



STATE OF NORTH CAROLINA

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2012

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL

CHAPEL HILL, NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

FOR THE YEAR ENDED JUNE 30, 2012

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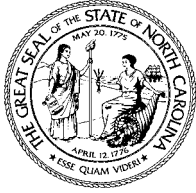
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Beth A. Wood, CPA
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Beverly E. Perdue, Governor
The General Assembly of North Carolina
Board of Trustees, The University of North Carolina at Chapel Hill

We have completed a financial statement audit of The University of North Carolina at Chapel Hill for the year ended June 30, 2012, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of The University of North Carolina at Chapel Hill, a constituent institution of the multi-campus University of North Carolina System, which is a component unit of the state of North Carolina, and its discretely presented component units, as of and for the year ended June 30, 2012, which collectively comprise the University's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the UNC Investment Fund, LLC, which represent 42 percent, 58 percent, and 2 percent, respectively, of the assets, net assets, and revenues of the University; nor the financial statements of The Medical Foundation of North Carolina, Inc., The Educational Foundation Scholarship Endowment Trust, and the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc., the University's discretely presented component units. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinions, insofar as they relate to the amounts included for those entities, are based on the reports of the other auditors.

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

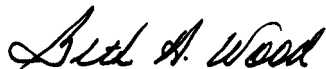
INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of North Carolina at Chapel Hill and its discretely presented component units as of June 30, 2012, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 19 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, during the year ended June 30, 2012.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2012 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, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not 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 the 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.



Beth A. Wood, CPA
State Auditor

December 3, 2012

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Management's Discussion and Analysis provides an overview of the financial position and activities of The University of North Carolina at Chapel Hill (the "University") for the fiscal year that ended June 30, 2012, with comparative information for the fiscal year ended June 30, 2011. Management has prepared the discussion and analysis to be read in conjunction with the financial statements and accompanying notes to the financial statements.

The University is a constituent institution of the multi-campus University of North Carolina System (UNC System), a component unit of the state of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report (CAFR)*. The financial reporting entity for the financial statements is comprised of the University and ten component units. Seven component units are reported as if they were part of the University, and three are reported as discretely presented component units based on the nature and significance of their relationship to the University. The reader may refer to Note 1A for detailed information on the financial reporting entity.

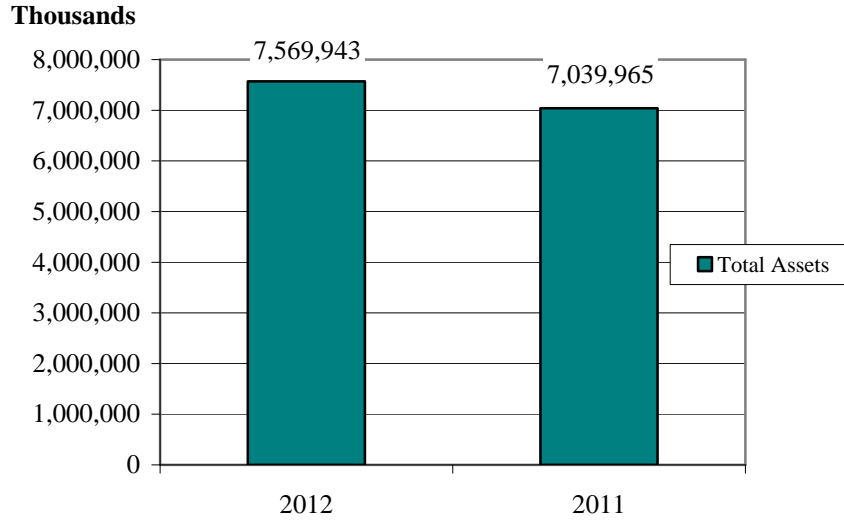
Financial Highlights

The University's financial position at June 30, 2012 remained solid as the University addressed a decline in state support and lower investment returns from the financial markets. Operating revenues recorded slightly higher increases than operating expenses. The University continued its efforts to streamline campus operations and provide more funding for academics and the University's core missions; to implement simpler, more responsive systems and processes that enable informed decision-making while complying with policies and laws; and to reduce bureaucracy and create a more satisfying work environment for faculty and staff. Necessary spending reductions and other measures to address shortfalls in resources were implemented.

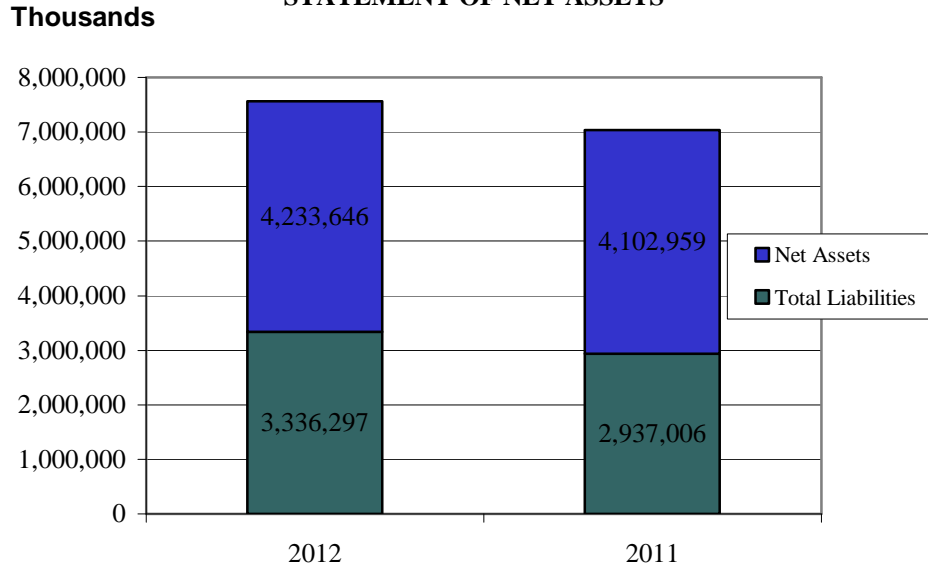
The University's total assets were \$7.6 billion at June 30, 2012. Net assets, which represent the residual interest in the University's assets after deducting liabilities, were \$4.2 billion at June 30, 2012. The University's net assets increased by \$130.7 million in fiscal year 2011-2012 as a result of operating, nonoperating, and other changes in net assets. A comparison of the total assets, liabilities, and net assets at June 30, 2012 and June 30, 2011, and a comparison of the major components of the changes in net assets for the two fiscal years are presented below:

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

STATEMENT OF NET ASSETS



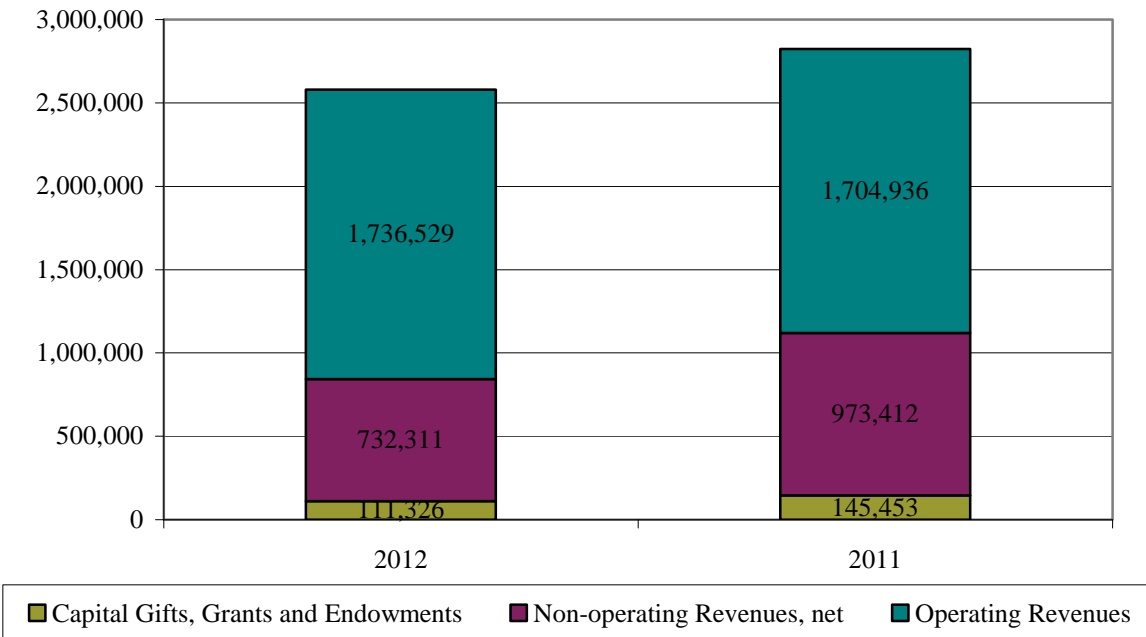
STATEMENT OF NET ASSETS



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

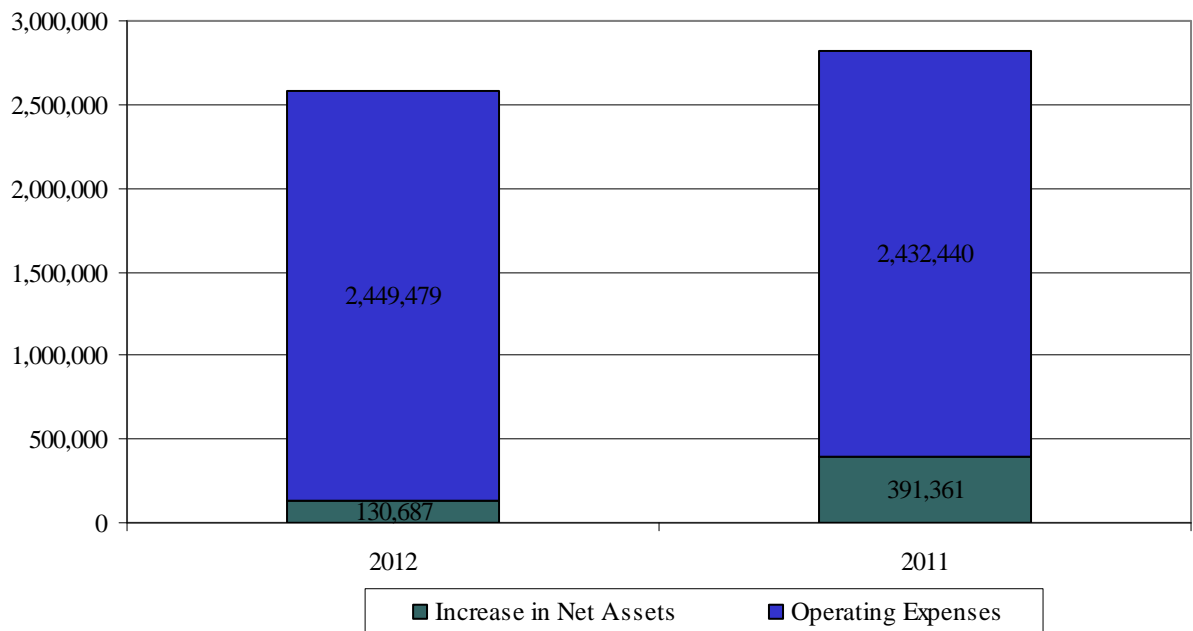
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Thousands



STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

Thousands



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Net assets increased 3.2% at June 30, 2012 over the prior year. Total assets increased 7.5% from the prior year and total liabilities rose 13.6% for the same period. Operating revenues increased at a greater rate than operating expenses in fiscal year 2011-2012 over the prior year, 1.9% and 0.7%, respectively. Net nonoperating revenues and expenses decreased 24.8% in fiscal year 2011-2012 over the prior year, reflecting the lower investment income and state appropriation sources. As a major research university, funding from contracts and grants remained a major revenue source. Fund-raising for operational and capital needs, sales and services, and tuition and fees continued to provide important resources for the University.

Using the Financial Statements

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the *Governmental Accounting Standards Board* (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the University as a whole. 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.

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

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

Management's Discussion and Analysis provides information regarding the Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Condensed Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year, includes all assets and liabilities of the University and segregates the assets and liabilities into current and noncurrent components. The following table summarizes the University's assets, liabilities, and net assets on June 30, 2012 and June 30, 2011.

Assets, Liabilities, and Net Assets (dollars in thousands)

	2012	2011	Percent Change
Assets:			
Current Assets	\$ 1,469,736	\$ 1,400,132	5.0
Noncurrent assets:			
Endowment, Restricted and Other Investments	2,832,661	2,552,449	11.0
Capital Assets, Net	3,022,692	2,931,679	3.1
Other Noncurrent Assets	244,854	155,705	57.3
Total Assets	7,569,943	7,039,965	7.5
Liabilities:			
Current Liabilities	437,747	404,803	8.1
Noncurrent liabilities:			
Funds Held in Trust for Pool Participants	1,455,473	1,179,704	23.4
Long-Term Liabilities	1,289,115	1,305,982	(1.3)
Other Noncurrent Liabilities	153,962	46,517	231.0
Total Liabilities	3,336,297	2,937,006	13.6
Net Assets:			
Invested in Capital Assets, Net of Related Debt	1,645,959	1,587,446	3.7
Restricted	1,691,595	1,664,259	1.6
Unrestricted	896,092	851,254	5.3
Total Net Assets	\$ 4,233,646	\$ 4,102,959	3.2

Current Assets and Liabilities

The Statement of Net Assets shows that working capital, which is current assets less current liabilities, was \$1 billion at June 30, 2012, an increase of 3.7%, or \$36.7 million, over the previous year. The working capital increase results from many factors. The largest changes were increases in cash and cash equivalents and in short-term investments for \$66.7 and \$49.3 million, respectively; offset by an increase in short-term debt of \$59 million. The Statement of Net Assets details the current asset and current liability categories.

Endowment, Restricted and Other Investments

Endowment investments increased 0.4% during 2011-2012 and were \$1.38 billion at June 30, 2012 and \$1.37 billion at June 30, 2011, and include permanent endowments, funds internally designated as endowments and similar funds such as gift annuities and charitable trusts.

The endowment assets are invested with The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. ("Chapel Hill Investment Fund"), which is reported as a governmental external investment pool in the financial statements. The Chapel Hill

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Investment Fund is a 501(c)(3) nonprofit corporation established to support the University by operating an investment pool for charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. It is expected that all or substantially all of the assets of the Chapel Hill Investment Fund will be invested in the UNC Investment Fund, LLC (UNC Investment Fund).

Most of the University's endowment assets are currently invested in the Chapel Hill Investment Fund, and the Chapel Hill Investment Fund's investment returns are generated from its participation in the UNC Investment Fund. The investment objective is to earn a long-term real rate of return of approximately 5.5%. This objective is intended to support the Chapel Hill Investment Fund's distribution policy providing a stable source of spending support that is sustainable over the long-term while preserving the purchasing power of the invested funds. The distribution rate for the Chapel Hill Investment Fund is set periodically at 5% of its average market value for the previous fiscal year. Each year's distribution is subject to a 4% floor and a 7% cap based on the previous fiscal year-end market value.

Restricted investments of \$1.43 billion at June 30, 2012 include funds of affiliated entities that are neither part of the University's reporting entity nor reported discretely but invested through the UNC Investment Fund. Other investments include bond reserves and related funds of \$27.6 million.

As reported by UNC Management Company, Inc. (Management Company), the manager of the UNC Investment Fund, the endowment assets invested in the UNC Investment Fund recorded a 2.1% return for fiscal year 2011-2012, reflecting the general weakness in global financial markets. The UNC Investment Fund's 2.1% return ranked in the top quartile within the BNY Mellon universe of 223 endowment and foundation (E&F Universe) funds for the fiscal year. The UNC Investment Fund's primary investment benchmark, the Strategic Investment Policy Portfolio (SIPP), gained 4.7% in fiscal year 2011-2012. The UNC Investment Fund significantly outperformed the 3.1% loss generated by the Global 70/30 (stock/bond) Index for fiscal year 2011-2012. The past five-year period has been characterized by extreme volatility within financial markets reflecting the financial crisis of 2008-2009 and the ensuing period best described as a post credit bubble deleveraging. Reflecting these difficult conditions, the median five-year annualized return in the BNY Mellon E&F Universe was 1.5% and the top quartile return was 2.4%. The Global 70/30 Index produced a 0.9% return for the 5-year period. In this context, the UNC Investment Fund's 1.8% five-year return was acceptable from a relative perspective, despite falling short of the long-term objective of a 5.5% return after inflation.

The UNC Investment Fund's ten-year annualized return of 8.3% ranks in the top quartile of the BNY Mellon E&F Universe, is attractive relative to financial market indices, and has surpassed the long-term objective of 5.5% plus inflation. The Global 70/30 Index generated an annualized return of 6.5% over the same ten-year period.

A policy for the University Statutory Endowment (established pursuant to North Carolina General Statute 116-36) addresses the provisions of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). Consistent with the procedures for implementing

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

UPMIFA, the recommended distribution of earnings excluded any invasion of principal. Therefore, the distribution for fiscal year 2011-2012 was reduced by a total of \$3.4 million, or 6%, from the calculated distribution of earnings. The policy indicates that campus departments shall examine the endowment-supported activity for the upcoming fiscal year for possible deferment of program expenses, and then pursue alternative funding for essential activities, and finally shall consult with donors regarding other funding options for program support. Invasion of endowment principal is an option of last resort and will only be done consistent with approved limitations to preserve the endowment principal's value.

Capital Assets and Debt Management

The University completed a comprehensive capital improvement program that renewed existing campus buildings, provided significant upgrades in campus infrastructure (utilities, parking, telecommunications), and expanded capacity of academic and research activities, and student life facilities. The State provided \$515 million for the program, in addition to University-issued debt of approximately \$1.05 billion. Moving forward through 2017, the University plans to issue an additional \$525 million (approximate) in debt, including the 2012AB Bonds. These funds will support continuing capital needs that are funded from a variety of sources, including debt.

Carolina North (formerly known as the Horace Williams property) is an approximately 963 acre parcel of land about 1.5 miles from the main campus of the University. Plans for this project have evolved since planning began in 1995. On September 26, 2007, the Board of Trustees approved a plan for development of 250 acres. On July 1, 2009, the University and the Town of Chapel Hill entered into a Development Agreement with a 20-year term allowing for up to 3 million square feet of development on 133 acres of the Carolina North Tract. Planning for the initial projects, the Collaborative Science Building, and supporting infrastructure, is under way.

Carolina North will be a living and learning community that will include teaching, office and research space for University uses, corporate space in partnership with University activities, service and retail facilities and housing. It is envisioned that development will occur in phases. Each phase will consist of mixed uses creating a community, with each community being integrated into the previous phases. Full development of Carolina North is expected to take at least 50 years and will proceed as demand for space and resources permit. While it is anticipated that a variety of funding sources will be utilized for Carolina North, a comprehensive financing plan for Carolina North has not yet been developed.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

A summary of changes in capital assets is disclosed in Note 5. Capital assets, net of accumulated depreciation and amortization, at June 30, 2012 and June 30, 2011, were as follows:

Capital Assets (dollars in thousands)	2012	2011	Percent Change
Capital Assets:			
Construction in Progress	\$ 219,371	\$ 316,011	(30.6)
Land and Other Nondepreciable Assets	170,112	156,431	8.7
Buildings	1,831,488	1,645,672	11.3
General Infrastructure	571,015	582,516	(2.0)
Machinery, Equipment, and Computer Software	230,706	231,049	(0.1)
Total	\$ 3,022,692	\$ 2,931,679	3.1

The University continues to use its commercial paper program to provide low-cost bridge financing for capital projects until gifts are received or in anticipation of an external bond issue. Commercial paper debt was \$132.7 million at June 30, 2012 and \$73.7 million at June 30, 2011. The Board of Governors of the University of North Carolina System issued General Revenue Bonds 2012AB in the amount of \$200 million during July, 2012 on behalf of the University to refund \$120 million of outstanding commercial paper and to provide an additional \$80 million for capital projects.

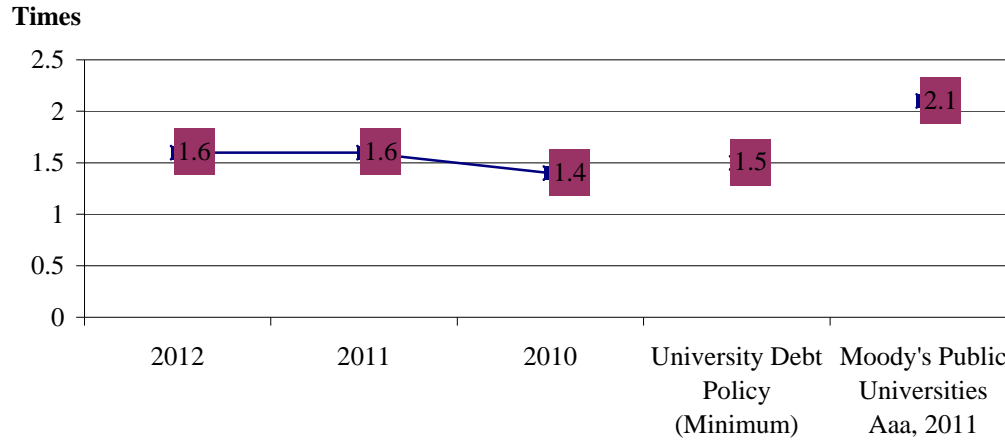
The University maintains a combination of variable and fixed rate debt, consistent with its debt management policy. The interest rate on the commercial paper program for fiscal year 2011-2012 was 0.15% and for 2010-2011 was 0.25%. Interest rates on the University's variable rate, long-term bonds were 0.09% for fiscal year 2011-2012 and 0.20% for fiscal year 2010-2011. Interest rates on fixed rate, long-term bonds are disclosed in Note 8B of the financial statements. These rates reflect direct interest rates and do not reflect any impact from the interest rate swaps as referenced in Note 9.

The University's debt policy uses two key ratios to measure debt capacity, financial health, and credit quality. The *expendable resources to debt ratio* measures unrestricted, expendable restricted, and temporarily restricted net assets to funded debt and serves as a relative indicator of financial health or cushion. The *debt service to operations ratio* provides an indicator of the University's ability to repay annual principal and interest relative to its overall operating expenses. Each ratio is compared to the University's debt policy standard and the appropriate peer group comparison for fiscal year 2010-2011 (the latest available numbers). At June 30, 2012, the *expendable resources to debt ratio* was 1.6 times, the *debt service to operations ratio* was 3.5%.

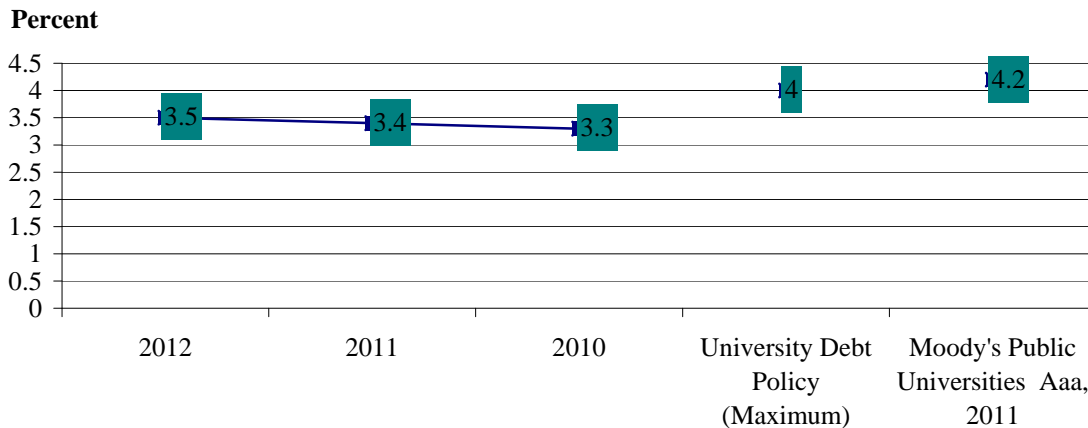
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The University continues to maintain its long-term bond ratings of Aaa/AA+/AAA from Moody's Investor Services, Standard & Poor's and Fitch Ratings, respectively.

EXPENDABLE RESOURCES TO DEBT



DEBT SERVICES TO OPERATIONS



Other Noncurrent Assets and Liabilities

Other noncurrent assets were \$244.9 million at June 30, 2012 and \$155.7 million at June 30, 2011, a 57.3% increase. The majority of the increase is due to a negative \$89 million fair value of a new interest rate swap agreement with the Bank of New York Mellon. This resulted in an increase in deferred outflow of resources which is offset by a corresponding increase in the noncurrent hedging derivative liability. Net assets were not affected.

Noncurrent liabilities were \$2.9 billion at June 30, 2012 and \$2.5 billion at June 30, 2011, and include funds held in trust for the University's affiliated foundations and other campuses in the UNC System and their affiliates of \$1.5 billion and \$1.2 billion, respectively. These

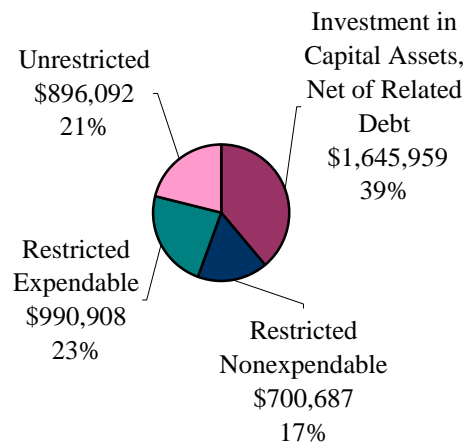
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

entities are not part of the University's financial reporting entity and are not discretely presented, but the entities do invest through the UNC Investment Fund. The increase in funds held in trust of 23.4% over the prior year resulted from additional participant contributions, new participants in the UNC Investment Fund, and net investment gains.

Net Assets

Net assets represent the value of the University's assets after liabilities are deducted. The University's net assets were \$4.2 billion at June 30, 2012, an increase of \$130.7 million over the prior year. Net assets invested in capital assets, net of related debt, represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included. Nonexpendable restricted net assets include endowment and similar 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. Expendable restricted net assets include resources in which the University is legally obligated to spend the resources in accordance with restrictions provided by external parties. Unrestricted net assets are not subject to externally imposed stipulations; however, most of these resources have been designated for particular academic, research, or other programs, as well as capital projects.

2012 NET ASSETS: \$4,233,646 (IN THOUSANDS)



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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

The Statements of Revenues, Expenses, and Changes in Net Assets present the University's results of operations. The statements for the fiscal year ended June 30, 2012 and the prior year are summarized as follows:

University Operations (dollars in thousands)

	2012	2011	Percent Change
Operating Revenues:			
Student Tuition and Fees, Net	\$ 320,535	\$ 289,897	10.6
Grants and Contracts	725,846	755,620	(3.9)
Sales and Services, Net	681,151	653,741	4.2
Other	8,997	5,678	58.5
Total Operating Revenues	1,736,529	1,704,936	1.9
Operating Expenses	2,449,479	2,432,440	0.7
Operating Loss	(712,950)	(727,504)	(2.0)
Nonoperating Revenues (Expenses):			
State Appropriations and State Aid	486,492	534,678	(9.0)
Noncapital Gifts and Grants	280,785	287,712	(2.4)
Investment Income	33,134	208,184	(84.1)
Interest and Fees on Debt	(64,321)	(56,765)	13.3
Federal Interest Subsidy on Debt	2,274	2,273	0.0
Other Net Nonoperating Expenses	(6,053)	(2,670)	126.7
Income Before Other Changes	19,361	245,908	(92.1)
Refund of Prior Years Capital Appropriations		(81)	(100.0)
Capital Grants	78,133	91,864	(14.9)
Capital Gifts	5,630	9,149	(38.5)
Additions to Permanent Endowments	27,563	44,521	(38.1)
Increase in Net Assets	130,687	391,361	(66.6)
Net Assets – July 1	4,102,959	3,711,598	10.5
Net Assets – June 30	\$ 4,233,646	\$ 4,102,959	3.2

Fiscal year 2011-2012 revenues and other changes total \$2,650,540 and expenses total \$2,519,853.

Fiscal year 2010-2011 revenues and other changes total \$2,883,317 and expenses total \$2,491,956.

Operating Revenues

The operating revenues represent resources generated by the University in fulfilling its instruction, research, and public service missions. Student tuition and fees are reported net of the scholarship discount, which was \$75.7 million for fiscal year 2011-2012 and \$72.7 million for the prior year. Net revenues from student tuition and fees increased 10.6% over the prior year. Tuition rates increased for fiscal year 2011-2012 by 6.5% for undergraduate residents, undergraduate nonresidents, graduate residents, and also for graduate nonresidents.

Revenues from operating and nonoperating grants and contracts decreased 4.5% over the prior year. Discussion of grants and contracts in terms of awards provides another useful

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

perspective. The University is among the nation's leading public research universities, with a diversified portfolio of research. In fiscal year 2011-2012, the University secured \$767 million in total research funding from all sources. Excluding federal stimulus support, research funding totaled \$759 million in that category, compared with \$732 million for fiscal year 2010-2011. In fiscal year 2010-2011, the University attracted \$788 million in total research support. Of that amount, 73% came from the federal government. Of the \$575 million in total federal funding, the National Institutes of Health accounted for 69%.

The University rose to ninth from 16th among leading private and public research universities for the level of federal funding devoted to research and development in all fields during fiscal year 2009-2010, the latest information available. The ranking is based on data compiled by the National Science Foundation. Among national public universities, the University ranked fourth in federal research and development spending.

In many cases, researchers from multiple University schools, departments and units collaborate on research grants, contracts and studies. That approach reflects the University's emphasis on interdisciplinary teaching and scholarship between and among the health, natural and social sciences, as well as the liberal arts and the humanities.

Sales and services include the revenues of campus auxiliary operations such as student housing, student stores, student health services, the utilities system, and parking and transportation, as well as revenues from patient services provided by the professional health-care clinics. Other revenues represent operating resources not separately identified and include, for example, an assessment to the Chapel Hill Investment Fund to support University administrative services.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating Expenses

The University's operating expenses were \$2.4 billion for the fiscal year ended June 30, 2012, an increase of 0.7% over the prior year. The operating expenses are reported by natural classification in the financial statements and by functional classification in Note 12. The following tables illustrate the University's operating expenses by natural classification and by functional classification.

Operating Expenses by Nature (dollars in thousands)

	2012	2011	Percent Change
Salaries and Benefits	\$ 1,375,758	\$ 1,379,178	(0.2)
Supplies and Mmaterials	164,899	162,999	1.2
Services	617,589	614,928	0.4
Scholarships and Fellowships	96,871	91,140	6.3
Utilities	80,832	81,471	(0.8)
Depreciation and Amortization	113,530	102,724	10.5
Total Operating Expenses	\$ 2,449,479	\$ 2,432,440	0.7

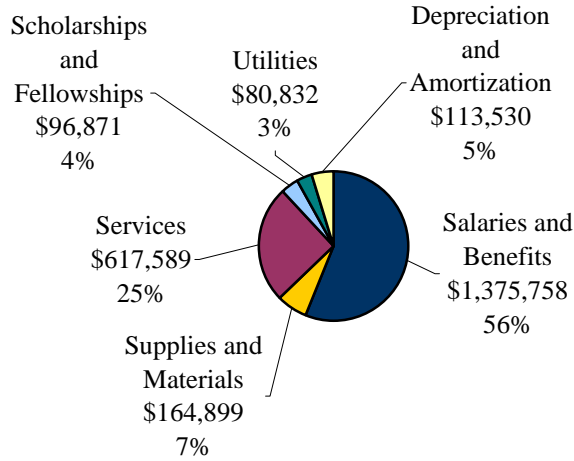
Operating Expenses by Function (dollars in thousands)

	2012	2011	Percent Change
Instruction	\$ 682,857	\$ 698,770	(2.3)
Research	472,102	468,685	0.7
Public Service	122,989	137,279	(10.4)
Academic Support	111,719	105,883	5.5
Student Services	25,992	28,320	(8.2)
Institutional Support	84,400	91,558	(7.8)
Operations and Maintenance of Plant	140,417	145,270	(3.3)
Student Financial Aid	96,871	91,140	6.3
Auxiliary Enterprises	598,602	562,811	6.4
Depreciation and Amortization	113,530	102,724	10.5
Total Operating Expenses	\$ 2,449,479	\$ 2,432,440	0.7

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

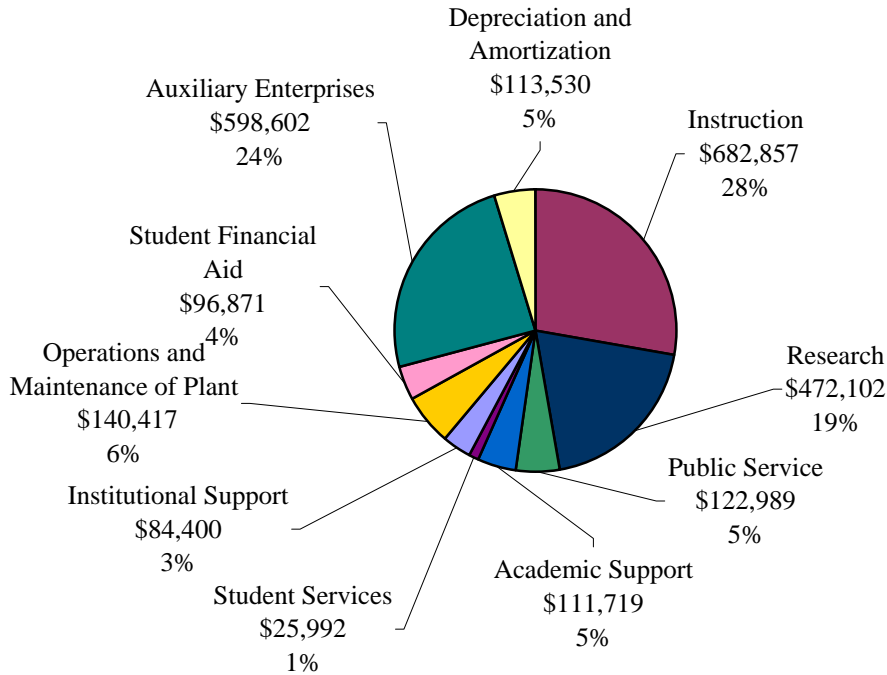
The following graph illustrates the University's operating expenses by natural classification.

**2012 OPERATING EXPENSES BY NATURE: \$2,449,479
(IN THOUSANDS)**



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

**2012 OPERATING EXPENSES BY FUNCTION: \$2,449,479
(IN THOUSANDS)**



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating expense categories changed at varying rates, although the overall rate of increase was 0.7%. Depreciation and amortization increased 10.5% as capital construction projects are completed and placed into service, and scholarships and fellowships increased 6.3%. The other operating expense categories by natural classification incurred minimal changes. Operating expenses by functional classification recorded the same increases for depreciation and amortization and for student financial aid. Several functional classifications recorded decreases in operating expenses for fiscal year 2011-2012 from the prior year.

Nonoperating Revenues and Expenses

State appropriations, noncapital gifts and grants, and investment income are considered nonoperating because they were not generated by the University's principal, ongoing operations. For example, state appropriations were not generated by the University but were provided to help fund operating expenses.

State appropriations totaled \$486.5 million for fiscal year 2011-2012, a net decrease of 9%, or \$48.2 million, from the state appropriations and state aid of \$534.7 million received during the prior year. The level of state appropriations was reduced by \$100.8 million for fiscal year 2011-2012 as the state and nation continued to address the current economic challenges. The significant reduction was offset by an additional \$20 million transfer of funds recorded in fiscal year 2011 from the UNC Health Care System to help the University and its School of Medicine absorb the reductions in appropriations. The reductions in state appropriations were also offset in part by increases for additional student enrollment, operating funds for new buildings, replacement of state aid funded by the American Recovery and Reinvestment Act, restoration of nonrecurring budget reductions, and other needs. Since the downturn began, the University's top priority has been to protect the classroom experience of students as much as possible. Administrative departments have absorbed more reductions than academic units by design.

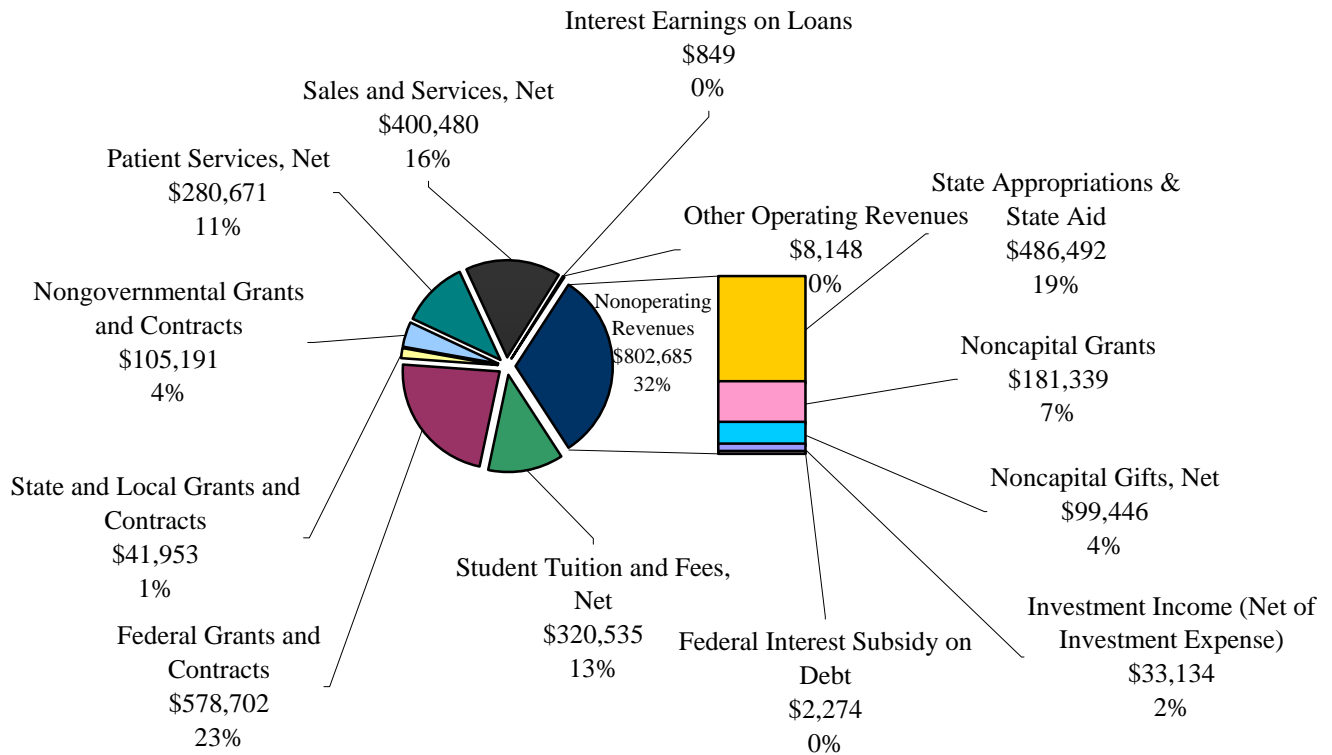
Noncapital gifts and grants decreased 2.4% to \$280.8 million and include expendable gifts and federal awards that are not considered to be operating revenues. Net investment income from fiscal year 2011-2012 of \$33.1 million, represents an 84.1% decrease from 2010-11, and includes income and realized and unrealized gains and is net of realized and unrealized losses and investment management fees. For additional discussion, the reader may refer to the Endowment and Other Investments section of Management's Discussion and Analysis.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total Operating and Nonoperating Revenues

Operating and nonoperating revenues such as state appropriations, noncapital grants, noncapital gifts, and investment income are used to fund University operations. The following chart illustrates the University's operating and nonoperating revenues, which total \$2.5 billion for fiscal year 2011-12.

2012 TOTAL REVENUES BY SOURCE; \$2,539,214



Other Changes in Net Assets

Capital grants of \$78.1 million for fiscal year 2011-2012 and \$91.9 million for fiscal year 2010-2011 are for capital construction projects. Capital gifts of \$5.6 million for fiscal year 2011-2012 and \$9.1 million for the prior year resulted from fund-raising efforts and also provided funding for construction projects. Nonexpendable gifts and funds from the state's program to match gifts for distinguished professorship endowments resulted in additions to permanent endowments of \$27.6 million during fiscal year 2011-2012 and \$44.5 million during fiscal year 2010-2011.

Economic Outlook

The fiscal year 2012-2013 state appropriations budget of \$512.7 million is fair and sensitive to the highest priority needs of the University. The state appropriations budget provides

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

stability with no significant new reductions. A salary increase, the first in four fiscal years, of 1.2% for faculty and staff was a positive indicator for the state appropriations budget.

The University will retain the tuition increases previously approved by the UNC System Board of Governors. Those funds will be particularly helpful in addressing campus priorities approved by the University Board of Trustees and the UNC System Board of Governors including need-based financial aid, retaining faculty who have received offers from other institutions, restoring courses eliminated through previous budget reductions, and graduate student aid. Tuition rates increased for fiscal year 2012-2013 by 13.6% for undergraduate residents, 6.5% for undergraduate nonresidents and graduate nonresidents, and 15.6% for graduate residents.

Stability and growth in sponsored awards is a proven and reliable source in support of the University's research mission. Philanthropic efforts continue to demonstrate success. Invested funds provide an important distribution of earnings and continued to rebound from previous declines in the global financial markets. The University's strong debt credit ratings of Aaa, AA+, and AAA allow it to obtain competitive financing for capital construction.

The University rose to ninth among leading private and public research universities for the level of federal funding devoted to research and development in all fields and secured \$767 million in total research funding from all sources in fiscal year 2011-12. Fund-raising has been a cornerstone resource for the University, and in a down economy becomes even more vital. The University received \$287.4 million in gifts from private donors in fiscal year 2011-2012. The total marked the University's second-best year in history and topped the previous fiscal year's total of \$277 million, then the second-highest total, by 4%. Commitments also rose for fiscal year 2011-2012 to \$331.4 million, an 8% increase over the previous year's total of \$305.6 million. Commitments include pledges as well as gifts. The University had more than 78,000 donors for the fiscal year 2011-2012.

The University's investment management operation is separately organized as the UNC Management Company, Inc. (Management Company), the nonprofit corporation organized and operated as a 501(c)(3) entity, to provide investment management services and administrative services to the University and to the other campuses of the UNC System and their affiliated nonprofit foundations as appropriate. As of June 30, 2012, the Management Company managed invested assets of \$3.2 billion in the UNC Investment Fund.

The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2012

Exhibit A-1
Page 1 of 2

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 447,760,589
Restricted Cash and Cash Equivalents	410,632,339
Short-Term Investments	272,573,649
Restricted Short-Term Investments	107,714,956
Receivables, Net (Note 4)	179,356,218
Due from State of North Carolina Component Units	25,089,383
Inventories	21,834,257
Notes Receivable, Net (Note 4)	4,311,364
Other Assets	462,717
	<hr/>
Total Current Assets	1,469,735,472

Noncurrent Assets:

Restricted Cash and Cash Equivalents	48,602,419
Receivables, Net (Note 4)	28,572,795
Restricted Due from Primary Government	1,504,019
Endowment Investments	1,378,644,136
Restricted Investments	1,426,443,281
Other Investments	27,573,986
Deferred Outflow of Resources (Note 9)	122,894,974
Notes Receivable, Net (Note 4)	34,960,829
Investment in Joint Venture (Note 18)	8,318,917
Capital Assets - Nondepreciable (Note 5)	389,483,495
Capital Assets - Depreciable, Net (Note 5)	2,633,208,557
	<hr/>
Total Noncurrent Assets	6,100,207,408

Total Assets	<hr/> 7,569,942,880 <hr/>
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LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 6)	132,285,498
Due to Primary Government	3,050
Due to State of North Carolina Component Units	14,472,157
Deposits Payable	6,676,965
Funds Held for Others	1,179,722
Unearned Revenue	41,778,064
Interest Payable	11,943,353
Short-Term Debt (Note 7)	132,650,000
Long-Term Liabilities - Current Portion (Note 8)	96,758,860
	<hr/>
Total Current Liabilities	437,747,669

Noncurrent Liabilities:

U. S. Government Grants Refundable	31,066,785
Funds Held in Trust for Pool Participants	1,455,472,565
Hedging Derivative Liability (Note 9)	122,894,974
Long-Term Liabilities (Note 8)	1,289,114,877
	<hr/>
Total Noncurrent Liabilities	2,898,549,201

Total Liabilities	<hr/> 3,336,296,870 <hr/>
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The University of North Carolina at Chapel Hill
Statement of Net Assets
June 30, 2012

Exhibit A-1
Page 2 of 2

NET ASSETS

Invested in Capital Assets, Net of Related Debt	1,645,958,688
Restricted for:	
Nonexpendable:	
Scholarships and Fellowships	153,075,458
Research	18,647,063
Library Acquisitions	29,237,867
Endowed Professorships	320,307,262
Departmental Uses	130,828,258
Loans	18,434,870
Other	30,156,322
Expendable:	
Scholarships and Fellowships	182,515,248
Research	14,129,673
Library Acquisitions	47,173,643
Endowed Professorships	308,715,215
Departmental Uses	320,266,218
Instruction and Educational Agreements	9,684,624
Plant Improvements	18,896,130
Capital Projects	20,261,135
Debt Service	69,266,480
Unrestricted	896,091,856
Total Net Assets	<u>\$ 4,233,646,010</u>

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

***The University of North Carolina at Chapel Hill
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2012***

Exhibit A-2

REVENUES

Operating Revenues:

Student Tuition and Fees, Net (Note 11)	\$ 320,535,342
Patient Services, Net (Note 11)	280,670,917
Federal Grants and Contracts	578,701,477
State and Local Grants and Contracts	41,953,253
Nongovernmental Grants and Contracts	105,191,402
Sales and Services, Net (Note 11)	400,479,549
Interest Earnings on Loans	849,473
Other Operating Revenues	8,147,655
	<hr/>
Total Operating Revenues	1,736,529,068

EXPENSES

Operating Expenses:

Salaries and Benefits	1,375,757,987
Supplies and Materials	164,899,338
Services	617,589,458
Scholarships and Fellowships	96,870,511
Utilities	80,831,565
Depreciation/Amortization	113,529,873
	<hr/>
Total Operating Expenses	2,449,478,732
	<hr/>
Operating Loss	(712,949,664)

NONOPERATING REVENUES (EXPENSES)

State Appropriations	486,492,294
Noncapital Grants - Student Financial Aid	17,898,888
Other Noncapital Grants	163,440,317
Noncapital Gifts, Net (Note 11)	99,445,647
Investment Income (Net of Investment Expense of \$4,033,274)	33,133,817
Interest and Fees on Debt	(64,321,547)
Federal Interest Subsidy on Debt	2,273,604
Other Nonoperating Expenses	(6,052,699)
	<hr/>
Net Nonoperating Revenues	732,310,321
	<hr/>
Income Before Other Revenues, Expenses, Gains, or Losses	19,360,657
Capital Grants	78,133,274
Capital Gifts	5,630,001
Additions to Endowments	27,563,546
	<hr/>
Increase in Net Assets	130,687,478

NET ASSETS

Net Assets - July 1, 2011	4,102,958,532
	<hr/>
Net Assets - June 30, 2012	\$ 4,233,646,010

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

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012

Exhibit A-3
Page 1 of 2

CASH FLOWS FROM OPERATING ACTIVITIES

Received from Customers	\$ 1,738,242,625
Payments to Employees and Fringe Benefits	(1,395,770,586)
Payments to Vendors and Suppliers	(864,945,296)
Payments for Scholarships and Fellowships	(96,870,511)
Loans Issued	(6,599,109)
Collection of Loans	5,818,377
Interest Earned on Loans	760,732
Other Receipts	11,186,546
	<hr/>
Net Cash Used by Operating Activities	(608,177,222)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State Appropriations	486,492,294
Noncapital Grants - Student Financial Aid	17,878,065
Other Noncapital Grants	157,713,272
Noncapital Gifts	104,571,405
Additions to Endowments	27,563,546
William D. Ford Direct Lending Receipts	164,418,997
William D. Ford Direct Lending Disbursements	(162,629,075)
Related Activity Agency Receipts	565,990,897
Related Activity Agency Disbursements	(272,641,482)
	<hr/>
Net Cash Provided by Noncapital Financing Activities	1,089,357,919

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	95,911,896
Capital Grants	78,724,690
Capital Gifts	3,267,517
Acquisition and Construction of Capital Assets	(205,964,812)
Principal Paid on Capital Debt and Leases	(67,247,467)
Interest and Fees Paid on Capital Debt and Leases	(58,903,013)
Federal Interest Subsidy on Debt Received	2,273,604
	<hr/>
Net Cash Used by Capital Financing and Related Financing Activities	(151,937,585)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	3,172,166,687
Investment Income	66,345,498
Purchase of Investments and Related Fees	(3,548,460,622)
	<hr/>
Net Cash Used by Investing Activities	(309,948,437)
	<hr/>
Net Increase in Cash and Cash Equivalents	19,294,675
Cash and Cash Equivalents - July 1, 2011	887,700,672
	<hr/>
Cash and Cash Equivalents - June 30, 2012	<u>\$ 906,995,347</u>

The University of North Carolina at Chapel Hill
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2012

Exhibit A-3
Page 2 of 2

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

Operating Loss	\$ (712,949,664)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:	
Depreciation/ Amortization Expense	113,529,873
Allowances, Write-Offs, and Amortizations	4,212,415
Changes in Assets and Liabilities:	
Receivables (Net)	21,890,941
Inventories	(1,013,417)
Notes Receivable (Net)	(786,943)
Other Assets	(222,723)
Accounts Payable and Accrued Liabilities	(14,707,106)
Due to Primary Government	(9,550,206)
U.S. Government Grants Refundable	81,260
Unearned Revenue	(8,305,155)
Compensated Absences	(356,497)
	<u>(356,497)</u>
Net Cash Used by Operating Activities	<u>\$ (608,177,222)</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	\$ 447,760,589
Restricted Cash and Cash Equivalents	410,632,339
Noncurrent Assets:	
Restricted Cash and Cash Equivalents	48,602,419
	<u>48,602,419</u>
Total Cash and Cash Equivalents - June 30, 2012	<u>\$ 906,995,347</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through a Gift	\$ 2,362,484
Change in Fair Value of Investments	(33,030,974)
Loss on Disposal of Capital Assets	(4,025,489)

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

The University of North Carolina at Chapel Hill Foundations
Statement of Financial Position
June 30, 2012

Exhibit B-1

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 12,971,871	\$ 10,946,509	\$ 48,950,742
Investments		168,513,595	
Unconditional Promises to Give, Net	3,732,450	2,940,447	1,589,646
Contributions Receivable from Split-Interest Agreements		3,171,158	
Accounts Receivable	73,046		
Funds Held in Trust	1,333,566		
Other Current Assets			598,743
Total Current Assets	<u>18,110,933</u>	<u>185,571,709</u>	<u>51,139,131</u>
Property and Equipment:			
Building			562,178
Furniture and Equipment	595,729		418,098
Leasehold Interest - Building	3,750,483		
Vehicle	26,422		28,011
Less: Allowance for Depreciation	<u>(1,152,200)</u>		<u>(505,868)</u>
Total Property and Equipment	<u>3,220,434</u>		<u>502,419</u>
Other Assets:			
Investments	145,189,682		152,862,928
Unconditional Promises to Give, Net	8,224,318		5,225,679
Split-Interest Agreements	1,730,700		
Cash Surrender Value of Life Insurance		1,875,756	
Other Assets			3,688,445
Total Other Assets	<u>155,144,700</u>	<u>1,875,756</u>	<u>161,777,052</u>
Total Assets	<u>\$ 176,476,067</u>	<u>\$ 187,447,465</u>	<u>\$ 213,418,602</u>
LIABILITIES			
Current Liabilities:			
Accounts Payable	\$ 9,847	\$ 0	\$ 334,083
Annuities Payable		66,865	
Agency Payable			327,092
Accrued Expenses	151,275		
Total Current Liabilities	<u>161,122</u>	<u>66,865</u>	<u>661,175</u>
Long-Term Debt	<u>625,000</u>		<u>29,265</u>
Total Liabilities	<u>786,122</u>	<u>66,865</u>	<u>690,440</u>
NET ASSETS			
Unrestricted	27,835,238		7,815,535
Temporarily Restricted	59,730,411	80,308,678	129,816,551
Permanently Restricted	88,124,296	107,071,922	75,096,076
Total Net Assets	<u>175,689,945</u>	<u>187,380,600</u>	<u>212,728,162</u>
Total Liabilities and Net Assets	<u>\$ 176,476,067</u>	<u>\$ 187,447,465</u>	<u>\$ 213,418,602</u>

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

The University of North Carolina at Chapel Hill Foundations
Statement of Activities
For the Fiscal Year Ended June 30, 2012

Exhibit B-2

	UNC-CH Arts and Sciences Foundation, Inc.	The Educational Foundation Scholarship Endowment Trust	The Medical Foundation of North Carolina, Inc.
REVENUES			
Support:			
Contributions	\$ 8,581,117	\$ 2,480,882	\$ 12,851,464
Development Assessment Fee Income	2,228,579		
Change in Fair Value of Split-Interest Agreements	(670,600)		274,929
Contributed Services and Facilities	82,675		1,584,926
Actuarial Adjustment of Annuities Payable		25,933	
Endowment Investment Return Designated for Current Operations		8,925,363	
Total Support	10,221,771	11,432,178	14,711,319
Revenue:			
Interest and Divident Income			2,509,271
Net Unrealized and Realized Gain on Investments	1,870,462		956,778
Investment Income	1,864,033		
Gain on Sale of Asset			11,746
Other Income	14,563		880,398
Total Revenue	3,749,058		4,358,193
Total Support and Revenue	13,970,829	11,432,178	19,069,512
EXPENSES			
Program Services:			
Grants	8,591,350		15,697,278
Scholarship Expense Distribution		8,917,172	
Annuity Payments		8,191	
Other Expenses		530,067	
Total Program Services	8,591,350	9,455,430	15,697,278
Supporting Services:			
Fundraising Expense	2,490,119		3,891,340
Management and General	1,047,328		2,149,778
Total Supporting Services	3,537,447		6,041,118
Total Expenses	12,128,797	9,455,430	21,738,396
Loss from Bad Debt	505,910		
Total Expenses and Bad Debt	12,634,707	9,455,430	21,738,396
Changes in Net Assets from Operations	1,336,122	1,976,748	(2,668,884)
OTHER CHANGES			
Investment Return in Excess of Amounts Designated for Current Operations		(5,568,902)	
CHANGES IN NET ASSETS			
Unrestricted	649,282		(2,892,599)
Temporarily Restricted	(2,682,812)	(5,542,969)	(753,119)
Permanently Restricted	3,369,652	1,950,815	976,834
Total Changes in Net Assets	1,336,122	(3,592,154)	(2,668,884)
NET ASSETS			
Net Assets at Beginning of Year	174,353,823	190,972,754	215,397,046
Net Assets at End of Year	\$ 175,689,945	\$ 187,380,600	\$ 212,728,162

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

THE UNIVERSITY OF NORTH CAROLINA AT CHAPEL HILL
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The University of North Carolina at Chapel Hill (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 units. While the Board of Governors of the University of North Carolina System has ultimate responsibility, the Chancellor, the Board of Trustees, and the Board of Trustees of the Endowment Fund have delegated responsibilities for financial accountability of the University's funds. The University's component units are either blended or discretely presented in the University's financial statements. The blended component units, although legally separate, are, in substance, part of the University's operations and therefore, are reported as if they were part of the University. Discretely presented component units' financial data are reported in separate financial statements because of their use of different GAAP reporting models and to emphasize their legal separateness.

Blended Component Units - Although legally separate, The University of North Carolina at Chapel Hill Foundation Investment Fund, Inc. (Chapel Hill Investment Fund), UNC Investment Fund, LLC (UNC Investment Fund), UNC Management Company, Inc. (Management Company), The University of North Carolina at Chapel Hill Foundation, Inc. (UNC-Chapel Hill Foundation), The Kenan-Flagler Business School Foundation (Business School Foundation), U.N.C. Law Foundation, Inc. (Law Foundation), and The University of North Carolina at Chapel Hill School of Education Foundation, Inc. (School of Education Foundation), component units of the University, are reported as if they were part of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Chapel Hill Investment Fund is governed by a board consisting of 11 ex officio directors and two to four elected directors. Ex officio directors include all of the members of the Board of Trustees of the Endowment Fund of the University, which includes the Chairman of the University Board of Trustees and the Chancellor, the Vice Chancellor for Finance and Administration, and the Vice Chancellor for University Advancement. The UNC-Chapel Hill Foundation Board may, in its discretion, elect one or two of its at-large members to the Chapel Hill Investment Fund Board. The ex officio directors may elect one or two directors by unanimous written consent. The Chapel Hill Investment Fund supports the University by operating an investment fund for charitable, non-profit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support the University. Because members of the Board of Directors of the Chapel Hill Investment Fund are officials or appointed by officials of the University and the Chapel Hill Investment Fund's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

The UNC Investment Fund was organized by the Chapel Hill Investment Fund to allow the University, other constituent institutions of the University of North Carolina System (UNC System), affiliated foundations, associations, trusts, and endowments that support the University and the UNC System, to pool their resources and invest collectively in investment opportunities identified, structured and managed by the Management Company. The membership interests are offered only to government entities or tax-exempt organizations that are controlled by or support the University or UNC System. The Chapel Hill Investment Fund contributed and assigned all of its assets to the UNC Investment Fund effective January 1, 2003, in exchange for its membership interest in the UNC Investment Fund. Upon such contribution and assignment, and in consideration thereof, the UNC Investment Fund has assumed all liabilities and obligations of the Chapel Hill Investment Fund in respect of such contributed assets. At June 30, 2012, the Chapel Hill Investment Fund membership interest was approximately 67.4% of the UNC Investment Fund total membership interests. Because the Chapel Hill Investment Fund is the organizer and controlling member of the UNC Investment Fund, the financial statements of the UNC Investment Fund have been blended with those of the University.

The Management Company is a North Carolina nonprofit corporation organized and operated exclusively to support the educational mission of the University. The Management Company provides investment management and administrative services to the University, UNC System, and institutions and affiliated tax-exempt organizations, and performs

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

other functions for and generally carries out the purposes of the University. The Management Company is governed by five ex officio directors and one to three additional directors as fixed or changed from time to time by the board, elected by the ex officio directors. The ex officio directors consist of the Chancellor, the Vice Chancellor for Finance and Administration, the Chairman of the University Board of Trustees, the Chairman of the Board of Directors of the Chapel Hill Investment Fund, and the President of the Management Company. Because members of the Board of Directors of the Management Company are officials or appointed by officials of the University and the Management Company's primary purpose is to benefit the University and other organizations operated primarily to support the University, its financial statements have been blended with those of the University.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

The School of Education Foundation is governed by a board consisting of seven ex officio directors and up to 15 elected directors. Ex officio directors include the Dean of the School of Education, as well as the school's associate Dean for Academic Programs, Assistant Dean for External Relations, Assistant Dean for Administration and Finance, Director of Alumni Relations, President of the Alumni Council, and President-Elect of the Alumni Council. The remaining directors are elected to the School of Education Foundation Board of Directors by action of the ex officio directors. The School of Education Foundation aids, supports and promotes teaching, research, and service at the School of Education. Because members of the Board of Directors of the School of Education Foundation are officials or appointed by officials of the University, the financial statements of the School of Education Foundation have been blended with those of the University.

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

Discretely Presented Component Units - The Medical Foundation of North Carolina, Inc. (Medical Foundation), the University of North Carolina at Chapel Hill Arts and Sciences Foundation, Inc. (Arts and Sciences Foundation), and The Educational Foundation Scholarship Endowment Trust (Educational Foundation Trust) are legally separate, not-for-profit, tax exempt organizations and are reported as discretely presented component units based on the nature and significance of their relationship to the University.

The Medical Foundation is governed by a board consisting of one ex officio director, the Dean of the UNC School of Medicine, and up to 33 elected directors, which serve staggered terms. Two other ex officio directors, the President of UNC Health Care and the President of the Medical Foundation, have no voting rights on any matters. Its purpose is to support educational, scientific, and public service efforts of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University's School of Medicine and UNC Health Care System. Historically, the University's School of Medicine has been the major recipient of financial support from the Medical Foundation rather than UNC Health Care System. Although the University does not control the timing or amount of receipts from the Medical Foundation, the majority of resources or income that the Medical Foundation holds and invests is restricted to the University by the donors. Because these restricted resources held by the Medical Foundation can only be used by, or for the benefit of the University, the Medical Foundation is considered a component unit of the University.

The Arts and Sciences Foundation is governed by a board consisting of four ex officio directors, 30 elected directors and such number of emeritus directors determined from time to time by the Board of Directors. The 30 elected directors are elected for staggered terms by the Board of Directors in office at the time of election. The purpose of the Arts and Sciences Foundation is to promote and support the University's College of Arts and Sciences. Although the University does not control the timing or amount of receipts from the Arts and Sciences Foundation, the majority of resources or income that the Arts and Sciences Foundation holds and invests is restricted to the activities of the University by the donors. Because these restricted resources held by the Arts and Sciences Foundation can only be used by, or for the benefit of the University, the Arts and Sciences Foundation is considered a component unit of the University.

The Educational Foundation Trust is governed by The Educational Foundation Scholarship Endowment Trust Agreement which designates the voting members of the Investment Committee of The Educational Foundation, Inc. as trustees. The Investment Committee consists of five members elected from the membership of The Educational Foundation, Inc. The Educational Foundation Trust operates solely to assist the University in providing financial assistance to students at the University. On an annual basis, the Board of Trustees of the Educational Foundation Trust appropriates a portion of the net appreciation on its assets to The Educational Foundation, Inc. in its capacity as agent for the Educational Foundation Trust. The distribution from the Educational Foundation Trust to The Educational Foundation, Inc. is then forwarded by The Educational Foundation, Inc. to the University to provide financial assistance to students at the University. Although the University does not control the timing or amount of receipts from the Educational Foundation Trust, the majority of resources or income that the Educational Foundation Trust holds and invests is restricted to the students of the University by the donors. Because these restricted resources held by the Educational Foundation Trust can only be used for the benefit of the students of the University, the Educational Foundation Trust is considered a component unit of the University.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust are private, nonprofit organizations that report their financial results under Financial Accounting Standards Board (FASB) Statements. As such, certain revenue recognition criteria and presentation features are different from Governmental Accounting Standards Board (GASB) revenue recognition criteria and presentation features. No modifications have been made to the financial information in the University's financial reporting entity for these differences.

During the year ended June 30, 2012, the Medical Foundation, the Arts and Sciences Foundation, and the Educational Foundation Trust distributed in total \$33,205,800 to the University for both restricted and unrestricted purposes. Complete financial statements for the Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust can be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

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

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

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

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

- 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- D. Cash and Cash Equivalents** - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the Short-Term Investment Fund. The Short-Term Investment Fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.
- E. Investments** - Investments generally are reported at fair value. The fair values of all debt and equity securities with readily determinable fair market values are based on quoted market prices. Investments for which a readily determinable fair value does not exist include investments in certain commingled funds and limited partnerships. These investments are carried at estimated fair values as provided by the respective fund managers of these investments or third party administrators. The Management Company reviews and evaluates the values provided by the fund managers as well as the valuation methods and assumptions used in determining the fair value of such investments. Those estimated fair values may differ significantly from the values that would have been used had a ready market for these investments existed. The net increase or decrease in the fair value of investments is recognized as a component of investment income. The majority of private equity limited partnerships and real assets limited partnerships are subject to fair value estimation, which includes discounted cash flow and transaction comparison. The estimated fair value of these investments is \$1.02 billion.

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

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

Endowment investments include the principal amount of gifts and bequests that, according to donor restrictions, must be held in perpetuity, 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

(i.e., quasi-endowments), along with accumulated investment earnings on such amounts. Land and other real estate held as investments by endowments are reported at fair value, consistent with how investments are generally reported.

- F. Receivables** - Receivables consist of tuition and fees charged to students and charges to patients for services provided by the UNC Physicians & Associates and the Dental Faculty Practices. Receivables also include amounts due from the federal government, state and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants, pledges that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied, and notes receivables from loans to students. Students, patients, pledges, and notes receivables are recorded net of the allowance for doubtful accounts. The accounts and other receivables are shown at book value with no provision for doubtful accounts considered necessary.
- G. Inventories** - Inventories held by the University are priced at cost or average cost except for the Student Stores inventory, which is valued at the lower of cost or market. Inventories consist of expendable supplies, postage, fuel held for consumption, textbooks, and other merchandise for resale.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 50 years for general infrastructure, 12 to 75 years for buildings, and 3 to 30 years for equipment. Amortization is computed using the straight-line method over the estimated useful lives of the assets from 3 to 20 years for computer software.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- 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 and 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. Funds Held in Trust for Pool Participants** - Funds held in trust for pool participants represent the external portion of the University's governmental external investment pool more fully described in Note 2. The assets associated with this liability are included in restricted investments, cash, and other similar asset accounts.
- K. Funds Held in Trust by Others** - Funds held in trust by others are resources neither in the possession nor the control of the University, but held and administered by an outside organization, with the University deriving income from such funds. Such funds established under irrevocable trusts where the University has legally enforceable rights or claims have not been recorded on the accompanying financial statements. The value of these assets at June 30, 2012 is \$29,990,540.
- L. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include principal amounts of revenue bonds payable, notes payable, capital lease obligations, annuity and life income payable, and compensated absences that are not scheduled to be paid within the next fiscal year.

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

- M. Compensated Absences** - The University's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at year-end is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

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

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

N. Net Assets - The University's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt - This represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

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

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

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

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

O. Scholarship Discounts - Student tuition and fees revenues and certain other revenues from University charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

- P. Revenue and Expense Recognition** - The University classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the University's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (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 and state appropriations 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 non-operating revenues and expenses.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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.

At June 30, 2012, the amount shown on the Statement of Net Assets as cash and cash equivalents includes \$862,664,868 which represents the University's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.5 years as of June 30, 2012. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Cash on hand at June 30, 2012 was \$160,152. The carrying amount of the University's deposits not with the State Treasurer, including certificates of deposit, was \$44,170,327 and the bank balance was \$50,541,426. 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, 2012, \$10,270,691 of the University's bank balance was exposed to custodial credit risk as uninsured and uncollateralized.

- B. Investments** - The University is authorized by The University of North Carolina Board of Governors pursuant to G.S. 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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; time deposits of specified institutions; prime quality commercial paper; and asset-backed securities with specified ratings. Also, G.S. 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. G.S. 147-69.2 authorizes the following: general obligations of other states; general obligations of North Carolina local governments; and obligations of certain entities with specified ratings.

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 units, UNC-Chapel Hill Foundation, Management Company, Chapel Hill Investment Fund, UNC Investment Fund, Business School Foundation, Law Foundation, School of Education Foundation, Medical Foundation, Arts and Sciences Foundation, and Educational Foundation Trust, 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. The Management Company does not hold endowment funds.

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

Investments are subject to the following risks.

Interest Rate Risk: Interest rate risk is the risk the University may face should interest rate variances affect the fair value of investments. The University does not have a formal policy that addresses interest rate risk.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University does not have a formal policy that addresses credit risk.

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The University does not have a formal policy for foreign currency risk.

Temporary Investment Pool (Temporary Pool) - This is a fixed income portfolio managed by the UNC Management Company, Inc. (Management Company) and Novant Asset Management, LLC. It operates in conjunction with the University's Bank of America disbursing account for all special funds, funds received for services rendered by health care professionals, and endowment revenue funds (internal portion) and funds of affiliated foundations (external portion). Because of the participation in the Temporary Pool by affiliated foundations, it is considered a governmental external investment pool. The external portion of the Temporary Pool is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Fund ownership of the University's Temporary Pool is measured using the unit value method. Under this method, participant activity is recorded on a cost basis in the UNC-Chapel Hill Money Market System. This is the official means of recording activity in the Temporary Pool. The Temporary Pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the University Board of Trustees. The University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Temporary Pool.

The Bank of New York Mellon is the custodian for the Temporary Pool and provides the University with monthly statements defining income and market value information. Investments of the Temporary Pool are generally highly liquid and include U.S. government securities, collateralized mortgage obligations, asset-backed securities, corporate bonds, and mutual funds. The University has elected to invest a portion of the Temporary Pool assets in the Chapel Hill Investment Fund.

By request to accounting services, participants may purchase and sell shares in the Temporary Pool at a fixed value of \$1 per share. Generally, the purchase and sale of participation shares occur only at the beginning of the month. Income distribution is determined each quarter by multiplying the distribution rate by the average of the invested fund balance. Statements are provided via internet website to each participating account or group of accounts on a quarterly basis reflecting the participants' balance and income distribution. The rate earned by an account is dependent upon its account classification and investable fund

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

balance. The rates are set by policy and approved by the Vice Chancellor for Finance and Administration.

The following table presents the fair value of the Temporary Pool investments by type and investments subject to interest rate risk at June 30, 2012.

Temporary Pool Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
U.S. Treasuries	\$ 14,054,840	\$ 9,059,140	\$ 4,995,700	\$ 0	\$ 0
U.S. Agencies	148,335,778	13,687,647	17,123,402	6,120,780	111,403,949
Collateralized Mortgage Obligations	63,676,088	10,398,544	104,198	391,567	52,781,779
Asset-Backed Securities	1,030,536				1,030,536
Money Market Mutual Funds	110,359,545	110,359,545			
Domestic Corporate Bonds	16,042,234	6,573,244	9,468,990		
Total Debt Securities	353,499,021	\$ 150,078,120	\$ 31,692,290	\$ 6,512,347	\$ 165,216,264
Other Securities					
Domestic Stocks	30,000				
Total Temporary Pool Investments	\$ 353,529,021				

The University has elected to invest \$40,697,887 of the Temporary Pool assets in the Chapel Hill Investment Fund. The disclosures for these investments are not included here. The disclosures for this portion of the Temporary Investment Pool can be found under the heading UNC Chapel Hill Foundation Investment Fund, Inc.

At June 30, 2012, investments in the Temporary Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below
U.S. Agencies	\$ 148,335,778	\$ 0	\$ 148,335,778	\$ 0	\$ 0	\$ 0
Collateralized Mortgage Obligations	63,676,088	40,423	54,133,082	274,614	49,638	9,178,331
Asset-backed Securities	1,030,536					1,030,536
Money Market Mutual Funds	110,359,545	110,359,545				
Domestic Corporate Bonds	16,042,234		3,868,468	11,644,392	492,260	37,114
Total	\$ 339,444,181	\$ 110,399,968	\$ 206,337,328	\$ 11,919,006	\$ 541,898	\$ 10,245,981

Rating Agency: Moody's/Standard & Poor's/Fitch

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Temporary Investment Pool's Statement of Net Assets and Statement of Operations and Changes in Net Assets as of and for the period ended June 30, 2012, are as follows:

Statement of Net Assets

June 30, 2012

	Amount
<i>Assets:</i>	
Cash in Bank	\$ 1,919,141
State Treasurer Investment Fund	83,700,000
Accounts Receivable	19
Accrued Investment Income	1,184,272
Chapel Hill Investment Fund	40,697,887
Investments	353,529,021
Total Assets	\$ 481,030,340
<i>Liabilities:</i>	
Deferred Income	\$ 268,183
Accounts Payable	1,995,052
Total Liabilities	2,263,235
<i>Net Assets Held in Trust for All Pool Participants:</i>	
Internal Portion	304,439,674
External Portion	174,327,431
Total Net Assets	478,767,105
Total Liabilities and Net Assets	\$ 481,030,340

Statement of Operations and Changes in Net Assets

For the Fiscal Year Ended June 30, 2012

	Amount
<i>Increase in Net Assets from Operations:</i>	
<i>Revenues:</i>	
Investment Income	\$ 6,431,963
<i>Expenses:</i>	
Investment Management	(618,798)
Net Increase in Net Assets Resulting from Operations	5,813,165
<i>Distributions to Participants:</i>	
Distributions Paid and Payable	(5,813,165)
<i>Share Transactions:</i>	
Net Share Purchases	27,723,347
Total Increase in Net Assets	27,723,347
<i>Net Assets:</i>	
Beginning of Year	451,043,758
End of Year	\$ 478,767,105

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Intermediate Investment Pool - Established in October 2007, this is a portfolio managed by the UNC Management Company, Inc. (Management Company) and is comprised of fixed income investments and investments with the UNC-Chapel Hill Foundation Investment Fund, Inc. (Chapel Hill Investment Fund). Participation in the Intermediate Pool is open to all participants that are eligible for the UNC Chapel Hill Temporary Investment Pool; however, currently the University is the only member. Fund ownership of the University's Intermediate Pool is measured using the unit value method. Under this method, each participant's investment balance is determined on a market value basis. The Intermediate Pool is not registered with the SEC and is not subject to any formal oversight other than that provided by the University Board of Trustees. The University has not provided legally binding guarantees during the period to support the value of the pool's investments. There are no involuntary participants in the Intermediate Pool.

The Bank of New York Mellon is the custodian for the Intermediate Pool and provides the University with monthly statements defining income and market value information. Generally a minimum of 45% and a maximum of 65% of the market value of the Intermediate Pool will be invested in the Chapel Hill Investment Fund. The remaining assets of the Intermediate Pool will be invested primarily (at least 80%) in cash, money market instruments, high quality bonds, and other high quality fixed income instruments in accordance with the Investment Guidelines.

By written request to university accounting services, the purchase and sale of participation shares occur at the beginning of the month. As calculated by the Management Company, returns net of fees and expenses will be allocated 85% to the Intermediate Pool participants and 15% to the University. Statements are provided by the Management Company to each participant on a monthly basis reflecting the participants' balance and investment activity.

The following table presents the fair value of the investments by type and investments subject to interest rate risk at June 30, 2012.

Investment Type	Fair Value	Investment Maturities (in Years)	
		Less Than 1	1 to 5
<i>Debt Securities</i>			
Debt Mutual Funds	\$ 12,311,804	\$ 0	\$ 12,311,804
Money Market Mutual Funds	8,237,624	8,237,624	
Total Intermediate Pool Investments	\$ 20,549,428	\$ 8,237,624	\$ 12,311,804

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2012, investments in the Intermediate Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A
Debt Mutual Funds	\$ 12,311,804	\$ 0	\$ 12,311,804	\$ 0
Money Market Mutual Funds	8,237,624	1,579,411		6,658,213
Total	\$ 20,549,428	\$ 1,579,411	\$ 12,311,804	\$ 6,658,213

Rating Agency: Moody's/Standard & Poor's/Fitch

At June 30, 2012, the Intermediate Investment Pool had investments of \$28,154,328 in the Chapel Hill Investment Fund. The disclosures for these investments are not included here. The disclosures for this portion of the Intermediate Investment Pool can be found under the heading UNC Chapel Hill Foundation Investment Fund, Inc.

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

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

The Chapel Hill Investment Fund is the primary participant of UNC Investment Fund, LLC (UNC Investment Fund) and on a monthly basis receives a unitization report from the Management Company defining change in book and market value, applicable realized gains and losses and expenses. The Chapel Hill Investment Fund uses a unit basis to determine each participant's market value and to distribute the fund's earnings

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

according to the fund's spending policy. There are no involuntary participants in the Chapel Hill Investment Fund. The University has not provided or obtained any legally binding guarantees during the period to support the value for the Chapel Hill Investment Fund. The audited financial statements for the Chapel Hill Investment Fund may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

The Chapel Hill Investment Fund consists of an approximately 67.4% membership in the UNC Investment Fund categorized below.

UNC Investment Fund, LLC (UNC Investment Fund) - This is a nonprofit limited liability company exempt from income tax pursuant to Section 501(c)(3) organized under the laws of the State of North Carolina. It was established in December 2002 by the Chapel Hill Investment Fund and is classified as a governmental external investment pool. The pool is utilized to manage the investments for The University of North Carolina, its constituent institutions, and affiliates of the constituent institutions. This includes charitable, nonprofit foundations, associations, trusts, endowments, and funds that are organized and operated primarily to support these institutions. The Chapel Hill Investment Fund, with an approximately 67.4% membership interest as of June 30, 2012, is the predominant member of the UNC Investment Fund. The University's reporting entity portion of the Chapel Hill Investment Fund and the Management Company's portion of the UNC Investment Fund is characterized as the internal portion. Other affiliated organizations in the Chapel Hill Investment Fund in addition to other members of the UNC Investment Fund not included in the University's reporting entity are characterized as the external portion. The external portion of the UNC Investment Fund is presented in the accompanying financial statements as Funds Held in Trust for Pool Participants. Membership interests of the UNC Investment Fund are measured using the unit value method. Under this method, each member's investment balance is determined on a market value basis.

The UNC Investment Fund is not registered with the SEC and is not subject to any formal oversight other than that provided by the Chapel Hill Investment Fund as the controlling member (See Note 1A). Effective January 1, 2003, the Management Company entered into an investment management services agreement with the UNC Investment Fund and provides investment management and administrative services.

The Bank of New York Mellon is the custodian for the UNC Investment Fund and provides the University with monthly statements defining income and market value information. The UNC Investment Fund uses a unit basis to determine each member's market value and to distribute the fund's earnings. The University has not provided or obtained any legally

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

binding guarantees during the period to support the value for the UNC Investment Fund investments. The audited financial statements for the UNC Investment Fund may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

The following table presents the fair value of the UNC Investment Fund investments by type and investments subject to interest rate risk at June 30, 2012.

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 13,369,869	\$ 0	\$ 10,694,730	\$ 0	\$ 2,675,139
U.S. Agencies	8,383,181	23,138		3,690,057	4,669,986
Collateralized Mortgage Obligations	19,926,042	14,024,147			5,901,895
Asset-backed Securities	5,151,568	5,151,568			
Debt Mutual Funds	100,650,854		44,407,381	54,745,376	1,498,097
Money Market Mutual Funds	105,509,943	105,509,943			
Domestic Corporate Bonds	3,736,427	364,612	2,708,600		663,215
Total Debt Securities	\$ 256,727,884	\$ 125,073,408	\$ 57,810,711	\$ 58,435,433	\$ 15,408,332
<i>Other Securities</i>					
International Equity Index Funds	170,292,081				
Equity Index Funds	35,683,517				
Real Estate Investment Trust	786,892				
Other Hedge Funds	942,570,769				
Long Only Hedge Funds	435,877,863				
Private Equity Limited Partnerships	737,422,774				
Real Assets Limited Partnerships	457,012,502				
Domestic Stocks	129,849,914				
Foreign Stocks	143,378				
Other	2,021				
Total UNC Investment Fund Pool Investments	\$ 3,166,369,595				

At June 30, 2012, investments in the UNC Investment Fund Pool had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB, Ba & Below	Unrated
U.S. Agencies	\$ 8,383,181	\$ 0	\$ 8,360,043	\$ 0	\$ 0	\$ 0	\$ 23,138
Collateralized Mortgage Obligations	19,926,042					19,926,042	
Asset-backed Securities	5,151,568					5,151,568	
Debt Mutual Funds	100,650,854		54,745,376		1,498,097	44,407,381	
Money Market Mutual Funds	105,509,943	102,837,613		2,672,330			
Domestic Corporate Bonds	3,736,427			3,371,815		364,612	
Total	\$ 243,358,015	\$ 102,837,613	\$ 63,105,419	\$ 6,044,145	\$ 1,498,097	\$ 69,849,603	\$ 23,138

Rating Agency: Moody's/Standard and Poor's/Fitch

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Foreign Currency Risk: At June 30, 2012, the UNC Investment Fund Pool's exposure to foreign currency risk is as follows:

	Currency	Fair Value (U.S. Dollars)
Private Equity Limited Partnerships	Euro	\$ 69,216,225
Real Assets Limited Partnerships	Euro	26,432,762
Other Hedge Funds	Euro	8,083,017
Private Equity Limited Partnerships	British Pound Sterling	9,185,723
Real Assets Limited Partnerships	British Pound Sterling	1,086,338
Private Equity Limited Partnerships	Australian Dollar	4,782,562
Real Assets Limited Partnerships	Canadian Dollar	4,061,142
Foreign Stocks	Euro	143,378
Total		\$ 122,991,147

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2012, for the University's non-pooled investments.

Non-Pooled Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
<i>Debt Securities</i>					
U.S. Treasuries	\$ 2,564,661	\$ 40,681	\$ 113,552	\$ 2,379,059	\$ 31,369
U.S. Agencies	129,287	70,364	58,923		
Mortgage Pass Throughs	34,924				34,924
Collateralized Mortgage Obligations	19,902		19,902		
State and Local Governments	129,921			129,921	
Debt Mutual Funds	4,905,600		1,025,629	2,759,606	1,120,365
Money Market Mutual Funds	49,054,909	49,054,909			
Domestic Corporate Bonds	755,274				755,274
Foreign Corporate Bonds	50,190		50,190		
Foreign Government Bonds	35,540				35,540
Total Debt Securities	\$ 57,680,208	\$ 49,165,954	\$ 1,268,196	\$ 5,268,586	\$ 1,977,472
<i>Other Securities</i>					
International Equity Index Funds	4,604,255				
Equity Index Funds	8,252,264				
Investments in Real Estate	2,283,303				
Real Estate Investment Trust	699				
Private Equity Limited Partnerships	2,438,541				
Real Assets Limited Partnerships	2,178,734				
Domestic Stocks	10,510,551				
Foreign Stocks	281,156				
Other	12,653,624				
Total Non-Pooled Investments	\$ 100,883,335				

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At June 30, 2012, the University's non-pooled investments had the following credit quality distribution for securities with credit exposure:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB, Ba and below	Unrated
U.S. Agencies	\$ 129,287	\$ 0	\$ 129,287	\$ 0	\$ 0	\$ 0	\$ 0
Mortgage Pass Throughs	34,924	8,903	1,215			24,003	803
Collateralized Mortgage Obligations	19,902					19,902	
State and Local Government	129,921				129,921		
Debt Mutual Funds	4,905,600	51,705	1,998,298	1,310,875	933,963	610,040	719
Money Market Mutual Funds	49,054,909	49,003,943		50,966			
Domestic Corporate Bonds	755,274					755,274	
Foreign Corporate Bonds	50,190				29,640	20,550	
Foreign Government Bonds	35,540			35,540			
Total	\$ 55,115,547	\$ 49,064,551	\$ 2,128,800	\$ 1,397,381	\$ 1,093,524	\$ 1,429,769	\$ 1,522

Rating Agency: Moody's/Standard & Poor's/Fitch

Foreign Currency Risk: At June 30, 2012, the non-pooled investments exposure to foreign currency risk is as follows:

	Currency	Fair Value (U.S. Dollars)
Foreign Stocks	British Pound Sterling	\$ 24,165
Foreign Stocks	Australian Dollar	22,289
Foreign Stocks	Japanese Yen	21,157
Foreign Stocks	Euro	17,220
Total		\$ 84,831

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Total Investments - The following table presents the fair value of the total investments at June 30, 2012:

Investment Type	<u>Fair Value</u>
<i>Debt Securities</i>	
U.S. Treasuries	\$ 29,989,370
U.S. Agencies	156,848,246
Mortgage Pass Throughs	34,924
Collateralized Mortgage Obligations	83,622,032
State and Local Government	129,921
Asset-backed Securities	6,182,104
Debt Mutual Funds	117,868,258
Money Market Mutual Funds	273,162,021
Domestic Corporate Bonds	20,533,935
Foreign Corporate Bonds	50,190
Foreign Government Bonds	35,540
Total Debt Securities	\$ 688,456,541
<i>Other Securities</i>	
International Equity Index Funds	174,896,336
Equity Index Funds	43,935,781
Investments in Real Estate	2,283,303
Real Estate Investment Trust	787,591
Other Hedge Funds	942,570,769
Long Only Hedge Funds	435,877,863
Private Equity Limited Partnerships	739,861,315
Real Assets Limited Partnerships	459,191,236
Domestic Stocks	140,390,465
Foreign Stocks	424,534
Other	12,655,645
Total Investments	\$ 3,641,331,379

Total investments include \$428,381,371 held in the UNC Investment Fund for the component units that are discretely presented in the accompanying financial statements. The University's reporting entity, including the three discretely presented component units, comprises 58.0% of the UNC Investment Fund.

Component Units - Investments of the University's discretely presented component unit, The Medical Foundation of North Carolina, Inc., 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 Medical Foundation reports under the FASB reporting model, disclosures of the various investment risks are not required. The following is an analysis of investments not held by the University:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

<u>Investment Type</u>	<u>Carrying Value</u>
Money Market Funds	\$ 200,052
Common Stock	58,296
Mutual Funds	30,292,143
International Equity Fund	6,592,462
Certificate of Deposit	<u>257,960</u>
Total Investments	<u>\$ 37,400,913</u>

NOTE 3 - ENDOWMENT INVESTMENTS

Substantially all of the investments of the University's endowment funds are pooled in the Chapel Hill Investment Fund. Under the "Uniform Prudent Management of Institutional Funds Act" (UPMIFA), authorized by the North Carolina General Assembly on March 19, 2009, the Board may 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. During the year, the Board did not appropriate expenditures from eligible nonexpendable endowment funds. Investment return of the University's pooled endowment funds is predicated on the total return concept (yield plus appreciation). Annual distributions from the Chapel Hill Investment Fund to the University's pooled endowment funds are generally based on an adopted distribution policy. Under this policy, the prior year distribution is increased by the rate of inflation as measured by the Consumer Price Index (CPI) unless the Board determines otherwise. Each year's distribution, however, is subject to a minimum of 4% and a maximum of 7% of the pooled endowment fund's average market value for the previous year.

To the extent that the total return for the current year exceeds the distribution, the excess is added to principal. If current year earnings do not meet the distribution requirements, the University uses accumulated income and appreciation to make up the difference. At June 30, 2012, accumulated income and appreciation of \$490,731,772 was available in the University's pooled endowment funds of which \$444,166,791 was restricted to specific purposes including scholarships and fellowships, research, library acquisitions, professorships, departmental and other uses. The remaining portion of net appreciation available to be spent is classified as unrestricted net assets.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - RECEIVABLES

Receivables at June 30, 2012, were as follows:

	<u>Gross Receivables</u>	<u>Less Allowance for Doubtful Accounts</u>	<u>Net Receivables</u>
<i>Current Receivables</i>			
Students	\$ 9,854,726	\$ 2,160,255	\$ 7,694,471
Student Sponsors	301,181		301,181
Patients	112,503,473	79,016,498	33,486,975
Accounts	49,338,199		49,338,199
Intergovernmental	67,698,036		67,698,036
Pledges	18,845,303	505,440	18,339,863
Investment Earnings	1,547,361		1,547,361
Interest on Loans	915,285		915,285
Other	34,847		34,847
Total Current Receivables	<u>\$ 261,038,411</u>	<u>\$ 81,682,193</u>	<u>\$ 179,356,218</u>
<i>Noncurrent Receivables</i>			
Pledges	<u>\$ 29,368,657</u>	<u>\$ 795,862</u>	<u>\$ 28,572,795</u>
Notes Receivable			
<i>Notes Receivable - Current:</i>			
Institutional Student Loan Programs	<u>\$ 4,644,903</u>	<u>\$ 333,539</u>	<u>\$ 4,311,364</u>
<i>Notes Receivable - Noncurrent:</i>			
Federal Loan Programs	\$ 30,292,683	\$ 1,923,282	\$ 28,369,401
Institutional Student Loan Programs	7,103,046	511,618	6,591,428
Total Notes Receivable - Noncurrent	<u>\$ 37,395,729</u>	<u>\$ 2,434,900</u>	<u>\$ 34,960,829</u>

Pledges are receivable over varying time periods ranging from one to 10 years, and have been discounted based on a projected interest rate of .35% for the outstanding periods, and allowances are provided for the amounts estimated to be uncollectible.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Fiscal Year	Amount
2013	\$ 18,933,185
2014	11,891,694
2015	8,481,706
2016	4,409,498
2017	1,492,019
2018-2022	3,333,230
Total Pledge Receipts Expected	48,541,332
Less Discount Amount Representing Interest (0.35% Rate of Interest)	327,372
Present Value of Pledge Receipts Expected	48,213,960
Less Allowance for Doubtful Accounts	1,301,302
Pledges Receivable	\$ 46,912,658

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2012, is presented as follows:

	Balance July 1, 2011	Increases	Decreases	Balance June 30, 2012
<i>Capital Assets, Non-depreciable</i>				
Land	\$ 62,312,770	\$ 760,373	\$ 0	\$ 63,073,143
Art, Literature, and Artifacts	81,877,543	2,662,401	386	84,539,558
Construction in Progress	316,011,018	95,936,280	192,576,004	219,371,294
Computer Software in Development	11,240,918	10,258,582		21,499,500
Other Intangible Assets	1,000,000			1,000,000
Total Capital Assets, Non-depreciable	472,442,249	109,617,636	192,576,390	389,483,495
<i>Capital Assets, Depreciable</i>				
Buildings	2,343,980,519	257,880,744		2,601,861,263
Machinery and Equipment	362,755,966	27,916,572	12,864,186	377,808,352
General Infrastructure	847,614,608	5,730,151		853,344,759
Computer Software	49,196,387			49,196,387
Total Capital Assets, Depreciable	3,603,547,480	291,527,467	12,864,186	3,882,210,761
<i>Less Accumulated Depreciation/Amortization for</i>				
Buildings	698,308,722	72,064,852		770,373,574
Machinery and Equipment	178,138,360	21,469,475	8,838,697	190,769,138
General Infrastructure	265,099,241	17,230,841		282,330,082
Computer Software	2,764,705	2,764,705		5,529,410
Total Accumulated Depreciation/Amortization	1,144,311,028	113,529,873	8,838,697	1,249,002,204
Total Capital Assets, Depreciable, Net	2,459,236,452	177,997,594	4,025,489	2,633,208,557
Capital Assets, Net	\$ 2,931,678,701	\$ 287,615,230	\$ 196,601,879	\$ 3,022,692,052

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2012, were as follows:

	Amount
Accounts Payable	\$ 74,200,742
Accrued Payroll	41,218,528
Contract Retainage	8,473,889
Intergovernmental Payables	8,392,339
Total Accounts Payable and Accrued Liabilities	\$ 132,285,498

NOTE 7 - SHORT-TERM DEBT

Short-term debt activity for the year ended June 30, 2012, was as follows:

	Balance July 1, 2011	Draws	Repayments	Balance June 30, 2012
Commercial Paper Program (2002A Bonds)	\$ 73,650,000	\$ 59,000,000	\$ 0	\$ 132,650,000

The University manages a commercial paper (“CP”) program under the issuer name of the Board of Governors of the University of North Carolina that provides up to \$500,000,000 in short-term financing for the University’s and North Carolina State University’s (“NCSU”) capital improvement programs. Under this CP program, the University is authorized to issue up to \$400,000,000 and NCSU is authorized to issue up to \$100,000,000. Contingent liquidity needs for the entire CP program are provided by the University of North Carolina at Chapel Hill and supported by a pledge of the University’s available funds.

The University will typically utilize the commercial paper program for construction financing and will periodically issue long-term bonds to refund the outstanding balances under this program in order to provide permanent financing for these capital improvement projects.

At its June 2012 meeting, the Board of Governors for the University of North Carolina issued a resolution to limit the cumulative amount of outstanding commercial paper for the University of North Carolina at Chapel Hill under this program to \$250,000,000. This resolution does not impact NCSU.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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, 2012, is presented as follows:

	Balance July 1, 2011	Additions	Reductions	Balance June 30, 2012	Current Portion
Revenue Bonds Payable	\$ 1,214,335,000	\$ 0	\$ 29,250,000	\$ 1,185,085,000	\$ 86,833,042
Add/Deduct Premium/Discount	11,915,384		(2,916,555)	14,831,939	
Deduct Deferred Charge on Refunding	(2,230,649)		(401,922)	(1,828,727)	
Total Revenue Bonds Payable	1,224,019,735		25,931,523	1,198,088,212	86,833,042
Notes Payable	45,750,000	36,911,896	36,721,118	45,940,778	961,717
Capital Leases Payable	813,557		759,183	54,374	54,374
Compensated Absences	126,861,626	71,256,267	71,612,764	126,505,129	7,289,103
Annuity and Life Income Payable	11,354,655	3,930,589		15,285,244	1,620,624
Total Long-Term Liabilities	\$ 1,408,799,573	\$ 112,098,752	\$ 135,024,588	\$ 1,385,873,737	\$ 96,758,860

Additional information regarding capital lease obligations is included in Note 10.

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 plus Capital Appreciation	Principal Paid Through June 30, 2012	Discount on Capital Appreciation Bonds	Principal Outstanding plus Capital Appreciation June 30, 2012	See Table Below
General Revenue								
	2001A	5.000% - 5.375%	12/01/25	\$ 89,930,000	\$ 57,250,000	\$ 0	\$ 32,680,000	
	2001B	4.448%*	12/01/25	54,970,000	22,750,000		32,220,000	
	2001C	3.289%*	12/01/25	54,970,000	22,750,000		32,220,000	
	2002B	5.00%	12/01/11	66,555,000	66,555,000			
	2003	4.625% - 5.000%	12/01/33	107,960,000	15,730,000		92,230,000	
	2005A	4.25% - 5.00%	12/01/34	404,960,000	7,675,000		397,285,000	
	2007	4.45 - 5.00%	12/01/36	298,475,000			298,475,000	
	2009A	3.00% - 5.00%	12/01/28	97,735,000	7,330,000		90,405,000	
	2009B	5.75%**	12/01/39	112,805,000			112,805,000	
Total General Revenue				1,288,360,000	200,040,000		1,088,320,000	
Housing System	1997B	5.00%	11/01/11	7,210,000	7,210,000			
Utilities System	1997	5.25% - 5.50%	08/01/21	84,135,000		(\$17,621,633)	66,513,367	(1)
U.S. EPA Project	1991	9.05%	02/15/15	58,125,000	45,495,000	(1,694,578)	10,935,422	
Total Revenue Bonds Payable (Principal Only)				\$ 1,437,830,000	\$ 252,745,000	\$ (19,316,211)	1,165,768,789	
Less: Unamortized Loss on Refunding							(1,828,727)	
Plus: Unamortized Discount							34,148,150	
Total Revenue Bonds Payable							\$ 1,198,088,212	

* For variable rate debt with interest rate swaps, the synthetic fixed rates in effect at June 30, 2012 are included.

** 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 35% 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

Ref	Revenue Source	Total Future Revenues Pledged	Current Year			Estimate of % of Revenues Pledged
			Revenues Net of Expenses	Principal & Accretion	Interest	
(1)	Utilities Revenues	\$ 84,135,000	\$ 39,355,683	\$ 3,460,012	\$ 0	7%

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

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

General Revenue, Series 2001B and 2001C: In 2001 the University issued two series of variable rate demand bonds in the amount of \$54,970,000 (2001B) and \$54,970,000 (2001C) that each has a final maturity date of December 1, 2025. The bonds are subject to mandatory sinking fund redemption on the interest payment date on or immediately preceding each December throughout the term of the bonds. The proceeds of these issuances were used to provide funds to refund in advance of their maturity the following issues: Ambulatory Care Clinic, Series 1990; Athletic Facilities, Series 1998; Carolina Inn, Series 1994; School of Dentistry, Series 1995; Kenan Stadium, Series 1996; Housing System, Series 2000; and Parking System, Series 1997C. While bearing interest at a weekly rate, the bonds are subject to purchase on demand with seven days notice and delivery to the University’s Remarketing Agents J.P. Morgan Securities Inc. (2001B) and Banc of America Securities LLC (2001C). Effective September 23, 2008, J.P. Morgan Securities Inc. replaced Lehman Brothers, Inc.

The University entered into a line of credit agreement in the amount of \$200,000,000 with Wells Fargo Bank, N.A. (the Bank) on September 21, 2011. The University also entered into a line of credit agreement in the amount of \$200,000,000 with JPMorgan Chase Bank, N.A. (the Bank) on September 21, 2011. Under each agreement, the University is entitled to draw amounts sufficient to pay the principal and accrued interest on Variable Rate Demand Bonds (or Commercial Paper Bonds) delivered for purchase. Under each agreement, the University may, at any time and for any reason, reduce the Commitment by any amount upon 30 days prior written notice to the Bank.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The University is required to pay a quarterly facility fee for each line of credit in the amount of 0.38% per annum based on the size of the available commitment. If a long-term debt rating assigned by Standard & Poor's (S&P), Fitch Ratings (Fitch) or Moody's Investors Service (Moody's) is lowered, the facility fee assigned to the rating in the below table shall apply. In the event of a split rating (i.e., one or more of the rating agency's ratings is at a different level than the rating of either of the other rating agencies), the facility fee rate shall be determined as follows: (i) if two of the three ratings appear in the same level, the facility fee rate shall be based on that level; (ii) if no two ratings appear in the same level, the facility fee rate shall be based on the level which includes the middle of the three ratings.

S&P	Fitch	Moody's	Facility Fee
AA	AA	Aa2	0.48%
AA-	AA-	Aa3	0.58%
A+	A+	A1	0.68%
A	A	A2	0.78%
A- or lower	A- or lower	A3 or lower	1.78%

The University will pay an accrued interest fee equal to the amount of accrued interest, at the time of purchase of the bonds, multiplied by the bank rate multiplied by the ratio of the number of days from the date of purchase of the bonds until the date of payment of the accrued interest to 365 days.

Under each line of credit agreement, draws to purchase bonds will accrue interest at the bank rate payable on the same interest date as provided in the Series Indenture for the original bonds. The University is required to begin making a series of six fully amortizing semi-annual principal payments on bonds held by the Bank six months after the date of funding. Commercial paper bonds held by the Bank may be rolled over for a period of 180 days and must be reduced by 1/6th of the original amount of the Commercial paper bonds for a period of up to 5 rollovers. All outstanding principal and accrued but unpaid interest is due in full at the maturity of the line of credit.

Each line of credit agreement expires on September 21, 2014 and is subject to covenants customary to this type of transaction, including a default provision in the event that the University's long-term bond ratings were lowered to below a BBB- for S&P, BBB- for Fitch, and Baa3 for Moody's. At June 30, 2012, no purchase drawings had been made under the line of credit.

D. Capital Appreciation Bonds - The University's Series 1997 Utility System and the Series 1991 U.S. Environmental Protection Agency

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Project bond issues include capital appreciation bonds with an original issue amount of \$30,379,142 and \$3,828,921, respectively. These bonds are recorded in the amounts of \$66,513,366 (\$84,135,000 ultimate maturity less \$17,621,634 discount) and \$10,935,422 (\$25,275,000 ultimate maturity less \$1,694,578 accreted principal less \$12,645,000 principal paid), respectively, which is the accreted value at June 30, 2012. These bonds mature in the years from 2013 to 2021.

E. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2012, are as follows:

Fiscal Year	Annual Requirements				
	Revenue Bonds Payable			Notes Payable	
	Principal	Interest	Interest Rate Swaps, Net*	Principal	Interest
2013	\$ 29,690,000	\$ 50,735,353	\$ 2,379,799	\$ 961,717	\$ 1,956,648
2014	28,695,000	50,199,036	2,194,363	\$577,951	1,922,785
2015	29,405,000	49,634,737	2,035,575	9,857,520	1,824,714
2016	25,915,000	49,063,658	1,871,355	638,602	1,712,677
2017	26,785,000	48,426,120	1,700,754	671,274	1,680,005
2018 - 2022	136,445,000	232,464,516	5,874,657	33,233,714	7,236,967
2023 - 2027	156,350,000	208,073,990	1,652,398		
2028 - 2032	197,735,000	166,948,981			
2033 - 2037	519,805,000	66,365,515			
2038 - 2042	34,260,000	3,007,745			
Total Requirements	\$ 1,185,085,000	\$ 924,919,651	\$ 17,708,901	\$ 45,940,778	\$ 16,333,796

Interest on the variable rate General Revenue Bonds 2001B is calculated at 0.15% at June 30, 2012.

Interest on the variable rate General Revenue Bonds 2001C is calculated at 0.14% at June 30, 2012.

Interest rates are reset each week by the remarketing agent based upon a combination of the University's credit rating and market conditions.

This schedule also includes the debt service requirements for debt associated with interest rate swaps. More detailed information about interest rate swaps is presented in Note 9 Derivative Instruments.

**Computed using $(5.24\% - 0.180\%) \times (\$22,000,000 - \text{annual swap reduction})$ and $(3.314\% - 0.165\%) \times \$45,070,000$ notional amount.*

The fiscal year 2013 principal requirements include demand bond principal payments due for 2013 only.

This differs from the amount disclosed as current in Note 8A Changes in Long-Term Liabilities as the current portion of bonds payable includes all outstanding principal for the demand bonds.

See Note 8C Demand Bonds.

F. 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	Beginning Balance July 1, 2011	Draws	Repayments	Principal Outstanding June 30, 2012
Real Property Purchases	Bank of America	1.616%	12/15/14	\$ 45,750,000	\$ 0	\$ 36,500,000	\$ 9,250,000
Real Property Purchases	Bank of America	1.396%	06/30/13		411,896		411,896
Real Property Purchases	Aviva	5.000%	01/01/22		36,500,000	221,118	36,278,882
Total Notes Payable				\$ 45,750,000	\$ 36,911,896	\$ 36,721,118	\$ 45,940,778

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The UNC-Chapel Hill Foundation, part of the University's reporting entity, has a line of credit agreement issued by Bank of America, previously in the principal amount of up to \$6,000,000, to finance the costs of projects benefiting the Foundation and/or the University. The line of credit had a maturity date of June 30, 2011. Prior to stated maturity, Bank of America extended the maturity date to September 30, 2011 to allow for documents to be restated and amended and to reduce the commitment amount, at the request of the Foundation, from \$6,000,000 to \$3,000,000. The Foundation has since executed the renewal of the line of credit in the amount of \$3,000,000 that carries the new maturity date to June 30, 2013. Under the new commitment, advances under the line of credit accrue interest at the variable rate of the London Interbank Offered Rate (LIBOR) Market Index plus 1.15%. An unused commitment fee is due each quarter calculated as 0.24% of the difference between the commitment amount and the average balance outstanding for the quarter and paid in arrears on a quarterly basis. If the Foundation utilizes the line of credit to purchase an asset on behalf of the University, and later sells such asset to the University, the University reimburses the Foundation the principal amount of the draw and all accrued interest and associated transaction expenses.

On July 1, 2009, the UNC Chapel Hill Foundation, Inc. and Chapel Hill Foundation Real Estate Holdings Inc., (collectively, the Borrowers; individually, the Foundation, former, or Real Estate Holdings, the latter), entered into a loan agreement with the Bank of America, N.A. for \$45,750,000 to fund the acquisition of student housing and rental real property.

On December 15, 2011, Real Estate Holdings transferred the condominiumized unit of Granville Towers to a newly established single asset limited liability corporation Granville Towers LLC of which Real Estate Holdings is the sole member. On the same date, Granville Towers LLC obtained a loan from Aviva Life and Annuity Company in the amount of \$36,500,000 (Aviva Loan) for which the proceeds were used to pay down the referenced purchase financing with Bank of America in the original amount of \$45,750,000. This Aviva loan is secured by a first deed of trust on the condominium unit of Granville Towers. In general, the loan is non-recourse to both Real Estate Holdings and the Foundation, except for in the following instances: fraud, misrepresentation; delinquent taxes or other assessments; misapplication of potential condemnation awards or loss between the difference in the loan amount and insurance proceeds; environmental issue on the property; and a bankruptcy filing. Loan payments are based upon a 30-year amortization, but the loan carries an actual maturity date of January 1, 2022. During the committed term of this loan, the interest rate is fixed at 5%, and the monthly payments of principal and interest in the combined amount of

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$195,939.89; all outstanding principal and accrued but unpaid interest is due at said maturity.

On December 15, 2011, the Borrowers executed a modification agreement with Bank of America with respect to the above loan in the original amount of \$45,750,000. The original principal balance of \$45,750,000 was paid down by \$36,500,000 with proceeds from the Aviva loan; the original maturity date of July 1, 2012, was extended to December 15, 2014; and the interest rate was changed to LIBOR plus 1.37%. Interest payments are made quarterly, and the principal balance of the loan is due at maturity. The loan is unsecured, but is governed by a loan agreement with financial and other covenants on the Borrowers.

G. Annuities Payable - The University participates in split-interest agreements with donors that require benefits payments for a specified period to a designated beneficiary out of assets held in trust for this purpose. At the end of the predetermined period (e.g., the lifetime of the beneficiary specified by the donor), the remaining assets of the trust revert to the University for its use or for a purpose specified by the donor. At the end of each fiscal year, annuities and life income payable to the beneficiaries is calculated using IRS issued 90CM table, taking into consideration beneficiary's age and the amount of the gift, and using IRS issued Life Table 90CM.

NOTE 9 - DERIVATIVE INSTRUMENTS

Derivative instruments held at June 30, 2012 are as follows:

Type	Notional Amount	Change in Fair Value		Fair Value at June 30, 2012	
		Classification	Increase (Decrease)	Classification	Asset (Liability)
Hedging Derivative Instruments					
<i>Cash Flow Hedges</i>					
Pay-Fixed Interest Rate Swap	\$ 100,000,000	Deferred outflow of resources	\$ (22,400,279)	Hedging derivative liability	\$ (33,851,212)
Pay-Fixed Interest Rate Swap	150,000,000	Deferred outflow of resources	(89,043,762)	Hedging derivative liability	(89,043,762)
			<u>\$ (111,444,041)</u>		<u>\$ (122,894,974)</u>
Investment Derivative Instruments					
Pay-Fixed Interest Rate Swap 2001B Bonds	\$ 19,370,000	Investment Income	\$ (1,504,704)	Accounts Payable	\$ (5,585,915)
Forward Foreign Currency		Investment Income	(1,127,704)	Accounts Payable	(1,127,704)
			<u>\$ (2,632,408)</u>		<u>\$ (6,713,619)</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Hedging derivative instruments held at June 30, 2012 are as follows:

Type	Objective	Notional Amount	Effective Start Date	Termination End Date	Terms
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash Flows on Variable Rate Debt	\$ 100,000,000	12/01/07	12/01/36	Pay 3.314%, Receive 67% 1 Mo. LIBOR
Pay-Fixed Interest Rate Swap	Hedge Changes in Cash Flows on Variable Rate Debt	150,000,000	12/01/11	12/01/41	Pay 4.375%, Receive 67% 1 Mo. LIBOR

The fair values of interest rate swaps at the University were provided either by their financial advisor or by the counterparty. The method used by their financial advisor calculated the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments were then discounted using the spot rates implied by the current yield curve for LIBOR due on the date of each future net settlement on the swap. The method used by their counterparty calculated the present value of all expected future payments on the swap based on forward curves discounted at current market rates.

The Lehman Brothers Special Financing, Inc. interest rate swap is reported as an investment derivative due to Lehman's bankruptcy filing in 2009. The swap was not assigned to another counterparty. Management determined that no restatement of beginning balances was necessary based on the minimal fair value.

Hedging Derivative Risks

Credit risk: As of June 30, 2012, the University was not exposed to credit risk on its interest rate swaps because the swaps had negative fair values. However, should interest rates change and the fair value of swaps become positive, the University would be exposed to the credit risk of counterparties in the amount of the derivative's positive fair value less collateral postings by such counterparties.

Interest rate risk: The University is exposed to interest rate risk on its interest rate swaps which is largely offset (or expected to be offset) by rates paid on variable-rate debt. In addition, the fair values of these instruments are highly sensitive to changes in interest rates. Because rates have declined significantly since the effective dates of the swaps, both of the swaps have a negative fair value as of June 30, 2012. The fair values are calculated as of June 30, 2012. As rates rise, the value of the swaps will increase, and as rates fall the fair value of the swaps will decrease.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Basis risk: The University is exposed to basis risk on the swaps to the extent there is a mismatch between variable bond rates paid and swap index rates received.

Termination risk: The swap agreements use the International Swaps and Derivatives Association (ISDA) Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. Termination could result in the University being required to make an unanticipated termination payment. The swaps may mandatorily terminate if the University fails to perform under terms of the contract.

Rollover risk: The University is exposed to rollover risk on the \$100,000,000 swap based upon the maturity date of the underlying debt and due to the form of the debt as variable rate demand bonds.

Investment Derivative Risks

Credit Risk: As of June 30, 2012, the University was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the University would be exposed to credit risk in the amount of the derivative's positive fair value. Should the swap have a positive fair value of more than \$1,000,000, at that point the counterparty would be required to collateralize 103% of their exposure.

The University does not have a formal policy regarding requiring collateral or other security to support investment derivative instruments subject to credit risk.

Interest Rate Risk: The University is exposed to interest rate risk on its interest rate swap. The fair value of this instrument is highly sensitive to interest rate changes. Because rates have changed since the effective date of the swap, the swap has a negative fair value of \$5,585,915 as of June 30, 2012. The negative fair value may be countered by a reduction in total interest payments required under the variable-rate bonds, creating lower synthetic interest rates. Because the coupons on the University's variable-rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value increases. The negative fair value is the calculated value as of June 30, 2012. As the yield curve rises, the value of the swap will increase and as rates fall, the value of the swap decreases. The University pays 5.24% and receives the Securities Industry and Financial Markets Association (SIFMA) Swaps Index rate. On June 30, 2012, SIFMA was 0.18%. The interest rate swap has a notional amount of \$19,370,000 and matures November 1, 2025.

Foreign Currency Risk: Foreign currency forward contracts are utilized from time to time to minimize the risk and exposure to fluctuations in the exchange rates of foreign currencies. See the University's Deposits and Investments

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Note for further information about the University's exposure to foreign currency risk.

NOTE 10 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations for machinery and equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2012:

<u>Fiscal Year</u>	<u>Amount</u>
2013	\$ 55,911
Total Minimum Lease Payments	55,911
Amount Representing Interest (2.544% - 13.066% Rate of Interest)	1,537
Present Value of Future Lease Payments	\$ 54,374

Machinery and equipment acquired under capital lease amounted to \$493,270 at June 30, 2012. Depreciation for the capital assets associated with capital leases is included in depreciation expense.

B. Operating Lease Obligations - Future minimum lease payments under noncancelable operating leases for equipment, building, and land consist of the following at June 30, 2012:

<u>Fiscal Year</u>	<u>Amount</u>
2013	\$ 4,387,719
2014	1,404,590
2015	1,033,562
2016	149,558
Total Minimum Lease Payments	\$ 6,975,429

Rental expense for all operating leases during the year was \$21,902,484.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - REVENUES

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

	<u>Gross Revenues</u>	<u>Internal Sales Eliminations</u>	<u>Less Scholarship Discounts</u>	<u>Less Allowance for Uncollectibles</u>	<u>Less Indigent Care and Contractual Adjustments</u>	<u>Net Revenues</u>
Operating Revenues						
Student Tuition and Fees	\$ 398,365,598	\$ 0	\$ 75,670,001	\$ 2,160,255	\$ 0	\$ 320,535,342
Patient Services	\$ 728,946,789	\$ 0	\$ 0	\$ 454,975	\$ 447,820,897	\$ 280,670,917
Sales and Services:						
Professional Income	\$ 118,303,224	\$ 6,236,824	\$ 0	\$ 0	\$ 0	\$ 112,066,400
Residential Life	75,524,271	35,075	9,530,946			65,958,250
Athletic	54,661,030	32,231				54,628,799
Dining	30,946,446					30,946,446
Utilities	126,188,467	97,121,896				29,066,571
Student Stores	29,621,528	2,483,594	882,944			26,254,990
Parking	23,379,177	1,462				23,377,715
Health, Physical Education, and Recreation Services	8,233,968	500	249,212			7,984,256
Other	42,536,989	35,084,565				7,452,424
UNC Management Company	7,294,509	6,148				7,288,361
Trademark License Program	6,743,727					6,743,727
School of Government	5,517,327					5,517,327
Rental Property	4,199,347					4,199,347
Telecommunications	17,274,356	13,387,679				3,886,677
Doubletree Carolina Inn	2,815,399					2,815,399
KFBS Center	2,536,507					2,536,507
Printing/Carolina Copy	5,124,180	2,838,511				2,285,669
Repairs & Maintenance	26,550,280	24,900,697				1,649,583
Gene Therapy Center	1,645,839					1,645,839
Performing Arts Series	1,505,573					1,505,573
ERP Student Fees	1,412,138					1,412,138
Carolina Living & Learning Center	1,000,980					1,000,980
Student Union Services	402,396	179,607				222,789
Materials Management and Disbursements	3,334,212	3,300,430				33,782
Total Sales and Services	\$ 596,751,870	\$ 185,609,219	\$ 10,663,102	\$ 0	\$ 0	\$ 400,479,549
Nonoperating - Noncapital Gifts	\$ 99,343,701	\$ 0	\$ 0	\$ (101,946)	\$ 0	\$ 99,445,647

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 12 - 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 and Amortization	Total
Instruction	\$ 510,259,628	\$ 25,366,562	\$ 147,110,443	\$ 0	\$ 119,985	\$ 0	\$ 682,856,618
Research	275,691,974	48,277,216	147,631,090		501,288		472,101,568
Public Service	61,647,096	6,512,799	54,644,509		184,340		122,988,744
Academic Support	70,344,874	13,511,489	27,700,139		163,038		111,719,540
Student Services	14,271,620	689,534	11,030,849		450		25,992,453
Institutional Support	60,606,390	2,201,387	21,551,862		40,838		84,400,477
Operations and							
Maintenance of Plant	41,525,546	10,133,501	18,673,937		70,084,143		140,417,127
Student Financial Aid				96,870,511			96,870,511
Auxiliary Enterprises	341,410,859	58,206,850	189,246,629		9,737,483		598,601,821
Depreciation and Amortization						113,529,873	113,529,873
Total Operating Expenses	\$ 1,375,757,987	\$ 164,899,338	\$ 617,589,458	\$ 96,870,511	\$ 80,831,565	\$ 113,529,873	\$ 2,449,478,732

NOTE 13 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2012, these rates were set at 7.44% of covered payroll for employers and 6% of covered payroll for members.

For the current fiscal year, the University had a total payroll of \$1,160,701,233, of which \$456,662,258 was covered under the Teachers' and State Employees' Retirement System. Total employer and employee contributions for pension benefits for the year were \$33,975,672 and \$27,399,735, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Required employer contribution rates for the years ended June 30, 2011, and 2010, were 4.93% and 3.57%, respectively, while employee contributions were 6% each year. The University made 100% of its annual required contributions for the years ended June 30, 2012, 2011, and 2010, which were \$33,975,672, \$23,308,729, and \$16,632,618, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the state of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports" or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

The Optional Retirement Program (Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant's death. Administrators and eligible faculty of the University may join the Program instead of the Teachers' and State Employees' Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program and designates the companies authorized to offer investment products or the trustee responsible for the investment of contributions under the Program and approves the form and contents of the contracts and trust agreements.

Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

Participant eligibility and contributory requirements are established by General Statute 135-5.1. Employer and member contribution rates are set each year by the North Carolina General Assembly. For the year ended June 30, 2012, 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 \$1,160,701,233 of which \$483,887,307 was covered under the Optional Retirement Program. Total employer and employee contributions for pension benefits for the year were \$33,097,892 and \$29,033,238, respectively.

- B. Deferred Compensation and Supplemental Retirement Income Plans** - Internal Revenue Code Section 457 Plan - The state of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. The plan administrator is Prudential Financial, Inc. No costs are incurred by the University. The voluntary contributions by employees amounted to \$8,884,339 for the year ended June 30, 2012.

Internal Revenue Code Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the University except for a 5% employer contribution for the University's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of University law enforcement officers for the year ended June 30, 2012, were \$125,130. The voluntary contributions by employees amounted to \$3,601,213 for the year ended June 30, 2012.

Internal Revenue Code Section 403(b) and 403(b)(7) Plans - Eligible University employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and state income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. The plan administrators are Fidelity Investments and TIAA-CREF. No costs are incurred by the University. The voluntary contributions by employees amounted to \$24,352,285 for the year ended June 30, 2012.

NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Benefits** - The University participates in the Comprehensive Major Medical Plan (the Plan), a cost-sharing, multi-employer defined

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 or the Optional Retirement Program. 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 the State Treasurer and the Board of Trustees of the State Health Plan for Teachers and State Employees as authorized by Chapter 135, Article 3B, of the General Statutes. 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 the Teachers' and State Employees' Retirement System 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 determined by the State Treasurer and the Board of Trustees of the State Health Plan for Teachers and State Employees.

For the current fiscal year the University contributed 5.0% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the Fund. Required contribution rates for the years ended June 30, 2011, and 2010, were 4.9% and 4.5%, respectively. The University made 100% of its annual required contributions to the Plan for the years ended June 30, 2012, 2011, and 2010, which were \$47,027,478, \$46,527,281, and \$41,953,228, respectively. The University assumes no liability for retiree health care benefits provided by the programs other than its required contribution.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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 the Teachers' and State Employees' Retirement System and the Optional Retirement Program. 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, 2012, the University made a statutory contribution of 0.52% of covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program to the DIPNC. Required contribution rates for the years ended June 30, 2011 and 2010, were 0.52% and 0.52%, respectively. The University made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2012, 2011, and 2010, which were \$4,890,858, \$4,937,589, and \$4,847,929 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 15 - 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. Settled claims have not exceeded coverage in any of the past three fiscal years.

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 per employee through a contract with a private insurance company. The University pays the premium, based on a composite rate, directly to the private insurer.

UNC Investment Fund, LLC (blended component unit) Liability Insurance - The UNC Investment Fund, LLC (UNC Investment Fund) is exposed to various risks of loss related to torts, theft of assets, and errors and omissions. The UNC Management Company, Inc. (Management Company) is a separate legal entity from The University of North Carolina System and the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

University. However, the Management Company's employees conduct UNC Investment Fund's affairs. Therefore, exposures to loss are handled by the purchase of commercial insurance by the Management Company. This insurance is independent of the risk management programs of The University of North Carolina System and the University.

Fire and Other Property Loss - The University is required to maintain fire and lightning coverage on all state-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the state. Such coverage is provided at no cost to 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. The University has opted to purchase additional coverages offered by the Fund. Examples of this additional coverage include special form (all-risk) and business interruption insurance for certain property exposures. Losses covered by the Fund are subject to a \$5,000 per occurrence deductible.

Automobile Liability Insurance - All state-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses 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.

Employee and Computer Fraud - The University is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. Universities are charged a premium by the private insurance company. Coverage limit is \$5,000,000 per occurrence. The private insurance company pays 90% of each loss less a \$75,000 deductible.

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

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

and compensation in accordance with the North Carolina Workers' Compensation Act. The University retains the risk for workers' compensation.

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

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

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

The Trust Fund is governed by the Liability Insurance Trust Fund Council (the Council). The Council consists of 13 members as follows: one member each appointed by the State Attorney General, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and nine members appointed by the UNC System's Board of Governors.

The Trust Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation, and other factors. Participant assessments are determined at a level to fund claim liabilities, discounted for future investment earnings.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Each participant is required by statute to maintain a fund balance of \$100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

For the period July 1, 2011 through June 30, 2012, the Trust Fund provided coverage on an occurrence basis of \$3,000,000 per individual and \$7,000,000 in the aggregate per claim. Effective July 1, 2006, in lieu of purchasing commercial reinsurance, participants contributed approximately \$10,000,000 to a reimbursement fund for future losses. Prior to July 1, 2006, the Trust Fund entered into an excess of loss agreement with an unaffiliated reinsurer.

For the fiscal year ending June 30, 2012, the Trust Fund purchased a direct insurance policy to cover the first \$1,000,000 per occurrence and \$3,000,000 in the aggregate for dental residents. *North Carolina General Statutes* Chapter 116 was amended during 1987 to authorize the Trust Fund to borrow necessary amounts up to \$30,000,000, in the event that the Trust Fund may have insufficient funds to pay existing and future claims. Any such borrowing would be repaid from the assets and revenues of program participants. No line of credit or borrowing has been established pursuant to this authorization. The Council believes adequate funds are on deposit in the Trust Fund to meet estimated losses based upon the results of the independent actuary's report.

The Trust Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs.

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

At June 30, 2012, University assets in the Trust Fund totaled \$33,136,477 while University liabilities totaled \$26,201,049 resulting in net assets of \$6,935,428.

Additional disclosures about the funding status and obligations of the Trust Fund are set forth in the Audited Financial Statements of the Liability Insurance Trust Fund. Copies of this report may be obtained from The University of North Carolina Health Care System, 211 Friday Center Drive, Hedrick Building, Room 2029, Chapel Hill, NC 27517.

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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

NOTE 16 - COMMITMENTS AND CONTINGENCIES

- A. Commitments** - The University has commitments of \$150,758,351 for various capital improvements projects that include construction and completion of new buildings, and renovations of existing buildings.

The UNC Investment Fund, LLC (UNC Investment Fund) has entered into agreements with limited partnerships to invest capital. These agreements represent the funding of capital over a designated period of time and are subject to adjustments. As of June 30, 2012, the UNC Investment Fund had approximately \$568,403,038 unfunded committed capital.

- B. Pending Litigation and Claims** - The University is undertaking environmental remediation efforts on the Old Sanitary Landfill. The amount of the liability associated with this site cannot reasonably be estimated at this time.

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

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

<u>Purpose</u>	<u>Amount</u>
Pledges to permanent endowments	<u>\$ 23,880,692</u>

NOTE 17 - RELATED PARTIES

There are 14 separately incorporated nonprofit foundations associated with the University. These foundations are the Botanical Garden Foundation, Inc., The

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Dental Alumni Association, Inc., The Dental Foundation of North Carolina, Inc., The Educational Foundation, Inc., The General Alumni Association, The School of Government Foundation, Inc., The Morehead-Cain Scholarship Fund, The Pharmacy Foundation of North Carolina, Inc., The School of Journalism and Mass Communication Foundation of North Carolina, Inc., The University of North Carolina at Chapel Hill Public Health Foundation, Inc., The University of North Carolina at Chapel Hill School of Nursing Foundation, Inc., The School of Social Work Foundation, Inc., James B. Hunt, Jr. Institute for Educational Leadership and Policy Foundation, Inc. and Carolina for Kibera, Inc. Some of these organizations serve, in conjunction with the University's component units (See Note 1A), 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 alumni associations provide educational opportunities or other services to alumni. The University's financial statements do not include the assets, liabilities, net assets, or operational transactions of these organizations, except for support from each organization to the University. This support totaled \$26,003,801 for the year ended June 30, 2012.

NOTE 18 - INVESTMENT IN JOINT VENTURE

The University is a member of the Southern Observatory for Astronomical Research Consortium (SOAR), a joint venture accounted for under the equity method. The University is partners with Michigan State University, the Association of Universities for Research in Astronomy, and the Ministry of Science and Technology of the Federal Republic of Brazil. SOAR designed, constructed, and now operates a 4.0-meter telescope with instrumentation and related support buildings located at Cerro Pachon, a mountain in central Chile. The SOAR agreement allocates the University 16.7% of observing time until 2023. The audited financial statements for SOAR may be obtained from the University Controller's Office, Campus Box 1270, Chapel Hill, NC 27599-1270, or by calling (919) 962-1370.

NOTE 19 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2012, the University implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*.

GASB Statement No. 64 sets forth criteria used to establish when an effective hedging relationship continues and hedge accounting should continue to be

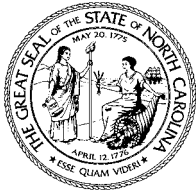
NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

applied when the swap counterparty or a swap counterparty's credit support provider has been replaced.

NOTE 20 - SUBSEQUENT EVENTS

On July 10, 2012 the Board of Governors of the University of North Carolina System issued \$127,095,000 in Series 2012C taxable fixed rate bonds. These bonds will bear interest from that date. Interest on the bonds will be payable semiannually on each December 1 and June 1, commencing on December 1, 2012. The bonds will mature from December 1, 2013 to December 1, 2033 and were issued at coupon rates ranging from 0.35% to 3.596%. The bonds were issued to provide for the refunding of all the outstanding principal amount of the outstanding General Revenue Bonds, Series 2001A and the advance refunding of the General Revenue Bonds, Series 2003.

On July 18, 2012 the Board of Governors of the University of North Carolina System issued \$100,000,000 in Series 2012A and \$100,000,000 in Series 2012B tax-exempt floating rate notes. The bonds will bear interest from that date. Interest on the bonds will be payable on the first business day of each month, commencing on August 1, 2012. The stated maturity date of the Series 2012A and Series 2012B Bonds is December 1, 2041. However, the Series 2012A Bond has an index tender date of December 1, 2015 and the Series 2012B Bond has an index tender date of December 1, 2017. The bonds were issued to provide funds for future capital projects and refunding of outstanding commercial paper.



Beth A. Wood, CPA
State Auditor

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

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

We have audited the financial statements of The University of North Carolina at Chapel Hill, 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 units, as of and for the year ended June 30, 2012, which collectively comprise the University's basic financial statements and have issued our report thereon dated December 3, 2012. Our report includes a reference to other auditors.

As discussed in Note 19 to the financial statements, the University implemented Governmental Accounting Standards Board Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, during the year ended June 30, 2012.

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. Other auditors audited the financial statements of the UNC Investment Fund, LLC and the discretely presented component units, as described in our report on the University's financial statements. The financial statements of UNC Investment Fund, LLC and the discretely presented component units were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

The University's management is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

**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 (CONCLUDED)**

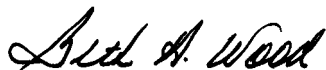
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

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

This report is intended solely for the information and use of management of the University, the Board of Governors, the Board of Trustees, the Budget, Finance, and Audit Committee, others within the entity, the Governor, the General Assembly, and the State Controller, and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA
State Auditor

December 3, 2012

ORDERING INFORMATION

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

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

Telephone: 919/807-7500

Facsimile: 919/807-7647

This audit required 1,651.5 audit hours at an approximate cost of \$118,908. The cost represents less than 0.0001% of the University's total assets and less than 0.0001% of the University's total expenses subjected to audit.