

STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF
U.S.S. NORTH CAROLINA BATTLESHIP COMMISSION
WILMINGTON, NORTH CAROLINA
FOR THE YEAR ENDED SEPTEMBER 30, 2002

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

**FINANCIAL STATEMENT AUDIT REPORT OF
U.S.S. NORTH CAROLINA BATTLESHIP COMMISSION**

WILMINGTON, NORTH CAROLINA

FOR THE YEAR ENDED SEPTEMBER 30, 2002

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Ralph Campbell, Jr.
State Auditor

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Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
The U.S.S. North Carolina Battleship Commission

This report presents the results of our financial statement audit of the U.S.S. North Carolina Battleship Commission (the Commission) for the year ended September 30, 2002. Our audit was made by authority of Article 5A of Chapter 147 of the General Statutes.

The accounts and operations of the Commission 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 Commission were subject 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 U.S.S. North Carolina Battleship Commission. 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 the U.S.S. North Carolina Battleship Commission. A summary of our reporting objectives and audit results are:

- 1. Objective** – To express an opinion on the accompanying financial statements.

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.

AUDITOR'S TRANSMITTAL (CONCLUDED)

2. **Objective** – To present significant deficiencies, if any, in internal control over financial reporting which could adversely affect the Commission'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.
State Auditor

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INDEPENDENT AUDITOR'S REPORT

Captain David R. Scheu, Sr., USN (Ret), Director
U.S.S. North Carolina Battleship Commission
Wilmington, North Carolina

We have audited the accompanying basic financial statements of the U.S.S. North Carolina Battleship Commission as of September 30, 2002 as listed in the table of contents. These financial statements are the responsibility of the Commission'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.

As discussed in Note 1, the financial statements of the Commission are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the Commission.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Commission as of September 30, 2002 and the results of its operations and 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 July 10, 2003 on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with a 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.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

The Management's Discussion and Analysis (MD&A) on pages 3 to 5 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.
State Auditor

July 10, 2003

MANAGEMENT'S DISCUSSION AND ANALYSIS

Overview

This discussion and analysis provides an overview of the activities of the U.S.S. North Carolina Battleship Commission during the fiscal year ending September 30, 2002. Management has, in addition to this analysis, prepared the accompanying Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, Statement of Cash Flows, and related note disclosures to detail its operations.

Financial Highlights

The Commission is an enterprise, non-appropriated fund activity of the State of North Carolina that is required by general statute to be self-sufficient for its operations. Funding for the annual operation of the Battleship North Carolina is met primarily from revenues generated through admissions to tour the ship and gift shop sales. Historically, funding for capital projects had come from operating revenue as well. However, deferred over the years were a number of restoration projects, the estimated cost of each in excess of \$1 million. Since addressing those needs was far beyond the ability to fund from operating dollars, in 1998 a capital fundraising campaign for the restoration of the Battleship was successfully undertaken that raised \$6.9 million, split almost evenly between public and private sector sources. A significant portion of the private contributions was pledged over a three to five year period. The first of the major restoration projects was the replacement of the ship's teak decking that was started in 1999. The second major restoration project is the restoration of forward berthing and refurbishment of the wardroom and other main deck spaces that is projected to start in fiscal year 2004. Completion of this second project in late fiscal year 2004 will allow the Commission to embark on an overnight education program for North Carolina scouts in fiscal year 2005 that will create a new revenue stream as well.

For fiscal year 2002, the aftermath of September 11, 2001 did not have an immediate or significant impact on visitation to the Battleship since the Wilmington area is primarily a drive-to rather than fly-to destination. However, the impact of that event extended into fiscal year 2002 with continuing reductions in the stock market and falling interest rates which had a significant impact on revenues.

Financial Analysis

For the fiscal year ending September 30, 2002 visitation of 216,626 was just under 4,000 less than the previous year, however, the Battleship Commission experienced a 5% increase in operating revenues primarily due to an increase in the admission fee schedule that went into effect on September 1, 2001. Overall operating expenses were negatively affected by a North Carolina Department of Transportation request for a payment of \$100,000 in order to start on an extensive project to repair and resurface the visitors parking area that was originally scheduled to commence in fiscal year 2003.

Condensed versions of the Commission's financial statements for the current and previous year are provided in the tables below for comparison.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

TABLE 1. Condensed Statement of Net Assets

	Fiscal Year Ending 2002	Fiscal Year Ending 2001	Difference	% Change
Assets				
Cash and Cash Equivalents	\$ 745,125.72	\$ 1,124,345.33	\$ (379,219.61)	(0.51)
Restricted Cash and Cash Equivalents (Current)	1,577.98	723,920.29	(722,342.31)	(457.76)
Restricted Cash and Cash Equivalents (Noncurrent)	136,967.08		136,967.08	1.00
Investments (Noncurrent)		51,615.19	(51,615.19)	100.00
Restricted Investments	3,076,447.63	2,421,022.33	655,425.30	0.21
Accounts Receivable	2,912.67	2,209.96	702.71	0.24
Pledges Receivable	77,999.33	186,424.33	(108,425.00)	(1.39)
Inventories	189,763.83	171,430.93	18,332.90	0.10
Prepaid Items	86,398.73	87,885.58	(1,486.85)	(0.02)
Total Assets	4,317,192.97	4,768,853.94	(451,660.97)	(0.10)
Capital Assets				
Capital Assets, Net	2,965,748.72	2,956,859.25	8,889.47	0.00
Total Assets	7,282,941.69	7,725,713.19	(442,771.50)	(0.06)
Current Liabilities				
Accounts Payable and Accrued Liabilities	18,415.94	170,505.54	(152,089.60)	(8.26)
Compensated Absences	7,657.10	5,387.20	2,269.90	0.30
Funds Held for Others		62,885.00	(62,885.00)	
Deferred Revenue	3,030.00	1,950.00	1,080.00	0.36
Total Current Liabilities	29,103.04	240,727.74	(211,624.70)	(7.27)
Long Term Liabilities				
Compensated Absences	40,169.89	45,821.96	(5,652.07)	(0.14)
Total Liabilities	69,272.93	286,549.70	(217,276.77)	(3.14)
Net Assets				
Invested in Capital Assets	2,965,748.72	2,956,859.25	8,889.47	0.00
Restricted Expendable	3,214,992.69	3,249,625.15	(34,632.46)	(0.01)
Unrestricted	1,032,927.35	1,232,679.09	(199,751.74)	(0.19)
Total Net Assets	\$ 7,213,668.76	\$ 7,439,163.49	\$ (225,494.73)	(0.03)

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

TABLE 2. Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	Fiscal Year Ending 2002	Fiscal Year Ending 2001	Difference	% Change
Revenues				
Operating Revenues				
Sales and Service	\$ 742,817.65	\$ 717,043.05	\$ 25,774.60	0.03
Fees, Licenses and Fees	1,494,246.90	1,504,121.80	(9,874.90)	(0.01)
Other Operating Revenues	137,455.60	40,463.56	96,992.04	0.71
Total Operating Revenues	<u>2,374,520.15</u>	<u>2,261,628.41</u>	<u>112,891.74</u>	0.05
Nonoperating Revenues				
Investment Earnings (Loss)	(112,608.41)	(302,492.39)	189,883.98	(1.69)
Miscellaneous	27.19		27.19	
Capital Gifts	63,418.01	53,067.34	10,350.67	0.16
Total Nonoperating Revenues	<u>(49,163.21)</u>	<u>(249,425.05)</u>	<u>200,261.84</u>	(4.07)
Total Revenues	<u>2,325,356.94</u>	<u>2,012,203.36</u>	<u>313,153.58</u>	0.13
Expenses				
Total Operating Expenses	2,539,885.84	2,221,735.41	318,150.43	0.13
Total Non-Operating Expenses	0.00	4,576.36	(4,576.36)	1.00
Total Expenses	<u>2,539,885.84</u>	<u>2,226,311.77</u>	<u>313,574.07</u>	0.12
Decrease in Net Assets	<u>\$ (214,528.90)</u>	<u>\$ (214,108.41)</u>	<u>\$ (420.49)</u>	0.00

U.S.S. North Carolina Battleship Commission
Statement of Net Assets
September 30, 2002

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents	\$	745,125.72
Restricted Cash and Cash Equivalents		1,577.98
Accounts Receivable		2,912.67
Pledges Receivable		77,999.33
Inventories		189,763.83
Prepaid Items		86,398.73
Total Current Assets		1,103,778.26

Noncurrent Assets:

Restricted Cash and Cash Equivalents		136,967.08
Restricted Investments		3,076,447.63
Capital Assets, Net (Note 6)		2,965,748.72
Total Noncurrent Assets		6,179,163.43

Total Assets

7,282,941.69

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 7)		18,415.94
Compensated Absences (Note 8)		7,657.10
Deferred Revenue		3,030.00
Total Current Liabilities		29,103.04

Noncurrent Liabilities:

Compensated Absences (Note 8)		40,169.89
Total Liabilities		69,272.93

NET ASSETS

Invested in Capital Assets		2,965,748.72
Restricted Expendable		3,214,992.69
Unrestricted		1,032,927.35

Total Net Assets

\$ 7,213,668.76

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

***U.S.S. North Carolina Battleship Commission
Statement of Revenues, Expenses, and
Changes in Net Assets
Year Ended September 30, 2002***

Exhibit B

REVENUES

Operating Revenues:		
Sales and Services	\$	742,817.65
Fees, Licenses and Fines		1,494,246.90
Miscellaneous		137,455.60
		<hr/>
Total Operating Revenues		2,374,520.15

EXPENSES

Operating Expenses:		
Personal Services		945,004.78
Supplies and Materials		57,018.23
Services		891,977.14
Cost of Goods Sold		357,941.17
Depreciation		105,430.53
Insurance and Bonding		16,495.22
Other		166,018.77
		<hr/>
Total Operating Expenses		2,539,885.84
		<hr/>
Operating Loss		(165,365.69)

NONOPERATING REVENUES (EXPENSES)

Investment Earnings (Loss)		(112,608.41)
Miscellaneous		27.19
		<hr/>
Total Nonoperating Expenses		(112,581.22)
		<hr/>
Loss Before Other Revenues		(277,946.91)
Capital Gifts		63,418.01
		<hr/>
Decrease in Net Assets		(214,528.90)

NET ASSETS

Net Assets - October 1, 2001 as Restated (Note 14)		7,428,197.66
		<hr/>
Net Assets - September 30, 2002	\$	7,213,668.76

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

U.S.S. North Carolina Battleship Commission
Statement of Cash Flows
Year Ended September 30, 2002

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from Customers	\$ 2,483,322.44
Payments to Suppliers	(1,724,176.71)
Payments to Employees	(945,481.42)
Net Cash Used by Operating Activities	<u>(186,335.69)</u>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Acquisition of Capital Assets	(125,285.83)
Ship Restoration Revenue	27.19
Capital Gifts	63,418.01
Net Cash Used for Capital Financing and Related Financing Activities	<u>(61,840.63)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	3,505,084.03
Investment Earnings (Loss)	(112,608.41)
Purchase of Investments and Related Fees	(4,108,894.14)
Net Cash Used by Investing Activities	<u>(716,418.52)</u>

Net Decrease in Cash and Cash Equivalents	(964,594.84)
Cash and Cash Equivalents - October 1, 2001	1,848,265.62
Cash and Cash Equivalents - September 30, 2002	<u>\$ 883,670.78</u>

RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES

Operating Loss	\$ (165,365.69)
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities:	
Depreciation	105,430.53
Changes in Net Assets and Liabilities:	
Accounts Receivable	(702.71)
Pledges Receivable	108,425.00
Inventories	(18,332.90)
Prepaid Items	1,486.85
Accounts Payable and Accrued Liabilities	(152,089.60)
Compensated Absences	(3,382.17)
Funds Held For Others	(62,885.00)
Deferred Revenue	1,080.00

Net Cash Used by Operating Activities	<u>\$ (186,335.69)</u>
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NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

Change in Fair Value of Investments	\$ (53,964.05)
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U.S.S. North Carolina Battleship Commission
Statement of Cash Flows
Year Ended September 30, 2002

Exhibit C
Page 2

RECONCILIATION OF CASH AND CASH EQUIVALENT BALANCES

Current Assets:		
Cash and Cash Equivalents		745,125.72
Restricted Cash and Cash Equivalents		1,577.98
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		136,967.08
Total Cash and Cash Equivalent Balances		<u>\$ 883,670.78</u>

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

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U.S.S. NORTH CAROLINA BATTLESHIP COMMISSION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2002

NOTE 1 - SUMMARY OF 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. The accompanying financial statements present all funds for which the Commission's board of commissioners is accountable. The financial statements of the Commission are an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the Commission. Related non-profit corporations for which the Commission is not financially accountable are not part of the accompanying financial statements. These entities are not included because they are separately incorporated and there are neither common commissioners nor other evidence of common control.

- 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*, effective for the Commission's year ended September 30, 2002, the full scope of the Commission's activities is considered to be a single business-type activity (BTA).

- C. Basis of Accounting** - The financial statements of the Commission 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.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Commission 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

D. Cash and Cash Equivalents - This classification appears on the Statement of Net Assets and the Statement of Cash Flows and includes undeposited receipts and cash on deposit with private bank accounts.

E. Investments - This classification includes long-term fixed income investments, equity investments, mutual funds, and money market funds of the Commission. Except for money market funds not held by a governmental external investment pool and other asset holdings, these 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 not held by a governmental external investment pool are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

F. Receivables - The Commission considers its accounts and pledges receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required.

G. Inventories - Inventories, consisting of expendable supplies and merchandise for resale, are stated at the lower of cost or market. Cost for merchandise for resale is computed by dividing the total cost of units available for sale by the number of units available for sale. This moving weighted average cost is then multiplied by the number of units in the ending inventory.

H. Capital Assets – Capital Assets are stated at cost at date of acquisition. During the year ended September 30, 2002, the Commission changed their capitalization threshold for assets that have a value or cost in excess of \$500 to \$5,000 at the date of acquisition and an expected useful life of one or more years.

Depreciation is computed using the straight-line and/or units of output method over the estimated useful lives of the assets, generally 15 to 20 years for general infrastructure, 25 years for buildings and 3 to 10 years for equipment.

The Commission does not capitalize the Battleship exhibit nor its art and artifact collections. The Battleship exhibit and its collections adhere to the Commission's policy to maintain for public exhibition, education or research; protect, keep unencumbered, care for, and preserve; and requires proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

permit collections maintained in this manner to be charged to operations at time of purchase rather than capitalized.

- I. **Restricted Assets** – Restricted assets represent assets whose use is restricted by external parties or by law through constitutional provisions or enabling legislation.
- J. **Compensated Absences** - The Commission’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 December 31st is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at September 30th equals the leave carried forward at the previous December 31st plus the leave earned, less the leave taken between January 1st and September 30th.

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

- K. **Net Assets** – The Commission’s net assets are classified as follows:

Invested in Capital Assets – This represents the Commission’s total investment in capital assets, net of outstanding debt obligations related to those capital assets, if any.

Restricted Net Assets – Expendable – Expendable restricted net assets include resources in which the Commission 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 admission fees, sales and services, unrestricted gifts, royalties, and interest income.

When both restricted and unrestricted funds are available for expenditure, the decision for funding is internally generated by management of the Commission.

- L. **Revenue and Expense Recognition** – The Commission presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. Operating activities are those activities that are necessary and essential to the mission of the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Commission. Operating revenues include all charges to customers. Revenues from nonexchange transactions that represent subsidies or gifts to the Commission, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital or noncapital financing activities.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - At year-end, cash on hand was \$9,410.00. The carrying amount (book balance) of the Commission's demand and time deposits was \$874,260.78.

The bank balance of demand and time deposits with private financial institutions at September 30, 2002 consisted of interest and non-interest bearing checking accounts and money market accounts totaling \$1,021,842.18. Of this amount, \$100,000.00 was covered by federal depository insurance, \$1,577.98 was covered by securities protection insurance, and \$920,264.20 was not insured or collateralized.

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

Credit Risk Categories - The Commission'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 Commission or its agent in the Commission's name. Category 2 includes uninsured and unregistered investments for which the securities are held by a counterparty's trust department or agent in the Commission'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 Commission's name. A summary of the Commission's investments at September 30, 2002 is presented below:

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

	Fair Value			
	Risk Category			Total
	1	2	3	
Categorized Investments:				
U.S. Government Securities	\$ 0.00	\$ 0.00	\$ 158,296.29	\$ 158,296.29
Corporate Bonds			1,776,531.72	1,776,531.72
Corporate Common Stock			1,003,121.75	1,003,121.75
Total Categorized Investments	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 2,937,949.76</u>	<u>\$ 2,937,949.76</u>
Investments Not Categorized:				
Money Market Funds				138,497.87
Total Investments				<u>\$ 3,076,447.63</u>

NOTE 3 - RESERVE FUND

In accordance with North Carolina General Statute 143B-74.1 the Commission established, on January 6, 1984, a cash reserve fund for contingencies and emergencies beyond those occurring in the course of routine maintenance and operation. This reserve is equal to one-half of the authorized operating budget for that fiscal year.

Accordingly, 50% of the authorized normal operating budget for Fiscal Year 2002 of \$2,439,039.00 yields a restricted reserve requirement of \$1,219,519.50. At year-end, \$1,082,552.42 of the investment portfolio, described in Note 2 and \$136,967.08 of cash and cash equivalents held in private financial institutions were restricted to meet the reserve requirement. The additional \$1,993,895.21 of the investment portfolio in Note 2 is considered available for restoration projects.

NOTE 4 - RESTORATION FUND

In 1998, the Commission undertook a capital campaign for the restoration of the Battleship North Carolina. In addition to funding three currently needed major restoration projects, another goal of the campaign was to establish a Restoration Fund from which future restoration projects could be funded. For the fiscal year ended September 30, 2002, the Battleship received pledges and donations in the amount of \$52,669.49. Because of the restricted-use nature of the Restoration Fund, the portfolio is managed as a separate account by Franklin Street Partners.

At year-end, the fair value of the Franklin Street Partners Restoration Fund segment of the portfolio, summarized in Note 2, was \$352,320.43.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - INVENTORIES

Inventories at year-end consisted of merchandise for resale. The Ship's Store and the concession inventories were valued at \$189,613.37 and \$150.46, respectively.

NOTE 6 - CAPITAL ASSETS

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

	Balance October 1, 2001	Increases	Decreases	Balance September 30, 2002
Capital Assets, Non-Depreciable:				
Land	\$ 97,425.80	\$ 0.00	\$ 0.00	\$ 97,425.80
Construction in Progress	2,052,741.11	116,367.52		2,169,108.63
Total Capital Assets, Non-Depreciable	2,150,166.91	116,367.52	0.00	2,266,534.43
Capital Assets, Depreciable:				
Buildings	1,114,823.35			1,114,823.35
Machinery and Equipment	1,268,700.44	8,918.31	250,219.91	1,027,398.84
General Infrastructure	629,165.74		2,975.00	626,190.74
Total Capital Assets, Depreciable	3,012,689.53	8,918.31	253,194.91	2,768,412.93
Less Accumulated Depreciation/Amortization for:				
Buildings	687,474.58	44,592.92		732,067.50
Machinery and Equipment	1,033,555.97	40,130.13	239,445.74	834,240.36
General Infrastructure	484,966.64	20,707.48	2,783.34	502,890.78
Total Accumulated Depreciation/Amortization	2,205,997.19	105,430.53	242,229.08	2,069,198.64
Total Capital Assets, Depreciable, Net	806,692.34	(96,512.22)	10,965.83	699,214.29
Capital Assets, Net	\$ 2,956,859.25	\$ 19,855.30	\$ 10,965.83	\$ 2,965,748.72

During the year ended September 30, 2002, the Commission changed its capitalization policy to conform to the statewide policy. The Commission previously capitalized assets, which had a value or cost in excess of \$500 at the date of acquisition. That amount was increased to \$5,000 and resulted in the write-off of \$10,965.83 during the year ended September 30, 2002.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2002 were as follows:

	Amount
Accounts Payable	\$ 12,715.54
Accrued Payroll	5,700.40
Total Accounts Payable and Accrued Liabilities	\$ 18,415.94

NOTE 8 - LONG-TERM LIABILITIES

A summary of changes in the long-term liabilities is presented as follows:

	Balance October 1, 2001	Additions	Reductions	Balance September 30, 2002	Current Portion
Compensated Absences	\$ 51,209.16	\$ 50,042.96	\$ 53,425.13	\$ 47,826.99	\$ 7,657.10

NOTE 9 - PENSION PLANS

A. Teachers' and State Employees' Retirement System - 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 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. The system was funded by employer and member contributions of 1.97% and 6% respectively, of covered payroll. For the period July 1, 2002 through September 30, 2002, the General Assembly required no contribution by employers and 6% of covered payroll for members.

For the year ended September 30, 2002, the Commission had a total payroll of \$760,197.64, of which \$687,629.31 was covered under the

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$41,257.76 and \$9,921.76, respectively.

The Commission made one hundred percent of its annual required contributions for the years ended September 30, 2002, 2001, and 2000, which were \$9,921.76, \$42,828.73, and \$48,812.00, 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/OSC> and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

- B. Supplemental Retirement Income Plan - 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. The voluntary contributions by employees amounted to \$7,097.08 for the year ended September 30, 2002.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The Commission 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 Commission contributed 2.35% of covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended September 30, 2002, the Commission's total contribution to the Plan was \$16,159.29. The Commission 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*.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

B. Long-Term Disability - The Commission 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 Teacher's 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 Commission contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. For the fiscal year ended September 30, 2002, the Commission's total contribution to the DIPNC was \$3,575.67. The Commission 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 Commission 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. All losses covered are subject to a \$150,000 deductible. 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 premium, based on a composite rate, is paid by the Commission directly to the State's agent of record.

The State Property Fire Insurance Fund (Fund), an internal service fund of the State, insures all State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses for all operations supported by the State's General Fund is provided at no cost to the Commission. Other operations not supported by the State's General Fund are charged for fire coverage. The Commission also purchased through the Fund extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft and "all risks" for buildings and contents. The Fund charges premiums for this coverage discounted from industry manual rates. The Fund generally insures fire losses up to \$1.1 million and extended coverage losses up to \$100,000 per building and

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

\$500,000 per occurrence. All losses covered by the Fund are subject to a \$1,000 per occurrence deductible. The Fund purchases excess insurance from a private insurer to cover losses over the amounts insured by the Fund. 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.

All State-owned vehicles are covered by liability insurance handled by the State Department of Insurance. The State is self-insured for the first \$500,000 of any loss through a retrospective rating plan. Excess insurance coverage is purchased through a private insurer to cover losses greater than \$500,000. The liability limits for losses occurring in State are \$500,000 per claimant and \$5,000,000 per occurrence. The Commission is charged premiums to cover the cost of excess insurance and to pay for those losses falling under the self-insured retention.

The Commission is protected for losses from employee dishonesty and computer fraud. The blanket honesty bond is handled by the State Department of Insurance with coverage of \$5,000,000 per occurrence and a \$50,000 deductible.

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

Employees and retirees are provided health care coverage by the Comprehensive Major Medical Plan (Plan), a component unit of the State. The Plan is funded by employer and employee contributions and is administered by a third party contractor.

Term life insurance of \$25,000 to \$50,000 is provided to eligible workers. This self-insured death benefit program is administered by the State Treasurer's Office and funded via employer contributions.

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

NOTE 12 - THE FRIENDS OF THE BATTLESHIP NORTH CAROLINA

The Friends of the Battleship North Carolina is a nonprofit organization that raises funds for providing additional resources to the U.S.S. North Carolina Battleship Commission. The records of the organization are maintained separately from the Commission. During the fiscal year ended September 30, 2002, the organization donated \$10,748.52 to the Commission.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

NOTE 13 - PLEDGES RECEIVABLE

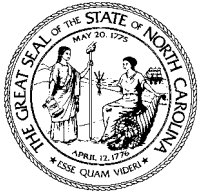
The Commission has pledges receivable in the amount of \$77,999.33. Due to the nature of the donor organizations, the Commission considers these pledges to be collectible.

NOTE 14 NET ASSETS RESTATEMENT

As of October 1, 2001, net assets as previously reported was restated as follows:

	<u>Amount</u>
October 1, 2001 Net Assets as Previously Reported	\$ 7,439,163.49
Restatement: Change in capitalization threshold	<u>(10,965.83)</u>
October 1, 2001 Net Assets as Restated	<u><u>\$ 7,428,197.66</u></u>

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Ralph Campbell, Jr.
State Auditor

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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**

Captain David R. Scheu, USN (Ret), Director
U.S.S. North Carolina Battleship Commission
Wilmington, North Carolina

We have audited the financial statements of the U.S.S. North Carolina Battleship Commission as of and for the year ended September 30, 2002, and have issued our report thereon dated July 10, 2003.

As discussed in Note 1, the financial statements of the Commission are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the Commission.

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 Commission'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 Commission'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

**INDEPENDENT AUDITOR'S REPORT
ON COMPLIANCE AND ON INTERNAL CONTROL
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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 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, the Board of Commissioners, the Department of Cultural Resources, management and staff of the Commission, 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.
State Auditor

July 10, 2003

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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 Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Ms. Lisbeth C. Evans	Secretary, Department of Cultural Resources
Captain David R. Scheu, USN (Ret)	Director, U.S.S. North Carolina Battleship Commission
Mr. Norwood E. Bryan	Chairman, U.S.S. North Carolina Battleship Commission

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Representative Richard Morgan	Speaker of the NC House of Representatives
Members of the Local Legislative Delegation	NC House and Senate
Mr. James D. Johnson	Director, Fiscal Research Division

August 13, 2003

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