STATE OF
NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

NORTH CAROLINA STATE PORTS AUTHORITY

WILMINGTON, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2003

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

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FOR THE YEAR ENDED JUNE 30, 2003

STATE OF NORTH CAROLINA
Office of the State Auditor

Ralph Campbell, Jr.
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Directors, North Carolina State Ports Authority

This report presents the results of our financial statement audit of the North Carolina State Ports Authority, a component unit of the State of North Carolina, for the year ended June 30, 2003. Our audit was made by authority of Article 5A of Chapter 147 of the General Statutes.

The accounts and operations of the Authority are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report* (CAFR) and the State's *Single Audit Report*. In those reports, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the audit results on the State's internal controls and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs.

As part of the audit work necessary for the CAFR and the *Single Audit Report*, the accounts and operations of the Authority were subjected to audit procedures as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to the North Carolina State Ports Authority. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is to present the results of our audit on the accompanying financial statements that relate solely to North Carolina State Ports Authority. A summary of our reporting objectives and audit results is:

1. **Objective –** To express an opinion on the accompanying financial statements that relate solely to North Carolina State Ports Authority.

   Results - The accompanying financial statements present fairly, in all material respects, the amounts and disclosures made in accordance with accounting principles generally accepted in the United States of America. These matters are more fully described in the Independent Auditor's Report on the Financial Statements.

2. **Objective –** To present significant deficiencies, if any, in internal control over financial reporting which could adversely affect the Authority's ability to record, process, summarize, and report financial data in the financial statements and present instances of noncompliance, if any, with laws, regulations, contracts, or grants.

   Results - Our tests disclosed no material weaknesses in internal control over financial reporting and no instances of noncompliance which require disclosure herein under *Government Auditing Standards*. These matters are more fully described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting.

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.

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Mr. Erik Stromberg, Executive Director
North Carolina State Ports Authority
Wilmington, North Carolina

We have audited the accompanying basic financial statements of the North Carolina State Ports Authority (the Authority), a component unit of the State of North Carolina, as of and for the year ended June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina State Ports Authority as of June 30, 2003, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 12, 2003 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

September 12, 2003

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Overview of the Financial Statements and Financial Analysis

This discussion and analysis (MD&A) provides an overview of the Authority's financial activities during the fiscal years ending June 30, 2003 and 2002, respectfully. Management, in addition to this analysis, is responsible for the preparation of the accompanying financial statements. The basic financial statements here include a Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows, plus Notes to the Financial Statements.

The MD&A is intended to aid the reader in interpreting the Authority's relative financial position as of the above referenced dates as well as gauging performance from one period to the next. Condensed key financial as well as nonfinancial information will be highlighted for the reader followed by a discussion of the Authority's current capital expansion program and economic outlook.

Financial Highlights and Analysis

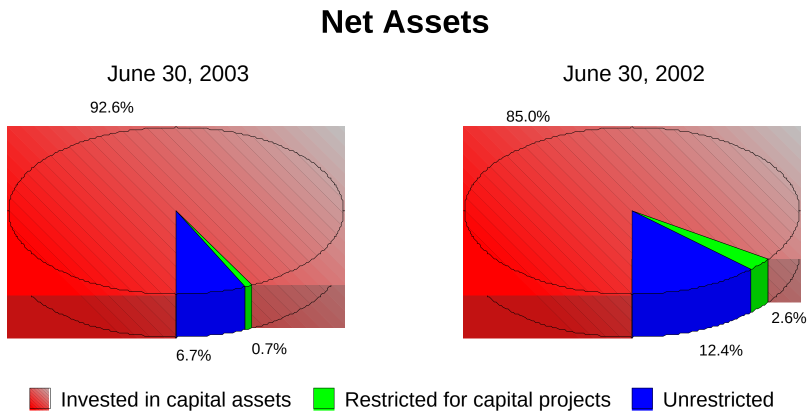
Taken in whole the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets and Statement of Cash Flows are one measure of an organization's overall financial health and value. Individually, the Statement of Net Assets is a static view of financial value while the other two depicts the movement of key elements from one view to the next, with a specific focus on the organization's net assets and cash and cash equivalents.

A comparison of net assets as of June 30, 2003 to that of the prior year yields several significant changes. The reduction in current assets and the increase in capital assets relate to the Authority's on-going capital investment (CapEx) program, which will be discussed later in this analysis. The reduction in total net assets relate to the loss incurred by the Authority during the current year. The following table summarizes the major categories of net assets and their corresponding changes.

Condensed Statement of Net Assets

	June 30, 2003	June 30, 2002	Change	% Change
Current Assets	$ 13,006,561	$ 24,952,319	$ (11,945,758)	-47.9%
Capital Assets	153,712,530	146,668,573	7,043,957	4.8%
Other Noncurrent Assets	1,178,551	3,185,560	(2,007,009)	-63.0%
Total Assets	167,897,642	174,806,452	(6,908,810)	-4.0%
Current Liabilities	3,932,537	5,603,381	(1,670,844)	-29.8%
Noncurrent Liabilities	19,216,157	20,122,300	(906,143)	-4.5%
Total Liabilities	23,148,694	25,725,681	(2,576,987)	-10.0%
Net Assets	$ 144,748,948	$ 149,080,771	$ (4,331,823)	-2.9%

The Authority's net assets are divided into three major categories. The first, invested in capital assets, net of related debt represents the Authority's equity position with regards to property, facilities and equipment. The second category is restricted to expenditure for capital assets and related debt. The final category is that of unrestricted which is available for any lawful purpose of the Authority. The following charts analyze the Authority's net asset category mix for the periods ending June 30, 2003 and 2002, respectfully. Significant changes again related to CapEx and the current period net operating loss.



The Statement of Revenues, Expenses, and Changes in Net Assets reflects an overall decrease in net assets for the current fiscal year ending June 30, 2003. This decease relates predominantly to operating activities and the decline of earnings on the Authority's investment reserves. The following table identifies variances between major financial categories for the fiscal years ending June 30, 2003 and 2002, respectfully.

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

	June 30, 2003	June 30, 2002	Change	% Change
Operating Revenues	$ 26,922,543	$ 26,277,109	$ 645,434	2.5%
Operating Expenses	31,731,105	30,091,835	1,639,270	5.4%
Operating Loss	(4,808,562)	(3,814,726)	(993,836)	
Nonoperating Revenues (Expenses)	476,739	886,406	(409,667)	-46.2%
Decrease in Net Assets	$ (4,331,823)	$ (2,928,320)	$ (1,403,503)	47.9%

Increases in operating expenses are attributable to an increase in depreciation expense associated with the Authority's CapEx program and an increase in outside services employed by the Authority. Additionally, during the year the Authority assumed the operations of the former North Carolina Ports Railway Commission (NCPRC), which was abolished effective July 1, 2003. This accounts for an approximate $500,000 increase in operating expenses. Operating revenues posted a modest increase over that of the prior year with approximately half of the additional revenues derived from the assumption of the NCPRC and the other from increase marine terminal activity. The following table analyzes several nonfinancial measures relating to marine activities.

Summarized Cargo Movement

	June 30, 2003	June 30, 2002	Change	% Change
Container Movement	56,293	51,972	4,321	8.3%
Short Tonnage Movement	3,147,070	3,000,241	146,829	4.9%
Vessel Call	786	782	4	0.5%
Rail Car Activity	9,148	7,969	1,179	14.8%

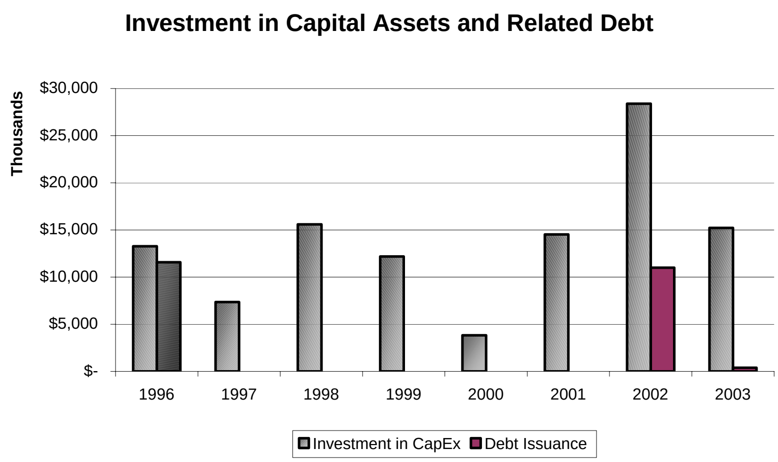
The Authority's overall liquidity position declined during the fiscal year ending June 30, 2003, with a decrease to cash and cash equivalents of approximately $1.5 million. This compares to a reduction of $4.6 million for the prior year. The current year decline, in general, relates to significant capital asset acquisitions. Typical sources of cash for the Authority are found in results of operations, sale of investment securities and debt issuances. Uses of cash typically are found in the purchase of investment securities and the acquisition of capital assets. During the fiscal year 2003 the Authority generated significant inflows of cash from net security investing activities ($12.2 million) and operating activities ($3.4 million). Significant uses of cash during the same time period included the acquisition of capital assets ($17.2 million) and retirement of debt ($0.9 million). The following table summarizes cash flow activities for the fiscal years ending June 30, 2003 and 2002 respectfully.

Summary Cash Flows

	June 30, 2003	June 30, 2002	Change	% Change
Cash Provided (Used) by:				
Operating Activities	$ 3,409,495	$ 5,961,302	$ (2,551,807)	-42.8%
Noncapital Financing Activities	250,000		250,000	
Capital and Related Financing Activities	(17,391,272)	(17,483,123)	91,851	-0.5%
Investing Activities	12,234,241	6,951,024	5,283,217	76.0%
Net Decrease in Cash and Cash Equivalents	$ (1,497,536)	$ (4,570,797)		

Capital Assets and Long-Term Debt

Beginning late fiscal year 1995 and early 1996 the Authority implemented an aggressive capital investment program. This program was based on a number of motivating factors including the need to address an aging infrastructure system, seek new business development ventures, and explore general growth opportunities. Central to this investment program is the Wilmington Harbor Deepening project, which is funded through a State and Federal matching program. During 2001 the Authority updated its Strategic Plan and began the implementation during 2002. This process guides business development, operations and capital investing priorities during the current fiscal year. It is anticipated that these activities will continue for another 12 month cycle at which point a number of the strategic initiatives will be in place resulting in increased operating revenues. The following graph summarizes recent capital investment and related debt issuance.



Capital investment for the upcoming fiscal year is projected at approximately $13.8 million, which will be funded by a combination of federal grants, debt issuance, and internal reserves.

Economic Outlook

With pressures on its budget, the State of North Carolina's capital contributions have been and will continue to be focused on the nonfederal share of the cost of the Wilmington Harbor Project. As such, the costs of terminal improvements in the next several years will likely have to be borne by the Authority and its private sector partners, placing continual pressure on the Authority's reserves. With the completion of the Harbor Project later in the following fiscal year combined with other strategic business initiatives, operating revenues are expected to increase thus reducing pressures on the Authority's operating results and cash flows. These increases in operating revenues are projected for the fiscal year 2005 with the upcoming year ending June 30, 2004 posting similar results to the current year.

North Carolina State Ports Authority
Statement of Net Assets
June 30, 2003 — *Exhibit A*

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	897,170.10
Restricted Pooled Cash		33,199.00
Restricted Cash and Cash Equivalents		654,427.63
Short-Term Investments		6,000,585.00
Receivables, Net (Note 3)		3,600,422.93
Inventories		1,133,234.21
Prepaid Items		687,522.35
Total Current Assets		13,006,561.22
Noncurrent Assets:		
Restricted Investments		368,990.18
Deferred Charges		809,560.80
Capital Assets - Nondepreciable (Note 4)		37,111,635.13
Capital Assets - Depreciable, Net (Note 4)		116,600,894.53
Total Noncurrent Assets		154,891,080.64
Total Assets		167,897,641.86
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 6)		1,701,698.06
Deferred Revenue		817,566.42
Interest Payable		17,581.74
Long-Term Liabilities - Current Portion (Note 7)		1,395,690.64
Total Current Liabilities		3,932,536.86
Noncurrent Liabilities:		
Long-Term Liabilities (Note 7)		19,216,156.98
Total Noncurrent Liabilities		19,216,156.98
Total Liabilities		23,148,693.84
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		134,035,527.49
Restricted for Expendable Capital Projects		1,056,616.81
Unrestricted		9,656,803.72
Total Net Assets	$	144,748,948.02

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

North Carolina State Ports Authority
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2003 ***Exhibit B***

REVENUES		
Operating Revenues:		
Sales and Services, Net	$	23,244,781.18
Rental and Lease Earnings		3,677,761.63
Total Operating Revenues		26,922,542.81
EXPENSES		
Operating Expenses:		
Personal Services		14,307,911.09
Supplies and Materials		1,614,259.51
Services		5,201,785.57
Depreciation/Amortization		8,473,664.47
Insurance and Bonding		1,086,937.43
Other		1,046,546.68
Total Operating Expenses		31,731,104.75
Operating Loss		(4,808,561.94)
NONOPERATING REVENUES (EXPENSES)		
Investment Earnings		264,068.36
Federal Grants and Contracts		250,000.00
Interest and Fees on Capital Asset-Related Debt		(255,467.05)
Gain on Sale of Property and Equipment		218,137.23
Net Nonoperating Revenues		476,738.54
Decrease in Net Assets		(4,331,823.40)
NET ASSETS		
Net Assets - July 1, 2002 as Restated (Note13)		149,080,771.42
Net Assets - June 30, 2003	$	144,748,948.02

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

North Carolina State Ports Authority
Statement of Cash Flows
For the Year Ended June 30, 2003 ***Exhibit C***

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	27,108,265.66
Payments to Employees and Fringe Benefits		(14,299,614.63)
Payments to Vendors and Suppliers		(8,312,217.96)
Payments for Insurance and Bonding		(1,086,937.43)
Net Cash Provided by Operating Activities		3,409,495.64
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Federal Grants for Other than Capital Purposes		250,000.00
Net Cash Provided by Noncapital Financing Activities		250,000.00
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Proceeds from Capital Debt		382,604.65
Proceeds from Sale of Capital Assets		270,932.02
Acquisition and Construction of Capital Assets		(17,153,891.82)
Principal Paid on Capital Debt and Leases		(643,657.00)
Interest and Fees Paid on Capital Debt and Leases		(247,259.61)
Net Cash Used by Capital Financing and Related Financing Activities		(17,391,271.76)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		41,328,183.14
Investment Income		406,642.36
Purchase of Investments and Related Fees		(29,500,585.00)
Net Cash Provided by Investing Activities		12,234,240.50
Net Decrease in Cash and Cash Equivalents		(1,497,535.62)
Cash and Cash Equivalents - July 1, 2002		3,082,332.35
Cash and Cash Equivalents - June 30, 2003	$	1,584,796.73
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating Loss	$	(4,808,561.94)
Adjustments to Reconcile Operating (Loss) to Net Cash Provided (Used) by Operating Activities:		
Depreciation/Amortization Expense		8,473,664.47
Receivables, Net		508,032.07
Inventories		(5,289.53)
Prepaid Items		(202,864.59)
Accounts Payable and Accrued Liabilities		(755,091.00)
Deferred Revenue		162,690.78
Compensated Absences		36,915.38
Net Cash Provided by Operating Activities	$	3,409,495.64

North Carolina State Ports Authority
Statement of Cash Flows — *Exhibit C*
For the Year Ended June 30, 2003 — *Page 2*

RECONCILIATION OF CASH AND CASH EQUIVALENTS		
Current Assets:		
Cash and Cash Equivalents	$	897,170.10
Restricted Pooled Cash		33,199.00
Restricted Cash and Cash Equivalents		654,427.63
Total Cash and Cash Equivalents - June 30, 2003	$	1,584,796.73
NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES		
Assets Acquired through the Assumption of a Liability	$	382,604.65

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The North Carolina State Ports Authority 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 for which the Authority's Board of Directors is financially accountable.

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). The full scope of the Authority'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 Authority does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

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

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

D. **Cash and Cash Equivalents** - This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, savings accounts, money market accounts, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. **Investments** - This classification includes money market funds, certificates of deposit, and governmental securities. Except for money market funds and certificates of deposit, investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment earnings.

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

F. **Receivables** - Receivables consist of charges to customers for services and use of facilities provided. Receivables are recorded net of estimated uncollectible amounts. All receivables are expected to be collected within one year.

G. **Inventories –** Inventories, consisting of expendable parts and supplies, are valued at the lower of cost or market on a moving weighted average cost basis which approximates cost on a first-in, first-out (FIFO) basis.

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 includes all material direct and indirect construction costs. Interest costs are capitalized during the period of construction.

The Authority capitalizes assets that have a value or cost in excess of $500 at the date of acquisition and an expected useful life of more than one year.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 20 to 50 years for buildings, 50 years for wharves, 10 to 25 years for improvements other than buildings, and 4 to 25 years for machinery and equipment.

I. **Restricted Assets** – Certain other assets are classified as restricted because their use is limited by external parties or statute.

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

Bonds payable are reported net of unamortized premium or discount. The Authority amortizes bond premiums/discounts over the life of the bonds using the straight-line method. Issuance costs are not considered material, and therefore, are expensed.

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

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 Authority has no obligation to pay sick leave upon termination or retirement. However, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

L. **Net Assets –** The Authority's net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt – This represents the Authority'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 – Expendable for Capital Projects – Expendable restricted net assets include resources for which the Authority is legally or contractually obligated to spend the resources in accordance with restrictions imposed by external parties.

Unrestricted Net Assets – Unrestricted net assets include resources derived from sales and services, rental income, sale of surplus property, and interest income.

Restricted and unrestricted resources and the use of those resources are accounted for separately. When both restricted and unrestricted funds are available for expenditure, management determines on a case-by-case basis which funds to expend.

M. **Revenue and Expense Recognition –** The Authority classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues include activities that have characteristics of exchange transactions, such as (1) sales and services and (2) rental and lease earnings. 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 to the Authority, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

NOTE 2 - DEPOSITS AND INVESTMENTS

A. **Deposits -** Unless specifically exempt, the Authority is required by General Statute 147-7 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer.

Deposits include cash and cash equivalents and certificates of deposit totaling $4,083,436.73. At year end, cash on hand was $1,360.00. The Authority's unexpended State appropriation with the State Treasurer's Cash and Investment Pool was $592,504.28. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name. The carrying amount of the Authority's deposits not with the State Treasurer was $990,932.45 and the bank balance was $1,259,986.73. Of the bank balance, $451,252.62 was covered by federal depository insurance and $808,734.11 was uninsured and uncollateralized.

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

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

B. Investments - As outlined in its cash management plan, the Authority is authorized to invest excess funds for the purposes of earning additional income.

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

A summary of the Authority's investments at June 30, 2003 is presented below:

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U.S. Government Securities	$ 0.00	$ 0.00	$ 3,500,585.00	$ 3,500,585.00
Investments Not Categorized:				
Certificates of Deposit				2,500,000.00
Money Market Funds				368,990.18
Total Investments Not Categorized				2,868,990.18
Total Investments				$ 6,369,575.18

Certificates of deposit reported as investments are also a component of the deposits total reported in the deposits section of this note.

Derivative and Similar Transactions - A derivative is a financial instrument created from, or whose value depends on (is derived from), the value of one or more underlying assets, reference rates, or indexes of asset values. These instruments may include forwards, futures, currency and interest rate swaps, options, floaters/inverse floaters and caps/floors/collars. During the year the Authority did not invest in derivative investments but did invest in transactions similar to a derivative instrument. Investment transactions similar to a derivative may include securitized assets, such as mortgage-backed securities and other asset backed securities. As required by accounting principles generally accepted in the United States of America, the nature of derivative or similar transactions entered into by the Authority, and the reasons for entering into those transactions follow:

Mortgage-Backed Securities - The Authority invests in mortgage-backed securities issued by government sponsored enterprises including the Federal Home Loan Mortgage Corporation (FHLMC) and the Federal National Mortgage Association (FNMA). The Authority invests in these securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The values of mortgage-backed securities are generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities may include mortgage pass-through securities and collateralized mortgage obligations (CMOs). Mortgage pass-through securities pay the holder of the security the principal and interest amounts received from the underlying pool of mortgages as these amounts are collected from the mortgage holders. In a CMO, the cash flows from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple security classes with different priority claims and payment streams (commonly referred to as tranches). A holder of the CMO security thus chooses the class of security that best meet its risk and return objectives. Both pass-through securities and CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets.

The mortgage pass-through securities issued by FNMA and FHLMC are classified by the Authority as U.S. government securities. The FNMA and FHLMC securities are collarterized by underlying pools of mortgages primarily issued by FNMA or FHLMC which guarantee full and timely payment of principal and interest.

The CMOs held by the Authority include mortgage-backed securities also issued by FNMA and FHLMC. In addition, nontraditional mortgage pass-through securities, such "interest-only strips" and "principal-only strips", if held by the Authority, are classified as CMOs. The Authority did not hold any nontraditional pass-through securities during the year.

As of June 30, 2003, the Authority had sold all of its mortgage-backed securities.

NOTE 3 - RECEIVABLES

Receivables at June 30, 2003 were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Accounts	$ 3,587,979.20	$ 5,250.27	$ 3,582,728.93
Investment Earnings	17,694.00		17,694.00
Total Current Receivables	$ 3,605,673.20	$ 5,250.27	$ 3,600,422.93

NOTE 4 - CAPITAL ASSETS

A summary of changes in the capital assets is presented as follows:

	Balance July 1, 2002	Adjustments	Increases	Decreases	Balance June 30, 2003
Capital Assets, Non-Depreciable:					
Land	$ 21,131,782.86	$ (689,816.00)	$ 1,010,524.24	$ 0.00	$ 21,452,491.10
Construction in Progress	23,221,115.58		13,096,938.64	(20,658,910.19)	15,659,144.03
Total Capital Assets, Non-Depreciable	$ 44,352,898.44	$ (689,816.00)	$ 14,107,462.88	$ (20,658,910.19)	$ 37,111,635.13
Capital Assets, Depreciable:					
Buildings	$ 56,783,023.82	$ 689,816.00	$ 11,733,364.98	$ 0.00	$ 69,206,204.80
Machinery and Equipment	42,294,568.51		2,547,555.04	(1,155,272.95)	43,686,850.60
General Infrastructure	118,492,919.56		13,854,098.15		132,347,017.71
Total Capital Assets, Depreciable	$ 217,570,511.89	$ 689,816.00	$ 28,135,018.17	$ (1,155,272.95)	$ 245,240,073.11
Less Accumulated Depreciation/Amortization for:					
Buildings	$ (24,973,321.23)	$ 0.00	$ (2,901,905.53)	$ 0.00	$ (27,875,226.76)
Machinery and Equipment	(27,555,150.23)		(9,155,820.78)	1,041,300.74	(35,669,670.27)
General Infrastructure	(63,745,254.24)		(1,349,027.31)		(65,094,281.55)
Total Accumulated Depreciation	(116,273,725.70)		(13,406,753.62)	1,041,300.74	(128,639,178.58)
Total Capital Assets, Depreciable, Net	101,296,786.19	689,816.00	14,728,264.55	(113,972.21)	116,600,894.53
Capital Assets, Net	$ 145,649,684.63	$ 0.00	$ 28,835,727.43	$ (20,772,882.40)	$ 153,712,529.66

NOTE 5 - FUTURE RENTAL REVENUE

The Authority leases to others certain land areas and facilities. These leases are accounted for as operating leases; revenues are recorded when earned and depreciation is provided, where appropriate, on leased facilities. Minimum future revenues to be received under noncancelable agreements treated as operating leases as of June 30, 2003 are as follows:

Fiscal Year	Amount
2004	$ 1,374,146.96
2005	704,399.67
2006	595,681.40
2007	554,793.68
2008	510,337.64
2009 and thereafter	5,614,199.96
Total Future Rental Revenue	$ 9,353,559.31

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2003 are as follows:

		Amount
Accounts Payable	$	1,601,728.77
Accrued Payroll		99,969.29
Total Accounts Payable and Accrued Liabilities	$	1,701,698.06

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities at June 30, 2003 is presented as follows:

	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Current Portion
Notes Payable	$ 483,054.52	$ 382,604.65	$ 78,657.00	$ 787,002.17	$ 218,429.93
Bonds Payable	19,455,000.00		565,000.00	18,890,000.00	1,115,000.00
Compensated Absences	897,930.07	741,255.54	704,340.16	934,845.45	62,260.71
Total Long-Term Liabilities	$ 20,835,984.59	$ 1,123,860.19	$ 1,347,997.16	$ 20,611,847.62	$ 1,395,690.64

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2003	Principal Outstanding 06/30/2003
Real Estate Acquisition	First Citizens Bank	2.97%	11/2007	$ 746,508.32	$ 326,359.00	$ 420,149.32
Forklift Acquisition	Central Carolina Bank	2.34%	05/2006	235,000.00		235,000.00
Forklift Acquisition	Branch Banking and Trust	2.96%	02/2006	147,604.65	15,751.80	131,852.85
				$ 1,129,112.97	$ 342,110.80	$ 787,002.17

C. Bonds Payable - The Authority was indebted for bonds payable for the purposes shown in the following table:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2003	Principal Outstanding 06/30/2003
Woodchip Exempt Faciltiy						
Construct Woodchip Facility	1995	1.1%-15%	12/01/2015	$ 5,080,000.00	$ 1,590,000.00	$ 3,490,000.00
Docks and Wharves Faciltiy						
Construct Docks and Wharves	1996	1.1%-15%	01/01/2016	6,500,000.00	2,100,000.00	4,400,000.00
Bulk Grain Facility						
Construct Bulk Grain Facility	2001	1.1%-15%	09/01/2022	11,000,000.00		11,000,000.00
Total Bonds Payable (Principal Only)				$ 22,580,000.00	$ 3,690,000.00	$ 18,890,000.00

D. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2003 are as follows:

	Annual Requirements			
	Bonds Payable		Notes Payable	
Fiscal Year	Principal	Interest	Principal	Interest
2004	$ 1,115,000.00	$ 208,508.25	$ 218,429.93	$ 19,135.93
2005	1,115,000.00	196,106.32	222,632.84	13,100.01
2006	1,115,000.00	183,810.72	209,740.91	6,999.15
2007	1,115,000.00	171,515.13	100,406.02	2,685.98
2008	1,115,000.00	159,219.52	35,792.47	243.92
2009-2013	5,775,000.00	610,563.69		
2014-2018	4,790,000.00	288,598.81		
2019 and thereafter	2,750,000.00	91,208.94		
Total Requirements	$ 18,890,000.00	$ 1,909,531.38	$ 787,002.17	$ 42,164.99

Interest on the variable rate Exempt Facility Revenue Bonds, the Dock and Wharves Facility Revenue Bonds, and the Bulk Grain Facility Revenue Bonds is calculated at 1.1% at June 30, 2003.

NOTE 8 - OPERATING LEASE OBLIGATIONS

The Authority entered into operating leases for machinery and equipment and office space. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2003:

Fiscal Year	Amount
2004	$ 10,539.92
2005	158.56
Total Minimum Lease Payments	$ 10,698.48

Rental expense for all operating leases during the year was $102,542.19.

NOTE 9 - PENSION PLANS

A. **Retirement Plans** - Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System.

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

Benefit and contribution provisions for 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, 2003, the General Assembly required no contribution by employers and 6% of covered payroll for members.

For the year ended June 30, 2003, the Authority had a total payroll of $11,529,504.15, of which $11,432,105.24 was covered under the Teachers' and State Employees' Retirement System. Total employee contributions for pension benefits for the year were $685,926.31. No employer contributions were required. The Authority made one hundred percent of its annual required contributions for the years ended June 30, 2002 and 2001, which were $213,916.01 and $596,171.02, respectively.

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

B. Deferred Compensation and Supplemental Retirement Income Plan - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (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. No costs are incurred by the Authority. The voluntary contributions by employees amounted to $63,979.15 for the year ended June 30, 2003.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System 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 Authority except for a 5% employer contribution for the Authority's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of Authority law enforcement officers for the year ended June 30, 2003 were $30,631.22. The voluntary contributions by employees amounted to $96,484.00 for the year ended June 30, 2003.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees - The Authority participates in State-administered programs which provide 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. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The Authority contributed 2.35% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended June 30, 2003, the Authority's total contribution to the Plan was $268,654.47. The Authority assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

B. **Long-Term Disability** - The Authority participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The Authority contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. For the fiscal year ended June 30, 2003, the Authority's total contribution to the DIPNC was $59,446.95. The Authority 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 11 - RISK MANAGEMENT

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to $500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to $11,000,000 via contract with a private insurance company. The Authority pays the premium, based on a composite rate, directly to the private insurer.

The Authority is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. The Authority also purchased through the Fund extended coverage and other property coverage such as limited business interruption for the Bulk Handling Facility. Losses covered by the Fund are subject to a $500 per occurrence deductible except theft losses carry a $1,000 per occurrence deductible.

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

The Authority 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. The Authority is charged a premium by the private insurance company. Coverage limit is $5,000,000 per occurrence and a $50,000 deductible and a 10% participation in each loss above the deductible. Forgery and alteration coverage is limited to $100,000 per occurrence with no deductible.

Other coverage not handled by the North Carolina Department of Insurance is purchased through the State's agent of record.

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

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

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

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

NOTE 12 - COMMITMENTS

At June 30, 2003, the Authority has committed $5,359,422.78 in contractual obligations for the purchase or expansion of facilities and equipment.

NOTE 13 - RESTATEMENT

Effective September 30, 2002, pursuant to Session Laws 2002-126, s. 6.6(d), all of the assets, real and personal, tangible and intangible, and all of the liabilities, including contractual obligations, of the North Carolina Ports Railway Commission were transferred to the North Carolina State Ports Authority. This resulted in a restatement to beginning net assets of $1,673,587.57.

As of July 1, 2002 net assets as previously reported was restated as follows:

	Amount
July 1, 2002 Net Assets as Previously Reported	$ 147,407,183.85
Restatement: Acquisition of North Carolina Ports Railway Commission	1,673,587.57
July 1, 2002 Net Assets as Restated	$ 149,080,771.42

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

Board of Directors
North Carolina State Ports Authority
Wilmington, North Carolina

We have audited the financial statements of the North Carolina State Ports Authority, a component unit of the State of North Carolina, as of and for the year ended June 30, 2003, and have issued our report thereon dated September 12, 2003.

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.

Compliance

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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 that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by

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

employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Audit Committee, management and staff of the Authority, the Governor, the State Controller, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

September 12, 2003

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Mr. James T. Fain, III	Secretary, Department of Commerce
Mr. Erik Stromberg	Chief Executive Officer North Carolina State Ports Authority
Mr. Jeffrey L. Strader	Chief Financial and Information Officer North Carolina State Ports Authority
Mr. J. Richard Futrell, Jr.	Chairman, Board of Directors North Carolina State Ports Authority

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Mr. James D. Johnson	Director, Fiscal Research Division

October 20, 2003

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