

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
Raleigh, North Carolina

Financial Statement Audit Report

Year Ended June 30, 2004

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

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

FINANCIAL STATEMENT AUDIT REPORT
NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
RALEIGH, NORTH CAROLINA
YEAR ENDED JUNE 30, 2004

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Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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AUDITOR'S TRANSMITTAL

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 North Carolina Agricultural Finance Authority, a component unit of the State of North Carolina, for the year ended June 30, 2004. Cherry, Bekaert, and Holland, L.L.P. performed this audit under contract with the Office of the State Auditor.

You will note from the independent auditor's report that an unqualified opinion was given on the fairness of presentation of the financial statements. Consideration of internal control over financial reporting and tests of compliance and other matters resulted in no reportable audit findings.

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.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the North Carolina Agricultural Finance Authority (the "Authority") as of and for the year ended June 30, 2004, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated June 5, 2005, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

The management's discussion and analysis 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.

CHERRY, BEKAERT & HOLLAND, L.L.P.

Cherry, Bekaert & Holland L.L.P.

Raleigh, North Carolina
June 5, 2005

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2004

Management's Discussion and Analysis is intended to give the reader an overview of factors that have affected operations 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 Balance Sheet, 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.

2004 Financial Highlights

- The assets of the Authority exceeded its liabilities at the close of the most recent fiscal year by \$15,599,420 (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 \$484,144. This increase is attributable to interest earnings on notes receivable and earnings for administering federally funded Farm Pilot projects.
- The Authority's liabilities decreased by \$257,953 during the fiscal year. The key factor in this change was the decrease in intergovernmental payables.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Year Ended June 30, 2004

Financial Statements

Balance Sheet

The Balance Sheet reports all assets and liabilities of the Authority; additionally the Statement classifies those assets and liabilities as current and noncurrent 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, 2004 and 2003.

Condensed Balance Sheet

	2004	2003 (Restated)	Variance
Assets			
Current Assets	\$ 6,111,701	\$ 5,475,070	\$ 636,631
Other Noncurrent Assets	9,747,384	10,157,824	(410,440)
Total Assets	15,859,085	15,632,894	226,191
Liabilities			
Current Liabilities	222,671	479,671	(257,000)
Noncurrent Liabilities	36,994	37,947	(953)
Total Liabilities	259,665	517,618	(257,953)
Net Assets			
Unrestricted	15,599,420	15,115,276	484,144
Total Net Assets	\$ 15,859,085	\$ 15,632,894	\$ 226,191

As of June 30, 2004 and 2003, the Authority's total assets were \$15.9 million and \$15.6 million, respectively. Of these totals, \$11 million and \$11.5 million were notes receivable from borrowers for the years ended June 30, 2004 and 2003, respectively.

The Authority's liabilities totaled \$259,665 and \$517,618 for the years ended June 30, 2004 and 2003, respectively. The total current liabilities of \$222,671 as of June 30, 2004 and \$479,671 as of June 30, 2003, were well covered by current assets of \$6.1 million in 2004 and \$5.5 million in 2003. This indicates the Authority's ability to pay current liabilities as they become due. Total net assets were \$15.6 million and \$15.1 million as of June 30, 2004 and 2003, respectively reflecting a \$484,144 increase between these years.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
 Year Ended June 30, 2004

Financial Statements (continued)

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

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.

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, and interest earnings on pooled investment accounts primarily represent nonoperating revenues.

Operating expenses increased from the prior year primarily due to an increase in contracted services. These services were incurred for two years of financial statement audits and for legal fees associated with the collection of bad loans. Nonoperating revenues increased primarily from the sale of loan portfolios to third parties.

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2004</u>	<u>2003</u>	<u>Variance</u>
Operating Revenues	\$ 778,415	\$ 772,798	\$ 5,617
Operating Expenses	<u>761,457</u>	<u>687,142</u>	<u>74,315</u>
Operating Income	16,958	85,656	(68,698)
Nonoperating Revenues	<u>467,186</u>	<u>300,572</u>	<u>166,614</u>
Change in Net Assets	484,144	386,228	97,916
Net Assets – July 1	15,115,276	14,853,952	261,324
Restatements		<u>(124,904)</u>	<u>124,904</u>
Net Assets - June 30	<u>\$ 15,599,420</u>	<u>\$ 15,115,276</u>	<u>\$ 484,144</u>

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)
Year Ended June 30, 2004

Financial Statements (continued)

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, 2004 and 2003.

The ending cash and cash equivalents on the Statement of Cash Flows corresponds directly with the sum of the cash and cash equivalents balances on the Balance Sheet.

The net cash provided (used) by operating activities shows net inflows and outflows of \$90,670 and (\$147,418) for the years ended June 30, 2004 and 2003, respectively. The major outflows were payments to borrowers for loans issued, which were \$.9 million and \$1.6 million for the years ended June 30, 2004 and 2003, respectively. The major sources of operating inflows were receipts from collections on loans (\$1.2 million and \$1.3 million for the years ended June 30, 2004 and 2003 respectively).

The Authority has cash inflows from investing activities of \$386,558 and \$255,462 for the years ended June 30, 2004 and 2003. These result from investment income.

Economic Factors and Future Outlook

The Authority is affected by North Carolina, U.S. and foreign economic conditions and policies. With 20 percent of the world's population, China as a growing economic power, provides challenges to the North Carolina economy. Whereas, textile and furniture companies have suffered immensely from Chinese competition, export of some agricultural items has increased as the purchasing power of Chinese citizens increases. Because changing economic conditions may increase risk, the Authority attempts to reduce the resultant risk to the loan portfolio by obtaining federal guarantees on loans where possible.

Since many countries now compete quite favorably with North Carolina agriculture, 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 NCAFA loans to 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 Authority had assisted many farmers to improve their net income by producing swine for the export market prior to the moratorium on new swine farms. In an attempt to be proactive, the Authority, in cooperation with FPPC (Farm Pilot Project Coordination, Inc.) continues to

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)
Year Ended June 30, 2004

Economic Factors and Future Outlook (continued)

be involved in financing innovative research projects to eliminate the negative environmental aspects of swine production. This should ultimately return an economic opportunity for increased swine production to North Carolina farmers that can be financed by the Authority.

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.

The Authority uses capital wisely. However, recent State budget shortfalls have prevented the Authority from receiving additional capital (nonoperating) for loan making. There are opportunities for financing for which there is a capital shortage, which cannot be met by the Authority. Legislation has been introduced in the General Assembly that would provide additional capital for value added processing and manufacturing through a tax credit program if enacted.

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 its 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
BALANCE SHEET
 June 30, 2004

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents (Note 3)	\$	4,330,301
Notes Receivable, Net (Note 4)		1,500,000
Interest Receivable		273,040
Other Receivable		6,664
Inventories		1,696

Total Current Assets		6,111,701
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Noncurrent Assets:

Notes Receivable, Net (Note 4)		9,575,884
Land Held for Investment (Note 5)		171,500

Total Noncurrent Assets		9,747,384
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Total Assets	\$	15,859,085
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LIABILITIES AND NET ASSETS

Current Liabilities:

Intergovernmental Payables (Note 6)	\$	204,320
Accounts Payable		14,763
Accrued Vacation Leave (Note 7)		3,588

Total Current Liabilities		222,671
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Noncurrent Liabilities

Accrued Vacation Leave (Note 7)		36,994
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Total Liabilities		259,665
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NET ASSETS

Unrestricted		15,599,420
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Total Liabilities and Net Assets	\$	15,859,085
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The accompanying notes are an integral part of these financial statements.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Year Ended June 30, 2004

Exhibit B

Operating Revenues:	
Interest Earnings on Loans	\$ 636,250
Sales and Services	138,605
Fees, Licenses and Fines	2,900
Rental and Lease Earnings	660
	778,415
Total Operating Revenues	778,415
Operating Expenses:	
Personal Services and Employee Benefits	455,521
Contracted Personal Services	170,417
Equipment	56,492
Rental Expense	27,820
Bad debts	13,256
Travel	12,596
Other Expenses	10,296
Supplies and Materials	6,022
Communications	5,262
Postage	3,775
	761,457
Total Operating Expenses	761,457
Operating Income	16,958
Nonoperating Revenues:	
Investment earnings	462,164
Miscellaneous	5,022
	467,186
Net Nonoperating Revenues	467,186
Change in Net Assets	484,144
Net Assets - July 1 as Originally Reported	15,240,180
Restatements (Note 13)	(124,904)
	15,115,276
Net Assets - July 1 restated	15,115,276
Net Assets - June 30	\$ 15,599,420

The accompanying notes are an integral part of these financial statements.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
STATEMENT OF CASH FLOWS
Year Ended June 30, 2004

Exhibit C

Cash Flows from Operating Activities:	
Receipts from Customers	\$ 775,813
Receipts from Collection of Loans	1,172,057
Payments for Loans Issued	(898,615)
Payments to Employees and Fringe Benefits	(456,935)
Payments to Vendors and Suppliers	<u>(501,650)</u>
Net Cash Flows from Operating Activities	<u>90,670</u>
Cash Flows from Noncapital Financing Activities:	
Other (Payments) Receipts	<u>5,022</u>
Cash Flows from Investing Activities:	
Interest on Investments	<u>386,558</u>
Net Increase in Cash and Cash Equivalents	482,250
Cash and Cash Equivalents - July 1	<u>3,848,051</u>
Cash and Cash Equivalents - June 30	<u><u>\$ 4,330,301</u></u>
Reconciliation of Net Operating Income to Net Cash	
Provided by Operating Activities:	
Operating Income	\$ 16,958
Adjustments to Reconcile Operating Income to Net Cash Provided	
by Operating Activities:	
Changes in Assets and Liabilities:	
Receivables - Net	270,841
Inventories	876
Intergovernmental Payables	(210,428)
Accounts Payable	<u>12,423</u>
Net Cash Provided by Operating Activities	<u><u>\$ 90,670</u></u>

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS
Year Ended June 30, 2004

NOTE 1 - THE 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 North Carolina 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 (*North Carolina General Statutes - Chapter 122D*).

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity – The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. 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 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)*.

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).

B. Basis of Presentation - The 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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 financial position, and changes in operations and 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.

C. Cash and Cash Equivalents – Cash and cash equivalents include 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.

D. 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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

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.

All receivables that historically experience uncollectible accounts are shown net of an allowance for doubtful accounts. This amount is estimated by analyzing the percentage of receivables that were written off in prior years.

- E. 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.
- F. Capital Assets** - It is the policy of the Authority to capitalize all capital assets costing more than \$5,000 with an estimated useful life of two or more years. In addition, other items that are purchased and used in large quantities are capitalized. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. There were no assets in excess of the capitalization threshold as of June 30, 2004.
- G. Lease Obligations** – Operating lease payments are recorded as expenses when incurred. All leases contain specific appropriation clauses indicating that continuation of each lease is subject to continued funding by the Legislature.
- H. Compensated Absences** - The Authority's policy is to record the cost of vacation leave when earned. The policy provides for the maximum

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

accumulation of unused vacation leave of 30 days which can be carried forward each January 1st or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at December 31st is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at 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.

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.

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.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The Authority incurs program expenses that are both restricted and unrestricted. It is the Authority's policy to first apply cost-reimbursement grant resources to such programs, followed by categorical block grants, and then by general revenues.

NOTE 3 - DEPOSITS

The State Treasurer holds all of the Authority's deposits. 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."

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 both a bank and a book balance of \$4,330,301 as of June 30, 2004.

NOTE 4 - NOTES RECEIVABLE, NET

A summary of changes in notes receivable is as follows:

Notes Receivable from Borrowers	\$	24,108,302
Notes Payable to Holders		(12,917,418)
		11,190,884
Less Allowance		(115,000)
		11,075,884
Notes Receivable, Net		(1,500,000)
		9,575,884
Noncurrent Portion	\$	9,575,884

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 5 - LAND HELD FOR INVESTMENT

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

NOTE 6 - INTERGOVERNMENTAL PAYABLES

A. 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 forestland held by the North Carolina Rural Rehabilitation Corporation. These funds are invested with the State Treasurer's Cash and Investment Pool.

B. Farm Pilot Project - The enactment of the Agricultural, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of Fiscal Year 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 Authority received and disbursed \$6,163 and \$216,591 for these projects during the year ended June 30, 2004.

NOTE 7 - CHANGES IN NONCURRENT LIABILITIES

A summary of changes in accrued vacation leave for the year ended June 30, 2004, is presented as follows:

	<u>July 1, 2003</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2004</u>	<u>Current Portion</u>
Accrued Vacation Leave	\$ 41,995	\$ 40,582	\$ (41,995)	\$ 40,582	\$ 3,588

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 8 - OPERATING LEASES

The Authority leases various equipment used in its daily operations. Future minimum rental payments required under leases that have noncancelable lease terms as of June 30, 2004, were \$48,895, \$51,614, and \$25,016 for fiscal years 2005, 2006 and 2007, respectively.

Rental expense for the year was \$27,820.

NOTE 9 - RETIREMENT PLANS

A. Plan Description – The Authority contributes to the Statewide Teachers’ and State Employees’ Retirement System (TSERS), a cost-sharing multiple-employer defined benefit pension plan administered by the State of North Carolina. TSERS provides retirement benefits to plan members and beneficiaries. Article 1 of General Statute Chapter 135 assigns the Authority to establish and amend benefit provisions to the North Carolina General Assembly. The Teachers’ and State Employees’ Retirement System is included in the Comprehensive Annual Financial Report (CAFR) for the State of North Carolina. The State’s CAFR includes financial statements and required supplementary information for TSERS. That report may be obtained by writing to the Office of the State Controller, 1410 Mail Service Center, Raleigh, North Carolina 27699-1410, or by calling (919) 981-5454.

B. Funding Policy – Employers and members are required to contribute to the Plan at rates 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. The Authority’s contributions to TSERS for the years ended June 30, 2004, 2003, and 2002 were \$850, \$0, and \$6,930, respectively, equal to the required contributions.

NOTE 10 - POST-EMPLOYMENT BENEFITS

A. 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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 10 - POST-EMPLOYMENT BENEFITS (CONTINUED)

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, 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 3.20% 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 \$12,358 for the year ended June 30, 2004. 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.

- A. Disability Income** - 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. There was no contribution made to the plan for the year ended June 30, 2004. Contributions to the plan 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.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 11 - 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.

A. States 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 employees and retirees make contributions for dependent coverage. 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.

B. 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. However, no contributions were required for the year ended

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 11 - RISK MANAGEMENT AND INSURANCE (CONTINUED)

June 30, 2004. The 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.

- C. 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.

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.

- D. 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.

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.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 11 - RISK MANAGEMENT AND INSURANCE (CONTINUED)

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.

- E. Public Officer' 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.

- F. 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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONTINUED)
Year Ended June 30, 2004

NOTE 11 - RISK MANAGEMENT AND INSURANCE (CONTINUED)

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.

- G. 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 12 - COMMITMENTS AND CONTINGENCIES

- A. 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.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY
NOTES TO FINANCIAL STATEMENTS (CONCLUDED)
Year Ended June 30, 2004

NOTE 12 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

As of June 30, 2004, there were five series of Agricultural Development Revenue Bonds outstanding with an aggregate principal amount payable of \$19,810,000.

- B. Loans Not Fully Dispersed** - The Authority had loan commitments of \$8,517,000 that were not fully dispersed at June 30, 2004.

NOTE 13 - RESTATEMENT

Net assets at July 1, 2003, have been restated by \$124,904 to adjust for transactions related to the Farm Pilot Program Corporation, to set up a reserve for loan losses, to write off an old liability for claims payable, and to write off an old outstanding deferred revenue item.

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

Board of 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 year ended June 30, 2004, and have issued our report thereon dated June 5, 2005. 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 an opinion 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 reportable 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 caused by error or fraud 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 operations 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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of

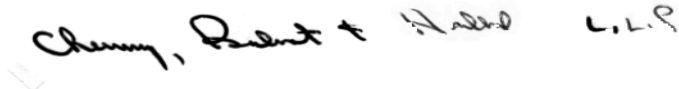
**INDEPENDENT AUDITOR'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS (CONCLUDED)**

our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the Authority in a separate letter dated June 5, 2005.

This report is intended solely for the information and use of the Board of Directors, management, the Governor and the General Assembly and is not intended to be, and should not be, used by anyone other than these specified parties.

CHERRY, BEKAERT & HOLLAND, L.L.P.



Raleigh, North Carolina
June 5, 2005

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Director, Fiscal Research Division

August 5, 2005

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