STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

NORTH CAROLINA STATE PORTS AUTHORITY

WILMINGTON, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF

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FOR THE YEAR ENDED JUNE 30, 2005

STATE OF NORTH CAROLINA
Office of the State Auditor

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
Board of Directors, North Carolina State Ports Authority

We have completed a financial statement audit of the North Carolina State Ports Authority for the year ended June 30, 2005, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements resulted in no 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

December 21, 2005

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STATE OF NORTH CAROLINA
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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, 2005, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the 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, 2005, 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.

As discussed in Note 14 to the financial statements, the Authority implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2005, 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 considered in assessing the results of our audit.

The Management's Discussion and Analysis, 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Leslie W. Merritt, Jr.

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

September 30, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2005, and 2004, respectfully. Management, in addition to this analysis, is responsible for the preparation of the accompanying financial statements. The basic financial statements here include a Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows, plus Notes to the Financial Statements.

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

Financial Highlights and Analysis

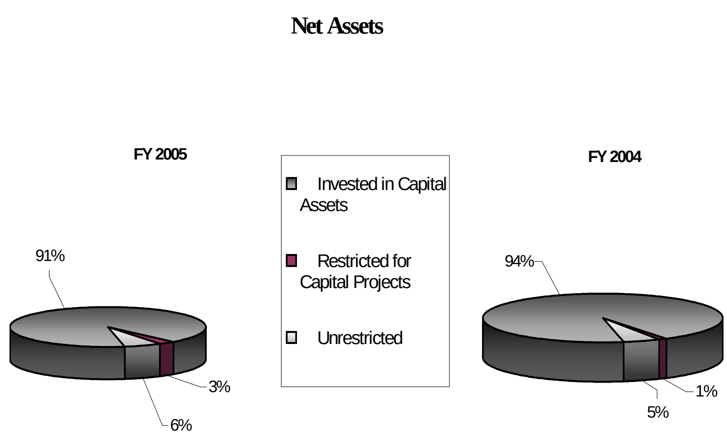
Taken in whole, the Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets and Statement of Cash Flows are one measure of an organization's overall financial health and value. Individually, the Statement of Net Assets is a static view of financial value while the other two depict 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. For the fiscal year ended June 30, 2005, the Authority implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*. The effects of this change are discussed further in Note 14 of the Notes to the Financial Statements.

A comparison of net assets as of June 30, 2005, to that of the prior year yields several significant changes. The increases in current assets and other noncurrent assets reflect increases in cash position. In the case of noncurrent assets, capital appropriations on deposit represents the largest component of the increase and in the case of current assets, the increase relates to growth in the Authority's investments reserve. The reduction in total liabilities relates predominately to the early retirement of bond debt, which through the write-off of associated assets also accounts for the majority of the change to capital assets. The following table summarizes the major categories of net assets and their corresponding changes.

Condensed Statement of Net Assets

	June 30, 2005	June 30, 2004	Change	% Change
Current Assets	$ 14,357,605.78	$ 11,795,517.05	$ 2,562,088.73	21.7 %
Capital Assets	145,570,405.40	153,357,588.22	(7,787,182.82)	(5.1) %
Other Noncurrent Assets	3,757,409.52	903,266.05	2,854,143.47	316.0 %
Total Assets	163,685,420.70	166,056,371.32	(2,370,950.62)	(1.4) %
Current Liabilities	6,183,939.32	6,735,180.75	(551,241.43)	(8.2) %
Noncurrent Liabilities	13,283,473.13	18,595,659.90	(5,312,186.77)	(28.6) %
Total Liabilities	19,467,412.45	25,330,840.65	(5,863,428.20)	(23.1) %
Net Assets	$ 144,218,008.25	$ 140,725,530.67	$ 3,492,477.58	2.5 %

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 expenditures 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, 2005, and 2004, respectively. Significant changes again relate to funds received from State and federal sources for planned capital improvements and increase in the investment reserve.



	2005
Invested in Capital Assets	$ 131,448,508.09
Restricted for Capital Projects	3,867,435.96
Unrestricted	8,902,064.20
Net Assets	$ 144,218,008.25

	2004
Invested in Capital Assets	$ 132,239,412.14
Restricted for Capital Projects	1,512,670.73
Unrestricted	6,973,447.80
Net Assets	$ 140,725,530.67

The Statement of Revenues, Expenses, and Changes in Net Assets reflects an overall increase in net assets for the current fiscal year ending June 30, 2005. This increase relates predominantly to increased marine terminal activity resulting in a substantially reduced operating loss from FY 2004 to FY 2005. This coupled with funding received from State and federal sources for planned capital improvements reported as nonoperating revenues account for the majority of the differences between the two years. The following table identifies variances between major financial categories for the fiscal years ending June 30, 2005, and 2004, respectively.

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

	June 30, 2005	June 30, 2004	Change	% Change
Operating Revenues	$ 35,016,111.18	$ 29,245,591.60	$ 5,770,519.58	19.7%
Operating Expenses	37,342,220.70	32,888,344.14	4,453,876.56	13.5%
Operating Loss	(2,326,109.52)	(3,642,752.54)	1,316,643.02	36.1%
Nonoperating Revenues (Expenses)	5,818,587.10	(380,664.81)	6,199,251.91	1,628.5%
Increase (Decrease) in Net Assets	3,492,477.58	(4,023,417.35)	$ 7,515,894.93	186.8%
Net Assets, Beginning of Period	140,725,530.67	144,748,948.02		
Net Assets, End of Period	$ 144,218,008.25	$ 140,725,530.67		

Increased cargo movements were posted for all major marine activities at both the Ports of Morehead City and Wilmington. This represents the second year for double digits growth in general cargo movements; 24.5%, FY 2003 to FY 2004 and 18.8%, FY 2004 to FY 2005 as well as a significant 36.5% single-year increase in containerized cargo movements from FY 2004 to FY 2005. These increases are being driven by growth in U. S. East Coast cargo volumes along with corresponding congestion in competing ports to the north and south as well as a declining U. S. East Coast capacity/facilities for bulk and breakbulk commodities. The following table analyzes several nonfinancial measures relating to these marine activities and cargo movement.

Summarized Cargo Movement

	June 30, 2005	June 30, 2004	Change	% Change
Container Movement (Units)	73,060	53,521	19,539	36.5%
General Cargo Movement (Short Tons)	4,653,765	3,918,188	735,577	18.8%
Vessel Calls	881	794	87	11.0%
Rail Car Activity	12,893	12,801	92	0.7%

Consistent with increased cargo movement and other terminal activities, operating revenues have posted an increase of 19.7% over that of the prior year. Correspondingly, operating expenses have increased 13.5% over the same time frame. The following table shows the major sources of both operating and nonoperating revenues in detail.

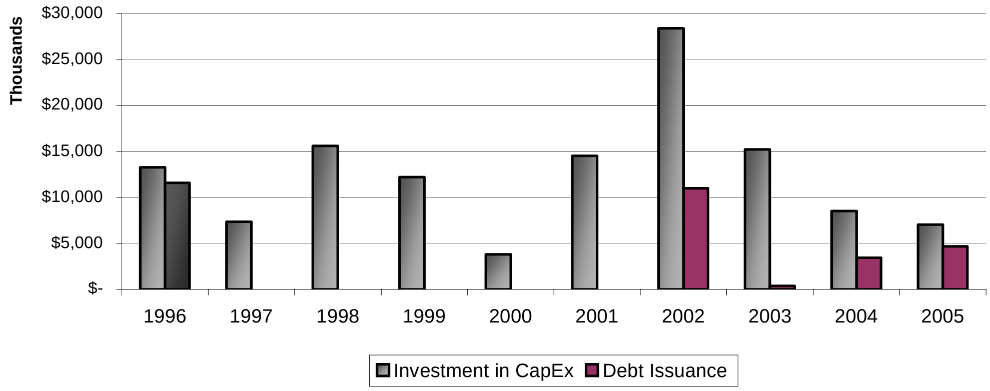
Operating and Nonoperating Revenues, by Major Source

	June 30, 2005	June 30, 2004	Change	% Change
Operating Revenues				
Sales and Services	$ 31,174,317.85	$ 25,395,867.87	$ 5,778,449.98	22.8 %
Rental and Lease Earnings	3,841,793.33	3,849,723.73	(7,930.40)	(0.2) %
Total Operating Revenues	35,016,111.18	29,245,591.60	5,770,519.58	19.7 %
Nonoperating Revenues (Expenses) and Other Revenues (Expenses)				
Investment Earnings	101,965.56	46,551.26	55,414.30	119.0 %
Capital Appropriations	4,968,570.00		4,968,570.00	
Capital Grants	578,526.20	156,419.76	422,106.44	269.9 %
Capital Gifts	6,581,452.43		6,581,452.43	
Loss on Sale of Property and Equipment	(5,274,651.88)	(280,102.54)	(4,994,549.34)	(1,783.1) %
Other Nonoperating Expenses, Net	(1,137,275.21)	(303,533.29)	(833,741.92)	(274.7) %
Total Nonoperating Revenues (Expenses)	5,818,587.10	(380,664.81)	6,199,251.91	1,628.5 %
Total Revenues	$ 40,834,698.28	$ 28,864,926.79	$ 11,969,771.49	41.5 %

Capital Assets and Long-Term Debt

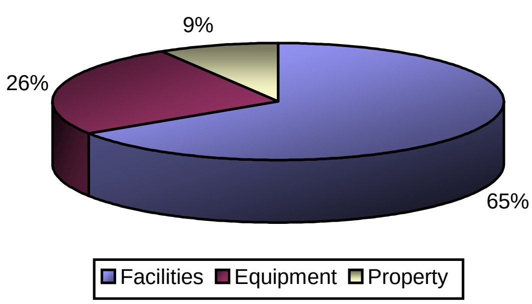
Beginning late fiscal year 1995 and early 1996, the Authority implemented an aggressive capital investment program. This program was based on a number of motivating factors including the need to address an aging infrastructure system, seek new business development ventures, and exploring general growth opportunities. Central to this investment program is the Wilmington Harbor Deepening project, which is funded through a State and Federal matching program. During 2005, the Authority updated its Strategic Plan identifying port terminal infrastructure that either needed refurbishment or expansion. As a result of this update, Authority's management identified approximately $266 million in capital expenditures that will be required over the next 13 years. Subsequently, the Authority's Board of Directors approved these expenditures in concept. These expenditures include acquisitions of equipment and land as well as the construction of new facilities and the rehabilitation of existing facilities and infrastructure at both terminals in Wilmington and Morehead City. The driving force behind this capital program is the Authority's expectation of market growth, which will be more fully described later in this discussion. The following graph summarizes recent capital investment and related debt issuance.

Investment in Capital Assets and Related Debt

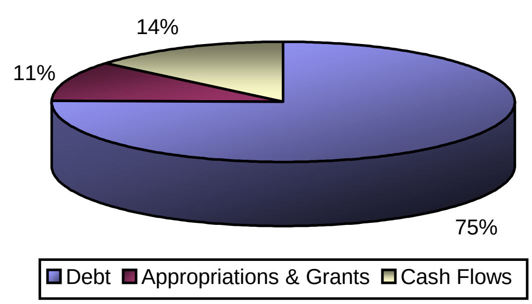


Capital investment for the upcoming fiscal year is projected at approximately $52 million, which will be funded by a combination of federal grants, State appropriations, debt issuance, and internal cash flows. Funding for outlying years 2007 to 2018 are anticipated to come from the same or similar sources as with planned 2006 expenditures. The following graphs provide a breakdown of expenditures by category as well as anticipated funding by sources.

Expenditures by Category



Funding by Source



Economic Outlook

With the completion of substantial portions of the Wilmington Harbor Deepening Project late in the prior fiscal year and other strategic business initiatives, as previously indicated operating revenues have increased, thus improving the Authority's operating results and cash flows. Also as discussed, the Authority experienced a 19.7% increase in operating revenues during the current fiscal period which was driven largely by increases in cargo volumes and only secondarily by pricing increases. This continued improvement in operating performance combined with mounting pressure to divert cargos from the U. S. West Coast to the East Coast has prompted the Authority to engage itself in a more exhaustive long-range market forecast. The results of this forecast indicate a significant growth opportunity for the

North Carolina Ports as well as the East Coast in general. As a result of this recent growth, as well as projected cargo volume expansion, the Authority is anticipating that its existing capacity will be maximized within the next two years. This has prompted the Authority to develop the expansion plans outlined above in order to better utilize the State's deep-water facilities. It is estimated that the combined capital projects will add 5,000 jobs and $25 million in tax revenues to the existing Statewide 48,000 jobs and nearly $30 million in tax revenues already attributable to activities at the State Ports. With the up coming fiscal year, operating results are anticipated to produce a positive bottom line. This improvement is predicted to continue over the next ten years. The following table summarizes these results.

Project Average Annual Growth Over 10-Year Time Period

		High	Low
Revenues from Container Operations		19%	16%
Revenues from Bulk & Breakbulk Operations		11%	9%
Container Movement	Moves	16%	14%
Bulk & Breakbulk Movement	Short Tons	13%	6%

Expansion requirements will continue to place pressures on the Authority's cash reserves as well as operating performance, but the above outlined growth rates are anticipated to improve operating results from a loss of 6.6% for fiscal year 2005, to a profit of 18.4% in 2015, which is more in line with the Authority's peer competing port group.

North Carolina State Ports Authority
Statement of Net Assets
June 30, 2005

Exhibit A-1

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	511,423.88
Restricted Cash and Cash Equivalents		437,926.57
Short-Term Investments		6,247,319.21
Receivables, Net (Note 3)		5,844,095.44
Inventories		851,992.72
Prepaid Items		464,847.96
Total Current Assets		14,357,605.78
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		2,968,570.00
Deferred Charges		788,839.52
Capital Assets - Nondepreciable (Note 4)		29,372,378.02
Capital Assets - Depreciable, Net (Note 4)		116,198,027.38
Total Noncurrent Assets		149,327,814.92
Total Assets		163,685,420.70
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 5)		4,204,751.01
Deferred Revenue		49,568.51
Interest Payable		16,371.70
Short-Term Debt (Note 6)		700,000.00
Long-Term Liabilities - Current Portion (Note 7)		1,213,248.10
Total Current Liabilities		6,183,939.32
Noncurrent Liabilities:		
Long-Term Liabilities (Note 7)		13,283,473.13
Total Liabilities		19,467,412.45
NET ASSETS		
Invested in Capital Assets, Net of Related Debt		131,448,508.09
Restricted for Expendable Capital Projects		3,867,435.96
Unrestricted		8,902,064.20
Total Net Assets	$	144,218,008.25

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, 2005

Exhibit A-2

REVENUES		
Operating Revenues:		
Sales and Services	$	31,174,317.85
Rental and Lease Earnings		3,841,793.33
Total Operating Revenues		35,016,111.18
EXPENSES		
Operating Expenses:		
Salaries and Benefits		18,528,512.27
Supplies and Materials		2,107,285.69
Services		6,255,742.66
Depreciation/Amortization		8,593,573.81
Insurance and Bonding		1,080,010.13
Other		777,096.14
Total Operating Expenses		37,342,220.70
Operating Loss		(2,326,109.52)
NONOPERATING REVENUES (EXPENSES)		
Investment Earnings		101,965.56
Interest and Fees on Capital Asset-Related Debt		(439,757.21)
Loss on Sale of Property and Equipment		(5,274,651.88)
Other Nonoperating Revenues (Expenses), Net		(697,518.00)
Net Nonoperating Revenues (Expenses)		(6,309,961.53)
Loss Before Other Revenues		(8,636,071.05)
Capital Appropriations		4,968,570.00
Capital Grants		578,526.20
Capital Gifts		6,581,452.43
Increase in Net Assets		3,492,477.58
NET ASSETS		
Net Assets - July 1, 2004		140,725,530.67
Net Assets - June 30, 2005	$	144,218,008.25

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, 2005 ***Exhibit A-3***

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	32,934,215.15
Payments to Employees and Fringe Benefits		(18,419,551.63)
Payments to Vendors and Suppliers		(7,471,017.98)
Payments for Insurance and Bonding		(1,080,010.13)
Net Cash Provided by Operating Activities		5,963,635.41
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Capital Appropriations		4,968,570.00
Capital Grants		578,526.20
Capital Gifts		6,581,452.43
Proceeds from Capital Debt		4,688,533.50
Proceeds from Sale of Capital Assets		775,300.79
Acquisition and Construction of Capital Assets		(7,033,430.14)
Principal Paid on Capital Debt		(11,684,812.27)
Interest and Fees Paid on Capital Debt		(434,614.29)
Net Cash Used by Capital Financing and Related Financing Activities		(1,560,473.78)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sales and Maturities of Investments		2,117,263.30
Investment Income		87,988.10
Purchase of Investments and Related Fees		(5,104,464.50)
Net Cash Used by Investing Activities		(2,899,213.10)
Net Increase in Cash and Cash Equivalents		1,503,948.53
Cash and Cash Equivalents - July 1, 2004		2,413,971.92
Cash and Cash Equivalents - June 30, 2005	$	3,917,920.45
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Loss	$	(2,326,109.52)
Adjustments to Reconcile Operating Loss to Net Cash Provided by Operating Activities:		
Depreciation/Amortization Expense		8,593,573.81
Casualty Loss		(697,518.00)
Changes in Assets and Liabilities:		
Receivables (Net)		(1,420,277.06)
Inventories		234,968.22
Prepaid Items		451,290.31
Accounts Payable and Accrued Liabilities		1,719,137.68
Deferred Revenue		(661,618.97)
Compensated Absences		70,188.94
Net Cash Provided by Operating Activities	$	5,963,635.41

North Carolina State Ports Authority
Statement of Cash Flows
Year Ended June 30, 2005

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	511,423.88
Restricted Cash and Cash Equivalents		437,926.57
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		2,968,570.00
Total Cash and Cash Equivalent Balances - June 30, 2005	$	3,917,920.45

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through the Assumption of a Liability	$	4,688,533.50

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, cash on deposit with fiscal agents, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. Investments - This classification includes money market funds 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 increase 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.

G. Inventories - Inventories, consisting of expendable 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 $5,000 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 10 to 25 years for general infrastructure, 20 to 50 years for buildings, 50 years for wharves and 4 to 25 years for 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 1 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, the decision for funding is determined by management on a case-by-case basis.

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 and producing and delivering goods 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 or gifts 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 G.S. 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer.

At June 30, 2005, the Authority's deposit with the State Treasurer's Short-Term Investment Fund totaled $2,968,570.00. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) 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.ncosc.net/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

The carrying amount of the Authority's deposits not with the State Treasurer was $947,990.45 and the bank balance was $1,808,537.86. Custodial credit risk is the risk that in the event of a bank failure, the Authority's deposits may not be returned to it. The Authority does not have a deposit policy for custodial credit risk. As of June 30, 2005, the Authority's bank balance was exposed to custodial credit risk as follows:

Uninsured and Uncollateralized	$ 1,494,620.86

B. Investments - The Authority is authorized to invest its excess funds in the same manner as the State Treasurer is required to invest, as discussed below.

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

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

Non-Pooled Investments - The following table presents the fair value of investments by type and investments subject to interest rate risk at June 30, 2005, for the Authority's non-pooled investments. Interest rate risk is defined by GASB Statement No. 40 as the risk a government may face should interest rate variances affect the fair value of investments. The Authority does not have a formal investment policy that addresses interest rate risk.

Non-Pooled Investments

	Fair Value	Investment Maturities (in Years) Less Than 1	1 to 5	6 to 10	More than 10
Investment Type					
Debt Securities					
U.S. Treasuries	$ 1,266,951.50	$ 472,698.50	$ 794,253.00	$ 0.00	$ 0.00
U.S. Agencies	4,309,102.38	3,033,644.85	969,051.00	159,746.16	146,660.37
		$ 3,506,343.35	$ 1,763,304.00	$ 159,746.16	$ 146,660.37
Other Securities					
Money Market Funds	671,265.33				
Total Non-Pooled Investments	$ 6,247,319.21				

Credit Risk: The Authority has a formal Reserve Investment Policy that addresses credit risk. The policy limits investments to: obligations of the United States, or obligations backed by the full faith and credit by the U.S. government; government agencies; repurchase agreements with regard to securities guaranteed by the U.S. government; obligations of the State of North Carolina; time deposits of banks with a physical presence in North Carolina for the purpose of receiving commercial or retail deposits, not to exceed $100,000 per deposit (must be FDIC insured); prime quality commercial paper with a rating of no less than A-1, P-1 by a nationally recognized rating agency; asset backed securities that bear a rating of no less than AAA by a nationally recognized rating agency; and corporate bonds and notes that bear a rating of no less than AAA by a nationally recognized rating agency. As of June 30, 2005, the Authority's non-pooled investments were rated as follows:

	Fair Value	AAA Aaa
U.S. Agencies	$ 4,309,102.38	$ 4,309,102.38
Rating Agency	Moody's/Standard & Poors	

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority does not have a formal policy for custodial credit risk. The Authority's non-pooled investments were exposed to custodial credit risk as follows:

Investment Type	Held by Couterparty's Trust Dept. or Agent not in Authority's Name
U. S. Agencies	$ 4,309,102.38

Concentration of Credit Risk: The Authority places no limit on the amount that may be invested in any one issuer. More than 5% of the Authority's non-pooled investments are in U. S. treasuries and U. S. agencies. These investments are 20% and 69%, respectively, of Authority's non-pooled investments.

NOTE 3 - RECEIVABLES

Receivables at June 30, 2005, were as follows:

	Gross Receivables	Less Allowance for Doubtful Accounts	Net Receivables
Current Receivables:			
Accounts	$ 5,823,448.89	$ 13,776.57	$ 5,809,672.32
Investment Earnings	34,423.12		34,423.12
Total Current Receivables	$ 5,857,872.01	$ 13,776.57	$ 5,844,095.44

NOTE 4 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2005, is presented as follows:

	Balance July 1, 2004	Adjustments	Increases	Decreases	Balance June 30, 2005
Capital Assets, Nondepreciable:					
Land	$ 21,504,064.66	$ 0.00	$ 155,471.39	$ 616,316.95	$ 21,043,219.10
Construction in Progress	11,667,590.90	(7,815,273.72)	4,619,500.16	142,658.42	8,329,158.92
Total Capital Assets, Nondepreciable	33,171,655.56	(7,815,273.72)	4,774,971.55	758,975.37	29,372,378.02
Capital Assets, Depreciable:					
Buildings	69,212,745.67	2,854,029.99	1,207,425.56	52,493.33	73,221,707.89
Machinery and Equipment	43,815,902.20	3,608,814.83	740,824.43	11,966,846.80	36,198,694.66
General Infrastructure	141,754,941.30	1,352,428.90		926,630.14	142,180,740.06
Total Capital Assets, Depreciable	254,783,589.17	7,815,273.72	1,948,249.99	12,945,970.27	251,601,142.61
Less Accumulated Depreciation for:					
Buildings	29,425,974.70		249,533.80	976,603.49	28,698,905.01
Machinery and Equipment	39,241,669.67		1,746,736.59	6,460,607.71	34,527,798.55
General Infrastructure	65,930,012.14		6,321,522.88	75,123.35	72,176,411.67
Total Accumulated Depreciation	134,597,656.51		8,317,793.27	7,512,334.55	135,403,115.23
Total Capital Assets, Depreciable, Net	120,185,932.66	7,815,273.72	(6,369,543.28)	5,433,635.72	116,198,027.38
Capital Assets, Net	$ 153,357,588.22	$ 0.00	$ (1,594,571.73)	$ 6,192,611.09	$ 145,570,405.40

During the year ended June 30, 2005, the Authority changed its capitalization policy. The Authority previously capitalized equipment which had a value or cost in excess of $500 at the date of acquisition. That amount was increased to $5,000 and resulted in the write-off of $2,373,292.56 during the year ended June 30, 2005.

NOTE 5 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2005, were as follows:

	Amount
Accounts Payable	$ 4,048,367.03
Accrued Payroll	156,383.98
Total Accounts Payable and Accrued Liabilities	$ 4,204,751.01

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.

Short-term debt activity for the year ended June 30, 2005, was as follows:

	Balance July 1, 2004	Draws	Repayments	Balance June 30, 2005
Lines of Credit	$ 2,024,000.00	$ 1,988,533.50	$ 3,312,533.50	$ 700,000.00

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, 2005, is presented as follows:

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Current Portion
Bonds Payable	$ 17,775,000.00	$ 0.00	$ 7,875,000.00	$ 9,900,000.00	$ 550,000.00
Notes Payable	1,319,176.08	2,700,000.00	497,278.77	3,521,897.31	587,150.57
Compensated Absences	1,004,634.98	913,332.57	843,143.63	1,074,823.92	76,097.53
Total Long-Term Liabilities	$ 20,098,811.06	$ 3,613,332.57	$ 9,215,422.40	$ 14,496,721.23	$ 1,213,248.10

B. 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 June 30, 2005	Principal Outstanding June 30, 2005
Construct Bulk Grain Facility	2001	1.1% - 15%	9/2022	$ 11,000,000.00	$ 1,100,000.00	$ 9,900,000.00

C. Annual Requirements - The annual requirements to pay principal and interest on the long-term obligations at June 30, 2005, are as follows:

	Annual Requirements			
	Bonds Payable		Notes Payable	
Fiscal Year	Principal	Interest	Principal	Interest
2006	$ 550,000.00	$ 109,450.72	$ 587,150.57	$ 131,822.18
2007	550,000.00	103,370.13	457,820.11	113,860.61
2008	550,000.00	97,289.52	353,863.30	99,051.96
2009	550,000.00	91,208.93	188,063.33	87,895.35
2010	550,000.00	85,128.33	180,000.00	79,931.25
2011-2015	2,750,000.00	334,432.74	900,000.00	282,206.25
2016-2020	2,750,000.00	182,417.86	855,000.00	86,782.50
2021-2025	1,650,000.00	36,483.58		
Total Requirements	$ 9,900,000.00	$ 1,039,781.81	$ 3,521,897.31	$ 881,550.10

Interest on the variable rate Bulk Grain Facility revenue bonds is calculated at 1.1% at June 30, 2005.

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

Purpose	Financial Institution	Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2005	Principal Outstanding June 30, 2005
Real Estate Acquisition	First Citizens	2.97%	11/2007	$ 746,508.32	$ 512,552.82	$ 233,955.50
Forklift Acquisition	BB&T	2.96%	2/2006	147,604.65	113,663.12	33,941.53
Forklift Acquisition	CCB - Suntrust	2.34%	5/2006	235,000.00	156,664.00	78,336.00
Tow Tugs and Trailers	BB&T	3.46%	11/2008	171,403.30	58,487.53	112,915.77
AS 400 System Upgrade	CCB - Suntrust	2.55%	8/2006	93,000.00	53,879.99	39,120.01
IT Equipment	CCB - Suntrust	3.43%	2/2007	105,506.27	40,768.83	64,737.44
Gantry Crane	RBC Centura	2.77%	8/2008	500,000.00	196,108.94	303,891.06
Crane 11 Acquisition	CCB - Suntrust	4.35%	2/2020	2,700,000.00	45,000.00	2,655,000.00
Total Notes Payable				$ 4,699,022.54	$ 1,177,125.23	$ 3,521,897.31

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, 2005:

Fiscal Year	Amount
2006	$ 75,612.62
2007	30,630.98
2008	11,447.12
2009	2,864.88
Total Minimum Lease Payments	$ 120,555.60

Rental expense for all operating leases during the year was $239,251.33.

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, 2005, are presented as follows:

Fiscal Year	Amount
2006	$ 2,376,623.96
2007	1,269,336.37
2008	1,168,729.04
2009	1,054,812.35
2010	781,040.12
2011 and Thereafter	4,978,564.92
Total Future Rental Revenues	$ 11,629,106.76

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, 2005, these rates were set at 2.17% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2005, the Authority had a total payroll of $13,760,156.70, of which $13,574,530.36 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $814,471.82 and $294,567.31, respectively. The Authority made 100% of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were $294,567.31, $27,190.85, and $0.00, respectively.

The Teachers' and State Employees' Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.osc.state.nc.us/ 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 $74,331.54 for the year ended June 30, 2005.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System and the Optional Retirement Program are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the Authority except for a 5% employer contribution for the Authority's law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of Authority law enforcement officers for the year ended June 30, 2005, were $39,225.57. The voluntary contributions by employees amounted to $61,062.43 for the year ended June 30, 2005.

NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees - The Authority participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The Authority contributed 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended
June 30, 2005, the Authority's total contribution to the Plan was $434,384.97. The Authority assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

B. Long-Term Disability - The Authority participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The Authority contributes .445% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. For the year ended June 30, 2005, the Authority's total contribution to the DIPNC was $60,406.66. 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. 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 Grain 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.

The Authority purchased other authorized coverage from private insurance companies through the North Carolina Department of Insurance.

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.

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 - The Authority has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were $4,418,763.00 at June 30, 2005.

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.

NOTE 14 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2005, the Authority implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*. This Statement establishes and modifies disclosure requirements related to investment risks: credit risk, interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.

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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*

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, 2005, and have issued our report thereon dated September 30, 2005.

As discussed in Note 14 to the financial statements, the Authority implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 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 operation that we consider to be material weaknesses.

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)**

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 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*.

This report is intended solely for the information and use of the Audit Committee, the Board of Directors, management 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.

Leslie W. Merritt, Jr.

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

September 30, 2005

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

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The Honorable Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Mr. James T. Fain, III	Secretary, Department of Commerce
Mr. Tom Eagar	Chief Executive Officer, North Carolina State Ports Authority
Mr. Jeffrey L. Strader, CPA	Chief Financial and Information Officer, North Carolina State Ports Authority
Mr. Carl Stewart, Jr.	Chairman, Board of Directors, North Carolina State Ports Authority

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Mr. James D. Johnson	Director, Fiscal Research Division

December 21, 2005

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