# State of North Carolina

Office of The State Auditor

Beth A. Wood, CPA



# East Carolina University

Greenville, North Carolina

Financial Statement Audit Report

For the Year Ended June 30, 2017

A Constituent Institution of the University of North Carolina System and a Component Unit of the State of North Carolina

NCOSA

The Taxpayers' Watchdog

STATE OF NORTH CAROLINA
Office of the State Auditor

**Beth A. Wood, CPA**
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0600
Telephone: (919) 807-7500
Fax: (919) 807-7647
http://www.ncauditor.net

## AUDITOR'S TRANSMITTAL

The Honorable Roy Cooper, Governor
The General Assembly of North Carolina
Board of Trustees, East Carolina University

We have completed a financial statement audit of East Carolina University for the year ended June 30, 2017, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

Beth A. Wood

Beth A. Wood, CPA
State Auditor

**Beth A. Wood, CPA**
**State Auditor**

# Table of Contents

PAGE



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

# INDEPENDENT AUDITOR’S REPORT

STATE OF NORTH CAROLINA

# Office of the State Auditor

**Beth A. Wood, CPA**
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0600
Telephone: (919) 807-7500
Fax: (919) 807-7647
http://www.ncauditor.net

## INDEPENDENT AUDITOR'S REPORT

Board of Trustees
East Carolina University
Greenville, North Carolina

Report on the Financial Statements

We have audited the accompanying financial statements of East Carolina University (University), a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of East Carolina University Foundation, Inc. and Consolidated Affiliates, the University's discretely presented component unit. Those statements were audited by other auditors, whose report has been furnished to us, and our opinions, insofar as they relate to the amounts included for East Carolina University Foundation, Inc. and Consolidated Affiliates, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of East Carolina University Foundation, Inc. and Consolidated Affiliates were not audited in accordance with *Government Auditing Standards*.

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

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

Opinions

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of East Carolina University, and its discretely presented component unit, as of June 30, 2017, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters – Required Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2017 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control over financial reporting and compliance.

Beth A. Wood

Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

October 18, 2017

# MANAGEMENT'S DISCUSSION AND ANALYSIS

## Introduction

East Carolina University (ECU or University) provides this Management's Discussion and Analysis as supplementary information to assist in understanding the financial statements and related notes for the fiscal year ended June 30, 2017. The University is one of the 16 universities in the 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 (CAFR)*. The University's financial report includes three financial statements:

- ECU Statement of Net Position;
- ECU Statement of Revenues, Expenses, and Changes in Net Position; and
- ECU Statement of Cash Flows.

It also includes two financial statements from the discretely presented component unit:

- ECU Foundation, Inc. and Consolidated Affiliates Consolidated Statements of Financial Position; and
- ECU Foundation, Inc. and Consolidated Affiliates Consolidated Statements of Activities and Changes in Net Assets.

Two Required Supplementary Information schedules are provided as follows:

- Schedule of the Proportionate Net Pension Liability Teachers' and State Employees' Retirement System; and
- Schedule of University Contributions Teachers' and State Employees' Retirement System.

The University's basic financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) principles, which establish standards for external financial reporting for public colleges and universities. Per GASB Standards, the University's Foundation is reported as a component unit in the financial statements, and is excluded from this Management's Discussion and Analysis unless specifically noted.

This discussion and analysis provides an overview of the University's financial position and activities for the year ended June 30, 2017, emphasizing current year data and significant changes between the prior and current fiscal years. Comparative information for the year ended June 30, 2016 is provided where applicable. This overview has been prepared by management and should be read in conjunction with the financial statements and the notes to the financial statements that are included in this annual report. The Statement of Net Position reveals the University's overall financial position; the Statement of Revenues, Expenses and Changes in Net Position provides a summation of the results of operations, and the Statement of Cash Flows identifies the sources of cash and how cash was used during the year.

## Statement of Net Position

The Statement of Net Position presents a fiscal snapshot of the University's financial position at a point-in-time, specifically, as of June 30, 2017 and includes all assets, deferred outflows and inflows of resources and liabilities of the University. The assets are available to continue the operations of the University and the liabilities are amounts owed to vendors, investors, and lending institutions. Assets and liabilities are classified as either current or noncurrent. The difference between total assets plus deferred outflows of resources and total liabilities plus deferred inflows of resources is net position. Net position represents the residual interest in the University's assets and deferred outflows of resources net of its liabilities and deferred inflows of resources. It is an indicator of the current financial strength of the University. The change in net position is an indicator of whether the overall financial condition of the University has improved or worsened during the year. The following table presents a summarized comparison of these accounts at June 30, 2017 and 2016:

Condensed Statement of Net Position

*(Dollars in Thousands)*

| | 2017 | 2016 | Increase/ (Decrease) | Percent Change |
|---|---|---|---|---|
| **Assets** | | | | |
| Current Assets | $ 346,363 | $ 333,525 | $ 12,838 | 3.8 % |
| Capital Assets, Net | 1,048,712 | 989,983 | 58,729 | 5.9 % |
| Other Noncurrent Assets | 184,560 | 233,567 | (49,007) | (21.0) % |
| Total Assets | 1,579,635 | 1,557,075 | 22,560 | 1.4 % |
| Deferred Outflows of Resources | 86,684 | 23,439 | 63,245 | 269.8 % |
| **Liabilities** | | | | |
| Current Liabilities: | | | | |
| Long-Term Liabilities - Current Portion | 17,441 | 13,617 | 3,824 | 28.1 % |
| Other Current Liabilities | 58,478 | 59,973 | (1,495) | (2.5) % |
| Total Current Liabilities | 75,919 | 73,590 | 2,329 | 3.2 % |
| Noncurrent Liabilities: | | | | |
| Long-Term Liabilities, Net | 494,892 | 436,244 | 58,648 | 13.4 % |
| Other Noncurrent Liabilities | 21,743 | 18,654 | 3,089 | 16.6 % |
| Total Noncurrent Liabilities | 516,635 | 454,898 | 61,737 | 13.6 % |
| Total Liabilities | 592,554 | 528,488 | 64,066 | 12.1 % |
| Deferred Inflows of Resources | 6,381 | 11,817 | (5,436) | (46.0) % |
| **Net Position** | | | | |
| Net Investment in Capital Assets | 753,037 | 744,676 | 8,361 | 1.1 % |
| Restricted | 104,694 | 89,852 | 14,842 | 16.5 % |
| Unrestricted | 209,653 | 205,681 | 3,972 | 1.9 % |
| Total Net Position | $ 1,067,384 | $ 1,040,209 | $ 27,175 | 2.6 % |

The condensed statement above indicates a stronger financial position compared to last fiscal year with total assets and deferred outflows of resources increasing by $85.8 million. Total liabilities and deferred inflows of resources increased by $58.6 million, for a net growth of $27.2 million in the University's total net position.

Capital assets (net of depreciation) increased $58.7 million and other noncurrent assets decreased $49.0 million from the previous fiscal year end. Capital assets will be discussed in detail in the capital assets section of this discussion and analysis. The decrease in noncurrent assets is reflective of lower restricted cash balances ($55.0 million) and an increase in endowment investments ($8.2 million). The large decrease in restricted cash balances is due to spending $59.4 million of accumulated bond proceeds for ongoing construction projects such as the East Student Union, the West Facility Student Center and renovations to Clement Hall. (See Note 8 for more information.) The University also held more cash for other agencies and organizations at June 30, 2017 and there was a $7.0 million increase in allotted capital improvement funds held in anticipation of starting several new capital projects. The increase in endowment investments is due to a higher market value on investments totaling $4.4 million from the prior year, $1.4 million in interest and dividends and an additional $1.9 million received in endowment funds.

The deferred outflows of resources for the University's amortized loss on bond refunding and the deferred outflows for pensions are shown in a separate section of the financial statements. Most of the $63.2 million increase in total deferred outflows is related to pensions. This account reflects the University's allocated portion of deferred outflows for the Teachers' and State Employees' Retirement System (TSERS) cost-sharing pension plan and is affected by projected versus actual investment earnings. Amounts in this account are amortized over time as pension expense. The increase in the deferred outflows for pensions is due to differences in the expected and actual investment earnings in the TSERS pension plan and changes in assumptions about future economic or demographic factors. (See Note 12A for detailed information.)

Current long-term liabilities increased $3.8 million due to increases in the current portion of University debt for bonds. These payables are associated with construction projects that will be discussed in the capital assets section of the discussion and analysis.

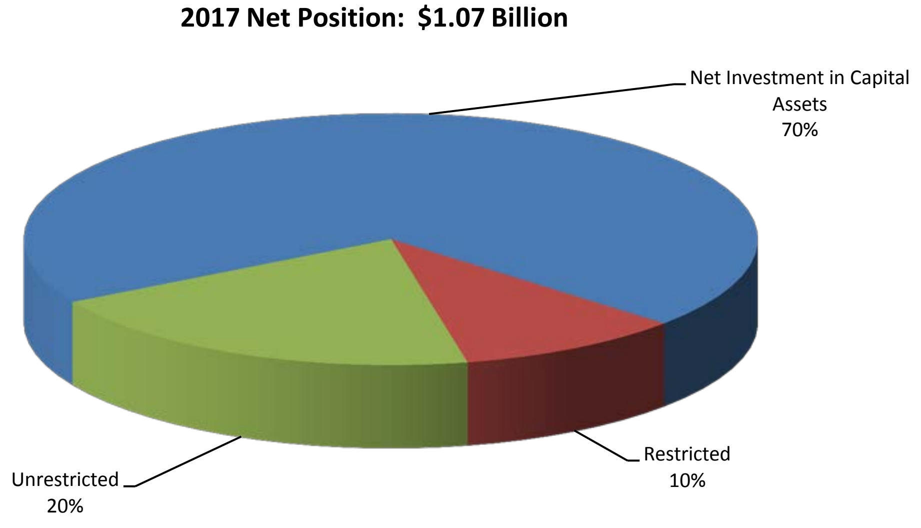
Noncurrent long-term liabilities increased $58.6 million. This change primarily includes a $73.1 million increase in the net pension liability and a $13.7 million decrease in bonds payable, net of bond discounts and premiums. (See Note 8 for information on bonds payable.) The net pension liability rose due to differences in the expected and actual earnings in the TSERS pension plan; substantially lower than anticipated investment earnings were generated from the pension plan.

Deferred inflows of resources are entirely related to pensions and is another allocation of the TSERS cost-sharing pension plan balances. The $5.4 million decrease in deferred inflows is driven by the higher pension liability related to the difference between projected and actual investment earnings. These deferred inflows for pensions are amortized over time as pension expense.

The University's liquidity remains strong. The current ratio, defined as current assets divided by current liabilities, of 4.6 indicates the University could pay its current obligations nearly five times before current assets are exhausted. Working capital, defined as current assets less current liabilities, is $270.4 million at June 30, 2017 and represents a $10.5 million increase or a 4.0 percent change from the prior year. The amount of available working capital is a measure of the University's ability to meet its short-term obligations.

The University's net position consists of three primary classifications: net investment in capital assets, restricted and unrestricted. The balance in each of the three classifications increased from the prior year with the greatest change in restricted net position that increased by $14.8 million, or 16.5 percent. Restricted net position includes the University's permanent endowment fund and expendable funds subject to externally imposed restrictions governing their use. The most notable increases are $8.4 million in capital projects and $5.2 million in endowed professorships. Capital projects net position increased primarily due to a higher cash balance, as previously discussed. Endowed professorships increased due to gains in market values and the receipt of new gifts, as previously discussed.

The following chart displays the contribution of each category to total net position for fiscal year 2017.




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

The Statement of Revenues, Expenses, and Changes in Net Position presents revenues earned and expenses incurred during the fiscal year, providing information to evaluate the University's management of operations and maintenance of financial strength. Activities are classified and reported as operating, nonoperating, or other revenues. In general, operating revenues are generated by providing goods and services and operating expenses are incurred to acquire or produce the goods and services needed to fulfill the mission of the University. The University consistently shows an operational loss (operating revenues less operating expenses) because public universities are dependent on state appropriations, which is not included in operating revenues. State appropriations, noncapital grants and gifts, and investment income (net of investment expense) are classified as nonoperating revenues because they are revenues received for which goods and services are not provided. When the nonoperating revenues, net of nonoperating expenses, are added to the operational loss, the University shows an increase in income before other revenues of $20.0 million. Other revenues are neither operating nor nonoperating and include capital appropriations, capital grants and gifts and additions to endowments. When these other revenues are added, the University shows a $27.2 million increase in net position as of June 30, 2017. The following table presents a summarized comparison of the statements as of June 30, 2017 and June 30, 2016:

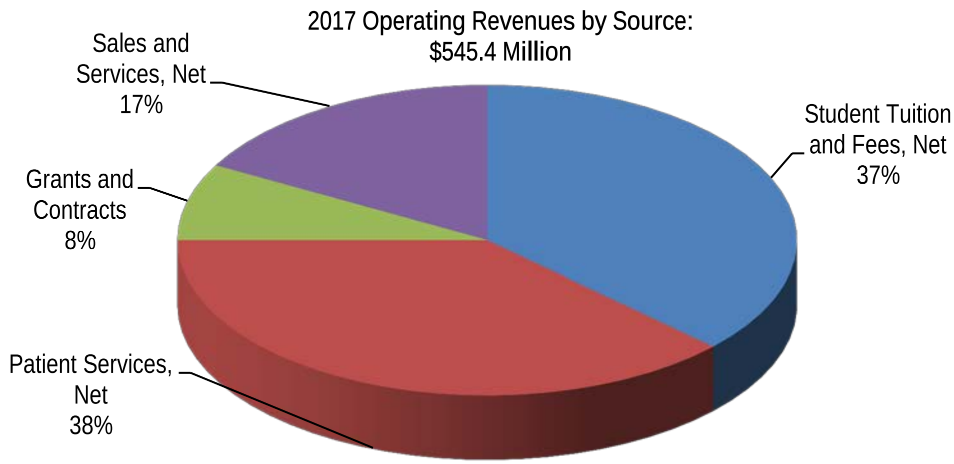
Condensed Statement of Revenues, Expenses, and Changes in Net Position
*(Dollars in Thousands)*

| | 2017 | 2016 | Increase/ (Decrease) | Percent Change |
|---|---|---|---|---|
| **Operating Revenues** | | | | |
| Student Tuition and Fees, Net | $ 198,550 | $ 189,407 | $ 9,143 | 4.8 % |
| Patient Services, Net | 207,489 | 204,523 | 2,966 | 1.5 % |
| Grants and Contracts | 43,652 | 41,730 | 1,922 | 4.6 % |
| Sales and Services, Net | 94,321 | 92,667 | 1,654 | 1.8 % |
| Other | 1,391 | 1,574 | (183) | (11.6) % |
| **Total Operating Revenues** | 545,403 | 529,901 | 15,502 | 2.9 % |
| **Operating Expenses** | | | | |
| Salaries and Benefits | 585,053 | 542,168 | 42,885 | 7.9 % |
| Supplies and Materials | 93,917 | 86,830 | 7,087 | 8.2 % |
| Services | 116,198 | 107,731 | 8,467 | 7.9 % |
| Scholarships and Fellowships | 39,414 | 42,954 | (3,540) | (8.2) % |
| Utilities | 17,763 | 17,456 | 307 | 1.8 % |
| Depreciation/Amortization | 31,198 | 28,204 | 2,994 | 10.6 % |
| **Total Operating Expenses** | 883,543 | 825,343 | 58,200 | 7.1 % |
| **Operating Loss** | (338,140) | (295,442) | 42,698 | 14.5 % |
| **Nonoperating Revenues (Expenses)** | | | | |
| State Appropriations | 294,057 | 285,708 | 8,349 | 2.9 % |
| Noncapital Grants and Gifts | 66,067 | 64,412 | 1,655 | 2.6 % |
| Investment Income, Net | 9,450 | 606 | 8,844 | 1,459.4 % |
| Other Nonoperating Expenses | (11,436) | (17,976) | (6,540) | (36.4) % |
| **Net Nonoperating Revenues** | 358,138 | 332,750 | 25,388 | 7.6 % |
| **Income Before Other Revenues** | 19,998 | 37,308 | (17,310) | (46.4) % |
| Capital Appropriations | 3,813 | 4,827 | (1,014) | (21.0) % |
| Capital Grants and Gifts | 1,485 | 3,088 | (1,603) | (51.9) % |
| Additions to Endowments | 1,879 | 2,377 | (498) | (21.0) % |
| **Increase in Net Position** | 27,175 | 47,600 | (20,425) | (42.9) % |
| **Net Position-July 1** | 1,040,209 | 992,609 | 47,600 | 4.8 % |
| **Net Position-June 30** | $ 1,067,384 | $ 1,040,209 | $ 27,175 | 2.6 % |

*Fiscal year 2016-2017 total revenues are $922,154 and total expenses are $894,979.*
*Fiscal year 2015-2016 total revenues are $890,919 and total expenses are $843,319.*

The University generates operating revenues by providing goods and services related to instruction, research, and public service missions. Operating revenues increased a modest $15.5 million, or 2.9 percent from the previous year. The most significant increase in operating revenues is the $9.1 million increase in student tuition and fees, net. This increase is primarily the result of higher tuition and fee rates. Tuition rates rose 5 percent for resident students and 3 percent for non-residents. General fees increased 3.5 percent and debt service fees (for the student unions) increased 38.6 percent. Student enrollment (headcount) increased 2.4 percent compared to the prior year.

The following chart shows each operating revenue component as it relates to total operating revenues:



Operating expenses are the day-to-day expenses incurred to carry out the mission of the University. Operating expenses are reported by natural classification. Amounts changed at varying rates with an overall increase of $58.2 million, or 7.1 percent. The largest change in dollars occurred in salaries and benefits with an increase of $42.9 million, or 7.9 percent. Part of the increase is an $18.7 million increase in pension expense that relates to the increase in deferred outflows for pensions previously discussed. Additional increases are due to a legislative salary increase of 1.5 percent, a one-time lump sum bonus of 0.50 percent, a legislative one-time merit bonus, higher medical insurance and pension contribution rates and higher benefit payments as a result of increased salaries.

Services increased $8.5 million, or 7.9 percent, due to higher repair and maintenance costs of buildings and equipment. Additionally, maintenance and contractual service contracts as well as legal and consulting fees increased.

Depreciation increased $3.0 million, or 10.6 percent, due to an increase in depreciable capital assets.

The following chart shows each operating expense component as it relates to total operating expenses and emphasizes the consistency between the two years:

2017 OPERATING EXPENSES: $883.5 Million

| | % to Total 2017 | % to Total 2016 |
|---|---|---|
| Salaries and Benefits | 66% | 66% |
| Supplies and Materials | 11% | 11% |
| Services | 13% | 13% |
| Scholarships and Fellowships | 4% | 5% |
| Utilities | 2% | 2% |
| Depreciation / Amortization | 4% | 3% |
| Total | 100% | 100% |

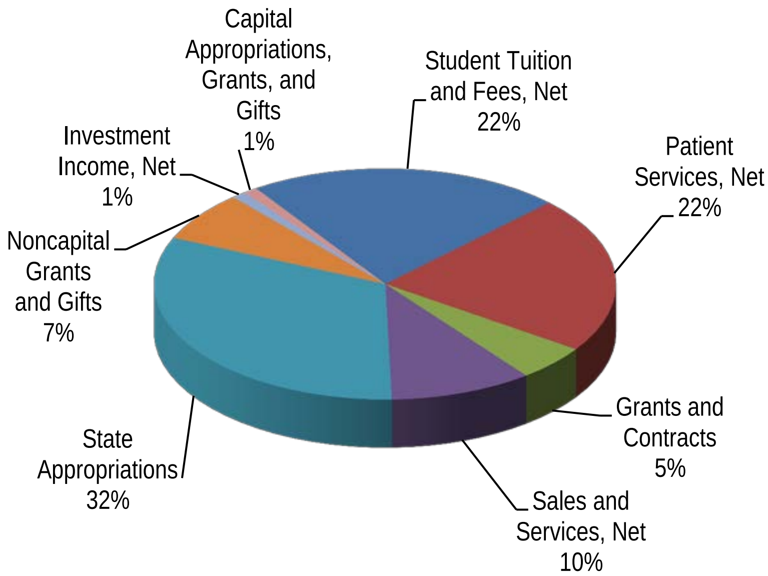
The University generates revenues and expenses in addition to its principal operations. These items are classified as nonoperating. Total net nonoperating revenues increased by $25.4 million, or 7.6 percent, from the prior year. The increase is the net effect of changes in state appropriations, noncapital grants and gifts, investment income and other nonoperating revenues and expenses such as interest and fees expenses. The most notable changes include:

- a $8.3 million increase in state appropriations primarily to fund legislated salary, bonus, and merit increases; higher medical and retirement rates, and additional veteran non-resident tuition waivers;
- a $8.8 million increase in net investment income due to improved market performance on investments and higher interest earnings; and
- a $6.5 million decrease in other nonoperating expenses over revenues primarily from a decrease in interest and fees on debt as payments were made and there were no bond issuance costs in fiscal year 2017.

Other revenues consisting of capital appropriations, capital grants and gifts, and additions to endowments were consistent with the prior year.

The following chart illustrates the University's total revenues by source (operating, nonoperating and other revenues) which total $922.2 million for fiscal year end 2017:

**2017 Total Revenues: $922.2 Million**




Note: Accounts with less than 0.5% of total revenues are not shown.

## Capital Assets

Capital assets for the University are comprised of nondepreciable and depreciable assets. Nondepreciable assets include land, construction in progress and computer software in development. Depreciable assets include buildings, machinery and equipment, general infrastructure and computer software. Completed buildings comprise 73.0 percent of the University's capital assets, net of accumulated depreciation.

The acquisition, construction and improvement of its capital assets are vital to the University's mission. The University continues to implement its long-range plan to modernize older teaching, research and residential facilities, balanced with new construction.

Capital assets at June 30, 2017 and June 30, 2016, are as follows:

Capital Assets
*(Dollars in Thousands)*

| | 2017 | 2016 | Increase/ (Decrease) | Percent Change |
|---|---|---|---|---|
| Land | $ 50,109 | $ 48,058 | $ 2,051 | 4.3 % |
| Construction in Progress | 78,711 | 63,114 | 15,597 | 24.7 % |
| Computer Software in Development | 551 | 479 | 72 | 15.0 % |
| Buildings | 1,016,485 | 959,630 | 56,855 | 5.9 % |
| General Infrastructure | 103,927 | 102,637 | 1,290 | 1.3 % |
| Machinery and Equipment | 149,893 | 139,995 | 9,898 | 7.1 % |
| Computer Software | 14,080 | 14,080 | | |
| Total Capital Assets | 1,413,756 | 1,327,993 | 85,763 | 6.5 % |
| Accumulated Depreciation | 365,044 | 338,010 | 27,034 | 8.0 % |
| Capital Assets, Net | $ 1,048,712 | $ 989,983 | $ 58,729 | 5.9 % |

Capital additions consist primarily of replacement, renovation and new capital assets construction, as well as significant investments in equipment, including information technology. The University's capital assets, as of fiscal year end 2017, are over $1.0 billion, representing a net increase of $58.7 million from the prior year.

The amount of construction in progress changes as construction costs on existing projects are incurred, completed projects are removed and new projects are added. During fiscal year 2017, construction on new facilities and renovations on older buildings to modernize the campus continued. Several major construction projects were completed in fiscal year 2017 and transferred to buildings and general infrastructure. These projects include:

- $30.9 million for the Health Sciences Campus Student Services Building;
- $16.8 million for Clement Hall Phase I and White Hall dormitories renovations; and
- $6.8 million for the fourth floor of the School of Dental Medicine.

University debt financing, student fees, state capital appropriations and university sources provided funding for these projects. The substantial increase in depreciable assets resulted in a corresponding increase in accumulated depreciation.

Although no new major projects were added to construction in progress during the 2017 fiscal year, significant work on many multi-year projects is on-going and includes the New Student Union and Parking Structure and Phase II of the Clement Hall renovation at a cost of $58.8 million and $15.4 million, respectively, as of fiscal year end 2017. These two projects represent 94.3 percent of the construction in progress balance at fiscal year end 2017.

The new student union under construction on main campus will be 210,000 square feet. The facility will provide a new home for the Ledonia Wright Cultural Center, a 250-seat multi-purpose auditorium, office space for student government and student groups, multi-venue dining facilities, retail and service points, and a dividable ballroom. The project includes a 700-car parking deck.

The renovation project for Clement residence hall is a combination of renovation, redesign, expansion and/or new facilities for bathrooms, laundry rooms, study lounges and the lobby. The bathroom renovations (Phase I) were completed in time for student use in Fall 2016. Phase II for the remainder of renovations is in progress.

To continue to provide quality educational experiences, the University must appropriately plan for a constant level of capital assets growth. Such a plan will avoid physical plant obsolescence and will provide a marketing tool to attract more students to the school. The University currently maintains a list of planned projects for the coming years. These projects are awaiting external review, approval and funding by the North Carolina Legislature or the University to proceed by issuing debt to construct the projects. The projects consist of a mix of new construction, repairs and renovations and infrastructure upgrades.

**Capital Debt**

The University uses revenue bonds, notes payable and capital leases to finance construction projects and purchase equipment. As reflected in the following chart, total capital debt decreased by $10.7 million in 2017.

Capital Debt Summary
*Dollars in Thousands*

| | 2017 | 2016 | Increase/ (Decrease) |
|---|---|---|---|
| Revenue Bonds Payable | $ 339,295 | $ 348,375 | $ (9,080) |
| Bond Discounts/Premiums | 17,017 | 17,973 | (956) |
| Notes Payable | 8,879 | 11,079 | (2,200) |
| Capital Leases Payable | 1,806 | 254 | 1,552 |
| Total Capital Debt | $ 366,997 | $ 377,681 | $ (10,684) |

Note 8 to the financial statements provides information on debt administration. The decrease in debt for revenue bonds and notes is the result of scheduled payments made by the University.

In December 2015, Moody's assigned a rating of Aa2 to the Series 2016A and 2016B General Revenue Bonds and affirmed the Aa2 rating on general and pooled revenue debt for the University. In December 2016, Standard & Poor's affirmed its AA- rating on the Series 2016A and 2016B General Revenue Bonds and affirmed the same AA- rating on general and pooled revenue debt for the University.

**Economic and Strategic Outlook**

The University's financial position remains strong. Total net position grew by $27.2 million due to effective institutional planning and cost controls as well as continued support from the State to meet educational needs.

Beginning in fiscal year 2018, the University will receive enrollment growth funds based on actual enrollment increases rather than projected increases. This is a change from years' past when enrollment growth funding was provided on projections. Enrollment funding was fully funded; however, the funds will be held in a reserve account at Office of State Budget and Management until actual enrollment can be verified following the fall semester census. If actual enrollment meets projections, the University should receive an increase of approximately $4 million in appropriations to fund enrollment growth. The UNC Board of Governors approved a tuition increase of 2 percent for incoming resident students and 2 percent for non-residents for academic year 2017-18. These increases will provide the University approximately $2 million dollars to invest in faculty and staff retention, technology improvements, merit based aid and academic and student support services. The Fall 2017 enrollment is a record-breaking 29,131 students. This is a 0.6% percent increase over Fall 2016 with the increase occurring in undergraduate programs.

The State budget for FY 2018 provided for $4.0 million in recurring appropriations for the Brody School of Medicine. This is in addition to $4 million of recurring funding to Brody in the prior fiscal year. In addition, Brody received about $163,000 in fiscal year 2018 and will receive an additional $803,000 in fiscal year 2019 for the expansion of Graduate Medical Education.

On July 26, 2017, ECU and Vidant Health reached an agreement that would combine the medical clinical practice plans of both entities into VECU, Inc., which is a new entity and a party to the agreement. ECU's clinical practice plan operates under the name ECU Physicians. The transaction is not complete and considerable due diligence remains. Once all conditions for closing are satisfied, the clinical operations of ECU Physicians and Vidant Health would be transferred to a separate 501(c)(3) entity governed by a board of directors that is appointed by Vidant Health and ECU. After close, the revenue and expense of ECU Physicians (approximately $200 million) would be recorded in the accounting records of the new entity on a go-forward basis. In addition, the agreement provides for an up-front payment to ECU as well as ongoing annual payments in support of the education and research missions of the Brody School of Medicine.

East Carolina University will be receiving $90 million from the statewide $2 billion bond package approved by voters in Spring 2016. The funds will be used to construct a life sciences and biotechnology building, which will house complementary programs from the departments of Biology, Chemistry, and Engineering. These programs will support natural interdisciplinary research and teaching. Planning and design work has commenced and construction is expected to start in mid-2019.

ECU is in the initial stages of a comprehensive $500 million fundraising campaign. The campaign will generate philanthropic, corporate, and research revenue to be used for academic programs, student scholarships, research programs, faculty professorships, capital needs, and other activities. In its entirety, the campaign is expected to span six or more years.

**Contacting the University's Financial Management**

This financial report is designed to provide our citizens, investors and creditors with a general overview of the University's finances and show accountability for all funds received. If you have any questions or need additional financial information, please contact East Carolina University's Financial Services at (252) 737-1133.

# FINANCIAL STATEMENTS

# *East Carolina University*
# *Statement of Net Position*
# *June 30, 2017*



| | | |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and Cash Equivalents | $ | 244,981,266.57 |
| Restricted Cash and Cash Equivalents | | 44,024,027.12 |
| Receivables, Net (Note 5) | | 45,641,945.00 |
| Due from University Component Units | | 57,652.13 |
| Inventories | | 5,719,971.18 |
| Notes Receivable, Net (Note 5) | | 1,850,496.07 |
| Other Assets | | 4,087,151.14 |
| Total Current Assets | | 346,362,509.21 |
| Noncurrent Assets: | | |
| Restricted Cash and Cash Equivalents | | 120,730,072.81 |
| Receivables (Note 5) | | 3,018,105.17 |
| Endowment Investments | | 51,030,090.93 |
| Restricted Investments | | 13,009.57 |
| Investment in Joint Ventures | | 319,668.00 |
| Notes Receivable, Net (Note 5) | | 9,450,181.95 |
| Capital Assets - Nondepreciable (Note 6) | | 129,370,889.99 |
| Capital Assets - Depreciable, Net (Note 6) | | 919,340,725.52 |
| Total Noncurrent Assets | | 1,233,272,743.94 |
| Total Assets | | 1,579,635,253.15 |
| **DEFERRED OUTFLOWS OF RESOURCES** | | |
| Deferred Loss on Refunding | | 3,492,590.37 |
| Deferred Outflows Related to Pensions | | 83,191,746.37 |
| Total Deferred Outflows of Resources | | 86,684,336.74 |
| **LIABILITIES** | | |
| Current Liabilities: | | |
| Accounts Payable and Accrued Liabilities (Note 7) | | 38,267,734.43 |
| Due to Primary Government | | 47,910.76 |
| Deposits Payable | | 1,523,267.10 |
| Unearned Revenue | | 15,221,638.31 |
| Interest Payable | | 3,417,788.60 |
| Long-Term Liabilities - Current Portion (Note 8) | | 17,440,971.45 |
| Total Current Liabilities | | 75,919,310.65 |
| Noncurrent Liabilities: | | |
| Funds Held for Others | | 9,449,226.89 |
| U. S. Government Grants Refundable | | 12,293,704.76 |
| Long-Term Liabilities, Net (Note 8) | | 494,892,166.90 |
| Total Noncurrent Liabilities | | 516,635,098.55 |
| Total Liabilities | | 592,554,409.20 |
| **DEFERRED INFLOWS OF RESOURCES** | | |
| Deferred Inflows Related to Pensions | | 6,381,514.00 |

## *East Carolina University*
## *Statement of Net Position* *Exhibit A-1*
## *June 30, 2017* 



| | |
|---|---|
| **NET POSITION** | |
| Net Investment in Capital Assets | 753,036,621.72 |
| Restricted for: | |
| Nonexpendable: | |
| Scholarships and Fellowships | 2,287,724.56 |
| Endowed Professorships | 31,618,266.41 |
| Departmental Uses | 439,125.09 |
| Loans | 1,810,387.37 |
| Expendable: | |
| Scholarships and Fellowships | 3,031,855.41 |
| Research | 1,665,133.20 |
| Endowed Professorships | 12,717,554.14 |
| Departmental Uses | 847,760.28 |
| Capital Projects | 33,750,247.37 |
| Debt Service | 16,150,085.44 |
| Other | 376,220.94 |
| Unrestricted | 209,652,684.76 |
| Total Net Position | $ 1,067,383,666.69 |

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

***East Carolina University***
***Statement of Revenues, Expenses, and Changes in Net Position***
***For the Fiscal Year Ended June 30, 2017*** ***Exhibit A-2***

| | |
|---|---|
| **REVENUES** | |
| Operating Revenues: | |
| Student Tuition and Fees, Net (Note 10) | $ 198,549,675.99 |
| Patient Services, Net (Note 10) | 207,488,958.36 |
| Federal Grants and Contracts | 17,647,015.77 |
| State and Local Grants and Contracts | 11,129,708.48 |
| Nongovernmental Grants and Contracts | 14,875,364.62 |
| Sales and Services, Net (Note 10) | 94,321,279.49 |
| Interest Earnings on Loans | 41,449.42 |
| Other Operating Revenues | 1,349,289.37 |
| Total Operating Revenues | 545,402,741.50 |
| **EXPENSES** | |
| Operating Expenses: | |
| Salaries and Benefits | 585,052,750.74 |
| Supplies and Materials | 93,916,961.69 |
| Services | 116,197,950.76 |
| Scholarships and Fellowships | 39,414,709.25 |
| Utilities | 17,762,974.94 |
| Depreciation / Amortization | 31,197,552.98 |
| Total Operating Expenses | 883,542,900.36 |
| Operating Loss | (338,140,158.86) |
| **NONOPERATING REVENUES (EXPENSES)** | |
| State Appropriations | 294,056,861.90 |
| Noncapital Grants - Student Financial Aid | 34,779,078.26 |
| Noncapital Grants | 16,446,008.49 |
| Noncapital Gifts | 14,841,834.70 |
| Investment Income (Net of Investment Expense of $98,371.94) | 9,449,807.94 |
| Interest and Fees on Debt | (8,141,154.30) |
| Federal Interest Subsidy on Debt | 421,589.52 |
| Other Nonoperating Expenses | (3,715,854.77) |
| Net Nonoperating Revenues | 358,138,171.74 |
| Loss Before Other Revenues | 19,998,012.88 |
| Capital Appropriations | 3,813,019.00 |
| Capital Grants | 571,751.25 |
| Capital Gifts | 912,372.49 |
| Additions to Endowments | 1,879,289.73 |
| Increase in Net Position | 27,174,445.35 |
| **NET POSITION** | |
| Net Position - July 1, 2016 | 1,040,209,221.34 |
| Net Position - June 30, 2017 | $ 1,067,383,666.69 |

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

## *East Carolina University*
## *Statement of Cash Flows*
## *For the Fiscal Year Ended June 30, 2017*

***Exhibit A-3***
***Page 1 of 2***

| | |
|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | |
| Received from Customers | $ 549,449,022.26 |
| Payments to Employees and Fringe Benefits | (580,654,343.04) |
| Payments to Vendors and Suppliers | (227,196,487.74) |
| Payments for Scholarships and Fellowships | (39,414,709.25) |
| Loans Issued | (2,309,276.00) |
| Collection of Loans | 1,904,917.74 |
| Interest Earned on Loans | 215,572.78 |
| Student Deposits Received | 1,745,546.43 |
| Student Deposits Returned | (1,668,475.95) |
| Net Cash Used by Operating Activities | (297,928,232.77) |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | |
| State Appropriations | 294,056,861.90 |
| Noncapital Grants - Student Financial Aid | 35,118,930.06 |
| Noncapital Grants | 16,459,638.79 |
| Noncapital Gifts | 14,784,888.80 |
| Additions to Endowments | 1,879,289.73 |
| William D. Ford Direct Lending Receipts | 160,342,474.04 |
| William D. Ford Direct Lending Disbursements | (160,417,137.00) |
| Related Activity Agency Receipts | 31,020,447.19 |
| Related Activity Agency Disbursements | (28,082,356.03) |
| Net Cash Provided by Noncapital Financing Activities | 365,163,037.48 |
| **CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES** | |
| Capital Appropriations | 3,813,019.00 |
| Capital Grants | 571,751.25 |
| Acquisition and Construction of Capital Assets | (82,413,704.82) |
| Principal Paid on Capital Debt and Leases | (11,360,092.03) |
| Interest and Fees Paid on Capital Debt and Leases | (14,150,020.84) |
| Federal Interest Subsidy on Debt Received | 425,526.69 |
| Net Cash Used by Capital Financing and Related Financing Activities | (103,113,520.75) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | |
| Proceeds from Sales and Maturities of Investments | 2,305,453.51 |
| Investment Income | 6,203,120.39 |
| Purchase of Investments and Related Fees | (6,936,407.68) |
| Net Cash Provided by Investing Activities | 1,572,166.22 |
| Net Decrease in Cash and Cash Equivalents | (34,306,549.82) |
| Cash and Cash Equivalents - July 1, 2016 | 444,041,916.32 |
| Cash and Cash Equivalents - June 30, 2017 | $ 409,735,366.50 |

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

| | |
|---|---|
| Operating Loss | $ (338,140,158.86) |
| Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities: | |
| Depreciation/ Amortization Expense | 31,197,552.98 |
| Allowances, Write-Offs, and Amortizations | (12,886.85) |
| Changes in Assets and Deferred Outflows of Resources: | |
| Receivables, Net | 5,898,268.17 |
| Due from State of North Carolina Component Units | 1,638,412.93 |
| Due from University Component Units | (27,324.40) |
| Inventories | 291,435.51 |
| Prepaid Assets | (673,377.41) |
| Notes Receivable, Net | (404,358.26) |
| Deferred Outflows for Pensions | (63,482,154.00) |
| Changes in Liabilities and Deferred Inflows of Resources: | |
| Accounts Payable and Accrued Liabilities | 1,444,581.92 |
| Due to Primary Government | 18,859.27 |
| Unearned Revenue | (3,475,355.12) |
| Net Pension Liability | 73,109,319.00 |
| Compensated Absences | 47,341.87 |
| Deposits Payable | 77,070.48 |
| Deferred Inflows for Pensions | (5,435,460.00) |
| Net Cash Used by Operating Activities | $ (297,928,232.77) |

## RECONCILIATION OF CASH AND CASH EQUIVALENTS

| | |
|---|---|
| Current Assets: | |
| Cash and Cash Equivalents | $ 244,981,266.57 |
| Restricted Cash and Cash Equivalents | 44,024,027.12 |
| Noncurrent Assets: | |
| Restricted Cash and Cash Equivalents | 120,730,072.81 |
| Total Cash and Cash Equivalents - June 30, 2017 | $ 409,735,366.50 |

## NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

| | |
|---|---|
| Assets Acquired through the Assumption of a Liability | $ 2,877,254.58 |
| Assets Acquired through a Gift | 912,372.49 |
| Change in Fair Value of Investments | 3,425,200.45 |
| Loss on Investment in Joint Ventures | (2,684,472.00) |
| Loss on Disposal of Capital Assets | (1,634,135.66) |
| Amortization of Bond Premiums/Discounts | 955,340.44 |

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

***East Carolina University Foundation, Inc. and Consolidated Affiliates***
***Consolidated Statements of Financial Position***
***For the Fiscal Year Ended June 30, 2017*** ***Exhibit B-1***

| | | |
|---|---|---|
| **ASSETS** | | |
| **CURRENT ASSETS** | | |
| Cash and Cash Equivalents | $ | 9,433,469 |
| Current Portion of Unconditional Promises to Give, Net | | 1,069,206 |
| Prepaid Expenses | | 23,779 |
| Other Receivables | | 31,926 |
| Total Current Assets | | 10,558,380 |
| **INVESTMENTS** | | |
| Investments | | 112,852,523 |
| Real Estate Held for Investment | | 2,750,031 |
| Total Investments | | 115,602,554 |
| **CAPITAL ASSETS** | | |
| Capital Assets, Net | | 7,794,435 |
| **OTHER ASSETS** | | |
| Life Insurance Policy - Cash Surrender Value | | 214,734 |
| Student Loans | | 44,155 |
| Beneficial Interest in Charitable Remainder Trusts | | 2,648,102 |
| Assets Held in Charitable Remainder Trusts and Annuities | | 1,307,498 |
| Unconditional Promises to Give, Less Current Portion, Net | | 2,234,981 |
| Other Assets | | 53,183 |
| Total Other Assets | | 6,502,653 |
| **TOTAL ASSETS** | $ | 140,458,022 |
| **LIABILITIES AND NET ASSETS** | | |
| **CURRENT LIABILITIES** | | |
| Accounts Payable | $ | 90,019 |
| Accrued Expenses | | 29,775 |
| Current Portion of Note Payable | | 349,124 |
| Current Portion of Charitable Gift Annuities Payable | | 92,684 |
| Agency Payables | | 1,094,870 |
| Total Current Liabilities | | 1,656,472 |
| **LONG-TERM LIABILITIES** | | |
| Refundable Advances | | 53,928 |
| Lines of Credit | | 3,094,043 |
| Note Payable, Less Current Portion | | 6,625,428 |
| Interest Rate Swap Agreement | | 49,420 |
| Charitable Gift Annuities Payable, Less Current Portion | | 596,653 |
| Liabilities Under Charitable Remainder Trusts | | 236,017 |
| Total Long-Term Liabilities | | 10,655,489 |
| Total Liabilities | | 12,311,961 |
| **NET ASSETS** | | |
| Unrestricted | | 15,936,544 |
| Temporarily Restricted | | 49,450,966 |
| Permanently Restricted | | 62,758,551 |
| Total Net Assets | | 128,146,061 |
| **TOTAL LIABILITIES AND NET ASSETS** | $ | 140,458,022 |

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

## *East Carolina University Foundation, Inc. and Consolidated Affiliates*
## *Consolidated Statements of Activities*
## *For the Fiscal Year Ended June 30, 2017* — *Exhibit B-2*

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| **REVENUES, GAINS AND OTHER SUPPORT** | | | | |
| Contributions | $ 237,444 | $ 3,277,050 | $ 3,539,061 | $ 7,053,555 |
| Gifts in Kind | 4,179 | 167,360 | 1 | 171,540 |
| Contributed Services and Facilities | 2,215,199 | | | 2,215,199 |
| Return on Investments | | | | |
| Interest and Dividends | 726,241 | 2,544,607 | 9,987 | 3,280,835 |
| Net Unrealized and Realized Gains on Investments | 1,187,657 | 8,562,907 | 33,088 | 9,783,652 |
| Other Income | 1,281,859 | 264,847 | 11,916 | 1,558,622 |
| Net Gain on Sales or Transfer of Property | 84,043 | 98,759 | | 182,802 |
| Change in Value of Split Interest Agreements | | 401,509 | 26,539 | 428,048 |
| Net Assets Released from Restrictions | 7,279,897 | (7,279,897) | | |
| Total Revenues, Gains and Other Support | 13,016,519 | 8,037,142 | 3,620,592 | 24,674,253 |
| **EXPENSES AND LOSSES** | | | | |
| Program Services | | | | |
| Program Development | 4,426,133 | | | 4,426,133 |
| Scholarships | 3,004,203 | | | 3,004,203 |
| Total Program Services | 7,430,336 | | | 7,430,336 |
| General and Administrative | 1,441,012 | | | 1,441,012 |
| Fund Raising | 1,961,957 | | | 1,961,957 |
| Total Operating Expenses | 10,833,305 | | | 10,833,305 |
| Bad Debt Losses | 924 | 61,961 | 34,027 | 96,912 |
| Total Expenses and Losses | 10,834,229 | 61,961 | 34,027 | 10,930,217 |
| Changes in Net Assets | 2,182,290 | 7,975,181 | 3,586,565 | 13,744,036 |
| **NET ASSETS** | | | | |
| Net Assets at Beginning of Year | 13,501,383 | 42,092,018 | 58,808,624 | 114,402,025 |
| Reclassification of Net Assets, Donor Stipulations | 252,871 | (616,233) | 363,362 | |
| Net Assets at End of Year | $ 15,936,544 | $ 49,450,966 | $ 62,758,551 | $ 128,146,061 |

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

# NOTES TO THE FINANCIAL STATEMENTS

## NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements present all funds belonging to the University and its component unit. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component unit is discretely presented in the University's financial statements. See below for further discussion of the University's component unit. Other related foundations and similar nonprofit corporations for which the University is not financially accountable are not part of the accompanying financial statements.

**Discretely Presented Component Unit** – East Carolina Foundation, Inc. (Foundation) is a legally separate, tax-exempt nonprofit corporation and is reported as a discretely presented component unit based on the nature and significance of its relationship to the University. East Carolina University Real Estate Foundation, Inc. and Green Town Properties, Inc. are the consolidated affiliates of the Foundation.

The Foundation acts primarily as a fundraising organization to supplement the resources that are available to the University in support of its programs. The Foundation board consists of 62 members. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources, or income thereon, that the Foundation holds and invests are restricted to the activities of the University by the donors. Because these restricted resources held by the Foundation can only be used by, or for the benefit of the University, the Foundation is considered a component unit of the University and is reported in separate financial statements because of the difference in its reporting model, as described below.

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

During the year ended June 30, 2017, the Foundation distributed $7,430,336.00 to the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the University Financial Services Office, 3800 East Tenth Street, Second Floor, Greenville, NC 27858, or by calling (252) 737-1133.

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

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

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

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

D. **Cash and Cash Equivalents** - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, and deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. **Investments** – To the extent available, investments are recorded at fair value based on quoted market prices in active markets on a trade-date basis. Additional information regarding the fair value measurement of investments is disclosed in Note 3. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net change in the value of investments is recognized as a component of investment income.

Other asset holdings are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

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

**F. Receivables** - Receivables consist of tuition and fees charged to students, charges for services rendered to patients, and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, state and local governments, and private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants. Receivables are recorded net of estimated uncollectible amounts.

**G. Inventories** - Inventories, consisting of expendable supplies, are valued at cost using the first-in, first-out method. Merchandise for resale is valued at the lower of cost or market using the retail inventory method.

**H. Capital Assets** - Capital assets are stated at cost at date of acquisition or acquisition value at date of donation in the case of gifts. Donated capital assets acquired prior to July 1, 2015 are stated at fair value as of the date of donation. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The University capitalizes assets that have a value or cost of $5,000 or greater at the date of acquisition and an estimated useful life of more than one year except for internally generated software which is capitalized when the value or cost is $1,000,000 or greater and other intangible assets which are capitalized when the value or cost is $100,000 or greater.

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

| Asset Class | Estimated Useful Life |
| --- | --- |
| Buildings | 25-75 years |
| Machinery and Equipment | 4-50 years |
| General Infrastructure | 10-50 years |
| Computer Software | 5-20 years |

The University does not capitalize the library and art collections. These collections adhere to the University's policy to maintain for public exhibition, education, or research; protect, keep unencumbered, care for, and preserve; and require proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than be capitalized.

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

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

Revenue bonds payable are reported net of unamortized premiums or discounts. The University amortizes bond premiums/discounts over the life of the bonds using the straight-line method that approximates the effective interest method. Deferred gains and losses on refundings are amortized over the life of the old debt or new debt (whichever is shorter) using the straight-line method, and are aggregated as deferred outflows of resources or deferred inflows of resources on the Statement of Net Position. Issuance costs are expensed in the reporting period in which they are incurred.

The net pension liability represents the University's proportionate share of the collective net pension liability reported in the State of North Carolina's 2016 *Comprehensive Annual Financial Report.* This liability represents the University's portion of the collective total pension liability less the fiduciary net position of the Teachers' and State Employees' Retirement System. See Note 12 for further information regarding the University's policies for recognizing liabilities, expenses, and deferred outflows of resources and deferred inflows of resources related to pensions.

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

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

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

L. **Deferred Outflows/Inflows of Resources** – In addition to assets, the Statement of Net Position reports a separate section for deferred outflows of resources. This separate financial statement element, deferred outflows of resources, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense) until then. The University has the following items that qualify for reporting in this category: deferred loss on refunding, and deferred outflows related to pensions.

In addition to liabilities, the Statement of Net Position reports a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and so will not be recognized as an inflow of resources (revenue) until then. The University has the following items that qualify for reporting in this category: deferred inflows related to pensions.

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

**Net Investment in Capital Assets** - This represents the University's total investment in capital assets, net of outstanding liabilities related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of net investment in capital assets. Additionally, deferred outflows of resources and deferred inflows of resources that are attributable to the acquisition, construction, or improvement of capital assets or related debt are also included in this component of net position.

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

**Restricted Net Position** - **Expendable** - Expendable restricted net position includes resources for which the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

**Unrestricted Net Position** - Unrestricted net position includes resources derived from student tuition and fees, sales and services, unrestricted gifts, royalties, and interest income.

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

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

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

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

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

## NOTE 2 - DEPOSITS AND INVESTMENTS

**A. Deposits** - Unless specifically exempt, the University is required by *North Carolina General Statute* 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. However, the University of North Carolina Board of Governors, pursuant to G.S. 116-36.1, may authorize the University to deposit its institutional trust funds in interest-bearing accounts and other investments authorized by the Board of Governors, without regard to any statute or rule of law relating to the investment of funds by fiduciaries. Although specifically exempted, the University may voluntarily deposit institutional trust funds, endowment funds, special funds, revenue bond proceeds, 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.

Cash on hand at June 30, 2017 was $116,154.72. The carrying amount of the University's deposits not with the State Treasurer was $90.556.25, and the bank balance was $90.837.30. Custodial credit risk is the risk that in the event of a bank failure, the University's deposits may not be returned to it. The University does not have a deposit policy for custodial credit risk. As of June 30, 2017, the University's bank balance was not exposed to custodial credit risk.

**B. Investments**

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

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

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

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

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

Investments of the University's component unit, the East Carolina University Foundation, Inc. and Consolidated Affiliates, are subject to and restricted by G.S. 36E "Uniform Prudent Management of Institutional Funds Act" (UPMIFA) and any requirements placed on them by contract or donor agreements.

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

Investments are subject to the following risks as defined by GASB Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3.*

*Interest Rate Risk*: Interest rate risk is the risk the University may face should interest rate variances affect the fair value of investments. The University's Endowment Board has a formal investment policy that addresses interest rate risk. The policy states that fixed income investments should have a duration that is not greater than +/- 40% that of Barclays Capital Aggregate Bond Index in order to minimize interest rate risk. The University has no formal investment policy that addresses interest rate risk for investments other than those under the control of the Endowment Board.

*Credit Risk*: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's Endowment Board has a formal investment policy that addresses credit risk. Each fixed income investment manager must assure that no position of any one issuer shall exceed 8% of the manager's portfolio at market value, with the exception of securities issued by the U.S. government and its agencies. Each fixed income portfolio must have an overall weighted average credit rating of "A" or better by Moody's and Standard & Poor's rating services, except where dedicated positions to less than investment grade securities are approved by the investment committee. There shall be no more than 7.5% of bond investments rated below "B" and no more than 25% of the portfolio may be in investments rated below investment grade (below Baa/BBB). Split rated securities will be governed by the lower rating. Investments in corporate securities of any one economic sector may be no more than 25% of the Portfolio value. No more than 60% of the portfolio shall be invested in either corporate or mortgage-backed securities. The University has no formal investment policy that addresses credit risk for investments other than those under the control of the Endowment Board.

*Custodial Credit Risk*: Custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Currently, the Endowment Fund does not participate in a securities lending program, therefore counterparty risk is not material. With regard to the safety of assets held by the custodian, the Endowment Fund retains title to those assets; as such, in the event of the broker/dealer failure, the assets held do not become assets of the broker/dealer and are protected from any counterparty claimants. The University has no formal investment policy that addresses custodial credit risk for investments other than those under the control of the Endowment Board.

**Short-Term Investment Fund** - At June 30, 2017, the amount shown on the Statement of Net Position as cash and cash equivalents includes $409,528,655.53, which represents the University's equity position in the State Treasurer's Short-Term Investment Fund (STIF). The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2017. Assets and shares of the STIF are valued at fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's STIF) are included in the North Carolina Department of State Treasurer Investment Programs' separately issued audit report. This separately issued report can be obtained from the Department of State Treasurer, 3200 Atlantic Avenue, Raleigh, NC 27604 or can be accessed from the Department of State Treasurer's website at https://www.nctreasurer.com/ in the Audited Financial Statements section.

**Long-Term Investment Pool** - This is an internal investment pool that is utilized for the investment of the endowment funds. Fund ownership is measured using the dollar value method. Under this method, each participating fund's investment balance is determined on the account balance and its proportionate share to the total pool. Investment returns and spending allocations are allocated and recorded to each fund accordingly. The investment strategy, including the selection of investment managers, is based on the directives of the University's Endowment Board.

The following table presents investments by type and investments subject to interest rate risk at June 30, 2017, for the Long-Term Investment Pool.

## Long-Term Investment Pool

| | Amount | Investment Maturities (in Years) Less Than 1 | 1 to 5 | 6 to 10 | More than 10 |
|---|---|---|---|---|---|
| Investment Type | | | | | |
| Debt Securities | | | | | |
| Debt Mutual Funds | $ 8,111,768.25 | $ 0.00 | $ 1,992,699.69 | $ 2,058,755.16 | $ 4,060,313.40 |
| Money Market Mutual Funds | 1,256,580.76 | 1,256,580.76 | | | |
| Total Debt Securities | 9,368,349.01 | $ 1,256,580.76 | $ 1,992,699.69 | $ 2,058,755.16 | $ 4,060,313.40 |
| Other Securities | | | | | |
| UNC Investment Fund | 2,771,215.95 | | | | |
| International Mutual Funds | 9,437,422.28 | | | | |
| Equity Mutual Funds | 21,158,781.77 | | | | |
| Hedge Funds | 7,137,179.99 | | | | |
| Private Equity Limited Partnerships | 850,895.53 | | | | |
| Domestic Stocks | 175,952.56 | | | | |
| Other | 130,293.84 | | | | |
| Total Long-Term Investment Pool | $ 51,030,090.93 | | | | |

At June 30, 2017, investments in the Long-Term Investment Pool had the following credit quality distribution for securities with credit exposure:

| | Amount | AAA Aaa | A | BBB Baa | BB/Ba and below | Unrated |
|---|---|---|---|---|---|---|
| Debt Mutual Funds | $ 8,111,768.25 | $ 8,006.24 | $ 4,142,983.74 | $ 3,933,332.32 | $ 13,657.35 | $ 13,788.60 |
| Money Market Mutual Funds | 1,256,580.76 | 1,256,580.76 | | | | |
| Totals | $ 9,368,349.01 | $ 1,264,587.00 | $ 4,142,983.74 | $ 3,933,332.32 | $ 13,657.35 | $ 13,788.60 |

Rating Agency: Moody's/Standard and Poors

At June 30, 2017, investments in the Long-Term Investment Pool were exposed to custodial credit risk as follows:

| Investment Type | Held by Counterparty |
|---|---|
| Domestic Stocks | $ 175,952.56 |

**UNC Investment Fund, LLC** - At June 30, 2017, the University's investments include $2,771,215.95 which represents the University's equity position in the UNC Investment Fund, LLC (UNC Investment Fund). The UNC Investment Fund is an external investment pool that is not registered with the Securities and Exchange Commission, does not have a credit rating, and is not subject to any regulatory oversight. Investment risks associated with the UNC Investment Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

**Non-Pooled Investments** - The following table presents investments by type and investments subject to interest rate risk at June 30, 2017, for the University's non-pooled investments.

### Non-Pooled Investments

| | Amount | Investment Maturities (in Years) Less Than 1 |
|---|---|---|
| Investment Type | | |
| Debt Securities | | |
| Money Market Mutual Funds | $ 13,009.57 | $ 13,009.57 |
| Total Non-Pooled Investments | $ 13,009.57 | |

At June 30, 2017, the University's non-pooled investments had the following credit quality distribution for securities with credit exposure:

| | Amount | AAA Aaa |
|---|---|---|
| Money Market Mutual Funds | $ 13,009.57 | $ 13,009.57 |

Rating Agency: Moody's / Standard and Poors

**Total Investments** - The following table presents the total investments at June 30, 2017:

| | Amount |
|---|---|
| Investment Type | |
| Debt Securities | |
| Debt Mutual Funds | $ 8,111,768.25 |
| Money Market Mutual Funds | 1,269,590.33 |
| Other Securities | |
| UNC Investment Fund | 2,771,215.95 |
| International Mutual Funds | 9,437,422.28 |
| Equity Mutual Funds | 21,158,781.77 |
| Hedge Funds | 7,137,179.99 |
| Private Equity Limited Partnerships | 850,895.53 |
| Domestic Stocks | 175,952.56 |
| Other | 130,293.84 |
| Total Investments | $ 51,043,100.50 |

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

| Investment Type | Carrying Value |
|---|---|
| Common Stock | $ 50,000.00 |
| Mutual Funds | 85,713,635.00 |
| Alternative Investments | 27,088,888.00 |
| Total | $ 112,852,523.00 |

**C. Reconciliation of Deposits and Investments** - A reconciliation of deposits and investments for the University as of June 30, 2017, is as follows:

| | |
|---|---|
| Cash on Hand | $ 116,154.72 |
| Amount of Deposits with Private Financial Institutions | 90,556.25 |
| Deposits in the Short-Term Investment Fund | 409,528,655.53 |
| Long-Term Investment Pool | 51,030,090.93 |
| Non-Pooled Investments | 13,009.57 |
| Total Deposits and Investments | $ 460,778,467.00 |
| Deposits | |
| Current: | |
| Cash and Cash Equivalents | $ 244,981,266.57 |
| Restricted Cash and Cash Equivalents | 44,024,027.12 |
| Noncurrent: | |
| Restricted Cash and Cash Equivalents | 120,730,072.81 |
| Total Deposits | 409,735,366.50 |
| Investments | |
| Noncurrent: | |
| Endowment Investments | 51,030,090.93 |
| Restricted Investments | 13,009.57 |
| Total Investments | 51,043,100.50 |
| Total Deposits and Investments | $ 460,778,467.00 |

## NOTE 3 - FAIR VALUE MEASUREMENTS

**University** - To the extent available, the University's investments are recorded at fair value as of June 30, 2017. GASB Statement No. 72, *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Level 1 — Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.

Level 2 — Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset, either directly or indirectly.

Level 3 — Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

The following table summarizes the University's investments, including the Short-Term Investment Fund, within the fair value hierarchy at June 30, 2017:

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| | Fair Value | Level 1 Inputs | Level 2 Inputs | Level 3 Inputs |
| Investments by Fair Value Level | | | | |
| Debt Securities | | | | |
| Debt Mutual Funds | $ 8,111,768.25 | $ 8,111,768.25 | $ 0.00 | $ 0.00 |
| Money Market Mutual Funds | 1,269,590.33 | 1,269,590.33 | | |
| Total Debt Securities | 9,381,358.58 | 9,381,358.58 | | |
| Other Securities | | | | |
| Short-Term Investment Fund | 409,528,655.53 | | 409,528,655.53 | |
| UNC Investment Fund | 2,771,215.95 | | | 2,771,215.95 |
| International Mutual Funds | 9,437,422.28 | 9,437,422.28 | | |
| Equity Mutual Funds | 21,158,781.77 | 21,158,781.77 | | |
| Domestic Stocks | 175,952.56 | 175,952.56 | | |
| Total Investments by Fair Value Level | 452,453,386.67 | $ 40,153,515.19 | $ 409,528,655.53 | $ 2,771,215.95 |
| Investments Measured at the Net Asset Value (NAV) | | | | |
| Long/Short Hedge Funds | 7,137,179.99 | | | |
| Private Equity Limited Partnerships | 850,895.53 | | | |
| Other - Private Distressed Debt LP | 130,293.84 | | | |
| Total Investments Measured at the NAV | 8,118,369.36 | | | |
| Total Investments Measured at Fair Value | $ 460,571,756.03 | | | |

**Short-Term Investment Fund -** Ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian.

**UNC Investment Fund** - Ownership interests of the UNC Investment Fund are determined on a market unit valuation basis each month and in accordance with the UNC Investment Fund's operating procedures.

**Debt and Equity Securities** - Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

The valuation of investments measured at the Net Asset Value (NAV) per share (or its equivalent) is presented on the following table.

Investments Measured at the NAV

| | Fair Value | Unfunded Commitments | Redemption Frequency (If Currently Eligible) | Redemption Notice Period |
|---|---|---|---|---|
| Hedge Funds[A] | | | | |
| Harvest | $ 1,804,103.18 | $ 0.00 | Monthly | 90 days |
| Lighthouse | 5,333,076.81 | | Quarterly | 30 days |
| Private Equity Limited Partnerships[B] | | | | |
| FEG Private Opportunities I | 412,614.87 | 45,750.00 | Ineligible | N/A |
| FEG Private Opportunities II | 275,706.13 | 225,000.00 | Ineligible | N/A |
| FEG Private Opportunities III | 96,530.15 | 1,488,000.00 | Ineligible | N/A |
| Northgate I | 18,596.00 | 12,000.00 | Ineligible | N/A |
| Northgate II | 47,448.38 | 10,000.00 | Ineligible | N/A |
| Other - Private Distressed Debt LP[C] | 130,293.84 | 15,000.00 | Ineligible | N/A |
| Total Investments Measured at the NAV | $ 8,118,369.36 | | | |

A. **Hedge Funds** - This type includes investments in two hedge funds that are in the fund-of-funds category. The funds invest in both long and short positions across a globally allocated pool of various types of assets. The hedge fund investments pursue a variety of strategies, including real estate, debt, equity, and other hedging strategies. Management of each hedge fund has the ability to use leverage in the funds and to shift investments from value to growth strategies, from small to large capitalization stocks and from net long positions to net short positions. The fair values of the investments in this type have been determined using the NAV per share of the investments. Restriction periods ranged from 30 to 90 days on these investments as of June 30, 2017.

B. **Private Equity Limited Partnerships** - This type includes investments in five private equity funds that are in the fund-of-funds category. The funds generally invest in long positions across a globally allocated pool of various types of assets. The private equity investments include funds whose focus is on buyouts, distressed debt, real assets, and various real estate purchases. Management of each fund has the ability to shift investments from value to growth strategies, from small to large capitalization stocks, invest in a variety of debt structures, and participate in buyout opportunities across a wide variety of industries. The fair values of the investments in this type have been determined using the NAV per share of the investments. A limited amount of the underlying managers use leverage in their return strategy. These are closed period funds which do not permit redemptions for an extended period of time or until the underlying mangers liquidate and disburse funds.

C. **Other – Private Distressed Debt LP** - This type includes investments in one private equity fund that is in the fund-of-funds category. The private equity investments include equity investments in limited partnership funds in banking, hedge fund, commercial real estate, distressed debt, residential real estate, real property, and hospitality.

**Component Unit -** Fair value as defined under GAAP is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Foundation uses various valuation approaches within the FASB ASC 820 fair value measurement framework. Fair value measurements are determined based on the assumptions that market participants would use in pricing an asset or liability.

FASB ASC 820 establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. FASB ASC 820 defines levels within the hierarchy based on the reliability of inputs as follows:

| | |
|---|---|
| Level 1 | Valuations based on unadjusted quoted prices for identical assets or liabilities in active markets |
| Level 2 | Valuations based on quoted prices for similar assets or liabilities or identical assets or liabilities in less active markets, such as dealer or broker markets |
| Level 3 | Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable, such as pricing models, discounted cash flow models and similar techniques not based on market, exchange, dealer or broker-traded transactions. |

The following is a description of the valuation methodologies used for instruments measured at fair value and their classification in the valuation hierarchy. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Foundation's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels. These valuation methodologies have not changed and are consistent with prior years.

Mutual funds listed on a national market or exchanges are valued at the last sales price. If there is no sale, and the market is considered still active, equity securities are valued at the last transaction price before year-end. Such securities are classified within Level 1 of the valuation hierarchy.

Investments in real estate are valued based on independent appraisals and county tax records and are classified within Level 2 of the valuation hierarchy.

Investments in charitable remainder trusts and annuities are valued at the market price of the investments held and are classified as Level 2 of the valuation hierarchy. While the Foundation has access to a detailed listing of the underlying assets held in these trusts, the majority of which are publically traded and readily available in active markets, the trusts themselves do not have daily quoted active market prices. Investments in these trusts are valued per share based on the market prices of the underlying assets.

Beneficial interest in charitable remainder trusts are valued at the market price of the investments and are classified as Level 3 of the valuation hierarchy. While the Foundation has access to a detailed listing of the underlying assets held in these trusts, the majority of which are publically traded and readily available in active markets, the beneficial interests are determined through discounted cash flow analysis.

The Foundation's interest rate swap agreement is valued based upon a calculated mathematical approximation of market values based upon proprietary models of the counterparty to the swap agreement. The interest rate swap is included in Level 2 of the fair value hierarchy, given that the significant inputs used in developing the calculations are determined to be observable and comparable to similar instruments within the market.

The fair value of the Foundation's charitable gift annuity obligations is based on the net present value of the anticipated benefit using the difference between the assets received and the original contribution. As beneficiary payments are made, the liability is adjusted based on an amortization schedule. The annuity obligations are included in Level 2 of the fair value hierarchy.

The fair value of liabilities under charitable remainder trusts is based on the net present value of the anticipated benefit payments from the trust for which the Foundation is both a beneficiary and trustee. As beneficiary payments are made, the life expectancy of the beneficiary decreases and discount rates fluctuate year to year, the Foundation adjusts the liability accordingly. The trust liabilities are included in Level 2 of the fair value hierarchy.

The following table presents assets and liabilities measured at fair value by classification within the fair value hierarchy as of June 30, 2017:

| | Financial Assets (Liabilities) at Fair Value as of June 30, 2017 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Investments in Mutual Funds | $ 85,713,635 | $ 0 | $ 0 | $ 85,713,635 |
| Investments in Common Stock | 50,000.00 | | | 50,000 |
| Investments in Real Estate | | 2,750,031.00 | | 2,750,031 |
| Investments in Private Equity Funds Measured at Net Asset Value [(a)] | | | | 4,955,856.00 |
| Investments in Hedge Funds Measured at Net Asset Value [(a)] | | | | 22,133,032.00 |
| Total | $ 85,763,635 | $ 2,750,031 | $ 0 | $ 115,602,554 |
| Investments in Charitable Remainder Trusts | $ 0 | $ 1,307,498 | $ 0 | $ 1,307,498 |
| Beneficial Interest in Charitable Remainder Trusts | $ 0 | $ 0 | $ 2,648,102 | $ 2,648,102 |
| Interest Rate Swaps | $ 0 | $ (49,420) | $ 0 | $ (49,420) |
| Liabilities Under Charitable Gift Annuities | $ 0 | $ (689,337) | $ 0 | $ (689,337) |
| Liabilities Under Charitable Remainder Trusts | $ 0 | $ (236,017) | $ 0 | $ (236,017) |

(a) In accordance with Subtopic 820-10, certain investments that were measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the line items presented in the Consolidated Statemnts of Financial Position.

There were no transfers among Level 1, Level 2, or Level 3 assets during the year ended June 30, 2017. When transfers occur, they are recognized at the end of the reporting period.

Management determines the fair value measurement valuation policies and procedures, including those for Level 3 recurring and nonrecurring measurements. The Foundation’s Board of Directors assesses and approves these policies and procedures. At least annually, management: (1) determines if the current valuation techniques used in fair value measurements are still appropriate, and (2) evaluates and adjusts the unobservable inputs used in the fair value measurements based on current market conditions and third-party information.

The following is a reconciliation of the beginning and ending balances of assets and liabilities measured at fair value on a recurring basis using significant unobservable (Level 3) inputs during the year ended June 30, 2017:

| | 2017 |
|---|---|
| Balance, Beginning of Year | $ 2,855,665 |
| Distribution from Level 3 | (477,939) |
| Revaluation of Split Interest Agreements | 270,376 |
| Balance, End of Year | $ 2,648,102 |

Revaluation of split interest agreements applicable to instruments valued using significant unobservable inputs (Level 3) shown above are included in the change in net assets for FY 2017 in the Consolidated Statement of Activities.

**Quantitative Information about Significant Unobservable Inputs Used in Level 3 Fair Value Measurements**

The following table represents the Foundation's Level 3 financial instruments, the valuation techniques used to measure the fair value of those financial instruments, and the significant unobservable inputs and ranges of values for those unobservable inputs.

| | Significant Unobservable Inputs at June 30, 201 | | |
|---|---|---|---|
| | Fair Value | Principal Valuation Technique | Unobservable Inputs |
| Beneficial Interests in Charitable Remainder Trusts | $ 2,648,102 | Discounted Cash Flows | Payout Rate Discount Rate |

The following table summarizes the Foundation's alternative investments at June 30, 2017:

| | Alternative Investments at June 30, 2017 | | | |
|---|---|---|---|---|
| | Fair Value | Unfunded Commitments | Redemption Frequency (If Currently Available) | Redemption Notice Point |
| Private Equity Funds | | | | |
| FEG Private Investors | $ 2,475,687 | $ 274,500 | Ineligible | N/A |
| FEG Private Investors II | 1,654,239 | 1,350,000 | Ineligible | N/A |
| FEG Private Investors III | 144,795 | 2,232,000 | Ineligible | N/A |
| Northgate Private Equity Partners I | 74,356 | 48,000 | Ineligible | N/A |
| Northgate Private Equity Partners II | 215,896 | 50,000 | Ineligible | N/A |
| Siguler Gulf Distressed Opportunities III | 390,883 | 45,000 | Ineligible | N/A |
| Total Private Equity Funds | 4,955,856 | 3,999,500 | | |
| Hedge Funds: | | | | |
| Fidelity Real Estate High Income Fund | 1,349,137 | | Daily | 5 days |
| Harvest MLP | 3,411,358 | | Monthly | 30 days |
| Lighthouse Diversified Fund | 9,803,268 | | Quarterly | 90 days |
| UNC Investment Fund, LLC | 7,569,269 | | Monthly | 30 days |
| Total Hedge Funds | 22,133,032 | | | |
| Total Alternative Investments | $ 27,088,888 | $ 3,999,500 | | |

The Foundation invests in alternative investment vehicles as a hedge against broader market risks by further diversifying the portfolio holdings. Investments in both private equity and hedge funds are in the fund-of-funds category. The private equity investments include funds whose focus is on buyouts and distressed debt purchases. The hedge fund investments pursue a variety of strategies, including real estate, equity, and other hedging strategies.

The Foundation invests in various types of investment securities, which are exposed to various risks, such as interest rate, market, and credit risk. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term, and such changes could materially affect the amounts reported in the Consolidated Statements of Financial Position.

## NOTE 4 - ENDOWMENT INVESTMENTS

Investments of the University's endowment funds are pooled, unless required to be separately invested by the donor. If a donor has not provided specific instructions, state law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the investments of the endowment funds. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may also appropriate expenditures from eligible nonexpendable balances if deemed prudent and necessary to meet program outcomes and for which such spending is not specifically prohibited by the donor agreements. However, a majority of the University's endowment donor agreements prohibit spending of nonexpendable balances and therefore the related nonexpendable balances are not eligible for expenditure. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds.

Investment return of the University's endowment funds is predicated on the total return concept (yield plus appreciation). Annual payouts from the University's endowment funds are based on an adopted spending policy which provides a distribution of 4% of its fiscal year end endowment fund's twelve month weighted average balance prior to the addition of the current year investment return. To the extent that the total return for the current year exceeds the payout and a 1.25% administrative fee, the excess is added to accumulated earnings unless donor restrictions require that it be added to principal. If current year earnings do not meet the payout requirements, the University uses accumulated income and appreciation from restricted, expendable net position endowment balances to make up the difference. At June 30, 2017, endowment net assets of $16,199,893.41 were available to be spent, all of which was restricted to specific purposes.

## NOTE 5 - RECEIVABLES

Receivables at June 30, 2017, were as follows:

| | Gross Receivables | Less Allowance for Doubtful Accounts | Net Receivables |
|---|---|---|---|
| Current Receivables: | | | |
| Students | $ 3,052,332.37 | $ 710,000.00 | $ 2,342,332.37 |
| Student Sponsors | 270,522.94 | | 270,522.94 |
| Patients | 57,488,555.48 | 21,143,055.00 | 36,345,500.48 |
| Accounts | 1,678,351.51 | 58,148.14 | 1,620,203.37 |
| Intergovernmental | 1,874,173.99 | | 1,874,173.99 |
| Grant Sponsors | 1,672,295.62 | | 1,672,295.62 |
| Investment Earnings | 1.76 | | 1.76 |
| Interest on Loans | 606,630.93 | | 606,630.93 |
| Federal Interest Subsidy on Debt | 104,413.09 | | 104,413.09 |
| Other | 825,972.31 | 20,101.86 | 805,870.45 |
| Total Current Receivables | $ 67,573,250.00 | $ 21,931,305.00 | $ 45,641,945.00 |
| Noncurrent Receivables: | | | |
| Patients | $ 3,018,105.17 | $ 0.00 | $ 3,018,105.17 |
| Notes Receivable: | | | |
| Notes Receivable - Current: | | | |
| Federal Loan Programs | $ 2,286,060.60 | $ 436,064.53 | $ 1,849,996.07 |
| Institutional Student Loan Programs | 500.00 | | 500.00 |
| Total Notes Receivable - Current | $ 2,286,560.60 | $ 436,064.53 | $ 1,850,496.07 |
| Notes Receivable - Noncurrent: | | | |
| Federal Loan Programs | $ 10,978,774.89 | $ 1,528,592.94 | $ 9,450,181.95 |

## NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2017, is presented as follows:

| | Balance July 1, 2016 | Increases | Decreases | Balance June 30, 2017 |
|---|---|---|---|---|
| Capital Assets, Nondepreciable: | | | | |
| Land | $ 48,058,438.61 | $ 2,050,352.42 | $ 0.00 | $ 50,108,791.03 |
| Construction in Progress | 63,113,937.15 | 74,633,629.58 | 59,036,461.96 | 78,711,104.77 |
| Computer Software in Development | 478,609.19 | 72,385.00 | | 550,994.19 |
| Total Capital Assets, Nondepreciable | 111,650,984.95 | 76,756,367.00 | 59,036,461.96 | 129,370,889.99 |
| Capital Assets, Depreciable: | | | | |
| Buildings | 959,630,072.57 | 58,469,126.70 | 1,614,618.06 | 1,016,484,581.21 |
| Machinery and Equipment | 139,994,874.38 | 14,080,975.29 | 4,182,662.08 | 149,893,187.59 |
| General Infrastructure | 102,637,246.54 | 1,289,895.00 | | 103,927,141.54 |
| Computer Software | 14,080,009.73 | | | 14,080,009.73 |
| Total Capital Assets, Depreciable | 1,216,342,203.22 | 73,839,996.99 | 5,797,280.14 | 1,284,384,920.07 |
| Less Accumulated Depreciation/Amortization for: | | | | |
| Buildings | 234,780,037.42 | 17,491,732.83 | 1,508,309.28 | 250,763,460.97 |
| Machinery and Equipment | 70,714,962.57 | 10,105,931.80 | 2,654,835.20 | 78,166,059.17 |
| General Infrastructure | 25,552,637.98 | 2,883,558.98 | | 28,436,196.96 |
| Computer Software | 6,962,148.08 | 716,329.37 | | 7,678,477.45 |
| Total Accumulated Depreciation/Amortization | 338,009,786.05 | 31,197,552.98 | 4,163,144.48 | 365,044,194.55 |
| Total Capital Assets, Depreciable, Net | 878,332,417.17 | 42,642,444.01 | 1,634,135.66 | 919,340,725.52 |
| Capital Assets, Net | $ 989,983,402.12 | $ 119,398,811.01 | $ 60,670,597.62 | $ 1,048,711,615.51 |

During the year ended June 30, 2017, the University incurred $13,344,252.63 in interest costs related to the acquisition and construction of capital assets. Of this total, $8,141,154.30 was charged in interest expense, and $5,203,098.33 was capitalized.

The University has pledged the energy savings improvements installed in its buildings and other structures financed through the UNC System Guaranteed Energy Savings Installment Financing Agreement (agreement) dated September 1, 2014. The value of the energy savings improvements assets associated with the agreement is $4,728,829.10 and is subject to security provisions in the agreement to ensure timely debt service payments. Additional information regarding the UNC System Energy Savings Installment Financing Agreement – Note Payable can be found in Note 8.

## NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2017, were as follows:

| | Amount |
|---|---|
| Current Accounts Payable and Accrued Liabilities | |
| Accounts Payable | $ 18,916,423.85 |
| Accrued Payroll | 15,752,634.67 |
| Contract Retainage | 3,325,679.01 |
| Other | 272,996.90 |
| Total Current Accounts Payable and Accrued Liabilities | $ 38,267,734.43 |

## 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, 2017, is presented as follows:

| | Balance July 1, 2016 | Additions | Reductions | Balance June 30, 2017 | Current Portion |
|---|---|---|---|---|---|
| Revenue Bonds Payable | $ 348,375,000.00 | $ 0.00 | $ 9,080,000.00 | $ 339,295,000.00 | $ 12,735,000.00 |
| Plus: Unamortized Premium | 20,570,489.61 | | 1,054,881.38 | 19,515,608.23 | |
| Less: Unamortized Discount | (2,597,653.36) | | (99,540.94) | (2,498,112.42) | |
| Total Revenue Bonds Payable, Net | 366,347,836.25 | 0.00 | 10,035,340.44 | 356,312,495.81 | 12,735,000.00 |
| Net Pension Liability | 49,590,972.00 | 73,109,319.00 | | 122,700,291.00 | |
| Notes Payable | 11,079,053.01 | | 2,200,528.39 | 8,878,524.62 | 2,269,352.65 |
| Capital Leases Payable | 254,091.19 | 1,631,241.00 | 79,563.64 | 1,805,768.55 | 200,930.56 |
| Compensated Absences | 22,588,716.50 | 14,769,181.76 | 14,721,839.89 | 22,636,058.37 | 2,235,688.24 |
| Total Long-Term Liabilities, Net | $ 449,860,668.95 | $ 89,509,741.76 | $ 27,037,272.36 | $ 512,333,138.35 | $ 17,440,971.45 |

Additional information regarding capital lease obligations is included in Note 9.
Additional information regarding the net pension liability is included in Note 12.

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

| Purpose | Series | Interest Rate/ Ranges | Final Maturity Date | Original Amount of Issue | Principal Paid Through June 30, 2017 | Principal Outstanding June 30, 2017 |
|---|---|---|---|---|---|---|
| General Revenue Bonds Payable | | | | | | |
| Tyler Dorm Project (BAB) | 2010B | 4.008-5.825* | 10/01/2030 | $ 10,045,000.00 | $ 1,425,000.00 | $ 8,620,000.00 |
| Wright Place Renovations (BAB) | 2010B | 4.008-4.581* | 10/01/2020 | 1,990,000.00 | 810,000.00 | 1,180,000.00 |
| Olympic Sports Facility (BAB) | 2010B | 4.008-5.875* | 10/01/2035 | 15,935,000.00 | 1,580,000.00 | 14,355,000.00 |
| Refunding of 2003A West End Dining Project | 2012 | 2.984 | 04/01/2024 | 4,650,000.00 | 1,410,000.00 | 3,240,000.00 |
| Refunding of 2004C College Hill Dormitory Construction | 2012 | 2.984 | 04/01/2027 | 5,770,000.00 | 955,000.00 | 4,815,000.00 |
| Refunding of 2004C College Hill Dormitory Construction | 2013A | 2.5-4.0 | 10/01/2033 | 10,905,000.00 | | 10,905,000.00 |
| Gateway East and West Housing Project | 2014A | 3.0-5.0 | 10/01/2043 | 53,685,000.00 | 970,000.00 | 52,715,000.00 |
| West Facility Student Center | 2015A | 3.0-5.0 | 10/01/2044 | 29,955,000.00 | 545,000.00 | 29,410,000.00 |
| Refunding of 2009A Bonds Dining Project Croatan | 2015A | 3.0-5.0 | 10/01/2029 | 5,164,921.99 | 105,807.53 | 5,059,114.46 |
| Refunding of 2009A Bonds Scott Residence Hall | 2015A | 3.0-5.0 | 10/01/2034 | 24,248,294.32 | 501,757.07 | 23,746,537.25 |
| Refunding of 2009A Bonds Softball Field Project | 2015A | 3.0-5.0 | 10/01/2034 | 3,946,783.69 | 82,435.40 | 3,864,348.29 |
| Refunding of 2006A Bonds College Hill Dormitory | 2015A | 3.0-5.0 | 10/01/2033 | 2,930,000.00 | 45,000.00 | 2,885,000.00 |
| Refunding of 2006A Ref Bonds 2001A Bonds (Jones and Galley) | 2015B | 3.0 | 10/01/2021 | 4,895,656.59 | 181,149.86 | 4,714,506.73 |
| Refunding of 2006A Ref Bonds 1999 Bonds (Student Health) | 2015B | 3.0 | 10/01/2018 | 524,343.41 | 18,850.14 | 505,493.27 |
| East Union Project | 2016A | 2.0-5.0 | 10/01/2045 | 102,730,000.00 | | 102,730,000.00 |
| Housing Projects (White, Clement, & Greene) | 2016A | 2.0-5.0 | 10/01/2045 | 37,190,000.00 | | 37,190,000.00 |
| East Union Project | 2016B | 1.25-1.3 | 10/01/2018 | 3,510,000.00 | | 3,510,000.00 |
| Total General Revenue Bonds | | | | 318,075,000.00 | 8,630,000.00 | 309,445,000.00 |
| The University of North Carolina System Pool Revenue Bonds | | | | | | |
| Dining Project Croatan | 2009A | 3.75-5.0 | 10/01/2019 | 8,050,000.00 | 6,980,000.00 | 1,070,000.00 |
| Scott Residence Hall | 2009A | 3.75-5.0 | 10/01/2019 | 29,360,000.00 | 26,590,000.00 | 2,770,000.00 |
| Softball Field Project | 2009A | 3.75-5.0 | 10/01/2019 | 4,885,000.00 | 4,435,000.00 | 450,000.00 |
| Refunding of 1998 Housing and Dining Bonds | 2009A | 3.75-4.25 | 10/01/2018 | 2,820,000.00 | 2,085,000.00 | 735,000.00 |
| East End Zone Project | 2010A | 3.0-5.0 | 10/01/2029 | 17,400,000.00 | 3,525,000.00 | 13,875,000.00 |
| Refunding of 2004C College Hill Dormitory Construction | 2010A | 3.0-5.0 | 10/01/2021 | 4,370,000.00 | 755,000.00 | 3,615,000.00 |
| Refunding of 2001C Student Fee Revenue Refunding Bonds | 2011A | 5.0 | 05/01/2019 | 7,125,000.00 | 5,170,000.00 | 1,955,000.00 |
| Refunding of 2003A West End Dining Project | 2011A | 4.0-5.0 | 05/01/2021 | 5,215,000.00 | 1,620,000.00 | 3,595,000.00 |
| Refunding of 2004C College Hill Dormitory Construction | 2011A | 4.0-5.0 | 05/01/2023 | 2,545,000.00 | 760,000.00 | 1,785,000.00 |
| Total The University of North Carolina System PoolRevenue Bonds | | | | 81,770,000.00 | 51,920,000.00 | 29,850,000.00 |
| Total Revenue Bonds Payable (principal only) | | | | $ 399,845,000.00 | $ 60,550,000.00 | 339,295,000.00 |
| Less: Unamortized Discount | | | | | | (2,498,112.42) |
| Plus: Unamortized Premium | | | | | | 19,515,608.23 |
| Total Revenue Bonds Payable | | | | | | $ 356,312,495.81 |

* The University has elected to treat these bonds as federally taxable "Build America Bonds" for the purposes of the American Recovery and Reinvestment Act and to receive a cash subsidy from the U.S. Treasury equal to 32% of the interest payable on these bonds. For these bonds, the interest rate included is the taxable rate, which does not factor in the cash subsidy from the U.S. Treasury.

**C. Annual Requirements** - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2017, are as follows:

| | Annual Requirements | | | |
|---|---|---|---|---|
| | Revenue Bonds Payable | | Notes Payable | |
| Fiscal Year | Principal | Interest | Principal | Interest |
| 2018 | $ 12,735,000.00 | $ 13,522,596.54 | $ 2,269,352.65 | $ 155,811.87 |
| 2019 | 13,295,000.00 | 13,054,732.13 | 2,344,835.62 | 111,623.60 |
| 2020 | 11,995,000.00 | 12,511,673.39 | 1,647,399.15 | 65,979.47 |
| 2021 | 12,610,000.00 | 11,950,629.82 | 919,597.98 | 41,910.28 |
| 2022 | 12,920,000.00 | 11,358,194.40 | 956,718.78 | 24,716.56 |
| 2023-2027 | 63,575,000.00 | 48,122,186.22 | 740,620.44 | 6,831.57 |
| 2028-2032 | 66,305,000.00 | 33,839,260.11 | | |
| 2033-2037 | 56,655,000.00 | 21,930,437.63 | | |
| 2038-2042 | 50,635,000.00 | 12,559,759.49 | | |
| 2043-2047 | 38,570,000.00 | 2,735,850.00 | | |
| Total Requirements | $ 339,295,000.00 | $ 181,585,319.73 | $ 8,878,524.62 | $ 406,873.35 |

**D. Prior Year Defeasance** - During prior years, the University defeased certain bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's financial statements. At June 30, 2017, the outstanding balance of prior year defeased bonds was $30,505,000.00.

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

| Purpose | Financial Institution | Interest Rate | Final Maturity Date | Original Amount of Issue | Principal Paid Through June 30, 2017 | Principal Outstanding June 30, 2017 |
|---|---|---|---|---|---|---|
| Auxiliary Gym | US Bank NA | 1.98% | 11/1/2019 | $ 13,251,669.83 | $ 9,536,623.05 | $ 3,715,046.78 |
| Energy Savings | Banc of America | 1.84% | 2/14/2023 | 4,797,969.10 | 765,320.38 | 4,032,648.72 |
| Energy Savings | Banc of America | 1.84% | 2/14/2023 | 1,345,439.10 | 214,609.98 | 1,130,829.12 |
| Total Notes Payable | | | | $ 19,395,078.03 | $ 10,516,553.41 | $ 8,878,524.62 |

## NOTE 9 - LEASE OBLIGATIONS

**A. Capital Lease Obligations** - Capital lease obligations relating to to medical and information technology 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, 2017:

| Fiscal Year | Amount |
|---|---|
| 2018 | $ 297,462.25 |
| 2019 | 302,451.72 |
| 2020 | 302,451.72 |
| 2021 | 257,546.49 |
| 2022 | 242,578.08 |
| 2023-2027 | 869,258.03 |
| Total Minimum Lease Payments | 2,271,748.29 |
| Amount Representing Interest (0-6.510% Rate of Interest) | 465,979.74 |
| Present Value of Future Lease Payments | $ 1,805,768.55 |

Machinery and equipment acquired under capital lease amounted to $2,391,759.92 at June 30, 2017.

Depreciation for the capital assets associated with capital leases is included in depreciation expense, and accumulated depreciation for assets acquired under capital lease totaled $499,099.25 at June 30, 2017.

**B. Operating Lease Obligations** - The University entered into operating leases for equipment and buildings. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2017:

| Fiscal Year | Amount |
|---|---|
| 2018 | $ 4,976,550.11 |
| 2019 | 3,890,640.19 |
| 2020 | 3,249,692.69 |
| 2021 | 2,273,534.68 |
| 2022 | 1,713,061.76 |
| Total Minimum Lease Payments | $ 16,103,479.43 |

Rental expense for all operating leases during the year was $5,487,752.15.

## NOTE 10 - REVENUES

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

| | Gross Revenues | Internal Sales Eliminations | Less Scholarship Discounts | Less Allowance for Uncollectibles | Less Indigent Care and Contractual Adjustments | Net Revenues |
|---|---|---|---|---|---|---|
| Operating Revenues: | | | | | | |
| Student Tuition and Fees, Net | $ 244,067,700.43 | $ 0.00 | $ 45,238,935.48 | $ 279,088.96 | $ 0.00 | $ 198,549,675.99 |
| Patient Services, Net | $ 436,528,132.59 | $ 0.00 | $ 0.00 | $ 26,100,461.87 | $ 202,938,712.36 | $ 207,488,958.36 |
| Sales and Services: | | | | | | |
| Sales and Services of Auxiliary Enterprises: | | | | | | |
| Residential Life | $ 31,156,794.46 | $ 1,400,718.10 | $ 5,471,851.98 | $ 0.00 | $ 0.00 | $ 24,284,224.38 |
| Dining | 29,437,039.11 | 1,219,796.73 | 3,590,369.09 | | | 24,626,873.29 |
| Student Union Services | 97,495.86 | 12,214.25 | | | | 85,281.61 |
| Health, Physical Education, and Recreation Services | 1,942,921.79 | 536,630.73 | | | | 1,406,291.06 |
| Bookstore | 12,597,673.67 | 904,384.97 | 1,232,004.05 | | | 10,461,284.65 |
| Parking | 3,518,658.96 | 121,480.50 | | 29,136.00 | | 3,368,042.46 |
| Athletic | 19,518,238.68 | 7,069.13 | | | | 19,511,169.55 |
| Other | 1,952,571.54 | 655,215.13 | | | | 1,297,356.41 |
| Sales and Services of Education and Related Activities | 11,522,460.60 | 2,241,704.52 | | | | 9,280,756.08 |
| Total Sales and Services, Net | $ 111,743,854.67 | $ 7,099,214.06 | $ 10,294,225.12 | $ 29,136.00 | $ 0.00 | $ 94,321,279.49 |

## 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 / Amortization | Total |
|---|---|---|---|---|---|---|---|
| Instruction | $ 249,545,495.52 | $ 12,259,868.29 | $ 19,650,799.48 | $ 0.00 | $ 71,058.12 | $ 0.00 | $ 281,527,221.41 |
| Research | 12,394,193.74 | 2,614,579.00 | 3,428,918.97 | | 2,343.10 | | 18,440,034.81 |
| Public Service | 18,554,934.82 | 138,564.85 | 3,049,284.67 | | 14,397.05 | | 21,757,181.39 |
| Academic Support | 21,565,398.14 | 15,449,280.01 | 4,025,197.49 | | 13,202.30 | | 41,053,077.94 |
| Student Services | 11,634,386.28 | 429,600.06 | 1,500,650.25 | | | | 13,564,636.59 |
| Institutional Support | 44,779,276.75 | 4,260,978.53 | 13,734,159.97 | | 45,531.45 | | 62,819,946.70 |
| Operations and Maintenance of Plant | 25,203,938.44 | 16,206,956.06 | 6,811,434.79 | | 17,046,099.67 | | 65,268,428.96 |
| Student Financial Aid | | | | 39,414,709.25 | | | 39,414,709.25 |
| Auxiliary Enterprises | 201,375,127.05 | 42,557,134.89 | 63,997,505.14 | | 570,343.25 | | 308,500,110.33 |
| Depreciation / Amortization | | | | | | 31,197,552.98 | 31,197,552.98 |
| Total Operating Expenses | $ 585,052,750.74 | $ 93,916,961.69 | $ 116,197,950.76 | $ 39,414,709.25 | $ 17,762,974.94 | $ 31,197,552.98 | $ 883,542,900.36 |

## NOTE 12 - PENSION PLANS

### A. Defined Benefit Plan

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

*Benefits Provided*: TSERS provides retirement and survivor benefits. Retirement benefits are determined as 1.82% of the member's average final compensation times the member's years of creditable service. A member's average final compensation is calculated as the average of a member's four highest consecutive years of compensation. General employee plan members are eligible to retire with full retirement benefits at age 65 with five years of creditable service, at age 60 with 25 years of creditable service, or at any age with 30 years of creditable service. General employee plan members are eligible to retire with partial retirement benefits at age 50 with 20 years of creditable service or at age 60 with five years of creditable service. Survivor benefits are available to eligible beneficiaries of general members who die while in active service or within 180 days of their last day of service and who also have either completed 20 years of creditable service regardless of age, or have completed five years of service and have reached age 60. Eligible beneficiaries may elect to receive a monthly Survivor's Alternate Benefit for life or a return of the member's contributions. The plan does not provide for automatic post-retirement benefit increases. Increases are contingent upon actuarial gains of the plan.

*Contributions:* Contribution provisions are established by General Statute 135-8 and may be amended only by the North Carolina General Assembly. Employees are required to contribute 6% of their annual pay. The contribution rate for employers is set each year by the North Carolina General Assembly in the Appropriations Act based on the actuarially-determined rate recommended by the actuary. The University's contractually-required contribution rate for the year ended June 30, 2017 was 9.98% of covered payroll. Employee contributions to the pension plan were $11,958,578.15, and the University's contributions were $19,891,101.65 for the year ended June 30, 2017.

The TSERS plan's financial information, including all information about the plan's assets, deferred outflows of resources, liabilities, deferred inflows of resources, and fiduciary net position, is included in the State of North Carolina's fiscal year 2016 *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at http://www.osc.nc.gov/ or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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

*Methods Used to Value TSERS Investment:* Pursuant to *North Carolina General Statutes*, the State Treasurer is the custodian and administrator of the retirement systems. The State Treasurer maintains various investment portfolios in its Investment Pool. The pension trust funds are the primary participants in the Long-term Investment portfolio and the sole participants in the External Fixed Income Investment, Equity Investment, Real Estate Investment, Alternative Investment, Credit Investment, and Inflation Protection Investment portfolios. The Fixed Income Asset Class includes the Long-Term Investment and External Fixed Income Investment Portfolios. The Global Equity Asset Class includes the Equity Investment Portfolio. The investment balance of each pension trust fund represents its share of the fair market value of the net position of the various portfolios within the pool. Detailed descriptions of the methods and significant assumptions regarding investments of the State Treasurer are provided in the 2016 *Comprehensive Annual Financial Report*.

*Net Pension Liability:* At June 30, 2017, the University reported a liability of $122,700,291.00 for its proportionate share of the collective net pension liability. The net pension liability was measured as of June 30, 2016. The total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of December 31, 2015, and update procedures were used to roll forward the total pension liability to June 30, 2016. The University's proportion of the net pension liability was based on the present value of future salaries for the University relative to the present value of future salaries for all participating employers, actuarially-determined. As of June 30, 2016, the University's proportion was 1.335%, which was a decrease of .01068 from its proportion measured as of June 30, 2015.

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

| | |
|---|---|
| Valuation Date | 12/31/2015 |
| Inflation | 3% |
| Salary Increases* | 3.50% - 8.10% |
| Investment Rate of Return** | 7.25% |

* Salary increases include 3.5% inflation and productivity factor.
** Investment rate of return is net of pension plan investment expense, including inflation.

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

The actuarial assumptions used in the December 31, 2015 valuations were based on the results of an actuarial experience study for the period January 1, 2010 through December 31, 2014.

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

The projected long-term investment returns and inflation assumptions are developed through review of current and historical capital markets data, sell-side investment research, consultant whitepapers, and historical performance of investment strategies. Fixed income return projections reflect current yields across the U.S. Treasury yield curve and market expectations of forward yields projected and interpolated for multiple tenors and over multiple year horizons. Global public equity return projections are established through analysis of the equity risk premium and the fixed income return projections. Other asset categories and strategies' return projections reflect the foregoing and historical data analysis. These projections are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. Best estimates of arithmetic real rates of return for each major asset class included in the pension plan's target asset allocation as of June 30, 2016 (the valuation date) are summarized in the following table:

| Asset Class | Long-Term Expected Real Rate of Return |
|---|---|
| Fixed Income | 1.4% |
| Global Equity | 5.3% |
| Real Estate | 4.3% |
| Alternatives | 8.9% |
| Credit | 6.0% |
| Inflation Protection | 4.0% |

The information in the preceding table is based on 30-year expectations developed with the consulting actuary and is part of the asset, liability, and investment policy of the North Carolina Retirement Systems. The long-term nominal rates of return underlying the real rates of return are arithmetic annualized figures. The real rates of return are calculated from nominal rates by multiplicatively subtracting a long-term inflation assumption of 3.05%. Return projections do not include any excess return expectations over benchmark averages. All rates of return and inflation are annualized.

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

*Sensitivity of the Net Pension Liability to Changes in the Discount Rate:* The following presents the net pension liability of the plan at June 30, 2016 calculated using the discount rate of 7.25%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.25%) or 1-percentage point higher (8.25%) than the current rate:

| Net Pension Liability | | |
|---|---|---|
| 1% Decrease (6.25%) | Current Discount Rate (7.25%) | 1% Increase (8.25%) |
| $ 230,775,535.95 | $ 122,700,291.00 | $ 31,823,823.45 |

*Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions:* For the year ended June 30, 2017, the University recognized pension expense of $24,055,110.00. At June 30, 2017, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

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

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Difference Between Actual and Expected Experience | $ 0.00 | $ 5,798,986.00 |
| Changes of Assumptions | 18,095,311.00 | |
| Net Difference Between Projected and Actual Earnings on Pension Plan Investments | 43,758,856.00 | |
| Change in Proportion and Differences Between Agency's Contributions and Proportionate Share of Contributions | 1,446,477.00 | 582,528.00 |
| Contributions Subsequent to the Measurement Date | 19,891,102.37 | |
| Total | $ 83,191,746.37 | $ 6,381,514.00 |

The amount of $19,891,102.37 reported as deferred outflows of resources related to pensions will be included as a reduction of the net pension liability in the fiscal year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

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

| Year Ended June 30: | Amount |
|---|---|
| 2018 | $ 9,873,939.00 |
| 2019 | 9,922,562.00 |
| 2020 | 23,726,979.00 |
| 2021 | 13,395,650.00 |
| Total | $ 56,919,130.00 |

**B. Defined Contribution Plan -** The Optional Retirement Program (ORP) is a defined contribution pension plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Faculty and staff of the University may join the ORP instead of the TSERS. The Board of Governors of the University of North Carolina is responsible for the administration of the ORP and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the ORP and approves the form and contents of the contracts and trust agreements.

Participants in the ORP are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the ORP. 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, 2017, these rates were set at 6.84% of covered payroll for employers and 6% of covered payroll for members. The University assumes no liability other than its contribution.

For the current fiscal year, the University had a total payroll of $450,104,194.24, of which $199,134,563.30 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were $13,620,804.13 and $11,948,073.80, respectively. The amount of expense recognized in the current year related to ORP is equal to the employer contributions.

## NOTE 13 - OTHER POSTEMPLOYMENT BENEFITS

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

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

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

For the period July 1, 2016 through December 31, 2016, the University contributed 5.60% of the covered payroll under TSERS and ORP to the Fund, and for the period January 1, 2017 through June 30, 2017, the University contributed 6.02% of the covered payroll under TSERS and ORP to the Fund. Required contribution rates for the years ended June 30, 2016, and 2015, were 5.60% and 5.49%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2017, 2016, and 2015, which were $23,149,607.97, $21,519,192.15, and $20,768,825.64, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available on the North Carolina Office of the State Controller's website at http://www.osc.nc.gov/ or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

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

Disability income benefits are funded by actuarially determined employer contributions that are established by the General Assembly. For the fiscal year ended June 30, 2017, the University made a statutory contribution of .38% of covered payroll under TSERS and ORP to the DIPNC. Required contribution rates for the years ended June 30, 2016, and 2015, were .41% in both years. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2017, 2016, and 2015, which were $1,514,087.96, $1,575,512.28, and $1,551,041.62, respectively. The University assumes no liability for long-term disability benefits under the Plan other than its contribution.

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

## NOTE 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. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

### A. Employee Benefit Plans

#### 1. State Health Plan

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

#### 2. Death Benefit Plan of North Carolina

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

### B. Other Risk Management and Insurance Activities

#### 1. Automobile, Fire, and Other Property Losses

The University is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to the University for operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a $5,000 per occurrence deductible. However, some agencies have chosen a higher deductible for a reduction in premium. University departments, as an individual business decision, may also purchase through the Fund for primary extended coverage for buildings and contents. Coverage may be purchased through the Fund for sprinkler leakage, theft, vandalism, or all-risk perils. Flood insurance may be purchased for qualifying assets. University departments also have the option to purchase all-risk coverage for computers and miscellaneous equipment on a scheduled basis.

The University has the option to purchase through the Fund different levels of coverage for the University's buildings and contents. The optional levels of coverage are decided upon and paid for by the departments occupying the University's buildings.

The types of optional coverage are: Sprinkler Leakage Coverage for buildings with fire sprinklers; Flood Coverage for buildings prone to flood; Extended Coverage for windstorm, hail, explosion, aircraft or vehicles, riot or civil commotion and smoke; Broad Form Coverage for windstorm, hail, explosion, aircraft or vehicles, riot or civil commotion, smoke, vandalism, sprinkler leakage, sinkhole collapse, volcanic action, falling objects, weight of snow, ice or sleet, and water damage; All Risk Special Form Coverage for windstorm, hail, explosion, aircraft or vehicles, riot or civil commotion, smoke, vandalism, sprinkler leakage, sinkhole collapse, volcanic action, falling objects, weight of snow, ice or sleet, water damage, theft, any other loss not specifically excluded. The coverage rates are determined by the Department of Insurance State Property Fire Insurance Fund.

All state-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses are $1,000,000 per claim and $10,000,000 per occurrence. The University pays premiums to the North Carolina Department of Insurance for the coverage. University departments, as an individual business decision may also purchase physical damage coverage for state-owned vehicles.

**2. Public Officers' and Employees' Liability Insurance**

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

**3. Employee Dishonesty and Computer Fraud**

The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is $5,000,000 per occurrence. The private insurance company pays 90% of each loss less a $100,000 deductible.

**4. Statewide Workers' Compensation Program**

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

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

**5. Other Insurance Held by the University**

The University purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance and the State's Agent of Record. The types of insurance policies purchased include: professional liability, medical malpractice, accident health, athletic accident, postal contract bond, surety bond, student internship liability, oceanographic equipment, leased equipment, boiler and machinery, inland marine property, drones, cyber insurance, watercraft, fine arts, musical instruments, modular units, international students, study abroad students, business travel and policies as the need for additional coverage arises.

The University provides medical malpractice insurance for Brody School of Medicine faculty physicians and employed independently licensed allied health providers (Nurse Practitioners, Certified Registered Nurse Anesthetists, Certified Nurse Midwives, and Physician Assistants). Each faculty physician and allied health provider has coverage of $3,000,000 per occurrence with $5,000,000 annual aggregate. There is a shared blanket policy for all other employees of the ECU Physicians with coverage of $3,000,000 per occurrence and $5,000,000 annual aggregate. The primary layer of medical malpractice insurance is provided by a private professional liability insurance company. There is also a shared, excess policy in the amount of $10,000,000 per occurrence and in aggregate.

## NOTE 15 - COMMITMENTS AND CONTINGENCIES

A. **Commitments** - The University has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were $81,566,704.06 and on other purchases were $11,203,434.19 at June 30, 2017.

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

## NOTE 16 - JOINT VENTURES

A. **Carolina Behavioral Health Alliance, LLC** – The University participates in a joint venture with The University of North Carolina at Chapel Hill and Wake Forest University to operate Carolina Behavioral Health Alliance, LLC. The University has an equity interest of $284,902.00 which has been reflected in the financial statements. The University has an ongoing financial responsibility for the joint venture because of its 33.33% ownership stake in the company. Complete financial statements for Carolina Behavioral Health Alliance, LLC can be obtained from 3800 East Tenth Street, Second Floor, Greenville, NC 27858.

B. **Medical Arts Center of Greenville Property Owners Association** – The University participates in a joint venture with Vidant Medical Center and Cambridge Highway, USA, LLC to operate the Medical Arts Center of Greenville Property Owners Association (MACOG). The University has an equity interest of $34,766.00 which has been reflected in the financial statements. The University has an ongoing financial responsibility for the joint venture because of its 20.64% ownership stake in the company. Complete financial statements for the Medical Arts Center of Greenville Property Owners Association can be obtained from 3800 East Tenth Street, Second Floor, Greenville, NC 27858.

## NOTE 17 - RELATED PARTIES

**Foundations** - There are three separately incorporated nonprofit foundations associated with the University. These foundations are the East Carolina University Educational Foundation, Inc., the East Carolina University Medical and Health Sciences Foundation, Inc., and the East Carolina University Alumni Association, Inc.

These organizations serve as the primary fundraising arm of the University through which individuals, corporations, and other organizations support University programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific colleges and the University's overall academic environment. The University's financial statements do not include the assets, liabilities, net position, or operational transactions of the foundations, except for support from each organization to the University. This support approximated $11,159,515.48 for the year ended June 30, 2017. Indirect support from the foundations that was not included in the University's financial statements was $1,119,244.48 for the year ended June 30, 2017.

## NOTE 18 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2017, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*

GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*

GASB Statement No. 82, *Pension Issues – An amendment of GASB Statement No. 67, No. 68, and No. 73*

GASB Statement No. 73 establishes requirements for defined benefit pensions that are not within the scope of Statement No. 68, *Accounting and Financial Reporting for Pensions,* as well as for the assets accumulated for purposes of providing those pensions. In addition, it establishes requirements for defined contribution pensions that are not within the scope of Statement 68. It also amends certain provisions of Statement No. 67, *Financial Reporting for Pension Plans,* and Statement 68 for pension plans and pensions that are within their respective scopes.

GASB Statement No. 74 establishes new accounting and financial reporting requirements for defined benefit other postemployment benefits (OPEB) plans that replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement 43, and Statement No. 50, *Pension Disclosures*. This Statement also includes requirements to address financial reporting for assets accumulated for purposes of providing defined benefit OPEB through OPEB plans that are *not* administered through trusts that meet the specified criteria.

GASB Statement No. 82 addresses certain issues with respect to Statements No. 67, *Financial Reporting for Pension Plans* , No. 68, *Accounting and Financial Reporting for Pensions* , and No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68* . Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

**NOTE 19 - SUBSEQUENT EVENTS**

On October 12, 2017, East Carolina University issued $20,635,000.00 in General Revenue Bonds, Series 2017A and 2017B with an average interest rate of 2.12%. The Series 2017A bond will advance refund $11,620,000.00 of outstanding The University of North Carolina System Pool Revenue Bonds, Series 2010A, with an average interest rate of 4.373%. The net proceeds of the refunding bonds along with additional funds will be used to purchase U.S. government securities. These securities will be deposited in an irrevocable trust to provide for all future debt service on the refunded bonds. This advance refunding was undertaken to reduce total debt service payments by $1,090,492.26 over the next thirteen years and will result in an economic gain of $959,138.91. The Series 2017B bond, along with additional funds, will be issued for a current refunding of $8,055,000.00 of the outstanding General Revenue Refunding Bond, Series 2012 with an average interest rate of 2.984%. The refunding is being undertaken to reduce total debt service payments by $529,096.80 over the next ten years and will result in an economic gain of $409,173.03.

On October 26, 2017, East Carolina University will close on a $55,000,000.00 Taxable General Revenue Bond Anticipation Note, Series 2017 from Branch Banking and Trust Company. Annual interest rate will be determined at the time of note issuance as one-month LIBOR + 40 basis points. The proceeds of the 2017 note will be applied to pay (1) the costs of renovating the South Side of Dowdy-Ficklen Stadium and (2) the costs incurred in connection with the issuance of the 2017 note. The 2017 note will mature October 26, 2019. East Carolina University intends to sell bonds prior to the October 26th, 2019 maturity date in order to pay off the $55,000,000.00 Taxable General Revenue Bond Anticipation Note.

# REQUIRED SUPPLEMENTARY INFORMATION

***East Carolina University***
***Required Supplementary Information***
***Schedule of the Proportionate Net Pension Liability***
***Teachers' and State Employees' Retirement System***
***Last Four Fiscal Years*** ***Exhibit C-1***

| | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|
| Proportionate Share Percentage of Collective Net Pension Liability | 1.33500% | 1.34568% | 1.37251% | 1.32460% |
| Proportionate Share of TSERS Collective Net Pension Liability | $ 122,700,291.00 | $ 49,590,972.00 | $ 16,091,595.00 | $ 80,416,718.00 |
| Covered Payroll | $ 193,108,255.42 | $ 190,483,460.49 | $ 191,033,860.52 | $ 186,582,942.15 |
| Net Pension Liability as a Percentage of Covered Payroll | 63.54% | 26.03% | 8.42% | 43.10% |
| Plan Fiduciary Net Position as a Percentage of the Total Pension Liability | 87.32% | 94.64% | 98.24% | 90.60% |

***East Carolina University***
***Required Supplementary Information***
***Schedule of University Contributions***
***Teachers' and State Employees' Retirement System***
***Last Ten Fiscal Years*** ***Exhibit C-2***

| | 2017 | 2016 | 2015 | 2014 | 2013 |
|---|---|---|---|---|---|
| Contractually Required Contribution | $ 19,891,101.65 | $ 17,669,405.37 | $ 17,429,236.63 | $ 16,600,842.48 | $ 15,542,359.08 |
| Contributions in Relation to the Contractually Determined Contribution | 19,891,101.65 | 17,669,405.37 | 17,429,236.63 | 16,600,842.48 | 15,542,359.08 |
| Contribution Deficiency (Excess) | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 |
| Covered Payroll | $ 199,309,635.77 | $ 193,108,255.42 | $ 190,483,460.49 | $ 191,033,860.52 | $ 186,582,942.15 |
| Contributions as a Percentage of Covered Payroll | 9.98% | 9.15% | 9.15% | 8.69% | 8.33% |

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| Contractually Required Contribution | $ 13,443,660.78 | $ 8,949,290.99 | $ 6,302,923.69 | $ 6,011,035.09 | $ 5,032,096.29 |
| Contributions in Relation to the Contractually Determined Contribution | 13,443,660.78 | 8,949,290.99 | 6,302,923.69 | 6,011,035.09 | 5,032,096.29 |
| Contribution Deficiency (Excess) | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 |
| Covered Payroll | $ 180,694,365.32 | $ 181,527,200.57 | $ 176,549,683.09 | $ 178,899,853.69 | $ 164,968,763.35 |
| Contributions as a Percentage of Covered Payroll | 7.44% | 4.93% | 3.57% | 3.36% | 3.05% |

Note: Changes in benefit terms, methods, and assumptions are presented in the Notes to Required Supplementary Information (RSI) schedule following the pension RSI tables.

# East Carolina University
# Notes to Required Supplementary Information
# Schedule of University Contributions
# Teachers' and State Employees' Retirement System
## Last Ten Fiscal Years

*Changes of Benefit Terms:*

**Cost of Living Increase**

| 2015 | 2014 | 2013 | 2012 | 2011 | 2010 | 2009 | 2008 | 2007 | 2006 |
|---|---|---|---|---|---|---|---|---|---|
| N/A | N/A | 1.00% | N/A | N/A | N/A | 2.20% | 2.20% | 3.00% | 2.00% |

*Changes of assumptions.* In 2008, 2012, and 2015, the actuarial assumptions were updated to more closely reflect actual experience. In 2015, the North Carolina Retirement Systems' consulting actuaries performed the quinquennial investigation of each retirement systems' actual demographic and economic experience (known as the "Experience Review"). The Experience Review provides the basis for selecting the actuarial assumptions and methods used to determine plan liabilities and funding requirements. The most recent Experience Review examined each plan's experience during the period between January 1, 2010, and December 31, 2014. Based on the findings, the Board of Trustees of the Teachers' and State Employees' Retirement System adopted a number of new actuarial assumptions and methods. The most notable changes to the assumptions include updates to the mortality tables and the mortality improvement projection scales to reflect reduced rates of mortality and significant increases in mortality improvements. These assumptions were adjusted to reflect the mortality projection scale MP-2015, released by the Society of Actuaries in 2015. In addition, the assumed rates of retirement, salary increases, and rates of termination from active employment were reduced to more closely reflect actual experience.

The Notes to Required Supplementary Information reflect the most recent available information included in the State of North Carolina’s 2016 *Comprehensive Annual Financial Report* .

# Independent Auditor’s Report

**Beth A. Wood, CPA**
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0600
Telephone: (919) 807-7500
Fax: (919) 807-7647
http://www.ncauditor.net

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

Board of Trustees
East Carolina University
Greenville, North Carolina

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of East Carolina University (University), a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the State of North Carolina, and its discretely presented component unit, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated October 18, 2017. Our report includes a reference to other auditors who audited the financial statements of East Carolina University Foundation, Inc. and Consolidated Affiliates, as described in our report on the University's financial statements. The financial statements of East Carolina University Foundation, Inc. and Consolidated Affiliates were not audited in accordance with *Government Auditing Standards*, and accordingly, this report does not include reporting on internal control over financial reporting or instances of reportable noncompliance associated with East Carolina University Foundation, Inc. and Consolidated Affiliates.

### Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

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

<u>Compliance and Other Matters</u>

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

<u>Purpose of this Report</u>

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

Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

October 18, 2017

# Ordering Information

**Copies of this report may be obtained by contacting:**

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0600

Telephone: 919-807-7500
Facsimile: 919-807-7647
Internet: http://www.ncauditor.net

To report alleged incidents of fraud, waste or abuse in state government contact the Office of the State Auditor Fraud Hotline: **1-800-730-8477**
or download our free app.

https://play.google.com/store/apps/details?id=net.ncauditor.ncauditor

https://itunes.apple.com/us/app/nc-state-auditor-hotline/id567315745

For additional information contact:
Brad Young
Director of External Affairs
**919-807-7513**

This audit required 976 hours at an approximate cost of $100,528.