues (expenses)	<u>(8,132,036)</u>
Net non-operating Revenues	<u>611,015,308</u>
Income before other revenues, expenses, gains, or losses	\$110,266,917
Capital grant	74,392,000
Capital appropriations	897,387
Capital gifts, net (Note 10)	6,358,879
Additions to permanent endowments	<u>24,098,374</u>
Increase in net assets	216,013,557

NET ASSETS

Net Assets - July 1, 2003	<u>2,025,185,600</u>
Net Assets - June 30, 2004	<u>\$2,241,199,157</u>

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

Statement of Cash Flows

For the Year Ended June 30, 2004

Cash Flows from Operating Activities

Received from customers	\$1,084,815,352
Payments to employees and fringe benefits	(898,444,861)
Payments to vendors and suppliers	(582,211,541)
Payments for scholarships and fellowships	(47,427,017)
Loans issued to students	(6,086,478)
Collection of loans to students	2,957,144
Other receipts (payments)	<u>97,655,370</u>
Net cash used by operating activities	<u>(348,742,031)</u>

Cash Flows from Non-capital Financing Activities

State appropriations	380,446,327
Non-capital grants received	53,345,290
Non-capital gifts	67,528,414
Additions to permanent endowments	24,098,374
Related activity agency receipts	<u>5,552,761</u>
Net cash provided by non-capital financing activities	<u>530,971,166</u>

Cash Flows from Capital Financing and Related Financing Activities

Proceeds from capital debt	138,165,874
Capital grant	69,032,898
Capital appropriations	897,387
Capital gifts	6,358,879
Acquisition and construction of capital assets	(243,602,829)
Principal paid on capital debt and leases	(21,900,068)
Redemption of short-term debt	(36,109,000)
Interest and fees paid on capital debt and leases	<u>(20,438,400)</u>
Net cash used by capital financing activities	<u>(107,595,259)</u>

Cash Flows from Investing Activities

Proceeds from sales and maturities of investments	426,565,826
Investment Income	42,094,867
Purchase of investments and related fees	(517,495,208)
Obligations under reverse repurchase agreements	<u>21,150,125</u>
Net cash used by investing activities	<u>(27,684,390)</u>

Net increase in cash	46,949,486
Cash July 1, 2003	<u>497,738,480</u>
Cash June 30, 2004	<u>\$544,687,966</u>

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

Statement of Cash Flows *(continued)*

For the Year Ended June 30, 2004

Reconciliation of Net Operating Revenues (Expenses) to Net Cash Used by Operating Activities:

Operating (loss)	(\$500,748,391)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	60,589,122
Allowances, write-offs and amortizations	(379,196)
Changes in assets and liabilities:	
Receivables, net	(22,816,576)
Notes receivable, net	(4,037,714)
Inventories	175,600
Accounts payable and accrued liabilities	(2,518,676)
Due to primary government	9,292
Deferred revenue	(81,495)
Compensated absences	17,426,149
US government grants refundable	973,863
Funds held for others	<u>102,665,991</u>
Net cash used by operating activities:	<u>(\$348,742,031)</u>

Non-cash investing, capital, and financing activities

Assets acquired through assumption of a liability	(\$691,207)
Assets acquired through a gift	\$3,848,657
Change in fair value of investments	\$84,092,546

Reconciliation of cash and cash equivalent:

Current assets:	
Cash and cash equivalents	\$229,145,462
Restricted cash and cash equivalents	244,717,418
Non-current assets:	
Restricted cash and cash equivalents	<u>70,825,086</u>
Total cash and cash equivalent - June 30, 2004	<u>\$544,687,966</u>

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

COMPONENT UNITS

Statement of Financial Position

June 30, 2004

	Arts and Sciences Foundation, Inc.	Educational Foundation Scholarship Endowment Trust	Medical Foundation of North Carolina, Inc.
ASSETS:			
Current Assets			
Cash and cash equivalents	\$8,304,966	\$6,564,214	\$30,168,986
Investments		104,679,158	84,761,433
Unconditional promises to give	5,825,902	7,282,354	1,839,697
Contributions receivable from remainder trusts		2,720,113	
Accounts receivable	160,602		
Funds held in trust	346,674		
Accrued income receivable	17,463		268,062
Prepaid expenses			11,080
Miscellaneous receivables			179,768
Total current assets	<u>14,655,607</u>	<u>121,245,839</u>	<u>117,229,026</u>
Property and Equipment			
Building			436,340
Furniture and equipment	<u>88,464</u>		<u>415,139</u>
	88,464		851,479
Less: allowance for depreciation	<u>(55,908)</u>		<u>(440,133)</u>
Total property and equipment, net	<u>32,556</u>		<u>411,346</u>
OTHER ASSETS:			
Investments	70,876,111		38,865,939
Unconditional promises to give, net	11,704,086		9,395,933
Restricted cash	2,230,638		484,947
Partnership interests held for investment	86,661		
Real estate interests held for investment	49,500		
Student loans receivable			45,120
Cash surrender value of life insurance		<u>1,932,343</u>	<u>331,083</u>
Total other assets	<u>84,946,996</u>	<u>1,932,343</u>	<u>49,123,022</u>
TOTAL ASSETS	<u>\$99,635,159</u>	<u>\$123,178,182</u>	<u>\$166,763,394</u>
LIABILITIES AND NET ASSETS:			
Current liabilities			
Accounts payable	\$8,776		\$258,791
Annuities payable		\$206,672	
Accrued expenses	152,534		1,265,369
Deferred revenue			240,000
Total current liabilities	<u>161,310</u>	<u>206,672</u>	<u>1,764,160</u>
Long-term debt	<u>255,343</u>		
Total liabilities	<u>\$416,653</u>	<u>\$206,672</u>	<u>\$1,764,160</u>
NET ASSETS:			
Unrestricted	8,028,817		9,695,006
Temporarily restricted	39,296,131	53,295,275	116,438,289
Permanently restricted	<u>51,893,558</u>	<u>69,676,235</u>	<u>38,865,939</u>
Total net assets	<u>99,218,506</u>	<u>122,971,510</u>	<u>164,999,234</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$99,635,159</u>	<u>\$123,178,182</u>	<u>\$166,763,394</u>

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

COMPONENT UNITS

Statement of Activities and Changes in Net Assets

For the Year Ended June 30, 2004

	Arts and Sciences Foundation, Inc.	Educational Foundation Scholarship Endowment Trust	Medical Foundation of North Carolina, Inc.
SUPPORT AND REVENUE:			
Support			
Contributions	\$13,018,807	\$7,139,394	\$9,033,597
Development assessment fee	1,063,668		
Donated Facilities	40,000		
Actuarial adjustment of annuities payable		10,620	
Endowment investment return designated for current operations		5,105,729	
Total Support	<u>14,122,475</u>	<u>12,255,743</u>	<u>9,033,597</u>
Revenue			
Interest and dividend income			3,605,019
Net unrealized and realized gains (losses) on investments	8,413,241		15,052,242
Investment income	1,752,603		
Loss on sale of real estate investments			(72,610)
Loss on sale of property and equipment			(4,995)
Other income			445,743
Total revenue	<u>10,165,844</u>		<u>19,025,399</u>
TOTAL SUPPORT AND REVENUE	<u>24,288,319</u>	<u>12,255,743</u>	<u>28,058,996</u>
EXPENSES			
Program Services			
Grants to the College of Arts and Sciences	5,292,123		10,160,058
Scholarship expense distribution		5,096,553	
Annuity payments		9,176	
Administrative expenses		69,244	
Other expenses		258,412	
Total Program Services	<u>5,292,123</u>	<u>5,433,385</u>	<u>10,160,058</u>
Supporting Services			
Fundraising expenses	1,983,664		1,017,694
Management and general	676,201		796,610
Total Supporting services	<u>2,659,865</u>		<u>1,814,304</u>
TOTAL EXPENSES	<u>7,951,988</u>	<u>5,433,385</u>	<u>11,974,362</u>
TRANSFERS:			
Transfers to UNC	(49,835)		
Transfers from UNC	101,555		
NET TRANSFERS	<u>51,720</u>		
Change in net assets from operations	<u>16,388,051</u>	<u>6,822,358</u>	<u>16,084,634</u>
Other Changes			
Investment return in excess of amounts designated for current operations		9,254,319	
Changes in net assets	<u>16,388,051</u>	<u>16,076,677</u>	<u>16,084,634</u>
Net assets - beginning of year	<u>82,830,455</u>	<u>106,894,833</u>	<u>148,914,600</u>
NET ASSETS - END OF YEAR	<u>\$99,218,506</u>	<u>\$122,971,510</u>	<u>\$164,999,234</u>

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

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June 30, 2004

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NOTE 1**SIGNIFICANT ACCOUNTING POLICIES****A. FINANCIAL REPORTING ENTITY**

The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Chapel Hill (University) is a constituent institution of the 16-campus University of North Carolina System, which is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

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

The Investment Fund is governed by a board consisting of 11 ex-officio directors and one or two elected directors. Ex-officio directors include all of the members of the Board of Trustees of the Endowment Fund of the University, the vice chancellor for finance and administration, and the vice chancellor for university advancement. The UNC-CH Foundation Board may, in its discretion, elect one or two of its at-large members to the Investment Fund Board. The Investment Fund supports the University by operating an investment fund for charitable, non-profit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. Because members of the Board of Directors of the Investment Fund are officials or appointed by officials of the University and the Investment Fund's primary purpose is to benefit the

University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

In December 2002, the System Fund was organized by the Investment Fund to allow the University, the University of North Carolina and its other constituent institutions (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured, and arranged by the Management Company (formerly University Investment Office). The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Investment Fund contributed and assigned all of its assets to the System Fund effective January 1, 2003, in exchange for its membership interest in the System Fund. Upon such contribution and assignment, and in consideration thereof, the System Fund has assumed all liabilities and obligations of the Investment Fund in respect of such contributed assets. At June 30, 2004, the Investment Fund membership interest was approximately 92 percent of the System Fund total membership interests. Because the Investment Fund is the organizer and a predominant member of the System Fund, the financial statements of the System Fund have been blended with those of the University.

The Management Company is a North Carolina non-profit corporation organized and operated exclusively to support the educational mission of the University. The Management Company will also provide investment management services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and perform other functions for and generally carry out the purposes of the University. The Management Company is governed by five ex-officio directors and one or two additional directors as fixed or changed from time to time by the board, elected by the ex-officio directors. The ex-officio directors consist of the chancellor of the University, the vice chancellor for finance and administration of the University, the chairman of the Board of Trustees of the University, the chairman of the Board of Directors of the Investment Fund, and the president of the Management Company. Because members of the Board of Directors of the Management Company are officials or appointed by officials of the University and the Management Company's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University. Effective January 1, 2003, the Management Company entered into an investment services agreement with the System Fund pursuant to which it will provide investment management and adminis-

trative services to the System Fund and the University. Effective January 1, 2004, the Management Company entered into an investment services agreement with the System Fund pursuant to which it will provide investment management and administrative services to the UNC-CH Foundation.

The UNC-CH Foundation is governed by a 17-member board consisting of nine ex-officio directors and eight elected directors. Ex-officio directors include the chairman of the University Board of Trustees, the chancellor, the vice chancellor for finance and administration, and the vice chancellor for university advancement (nonvoting). In addition, the Board of Trustees elects two ex-officio directors from among its own members as well as three ex-officio directors from the membership of the Board of Trustees of the Endowment Fund who have not otherwise been selected. The eight remaining directors are elected as members of the UNC-CH Foundation Board of Directors by action of the ex-officio directors. The UNC-CH Foundation aids, supports, and promotes teaching, research and service in the various educational, scientific, scholarly, professional, artistic and creative endeavors of the University. Because members of the Board of Directors of the UNC-CH Foundation are officials or appointed by officials of the University and the UNC-CH Foundation's sole purpose is to benefit the University, its financial statements have been blended with those of the University.

The Business School Foundation is governed by a board consisting of four ex-officio directors and four or more elected directors. Ex-officio directors include the dean of the Kenan-Flagler Business School (Business School), as well as the school's chief financial officer, associate dean of academic affairs, and associate dean for MBA Programs. The remaining directors are elected to the Business School Foundation Board of Directors by action of the ex-officio directors. The Business School Foundation aids, promotes and supports the Kenan-Flagler Business School at the University. Because members of the Board of Directors of the Business School Foundation are officials or appointed by officials of the University, the financial statements of the Business School Foundation have been blended with those of the University.

The Social Work Foundation is governed by a board consisting of three ex-officio directors and 10 elected directors. Ex-officio directors include the dean of the School of Social Work as well as the chairman of the school's Board of Advisors and the assistant dean for external affairs. The remaining 10 directors are elected to the Social Work Foundation Board of Directors by action of the ex-officio directors. The Social Work Foundation fosters and promotes the growth, progress, and general welfare of social work

practice and research at the School of Social Work of the University. Because members of the Board of Directors of the Social Work Foundation are officials or appointed by officials of the University, the financial statements of the Social Work Foundation have been blended with those of the University.

The Law Foundation is governed by a board consisting of one ex-officio director, six appointed directors and six elected directors. The ex-officio director is the dean of the School of Law of the University. The ex-officio director appoints six directors and the Board of Directors of the Law Alumni Association of the UNC, Inc. elects the other six directors. The Law Foundation provides support, fosters, and encourages the study and teaching of law at the University Law School. Because a majority of the members of the Board of Directors of the Law Foundation are officials or appointed by officials of the University, the financial statements of the Law Foundation have been blended with those of the University.

Separate financial statements for the Investment Fund, System Fund, the Management Company and blended foundations may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Medical Foundation of North Carolina, Inc. (Medical Foundation), The Educational Foundation Scholarship Endowment Trust (Educational Foundation Trust), and The University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. (Arts and Sciences Foundation) are legally separate, non-profit, tax-exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Medical Foundation is governed by an 83-member board of directors, elected annually by its members. Its purpose is to support educational and research efforts of the University's medical school and UNC Hospitals. Historically, the University's medical school has been the major recipient of financial support from the Medical Foundation compared to UNC Hospitals. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

The Arts and Sciences Foundation is governed by a board consisting of three ex-officio directors, 24 elected directors and such number of emeritus directors deter-

mined from time to time by the board of directors. The 24 elected directors are elected for staggered terms, by the board of directors in office at the time of election. The purpose of the Arts and Sciences Foundation is to promote and support the University's College of Arts and Sciences. Although the University does not control the timing or amount of receipts from the Arts and Sciences Foundation, the majority of resources or income that the Arts and Sciences Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Arts and Sciences Foundation can only be used by, or for the benefit of the University, the Arts and Sciences Foundation is considered a component unit of the University.

The Educational Foundation Trust is governed by the Board of Trustees consisting of 10 trustees and the chairman of the executive committee, who also serves as a trustee during his or her term as chairman. The Educational Foundation Trust operates solely to assist the University in providing financial assistance to students at the University. On an annual basis, the Board of Trustees of the Educational Foundation Trust appropriates a portion of the net appreciation on its assets to the Educational Foundation, Inc. in its capacity as agent for the Educational Foundation Trust. The distribution from the Educational Foundation Trust to the Educational Foundation, Inc. is then forwarded by the Educational Foundation, Inc. to the University to provide financial assistance to students at the University. Although the University does not control the timing or amount of receipts from the Educational Foundation Trust, the majority of resources or income that the Educational Foundation Trust holds and invests are restricted to the students of the University by the donors. Because these restricted resources held by the Educational Foundation Trust can only be used for the benefit of the students of the University, the Educational Foundation Trust is considered a component unit of the University.

The Medical Foundation, the Arts and Sciences Foundation and the Educational Foundation Trust are private, non-profit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from Governmental Accounting Standards Board (GASB) revenue recognition criteria

and presentation features. No modifications have been made to the financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2004, the Medical Foundation, Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total \$20,497,014 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

Other related foundations and similar non-profit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

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 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 (BTA) and accordingly, is reported within a single column in the basic financial statements.

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

C. BASIS OF ACCOUNTING

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

Non-exchange 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, cash on deposit with private bank accounts, savings accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio 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

This classification includes long-term fixed income investments, repurchase agreements, equity investments, mutual funds, money market funds, certificates of deposit, limited partnerships, real estate investment trusts, real estate, and other asset holdings by the University. Except for money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings, these investments are accounted for at fair value for year-end financial reporting purposes. Fair value for financial reporting purposes is based on quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds, certificates of deposit, real estate not held by a governmental external investment pool, and other asset holdings are reported at cost, if purchased or at fair value or appraised value at date of gift, if donated.

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

F. RECEIVABLES

Receivables consist of tuition and fees charges to students and charges to patients for services provided by the UNC Physicians & Associates and the Dental Faculty Practices. Receivables also include amounts due from the federal government, state and local governments, private sources in connection with reimbursement of allowable expenses made pursuant to contracts and grants, and pledges that are verifiable, measurable, and expected to be collected and available for expenses for which the resource provider's conditions have been satisfied, and notes receivables from loans to students. Patients, pledges, and notes receivables are recorded net of the allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.

G. INVENTORIES

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

H. CAPITAL ASSETS

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

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

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

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

I. RESTRICTED ASSETS

Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

J. FUNDS HELD IN TRUST FOR POOL PARTICIPANTS

Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2.

K. FUNDS HELD IN TRUST BY OTHERS

Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2004, is approximately \$30,696,886.

L. NON-CURRENT LONG-TERM LIABILITIES

Non-current long-term liabilities include principal amounts of bonds payable, notes payable, capital lease obligations, annuity payable, and compensated absences that are not scheduled to be paid within the next fiscal year.

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

M. COMPENSATED ABSENCES

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

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002, and as of July 1, 2003. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

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

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.

N. NET ASSETS

The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt –

This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not

included as a component of invested in capital assets, net of related debt.

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

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

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

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the 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.

O. SCHOLARSHIP DISCOUNTS

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

P. REVENUE AND EXPENSE RECOGNITION

The University classifies its revenues and expenses as operating or non-operating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets.

Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as student tuition and fees, sales and services of auxiliary enterprises, certain feder-

al, state and local grants and contracts that are essentially contracts for services, and interest earned on loans.

Operating expenses are all expense transactions incurred other than those related to capital and non-capital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Non-operating revenues include activities that have the characteristics of non-exchange transactions. Revenues from non-exchange transactions and state appropriations that represent subsidies or gifts to the University, as well as investment income, are considered non-operating since these are either investing, capital or non-capital financing activities. Capital contributions are presented separately after non-operating revenues and expenses.

Q. INTERNAL SALES ACTIVITIES

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

R. RELATED PARTIES

Related parties are non-profit organizations established to assist and provide support to University programs by funding scholarships, fellowships, professorships and other needs of specific schools as well as the University's overall academic endeavors. Except as described in Note 1 A, the University's financial statements do not include the assets, liabilities, net assets or operational transactions of these organizations except for support from each organization to the University.

NOTE 2 DEPOSITS AND INVESTMENTS

A. DEPOSITS

Unless specifically exempt, the University is required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name

of the State Treasurer. General Statute 116-36.1, requires the University to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the University may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for intercollegiate athletics and agency funds held directly by the University.

Deposits include cash and cash equivalents and certificates of deposit totaling \$545,473,494. At year-end, cash on hand was \$214,472. The University's portion of the State Treasurer's Investment Pool was \$510,025,948. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the state and for investments to be held by the state's agent in the state's name. The carrying amount of the University's deposits not with the State Treasurer was \$34,662,018 and the bank balance was \$5,579,967. Of the bank balance, \$731,220 was covered by federal depository insurance and \$4,848,747 was uninsured and uncollateralized.

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

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

B. INVESTMENTS

The University is authorized by The University of North Carolina Board of Governors pursuant to General Statute 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina, to invest its special funds and funds received for services rendered by health care professionals pursuant to General Statute 116-36.1(h) in the same manner as the State Treasurer is required to invest, as previously discussed.

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

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

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

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

Temporary Investment Pool (Temporary Pool) – This is a fixed income portfolio managed by the Management Company and Tanglewood Asset Management LLC. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. The Temporary Pool is not registered

with the SEC and the University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Northern Trust Company is the custodian for the Temporary Pool and provides the University with monthly statements defining income and market value information. Investments of the Temporary Pool are highly liquid and generally include U.S. government securities, collateralized mortgage obligations, corporate bonds, mutual funds and money market funds. The University has elected to invest a portion of the Temporary Pool assets in the University's Investment Fund.

Through written request to accounting services, participants may purchase and sell shares in the Temporary Pool at a fixed value of \$1 per share. Generally, the purchase and sale of participation shares occur only at the beginning of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are sent to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund balance. The rates are set in coordination between the Management Company and the vice chancellor for finance and administration.

UNC-CH Foundation Investment Fund Inc. (Investment Fund) – This is a North Carolina non-profit corporation exempt from income tax pursuant to Section 501(c)(3). It began operations in January 1997, by the University, and is classified as a governmental external investment pool. The pool is utilized to manage the investments for charitable, non-profit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support the University. The University's Endowment, UNC-CH Foundation, Business School Foundation, Social Work Foundation, Law Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust are participants in the Investment Fund and are included in the University's reporting entity (internal portion). See Note 1 A. Other affiliated organizations (external portion) in the Investment Fund are not included in the University's reporting entity. Fund ownership of the University's Investment Fund is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The external portion of the Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants.

The Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Investment Fund Board of Directors (See Note 1 A).

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

UNC Investment Fund, LLC (System Fund) – This is a limited liability company organized under the laws of the State of North Carolina. It was established in December 2002, by the Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, non-profit foundations, associations, trusts, endowments and funds that are organized and operated primarily to support these institutions. The Investment Fund, with an approximately 92 percent membership interest as of June 30, 2004, is the organizer and a predominant member of the System Fund. The University's reporting entity portion of the Investment Fund is characterized as the internal portion. Other affiliated organizations in the Investment Fund in addition to other members of the System Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the System Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the System Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

The System Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Members and the Management Company (See Note 1 A). Effective January 1, 2003, the Management Company entered into an investment management services agreement with the System Fund and will provide investment management and administrative services.

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

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

A summary of the University's investments at June 30, 2004, is presented below.

TEMPORARY POOL INVESTMENTS

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U. S. Government Securities	\$44,635,637	\$0	\$0	\$44,635,637
Collateralized Mortgage Obligations	46,925,563			46,925,563
State and Municipal Securities	3,532,086			3,532,086
Corporate Bonds	11,859,453			11,859,453
Corporate Stock	30,000			30,000
Total Categorized Investments	\$106,982,739	\$0	\$0	\$106,982,739
Investments Not Categorized:				
Investments Held by Broker-Dealers				
Under Reverse Repurchase Agreements:				
U. S. Government Securities				\$103,251,244
Certificates of Deposit				1,000,000
Money Market Funds				26,709,643
Mutual Funds				15,232,942
Total Investments Not Categorized				\$146,193,829
Total Temporary Pool Investments (a)				\$253,176,568

(a) The Temporary Pool also has \$32,839,710 of equity in the Investment Fund categorized below.

INVESTMENT FUND POOL INVESTMENTS

The Investment Fund consists of an approximately 92 percent membership interest in the System Fund categorized below.

SYSTEM FUND POOL INVESTMENTS

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U. S. Government Securities	\$794,790	\$0	\$0	\$794,790
Collateralized Mortgage Obligations	2,233,109			2,233,109
Corporate Bonds	12,319,576			12,319,576
Corporate Stocks	50,402,573			50,402,573
International Corporate Bonds	4,705,551			4,705,551
International Stocks	4,525,984			4,525,984
Total Categorized Investments	\$74,981,583	\$0	\$0	\$74,981,583
Investments Not Categorized:				
Investments Held by Broker-Dealers				
Under Reverse Repurchase Agreements:				
U. S. Government Securities				\$24,309,934
Money Market Funds				5,777,098
Mutual Funds				433,606,203
Limited Partnerships				574,400,839
Other Investments				37,219,342
Total Investments Not Categorized				\$1,075,313,416
Total System Fund Pool Investments				\$1,150,294,999

NON-POOLED INVESTMENTS

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U. S. Government Securities	\$3,688,435	\$1,551,067	\$0	\$5,239,502
Collateralized Mortgage Obligations	315,560	57,428		372,988
State and Municipal Securities	152,102			152,102
Corporate Bonds	226,342	41,115		267,457
Corporate Stocks	4,667,663	779,460		5,447,123
International Stocks		8,039		8,039
Total Categorized Investments	\$9,050,102	\$2,437,109	\$0	\$11,487,211
Investments Not Categorized:				
Money Market Funds				\$58,158,625
Mutual Funds				61,395,148
Real Estate				15,057,965
Other Investments				4,842,810
Total Investments Not Categorized				\$139,454,548
Total Non Pooled Investments				\$150,941,759

TOTAL INVESTMENTS

	Fair Value			
	Risk Category			
	1	2	3	Total
Total Categorized Investments	\$191,014,424	\$2,437,109	\$0	\$193,451,533
Total Investments Not Categorized				1,360,961,793
Total Investments				\$1,554,413,326

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

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2004, are as follows:

STATEMENT OF NET ASSETS JUNE 30, 2004

Assets:	
State Treasurer Investment Fund	\$120,000,000
Accrued Investment Income	1,139,459
Investment Fund Equity	32,839,710
Investments	253,176,568
Total Assets	\$407,155,737
Liabilities:	
Obligations Under Reverse Repurchase Agreements	\$103,186,250
Deferred Income	771,832
Total Liabilities	\$103,958,082
Net Assets:	
Internal Portion	\$175,036,006
External Portion	128,161,649
Total Net Assets	\$303,197,655
Total Liabilities and Net Assets	\$407,155,737

STATEMENT OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE FISCAL YEAR ENDED JUNE 30, 2004

Increase in Net Assets From Operations:	
Revenues:	
Investment Income	\$19,233,988
Expenses:	
Investment Management	417,992
Net Increase in Net Assets Resulting from Operations	\$18,815,996
Distributions to Participants:	
Distributions Paid and Payable	\$18,815,996
Share Transactions:	
Net Share Purchases	\$6,432,593
Total Increase in Net Assets	6,432,593
Net Assets:	
Beginning of Year	296,765,062
End of Year	\$303,197,655

The major investment classifications of the Temporary Pool had the following attributes at June 30, 2004:

Investment Classification	Fair Value	Principal Amount	Yield to Maturity	Range of Maturities
U.S. Government Securities	\$44,635,637	\$45,081,630	1.8% - 7.6%	2005 - 2034
Collateralized Mortgage Obligations	46,925,563	48,245,420	1.9% - 9.2%	2005 - 2033
State and Municipal Securities	3,532,086	3,396,404	3.6%	2009
Corporate Bonds	11,859,453	11,810,369	1.4% - 5.9%	2006 - 2033
Corporate Stocks	30,000	30,000	n/a	n/a
Certificate of Deposit	1,000,000	1,000,000	3.5%	2004
Mutual Funds	15,232,942	15,665,392	n/a	n/a
Money Market Funds	26,709,643	26,709,643	0.9%	1 day
Reverse Repurchase Agreements	103,251,244	103,310,232	1.1% - 1.5%	1 - 15 days; open
Total Temporary Pool Investments	\$253,176,568	\$255,249,090		

C. REVERSE REPURCHASE AGREEMENTS

Under the University's authority to purchase and sell securities, it has entered into fixed coupon reverse repurchase (reverse repurchase) agreements, that is, a sale of securities with a simultaneous agreement to repurchase them in the future at the same price plus a contract rate of interest. The fair value of the securities underlying reverse repurchase agreements normally exceeds the cash received, providing the dealers a margin against a decline in fair value of the securities. If the dealers default on their obligations to resell these securities to the University or provide securities or cash of equal value, the University would suffer an economic loss equal to the difference between the fair value plus accrued interest of the underlying securities and the agreement obligation, including accrued interest. This credit exposure at year end was \$372,489.

At June 30, 2004, reverse repurchase agreements are both fixed term and open (on-demand) agreements. The amount and interest rate of the open agreements may be changed daily and either party may terminate the transaction at any time. In investing the proceeds of reverse repurchase agreements, the University's practice is for the term to maturity of the investment to be the same as the term of the reverse repurchase agreement. The University's investments in the underlying securities and the securities purchased with proceeds from the reverse repurchase agreements are in accordance with the statutory requirements as noted. The interest earnings and interest cost arising from reverse repurchase agreement transactions are reported at gross amounts on the accompanying financial statements.

D. DERIVATIVE AND SIMILAR TRANSACTIONS

A derivative is a financial instrument created from, or whose value depends on (is derived from), the value of one

or more underlying assets, reference rates, or indexes of asset values. These instruments may include forwards, futures, currency and interest rate swaps, options, floaters/inverse floaters and caps/floors/collars. Investment transactions similar to a derivative may include securitized assets, such as mortgage-backed securities and other asset-backed securities. As required by accounting principles generally accepted in the United States of America, the nature of derivative or similar transactions entered into by the University, and the reasons for entering into those transactions follow:

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

The values of mortgage-backed securities are generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities may include mortgage pass-through securities and collateralized mortgage obligations (CMOs). Mortgage pass-through securities pay the holder of the security the principal and interest amounts received from the underlying pool of mortgages as these amounts are collected from the mortgage holders. In a CMO, the cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple security classes with different priority claims and payment streams (commonly

referred to as tranches). A holder of the CMO security thus chooses the class of security that best meet its risk and return objectives. Both pass-through securities and CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets.

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

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

As of June 30, 2004, the University was holding \$141,595,246 in mortgage-backed securities valued at fair value representing approximately 9.1 percent of its total investments. Of this amount, \$49,531,660 represents investments in CMOs.

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

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

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

could be liquidated at market values at the time of non-performance, reduce the credit risk.

As of June 30, 2004, the University was holding \$7,399,041 in asset-backed securities valued at fair value representing approximately 0.5 percent of its total investments.

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

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

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

As of June 30, 2004, the futures contracts held by the University had expiration dates not exceeding September 2004.

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

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

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

income accounts. Unlike purchased options and most securities investments, losses on written options can exceed their cost.

During the year ending June 30, 2004, the option contracts held by the University vary with changes in the market price of their underlying futures contracts and accordingly also fluctuate with changes in their respective foreign currency rates or security values. The University's option contracts are traded on organized exchanges which mitigate its credit risk of default by counterparty.

As of June 30, 2004, the option contracts held by the University had expiration dates not exceeding September 2004.

Indirect Derivative Holdings – The University identifies various external investment funds (mutual funds, external investment pools, and limited partnerships) that meet asset allocation and investment management objectives. The University invests in these funds to increase the yield and return on its investment portfolio given the available alternative investment opportunities and to diversify its asset holdings. Fund investments generally include equity and bond funds. Certain funds expose the University to signifi-

cant amounts of market risk by trading or holding derivative instruments and by leveraging the securities in the fund.

The University limits the amount of funds managed by any single asset manager and also limits the amount of funds to be invested in particular security classes. The asset classes of the System Fund that utilized derivative securities for the fiscal year ending June 30, 2004, are summarized in the chart below. The amounts shown in the chart represent the market value of the System Fund's investment in the various asset classes and the market value and percent of holdings held in derivatives in those classifications. The University's reporting entity, including the three discreetly presented component units, comprises 84.26 percent of the System Fund.

The market values reported for each asset class do not include accrued income, reverse repurchase liabilities, investments in the State Treasurer's Investment Fund, cash with a fiscal agent, accounts receivable, or accounts payable.

The UNC Investment Fund, LLC (System Fund)
Indirect Derivative Analysis for Fiscal Year Ending June 30, 2004:

Asset Class	Total Market Value	Percent Invested Derivatives	Amount
Domestic Equity	\$221,299,722	12.49 %	\$27,646,740
International Equity	189,258,690	15.31 %	28,981,246
Global Equity	116,448,467	16.87 %	19,649,812
Private Equity	200,654,634	0.41 %	826,298
Absolute Return	88,103,420	10.08 %	8,882,272
Fixed Income			
Domestic Fixed Income	48,200,250	4.84 %	2,333,912
Enhanced Fixed Income	126,749,538	0.40 %	503,421
Real Estate	72,041,092	1.60 %	1,155,158
Energy	84,652,068	1.23 %	1,041,478
Total			\$91,020,337
Total Market Value of Investments in the System Fund			\$1,150,294,999
Total Percent of Market Value for Indirect Derivative Exposure			7.91 %

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

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

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

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

Private Equity – By serving as substitutes for domestic and global common stocks, the role of these investments is to provide high real returns and control volatility. The private equity allocation is expected to be approximately one-half in traditional venture capital and one-half in buyout strategies.

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

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

Real Estate – Primarily serves as a hedge against high-unanticipated general price inflation, but is also a source of current income. Investments in this area include private portfolio investments, which focus on specific niche markets within the real estate sector or public Real Estate Investment Trust (REIT) investments, which provide a more liquid means of gaining exposure to the asset class.

Energy – Principally included to hedge against unanticipated inflation. These strategies include direct energy investments, energy security investments, commodity-linked notes and direct investments in commodity indices or the futures markets. The principal attraction of these investments is the lack of correlation with the balance of the portfolio.

The System Fund's holdings in indirect derivatives

(i.e., derivatives held by external investment managers) are primarily used to decrease risk. This is because the indirect derivatives are used by the fund's hedge fund managers primarily to hedge underlying positions, or to gain exposure to specific markets in an efficient, inexpensive, liquid, and diversified manner. In the former case, risk is actually reduced by the use of derivatives because the derivative is directly offsetting market exposure. In the latter case, the derivatives are merely substituting for what would otherwise be a more traditional (individual security) array. Hence, there would be no greater risk and often less risk than the traditional array that would exist in place of such derivatives. In limited cases, select managers are allowed to use derivatives to lever specific holdings or market positions. In aggregate, the fund's 7.91 percent exposure to indirect derivative holdings reflects a smaller degree of risk than there would be without such derivatives in the portfolio. The University considers the risk associated with these holdings to be prudent and within acceptable bounds.

NOTE 3 ENDOWMENT INVESTMENTS RETURN

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

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2004, accumulated income and appreciation of \$337,829,022 was available in the University's pooled endowment funds of which \$302,110,699 was restricted to specific purposes.

NOTE 4 RECEIVABLES

Receivables at June 30, 2004, were as follows:

	Gross Receivables	Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Students	\$2,095,068		\$2,095,068
Patients	69,199,973	(\$44,835,457)	24,364,516
Accounts	36,647,242		36,647,242
Intergovernmental	32,506,706		32,506,706
Pledges	14,956,001	(373,900)	14,582,101
Investment Earnings	2,501,970		2,501,970
Interest on Loans	698,832		698,832
Total Current Receivables	\$158,605,792	(\$45,209,357)	\$113,396,435
Non-current Receivables:			
Pledges	\$30,301,367	(\$757,534)	\$29,543,833
Notes Receivable - Current:			
Federal Loan Programs	\$2,706,567	(\$198,517)	\$2,508,050
Institutional Student Loan Programs	834,285	(40,941)	793,344
Other Notes Receivable	955,343		955,343
Total Notes Receivable Current	\$4,496,195	(\$239,458)	\$4,256,737
Notes Receivable - Non-current:			
Federal Loan Programs	\$27,076,484	(\$1,985,393)	\$25,091,091
Institutional Student Loan Programs	4,293,969	(117,007)	4,176,962
Total Notes Receivable Non-current	\$31,370,453	(\$2,102,400)	\$29,268,053

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

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

Fiscal Year	Amount
2005	\$14,956,001
2006	14,119,275
2007	7,911,315
2008	4,061,479
2009	2,549,536
2010-2014	5,290,203
Total Pledge Receipts Expected	48,887,809
Discount Amount Representing Interest (3.58% Rate of Interest)	(3,630,441)
Present Value of Pledge Receipts Expected	45,257,368
Less Allowance for Uncollectible	(1,131,434)
Pledges Receivable	\$44,125,934

NOTE 5**CAPITAL ASSETS**

A summary of changes in the capital assets for the year ended June 30, 2004, is presented as follows:

	Balance July 1, 2003	Adjustments	Increases	Decreases	Balance June 30, 2004
Capital Assets, Non-Depreciable:					
Land	\$25,611,965		\$1,405,675	\$678,559	\$26,339,081
Art, Literature, and Artifacts	54,468,304		3,328,382	32,551	57,764,135
Construction in Progress	226,958,080	(\$160,135,093)	152,678,489	162,185	219,339,291
Intangible assets	1,000,000				1,000,000
Total Capital Assets, Non-Depreciable	308,038,349	(160,135,093)	157,412,546	873,295	304,442,507
Capital Assets, Depreciable:					
Buildings	903,545,671	159,301,391	32,841,381	3,912,034	1,091,776,409
Machinery and Equipment	205,511,121		21,435,222	13,441,619	213,504,724
General Infrastructure	334,531,192	833,702	1,030,070		336,394,964
Total Capital Assets, Depreciable	1,443,587,984	160,135,093	55,306,673	17,353,653	1,641,676,097
Less Accumulated Depreciation/					
Amortization for:					
Buildings	357,092,528		31,190,228	52,668	388,230,088
Machinery and Equipment	124,692,635		16,213,426	8,492,040	132,414,021
General Infrastructure	135,619,685		13,185,469		148,805,154
Total Accumulated Depreciation	617,404,848	0	60,589,123	8,544,708	669,449,263
Total Capital Assets,					
Depreciable, net	826,183,136	160,135,093	(5,282,450)	8,808,945	972,226,834
Capital Assets, net	\$1,134,221,485	\$0	\$152,130,096	\$9,682,240	\$1,276,669,341

NOTE 6**ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

Accounts payable and accrued liabilities at June 30, 2004, were as follows:

	Amount
Accounts Payable	\$51,339,205
Accrued Payroll	21,151,001
Contract Retainage	5,300,762
Other	28,707
Total accounts payable and accrued liabilities	\$77,819,675

NOTE 7

SHORT-TERM DEBT

Short-term debt activity for the year ended June 30, 2004, was as follows:

	Balance July 1, 2003	Issued	Redeemed	Balance June 30, 2004
Commercial Paper Program	\$19,000,000	\$25,950,000	\$36,109,000	\$8,841,000

Commercial paper was issued from the University of North Carolina General Revenue Bonds, Series 2002A, to provide interim financing for the construction of capital projects. Commercial paper was redeemed with proceeds from the University of North Carolina General Revenue Bonds, Series 2003.

The UNC-CH Foundation entered into a line of credit agreement on June 30, 2004, issued by Bank of America, N.A., in the aggregate principal amount up to \$10,000,000 to finance the costs of projects benefiting the Foundation or the University. The line of credit has a maturity date of June 30, 2005, and may be extended by agreement between Bank of America and the UNC-CH Foundation. At June 30, 2004, no principal amounts have been advanced.

NOTE 8

LONG-TERM LIABILITIES

A. CHANGES IN LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities for the year ended June 30, 2004, is presented as follows:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	\$428,860,000	\$107,960,000	\$17,080,000	\$519,740,000	\$115,057,582
Add/Deduct Premium/Discount	(52,380,920)	4,017,452	(2,913,148)	(45,450,320)	
Deduct Deferred Charge on Refunding	(2,931,529)		(325,726)	(2,605,803)	
Total Bonds Payable	373,547,551	111,977,452	13,841,126	471,683,877	115,057,582
Notes Payable	39,332,505		4,332,505	35,000,000	
Capital Leases Payable	926,628	881,350	487,564	1,320,414	693,439
Compensated Absences	72,588,314	61,805,858	44,379,710	90,014,462	5,568,119
Annuity and Life Income Payable	7,220,826	582,866	1,136,845	6,666,847	809,005
Total Long-Term Liabilities	\$493,615,824	\$175,247,526	\$64,177,750	\$604,685,600	\$122,128,145

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

B. BONDS PAYABLE

The University was indebted for bonds payable for the purposes shown in the following table:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue plus Capital Appreciation	Principal Paid Through 6/30/2004	Discount on Capital Appreciation Bonds	Principal Outstanding 6/30/2004
Housing System							
	1997A	4.500%-5.100%	1-Nov-17	\$9,170,000	\$1,680,000		\$7,490,000
	1997B	4.000%-5.000%	1-Nov-17	7,210,000	1,385,000		5,825,000
Total Housing System				16,380,000	3,065,000		13,315,000
Utilities System							
	1997	5.250%-5.500%	1-Aug-21	84,135,000	0	(\$40,752,639)	43,382,361
Total Utilities System				84,135,000	0	(40,752,639)	43,382,361
Parking System							
	1997A	4.350%-5.700%	15-May-27	11,750,000	1,075,000		10,675,000
	1997B	3.900%-5.150%	15-May-09	8,245,000	4,175,000		4,070,000
Total Parking System				19,995,000	5,250,000		14,745,000
General Revenue							
	2001A	2.900%-5.125%	1-Dec-25	89,930,000	5,675,000		84,255,000
	2001B	variable	1-Dec-25	54,970,000	4,870,000		50,100,000
	2001C	variable	1-Dec-25	54,970,000	4,870,000		50,100,000
	2002B	3.500%-5.000%	1-Dec-11	66,555,000	7,540,000		59,015,000
	2003	2.000%-5.000%	1-Dec-33	107,960,000	0		107,960,000
Total General Revenue				374,385,000	22,955,000		351,430,000
Student Union	2000	4.550%-5.659%	1-Jun-22	12,465,000	1,060,000		11,405,000
Student Recreation Center	1997	3.900%-5.000%	1-Jun-11	3,545,000	1,060,000		2,485,000
U.S. EPA Project	1991	8.250%-9.050%	15-Feb-15	58,125,000	16,495,000	(13,003,930)	28,626,070
U.S. EPA Project	1996	6.72%	15-Feb-06	2,400,000	1,805,000		595,000
Total Bonds Payable (principal only)				\$571,430,000	\$51,690,000	(\$53,756,569)	465,983,431
Less: Unamortized Loss on Refunding							(2,605,803)
Less: Unamortized Discount							0
Plus: Unamortized Premium							8,306,249
Total Bonds Payable							\$471,683,877

C. DEMAND BONDS

Included in bonds payable are two variable rate demand bond issues. Demand bonds are securities that contain a “put” feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the University’s remarketing or paying agents.

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

General Revenue, Series 2001B and 2001C – In 2001, the University issued two series of variable rate demand bonds in the amount of \$54,970,000 (2001B) and \$54,970,000 (2001C) that each have a final maturity date of December 1, 2025, and are repaid from available funds. Available funds are defined as any Unrestricted Net Assets remaining after satisfying obligations of the University under trust indentures, trust agreements or bond resolutions (specific revenue bonds), but excluding state appropriations, tuition, restricted gifts and certain special facilities revenues. The bonds are subject to mandatory sinking fund redemp-

tion on the interest payment date on or immediately preceding each December. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University's remarketing agents, Lehman Brothers, Inc. (2001B) and UBS Financial Services, Inc. (2001C).

The line of credit issued by Toronto-Dominion Bank and Chase Manhattan Bank expired on February 4, 2004, and a new line of credit was issued by JP Morgan Chase Bank on February 4, 2004. Under the new line of credit agreement, the University is entitled to draw amounts sufficient to pay the principal, and, while the bonds are bearing interest at the daily or weekly rate, accrued interest on bonds delivered for purchase.

The University is required to pay a quarterly commitment fee for the line of credit of 0.13 percent per annum based on the unused portion of the line of credit commitment. If the University's credit rating for unsecured debt were to drop below "Aa3" (or its equivalent) by Moody's, "AA-" (or its equivalent) by S&P, or "AA-" (or its equivalent) by Fitch, the quarterly commitment fee would increase to 0.18 percent. If the University's credit rating for unsecured debt were to drop below "A3" (or its equivalent) by Moody's, "A-" (or its equivalent) by S&P, or "A-" (or its equivalent) by Fitch, the quarterly commitment fee would increase to 0.28 percent. Additionally, if the University were to terminate the line of credit prior to February 2, 2005, then the University must pay a termination fee of \$50,000 less any unused commitment fees paid to date.

Under the line of credit agreement, the University has promised to repay loans that represent purchase drawings in equal semi-annual payments after termination of the line of credit. Interest at the rate of prime plus 1.0 percent (prime plus 2.0 percent after 60 days) is payable quarterly and upon draw repayment. At June 30, 2004, no purchase draws had been made under the letter of credit.

The new line of credit agreement expires on February 2, 2005. However, between November 3, 2004, and December 3, 2004, the University may request that the Bank extend the expiration date for another year. The Bank shall respond affirmatively or negatively within 30 days after receipt of such request.

In the event of termination of the line of credit, outstanding principal is to be repaid in semi-annual installments of principal on each February 1 and August 1, commencing

on the first of such dates succeeding the termination date with the remaining principal amount payable on the second anniversary of the termination date. Further, accrued interest will continue to be due and payable on the first day of the calendar quarter and on the date any portion of principal is payable.

In order to protect against the risk of interest rate changes, effective October 3, 2000, the University entered into an interest rate swap contract agreement with Lehman Brothers Special Financing, Inc. (Lehman Brothers) related to \$22,000,000 of The University of North Carolina at Chapel Hill Variable Rate Housing System Revenue Bonds, Series 2000. This series of bonds was refunded in its entirety by the issuance of the University's Variable Rate General Revenue Bonds, Series 2001B, and the interest swap agreement was amended to reflect the refunding.

Under this amended agreement, Lehman Brothers pays the University interest on the notional amount based on the Bond Market Association (BMA) Municipal Bond Index on a quarterly basis. On a semiannual basis, the University pays Lehman Brothers interest at the fixed rate of 5.24 percent. The notional amount of the swap reduces annually; the reductions began in November 2002 and end in November 2025. The swap agreement matures November 1, 2025. As of June 30, 2004, rates were as follows:

	<u>Terms</u>	<u>Rates %</u>
Fixed payment to Lehman	Fixed	5.24
Variable payment from Lehman	BMA	<u>0.98</u>
Net interest rate swap payments		4.26
Variable rate bond coupon payments		<u>1.01</u>
Synthetic interest rate on bonds		5.27

As of June 30, 2004, the swap had a negative fair value of \$3,513,801. The fair value was developed by Lehman Brothers. Its method calculates the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for London Interbank Offered Rate (LIBOR) due on the date of each future net settlement on the swap.

As of June 30, 2004, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair

value of more than \$1,000,000, Lehman would be required to collateralize 103 percent of its exposure. Lehman Brothers Holdings, guarantor of Lehman Brothers Special Financing, Inc., was rated A1 by Moody's Investor's Service, A by Standard and Poor's Corporation, and A+ by Fitch Ratings.

The University receives the BMA Index from Lehman Brothers and pays a floating rate to its bondholders set by the remarketing agent. The University incurs basis risk when its bonds begin to trade at a yield above the BMA. Basis risk also exists since swap payments are made quarterly while bond payments are made monthly. With the alternative tax structure of the swap, a change in tax law would trigger the swap being converted from a BMA swap to a percentage of LIBOR swap. This would introduce basis risk. If the weekly reset interest rates on

the University's bonds are in excess of 65 percent of LIBOR, the University will experience an increase in debt service above the fixed rate on the swap to the extent that the interest rates on the bonds exceed 65 percent of LIBOR.

The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swap terminates if the University or Lehman Brothers fails to perform under terms of the contract.

As rates vary, variable rate bond interest payments and net swap payments will vary. Using rates as of June 30, 2004, debt service requirements of the variable rate debt and net swap payments, assuming current interest rates remain the same for the their term, are as follows.

General Revenue Bonds, Series 2001B

Fiscal Year	Principal	Interest	Interest Rate Swaps, Net*	Total
2005	\$1,925,000	\$496,289	\$913,451	\$3,334,740
2006	2,060,000	476,165	903,227	3,439,392
2007	2,140,000	454,955	892,577	3,487,532
2008	2,175,000	433,164	881,394	3,489,558
2009	2,285,000	410,641	869,786	3,565,427
2010-2014	12,560,000	1,680,489	4,117,610	18,358,099
2015-2019	11,975,000	1,061,333	3,283,182	16,319,515
2020-2024	10,295,000	499,066	1,810,074	12,604,140
2025-2029	4,685,000	47,849	175,832	4,908,681
Total	\$50,100,000	\$5,559,951	\$13,847,133	\$69,507,084

* Computed using $(5.24\% - 0.98\%) \times (\$22,000,000 - \text{annual reduction})$

D. CAPITAL APPRECIATION BONDS

The University's Series 1997 Utility System and the Series 1991 U. S. Environmental Protection Agency Project bond issues include capital appreciation bonds with an original issue amount of \$30,379,142 and \$3,828,921, respectively. These bonds are recorded in the amounts of \$43,382,361 (\$84,135,000 ultimate maturity less \$40,752,639 discount) and \$12,271,070 (\$25,275,000 ultimate maturity less \$13,003,930 discount), respectively, which are the accreted values at June 30, 2004. These bonds mature in the years from 2010 to 2021.

E. ANNUAL REQUIREMENTS

The annual requirements to pay principal and interest on the long-term obligations at June 30, 2004, are as follows:

Fiscal Year	Annual Requirements			
	Bonds Payable		Notes Payable	
	Principal	Interest	Principal	Interest
2005	\$18,920,000	\$17,587,809		\$619,500
2006	20,840,000	16,728,662	\$35,000,000	154,875
2007	21,635,000	15,783,717		
2008	22,645,000	14,788,536		
2009	23,920,000	13,706,786		
2010-2014	125,585,000	55,054,900		
2015-2019	113,580,000	40,837,693		
2020-2024	95,220,000	26,272,428		
2025-2029	47,140,000	11,678,158		
2030-2034	30,255,000	3,917,331		
Total Requirements	\$519,740,000	\$216,356,020	\$35,000,000	\$774,375

Interest on the variable rate General Revenue Bonds 2001B is calculated at 1.010% at June 30, 2004.

Interest on the variable rate General Revenue Bonds 2001C is calculated at 1.000% at June 30, 2004.

For General Revenue Bonds, Series 2001B and 2001C, interest rates change weekly.

This schedule also includes the debt service requirements for debt associated with interest rate swaps.

More detailed information about the interest rate swaps is presented in Note 8C.

F. BOND DEFEASANCE

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

Utilities System – On May 7, 2002, the University defeased \$69,895,000 of outstanding Utilities System Revenue Bonds, Series 1993. Securities were placed in an irrevocable trust with an escrow agent and provided payment in full for the defeased bonds on August 1, 2002. At June 30, 2004, the outstanding balance of the defeased Utilities System Revenue Bonds was \$0.

Dining System – On February 7, 2001, the University defeased \$13,205,000 of outstanding Dining System Revenue Bonds, Series 1997. Securities were deposited into an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2004, the outstanding balance of the defeased Dining System bonds was \$11,010,000.

Dormitory System – On December 1, 1999, the University defeased \$1,225,000 of outstanding Dormitory

System Revenue Bonds, Series E, F & G (1963).

Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2004, the outstanding balance was \$202,000 for the defeased outstanding Dormitory System Revenue Bonds, Series F and Series G (1963).

Student Union – On December 1, 1999, the University defeased \$620,000 of outstanding Student Union Revenue Bonds, Series 1967. Securities were placed in an irrevocable trust with an escrow agent to provide for all future debt service payments on the defeased bonds. For financial reporting purposes, the trust account assets and the liability for the defeased bonds are not included in the University's Statement of Net Assets. At June 30, 2004, the outstanding balance was \$330,000 for the defeased outstanding Student Union Revenue Bonds, Series 1967.

G. NOTES PAYABLE

The University was indebted for notes payable for the purposes shown in the following table:

Purpose	Financial Institution	Interest Rate/Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2004	Principal Outstanding 06/30/2004
Student Housing Facility	Bank of America	1.77%	04/01/2005	\$35,000,000	\$0	\$35,000,000

The loan agreement is between the UNC-CH Foundation, which is part of the University's financial reporting entity, and Bank of America in the amount of \$35,000,000 with a maturity date of April 1, 2005. Subsequently, the loan agreement was refinanced and the maturity date extended to October 1, 2005 (Refer to Note 18 – Subsequent Events). The University plans to refinance the note with other long-term financing.

NOTE 9 LEASE OBLIGATIONS

A. CAPITAL LEASE OBLIGATIONS

Capital lease obligations relating to medical and research equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2004:

Fiscal Year	Amount
2005	\$758,292
2006	248,077
2007	197,335
2008	145,632
2009	95,031
Total Minimum Lease Payments	\$1,444,367
Amount Representing Interest (4.0% - 14.9% Rate of Interest)	123,953
Present Value of Future Lease Payments	\$1,320,414

Machinery and equipment acquired under capital leases amounted to \$1,746,469 at June 30, 2004.

B. OPERATING LEASE OBLIGATIONS

Future minimum lease payments under non-cancelable operating leases consist of the following at June 30, 2004:

Fiscal Year	Amount
2005	\$5,926,647
2006	4,246,450
2007	2,825,428
2008	1,052,697
2009	164,375
Total Minimum Lease Payments	\$14,215,597

Rental expense for all operating leases during the year was \$10,667,677.

C. OTHER LEASE OBLIGATIONS

The UNC-CH Foundation issued certificates of participation to provide for construction of alumni facilities. The University constructed the facilities as an agent for the UNC-CH Foundation. In October 1989, the University entered into a 20-year lease agreement with the UNC-CH Foundation and simultaneously entered into a sublease agreement with the General Alumni Association, an affiliated organization, for the same time period for the use of the alumni facilities.

Payments under the terms of the lease are a limited obligation of the University, payable solely from and secured by the annual rental income derived from the sublease of the alumni facilities. The University has no other obligations for repayment of the certificates of participation; therefore, the certificates are not reported as a liability in the accompanying financial statements. As of June 30, 2004, the aggregate principal amount of the certificates was \$9,950,000.

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

NOTE 10 REVENUES

Revenues pledged as security for revenue bonds is presented as follows:

	Gross Revenues	Internal Sales Eliminations	Less: Scholarship Discounts	Less: Allowance for Uncollectibles	Less: Indigent Care and Contractual Adjustments	Net Revenues	Net Revenues Pledged as Security for Debt
Operating revenues:							
Student tuition and fees	\$187,243,558		\$33,300,343			\$153,943,215	
Patient Service	380,322,481			(\$17,969,088)	\$225,414,544	172,877,025	
Sales and Services:							
Residential Life	26,834,809		4,990,012			21,844,797	\$21,004,736 (a)
Dining	18,649,175	\$72,758	244,431			18,331,986	
Student Union Services	2,141,134		425,019			1,716,115	
Health, Physical Education and Recreation Services	15,112,580		3,180,178			11,932,402	11,932,402 (b)
Bookstore	33,454,712	5,075,010				28,379,702	
Parking	15,431,949					15,431,949	15,431,949 (c)
Athletic	33,671,572	20,574	471,558			33,179,440	
Utilities	72,193,037	56,335,143				15,857,894	15,857,894 (d)
Other Professional Income	68,147,187					68,147,187	
Other	143,866,637	88,337,471				55,529,166	4,527,555 (e)
Total Sales and Services	\$429,502,792	\$149,840,956	\$9,311,198			\$270,350,638	\$68,754,536
Non-operating non-capital gifts	\$73,279,067			\$4,761,875*		\$68,517,192	
Capital Gifts, Net	\$6,358,879					\$6,358,879	

(a) Housing System Revenue Bonds, Series 1997 A & B

(b) Student Fee Revenue Bonds, Series 1997 & 2000

(c) Parking System Revenue Bonds, Series 1997 A & B

(d) Utility System Revenue Bonds, Series 1997

(e) US EPA Project, Series 1991 & 1996

* Includes \$3,630,441 present value discount on pledges receivable

NOTE 11 OPERATING EXPENSES BY FUNCTION

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

	Salaries and Benefits	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	\$405,156,040	\$27,896,687	\$99,838,351		\$36,248		\$532,927,326
Research	168,172,666	38,991,238	50,732,175		49,149		257,945,228
Public Service	28,331,147	1,121,468	48,776,636		46,350		78,275,601
Academic Support	48,036,408	14,159,806	13,495,957		809		75,692,980
Student Services	10,266,755	765,904	9,453,893		1,338		20,487,890
Institutional Support	41,582,465	4,175,161	18,952,564		21,181		64,731,371
Operations and Maintenance of Plant	29,812,183	4,266,718	13,066,329		40,745,634		87,890,864
Student Financial Aid				\$47,427,018			47,427,018
Auxiliary Enterprises	186,482,571	59,819,326	125,809,735		5,306,680		377,418,312
Depreciation						\$60,589,122	60,589,122
Total Operating Expenses	\$917,840,235	\$151,196,308	\$380,125,640	\$47,427,018	\$46,207,389	\$60,589,122	\$1,603,385,712

NOTE 12

PENSION PLANS

A. RETIREMENT PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by North Carolina General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2004, these rates were set at 0.22 percent of covered payroll for employers and 6 percent of covered payroll for members.

For the year ended June 30, 2004, the University had a total payroll of \$800,874,408, of which \$344,434,804 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$20,666,088 and \$757,757, respectively. The University made 100 percent of its annual required contributions for the years ended June 30, 2004, 2003, and 2002, which were \$757,757, \$0, and \$6,175,101, respectively.

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

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

North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products. The board has authorized the following carriers: Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF), Lincoln Life Insurance Company, Variable Annuity Life Insurance Company (VALIC), and Fidelity Investments. Participants may elect to allocate their contributions and the University contributions to the carrier of their choice. Each carrier offers a variety of investment funds, including both fixed and variable account investment options and mutual funds.

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, 2004, these rates were set at 6.84 percent of covered payroll for employers and 6 percent of covered payroll for members. The University assumes no liability other than its contribution.

For the year ended June 30, 2004, the University had a total payroll of \$800,874,408, of which \$300,100,834 was covered under the Optional Retirement Program. Total employee and employer contributions for pension benefits for the year were \$18,006,050 and \$20,526,897, respectively.

B. DEFERRED COMPENSATION AND SUPPLEMENTAL RETIREMENT INCOME PLANS

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

amounted to \$3,409,430 for the year ended June 30, 2004.

IRC Section 401(k) Plan – All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5 percent employer contribution for the University's law enforcement officers, which are mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2004 were \$95,346. The voluntary contributions by employees amounted to \$2,504,985 for the year ended June 30, 2004.

IRC Section 403(b) and 403(b)(7) Plans – Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other non-profit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the University. The voluntary contributions by employees amounted to \$20,049,594 for the year ended June 30, 2004.

NOTE 13 OTHER POST-EMPLOYMENT BENEFITS

A. HEALTH CARE FOR LONG-TERM

DISABILITY BENEFICIARIES AND RETIREES

The University participates in state-administered programs that provide post-employment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The University contributed 3.2 percent of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2004, the University's total contribution to the Plan was \$20,625,140. The University assumes no liability for retiree health care benefits provided by the programs other than its

required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

B. LONG-TERM DISABILITY

The University participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. Employer contributions are established in the Appropriations Bill by the General Assembly. The University was not required to contribute to the DIPNC for the fiscal year ended June 30, 2004. The University assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 14 RISK MANAGEMENT

The University is exposed to various risks of loss related to torts; theft of, damage to and 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. Except for a reduction in the public officers and employees liability insurance limit from \$11,000,000 to \$5,000,000, and additional limitation to the state's property reinsurance, there have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Public Officer's and Employee's Liability Insurance – Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the state provides excess public officers and employees liability insurance up to \$5,000,000 per occurrence via contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

Fire and Other Property Loss – The 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 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 \$500 per occurrence deductible. The University also purchased through the Fund extended coverage or all risk coverage with a \$500 per occurrence deductible for certain buildings and contents.

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

Employee 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 with a \$50,000 deductible and a 10 percent participation in each loss above the deductible.

Other authorized coverage not handled by the North Carolina Department of Insurance is purchased through the state's insurance agent of record. Examples include, but are not limited to, fine arts, boiler and machinery, medical professional liability, athletic accident and revenues and study abroad health insurance

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

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

Liability Insurance Trust Fund – The University participates in the Liability Insurance Trust Fund (Trust

Fund), a claims-servicing public entity risk pool for health-care professional liability protection. The Trust Fund services professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Trust Fund.

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

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

The Trust Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of 13 members as follows: one member each appointed by the state attorney general, the state auditor, the state insurance commissioner, the director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and eight members appointed to three year terms (with no limit on the number of terms) by the UNC System's Board of Governors.

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

The Trust Fund provides coverage for participants as a corporate entity, as well as for the employees and professional staff of the participants. From July 1, 2003 through June 30, 2004, the Trust Fund provided coverage on an occurrence basis of \$7,000,000 per individual for each and every claim, self-insured through the Trust Fund. During the period July 1, 2003 – June 30, 2004, the Trust Fund had no excess of loss reinsurance coverage. For fiscal year ending June 30, 2004, the Trust Fund purchased a direct insurance policy to cover the first \$1,000,000 per occurrence and \$3,000,000 in the aggregate for dental residents. The Trust Fund provides coverage of \$500,000 per occurrence in accordance with the limited waiver of sovereign immunity afforded by the State Tort Claims Act, for any recovery against the participants for the negligence of its employees. To assure that both existing and future claims will be paid, the UNC System Board of Governors is authorized by law to borrow up to \$30,000,000 to replenish the Trust Fund. No borrowings have been made under this line of credit to date. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

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

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

At June 30, 2004, University assets in the Trust Fund totaled \$24,677,500 while University liabilities totaled \$23,581,211 resulting in net assets of \$1,096,289.

Additional disclosures relative to the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund for the years ended June 30, 2004 and 2003. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 6001 East Wing, University of North Carolina Hospitals, 101 Manning Drive, Chapel Hill, North Carolina 27514, or by calling (919) 966-3041.

Term Life Insurance – Term life insurance (death benefit plan) 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.

There were no employer contributions required for the current fiscal year.

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

NOTE 15 COMMITMENTS AND CONTINGENCIES

A. COMMITMENTS

The University has commitments of \$67,258,187 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

B. PENDING LITIGATION AND CLAIMS

A \$2.1 million claim related to the construction of the Frank Porter Graham Student Union project has been submitted to the State Construction Office by the contractor. No ruling has been made regarding this claim.

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

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

C. UNIVERSITY IMPROVEMENT GENERAL OBLIGATION BONDS

The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of \$2.5 billion of general obligation bonds of the state, as subsequently approved by a vote of qualified voters of the state, to provide funds for capital improvements for the University of North Carolina. The funds authorized are to be used solely for capital facilities cost on the University of North Carolina campuses as specified in the legislation. The bond legislation specifies the amount of bond funding for each University campus and the level of bond funding intended for each project. The bonds are authorized to be issued over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The University of North Carolina – Office of the President (UNC-OP), establishes annual amounts not to exceed for each approved project.

The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, UNC-OP notifies the Office of State Budget and Management (OSBM) of the amounts not to exceed for each approved project. Within these amounts, based on an official request of cash needs from the University, OSBM authorizes allotments. The University records the allotments as revenue on the accompanying financial statements. The University's remaining authorization of \$312,423,928 is contingent on future bond sales and OSBM allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

D. OTHER CONTINGENT RECEIVABLES

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

Purpose	Amount
Pledges to permanent endowments	\$29,070,767

NOTE 16 RELATED PARTIES

There are 12 separately incorporated non-profit foundations associated with the University. These foundations are The Botanical Garden Foundation, Inc., The Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The Institute of Government Foundation, Inc., The Law Alumni Association of N.C., Inc., The Pharmacy Foundation of North Carolina, Inc., The School of Education Foundation, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., and The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc. The support from these organizations to the University approximated \$13,422,394 for the year ended June 30, 2004.

NOTE 17 CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2004, the University implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

NOTE 18 SUBSEQUENT EVENTS

On September 22, 2004, the Kenan-Flagler Business School Foundation, part of the University reporting entity, closed a \$20 million unsecured line of credit with Wachovia Bank. This credit facility is to be used to fund the expansion of the Paul J. Rizzo Business Conference Center and will expire on September 22, 2006. Advances under the line of credit accrue interest at the variable rate of the LIBOR Market Index plus 1.20 percent. There is an availability fee due each year on the anniversary date of the line of credit and is calculated as 0.125 percent of the difference between the commitment amount and the average balance outstanding for the year leading up to the anniversary date.

On October 1, 2004, the UNC-CH Foundation, also part of the University reporting entity, refinanced its \$35,000,000 unsecured loan with Bank of America. The purpose of the refinance was to increase the commitment to \$47,300,000 to provide additional funding for a Student Family Housing Project, and the facility will mature on October 1, 2005. The outstanding balance under the credit facility accrues interest at the LIBOR Rate plus 0.40 percent.

Statistical Section

Chapel Hill, North Carolina
Fiscal Year Ended June 30, 2004

Effective July 1, 2001, the University implemented GASB Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management’s Discussion and Analysis – For Public Colleges and Universities*. The financial statement presentation required by these Statements is a single-column enterprise activity rather than the fund-group perspective previously reported. Significant accounting changes in order to comply with the new requirements include adopting depreciation on capital assets, reporting revenues net of discounts and allowances, eliminating inter-fund activities, classifying activities as operating or non-operating, classifying assets and liabilities as current or non-current, and prorating summer school activities to periods earned.

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

For the fiscal year ended June 30, 2004, the University implemented GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University.

Due to these significant changes in financial reporting, the University is presenting only three years of data in this statistical section, except for specific revenue and general revenue bond coverage and demographic data which are not affected by the GASB implementation. For informational purposes, selected 10 years of statistical data (Fiscal years 1992 – 2001) are included in the “Historical Statistical Section,” reproduced from the 2001 CAFR.



THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

OPERATING AND NON-OPERATING REVENUES BY SOURCE

	For the Year Ended June 30,		
	2004	2003	2002
Operating Revenues			
Student Tuition and Fees, net	\$153,943,215	\$146,961,417	\$124,661,145
Federal Grants and Contracts	384,617,775	356,845,158	330,402,676
State and Local Grants and Contracts	39,793,048	34,288,762	38,512,136
Non-governmental Grants and Contracts	75,387,855	64,546,516	75,536,237
Patient Services, net	172,877,025	131,256,051	137,035,225
Sales and Services, net	270,350,638	262,105,915	246,567,989
Interest Earnings on Loans	434,974	281,215	120,650
Other Operating Revenues	5,232,791	7,282,755	14,628,956
Total Operating Revenues	\$1,102,637,321	\$1,003,567,789	\$967,465,014
Non-operating Revenues			
State Appropriations	\$380,446,327	\$368,024,036	\$368,504,553
Non-capital Grants, net	53,153,741	40,994,829	34,768,925
Non-capital Gifts, net	68,517,192	60,887,596	62,403,802
Investment Income, net	135,369,198	47,398,174	52,956,614
Total Non-operating Revenues	\$637,486,458	\$517,304,635	\$518,633,894
TOTAL REVENUES	\$1,740,123,779	\$1,520,872,424	\$1,486,098,908

	For the Year Ended June 30,		
	2004	2003	2002
Operating Revenues			
Student Tuition and Fees, net	8.9%	9.7%	8.4%
Federal Grants and Contracts	22.1%	23.5%	22.2%
State and Local Grants and Contracts	2.3%	2.3%	2.6%
Non-governmental Grants and Contracts	4.3%	4.2%	5.1%
Patient Services, net	9.9%	8.6%	9.2%
Sales and Services, net	15.5%	17.2%	16.6%
Interest Earnings on Loans	0.0%	0.0%	0.0%
Other Operating Revenues	0.3%	0.5%	1.0%
Total Operating Revenues	63.3%	66.0%	65.1%
Non-operating Revenues			
State Appropriations	21.9%	24.2%	24.8%
Non-capital Grants, net	3.1%	2.7%	2.3%
Non-capital Gifts, net	3.9%	4.0%	4.2%
Investment Income, net	7.8%	3.1%	3.6%
Total Non-operating Revenues	36.7%	34.0%	34.9%
TOTAL REVENUES	100.0%	100.0%	100.0%

(Percent of total revenues)

Reclassifications: Certain prior year numbers have been reclassified to conform to current year presentations.

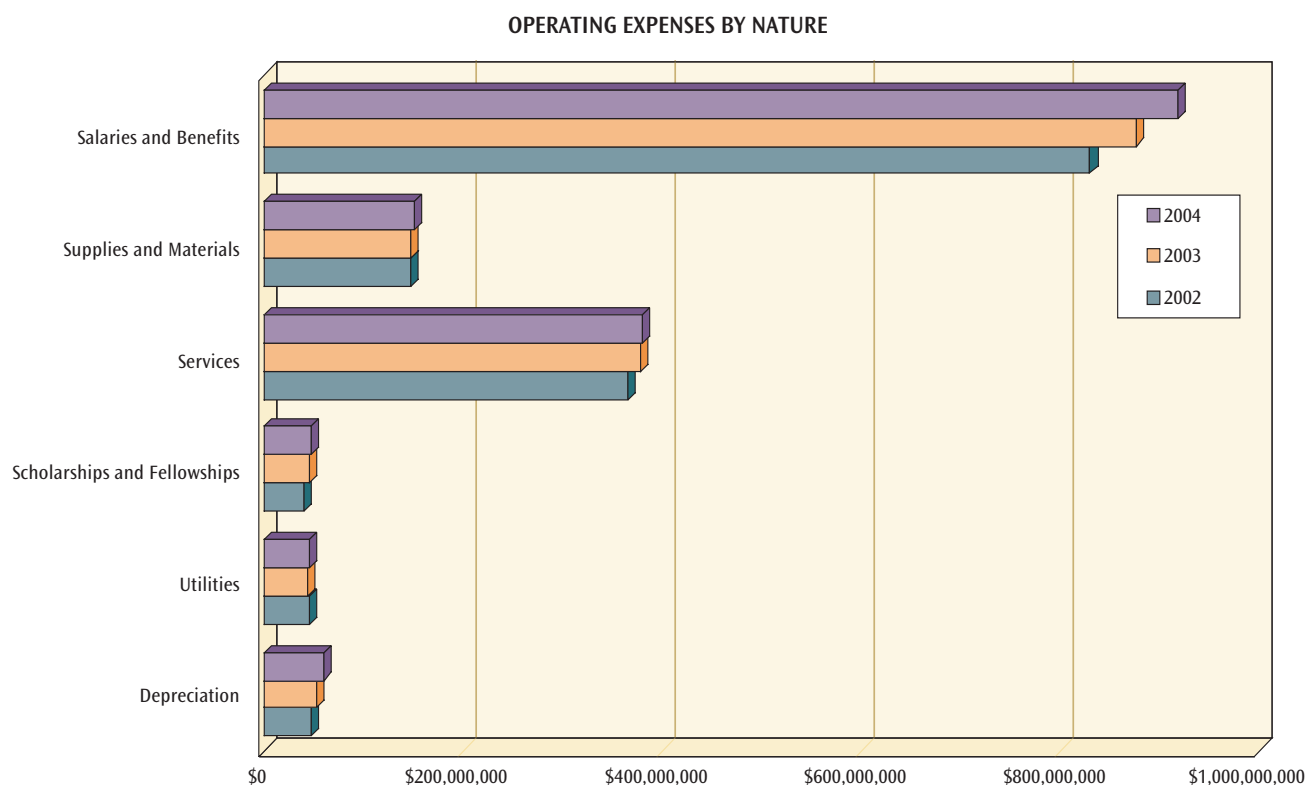
OPERATING EXPENSES BY NATURE

	For the Year Ended June 30,		
	2004	2003	2002
Operating Expenses			
Salaries and Benefits	\$917,840,235	\$876,265,477	\$829,473,249
Supplies and Materials	151,196,308	146,986,272	148,324,265
Services	380,125,640	377,855,970	364,831,514
Scholarships and Fellowships	47,427,018	45,618,092	40,414,555
Utilities	46,207,389	43,914,948	45,452,167
Depreciation	60,589,122	53,075,830	48,517,249
Total Operating Expenses by Nature	\$1,603,385,712	\$1,543,716,589	\$1,477,012,999

	For the Year Ended June 30,		
	2004	2003	2002
Operating Expenses			
Salaries and Benefits	57.2%	56.8%	56.2%
Supplies and Materials	9.4%	9.5%	10.0%
Services	23.7%	24.4%	24.7%
Scholarships and Fellowships	3.0%	3.0%	2.7%
Utilities	2.9%	2.9%	3.1%
Depreciation	3.8%	3.4%	3.3%
Total Operating Expenses by Nature	100.0%	100.0%	100.0%

(Percent of total operating expenses by nature)

Reclassifications: Certain prior year numbers have been reclassified to conform to current year presentations.



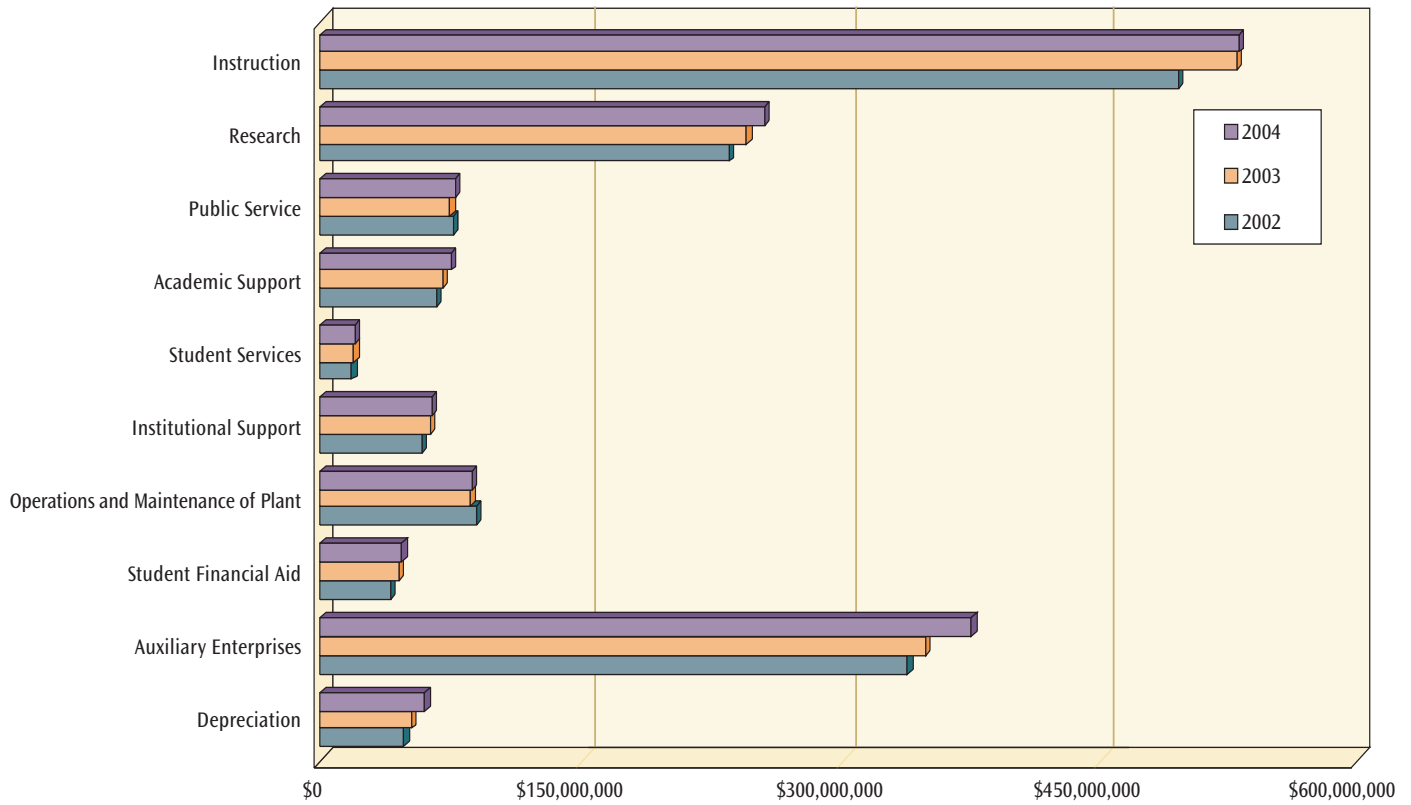
OPERATING EXPENSES BY FUNCTION

	For the Year Ended June 30,		
	2004	2003	2002
Operating Expenses by Function			
Instruction	\$532,927,326	\$531,123,250	\$497,770,880
Research	257,945,228	247,434,086	237,275,464
Public Service	78,275,601	75,409,910	76,896,238
Academic Support	75,692,980	70,888,224	67,617,814
Student Services	20,487,890	19,490,735	18,224,875
Institutional Support	64,731,371	63,460,504	58,560,098
Operations and Maintenance of Plant	87,890,864	86,451,422	90,941,785
Student Financial Aid	47,427,018	45,618,092	40,414,555
Auxiliary Enterprises	377,418,312	350,764,536	340,794,041
Depreciation	60,589,122	53,075,830	48,517,249
Total Operating Expenses by Function	\$1,603,385,712	\$1,543,716,589	\$1,477,012,999

	For the Year Ended June 30,		
	2004	2003	2002
Operating Expenses by Function			
Instruction	33.2%	34.4%	33.7%
Research	16.1%	16.0%	16.0%
Public Service	4.9%	4.9%	5.2%
Academic Support	4.7%	4.6%	4.6%
Student Services	1.3%	1.3%	1.2%
Institutional Support	4.0%	4.1%	4.0%
Operations and Maintenance of Plant	5.5%	5.6%	6.2%
Student Financial Aid	3.0%	3.0%	2.7%
Auxiliary Enterprises	23.5%	22.7%	23.1%
Depreciation	3.8%	3.4%	3.3%
Total Operating Expenses by Function	100.0%	100.0%	100.0%

(Percent of total operating expenses by function)

OPERATING EXPENSES BY FUNCTION



SUMMARY OF RATIOS

PRIMARY RESERVE RATIO

	For the Year Ended June 30,		
	2004	2003	2002
Unrestricted Net Assets	\$408,704,774	\$370,815,821	\$346,545,802
Expendable Restricted Net Assets	648,019,434	559,127,937	645,389,715
Less: Expendable Restricted for Capital Projects	(27,910,308)	(21,517,527)	(58,608,182)
Expendable Net Assets	\$1,028,813,900	\$908,426,231	\$933,327,335
Operating Expenses	\$1,603,385,712	\$1,543,716,589	\$1,477,012,999
Interest and Fees on Capital Asset-related Debt	18,339,114	15,680,788	15,031,104
Other Non-operating Expenses	8,132,036	1,899,072	7,661,489
Total Expenses	\$1,629,856,862	\$1,561,296,449	\$1,499,705,592
Expendable Net Assets	\$1,028,813,900	\$908,426,231	\$933,327,335
Total Expenses	\$1,629,856,862	\$1,561,296,449	\$1,499,705,592
Ratio	0.63 x	0.58 x	0.62 x

Measures the financial strength of the institution by indicating how long the institution could function using its expendable reserves to cover operations should additional net assets not be available. A positive ratio and an increasing amount over time denotes strength.

RETURN ON NET ASSETS RATIO

	For the Year Ended June 30,		
	2004	2003	2002
Change in Net Assets	\$216,013,557	\$60,767,554	\$45,393,586
Total Net Assets (Beginning of Year)	\$2,025,185,600	\$1,964,418,046	\$1,919,024,460
Ratio	10.7%	3.1%	2.4%

Measures total economic return. While an increasing trend reflects strength, a decline may be appropriate and even warranted if it represents a strategy on the part of the institution to fulfill its mission.

SUMMARY OF RATIOS *(continued)*

NET OPERATING REVENUES RATIO

	For the Year Ended June 30,		
	2004	2003	2002
Total Operating Revenues	\$1,102,637,321	\$1,003,567,789	\$967,465,014
State Appropriations	380,446,327	368,024,036	368,504,553
Non-capital Gifts and Grants, net	121,670,933	101,882,425	97,172,727
Investment Income, net	135,369,198	47,398,174	52,956,614
Adjusted Net Operating Revenues	\$1,740,123,779	\$1,520,872,424	\$1,486,098,908
Income Before Other Revenues, Expenses, Gains, or Losses	\$110,266,917	(\$40,424,025)	(\$13,606,684)
Adjusted Net Operating Revenues	\$1,740,123,779	\$1,520,872,424	\$1,486,098,908
Ratio	6.3%	-2.7%	-0.9%

Measures whether the institution is living within available resources. A positive ratio and an increasing amount over time, generally reflects strength.

OPERATING MARGIN EXCLUDING GIFTS

	For the Year Ended June 30,		
	2004	2003	2002
Income Before Other Revenues, Expenses, Gains, or Losses	\$110,266,917	(\$40,424,025)	(\$13,606,684)
Less: Noncapital Gifts and Grants, net	(121,670,933)	(101,882,425)	(97,172,727)
Adjusted Income Before Other Revenues, Expenses, Gains, or Losses	(\$11,404,016)	(\$142,306,450)	(\$110,779,411)
Total Operating Revenues	\$1,102,637,321	\$1,003,567,789	\$967,465,014
State Appropriations	380,446,327	368,024,036	368,504,553
Investment Income, net	135,369,198	47,398,174	52,956,614
Adjusted Net Operating Revenues less Gifts	\$1,618,452,846	\$1,418,989,999	\$1,388,926,181
Adjusted Income Before Other Revenues, Expenses, Gains, or Losses	(\$11,404,016)	(\$142,306,450)	(\$110,779,411)
Adjusted Net Operating Revenues less Gifts	\$1,618,452,846	\$1,418,989,999	\$1,388,926,181
Ratio	-0.7%	-10.0%	-8.0%

A more restrictive measure of whether the institution is living within available resources. A positive ratio and an increasing amount over time generally reflects strength.

SUMMARY OF RATIOS *(continued)*

VIABILITY RATIO

	For the Year Ended June 30,		
	2004	2003	2002
Unrestricted Net Assets	\$408,704,774	\$370,815,821	\$346,545,802
Expendable Restricted Net Assets	648,019,434	559,127,937	645,389,715
Less: Expendable Restricted for Capital Projects	(27,910,308)	(21,517,527)	(58,608,182)
Expendable Net Assets	\$1,028,813,900	\$908,426,231	\$933,327,335
Expendable Net Assets	\$1,028,813,900	\$908,426,231	\$933,327,335
Total Notes, Bonds, Capital Leases, and Commercial Paper	\$516,845,291	\$432,806,684	\$389,360,567
Ratio	2.0 x	2.1 x	2.4 x

Measures the ability of the institution to cover its debt as of the balance sheet date, should the institution need to do so. A positive ratio of greater than 1:1 generally denotes strength.

SUMMARY OF RATIOS *(continued)*

EXPENDABLE RESOURCES TO DEBT

	For the Year Ended June 30,		
	2004	2003	2002
Unrestricted Net Assets	\$408,704,774	\$370,815,821	\$346,545,802
Unrestricted Net Assets – Component Units ⁽¹⁾	17,723,823	n/a	n/a
Expendable Restricted Net Assets	648,019,434	559,127,937	645,389,715
Temporarily Restricted Net Assets – Component Units ⁽¹⁾	209,029,695	n/a	n/a
Less: Expendable Restricted for Capital Projects	(27,910,308)	(21,517,527)	(58,608,182)
Gross Expendable Net Assets	\$1,255,567,418	\$908,426,231	\$933,327,335
Total Notes, Bonds, Capital Leases and Commercial Paper	\$516,845,291	\$432,806,684	\$389,360,567
Less: U.S. EPA Project Bonds ⁽²⁾	(29,221,070)	(30,975,153)	(32,590,965)
Total Adjusted University Debt	\$487,624,221	\$401,831,531	\$356,769,602
Gross Expendable Net Assets	\$1,255,567,418	\$908,426,231	\$933,327,335
Total Adjusted University Debt	\$487,624,221	\$401,831,531	\$356,769,602
Ratio	2.6 x	2.3 x	2.6 x

A broader measure of the ability of the institution to cover its debt as of the balance sheet date.

⁽¹⁾ For the fiscal year ended June 30, 2004, the University implemented GASB Statement No. 39, *Determining Whether Certain Organizations are Component Units*. This Statement amends GASB Statement No. 14, *The Financial Reporting Entity*, to provide additional guidance to determine whether certain organizations for which the University is not financially accountable should be reported as component units based on the nature and significance of their relationship to the University. The component units of the University are discretely presented in the Financial Section.

⁽²⁾ U.S. EPA Project Bonds are secured by an irrevocable lease from the U.S. government. This lease covers the debt service requirements for the term of the Bonds.

SUMMARY OF RATIOS *(continued)*

TOTAL FINANCIAL RESOURCES TO DIRECT DEBT

	For the Year Ended June 30,		
	2004	2003	2002
Unrestricted Net Assets	\$408,704,774	\$370,815,821	\$346,545,802
Non-expendable Restricted Net Assets	328,735,341	323,961,205	304,096,632
Expendable Restricted Net Assets	648,019,434	559,127,937	645,389,715
Total Financial Resources	\$1,385,459,549	\$1,253,904,963	\$1,296,032,149
Total Financial Resources	\$1,385,459,549	\$1,253,904,963	\$1,296,032,149
Total Notes, Bonds, Capital Leases, and Commercial Paper	\$516,845,291	\$432,806,684	\$389,360,567
Ratio	2.7 x	2.9 x	3.3 x

A broader measure of the ability of the institution to cover its debt as of the balance sheet date.

DIRECT DEBT TO ADJUSTED CASH FLOW

	For the Year Ended June 30,		
	2004	2003	2002
Net Cash Used by Operating Activities	(\$348,742,031)	(\$382,265,470)	(\$440,098,807)
State Appropriations	380,446,327	368,024,036	368,504,553
Grants for Other than Capital Purposes	53,153,741	40,994,829	34,768,925
Non-capital Gifts	68,517,192	60,887,596	62,403,802
Adjusted Cash Flow from Operations	\$153,375,229	\$87,640,991	\$25,578,473
Total Notes, Bonds, Capital Leases, and Commercial Paper	\$516,845,291	\$432,806,684	\$389,360,567
Adjusted Cash Flow from Operations	\$153,375,229	\$87,640,991	\$25,578,473
Ratio	3.4 x	4.9 x	15.2 x

Measures the financial strength of the institution by indicating how long the institution would take to repay the debt using the cash provided by its operations. A decreasing ratio over time denotes strength.

SUMMARY OF RATIOS *(continued)*

DEBT BURDEN RATIO

	For the Year Ended June 30,		
	2004	2003	2002
Interest and Fees Paid on Capital Debt and Leases	\$20,438,400	\$18,302,926	\$21,117,301
Principal Paid on Capital Debt and Leases	21,900,068	14,044,252	14,130,000
Debt Service	\$42,338,468	\$32,347,178	\$35,247,301
Operating Expenses	\$1,603,385,712	\$1,543,716,589	\$1,477,012,999
Interest and Fees on Capital Asset-related Debt	18,339,114	15,680,788	15,031,104
Other Non-operating Revenues (Expenses)	8,132,036	1,899,072	7,661,489
Less: Depreciation Expense	(60,589,122)	(53,075,830)	(48,517,249)
Plus: Principal Paid on Capital Debt and Leases	21,900,068	14,044,252	14,130,000
Total Expenses	\$1,591,167,808	\$1,522,264,871	\$1,465,318,343
Debt Service	\$42,338,468	\$32,347,178	\$35,247,301
Total Expenses	\$1,591,167,808	\$1,522,264,871	\$1,465,318,343
Ratio	2.7%	2.1%	2.4%

Measures the financial strength of the institution by indicating how long the institution could function using its expendable reserves to cover operations should additional net assets not be available. A positive ratio and an increasing amount over time denotes strength.

SUMMARY OF RATIOS *(continued)*

DEBT SERVICE TO OPERATIONS

	For the Year Ended June 30,		
	2004	2003	2002
Interest and Fees Paid on Capital Debt and Leases	\$20,438,400	\$18,302,926	\$21,117,301
Principal Paid on Capital Debt and Leases	21,900,068	14,044,252	14,130,000
Debt Service	\$42,338,468	\$32,347,178	\$35,247,301
Operating Expenses	\$1,603,385,712	\$1,543,716,589	\$1,477,012,999
Interest and Fees on Capital Asset-related Debt	18,339,114	15,680,788	15,031,104
Other Non-operating Revenues (Expenses)	8,132,036	1,899,072	7,661,489
Total Expenses	\$1,629,856,862	\$1,561,296,449	\$1,499,705,592
Debt Service	\$42,338,468	\$32,347,178	\$35,247,301
Total Expenses	\$1,629,856,862	\$1,561,296,449	\$1,499,705,592
Ratio	2.6%	2.1%	2.4%

Measures the financial strength of the institution.

RESEARCH EXPENSES TO TOTAL OPERATING EXPENSES

	For the Year Ended June 30,		
	2004	2003	2002
Operating Expenses	\$1,603,385,712	\$1,543,716,589	\$1,477,012,999
Interest and Fees on Capital Asset-related Debt	18,339,114	15,680,788	15,031,104
Other Non-operating (Revenues) Expenses	8,132,036	1,899,072	7,661,489
Total Adjusted Operating Expenses	\$1,629,856,862	\$1,561,296,449	\$1,499,705,592
Research Expenses	\$257,945,228	\$247,434,086	\$237,275,464
Total Adjusted Operating Expenses	\$1,629,856,862	\$1,561,296,449	\$1,499,705,592
Ratio	15.8%	15.8%	15.8%

Measures the institution's research expense to the total operating expenses.

SUMMARY OF RATIOS *(continued)*

NET TUITION PER STUDENT

	For the Year Ended June 30,		
	2004	2003	2002
Student Tuition and Fees, net	\$153,943,215	\$146,961,417	\$124,661,145
Less: Scholarships and Fellowships	(47,427,018)	(45,618,092)	(40,414,555)
Net Tuition and Fees	\$106,516,197	\$101,343,325	\$84,246,590
Net Tuition and Fees	\$106,516,197	\$101,343,325	\$84,246,590
Undergraduate, Graduate, and Professional FTE	24,314	24,041	23,517
Net Tuition per Student	\$4,381	\$4,215	\$3,582

Measures the institution's net student tuition and fees received per student.

STATE APPROPRIATION PER STUDENT

	For the Year Ended June 30,		
	2004	2003	2002
State Appropriations	\$380,446,327	\$368,024,036	\$368,504,553
Undergraduate, Graduate, and Professional FTE	24,314	24,041	23,517
State Appropriation per Student	\$15,647	\$15,308	\$15,670

Measures the institution's dependency on state appropriations.

SPECIFIC REVENUE AND GENERAL REVENUE BOND COVERAGE LAST TEN FISCAL YEARS (IN THOUSANDS)

The University of North Carolina at Chapel Hill has issued General Revenue Bonds, which are repaid from Available Funds. Available Funds are defined as any unrestricted Net Assets remaining after satisfying obligations of the University under trust indentures, trust agreements or bond resolutions (Specific Revenue Bonds), but excluding State Appropriations, Tuition, and certain special facilities revenues. Specific Revenue Bonds have a pledged revenue stream as the repayment source.

	For the Year Ended June 30,				
	2004	2003	2002	2001	2000
Specific Revenue Bond Coverage					
Gross Operating Revenues	\$121,470	\$116,985	\$102,042	\$92,977	\$250,316
Direct Operating Expenses	90,057	90,731	73,720	64,808	214,212
Net Revenue Available for Debt Service	\$31,413	\$26,254	\$28,322	\$28,169	\$36,104
Principal	\$5,335	\$6,420	\$10,090	\$9,195	\$11,601
Interest	4,034	4,414	8,433	10,203	11,351
Specific Revenue Debt Service Requirements	\$9,369	\$10,834	\$18,523	\$19,398	\$22,952
Coverage	3.35	2.42	1.53	1.45	1.57
	For the Year Ended June 30,				
	2004	2003	2002 ⁽¹⁾	2001	2000
Available Funds General Revenue Bonds					
Total Unrestricted Revenue	\$1,148,297	\$1,055,273	\$987,708	\$1,009,353	\$924,667
Less:					
State Appropriations	(380,446)	(368,024)	(368,505)	(402,205)	(383,189)
Tuition and Fees	(153,943)	(146,961)	(124,661)	(139,319)	(121,507)
Specific Revenue Debt Service Requirements	(9,369)	(10,834)	(18,523)	(19,398)	(22,952)
Plus:					
Adjusted Beginning Unrestricted Net Assets	370,816	346,546	392,613	354,936	347,359
Total Available Funds	\$975,355	\$876,000	\$868,632	\$803,367	\$744,378
<i>Annual Increase</i>	\$99,355	\$7,368	\$65,265	\$58,989	\$69,898
<i>% Increase</i>	11.3%	0.8%	8.1%	7.9%	10.4%
	For the Year Ended June 30,				
	2004	2003	2002	2001	2000
General Revenue Bond Coverage					
Total Available Funds	\$975,355	\$876,000	\$868,632	\$803,367	\$744,378
Principal	\$11,745	\$7,150	\$4,060	\$2,840	
Interest	10,017	8,332	7,094	5,012	
General Revenue Debt Service Requirements	\$21,762	\$15,482	\$11,154	\$7,852	n/a
Coverage	44.82	56.58	77.88	102.31	

General Revenue Bond Debt Service includes debt service for specific revenue bonds refunded or defeased by issuance of general revenue debt during the year of refunding.

⁽¹⁾ For fiscal year ended June 30, 2002, the University implemented GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* as amended by GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*. In addition, the University implemented GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. The definition of available funds has not changed as a result of implementing these GASB Statements.

⁽²⁾ As of July 1, 1997, the fund balances of the various funds as previously reported were restated as a result of the University implementing GASB Number 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. This statement requires that certain investments be reported at fair value for year-end financial reporting purposes.

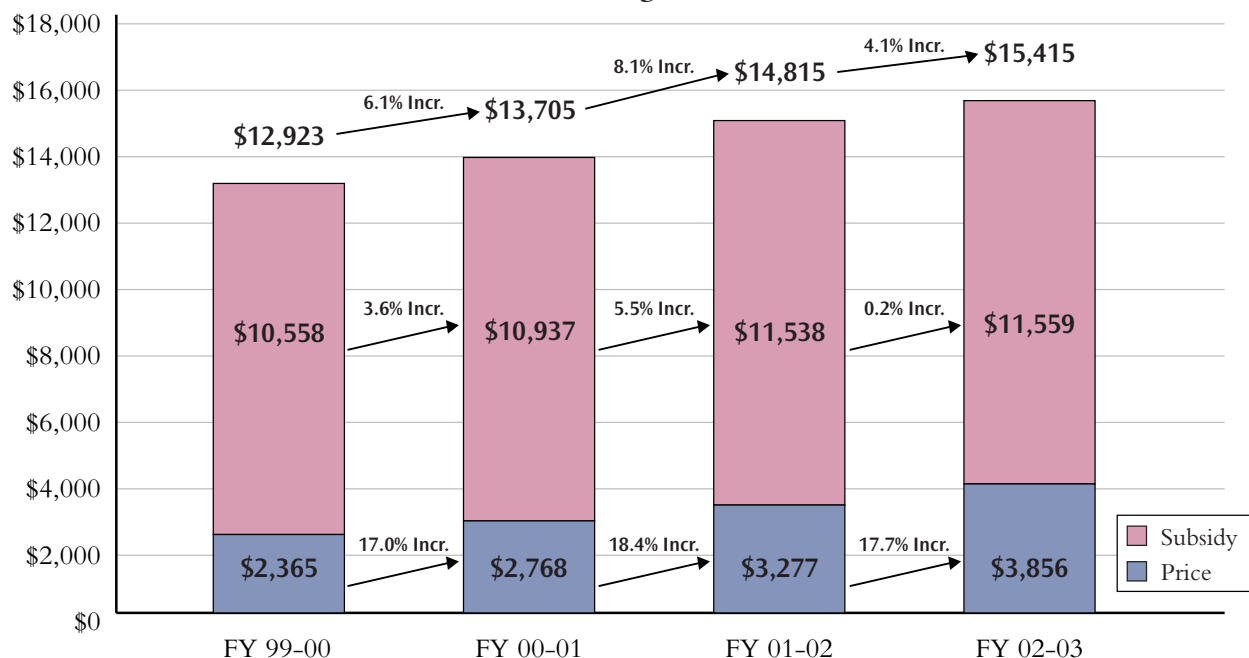
For the Year Ended June 30,					
	1999	1998	1997	1996	1995
Specific Revenue Bond Coverage					
Gross Operating Revenues	\$246,610	\$226,567	\$228,228	\$205,387	\$189,346
Direct Operating Expenses	208,753	189,205	177,793	158,584	147,847
Net Revenue Available for Debt Service	\$37,857	\$37,362	\$50,435	\$46,803	\$41,499
Principal	\$10,128	\$8,913	\$8,279	\$7,743	\$6,217
Interest	11,008	10,634	11,063	11,610	13,937
Specific Revenue Debt Service Requirements	\$21,136	\$19,547	\$19,342	\$19,353	\$20,154
Coverage	1.79	1.91	2.61	2.42	2.06
For the Year Ended June 30,					
	1999	1998 (2)	1997	1996	1995
Available Funds General Revenue Bonds					
Total Unrestricted Revenue	\$877,492	\$819,645	\$776,658	\$709,447	\$682,180
Less:					
State Appropriations	(382,372)	(352,283)	(331,650)	(308,245)	(302,337)
Tuition and Fees	(110,400)	(105,745)	(102,277)	(88,478)	(81,465)
Specific Revenue Debt Service Requirements	(21,136)	(19,547)	(19,342)	(19,353)	(20,154)
Plus:					
Beginning Unrestricted Net Assets	310,896	300,367	251,740	225,795	206,190
Total Available Funds	\$674,480	\$642,437	\$575,129	\$519,166	\$484,414
<i>Annual Increase</i>	\$32,043	\$67,308	\$55,963	\$34,752	\$28,733
<i>% Increase</i>	5.0%	11.7%	10.8%	7.2%	6.3%
For the Year Ended June 30,					
	1999	1998	1997	1996	1995
General Revenue Bond Coverage					
Total Available Funds	\$674,480	\$642,437	\$575,129	\$519,166	\$484,414
Principal					
Interest					
General Revenue Debt Service Requirements	n/a	n/a	n/a	n/a	n/a
Coverage					

ANNUAL UNDERGRADUATE EDUCATIONAL COSTS PER STUDENT

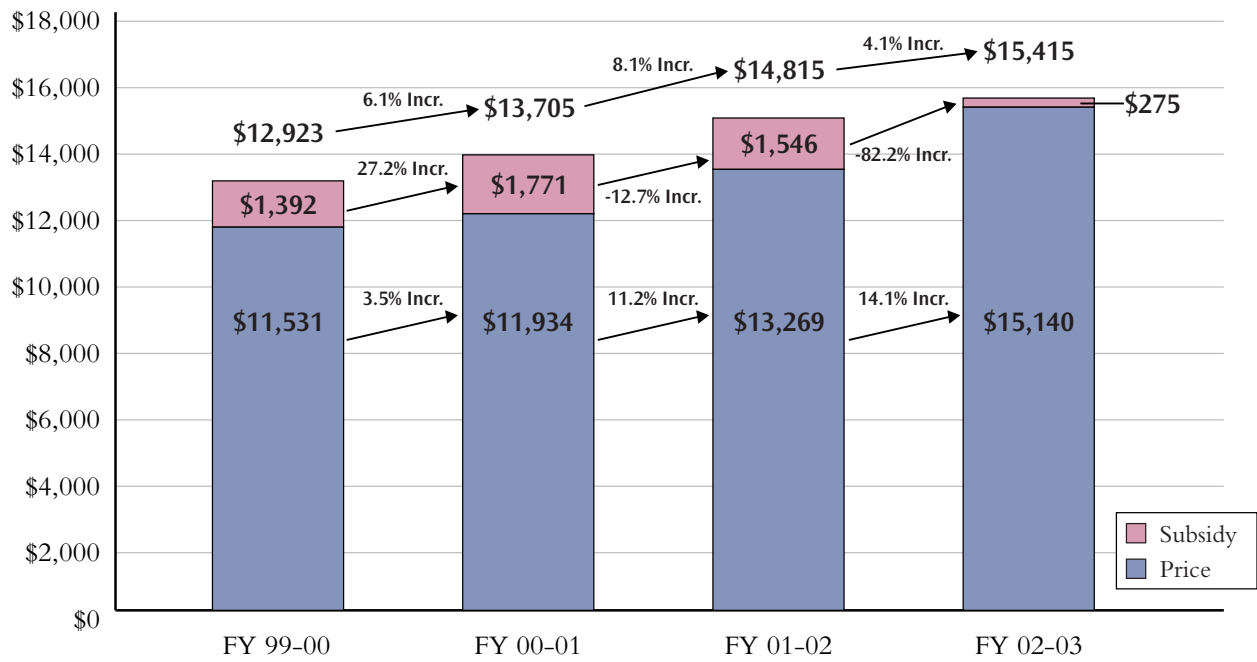
Public concern over tuition prices at colleges and universities led in 1997 to the establishment by Congress of the National Commission on the Cost of Higher Education. The task of the commission was to investigate the college cost-price conundrum and recommend ways to address it. In response, the National Association of College and University Business Officers (NACUBO) developed the Cost of College Project. The goal was to create a uniform methodology that any college or university could use to explain and present how much it costs to provide one year of undergraduate education and related services. The criteria governing the project include: simplicity of use and understanding; basis should be on existing data from annual financial statements; should be applicable to all types of colleges and universities; and should produce reasonable results when compared with more detailed cost data derived from the institution's internal accounting methods.

After more than two years in development and testing by almost 150 colleges and universities, the final project report was delivered in November, 2002. Carolina was one of those testing sites. A single-page template was developed by NACUBO to be used to record the necessary information. The template shows annual costs per resident undergraduate student at the University. The graphs displayed below show historical trends in the total annual costs per resident and non-resident undergraduate student at the University, and the difference between the price the student pays (i.e., tuition and fees) and state support (i.e., "subsidy"). The methodology was created to help individual institutions calculate and report the annual cost of providing an undergraduate education. It was not designed to be a mechanism for collecting national data on college costs or creating industry benchmarks. It is also not a measure of the value or quality of the education provided by the institution.

UNC - Chapel Hill's Cost of College
Resident Undergraduate Student



UNC - Chapel Hill's Cost of College Non-Resident Undergraduate Student

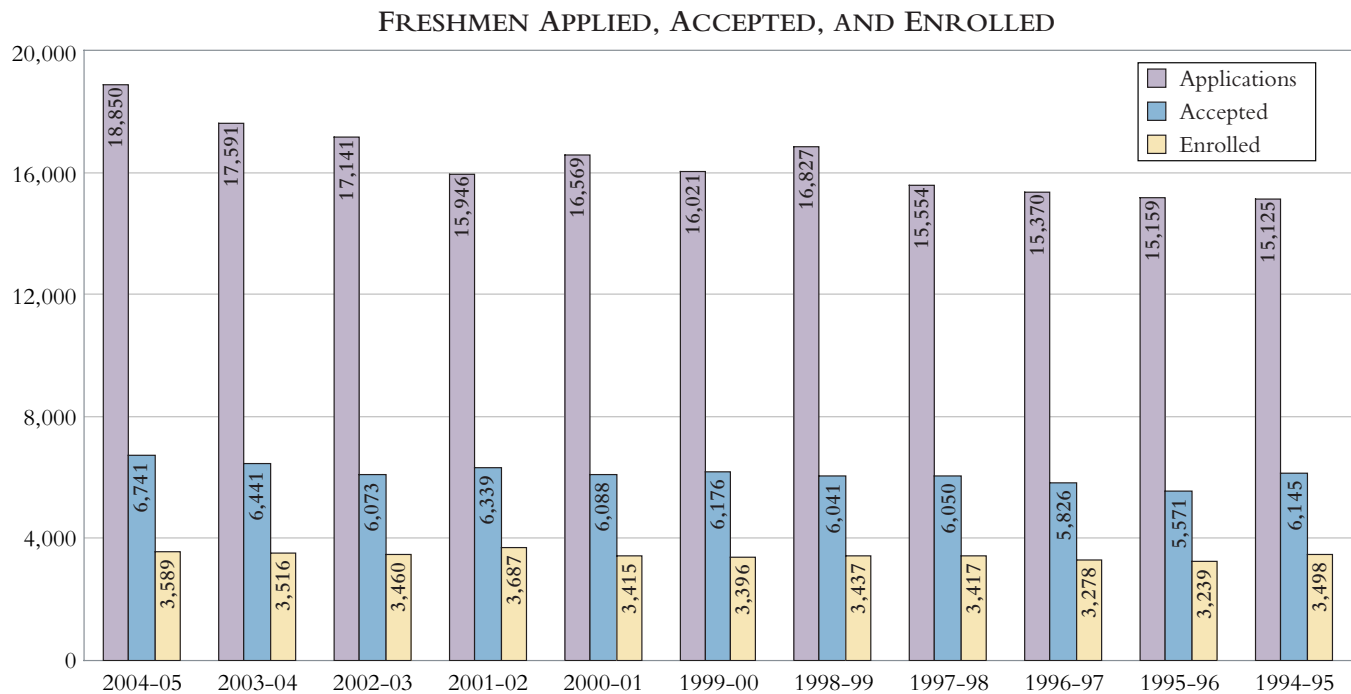


ADMISSIONS

FALL ENROLLMENT 2004-05 AND LAST TEN FISCAL YEARS

	Fall Enrollment of Fiscal Year										
	2004-05	2003-04	2002-03	2001-02	2000-01	1999-00	1998-99	1997-98	1996-97	1995-96	1994-95
Admissions - Freshmen											
Applications	18,850	17,591	17,141	15,946	16,569	16,021	16,827	15,554	15,370	15,159	15,125
Accepted	6,741	6,441	6,073	6,339	6,088	6,176	6,041	6,050	5,826	5,571	6,145
Enrolled	3,589	3,516	3,460	3,687	3,415	3,396	3,437	3,417	3,278	3,239	3,498
Accepted as a Percentage of Applications	35.8%	36.6%	35.4%	39.8%	36.7%	38.5%	35.9%	38.9%	37.9%	36.8%	40.6%
Enrolled as a Percentage of Accepted	53.2%	54.6%	57.0%	58.2%	56.1%	55.0%	56.9%	56.5%	56.3%	58.1%	56.9%
Average SAT Scores - Total	1,287	1,283	1,267	1,257	1,251	1,245	1,230	1,220	1,222	1,142	1,128
Verbal	638	634	625	623	622	620	613	609	611	539	529
Math	649	649	642	634	629	625	617	611	611	603	599

Source: The University of North Carolina at Chapel Hill Fact Book.

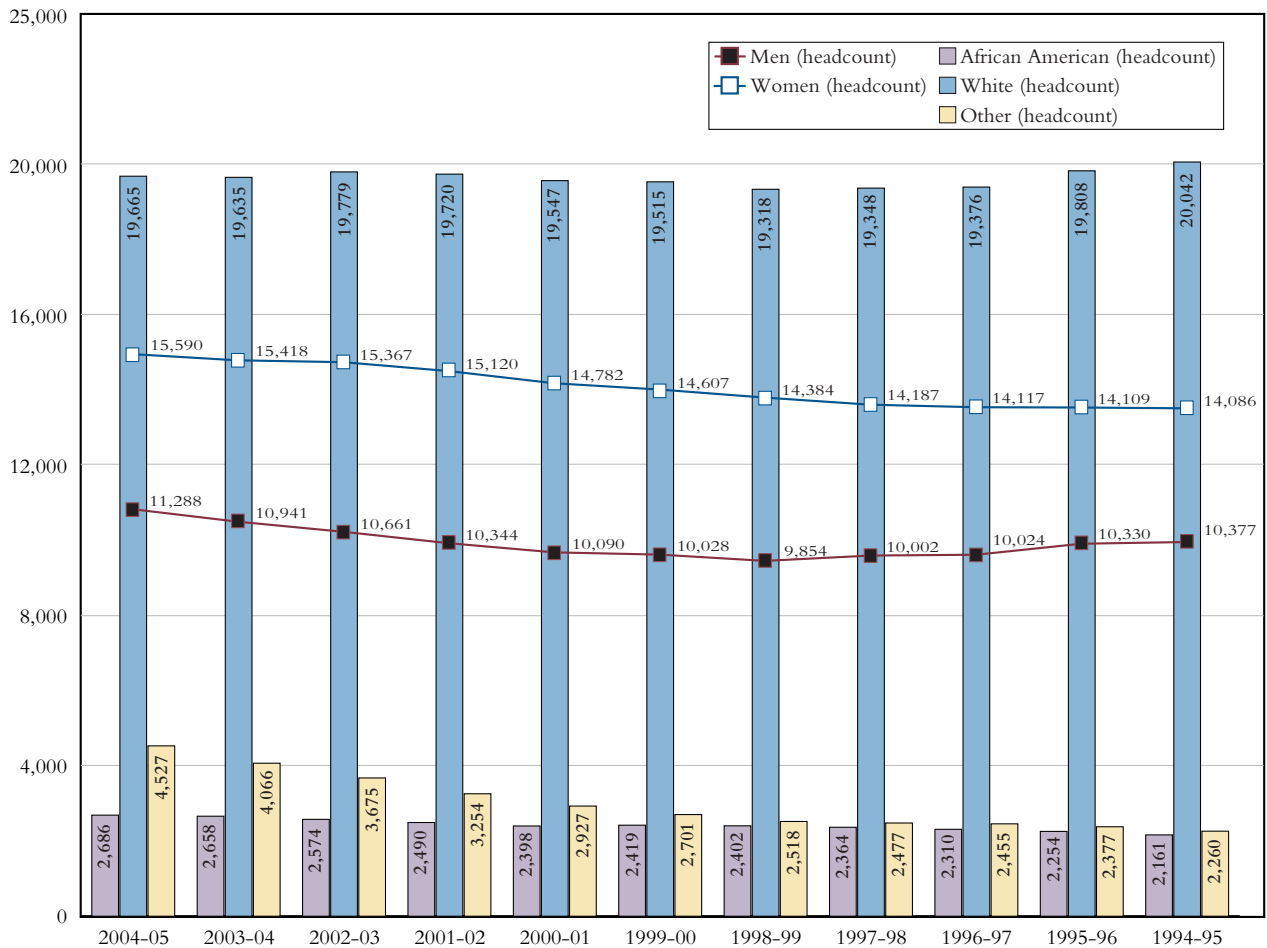


ENROLLMENT

FALL ENROLLMENT 2004-05 AND LAST TEN FISCAL YEARS

	Fall Enrollment of Fiscal Year										
	2004-05	2003-04	2002-03	2001-02	2000-01	1999-00	1998-99	1997-98	1996-97	1995-96	1994-95
Enrollment											
Undergraduate, Graduate and Professional FTE	24,736	24,314	24,041	23,517	23,000	22,761	21,940	21,794	21,709	21,961	21,918
Undergraduate, Graduate and Professional Headcount	26,878	26,359	26,028	25,464	24,872	24,635	24,238	24,189	24,141	24,439	24,463
Men (Headcount)	11,288	10,941	10,661	10,344	10,090	10,028	9,854	10,002	10,024	10,330	10,377
Percentage of Total	42.0%	41.5%	41.0%	40.6%	40.6%	40.7%	40.7%	41.3%	41.5%	42.3%	42.4%
Women (Headcount)	15,590	15,418	15,367	15,120	14,782	14,607	14,384	14,187	14,117	14,109	14,086
Percentage of Total	58.0%	58.5%	59.0%	59.4%	59.4%	59.3%	59.3%	58.7%	58.5%	57.7%	57.6%
African American (Headcount)	2,686	2,658	2,574	2,490	2,398	2,419	2,402	2,364	2,310	2,254	2,161
Percentage of Total	10.0%	10.1%	9.9%	9.7%	9.6%	9.8%	9.9%	9.8%	9.6%	9.2%	8.8%
White (Headcount)	19,665	19,635	19,779	19,720	19,547	19,515	19,318	19,348	19,376	19,808	20,042
Percentage of Total	73.2%	74.4%	76.0%	77.3%	78.5%	79.2%	79.7%	80.0%	80.2%	81.1%	82.0%
Other (Headcount)	4,527	4,066	3,675	3,254	2,927	2,701	2,518	2,477	2,455	2,377	2,260
Percentage of Total	16.8%	15.5%	14.1%	12.9%	11.9%	11.0%	10.4%	10.2%	10.2%	9.7%	9.2%

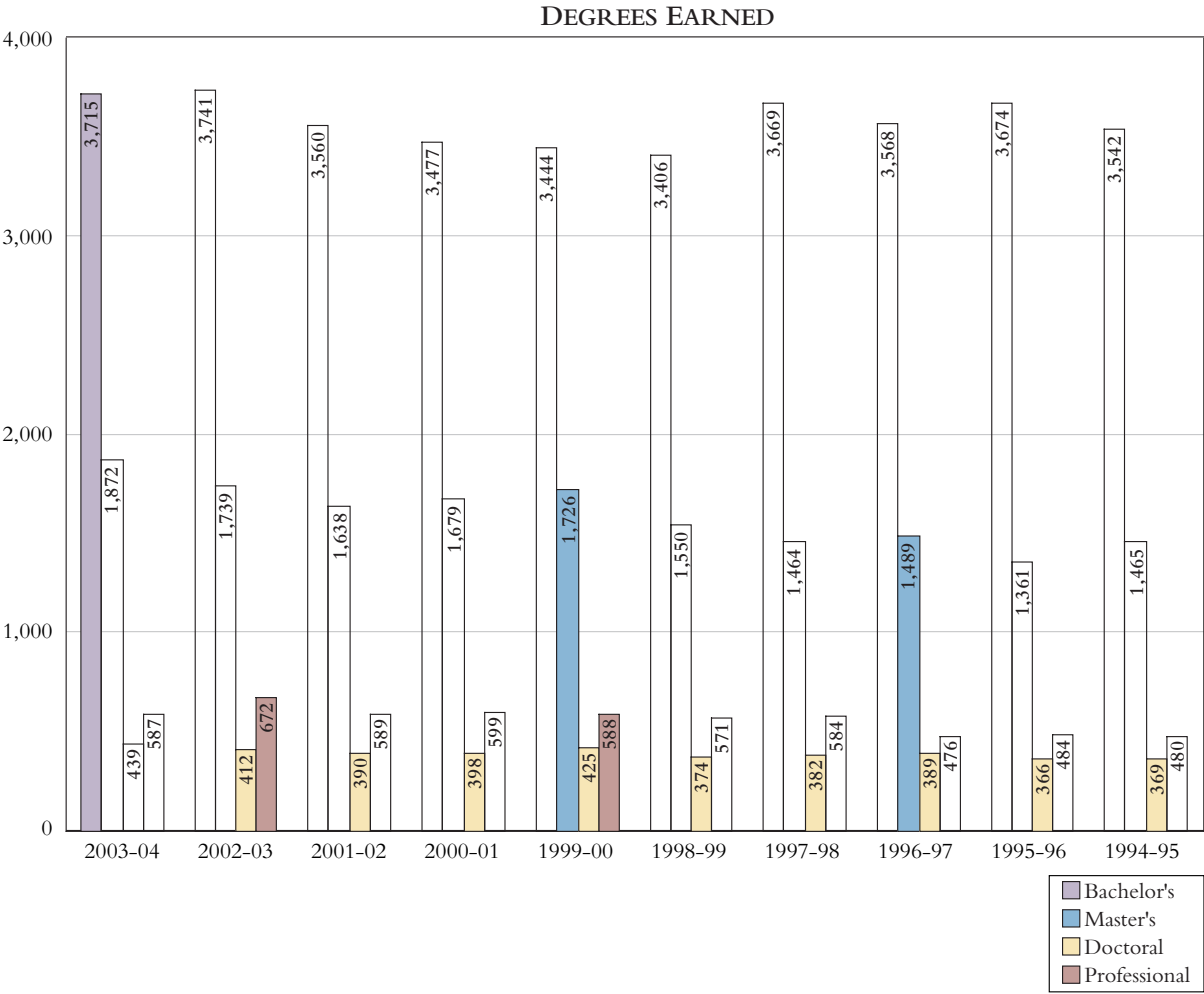
HEADCOUNT TOTAL



DEGREES EARNED
LAST TEN FISCAL YEARS

	Fall Enrollment of Fiscal Year									
	2003-04	2002-03	2001-02	2000-01	1999-00	1998-99	1997-98	1996-97	1995-96	1994-95
Degrees Granted										
Bachelor's	3,715	3,741	3,560	3,477	3,444	3,406	3,669	3,568	3,674	3,542
Master's	1,872	1,739	1,638	1,679	1,726	1,550	1,464	1,489	1,361	1,465
Doctoral	439	412	390	398	425	374	382	389	366	369
Professional	587	672	589	599	588	571	584	476	484	480

Source: The University of North Carolina at Chapel Hill Fact Book.



FACULTY AND STAFF STATISTICS

FALL EMPLOYMENT 2004-05 AND LAST TEN FISCAL YEARS

	Fall Employment of Fiscal Year					
	2004-05	2003-04	2002-03	2001-02	2000-01	1999-00
Faculty						
Full-time	2,844	2,744	2,701	2,598	2,488	2,601
Part-time	330	313	307	322	294	260
Total Faculty	3,174	3,057	3,008	2,920	2,782	2,861
Percentage Tenured	48.7%	45.9%	50.5%	52.1%	53.9%	51.9%
Staff and EPA Non-Faculty						
Full-time	1,307	1,227	1,157	1,034	993	784
Part-time	132	128	111	97	92	63
EPA Non-Faculty	1,439	1,355	1,268	1,131	1,085	847
Full-time	6,004	5,947	5,915	5,782	5,574	5,996
Part-time	321	317	290	278	284	307
SPA	6,325	6,264	6,205	6,060	5,858	6,303
Total Full-time	7,311	7,174	7,072	6,816	6,567	6,780
Total Part-time	453	445	401	375	376	370
Total Staff and EPA Non-Faculty	7,764	7,619	7,473	7,191	6,943	7,150

	Fall Employment of Fiscal Year				
	1998-99	1997-98	1996-97	1995-96	1994-95
Faculty					
Full-time	2,477	2,421	2,417	2,369	2,328
Part-time	260	239	223	216	210
Total Faculty	2,737	2,660	2,640	2,585	2,538
Percentage Tenured	54.6%	56.2%	57.9%	58.3%	59.2%
Staff and EPA Non-Faculty					
Full-time	725	674	653	648	627
Part-time	56	53	56	57	51
EPA Non-Faculty	781	727	709	705	678
Full-time	5,790	5,587	5,236	5,519	5,468
Part-time	311	314	298	322	328
SPA	6,101	5,901	5,534	5,841	5,796
Total Full-time	6,515	6,261	5,889	6,167	6,095
Total Part-time	367	367	354	379	379
Total Staff and EPA Non-Faculty	6,882	6,628	6,243	6,546	6,474

Note: SPA denotes employees subject to the State Personnel Act
 EPA denotes employees exempt from the State Personnel Act

Source: The University of North Carolina at Chapel Hill Fact Book.



Historical Statistical Section

Chapel Hill, North Carolina

For informational purposes, selected 10 years of statistical data (Fiscal years 1992 - 2001) are reproduced from the 2001 CAFR, prior to the implementation 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 UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

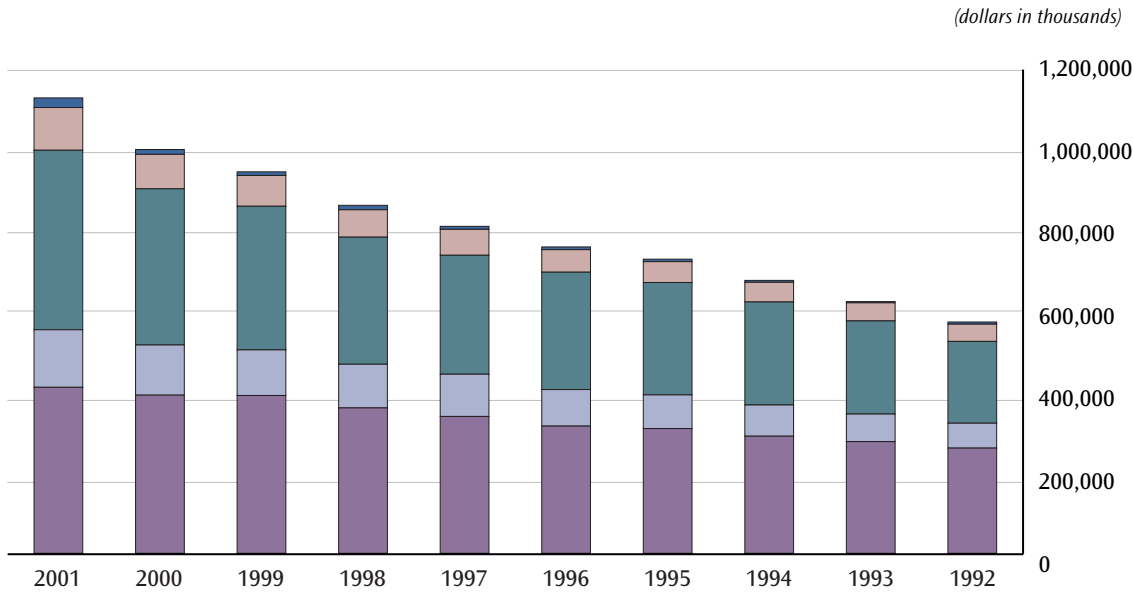
UNRESTRICTED GENERAL AND RESTRICTED CURRENT FUNDS REVENUES BY SOURCE

TEN FISCAL YEARS

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Funds Revenues					
State Appropriations	\$402,205	\$383,189	\$382,372	\$352,283	\$331,650
Tuition and Fees	139,319	121,507	110,400	105,745	102,277
Contracts and Grants	434,683	378,094	347,850	307,685	288,042
Gifts, Investment and Endowment Income	103,382	83,459	74,557	66,321	62,720
Sales and Services and Others	23,347	11,797	8,767	10,816	7,317
Total Current Funds Revenues	\$1,102,936	\$978,046	\$923,946	\$842,850	\$792,006

Unrestricted General and Restricted Current Funds Revenues By Source for year ended June 30,



(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Current Funds Revenues					
State Appropriations	\$308,245	\$302,337	\$283,826	\$270,700	\$255,003
Tuition and Fees	88,478	81,465	75,531	66,718	60,247
Contracts and Grants	284,195	272,176	249,448	225,512	198,095
Gifts, Investment and Endowment Income	54,486	50,429	47,637	43,783	41,676
Sales and Services and Others	6,693	6,043	4,646	3,066	5,310
Total Current Funds Revenues	\$742,097	\$712,450	\$661,088	\$609,779	\$560,331

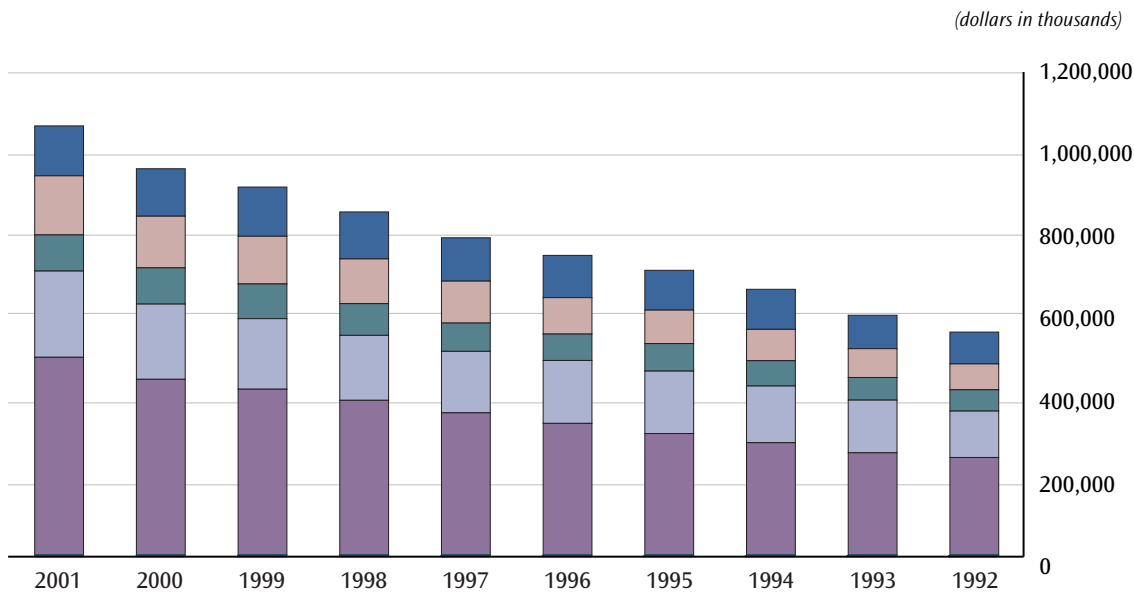
- Sales and Services and Others
- Gifts, Investment and Endowment Income
- Contracts and Grants
- Tuition and Fees
- State Appropriations

UNRESTRICTED GENERAL AND RESTRICTED CURRENT FUNDS
EXPENDITURES AND MANDATORY TRANSFERS BY FUNCTION
TEN FISCAL YEARS

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Funds Expenditures					
Instruction	\$490,447	\$435,839	\$411,292	\$383,759	\$352,711
Organized Research	213,833	186,550	174,973	161,128	152,478
Public Service	89,663	89,906	86,062	78,678	70,106
Academic Support, Student Services, and Financial Aid	146,575	128,107	118,351	110,863	104,051
Institutional Support, Plant Maintenance and Operations	123,867	117,690	122,029	116,583	107,535
Total Current Funds Expenditures	\$1,064,385	\$958,092	\$912,707	\$851,011	\$786,881
Current Funds Mandatory Transfers	1,346	502	37	43	689
Total Current Funds Expenditures and Mandatory Transfers	\$1,065,731	\$958,594	\$912,744	\$851,054	\$787,570

Unrestricted General and Restricted Current Funds Expenditures and Madatory Transfers by Function for year ended June 30,



(in thousands)

For the Year Ended June 30,

	1996	1995	1994	1993	1992
Current Funds Expenditures					
Instruction	\$326,546	\$301,323	\$278,587	\$253,662	\$241,956
Organized Research	156,034	154,817	140,586	130,570	115,014
Public Service	65,502	68,317	62,834	56,111	52,952
Academic Support, Student Services and Financial Aid	90,236	83,016	77,728	71,427	64,079
Institutional Support, Plant Maintenance and Operations	104,929	98,751	99,372	82,921	78,970
Total Current Funds Expenditures	\$743,247	\$706,224	\$659,107	\$594,691	\$552,971
Current Funds Mandatory Transfers	57	490	1,323	2,202	2,754
Total Current Funds Expenditures and Mandatory Transfers	\$743,304	\$706,714	\$660,430	\$596,893	\$555,725

- Institutional Support, Plant Maintenance and Operations
- Academic Support, Student Support and Financial Aid
- Public Service
- Organized Research
- Instruction

CURRENT FUNDS REVENUES BY SOURCE

TEN FISCAL YEARS

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Funds Revenues					
State Appropriations	\$402,205	\$383,189	\$382,372	\$352,283	\$331,650
Tuition and Fees	139,319	121,507	110,400	105,745	102,277
Federal Contracts and Grants	311,821	276,548	259,152	231,687	221,548
State Contracts and Grants	52,519	44,782	37,570	31,269	26,402
Nongovernmental Contracts and Grants	70,343	56,764	51,128	44,729	40,092
Gifts and Bequests	80,007	53,484	46,657	44,312	38,197
Investment Income	28,679	18,619	20,335	17,045	21,748
Endowment Income	8,727	21,110	19,556	16,176	15,544
Sales and Services	333,262	307,929	280,484	268,455	255,593
Other Revenues	29,790	15,506	13,027	15,547	9,231
Total Current Funds Revenues	\$1,456,672	\$1,299,438	\$1,220,681	\$1,127,248	\$1,062,282

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
	%	%	%	%	%
Current Funds Revenues					
State Appropriations	27.6	29.5	31.3	31.3	31.2
Tuition and Fees	9.6	9.4	9.0	9.4	9.6
Federal Contracts and Grants	21.4	21.3	21.2	20.5	20.8
State Contracts and Grants	3.6	3.4	3.1	2.8	2.5
Nongovernmental Contracts and Grants	4.8	4.4	4.2	4.0	3.8
Gifts and Bequests	5.5	4.1	3.8	3.9	3.6
Investment Income	2.0	1.4	1.7	1.5	2.0
Endowment Income	0.6	1.6	1.6	1.4	1.5
Sales and Services	22.9	23.7	23.0	23.8	24.1
Other Revenues	2.0	1.2	1.1	1.4	0.9
Total Current Funds Revenues	100.0	100.0	100.0	100.0	100.0

(percent of total current funds revenues)

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Current Funds Revenues					
State Appropriations	\$308,245	\$302,337	\$283,826	\$270,700	\$255,003
Tuition and Fees	88,478	81,465	75,531	66,718	60,247
Federal Contracts and Grants	219,878	208,802	190,534	172,288	147,556
State Contracts and Grants	24,607	26,394	22,696	17,948	15,498
Nongovernmental Contracts and Grants	39,710	36,980	36,218	35,276	35,041
Gifts and Bequests	34,464	30,688	27,928	25,544	23,851
Investment Income	15,274	12,726	13,748	14,534	15,828
Endowment Income	13,599	13,798	11,895	9,212	8,040
Sales and Services	233,888	224,600	210,767	187,390	176,297
Other Revenues	6,526	5,679	4,246	4,632	3,847
Total Current Funds Revenues	\$984,669	\$943,469	\$877,389	\$804,242	\$741,208

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
	%	%	%	%	%
Current Funds Revenues					
State Appropriations	31.3	32.1	32.3	33.7	34.4
Tuition and Fees	9.0	8.6	8.6	8.3	8.1
Federal Contracts and Grants	22.3	22.1	21.7	21.4	19.9
State Contracts and Grants	2.5	2.8	2.6	2.2	2.1
Nongovernmental Contracts and Grants	4.0	3.9	4.1	4.4	4.8
Gifts and Bequests	3.5	3.3	3.2	3.2	3.2
Investment Income	1.5	1.3	1.6	1.8	2.1
Endowment Income	1.4	1.5	1.4	1.1	1.1
Sales and Services	23.8	23.8	24.0	23.3	23.8
Other Revenues	0.7	0.6	0.5	0.6	0.5
Total Current Funds Revenues	100.0	100.0	100.0	100.0	100.0

(percent of total current funds revenues)

CURRENT FUNDS REVENUES BY SOURCE

ADJUSTED FOR INFLATION (1992 DOLLARS)

TEN FISCAL YEARS

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Funds Revenues					
State Appropriations	\$316,793	\$311,619	\$322,554	\$303,007	\$290,064
Tuition and Fees	109,733	98,813	93,129	90,954	89,452
Federal Contracts and Grants	245,603	224,896	218,611	199,279	193,768
State Contracts and Grants	41,366	36,418	31,693	26,895	23,091
Nongovernmental Contracts and Grants	55,405	46,162	43,130	38,472	35,065
Gifts and Bequests	63,017	43,495	39,358	38,114	33,407
Investment Income	22,589	15,141	17,154	14,661	19,021
Endowment Income	6,874	17,167	16,497	13,913	13,595
Sales and Services	262,491	250,416	236,606	230,904	223,544
Other Revenues	23,464	12,610	10,989	13,372	8,074
Total Current Funds Revenues	\$1,147,335	\$1,056,737	\$1,029,721	\$969,571	\$929,081

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
	%	%	%	%	%
Current Funds Revenues					
State Appropriations	27.6	29.5	31.3	31.3	31.2
Tuition and Fees	9.6	9.4	9.0	9.4	9.6
Federal Contracts and Grants	21.4	21.3	21.2	20.5	20.9
State Contracts and Grants	3.6	3.4	3.1	2.8	2.5
Nongovernmental Contracts and Grants	4.8	4.4	4.2	4.0	3.8
Gifts and Bequests	5.5	4.1	3.8	3.9	3.6
Investment Income	2.0	1.4	1.7	1.5	2.0
Endowment Income	0.6	1.6	1.6	1.4	1.5
Sales and Services	22.9	23.7	23.0	23.8	24.0
Other Revenues	2.0	1.2	1.1	1.4	0.9
Total Current Funds Revenues	100.0	100.0	100.0	100.0	100.0

(percent of total current funds revenues)

Consumer Price Index	178.0	172.4	166.2	163.0	160.3
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(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Current Funds Revenues					
State Appropriations	\$275,788	\$277,952	\$268,868	\$262,826	255,003
Tuition and Fees	79,162	74,894	71,550	64,777	60,247
Federal Contracts and Grants	196,726	191,961	180,492	167,277	147,556
State Contracts and Grants	22,016	24,265	21,500	17,426	15,498
Nongovernmental Contracts and Grants	35,529	33,997	34,309	34,250	35,041
Gifts and Bequests	30,835	28,213	26,456	24,801	23,851
Investment Income	13,666	11,700	13,023	14,111	15,828
Endowment Income	12,167	12,685	11,268	8,944	8,040
Sales and Services	209,260	206,485	199,659	181,940	176,297
Other Revenues	5,839	5,221	4,022	4,497	3,847
Total Current Funds Revenues	\$880,988	\$867,373	\$831,147	\$780,849	\$741,208

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
	%	%	%	%	%
Current Funds Revenues					
State Appropriations	31.2	32.1	32.3	33.7	34.4
Tuition and Fees	9.0	8.6	8.6	8.3	8.1
Federal Contracts and Grants	22.3	22.1	21.7	21.4	19.9
State Contracts and Grants	2.5	2.8	2.6	2.2	2.1
Nongovernmental Contracts and Grants	4.0	3.9	4.1	4.4	4.8
Gifts and Bequests	3.5	3.3	3.2	3.2	3.2
Investment Income	1.6	1.3	1.6	1.8	2.1
Endowment Income	1.4	1.5	1.4	1.1	1.1
Sales and Services	23.8	23.8	24.0	23.3	23.8
Other Revenues	0.7	0.6	0.5	0.6	0.5
Total Current Funds Revenues	100.0	100.0	100.0	100.0	100.0

(percent of total current funds revenues)

Consumer Price Index	156.7	152.5	148.0	144.4	140.2
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CURRENT FUNDS EXPENDITURES AND MANDATORY TRANSFERS BY FUNCTION

TEN FISCAL YEARS

(in thousands)

For the Year Ended June 30,

	2001	2000	1999	1998	1997
Current Funds Expenditures					
Instruction	\$490,447	\$435,839	\$411,292	\$383,759	\$352,711
Organized Research	213,833	186,550	174,973	161,128	152,478
Public Service	89,663	89,906	86,062	78,678	70,106
Academic Support	75,226	63,528	60,384	56,528	53,663
Student Services	16,679	14,735	13,662	12,661	11,763
Institutional Support	51,122	48,165	58,078	49,309	44,105
Plant Maintenance and Operations	72,745	69,525	65,501	63,359	60,224
Student Financial Aid	54,670	49,844	44,305	41,674	38,625
Auxiliary Enterprises and Internal Services	135,706	127,443	121,148	112,844	101,556
Professional and Clinical Services	167,703	156,522	133,057	135,099	116,393
Other Expenditures and Deductions	0	0	0	5,974	5,669
Total Current Funds Expenditures	\$1,367,794	\$1,242,057	\$1,168,462	\$1,101,013	\$1,007,293
Current Funds Mandatory Transfers	27,481	27,620	20,079	22,852	29,007
Total Current Funds Expenditures and Mandatory Transfers	\$1,395,275	\$1,269,677	\$1,188,541	\$1,123,865	\$1,036,301

For the Year Ended June 30,

	2001	2000	1999	1998	1997
	%	%	%	%	%
Current Funds Expenditures					
Instruction	35.2	34.3	34.6	34.1	34.0
Organized Research	15.3	14.7	14.7	14.3	14.7
Public Service	6.4	7.1	7.2	7.0	6.8
Academic Support	5.4	5.0	5.1	5.0	5.2
Student Services	1.2	1.2	1.2	1.1	1.1
Institutional Support	3.7	3.8	4.9	4.4	4.3
Plant Maintenance and Operations	5.2	5.5	5.5	5.7	5.8
Student Financial Aid	3.9	3.9	3.7	3.7	3.8
Auxiliary Enterprises and Internal Services	9.7	10.0	10.2	10.1	9.8
Professional and Clinical Services	12.0	12.3	11.2	12.0	11.2
Other Expenditures and Deductions			0.6	0.5	
Total Current Funds Expenditures	98.0	97.8	98.3	98.0	97.2
Current Funds Mandatory Transfers	2.0	2.2	1.7	2.0	2.8
Total Current Funds Expenditures and Mandatory Transfers	100.0	100.0	100.0	100.0	100.0

(percent of total current funds expenditures and mandatory transfers)

(in thousands)

For the Year Ended June 30,

	1996	1995	1994	1993	1992
Current Funds Expenditures					
Instruction	\$326,546	\$301,323	\$278,587	\$253,662	\$241,956
Organized Research	156,034	154,817	140,586	130,570	115,014
Public Service	65,502	68,317	62,834	56,111	52,952
Academic Support	47,771	43,423	40,507	35,845	32,740
Student Services	10,986	9,998	9,191	8,585	7,624
Institutional Support	41,500	37,698	36,800	32,118	30,097
Plant Maintenance and Operations	62,402	59,662	58,447	49,606	48,552
Student Financial Aid	31,479	29,595	28,030	26,997	23,715
Auxiliary Enterprises and Internal Services	89,946	89,532	80,587	85,774	73,199
Professional and Clinical Services	108,282	99,140	97,265	85,187	74,769
Other Expenditures and Deductions	1,027	1,391	4,125	1,197	345
Total Current Funds Expenditures	\$941,475	\$894,896	\$836,959	\$765,652	\$700,963
Current Funds Mandatory Transfers	24,084	20,758	21,158	18,140	9,066
Total Current Funds Expenditures and Mandatory Transfers	\$965,559	\$915,654	\$858,117	\$783,792	\$710,029

For the Year Ended June 30,

	1996	1995	1994	1993	1992
	%	%	%	%	%
Current Funds Expenditures					
Instruction	33.8	32.9	32.5	32.4	34.1
Organized Research	16.2	16.9	16.4	16.7	16.2
Public Service	6.8	7.5	7.3	7.2	7.5
Academic Support	4.9	4.7	4.7	4.6	4.6
Student Services	1.1	1.1	1.1	1.1	1.1
Institutional Support	4.3	4.1	4.3	4.1	4.2
Plant Maintenance and Operations	6.5	6.5	6.8	6.3	6.8
Student Financial Aid	3.3	3.2	3.3	3.4	3.3
Auxiliary Enterprises and Internal Services	9.3	9.8	9.4	10.9	10.3
Professional and Clinical Services	11.2	10.8	11.3	10.9	10.5
Other Expenditures and Deductions	0.1	0.2	0.4	0.1	0.1
Total Current Funds Expenditures	97.5	97.7	97.5	97.7	98.7
Current Funds Mandatory Transfers	2.5	2.3	2.5	2.3	1.3
Total Current Funds Expenditures and Mandatory Transfers	100.0	100.0	100.0	100.0	100.0

(percent of total current funds expenditures and mandatory transfers)

TEN YEAR SUMMARY OF RATIOS

TEN FISCAL YEARS

RATIO OF TOTAL CURRENT REVENUES TO TOTAL CURRENT EXPENDITURES

	(in thousands)				
	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Total Current Revenues	\$1,456,672	\$1,299,438	\$1,220,681	\$1,127,248	\$1,062,282
Total Current Expenditures and Mandatory Transfers	1,395,275	1,269,677	1,188,541	1,123,865	1,036,301
Ratio	104.40%	102.34%	102.70%	100.30%	102.51%

This ratio indicates the percentage of current funds revenues that remain after all current funds expenditures and mandatory transfers are applied. A percentage greater than 100% indicates a surplus for the year. The larger the surplus, the stronger the institution's financial position as a result of the year's operations. Large deficits are usually a bad sign, particularly if they occur in successive years. A pattern of large deficits can reduce an institution's financial strength. Such a pattern is a warning signal that corrective action should be taken.

RATIO OF AVAILABLE FUNDS TO EDUCATIONAL AND GENERAL EXPENDITURES AND MANDATORY TRANSFERS

	(in thousands)				
	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Fund Balance - General	\$115,263	\$86,061	\$60,828	\$54,643	\$60,437
Current Fund Balance - Proprietary	170,668	162,193	165,090	157,697	154,264
Quasi Endowment Fund Balance - Unrestricted	106,682	121,441	98,556	85,787	48,704
Total Availability	\$392,613	\$369,695	\$324,474	\$298,127	\$263,405
Total Availability	392,613	369,695	324,474	298,127	263,405
Educational and General Expenditures and Mandatory Transfers	1,091,866	985,712	934,336	869,948	812,682
Ratio	35.96%	37.51%	34.73%	34.27%	32.41%

This ratio measures the size of the institution's financial reserves. Increasing ratios indicate better preparation for financial disruptions. The University receives its state appropriations on a quarterly allotment basis and state appropriations are not accrued at year end to finance accrued expenses.

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Total Current Revenues	\$984,669	\$943,469	\$877,389	\$804,242	\$741,208
Total Current Expenditures and Mandatory Transfers	965,559	915,654	858,117	783,792	710,029
Ratio	101.98%	103.04%	102.25%	102.61%	104.39%

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Current Fund Balance - General	\$53,902	\$49,726	\$44,104	\$37,536	\$29,681
Current Fund Balance - Proprietary	149,134	140,429	127,098	116,643	111,371
Quasi Endowment Fund Balance - Unrestricted	35,640	34,988	36,656	36,066	33,761
Total Availability	\$238,676	\$225,143	\$207,858	\$190,245	\$174,813
Total Availability	238,676	225,143	207,858	190,245	174,813
Educational and General Expenditures and Mandatory Transfers	766,304	725,591	676,140	611,634	561,716
Ratio	31.15%	31.03%	30.74%	31.10%	31.12%

TEN YEAR SUMMARY OF RATIOS *(continued)*

TEN FISCAL YEARS

RATIO OF EXPENDABLE FUND BALANCE TO TOTAL EXPENDITURES AND MANDATORY TRANSFERS

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Fund Balance - General	\$115,263	\$86,061	\$60,828	\$54,643	\$60,437
Current Fund Balance - Proprietary	170,668	162,193	165,090	157,697	154,264
Current Fund Balance - Restricted	207,040	147,942	137,437	112,855	94,072
Quasi Endowment Fund Balance	489,126	493,209	161,984	143,043	92,180
Unexpended Plant Fund Balance	63,159	55,581	86,670	72,332	61,063
Debt Service Fund Balance	24,761	28,485	28,628	32,329	26,454
Total Expendable Fund Balance	\$1,070,017	\$973,471	\$640,637	\$572,899	\$488,470
Total Expendable Fund Balance	1,070,017	973,471	640,637	572,899	488,470
Total Current Expenditures and Mandatory Transfers	1,395,275	1,269,677	1,188,541	1,123,865	1,036,301
Ratio	76.69%	76.67%	53.90%	50.98%	47.14%

This ratio is an important measure of financial strength relative to institutional operating size. Expendable fund balances should increase at least proportionally as the rate of growth of operating size. If this is not the case, the same dollar amount of expendable fund balances will provide less margin of protection against adversity as the institution grows in dollar level of expenditure.

RATIO OF INSTRUCTION AND ACADEMIC SUPPORT TO TOTAL EDUCATIONAL AND GENERAL EXPENDITURES LESS RESTRICTED SCHOLARSHIPS

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Instruction	\$490,447	\$435,839	\$411,292	\$383,759	\$352,711
Other Academic Support	75,226	63,528	60,384	56,528	53,663
Total Instruction and Academic Support	\$565,673	\$499,367	\$471,676	\$440,287	\$406,374
Educational and General Expenditures and Mandatory Transfers	1,065,655	958,594	914,294	847,139	784,364
Less: Restricted Scholarships	25,853	24,953	19,945	21,489	20,705
Total Educational and General Expenditures less Restricted Scholarships	\$1,039,802	\$933,641	\$894,349	\$825,650	\$763,659
Total Instruction and Academic Support	565,673	499,367	471,676	440,287	406,374
Total Educational and General Expenditures less Restricted Scholarships	1,039,802	933,641	894,349	825,650	763,659
Ratio	54.40%	53.49%	52.74%	53.33%	53.21%

This ratio indicates whether the institution has been maintaining the allocation of resources to the academic program. If financial resources are decreasing, the instruction and academic support proportion may also decrease due to greater demands for administrative expenditures, such as admissions or fund raising. A decrease in instruction and academic support expenditures as a proportion of the operating budget may not indicate an absolute decline, specifically when there is an alternative increase in quality; however, such a change in quality is difficult to measure.

(in thousands)

For the Year Ended June 30,

	1996	1995	1994	1993	1992
Current Fund Balance - General	\$53,902	\$49,726	\$44,104	\$37,536	\$29,681
Current Fund Balance - Proprietary	149,134	140,429	127,098	116,643	111,371
Current Fund Balance - Restricted	92,510	91,586	77,839	66,205	53,318
Quasi Endowment Fund Balance	71,023	64,935	66,525	63,364	56,024
Unexpended Plant Fund Balance	55,763	48,658	34,830	20,573	9,657
Debt Service Fund Balance	10,833	17,073	16,421	16,244	18,300
Total Expendable Fund Balance	\$433,165	\$412,407	\$366,817	\$320,565	\$278,351
Total Expendable Fund Balance	433,165	412,407	366,817	320,565	278,351
Total Current Expenditures and Mandatory Transfers	965,559	915,654	858,117	783,792	710,029
Ratio	44.86%	45.04%	42.75%	40.90%	39.20%

(in thousands)

For the Year Ended June 30,

	1996	1995	1994	1993	1992
Instruction	\$326,546	\$301,323	\$278,587	\$253,662	\$241,956
Other Academic Support	47,771	43,423	40,507	35,845	32,740
Total Instruction and Academic Support	\$374,317	\$344,746	\$319,094	\$289,507	\$274,696
Educational and General Expenditures and Mandatory Transfers	742,277	705,323	656,305	595,696	555,404
Less: Restricted Scholarships	19,021	17,713	17,439	17,116	14,940
Total Educational and General Expenditures less Restricted Scholarships	\$723,256	\$687,610	\$638,866	\$578,580	\$540,464
Total Instruction and Academic Support	374,317	344,746	319,094	289,507	274,696
Total Educational and General Expenditures less Restricted Scholarships	723,256	687,610	638,866	578,580	540,464
Ratio	51.75%	50.14%	49.95%	50.04%	50.83%

TEN YEAR SUMMARY OF RATIOS *(continued)*

TEN FISCAL YEARS

EDUCATIONAL EXPENDITURES PER STUDENT

	(in thousands)				
	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Total Current Fund Expenditures	\$1,367,794	\$1,242,057	\$1,168,462	\$1,101,013	\$1,007,293
Plus: Current Fund Mandatory Transfers	27,481	27,620	20,079	22,852	29,007
Less: Student Financial Aid	54,670	49,844	44,305	41,674	38,625
Less: Auxiliary Enterprises Expenditures	127,425	121,969	115,280	106,837	96,674
Less: Professional Clinical Services	167,703	156,522	133,057	135,099	116,393
Total Educational Expenditures	\$1,045,477	\$941,342	\$895,899	\$840,255	\$784,608
Total Educational Expenditures	1,045,477	941,342	895,899	840,255	784,608
Undergraduate, Graduate and Professional FTE	23,000	22,761	21,940	21,794	21,709
Educational Expenditures per Student (in thousands)	\$45.5	\$41.4	\$40.8	\$38.6	\$36.1

This ratio measures average educational expenditures incurred per student FTE.

RATIO OF NET GAIN IN ENDOWMENT ASSETS

	(in thousands)				
	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Year - End Endowment Assets (Market Value)	\$768,816	\$750,321	\$593,373	\$554,029	\$465,152
Year - Begin Endowment Assets (Market Value)	750,321	593,373	554,029	465,152	390,146
Yearly Change	18,495	156,948	39,344	88,877	75,006
Yearly Change	18,495	156,948	39,344	88,877	75,006
Year - Begin Endowment Assets (Market Value)	750,321	593,373	554,029	465,152	390,146
Ratio	2.46%	26.45%	7.10%	19.11%	19.23%

This ratio measures the growth of endowment assets resulting directly from investment policies and/or gifts. If the ratios are increasing, the endowment assets are growing through efficient investment of the endowment funds and/or additional gifts and transfers to the endowment funds.

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Total Current Fund Expenditures	\$941,475	\$894,896	\$836,959	\$765,652	\$700,963
Plus: Current Fund Mandatory Transfers	24,084	20,758	21,158	18,140	9,066
Less: Student Financial Aid	31,479	29,595	28,030	26,997	23,715
Less: Auxiliary Enterprises Expenditures	88,032	83,823	76,560	81,907	56,996
Less: Professional Clinical Services	108,282	99,140	97,265	85,187	74,769
Total Educational Expenditures	\$737,766	\$703,096	\$656,262	\$589,701	\$554,549
Total Educational Expenditures	737,766	703,096	656,262	589,701	554,549
Undergraduate, Graduate and Professional FTE	21,961	21,918	21,758	21,398	21,391
Educational Expenditures per Student (in thousands)	\$33.6	\$32.1	\$30.2	\$27.6	\$25.9

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Year - End Endowment Assets (Market Value)	\$390,146	\$335,076	\$293,214	\$223,948	\$209,547
Year - Begin Endowment Assets (Market Value)	335,076	293,214	223,948	209,547	181,413
Yearly Change	55,070	41,862	69,266	14,401	28,134
Yearly Change	55,070	41,862	69,266	14,401	28,134
Year - Begin Endowment Assets (Market Value)	335,076	293,214	223,948	209,547	181,413
Ratio	16.44%	14.28%	30.93%	6.87%	15.51%

TEN YEAR SUMMARY OF RATIOS *(continued)*

TEN FISCAL YEARS

RATIO OF UNRESTRICTED OPERATING RESOURCES TO DEBT

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Fund Balance - General	\$115,263	\$86,061	\$60,828	\$54,643	\$60,437
Current Fund Balance - Proprietary	170,668	162,193	165,090	157,697	154,264
Unrestricted Quasi Endowment Fund Balance	106,682	121,441	98,556	85,787	48,704
Unrestricted Unexpended Plant Fund Balance	1,433	1,828	1,837	6,291	3,112
Unrestricted Debt Service Fund Balance	5,892	6,725	5,211	11,305	7,453
Total Expendable Fund Balance	\$399,938	\$378,248	\$331,522	\$315,723	\$273,970
Total Expendable Fund Balance	399,938	378,248	331,522	315,723	273,970
Total Debt Outstanding	396,805	306,603	286,366	279,096	272,965
Ratio	100.79%	123.37%	115.77%	113.12%	100.37%

This ratio is a conservative measure of resources available to investors from unrestricted expendable reserves that excludes amounts designated for long-term investment.

RATIO OF TOTAL RESOURCES TO DEBT

(in thousands)

	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Current Fund Balance - General	\$115,263	\$86,061	\$60,828	\$54,643	\$60,437
Current Fund Balance - Proprietary	170,668	162,193	165,090	157,697	154,264
Current Fund Balance - Restricted	207,040	147,942	137,437	112,855	94,072
Endowment Fund Balance	731,170	727,798	587,946	547,750	376,052
Unexpended Plant Fund Balance	63,159	55,581	86,670	72,332	61,063
Debt Service Fund Balance	24,761	28,485	28,628	32,329	26,454
Total Expendable Fund Balance	\$1,312,061	\$1,208,060	\$1,066,599	\$977,606	\$772,342
Total Expendable Fund Balance	1,312,061	1,208,060	1,066,599	977,606	772,342
Total Debt Outstanding	396,805	306,604	286,366	279,096	272,965
Ratio	330.66%	394.01%	372.46%	350.28%	282.95%

This ratio is a broad measure of resources to debt that includes the corpus of endowed contributions.

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Current Fund Balance - General	\$53,902	\$49,726	\$44,104	\$37,536	\$29,681
Current Fund Balance - Proprietary	149,134	140,429	127,098	116,643	111,371
Unrestricted Quasi Endowment Fund Balance	35,640	34,988	36,656	36,066	33,761
Unrestricted Unexpended Plant Fund Balance	3,645	4,658	4,366	5,178	1,872
Unrestricted Debt Service Fund Balance	(6,238)	2,298	3,798	7,901	9,327
Total Expendable Fund Balance	\$236,083	\$232,099	\$216,022	\$203,324	\$186,012
Total Expendable Fund Balance	236,083	232,099	216,022	203,324	186,012
Total Debt Outstanding	232,028	238,176	225,834	230,825	222,548
Ratio	101.75%	97.45%	95.66%	88.09%	83.58%

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Current Fund Balance - General	\$53,902	\$49,726	\$44,104	\$37,536	\$29,681
Current Fund Balance - Proprietary	149,134	140,429	127,098	116,643	111,371
Current Fund Balance - Restricted	92,510	91,586	77,839	66,205	53,318
Endowment Fund Balance	303,674	273,448	270,211	212,158	191,497
Unexpended Plant Fund Balance	55,763	48,658	34,830	20,573	9,657
Debt Service Fund Balance	10,833	17,073	16,421	16,244	18,300
Total Expendable Fund Balance	\$665,816	\$620,920	\$570,503	\$469,359	\$413,824
Total Expendable Fund Balance	665,816	620,920	570,503	469,359	413,824
Total Debt Outstanding	232,028	238,176	225,834	230,825	222,548
Ratio	286.96%	260.70%	252.62%	203.34%	185.95%

GROSS DEBT SERVICE COVERAGE

TEN FISCAL YEARS

	(in thousands)				
	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
General Fund Increase in Fund Equity	\$29,202	n/a	n/a	n/a	n/a
General Fund Mandatory Transfers	1,270	n/a	n/a	n/a	n/a
Proprietary Fund Increase in Fund Equity	8,475	(2,897)	7,393	2,699	5,130
Proprietary Fund Mandatory Transfers	26,135	27,118	20,042	22,809	28,318
Total Resources	\$65,082	\$24,221	\$27,435	\$25,508	\$33,448
Total Debt Service Requirements	27,250	22,952	21,136	19,547	19,342
Total Resources	65,082	24,221	27,435	25,508	33,448
Coverage	2.39	1.06	1.30	1.30	1.73

RATIO OF DEBT SERVICES TO CURRENT EXPENDITURES

LAST TEN FISCAL YEARS

	(in thousands)				
	For the Year Ended June 30,				
	2001	2000	1999	1998	1997
Debt Service Requirements	27,250	22,952	21,136	19,547	19,342
Current Funds Expenditures	1,367,794	1,242,057	1,168,462	1,101,013	1,007,293
Ratio %	1.99	1.85	1.81	1.78	1.92

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
General Fund Increase in Fund Equity	n/a	n/a	n/a	n/a	n/a
General Fund Mandatory Transfers	n/a	n/a	n/a	n/a	n/a
Proprietary Fund Increase in Fund Equity	8,705	13,331	10,455	5,272	17,421
Proprietary Fund Mandatory Transfers	24,027	20,268	19,835	15,938	6,312
Total Resources	\$32,732	\$33,599	\$30,290	\$21,210	\$23,733
Total Debt Service Requirements	19,353	20,154	19,058	15,642	14,719
Total Resources	32,732	33,599	30,290	21,210	23,733
Coverage	1.69	1.67	1.59	1.36	1.61

(in thousands)

	For the Year Ended June 30,				
	1996	1995	1994	1993	1992
Debt Service Requirements	19,353	20,154	19,058	15,642	14,719
Current Funds Expenditures	941,475	894,896	836,959	765,652	700,963
Ratio %	2.06	2.25	2.28	2.04	2.10





THE UNIVERSITY
of NORTH CAROLINA
at CHAPEL HILL

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

2004

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R E P O R T

FISCAL YEAR ENDED JUNE 30, 2004 CHAPEL HILL, NORTH CAROLINA