

**NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY**  
Raleigh, North Carolina

**Financial Statement Audit Report**

Years Ended June 30, 2003 and 2002

Performed Under Contract With the  
North Carolina Office of the State Auditor

Ralph Campbell, Jr.  
State Auditor

**FINANCIAL STATEMENT AUDIT REPORT**

**NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY**

**RALEIGH, NORTH CAROLINA**

**YEARS ENDED JUNE 30, 2003 AND 2002**

**BOARD MEMBERS OF THE AUTHORITY**

**ROBERT FRANK TIMBERLAKE, JR., CHAIRMAN**

**JOSEPH BROOKS**

**STAN CROWE**

**DAVID HALL**

**JIMMY A. HARRELL, JR.**

**RICHARD A. HOLDER**

**DEBORAH JOHNSON**

**DAVID MCLEOD**

**WILLIAM C. THACKER**

**JAMES WORLEY**

**W. BRITT COBB, JR., INTERIM AGRICULTURE COMMISSIONER**

**ADMINISTRATIVE OFFICERS**

**DR. FRANK BORDEAUX, EXECUTIVE DIRECTOR**



Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

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**AUDITOR'S TRANSMITTAL**

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The Honorable Michael F. Easley, Governor  
The General Assembly of North Carolina  
The Board Members, North Carolina Agricultural Finance Authority

This report presents the results of the financial statement audit of the North Carolina Agricultural Finance Authority, a component unit of the State of North Carolina, for the year ended June 30, 2003. Thomas & Gibbs CPAs, PLLC performed this audit under contract with the Office of the State Auditor and their report is submitted herewith.

The audit of the Authority was conducted in accordance with North Carolina General Statute 122D, the North Carolina Agricultural Finance Act. That legislation created the Authority within the North Carolina Department of Agriculture and Consumer Services. General Statute 122D-18 provides that the Authority may cause an independent audit of its books and accounts to be prepared annually. General Statute 147.64.2 provides that the State Auditor shall perform or coordinate all audit functions for State government. General Statute 147-64.7 allows the State Auditor to obtain the services of independent public accountants to carry out its duties and functions.

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

A handwritten signature in black ink that reads 'Ralph Campbell, Jr.'.

Ralph Campbell, Jr.  
State Auditor

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
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Years Ended June 30, 2003 and 2002

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Certified Public Accountants  
and Consultants

## INDEPENDENT AUDITORS' REPORT

The Board Members  
North Carolina Agricultural Finance Authority  
Raleigh, North Carolina

We have audited the accompanying Statements of Net Assets of the North Carolina Agricultural Finance Authority (the "Authority"), a component unit of the State of North Carolina, as of June 30, 2003 and 2002, and the related Statements of Revenues, Expenses, and Changes in Net Assets and Statements of Cash Flows for the years then ended. 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 audits.

We conducted our audits 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 audits provide 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 Agricultural Finance Authority as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

As discussed in Note 13 to the financial statements, the Authority implemented Governmental Accounting Standards Board Statement No. 34, *Basis Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and Statement No. 38, *Certain Financial Statement Note Disclosures* during the year ended June 30, 2002.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2003 on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of our audits performed in accordance with *Government Auditing Standards* and should be read in conjunction with the independent auditor's report in considering the results of our audits.

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

*Thomas S. Gibbs CMA, PLLC*

Durham, North Carolina  
November 30, 2003

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
Years Ended June 30, 2003 and 2002

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Management's Discussion and Analysis is intended to give the reader an overview of factors that have affected operation and may affect operations in the future. The Authority is required by the Governmental Accounting Standards Board's (GASB) Statement No. 34 to present three basic financial statements. Those statements are the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These statements provide both long-term and short-term financial information for the North Carolina Agricultural Finance Authority.

Since the Management's Discussion and Analysis (MD&A) is designed to focus on the current activities, resulting changes, and currently known facts, please read it in conjunction with the Authority's financial statements.

### **2003 Financial Highlights**

- The assets of the Authority exceeded its liabilities at the close of the most recent fiscal year by \$15,240,180 (net assets). This amount is unrestricted and may be used to meet the Authority's ongoing obligations to citizens and creditors.
- The Authority's total net assets increased by \$386,228. This increase is attributable to interest earnings on notes receivable and earnings for administering federally funded Farm Pilot projects.
- The Authority's liabilities increased by \$41,577 during the fiscal year. The key factor in this change was the increase in intergovernmental payables.

### **2002 Financial Highlights**

- The assets of the Authority exceeded its liabilities at the close of the 2002 fiscal year by \$14,853,952 (net assets). This amount is unrestricted and may be used to meet the Authority's ongoing obligations to citizens and creditors.
- The Authority's total net assets increased by \$741,269. This increase is attributable to interest earnings on notes receivable and earnings for administering federally funded Farm Pilot projects as well as a \$104,000 operating appropriation from the primary government. Fiscal year ended June 30, 2002 was the last year that the Authority received such an appropriation.

**NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Years Ended June 30, 2003 and 2002

**Financial Statements**

Statement of Net Assets

The Statement of Net Assets reports all assets and liabilities of the Authority; additionally the Statement classifies those assets and liabilities as current and non-current depending on the availability of the assets or satisfaction of the obligation within twelve months (current) or longer. This statement also reports the net assets, which is the difference between the total assets and total liabilities. The reader may use the net assets to gauge the financial position of the Authority as of June 30, 2003 and 2002.

**Condensed Statement of Net Assets**

	2003	2002	Variance
Assets			
Current Assets	\$ 5,475,070	\$ 5,457,963	\$ 17,107
Other Noncurrent Assets	10,277,850	9,867,152	410,698
Total Assets	15,752,920	15,325,115	427,805
Liabilities			
Current Liabilities	474,793	444,091	30,702
Noncurrent Liabilities	37,947	27,072	10,875
Total Liabilities	512,740	471,163	41,577
Net Assets			
Unrestricted	15,240,180	14,853,952	386,228
Total Net Assets	\$ 15,240,180	\$ 14,853,952	\$ 386,228

As of June 30, 2003 and 2002, the Authority's total assets were \$15.7 million and \$15.3 million, respectively. Of these totals, \$11.5 million and \$11.3 million were notes receivable from borrowers for the years ended June 30, 2003 and 2002, respectively.

The Authority's liabilities totaled \$512,740 and \$471,163 for the years ended June 30, 2003 and 2002, respectively. The total current liabilities of \$474,793 as of June 30, 2003 and \$444,091 as of June 30, 2002, were well covered by current assets of \$5.5 million in both years. This indicates the Authority's ability to pay current liabilities as they become due. Total net assets were \$15.2 million and \$14.9 million as of June 30, 2003 and 2002, respectively reflecting a \$386,228 increase between these years.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets reports the revenues earned and expenses incurred during the fiscal year. The increase or decrease of revenues over expenses directly affects (increases/decreases) the total net assets reported on the Statement of Net Assets. These transactions are classified as operating or nonoperating.



**NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Years Ended June 30, 2003 and 2002

**Financial Statements (continued)**

Statement of Revenues, Expenses, and Changes in Net Assets (continued)

Operating revenues primarily consist of interest earnings on notes receivable, net of amounts paid to other entities for sold notes. Operating expenses primarily consist of salaries, supplies, services, and utilities.

Nonoperating revenues stem from transactions that occur outside of the primary scope of the Authority's existence and for which no goods or services are provided. Operating grants from the primary government, interest earnings on pooled investment accounts, and federal grants to administer farm pilot projects primarily represent nonoperating revenues.

The Authority sustained a total operating income of \$85,656 and \$202,293 for the years ended June 30 2003 and 2002, respectively. The \$116,637 decline in operating income from 2002 is mostly explained by two events. The decline in interest rates significantly impacted the amount of interest earned on loans. Also, operating expenses increased due to the write off of two defaulted loans from a single borrower, in the amount of \$59,637. The amount written off represented less than 0.3% of the outstanding gross notes receivable balance at time of default and is the remaining receivable following the receipt of proceeds from foreclosure and claims paid by the Farm Service Agency (FSA). FSA guarantees up to 90% of the loan principal balance in the event of default. Given past experience, Management believes that the default is an isolated occurrence. Therefore, no provision for an allowance for doubtful accounts has been made in the accompanying financial statements.

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

	June 30,		Variance
	2003	2002	
Operating Revenues	\$ 772,798	\$ 800,653	\$ (27,855)
Operating Expenses	<u>687,142</u>	<u>598,360</u>	<u>88,782</u>
Operating Income	85,656	202,293	(116,637)
Non-operating Revenues	<u>300,572</u>	<u>538,976</u>	<u>(238,404)</u>
Change in Net Assets	386,228	741,269	(355,041)
Net Assets – July 1	14,853,952	14,214,766	639,186
Restatements	<u>-</u>	<u>(102,083)</u>	<u>102,083</u>
Net Assets - June 30	<u>\$ 15,240,180</u>	<u>\$ 14,853,952</u>	<u>\$ 386,228</u>

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Years Ended June 30, 2003 and 2002

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Statement of Cash Flows

A very useful measure of financial operations is the Statement of Cash Flows. This statement provides the sources of cash inflows and outflows for four major activities: operating, noncapital financing, capital and related financing, and investing activities. The Authority did not use cash for capital financing activities during the years ended June 30, 2003 and 2002.

The ending cash and cash equivalents on the Statements of Cash Flows corresponds directly with the sum of the cash and cash equivalents balances on the Statements of Net Assets.

The net cash used by operating activities shows net outflows of \$147,418 and \$2.4 million for the years ended June 30, 2003 and 2002, respectively. The major outflows were payments to borrowers for loans issued, which were \$1.6 million and \$3.6 million for the years ended June 30, 2003 and 2002, respectively. The major sources of operating inflows were receipts from collections on loans (\$1.3 million and \$0.9 million for the years ended June 30, 2003 and 2002 respectively).

The Authority has cash inflows from investing activities of \$255,462 and \$282,817 for the years ended June 30, 2003 and 2002. These result from investment income.

**Economic Factors and Future Outlook**

The Authority is affected by both US and North Carolina economic conditions and policies. Federal policy changes such as NAFTA (North American Fair Trade Act) affect the prices farmers receive for their products thereby affecting their ability to repay loans. The Authority attempts to reduce the resultant risk to the loan portfolio by obtaining federal guarantees on loans where possible.

State policies such as the moratorium on new swine production facilities being constructed by farmers reduce income opportunities for the Authority's farm clientele. The Authority had assisted many farmers to improve their net income by producing swine for the export market. In an attempt to be proactive the Authority, in cooperation with FPPC (Farm Pilot Project Coordination, Inc.) has used \$4.5 million for innovative projects to eliminate the negative environmental aspects of swine production. This should ultimately return an economic opportunity to North Carolina farmers that can be financed by the Authority.

Since many countries now compete quite favorably with North Carolina, the Authority attempts to find every opportunity to finance "further processing" or "value added" manufacturing for farmers. This increases the farmer's share of the consumer's dollar and provides additional jobs in rural areas. This is evidenced by the recent loans to the local wineries totaling \$1.3 million to bring on board new income sources in an area severely affected by reductions in tobacco acreage and closing of manufacturing plants due to relocation to Mexico as part of the NAFTA agreement.

The trend toward smaller farm numbers will no doubt continue. However the Authority will continue to promote alternative farm enterprises so that the remaining farmers can continue as economically strong independent producers.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS (continued)**

Years Ended June 30, 2003 and 2002

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**Economic Factors and Future Outlook (continued)**

The Authority uses capital wisely. However, the recent state budget shortfalls have prevented the Authority from receiving additional capital (non-operating) for loan making. There are opportunities for financing for which there is a capital shortage, which cannot be met by the Authority.

**Request for Information**

The financial report is designed to provide a general overview of the Authority's finances for all those who have an interest in this agency's finances. Questions concerning any of the information presented in this report or requests for additional financial information should be addressed to the Authority's office at P.O. Box 27908, Raleigh, NC 27611-7908.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**STATEMENTS OF NET ASSETS**  
June 30, 2003 and 2002

**Exhibit A**

	2003	2002
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents (Note 2)	\$ 3,848,051	\$ 3,724,991
Notes receivable, net (Note 3)	1,357,975	1,495,006
Interest receivable	266,471	236,378
Inventories	2,573	1,588
Total Current Assets	5,475,070	5,457,963
<b>Non-current Assets:</b>		
Notes receivable, net (Note 3)	10,106,350	9,867,152
Land held for investment (Note 4)	171,500	-
Total Non-current Assets	10,277,850	9,867,152
<b>Total Assets</b>	15,752,920	15,325,115
<b>LIABILITIES</b>		
<b>Current Liabilities:</b>		
Accounts payable	926	446
Intergovernmental payables (Note 10)	414,748	386,907
Claims payable	16,114	16,114
Due to primary government	-	154
Accrued vacation leave (Note 11)	4,048	1,513
Deferred revenues	38,957	38,957
Total Current Liabilities	474,793	444,091
<b>Non-current Liabilities:</b>		
Accrued vacation leave (Note 11)	37,947	27,072
Total Non-current Liabilities	37,947	27,072
<b>Total Liabilities</b>	512,740	471,163
<b>NET ASSETS</b>		
Unrestricted	15,240,180	14,853,952
<b>Total Net Assets</b>	\$ 15,240,180	\$ 14,853,952

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

**NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY**  
**STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**

Years Ended June 30, 2003 and 2002

**Exhibit B**

	2003	2002
<b>Operating Revenues:</b>		
Sales and services	\$ 86,966	\$ 83,056
Interest earnings on loans	682,222	705,692
Rental and lease earnings	660	10,830
Fees, licenses and fines	2,950	1,075
Total Operating Revenues	772,798	800,653
<b>Operating Expenses:</b>		
Personal services and employee benefits	476,247	421,506
Supplies and materials	4,383	3,768
Travel	11,099	7,550
Contracted personal services	82,410	121,365
Communications	5,782	5,206
Rental expense	18,296	16,900
Insurance	1,865	2,030
Other fixed charges	3,600	1,753
Equipment	19,892	14,261
Other expenses	63,568	4,021
Total Operating Expenses	687,142	598,360
<b>Operating Income</b>	85,656	202,293
<b>Non-operating Revenues (Expenses):</b>		
Non-capital grants	1,281,830	578,813
Operating grants	-	104,008
Investment earnings	285,555	383,655
Grants, aid and subsidies	(1,265,676)	(528,091)
Miscellaneous	(1,137)	591
Net Non-operating Revenues	300,572	538,976
<b>Change in Net Assets</b>	386,228	741,269
<b>Net Assets – July 1</b>	14,853,952	14,214,766
Restatements (Note 14)	-	(102,083)
<b>Net Assets - June 30</b>	\$ 15,240,180	\$ 14,853,952

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**STATEMENTS OF CASH FLOWS**  
Years Ended June 30, 2003 and 2002

**Exhibit C**

	2003	2002
<b>Cash Flows from Operating Activities:</b>		
Receipts from customers	\$ 772,798	\$ 800,653
Receipts from collection of loans	1,326,767	934,280
Payments for loans issued	(1,600,434)	(3,598,058)
Payments to employees and fringe benefits	(462,836)	(417,041)
Payments to vendors and suppliers	(183,713)	(166,250)
Net Cash Used by Operating Activities	(147,418)	(2,446,416)
<b>Cash Flows from Non-capital Financing Activities:</b>		
Non-capital grants received	1,281,830	644,621
Non-capital grants paid	(1,265,677)	(528,091)
Operating grants	-	104,008
Other (payments) receipts	(1,137)	591
Net Cash Provided by Non-capital Financing Activities	15,016	221,129
<b>Cash Flows from Investing Activities:</b>		
Interest on Investments	255,462	282,817
Net Cash Provided by Investing Activities	255,462	282,817
Net Increase (Decrease) in Cash and Cash Equivalents	123,060	(1,942,470)
Cash and Cash Equivalents - July 1	3,724,991	5,667,461
Cash and Cash Equivalents - June 30	\$ 3,848,051	\$ 3,724,991
<b>Reconciliation of Net Operating Income to Net Cash Used by Operating Activities:</b>		
Operating Income	\$ 85,656	\$ 202,293
Adjustments to Reconcile Operating Income to Net Cash Used by Operating Activities:		
Changes in Assets and Liabilities:		
Notes receivable, net	(102,166)	(2,663,779)
Inventories	(985)	152
Land held for investment	(171,500)	-
Accounts Payable	480	(1,434)
Accrued Vacation Leave	13,410	4,463
Other Payables	27,687	11,889
Net Cash Used by Operating Activities	\$ (147,418)	\$ (2,446,416)

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

- A. Organization** - The North Carolina Agricultural Finance Authority (the “Authority”) was established in 1986 by the North Carolina Agricultural Finance Act. The Authority was created and empowered to alleviate the severe shortage of capital and credit available at affordable interest rates for investment in agriculture and for the export of agricultural products, commodities and services by providing such capital and credit at interest rates within the financial means of persons and businesses engaged in agriculture and agricultural exports. The Authority is a body politic and corporate created within the Department of Agriculture and Consumer Services. The Authority is constituted as a public agency and an instrumentality of the State for the performance of essential public functions as established by the General Assembly (NCGA General Statutes - Chapter 122D).

Effective September 26, 2001, the North Carolina General Assembly approved General Statute 143A-63, which abolished the North Carolina Rural Rehabilitation Corporation and required the transfer of the functions and the board of directors of the Corporation to the North Carolina Agricultural Finance Authority. The North Carolina Rural Rehabilitation Corporation (the “Corporation”) was organized in 1934 by the North Carolina Emergency Relief Commission at the direction of the federal government primarily for the purposed of facilitating the legal and financial transactions involved in the rural rehabilitation program then being administered by the North Carolina Emergency Relief Administration of North Carolina farm families left destitute by the depression.

- B. 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 Agricultural Finance Authority is a component unit of the primary government of the State of North Carolina and is an integral part of the State’s *Comprehensive Annual Financial Report* (CAFR).

Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State’s substantive appointment of a majority of the component unit’s governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on, the State.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)**

As required by General Statute 122D-4, the governing body of the Authority is composed of 10 members. The Commissioner of Agriculture serves ex officio, with the same rights and privileges, including voting rights, as other members. The remaining nine members are appointed by the Governor of North Carolina (3 members), the General Assembly upon recommendation of the Speaker of the House (3 members), and the General Assembly upon recommendation of the President Pro Tempore of the Senate (3 members).

- C. Basis of Presentation** - The North Carolina Agricultural Finance Authority is accounted for as a proprietary fund type (enterprise fund) in conformity with the accounting and reporting requirements of the Governmental Accounting Standards Board (GASB). 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. The measurement focus is upon determination of net income, financial position, and changes in cash flows. The accounting principles used are those generally accepted in the United States of America and applicable to similar businesses in the private sector; thus, the accompanying financial statements have been prepared in accordance with the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.
- D. Cash and Cash Equivalents** - This classification appears on the statement of net assets and statement of cash flows. It includes short-term investments with the State Treasurer's Cash and Investment Pool (a governmental external investment pool). The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.



NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)**

**E. Notes Receivable and Allowance for Doubtful Accounts** - The Authority provides the following direct loan programs:

**Farm Loan Programs** – Loans made for the purpose of buying, improving, or enlarging farms. This category comprises the majority of loans made by the Authority. Loan rates are variable based on the Prime Rate as published in the Wall Street Journal plus an additional percentage. Loan terms and limits vary depending on the type of loan; however, all are secured by liens on the real estate owned or purchased, improvements made with the loan funds, and any other additional security that might be required on an individual loan basis.

**Agribusiness Loan Program** – Loans made to assist agribusinesses in obtaining capital to start-up, increase, or make changes to their business. Agribusiness loans are designed to provide capital to acquire and build facilities. Loan rates are variable based on the Prime Rate as published in the Wall Street Journal.

**Agricultural Facilities Disaster Loans** – Loans made to assist agricultural property owners who have suffered property damage due to natural disasters to repair or replace structures and to return to normal work routines as quickly as possible. These loans are designed to provide for damages to farm facilities (structures) not fully covered for replacement costs or covered by federal disaster funds. Interest rates are fixed for the life of the loan and established on criteria tied to the Prime Rate. Maximum length of the loan cannot exceed 10 years.

**Cotton Gin Air Quality Loan Program** – Loans are made to assist modern day cotton gins in complying with changes in the dust emissions regulations. Eligible cotton gins must have been in operation at least one year prior to application and the financed improvements must comply with state and federal air quality standards. Each loan program has specified eligibility that must be met. These loans are normally secured by a first lien on collateral. The loan committee determines the interest rate on the loans and the interest accrues from the original date that the loan is closed.

Principal payments can be made either annually, quarterly, or monthly. The loans are repaid over various term lengths, generally with a maximum of 20 years. Application fees and loan processing fees vary by loan type.

Notes Receivable are shown in the accompanying financial statements at book value. No provision for doubtful accounts is considered necessary as the Authority expects to collect the receivable amounts. The Authority sells a portion of notes receivable to other entities and continues to act as the collection agent for borrower payments. The note receivable balance reported is the difference between the original notes receivable balance and the portion of the note sold to other entities.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)**

- F. Inventories** - Inventories held by the Authority are priced at the lower of cost or market value using the first-in, first-out method. The inventories consist of expendable supplies and postage.
- G. Lease Obligations** – All leases are accounted for as operating leases and are not recorded on the statement of net assets. Operating lease payments are recorded as expenses when incurred. All leases of the Authority contain appropriation clauses indicating that continuation of the lease is subject to continued funding by the Legislature. For reporting purposes, leases are fully disclosed since cancellation due to lack of appropriation is deemed unlikely.
- H. Compensated Absences** - The Authority's policy is to record the cost of vacation leave when earned. The policy provides for the 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 31<sup>st</sup> is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30<sup>th</sup> equals the leave carried forward at the previous December 31<sup>st</sup> plus the leave earned, less the leave taken between January 1<sup>st</sup> and June 30<sup>th</sup>.

The Authority has the policy of recording the cost of sick leave when taken and paid rather than when the leave is earned. The policy provides for unlimited accumulation of sick leave, but the employee cannot be compensated for any unused sick leave upon termination of employment.

Full-time permanent, probationary and trainee employees earn vacation leave ranging from .98 to 2.15 days per month, depending upon years of service. Part-time employees earn the same range of leave on a pro-rata amount based on the number of hours a week they work. At termination, employees are paid for any accumulated vacation leave. Full-time permanent, probationary and trainee employees earn sick leave at the rate of one day per month with an unlimited accumulation. Part-time employees earn a percentage of the total of 8 hours per month based on the number of hours a week they work. While payment for accumulated sick leave upon termination is not allowed, additional service credit for retirement pension benefits is given for accumulated sick leave upon retirement.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES (continued)**

**I. Net Assets** – The Authority’s net assets are classified as follows:

**Unrestricted Net Assets** – Unrestricted net assets are all those not invested in capital assets or restricted by external parties.

**J. Revenue and Expense Recognition** – The Authority 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 Authority. Investment income is considered nonoperating since it is 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**

All of the Authority’s deposits are held by the State Treasurer. The cash on deposit with the State Treasurer is pooled with state agencies and similar institutions in short-term investments with the State Treasurer’s Cash and Investment Pool. These moneys are invested in accordance with General Statutes 147-69.1(c) and 147-69.2, and as required by law are “readily convertible into cash.” All investments of the fund are held either by the Department of State Treasurer or its agent in the State’s name. The fund’s uninvested cash is either covered by federal depository insurance or, pursuant to 20 NCAC 7, is collateralized under either the dedicated or pooling method.

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.

The Authority’s deposits in the State Treasurer’s Short Term Investment Fund had book and bank balances of \$3,848,051 and \$3,724,991 as of June 30, 2003 and June 30, 2002, respectively.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2003 and 2002

**NOTE 3 - NOTES RECEIVABLE, NET**

A summary of changes in notes receivable is presented as follows:

	June 30, 2003	June 30, 2002
Notes receivable from borrowers	\$ 21,775,004	\$ 21,735,528
Notes payable to holders	(10,310,679)	(10,373,370)
Notes receivable, net	11,464,325	11,362,158
Current portion	(1,357,975)	(1,495,006)
Non-current portion	\$ 10,106,350	\$ 9,867,152

See Note 1E for an detailed explanation of the components of notes receivable.

**NOTE 4 - LAND HELD FOR INVESTMENT**

Land held for investment of \$171,500 at June 30, 2003 was acquired as part of a loan foreclosure and is valued at the acquisition value on the date of foreclosure.

**NOTE 5 - LEASE OBLIGATIONS – OPERATING**

The following is a schedule by years of future minimum rental payments required under leases that have noncancelable lease terms as of June 30, 2003:

Fiscal Year	Operating Leases
2004	\$ 18,196
2005	18,196
2006	18,196
<b>Total Minimum Lease Payments</b>	<b>\$ 54,588</b>

Total rental expense for all operating leases was \$18,196 and \$16,900 for the years ended June 30, 2003 and 2002, respectively.

**NOTE 6 - RETIREMENT PLANS**

Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System of North Carolina. This plan is a cost-sharing, multiple-employer, defined benefit pension plan established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the State's reporting entity. Membership is comprised of employees of state agencies and institutions, local boards of education, universities and community colleges and certain proprietary component units.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2003 and 2002

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**NOTE 6 - RETIREMENT PLANS (continued)**

Benefits and administrative expenses are funded by plan investment income, member contributions of 6% of compensation, and by employer contributions of 0% and 1.97% of covered payroll for the periods ending June 30, 2003 and June 30, 2002, respectively. Benefit and actuarially based contribution provisions are established by General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Additional detail information about the plan is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

For the year ended June 30, 2003, the Authority had a total payroll of \$394,359, all of which was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$23,661 and \$0, respectively. For the year ended June 30, 2002, the Authority had a total payroll of \$351,797, all of which was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$21,108 and \$6,930, respectively. The Authority made one hundred percent of its annual required contributions to the retirement plans for the years ended June 30, 2003, 2002, 2001, and 2000, which were \$0, \$6,930, \$14,847, and \$18,652 respectively.

In accordance with constitutional provisions requiring a balanced budget for the State of North Carolina, the Governor issued an executive order requiring the employers' share of retirement contributions for the months February 2001 through June 2001 to be transferred to a reserve account rather than paid to the Teachers' and State Employees' Retirement System. A portion of those funds was ultimately used by the State of North Carolina for general fund purposes and not released to the retirement system. The total amount of employer contributions paid by the Authority has been recognized as pension costs in the financial statements. The contributions which were not released to the Teachers' and State Employees' Retirement System are considered immaterial to the Authority's financial statements taken as whole. The Authority has no liability for pension costs beyond the contributions already made.

**NOTE 7 - DEFERRED COMPENSATION PLANS**

**IRC Section 457 Plan** – General Statute 143B-426.24 authorized the creation of the Board of Trustees of the North Carolina Public Employee Deferred Compensation Plan (the Board). The Board was established as an agency of the State of North Carolina to offer the State's permanent employees, university employees, and the employees of certain other component units, a uniform Deferred Compensation Plan (the Plan) in accordance with the Internal Revenue Code Section 457. The Plan permits each participating employee to defer a portion of his or her salary until future years by having the funds invested in various instruments that make up the North Carolina Public Employee Deferred Compensation Trust Fund. This fund is held in trust by the Plan for the exclusive benefit of participating employees and their beneficiaries.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2003 and 2002

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**NOTE 7 - DEFERRED COMPENSATION PLANS (CONTINUED)**

The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board. All costs of administering and funding the Plan are the responsibility of the plan participants.

**IRC Section 401(k) Plan** – Effective January 1, 1985, Chapter 135, Article 5 of the North Carolina General Statutes authorized the creation of the Supplemental Retirement Income Plan of North Carolina (the Plan) in accordance with Internal Revenue Code Section 401(k). All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Plan and may contribute up to 20% of their compensation during the plan fiscal year. Members of the Plan may receive their benefits upon retirement, disability, termination, or death. All contributions and costs of administering the Plan are the responsibility of the participants. No costs are incurred by the Authority.

**NOTE 8 - OTHER POSTEMPLOYMENT BENEFITS**

**Health Care for Long-Term Disability Beneficiaries and Retirees** – The Authority participates in State administered programs that provide health care benefits to eligible former employees. The State Health Plan provides postemployment health insurance to former employees of the State. Those former employees who are eligible to receive health care as another postemployment benefit are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the Teachers' and State Employees' Retirement System (TSERS), with five or more years of contributory membership service in the Retirement System prior to disability or retirement. The health insurance plan is the same as for active employees as described in Note 9, except that coverage becomes secondary when former employees become eligible for Medicare. These former employees are eligible to participate in the self-funded Comprehensive Major Medical Plan (Plan).

The funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. These health care benefits are funded by employer contributions that are established in the biennial appropriation bill by the General Assembly. The Authority contributed a monthly amount equal to 2.35% of active employees' salaries to the General Fund's Reserve for Retirees' Health Premium Account (Reserve). The Authority's total contribution to the Plan was \$9,267 and \$8,267 for the fiscal years ended June 30, 2003 and 2002 respectively. The Reserve pays the full cost of coverage for long-term disability beneficiaries and retirees enrolled in the Plan. These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 8 - OTHER POSTEMPLOYMENT BENEFITS (continued)**

**Disability Income** – As discussed in Note 9, short-term and long-term disability benefits are provided to the eligible members of the TSERS through the Disability Income Plan of North Carolina (DIPNC). Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided he/she meets specified requirements. For the DIPNC's plan year, (the calendar years ended December 31, 2002 and 2001), the Authority contributed .52% of active employees' salaries to fund the disability benefits or \$2,051 and \$1,829 respectively. The contributions cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees. These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

Additional detailed information about the above postemployment benefits is disclosed in North Carolina's *Comprehensive Annual Financial Report*.

**NOTE 9 - RISK MANAGEMENT AND INSURANCE**

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 by a combination of methods, including participation in various State-administered risk pools, purchase of commercial insurance and self-retention of certain risks.

**State Health Plan** – In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State of North Carolina provides comprehensive major medical care for employees and retirees of the State and its participating component units, as well as their dependents. Coverage is self-funded by contributions to the State Health Plan (the Plan). Contributions for employee and retiree coverage are made by the State while contributions for dependent coverage are made by employees and retirees. As described in Note 8, coverage is also extended to certain individuals as another postemployment benefit. The Plan is administered by a third party contractor who is responsible for the processing of claims and administration of cost containment. Additionally, health care coverage is optionally available through contractual agreements with several Health Maintenance Organizations.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and co-payment requirements. The Plan disallows claims in excess of a lifetime maximum of \$2 million.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 9 - RISK MANAGEMENT AND INSURANCE (continued)**

**Death Benefit Plan of North Carolina** - Term life insurance (death benefits) is provided through the Death Benefit Plan to all members of the Teachers' and State Employees' Retirement System who have completed at least 12 consecutive months of membership in the System. The benefit payment is equal to the greater of (1) the compensation on which contributions were made by the member during the calendar year preceding the year in which his/her death occurs or (2) the member's highest twelve month's salary in a row during the twenty-four months prior to his/her death. The benefit is subject to a minimum of \$25,000 and to a maximum of \$50,000. Death benefits are funded by actuarially based employer contributions that are established in the biennial appropriation bill by the General Assembly. The State and participating component units contributed .16% of active employees' salaries to fund the Death Benefit Plan. The Authority contributed \$631 and \$563 to the plan for the fiscal years ended June 30, 2003 and June 30, 2002 respectively. These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

**Disability Income Plan of North Carolina** - Short-term and long-term disability benefits are provided through the Disability Income Plan of North Carolina (DIPNC) to eligible members of the Teachers' and State Employees' Retirement System. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability, which is determined as the last actual day of service or the day succeeding at least 365 calendar days after the commencement of service, whichever is later. Short-term benefits are provided to currently active employees and the related liability is not measurable.

As discussed in Note 8, long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly.

**Automobile, Fire and Other Property Losses** - The State of North Carolina is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle. The State is self-insured for the first \$500,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than \$500,000. The liability limits for losses incurring in-state are \$500,000 per claimant and \$5 million per occurrence. For losses incurring out-of-state, the limits are \$1 million per claimant and \$5 million per occurrence. Users of the state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred.



NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 9 - RISK MANAGEMENT AND INSURANCE (continued)**

The private insurer processes all claims, establishes a reserve for amounts expected to be paid for claims, and pays claims after they are approved by the Attorney General's Office. Settled claims have not exceeded coverage in any of the past three fiscal years.

The State Property Fire Insurance Fund (the Fund) was also created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses is free for all operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage. Extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and "all risk" for buildings and contents can be purchased through the Fund at premiums discounted from industry manual rates. The fund insures losses up to \$2.5 million per occurrence. All losses covered by the Fund are subject to a \$500 per occurrence deductible except for theft, which carries 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. Settled claims have not exceeded coverage in any of the past three fiscal years.

**Public Officers' and Employees' Liability Insurance** – In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers' and employees' liability insurance is provided by private insurers for all employees of the State and participating component units. The policy provides \$11 million excess insurance over the \$500,000 statutory limit payable for any one claim under the State Tort Claims Act. The first \$150,000 of an award against a State agency is the responsibility of the state agency's general fund budget code or up to \$500,000 if a non-general fund budget code.

For general fund budget codes, any award greater than \$150,000 but less than \$500,000 is funded by proportionate shares of estimated lapse salaries from all agencies general fund budget codes. Since State agencies and component units are responsible for funding any tort claims of \$500,000 or less from their budget and/or lapse salaries, total claims liabilities are not measurable. Employers are charged a premium for the excess insurance based on a composite rate. The employers pay the premiums directly to the private insurer. Settled claims have not exceeded coverage in any of the past three fiscal years.

**Employee Dishonesty and Computer Fraud** – Blanket public employee dishonesty and computer fraud insurance is provided for agencies of the State and its component units with a limit of \$5 million per occurrence, subject to a \$50,000 deductible and a 10% participation in each loss above the deductible. The coverage is placed with a private insurance company and is handled by the North Carolina Department of Insurance. Agencies of the State and its component units are charged premiums by the private insurance company. Settled claims have not exceeded coverage in any of the past three fiscal years.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
June 30, 2003 and 2002

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**NOTE 9 - RISK MANAGEMENT AND INSURANCE (continued)**

**Statewide Workers' Compensation Program** - The Workers' Compensation Program (the Program) was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job and includes all employees of the State and its component units. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment.

Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits. The State and its component units are self-insured for workers' compensation. State agencies and participating component units contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. A third-party administrator handles workers' compensation claims, receives a per case administration fee, and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act.

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 10 - INTERGOVERNMENTAL PAYABLES**

**North Carolina State University Agreement** - The Authority administers funds on behalf of the North Carolina State University College of Natural Resources (the University) for approved projects that rehabilitate or educate the people of rural North Carolina. The funds originated from proceeds of a sale of federal forest land held by the North Carolina Rural Rehabilitation Corporation. These funds are invested with the State Treasurer's Cash and Investment Pool. During 2003, the Authority approved the use \$200,000 for future projects and paid \$19,595 for project costs incurred.

**Farm Pilot Project** - The enactment of the Agricultural, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of Fiscal Years 2002 (the Act) appropriated funds to the United States Department of Agriculture Natural Resources Conservation Service (NRCS) for pilot projects demonstrating innovative treatment technologies which result in at least a 75% reduction in the nutrient content of wastewater discharged by animal feeding operations. The Act identified the Authority and a Florida not-for-profit corporation, as entities authorized to create and implement the pilot project. For its services, the Authority receives cash advances to cover project and administrative costs. Unexpended cash advances must be returned to the NRCS at the end of the project term. The Agency received and disbursed \$528,090 and \$1,265,676 for pilot projects during the years ended June 30, 2003 and June 30, 2002 respectively. The Agency incurred reimbursed administrative expenses of \$51,407 and \$39,058 during the years ended June 30, 2003 and June 30, 2002 to manage the projects.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2003 and 2002

**NOTE 10 - INTERGOVERNMENTAL PAYABLES (continued)**

Intergovernmental payables consist of the following at June 30:

	2003	2002
Due to North Carolina State University	\$ 351,138	\$ 354,003
Due to the U.S. Department of Agriculture Natural Resources Conservation Service	63,610	32,904
Total Intergovernmental Payables	\$ 414,748	\$ 386,907

**NOTE 11 - CHANGES IN NON-CURRENT LIABILITIES**

A summary of changes in accrued vacation leave for the year ended June 30, 2003, is presented as follows:

	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Current Portion
Accrued Vacation Leave	\$ 28,585	\$ 25,630	\$ (12,220)	\$ 41,995	\$ 4,048

A summary of changes in accrued vacation leave for the year ended June 30, 2002 is presented as follows:

	Balance July 1, 2001	Additions	Reductions	Balance June 30, 2002	Current Portion
Accrued Vacation Leave	\$ 24,122	\$ 21,097	\$ (16,634)	\$ 28,585	\$ 1,513

**NOTE 12 - COMMITMENTS AND CONTINGENCIES**

**No Commitment Debt** - Since 1995, the Authority has issued Agricultural Development Revenue Bonds to provide financial assistance to North Carolina farmers and agribusinesses for the acquisition, construction, and equipping of various agricultural projects deemed to be in furtherance of the Authority's purpose. The bonds are secured by an Indenture of Trust and a Letter of Credit and are payable solely from payments received on the underlying loan obligations. Neither the Authority nor the State of North Carolina is obligated in any manner for repayment of the bonds. Accordingly, the bonds are not reported as liabilities in the accompanying financial statements.

As of June 30, 2003, there were seven series of Agricultural Development Revenue Bonds outstanding with an aggregate principal amount payable of \$27,310,000. There were six series of Agricultural Development Revenue Bonds outstanding with an aggregate principal amount payable of \$25,040,000 as of June 30, 2002.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
June 30, 2003 and 2002

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**NOTE 12 - COMMITMENTS AND CONTINGENCIES (continued)**

**Loans Not Fully Dispersed** – At June 30, 2003 and 2002, the Authority had loan commitments of \$1,023,802 and \$679,026, respectively, that were not fully dispersed.

**NOTE 13 - ACCOUNTING CHANGES**

Effective July 1, 2001, the Authority implemented Governmental Accounting Standards Board Statement 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* and Statement 38, *Certain Financial Statement Note Disclosures*. The implementation of these new standards impacted the presentation format of the financial statements and added additional disclosures about financial statement amounts.

**NOTE 14 - NET ASSET RESTATEMENTS**

Net assets at July 1, 2001 have been restated by \$102,083 for capital asset amounts recognized in prior years. These assets were previously reported by the Rural Rehabilitation Corporation. Due diligence proceedings relating to the transfer of the Corporation’s assets to the Authority revealed that ownership of these assets resided with another State agency.



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

Board of Directors  
North Carolina Agricultural Finance Authority  
Raleigh, North Carolina

We have audited the financial statements of the North Carolina Agricultural Finance Authority (the "Authority") as of and for the years ended June 30, 2003 and June 30, 2002, and have issued our report thereon dated November 30, 2003. We conducted our audits 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 audits 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 audits, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purposes of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Authority's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements.

The following reportable condition was noted as a result of our audits and is described in the Audit Findings and Recommendations section of this report:

## **Finding**

### 1. Control Environment

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 employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, the reportable condition described above, is considered to be a material weakness.

This report is intended solely for the information and use of the management of the Authority, the Governor, the Office of State Budget and Management, the Office of the State Controller and the General Assembly and is not intended to be, and should not be, used by anyone other than these specified parties.

*Thomas S. Gilbo CAE, FCC*

Durham, North Carolina  
November 30, 2003

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**AUDIT FINDINGS AND RECOMMENDATIONS**  
Years Ended June 30, 2003 and 2002

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**Matters Related to Internal Control Over Financial Reporting**

*Current Year Findings and Recommendations* - The following finding and recommendation was identified during our audits and represents significant deficiencies in internal control.

1. CONTROL ENVIRONMENT

The reporting relationship between the North Carolina Agricultural Finance Authority (the “Authority”) and the North Carolina Department of Agriculture and Consumer Services (the “Department”) is not well defined resulting in inadequate financial oversight. The Authority, constituted as a public agency within the Department, is authorized to establish a system of accounts and records for its activities. However, the Authority has relied on the Department for accounting services and financial statement preparation since its inception and is listed as a Board within the Department.

During our review of the reporting relationship between the two entities, we noted the following:

- All matters related to financial reporting for the Authority are handled by the Department. The Authority’s management does not approve journal entries, prepare the CAFR package or prepare the statement of cash flows as required for the annual financial audit.
- The Authority does not have a policy for investigating unusual changes in its financial statements. For example, the Authority was unable to explain why certain liability account balances carried forward each year.
- We identified an operating cutoff error that resulted in the overstatement of revenue by \$32,904 and \$30,706 for the years ended June 30, 2003 and June 30, 2002, respectively.
- Transactions for the Authority are reported in the accounts of the Department. Separate bank reconciliations are available for the activities of the Authority. It was noted during our audit, however, that the Department is not current with the reconciliations of the Authority’s bank accounts.

Management of the Authority is ultimately responsible for its financial reporting despite the assistance provided by the Department regarding certain accounting functions. Internal control procedures should be designed to provide reasonable assurance as to the accuracy and reliability of the Authority’s financial reporting.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**AUDIT FINDINGS AND RECOMMENDATIONS (continued)**  
Years Ended June 30, 2003 and 2002

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*Recommendation:* We recommend that representatives from the Authority and the Department meet to evaluate their current financial reporting relationship. The goal of this meeting should be to define the duties and responsibilities for the financial activities and reporting for the Authority. Consideration should be given to implementing procedures that will allow the Authority to identify its financial position and cash balance on a monthly basis.

*Agency's Response:* The North Carolina Agricultural Finance Authority (the "Authority") agrees with your finding that the financial reporting relationship is not completely reconciled. However, considerable progress has been realized in the last six months. The Authority used the services of a former state auditor in May through September of 2003 to assist in the process. He was able to move the Authority toward having the complete ability to identify its financial position and cash balance at the end of each month by developing a cash reconciliation system using available information. This involved receiving assistance from the Office of the State Controller in identifying the appropriate reports in the CAFR system. The North Carolina Department of Agriculture and Consumer Services was then asked to make these reports available to the Authority by electronic transmission (they had not been available before). With these reports and assistance from the Office of the State Controller, the Authority should be able to construct trial balance reports at the end of fiscal year 2003 - 2004. Also, the ability to identify its financial position and cash balance at the end of each month is in place. The Authority is prepared to assume responsibility for year end reports consistent with GASB 34 reporting requirements as soon as additional training has been obtained with assistance from the Office of the State Controller.



## DISTRIBUTION OF AUDIT REPORT

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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.

### EXECUTIVE BRANCH

The Honorable Michael F. Easley	Governor of North Carolina
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
Dr. Frank Bordeaux	Executive Director
	North Carolina Agricultural Finance Authority
Mr. Robert Frank Timberlake, Jr.	Chairman of the Board
	North Carolina Agricultural Finance Authority

### LEGISLATIVE BRANCH

Appointees to the Joint Legislative Commission on Governmental Operations

President Pro Tempore	Speaker of the House
Senator Marc Basnight, Co-Chair	Representative James B. Black, Co-Chair
Senator Charles W. Albertson	Representative Richard T. Morgan, Co-Chair
Senator Patrick J. Ballantine	Representative Martha B. Alexander
Senator Daniel G. Clodfelter	Representative Rex L. Baker
Senator Walter H. Dalton	Representative Bobby H. Barbee, Sr.
Senator Charlie S. Dannelly	Representative Harold J. Brubaker
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Senator Linda Garrou	Representative E. Nelson Cole
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Senator Eric M. Reeves	Representative Edd Nye
Senator Robert A. Rucho	Representative William C. Owens, Jr.
Senator R. C. Soles, Jr.	Representative Wilma M. Sherrill
Senator Scott Thomas	Representative Thomas E. Wright

### Other Legislative Officials

Mr. James D. Johnson	Director, Fiscal Research Division
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January 15, 2004

## ORDERING INFORMATION

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