STATE OF
NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

NORTH CAROLINA STATE PORTS AUTHORITY

WILMINGTON, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

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WILMINGTON, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2004

STATE OF NORTH CAROLINA
Office of the State Auditor

Ralph Campbell, Jr.
State Auditor

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AUDITOR'S TRANSMITTAL

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

This report presents the results of our financial statement audit of the North Carolina State Ports Authority, a component unit of the State of North Carolina, for the year ended June 30, 2004. Our audit was made by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes.*

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

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

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

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

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

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

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

Special Review – In addition, a separate report, dated February 2004, has been issued by the Office of the State Auditor related to allegations concerning the abuse of North Carolina State Ports Authority resources.

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

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

We have audited the accompanying basic financial statements of the North Carolina State Ports Authority, a component unit of the State of North Carolina, as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina State Ports Authority as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 1, 2004 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be 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), as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

September 1, 2004

Overview of the Financial Statements and Financial Analysis

This discussion and analysis (MD&A) provides an overview of the Authority's financial activities during the fiscal years ending June 30, 2004 and 2003, respectively. Management, in addition to this analysis, is responsible for the preparation of the accompanying financial statements. The basic financial statements here include a Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows, plus Notes to the Financial Statements.

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

Financial Highlights and Analysis

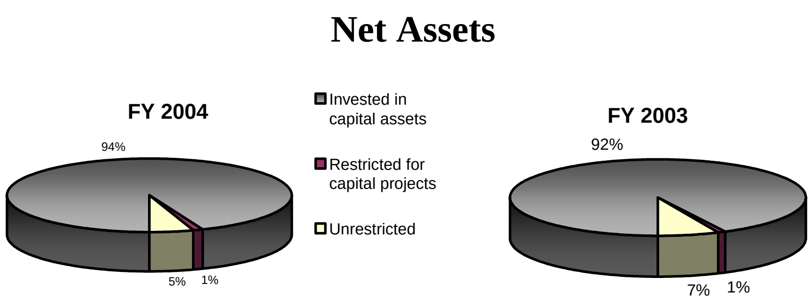
Taken in whole, the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets and Statement of Cash Flows are one measure of an organization's overall financial health and value. Individually, the Statement of Net Assets is a static view of financial value while the other two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

A comparison of net assets as of June 30, 2004 to that of the prior year yields several significant changes. The reduction in current assets and the increase in capital assets before depreciation relates to the Authority's on-going capital investment (CapEx) program, which will be discussed later in this analysis. The reduction in total net assets relate to the loss incurred by the Authority during the current year. The following table summarizes the major categories of net assets and their corresponding changes.

Condensed Statement of Net Assets

	June 30, 2004	June 30, 2003	Change	% Change
Current Assets	$ 11,795,517	$ 13,006,561	$ (1,211,044)	-9.3%
Capital Assets	153,357,589	153,712,530	(354,941)	-0.2%
Other Noncurrent Assets	903,265	1,178,551	(275,286)	-23.4%
Total Assets	166,056,371	167,897,642	(1,841,271)	-1.1%
Current Liabilities	6,735,180	3,932,537	2,802,643	71.3%
Noncurrent Liabilities	18,595,660	19,216,157	(620,497)	-3.2%
Total Liabilities	25,330,840	23,148,694	2,182,146	9.4%
Net Assets	$ 140,725,531	$ 144,748,948	$ (4,023,417)	-2.8%

The Authority's net assets are divided into three major categories. The first, invested in capital assets, net of related debt represents the Authority's equity position with regards to property, facilities and equipment. The second category is restricted to expenditure for capital assets and related debt. The final category is that of unrestricted which is available for any lawful purpose of the Authority. The following exhibit analyzes the Authority's net asset category mix for the periods ending June 30, 2004 and 2003, respectively. Significant changes again relate to CapEx and the current period net operating loss.



		2004
Invested in capital assets	$	132,239,412
Restricted for capital projects		1,512,671
Unrestricted		6,973,448
Net Assets	$	140,725,531

		2003
Invested in capital assets	$	134,035,527
Restricted for capital projects		1,056,617
Unrestricted		9,656,804
Net Assets	$	144,748,948

The Statement of Revenues, Expenses, and Changes in Net Assets reflects an overall decrease in net assets for the current fiscal year ending June 30, 2004. This decrease relates predominantly to operating activities and the decline of earnings on the Authority's investment reserves. The following table identifies variances between major financial categories for the fiscal years ending June 30, 2004 and 2003, respectively.

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

	June 30, 2004	June 30, 2003	Change	% Change
Operating Revenues	$ 29,245,592	$ 26,922,543	$ 2,323,049	8.6%
Operating Expenses	32,888,344	31,731,105	1,157,239	3.6%
Operating Loss	(3,642,752)	(4,808,562)	1,165,810	-24.2%
Nonoperating Revenues (Expenses)	(380,665)	476,739	(857,404)	-179.8%
Decrease in Net Assets	(4,023,417)	(4,331,823)	$ 308,406	7.1%
Net Assets, beginning of period	144,748,948	149,080,771		
Net Assets, end of period	$ 140,725,531	$ 144,748,948		

Increases in operating expenses (+3.6%) are attributable to an increase in depreciation expense driven by the Authority's CapEx expansion program and a general increase in terminal operating costs associated with improved cargo movements for bulk and break bulk activities. Consistent with improved cargo movement, operating revenues have posted increased levels (+8.6%) over that of the prior year. The variance noted above for Nonoperating revenues (expenses) relate to the disposition of several obsolete or otherwise idle assets and associated loss on disposal. The following table analyzes several nonfinancial measures relating to marine activities and cargo movement.

Summarized Cargo Movement

	June 30, 2004	June 30, 2003	Change	% Change
Container Movement	53,521	56,293	(2,772)	-4.9%
Short Tonnage Movement	3,918,188	3,147,070	771,118	24.5%
Vessel Call	794	786	8	1.0%
Rail Car Activity	12,801	9,148	3,653	39.9%

The Authority's overall liquidity position improved during the fiscal year ending June 30, 2004, with an increase to cash and cash equivalents of approximately $830,000. This compares to a reduction of $1.5 million for the prior year. The current year increment, in general, relates to increased operating activities and efficiencies. Additionally, while the Authority continues to make significant investment in capital projects these investments are down as compared to the prior year. Typical sources of cash for the Authority are found in results of operations, sale of investment securities and debt issuances. Uses of cash typically are found in the purchase of investment securities and the acquisition of capital assets. During the fiscal year 2004, the Authority generated significant inflows of cash from net security investing activities ($3.2 million) and operating activities ($4.7 million). Significant uses of cash during the same time period included the acquisition of capital assets ($7.2 million) and retirement of debt ($2.3 million). The following table summarizes cash flow activities for the fiscal years ending June 30, 2004 and 2003 respectively.

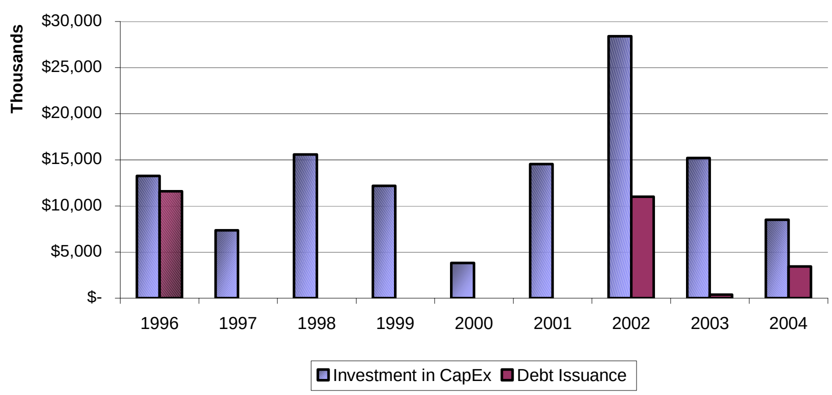
Summary Cash Flows

	June 30, 2004	June 30, 2003	Change	% Change
Cash Provided (Used) by:				
Operating Activities	$ 4,726,303	$ 3,409,495	$ 1,316,808	38.6%
Noncapital Financing Activities	156,419	250,000	(93,581)	-37.4%
Capital and Related Financing Activities	(7,206,804)	(17,391,272)	10,184,468	-58.6%
Investing Activities	3,153,257	12,234,241	(9,080,984)	-74.2%
Net Decrease in Cash and Cash Equivalents	829,175	(1,497,536)		
Cash and cash equivalents, beginning of period	1,584,797	3,082,333		
Cash and cash equivalents, end of period	$ 2,413,972	$ 1,584,797		

Capital Assets and Long-Term Debt

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

Investment in Capital Assets and Related Debt



Capital investment for the upcoming fiscal year is projected at approximately $9.2 million, which will be funded by a combination of federal grants, State appropriations, debt issuance, and internal cash flows.

Economic Outlook

With the completion of substantial portions of the Wilmington Harbor Deepening Project late in the current fiscal year combined with other strategic business initiatives, operating revenues as previously indicated, have increased thus reducing some of the pressures on the Authority's operating results and cash flows. This growth in revenues is expected to continue during the upcoming fiscal year with the anticipated increase to be in excess of 10%. As cargo movement expansion resulting from utilization of the deeper vessel draft capabilities continues filling available capacities, the Authority will be required to further expand its facility in Wilmington as well as look for ways to better utilize existing and expansion opportunities at its facility in Morehead City. These expansion requirements will continue to place pressures on the Authority's reserves. Alternative funding sources will be sought through commercial debt issuance, public/private joint ventures as well as State and federal sources.

North Carolina State Ports Authority
Statement of Net Assets
June 30, 2004 ***Exhibit A***

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	1,192,814.20
Restricted Cash and Cash Equivalents		1,221,157.72
Short-Term Investments		2,968,605.00
Receivables, Net (Note 3)		4,409,840.92
Inventories		1,086,960.94
Prepaid Items		916,138.27
Total Current Assets		11,795,517.05
Noncurrent Assets:		
Restricted Investments		291,513.01
Deferred Charges		611,753.04
Capital Assets - Nondepreciable, (Note 4)		33,171,655.56
Capital Assets - Depreciable, Net (Note 4)		120,185,932.66
Total Noncurrent Assets		154,260,854.27
Total Assets		166,056,371.32
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 5)		2,485,613.33
Deferred Revenue		711,187.48
Interest Payable		11,228.78
Short-Term Debt (Note 6)		2,024,000.00
Long-Term Liabilities - Current Portion (Note 7)		1,503,151.16
Total Current Liabilities		6,735,180.75
Noncurrent Liabilities:		
Long-Term Liabilities (Note 7)		18,595,659.90
Total Liabilities		25,330,840.65
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		132,239,412.14
Restricted for Expendable Capital Projects		1,512,670.73
Unrestricted		6,973,447.80
Total Net Assets	$	140,725,530.67

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

North Carolina State Ports Authority
Statement of Revenues, Expenses,
and Changes in Net Assets
For the Fiscal Year Ended June 30, 2004 ***Exhibit B***

REVENUES	
Operating Revenues:	
Sales and Services, Net	$ 25,395,867.87
Rental and Lease Earnings	3,849,723.73
Total Operating Revenues	29,245,591.60
EXPENSES	
Operating Expenses:	
Personal Services	15,892,231.74
Supplies and Materials	1,471,518.21
Services	4,868,165.72
Depreciation/Amortization	8,610,738.62
Insurance and Bonding	1,163,309.91
Other	882,379.94
Total Operating Expenses	32,888,344.14
Operating Loss	(3,642,752.54)
NONOPERATING REVENUES (EXPENSES)	
Investment Earnings	46,551.26
Federal Grants and Contracts	156,419.76
Interest and Fees on Capital Asset-Related Debt	(303,533.29)
Loss on Sale of Property & Equipment	(280,102.54)
Net Nonoperating Revenues (Expenses)	(380,664.81)
Decrease in Net Assets	(4,023,417.35)
NET ASSETS	
Net Assets - July 1, 2003	144,748,948.02
Net Assets - June 30, 2004	$ 140,725,530.67

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

North Carolina State Ports Authority
Statement of Cash Flows
For the Year Ended June 30, 2004 — ***Exhibit C***

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	28,318,046.33
Payments to Employees and Fringe Benefits		(15,804,799.22)
Payments to Vendors and Suppliers		(6,623,634.24)
Payments for Insurance and Bonding		(1,163,309.91)
Net Cash Provided by Operating Activities		4,726,302.96
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Noncapital Grants Received		156,419.76
Net Cash Provided by Noncapital Financing Activities		156,419.76
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVTIES		
Proceeds from Capital Debt		3,443,909.57
Proceeds from Sale of Capital Assets		186,173.14
Acquisition and Construction of Capital Assets		(8,524,265.10)
Principal Paid on Capital Debt and Leases		(2,002,735.66)
Interest and Fees Paid on Capital Debt and Leases		(309,886.25)
Net Cash Used by Capital Financing and Related Financing Activities		(7,206,804.30)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		11,726,344.47
Investment Income		43,799.60
Purchase of Investments and Related Fees		(8,616,887.30)
Net Cash Provided by Investing Activities		3,153,256.77
Net Increase in Cash and Cash Equivalents		829,175.19
Cash and Cash Equivalents - July 1, 2003		1,584,796.73
Cash and Cash Equivalents - June 30, 2004	$	2,413,971.92

North Carolina State Ports Authority
Statement of Cash Flows ***Exhibit C***
Year Ended June 30, 2004 ***Page 2***

RECONCILIATION OF NET OPERATING REVENUES (EXPENSES)		
TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Loss	$	(3,642,752.54)
Adjustments to Reconcile Operating Loss to Net Cash Provided by		
Operating Activities:		
Depreciation/Amortization Expense		8,610,738.62
Changes in Assets and Liabilities:		
Receivables (Net)		(806,666.33)
Inventories		46,273.27
Prepaid Items		(228,615.92)
Accounts Payable and Accrued Liabilities		783,915.27
Deferred Revenue		(106,378.94)
Compensated Absences		69,789.53
Net Cash Provided by Operating Activities	$	4,726,302.96
RECONCILIATION OF CASH AND CASH EQUIVALENT		
Current Assets:		
Cash and Cash Equivalents	$	1,192,814.20
Restricted Cash and Cash Equivalents		1,221,157.72
Total Cash and Cash Equivalent Balances - June 30, 2004	$	2,413,971.92
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES		
Assets Acquired through the Assumption of a Liability	$	3,443,909.57

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

The accompanying financial statements present all funds for which the Authority's Board of Directors is financially accountable.

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

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, the full scope of the Authority's activities is considered to be a single business-type activity (BTA) and accordingly, is reported within a single column in the basic financial statements.

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

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

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

D. **Cash and Cash Equivalents –** This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, savings accounts, money market accounts and cash on deposit with fiscal agents.

E. **Investments** - This classification includes money market funds and government securities held by the Authority. Except for money market funds, 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 decrease in the fair value of investments is recognized as a component of investment income.

Money market funds are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

F. **Receivables –** Receivables consist of charges to customers for services and use of facilities provided, as well as amounts due from the federal government. Receivables are recorded net of estimated uncollectible amounts. All receivables are expected to be collected within one year.

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

H. **Capital Assets –** Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

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

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

I. **Restricted Assets –** Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

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

Bonds payable are reported net of unamortized premiums or discounts. The Authority amortizes bond premiums/discounts over the life of the bonds using the straight-line method. Issuance costs are expensed.

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

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly to all full-time permanent employees as of September 30, 2002 and as of July 1, 2003. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

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

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

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

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

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

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

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

M. Revenue and Expense Recognition – The Authority classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as sales and services and rental and lease earnings. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.*

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

NOTE 2 - DEPOSITS AND INVESTMENTS

A. Deposits – Unless specifically exempt, the Authority is required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer.

Deposits include cash and cash equivalents with a carrying amount of $2,412,611.92 and a bank balance of $2,176,901.98. At year-end, cash on hand was $1,360.00. Of the bank balance, $472,071.03 was covered by federal depository insurance and $1,704,830.95 was uninsured and uncollateralized. All of the cash was on deposit with private financial institutions.

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

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

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

A summary of the Authority's investments at June 30, 2004 is presented below:

	Fair Value			
	Risk Category			
	1	2	3	Total
Categorized Investments:				
U.S. Government Securities	$ 0.00	$ 0.00	$ 2,968,605.00	$ 2,968,605.00
Investments Not Categorized:				
Money Market Funds				291,513.01
Total Investments				$ 3,260,118.01

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

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

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

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

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

As of June 30, 2004, the Authority had sold all of its mortgage-backed securities.

NOTE 3 - RECEIVABLES

Receivables at June 30, 2004 were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Accounts	$ 4,394,645.53	$ 5,250.27	$ 4,389,395.26
Investment Earnings	20,445.66		20,445.66
Total Current Receivables	$ 4,415,091.19	$ 5,250.27	$ 4,409,840.92

NOTE 4 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2004, is presented as follows:

	Balance July 1, 2003	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:				
Land	$ 21,452,491.10	$ 85,245.07	$ 33,671.51	$ 21,504,064.66
Construction in Progress	15,659,144.03	7,453,501.85	11,445,054.98	11,667,590.90
Total Capital Assets, Nondepreciable	37,111,635.13	7,538,746.92	11,478,726.49	33,171,655.56
Capital Assets, Depreciable:				
Buildings	69,206,204.80	377,880.05	371,339.18	69,212,745.67
Machinery and Equipment	43,686,850.60	2,584,629.93	2,455,578.33	43,815,902.20
General Infrastructure	132,347,017.71	9,412,663.18	4,739.59	141,754,941.30
Total Capital Assets, Depreciable	245,240,073.11	12,375,173.16	2,831,657.10	254,783,589.17
Less Accumulated Depreciation for:				
Buildings	27,875,226.76	1,838,607.29	287,859.35	29,425,974.70
Machinery and Equipment	35,669,670.27	5,683,192.98	2,111,193.58	39,241,669.67
General Infrastructure	65,094,281.55	835,730.59		65,930,012.14
Total Accumulated Depreciation	128,639,178.58	8,357,530.86	2,399,052.93	134,597,656.51
Total Capital Assets, Depreciable, Net	116,600,894.53	4,017,642.30	432,604.17	120,185,932.66
Capital Assets, Net	$ 153,712,529.66	$ 11,556,389.22	$ 11,911,330.66	$ 153,357,588.22

NOTE 5 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2004 were as follows:

	Amount
Accounts Payable	$ 2,368,001.05
Accrued Payroll	117,612.28
Total Accounts Payable and Accrued Liabilities	$ 2,485,613.33

NOTE 6 - SHORT-TERM DEBT – LINES OF CREDIT

The Authority uses revolving lines of credit to finance capital purchases. These lines of credit were necessary to maintain current cash flows. The Authority plans to refinance the BB&T line of credit, maturing January 2005, with long-term financing.

Short-term debt activity for the year ended June 30, 2004 was as follows:

	Balance July 1, 2003	Draws	Repayments	Balance June 30, 2004
Line of Credit - First Citizens Bank	$ 0.00	$ 750,000.00	$ 550,000.00	$ 200,000.00
Line of Credit - BB&T	0.00	1,824,000.00		1,824,000.00
Total Lines of Credit	$ 0.00	$ 2,574,000.00	$ 550,000.00	$ 2,024,000.00

NOTE 7 - LONG-TERM LIABILITIES

A. Changes in Long-Term Liabilities - A summary of changes in the long-term liabilities for the year ended June 30, 2004 is presented as follows:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	$ 18,890,000.00	$ 0.00	$ 1,115,000.00	$ 17,775,000.00	$ 1,115,000.00
Notes Payable	787,002.17	869,909.57	337,735.66	1,319,176.08	321,312.10
Compensated Absences	934,845.45	670,003.01	600,213.48	1,004,634.98	66,839.06
Total Long-Term Liabilities	$ 20,611,847.62	$ 1,539,912.58	$ 2,052,949.14	$ 20,098,811.06	$ 1,503,151.16

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

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 6/30/2004	Principal Outstanding 6/30/2004
Real Estate Acquisition	First Citizens	2.97%	11/2007	$ 746,508.32	$ 418,049.34	$ 328,458.98
Forklift Acquisition	BB&T	2.96%	2/2006	147,604.65	63,988.80	83,615.85
Forklift Acquisition	CCB	2.34%	5/2006	235,000.00	78,336.00	156,664.00
Tow Tugs & Trailers	BB&T	3.46%	11/2008	171,403.30	18,505.39	152,897.91
AS400 System Upgrades	CCB	2.55%	8/2006	93,000.00	25,833.30	67,166.70
IT Equipment	CCB	3.43%	2/2007	105,506.27	11,722.92	93,783.35
Gantry Crane	RBC Centura	2.77%	10/2008	500,000.00	63,410.71	436,589.29
Total Notes Payable				$ 1,999,022.54	$ 679,846.46	$ 1,319,176.08

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

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 6/30/2004	Principal Outstanding 6/30/2004
Woodchip Facility						
Construct Woodchip Facility	1995	1.1%-15%	12/2015	$ 5,080,000.00	$ 1,855,000.00	$ 3,225,000.00
Docks and Wharves Facility						
Construct Docks and Wharves	1996	1.1%-15%	1/2016	6,500,000.00	2,400,000.00	4,100,000.00
Bulk Grain Facility						
Construct Bulk Grain Facility	2001	1.1%-15%	9/2022	11,000,000.00	550,000.00	10,450,000.00
Total Bonds Payable (Principal Only)						$ 17,775,000.00

D. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2004 are as follows:

	Annual Requirements			
	Bonds Payable		Notes Payable	
Fiscal Year	Principal	Interest	Principal	Interest
2005	$ 1,115,000.00	$ 196,106.32	$ 430,834.18	$ 32,433.11
2006	1,115,000.00	183,810.72	407,142.57	20,570.93
2007	1,115,000.00	171,515.13	272,891.37	10,439.36
2008	1,115,000.00	159,219.52	177,535.17	3,460.71
2009	1,115,000.00	146,923.93	30,772.79	2,706.51
2010-2014	5,875,000.00	546,885.71		
2015-2019	4,125,000.00	235,755.84		
2020-2024	2,200,000.00	60,805.96		
Total Requirements	$ 17,775,000.00	$ 1,701,023.13	$ 1,319,176.08	$ 69,610.62

Interest on the variable rate revenue bonds was calculated at 1.1% at June 30, 2004.

NOTE 8 - OPERATING LEASE OBLIGATIONS

The Authority entered into operating leases for machinery and equipment. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2004:

Fiscal Year	Amount
2005	$ 104,877.20
2006	68,755.78
2007	18,531.72
2008	2,864.88
2009	2,864.88
Total Minimum Lease Payments	$ 197,894.46

Rental expense for all operating leases during the year was $74,395.48.

NOTE 9 - FUTURE RENTAL REVENUES

The Authority leases certain land and facilities to others. These leases are accounted for as operating leases; revenues are recorded when earned, and depreciation is provided, where appropriate, on leased facilities. Minimum future revenues under noncancelable agreements treated as operating leases as of June 30, 2004 are presented as follows:

Fiscal Year	Amount
2005	$ 1,720,165.86
2006	1,124,919.53
2007	752,056.48
2008	696,825.44
2009	586,226.69
2010 and thereafter	5,435,237.22
Total Future Rental Revenue	$ 10,315,431.22

NOTE 10 - PENSION PLANS

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

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

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by North Carolina General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2004, these rates were set at .22% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2004, the Authority had a total payroll of $12,477,031.01, of which $12,359,476.71 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $741,568.60 and $27,190.85, respectively. The Authority made one hundred percent of its annual required contributions for the years ended

June 30, 2004, 2003, and 2002, which were $27,190.85, $0.00, and $213,916.01, respectively.

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

B. **Deferred Compensation and Supplemental Retirement Income Plans** - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement, or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, *the North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the Authority. The voluntary contributions by employees amounted to $64,050.48 for the year ended June 30, 2004.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the Authority except for a 5% employer contribution for the Authority's law enforcement officer, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of Authority law enforcement officers for the year ended June 30, 2004 were $38,316.72. The voluntary contributions by employees amounted to $51,118.96 for the year ended June 30, 2004.

NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS

A. **Health Care for Long-Term Disability Beneficiaries and Retirees** - The Authority participates in State-administered programs which provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System or the Optional Retirement Program. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The Authority contributed 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System and the Optional Retirement Program for these health care benefits. For the fiscal year ended June 30, 2004, the Authority's total contribution to the Plan was $395,503.25. The Authority assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report.*

B. **Long-Term Disability** - The Authority participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. Employer contributions are established in the Appropriations Bill by the General Assembly. The Authority was not required to contribute to the DIPNC for the fiscal year ended June 30, 2004. The Authority assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 12 - RISK MANAGEMENT

The Authority is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. Except for a reduction in the public officers' and employees' liability insurance from $11,000,000 to $5,000,000, there have been no significant reductions in insurance coverage from the previous year, and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to $500,000 are self-insured under the authority of the State Tort Claims Act. In addition, the State provides excess public officers' and employees' liability insurance up to $5,000,000 via contract with a private insurance company. The Authority pays the premium, based on a composite rate, directly to the private insurer.

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

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

The Authority is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. The Authority is charged a premium by the private insurance company. Coverage limit is $5,000,000 per occurrence with a $50,000 deductible and a 10% participation in each loss above the deductible. Forgery and alteration coverage is limited to $100,000 per occurrence with no deductible.

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

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

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

Term life insurance (death benefits) of $25,000 to $50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. There were no employer contributions required for the current fiscal year.

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

NOTE 13 - COMMITMENTS AND CONTINGENCIES

A. Commitments - Outstanding commitments on construction contracts were $1,708,161.00 at June 30, 2004.

B. Pending Litigation and Claims – The Authority is a party to litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of these matters, no provision for any liability has been made in the financial statements. Authority management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the Authority. A claim in the amount of $454,264.00 is pending, and it is considered reasonably possible that the Authority's potential loss could be as much as $300,000.00.

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

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

We have audited the financial statements of the North Carolina State Ports Authority, a component unit of the State of North Carolina, as of and for the year ended June 30, 2004, and have issued our report thereon dated September 1, 2004.

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.

Internal Control Over Financial Reporting

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit

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

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*.

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

Ralph Campbell, Jr.

Ralph Campbell, Jr.
State Auditor

September 1, 2004

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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 Roy A. Cooper, III	Attorney General
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October 18, 2004

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