



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF USS NORTH CAROLINA BATTLESHIP COMMISSION

WILMINGTON, NORTH CAROLINA

FOR THE YEAR ENDED SEPTEMBER 30, 2004

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT OF
USS NORTH CAROLINA BATTLESHIP COMMISSION
WILMINGTON, NORTH CAROLINA
FOR THE YEAR ENDED SEPTEMBER 30, 2004

BOARD OF COMMISSIONERS

NORWOOD E. BRYAN, CHAIRMAN

THOMAS H. WRIGHT, III, VICE CHAIRMAN

J. ALLEN ADAMS
DANIEL W. BAREFOOT
RICHARD W. CANTWELL
JAMES T. FAIN, III
DR. WILKINSON DAVIS FORT
MICHAEL S. FOX
RADM F. STEPHEN GLASS, JAGC, USNR (RET)
JIMMY MEDLIN

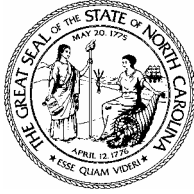
LES MARTIN NOBLE
LINDA A. PEARCE
H. BRIAN PREVATTE
WALLACE E. RUCKER
SAMUEL O. SOUTHERN
RONALD LEE THOMPSON
JERRY L. WILKINS, SR.

ADMINISTRATIVE OFFICERS

CAPTAIN DAVID R. SCHEU, SR., USN (RET), DIRECTOR

THE HONORABLE LISBETH C. EVANS, SECRETARY, DEPARTMENT OF CULTURAL RESOURCES

STATE OF NORTH CAROLINA
Office of the State Auditor



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

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

AUDITOR'S TRANSMITTAL

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

We have completed a financial statement audit of the USS North Carolina Battleship Commission (the "Commission") for the year ended September 30, 2004. 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.

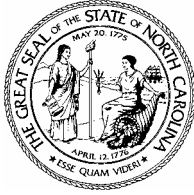
Leslie W. Merritt, Jr.

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

October 31, 2005

TABLE OF CONTENTS

	PAGE
INDEPENDENT AUDITOR’S REPORT	1
MANAGEMENT’S DISCUSSION AND ANALYSIS	3
FINANCIAL STATEMENTS	
Exhibits	
A Statement of Net Assets	9
B Statement of Revenues, Expenses, and Changes in Net Assets	10
C Statement of Cash Flows	11
Notes to the Financial Statements	13
INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	25
DISTRIBUTION OF AUDIT REPORT	27



STATE OF NORTH CAROLINA
Office of the State Auditor

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

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying basic financial statements of the USS North Carolina Battleship Commission (the "Commission") as of September 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the financial statements of the USS North Carolina Battleship Commission are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the Commission. They do not purport to, and do not, present fairly the financial position of the State of North Carolina as of June 30, 2005, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

As discussed in Note 13 to the financial statements, the Commission implemented Governmental Accounting Standard Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended September 30, 2004.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In accordance with *Government Auditing Standards*, we have also issued our report dated August 29, 2005, on our consideration of the Commission's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

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 supplementary information. However, we did not audit the information and express no opinion on it.



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

August 29, 2005

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the Annual Financial Report presents management's discussion and analysis of the financial activities of the USS North Carolina Battleship Commission (the Commission) during the fiscal years ended September 30, 2004, and September 30, 2003. Since this management's discussion and analysis is designed to focus on current activities, resulting change and currently known facts, please read it in conjunction with the transmittal letter, the Commission's basic financial statements and the notes to the financial statements. Responsibility for the completeness and fairness of this information rests with the Commission.

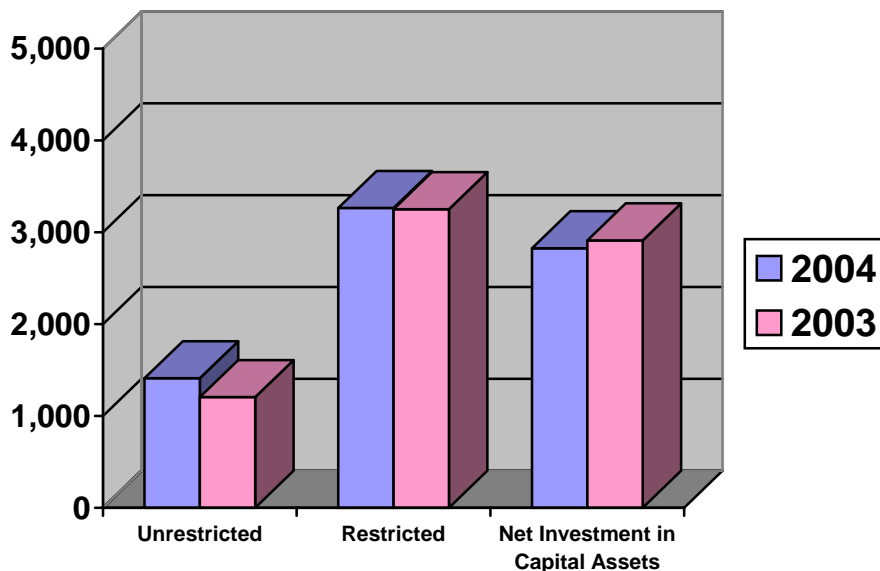
While the financial statements reflect on the Commission as a whole, the Commission is an enterprise, non-appropriated fund activity of the State of North Carolina that is required by general statute to be self-sufficient for its annual operations. Funding for the annual operation of the Battleship NORTH CAROLINA is met primarily from revenues generated through admissions to tour the ship and gift shop sales, hence a principal focus on the Statement of Revenues, Expenses, and Change in Net Assets.

Financial Highlights

For fiscal year 2004, the 189,858 visitors to the Battleship reflected the second year of significantly reduced visitation from the historical norm. Probable causes for reduced visitor levels were the continuing weakness in the national economic climate and its impact on discretionary spending, as well as near misses from three hurricanes.

For the fiscal year ending September 30, 2004, a 1.3% decrease in visitors from the previous year resulted in a 1.9% decrease in admissions revenues but a 3.2% increase in gift shop sales. Compensating operating expense reductions and savings fully offset the revenue shortfall.

Comparison of Net Assets - Fiscal Years 2004 and 2003
(in thousands)



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Financial Analysis of the Battleship as a Whole

	Net Assets As of 09/30/04 (in thousands)	Net Assets As of 09/30/03 (in thousands)	Increase (Decrease)	Percent (Change)
Current Assets	\$ 1,289.5	\$ 1,291.6	\$ -2.1	-0.2
Noncurrent Assets:				
Unrestricted and Restricted				
Investments	3,481.0	3,291.3	189.7	5.8
Capital Assets, Nondepreciable	629.6	2,276.6	-1,647.0	-72.3
Capital Assets, Depreciable, Net	<u>2,196.7</u>	<u>634.1</u>	<u>1,562.6</u>	246.4
Total Assets	<u>7,596.8</u>	<u>7,493.6</u>	<u>103.2</u>	1.4
Current Liabilities	57.9	64.7	-6.8	-10.5
Noncurrent Liabilities	<u>38.2</u>	<u>61.1</u>	<u>-22.9</u>	-37.5
Total Liabilities	<u>96.1</u>	<u>125.8</u>	<u>-29.7</u>	-23.6
Net Assets:				
Invested in Capital Assets	2,826.3	2,910.8	-84.5	-2.9
Restricted	3,264.1	3,251.7	12.4	0.4
Unrestricted	<u>1,410.3</u>	<u>1,205.3</u>	<u>205.0</u>	17.0
Total Net Assets	<u>\$ 7,500.7</u>	<u>\$ 7,367.8</u>	<u>\$ 132.9</u>	1.8

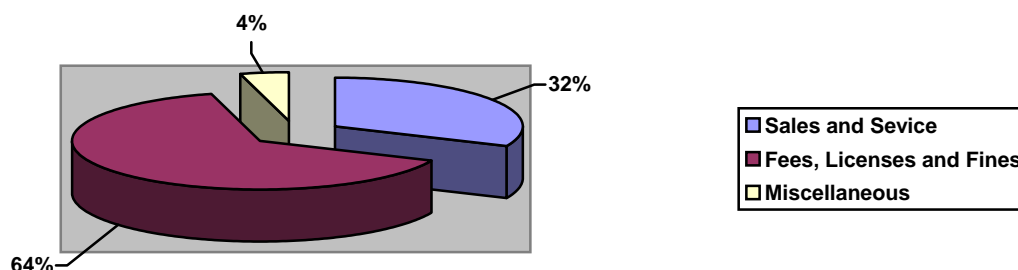
The above schedule is prepared from the Battleship's Statement of Net Assets, which is presented on an accrual basis of accounting whereby assets are capitalized and depreciated.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Operating Revenue For the Years Ended September 30, 2004 and 2003 (in thousands)

	2004	2003	Increase (Decrease)	Percent Change
Operating Revenues:				
Sales and Services	\$ 706.2	\$ 684.0	\$ 22.2	3.2
Fees, Licenses and Fines	1,434.5	1,462.9	-28.4	-1.9
Miscellaneous	91.1	85.0	6.1	7.2
Total	<u>2,231.8</u>	<u>2,231.9</u>	<u>-0.1</u>	0.0
Less Operating Expenses	<u>2,350.4</u>	<u>2,384.5</u>	<u>-34.1</u>	-1.4
Operating Loss	<u>-118.6</u>	<u>-152.6</u>	<u>34.0</u>	-22.3
Non-Operating Revenue:				
Noncapital Gifts	52.1	30.3	21.8	71.9
Other Revenue:				
Investment Earnings	<u>199.3</u>	<u>276.5</u>	<u>-77.2</u>	-27.9
Total	<u>251.4</u>	<u>306.8</u>	<u>-55.4</u>	-18.1
Increase in Net Assets	132.8	154.2	-21.4	-13.9
Net Assets, Beginning of Year	<u>7,367.9</u>	<u>7,213.7</u>	<u>154.2</u>	2.1
Net Assets, End of Year	<u>\$ 7,500.7</u>	<u>\$ 7,367.9</u>	<u>\$ 132.8</u>	1.8

The following is a graphic illustration of operating revenues by source.



The total operating revenue for 2004 is materially equal to 2003 despite a 1.3% decrease in the number of visitors due to an increase in gift store sales and a slightly stronger performance in other sources of revenue.

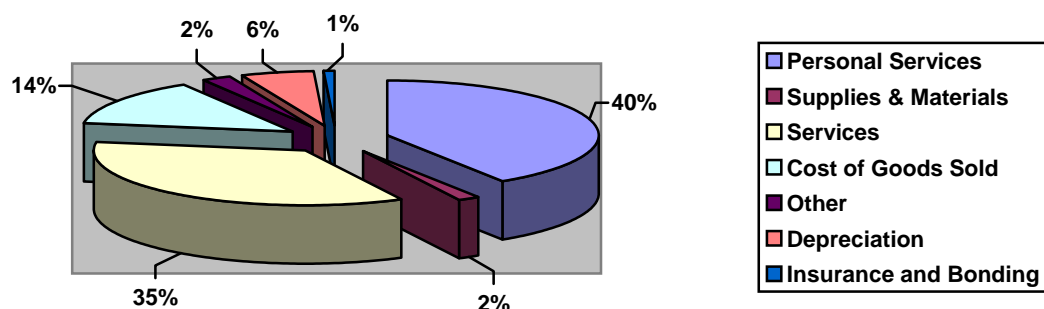
Nonoperating revenue decreased \$55,000 primarily due to market conditions impacting the investment portfolio.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

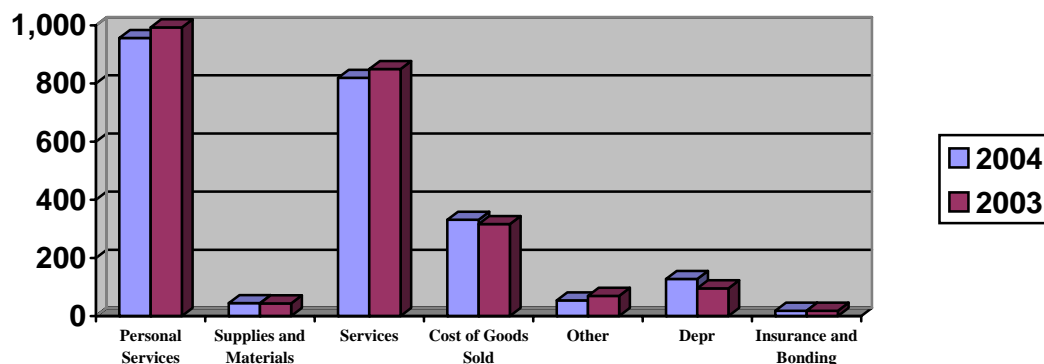
Operating Expenses For the Years Ended September 30, 2004 and 2003 (in thousands)

	2004	2003	Increase (Decrease)	Percent Change
Operating Expenses:				
Personal Services	\$ 956.3	\$ 992.7	\$ -36.4	-3.7
Supplies and Materials	44.4	43.4	1.0	2.3
Services	819.2	849.4	-30.2	-3.6
Cost of Goods Sold	331.0	316.2	14.8	4.7
Insurance and Bonding	18.3	18.2	0.1	0.5
Other	53.8	69.4	-15.6	-22.5
Depreciation	127.4	95.2	32.2	33.8
Total Operating Expenses	\$ 2,350.4	\$ 2,384.5	\$ -34.1	-1.4

The following is a graphic illustration of operating expenses.



Comparison of Operating Expenses Fiscal Years 2004 and 2003 (in thousands)



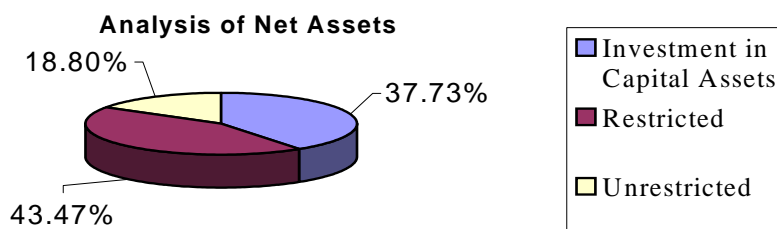
MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

Total operating expenses for fiscal year 2004 decreased marginally over fiscal year 2003.

Analysis of Net Assets For the Years Ended September 30, 2004 and 2003 (in thousands)

	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Net Assets:				
Investment on Capital Assets	\$ 2,826.3	\$ 2,910.8	\$ -84.5	-2.9
Restricted	3,264.1	3,251.8	12.3	0.4
Unrestricted	<u>1,410.3</u>	<u>1,205.3</u>	<u>205.0</u>	17.0
Total Net Assets	<u><u>\$ 7,500.7</u></u>	<u><u>\$ 7,367.9</u></u>	<u><u>\$ 132.8</u></u>	1.8

The following is a graphic illustration of Net Assets.



MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

Capital Assets, Net
For the Years Ended September 30, 2004 and 2003
(in thousands)

	<u>2004</u>	<u>2003</u>	<u>Increase (Decrease)</u>	<u>Percent Change</u>
Capital Assets:				
Land	\$ 97.4	\$ 97.4	\$ 0.0	0.0
Buildings	1,114.8	1,114.8		
Machinery and Equipment	982.9	976.9	6.0	0.6
Infrastructure	2,310.1	626.2	1,683.9	268.9
Construction in Progress	<u>532.2</u>	<u>2,179.2</u>	<u>-1,647.0</u>	<u>-75.6</u>
Total	5,037.4	4,994.5	42.9	0.9
Less: Accumulated Depreciation	<u>2,211.1</u>	<u>2,083.7</u>	<u>127.4</u>	6.1
Capital Assets, Net	<u><u>\$ 2,826.3</u></u>	<u><u>\$ 2,910.8</u></u>	<u><u>\$ -84.5</u></u>	<u>-2.9</u>

As of September 30, 2004, the Battleship had recorded \$5.04 million invested in capital assets, \$2.21 million in accumulated depreciation, and \$2.83 million in net capital assets.

USS North Carolina Battleship Commission
Statement of Net Assets
September 30, 2004

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents	\$ 974,337.07
Receivables	2,535.38
Inventories (Note 5)	228,819.00
Prepaid Items	83,872.52
	<hr/>
Total Current Assets	1,289,563.97
	<hr/>

Noncurrent Assets:

Investments	216,879.77
Restricted Investments	3,264,102.51
Capital Assets - Nondepreciable (Note 6)	629,644.98
Capital Assets - Depreciable, Net (Note 6)	2,196,644.41
	<hr/>
Total Noncurrent Assets	6,307,271.67
	<hr/>

Total Assets	7,596,835.64
	<hr/>

LIABILITIES

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 7)	42,540.52
Deferred Revenue	1,878.50
Long - Term Liabilities - Current Portion (Note 8)	13,492.53
	<hr/>
Total Current Liabilities	57,911.55
	<hr/>

Noncurrent Liabilities:

Long-Term Liabilities (Note 8)	38,242.64
	<hr/>
Total Liabilities	96,154.19
	<hr/>

NET ASSETS

Invested in Capital Assets	2,826,289.39
Restricted Expendable:	
Other	1,161,195.00
Restoration Projects	2,102,907.51
Unrestricted	1,410,289.55
	<hr/>

Total Net Assets	\$ 7,500,681.45
	<hr/> <hr/>

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

***USS North Carolina Battleship Commission
Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended September 30, 2004***

Exhibit B

REVENUES

Operating Revenues:	
Sales and Services	\$ 706,152.17
Fees, Licenses and Fines	1,434,508.75
Miscellaneous	91,120.38
	<hr/>
Total Operating Revenues	2,231,781.30
	<hr/>

EXPENSES

Operating Expenses:	
Personal Services	956,284.87
Supplies and Materials	44,351.03
Services	819,241.90
Cost of Goods Sold	331,005.71
Depreciation	127,426.44
Insurance and Bonding	18,281.38
Other Operating Expenses	53,796.75
	<hr/>
Total Operating Expenses	2,350,388.08
	<hr/>
Operating Loss	(118,606.78)
	<hr/>

NONOPERATING REVENUES

Investment Earnings	199,292.17
	<hr/>
Net Nonoperating Revenues	199,292.17
	<hr/>
Income Before Other Revenues	80,685.39
	<hr/>
Capital Gifts	52,154.08
	<hr/>
Increase in Net Assets	132,839.47
	<hr/>
Net Assets, October 1, 2003	7,367,841.98
	<hr/>
Net Assets, September 30, 2004	\$ 7,500,681.45
	<hr/> <hr/>

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

USS North Carolina Battleship Commission
Statement of Cash Flows
Year Ended September 30, 2004

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from Customers	\$ 2,360,163.09
Payments to Suppliers	(1,249,600.29)
Payments to Employees	<u>(975,339.35)</u>
Net Cash Provided by Operating Activities	<u>135,223.45</u>

CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES

Acquisition of Capital Assets	(42,925.09)
Capital Gifts	<u>52,154.08</u>
Net Cash Provided by Capital Financing and Related Financing Activities	<u>9,228.99</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from Sales and Maturities of Investments	3,032,185.12
Investment Earnings	175,821.76
Purchase of Investments and Related Fees	<u>(3,198,446.12)</u>
Net Cash Provided by Investing Activities	<u>9,560.76</u>

Net Increase in Cash and Cash Equivalents	154,013.20
Cash and Cash Equivalents - October 1, 2003	<u>820,323.87</u>
Cash and Cash Equivalents - September 30, 2004	<u><u>\$ 974,337.07</u></u>

RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED BY OPERATING ACTIVITIES

Operating Loss	\$ (118,606.78)
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities:	
Depreciation	127,426.44
Changes in Net Assets and Liabilities:	
Accounts Receivable	129,126.29
Inventories	22,640.16
Prepaid Items	4,282.77
Accounts Payable and Accrued Liabilities	(4,334.67)
Compensated Absences	(24,566.26)
Deferred Revenue	<u>(744.50)</u>

Net Cash Provided by Operating Activities	<u><u>\$ 135,223.45</u></u>
-------------------------------------------	-----------------------------

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

Change in Fair Value of Investments	\$ 23,470.41
-------------------------------------	--------------

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

[This Page Left Blank Intentionally]

USS NORTH CAROLINA BATTLESHIP COMMISSION
NOTES TO THE FINANCIAL STATEMENTS
SEPTEMBER 30, 2004

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The USS North Carolina Battleship Commission (the "Commission") is a part of the State of North Carolina and is not a separate legal or reporting entity. The Commission's accounts and transactions are included in the State of North Carolina's *Comprehensive Annual Financial Report* (CAFR) as an enterprise fund. The accompanying financial statements present only those accounts and transactions associated with the operations of the Commission.
- 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 Governmental Accounting Standards Board (GASB), which consist of GASB statements and interpretations, as well as American Institute of Certified Public Accountants (AICPA) and Financial Accounting Standards Board (FASB) pronouncements specifically made applicable to state and local government entities by GASB statements and interpretations. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Fund Accounting*, the Commission does not apply 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.
- C. Basis of Accounting** - The financial statements of the Commission have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.
- D. Cash and Cash Equivalents** - This classification appears on the Statement of Net Assets and the Statement of Cash Flows and includes undeposited receipts and cash on deposit with private bank accounts.
- E. Investments** - This classification includes long-term fixed income investments, equity investments, mutual funds, and money market funds of the Commission. Except for money market funds not held by a governmental external investment pool and other asset holdings, these investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

prices are not available. The net increase (decrease) in the fair value of investments is recognized as a component of investment income.

Money market funds not held by a governmental external investment pool are reported at cost, if purchased, or at fair value or appraised value at date of gift, if donated.

- F. Receivables** - The Commission considers its accounts and pledges receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required.
- G. Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are stated at the lower of cost or market. Cost for merchandise for resale is computed by dividing the total cost of units available for sale by the number of units available for sale. This moving weighted average cost is then multiplied by the number of units in the ending inventory.
- H. Capital Assets** - Capital Assets are those assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of one or more years.

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

The Commission does not capitalize the Battleship exhibit or its art and artifact collections. The Battleship exhibit and its collections adhere to the Commission's policy to maintain for public exhibition, education or research; protect, keep unencumbered, care for, and preserve; and requires proceeds from their sale to be used to acquire other collection items. Accounting principles generally accepted in the United States of America permit collections maintained in this manner to be charged to operations at time of purchase rather than capitalized.

- I. Restricted Assets** - Restricted assets represent assets whose use is restricted by external parties or by law through constitutional provisions or enabling legislation.
- J. Compensated Absences** - The Commission's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1st or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at December 31st is converted to sick leave. Under this

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

policy, the accumulated vacation leave for each employee at September 30th equals the leave carried forward at the previous December 31st plus the leave earned, less the leave taken between January 1st and September 30th.

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 method.

K. Net Assets - The Commission's net assets are classified as follows:

Invested in Capital Assets – This represents the Commission's total investment in capital assets.

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

Unrestricted Net Assets - Unrestricted net assets include resources derived from admission fees, sales and services, unrestricted gifts, royalties, and interest income.

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

L. Revenue and Expense Recognition - The Commission presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. Operating activities are those activities that are necessary and essential to the mission of the Commission. Operating revenues include all charges to customers. Revenues from nonexchange transactions that represent subsidies or gifts to the Commission, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities. Operating expenses are all expense transactions

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

incurred other than those related to investing, capital or noncapital financing activities.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - At year end, cash on hand was \$6,500.00. The carrying amount (book balance) of the cash on deposit was \$967,837.07 and the bank balance was \$991,442.78. All of the cash on deposit was with a private financial institution.

Custodial credit risk is the risk that in the event of a bank failure, the Commission's deposits may not be returned to it. The Commission does not have a deposit policy for custodial credit risk. The bank balance of demand and time deposits with the private financial institution at September 30, 2004, consisted of interest and non-interest bearing checking accounts totaling \$991,442.78. Of this amount, \$100,000 was covered by federal depository insurance and \$891,442.78 was uninsured and uncollateralized.

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

The following table presents the fair value of investments by type and investments subject to interest rate risk at September 30, 2004, for the Commission's 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 Commission does not have a formal investment policy that addresses interest rate risk.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Investments

Investment Type	Fair Value	Investment Maturities (in Years)			
		Less Than 1	1 to 5	6 to 10	More than 10
Debt Securities					
U.S. Treasuries	\$ 43,661.37	\$ 0.00	\$ 11,200.00	\$ 6,013.03	\$ 26,448.34
U.S. Agencies	30,330.00		30,330.00		
Motrgage Pass Throughs	146,476.57		110,364.87	36,111.70	
Collateralized Mortgage Obligations	5,357.39		2,862.56	2,494.83	
Asset-backed Securities	28,036.00		26,606.00	1,430.00	
Mutual Bond Funds	19,704.99			19,704.99	
Domestic Corporate Bonds	116,667.00		51,731.00	51,088.00	13,848.00
		<u>\$ 0.00</u>	<u>\$ 233,094.43</u>	<u>\$ 116,842.55</u>	<u>\$ 40,296.34</u>
Other Securities					
Domestic Stocks (Common and Preferred)	475,130.43				
Money Market Funds	36,616.56				
Other Mutual Funds	957,603.95				
Certificates of Deposits	1,621,398.02				
Total Investments	<u>\$ 3,480,982.28</u>				

A reconciliation of deposits and investments for the Commission to the basic financial statements at September 30 2004, is as follows:

Cash on hand	\$ 6,500.00
Carrying amount of deposits	967,837.07
Investments reported above	<u>3,480,982.28</u>
Total Deposits and Investments	<u>\$ 4,455,319.35</u>
Cash and Cash Equivalents	\$ 974,337.07
Noncurrent:	
Investments	216,879.77
Restricted Investments	<u>3,264,102.51</u>
Total	<u>\$ 4,455,319.35</u>

In addition to the interest rate risk disclosed above, the Commission's investments include investments with fair values highly sensitive to interest rate changes.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Credit Risk: The Commission does not have a formal policy that addresses credit risk. As of September 30, 2004, the Commission's investments were rated as follows:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	BB Ba	Unrated
U.S. Agencies	\$ 30,330.00	\$ 30,330.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Motrgage Pass Throughs	146,475.57	122,139.00					24,336.57
Collateralized Mortgage Obligations	5,357.39	1,242.41		2,678.52			1,436.46
Asset-backed Securities	28,036.00	28,036.00					
Mutual Bond Funds	19,704.99						19,704.99
Domestic Corporate Bonds	116,667.00	9,787.00	19,863.00		42,626.00	44,391.00	
Total	<u>\$ 346,570.95</u>	<u>\$ 191,534.41</u>	<u>\$ 19,863.00</u>	<u>\$ 2,678.52</u>	<u>\$ 42,626.00</u>	<u>\$ 44,391.00</u>	<u>\$ 45,478.02</u>

Rating Agency: Moody's/S&P/Fitch

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

Investment Type	Held by Counterparty
U.S. Treasuries	\$ 43,661.37
U.S. Agencies	30,330.00
Mortgage Pass Throughs	146,476.57
Collateralized Mortgage Obligations	5,357.39
Asset-Backed Securites	28,036.00
Domestic Corporate Bonds	116,667.00
Domestic Stocks	475,130.43
Total	<u>\$ 845,658.76</u>

NOTE 3 - RESERVE FUND

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Accordingly, 50% of the authorized normal operating budget for fiscal year 2004 of \$2,322,390.00 yields a restricted reserve requirement of \$1,161,195.00. At year end the investment portfolio described in Note 2 exceeded the restricted reserve requirement; therefore, the \$2,319,787.28 excess is considered available for operations and restoration projects.

NOTE 4 - RESTORATION FUND

In 1998, the Commission undertook a capital campaign for the restoration of the USS Battleship North Carolina. In addition to funding three currently needed major restoration projects, another goal of the campaign was to establish a Restoration Fund from which future restoration projects could be funded. For the fiscal year ended September 30, 2004, the Battleship received pledges and donations in the amount of \$39,114.02. Because of the restricted-use nature of the Restoration Fund, the portfolio is managed as a separate account by Franklin Street Partners.

At year end, the fair value of the Franklin Street Partners Restoration Fund segment of the portfolio, summarized in Note 2, was \$481,467.72.

NOTE 5 - INVENTORIES

Inventories at year end consisted of merchandise for resale. The Ship's Store and the concession inventories were valued at \$228,674.38 and \$144.62, respectively.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - CAPITAL ASSETS

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

	Balance October 1, 2003	Increases	Decreases	Balance September 30, 2004
Capital Assets, Nondepreciable:				
Land	\$ 97,425.80	\$ 0.00	\$ 0.00	\$ 97,425.80
Construction in Progress	2,179,212.72	36,925.09	1,683,918.63	532,219.18
Total Capital Assets, Nondepreciable	<u>2,276,638.52</u>	<u>36,925.09</u>	<u>1,683,918.63</u>	<u>629,644.98</u>
Capital Assets, Depreciable:				
Buildings	1,114,823.35			1,114,823.35
Machinery and Equipment	976,843.81	6,000.00		982,843.81
General Infrastructure	626,190.74	1,683,918.63		2,310,109.37
Total Capital Assets, Depreciable	<u>2,717,857.90</u>	<u>1,689,918.63</u>		<u>4,407,776.53</u>
Less Accumulated Depreciation for:				
Buildings	776,660.41	44,592.92		821,253.33
Machinery and Equipment	784,234.62	30,069.59		814,304.21
General Infrastructure	522,810.65	52,763.93		575,574.58
Total Accumulated Depreciation	<u>2,083,705.68</u>	<u>127,426.44</u>		<u>2,211,132.12</u>
Total Capital Assets, Depreciable, Net	<u>634,152.22</u>	<u>1,562,492.19</u>		<u>2,196,644.41</u>
Capital Assets, Net	<u>\$ 2,910,790.74</u>	<u>\$ 1,599,417.28</u>	<u>\$ 1,683,918.63</u>	<u>\$ 2,826,289.39</u>

NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

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

	Amount
Accounts Payable	\$ 28,600.92
Accrued Payroll	13,939.60
Total Accounts Payable and Accrued Liabilities	<u>\$ 42,540.52</u>

NOTE 8 - LONG-TERM LIABILITIES

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

	Balance October 1, 2003	Additions	Reductions	Balance September 30, 2004	Current Portion
Compensated Absences	\$ 76,301.43	\$ 54,231.80	\$ 78,798.06	\$ 51,735.17	\$ 13,492.53

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 9 - PENSION PLANS

- A. Teachers' and State Employees' Retirement System** - Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System. The Teachers' and State Employees' Retirement System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by North Carolina General Statutes 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the period October 1, 2003, through June 30, 2004, the General Assembly required contributions of 0.22% by employers and 6% of covered payroll for members. The system was funded by employer and member contributions of 2.17% and 6% respectively, of covered payroll for the period July 1, 2004, through September 30, 2004.

For the year ended September 30, 2004, the Commission had a total payroll of \$789,639.60 of which \$722,310.33 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$43,338.62 and \$5,403.06, respectively.

The Commission made one hundred percent of its annual required contributions for the years ended September 30, 2004, 2003, and 2002, which were \$5,403.06, \$418.40, and \$9,921.76, respectively.

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

- B. Supplemental Retirement Income Plan** - IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of the Plan

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

participants. The voluntary contributions by employees amounted to \$7,590.00 for the year ended September 30, 2004.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The Commission participates in State-administered programs which provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The Commission contributed 3.20% of covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits for the year ended September 30, 2004. For the fiscal year ended September 30, 2004, the Commission's total contribution to the Plan was \$23,113.93. The Commission assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Long-Term Disability -** The Commission participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teacher's and State Employees' Retirement System. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. Employer contributions are established in the Appropriations Bill by the General Assembly. For the period October 1, 2003, through June 30, 2004, the General Assembly required no contributions by employers. For the period July 1, 2004, through September 30, 2004, the Commission contributed 0.445% of covered payroll under the Teachers' and State Employees' Retirement System. For the year ended September 30, 2004, the Commission's total contribution to the DIPNC was \$870.32. The Commission assumes no liability for long-term disability benefits under the plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 11 - RISK MANAGEMENT

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

Tort claims of up to \$500,000 are self-insured under the authority of the State Tort Claims Act. All losses covered are subject to a \$150,000 deductible. In addition, the State provides excess public officers' and employees' liability insurance up to \$5,000,000 via contract with a private insurance company. The premium, based on a composite rate, is paid by the Commission directly to the state's agent of record.

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

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

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

The Commission is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from State funds. The blanket honesty bond is with a private insurance company and is handled by the North Carolina Department of Insurance with coverage of \$5,000,000 per occurrence and a \$50,000 deductible.

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

Term life insurance of \$25,000 to \$50,000 is provided to eligible workers. This self-insured death benefit plan is administered by the State Treasurer and funded via employer contributions. There were no employer contributions required for the current fiscal year.

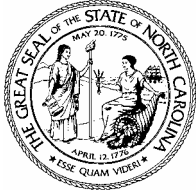
Additional details on the State-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of State Controller.

NOTE 12 - THE FRIENDS OF THE BATTLESHIP NORTH CAROLINA, INC.

The Friends of the Battleship North Carolina, Inc. is a nonprofit organization that raises funds for providing additional resources to the USS North Carolina Battleship Commission. The records of the organization are maintained separately from the Commission. During the fiscal year ended September 30, 2004, the organization donated \$12,066.99 to the Commission.

NOTE 13 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended September 30, 2004, the Commission 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.



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

STATE OF NORTH CAROLINA
Office of the State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
Internet
<http://www.ncauditor.net>

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

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

We have audited the financial statements of the USS North Carolina Battleship Commission (the "Commission") as of and for the year ended September 30, 2004, and have issued our report thereon dated August 29, 2005.

As discussed in Note 13 to the financial statements, the Commission 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 Commission's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University'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, which are reported in the Audit Findings and Recommendations section of this report, disclosed 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 Commissioners, the Department of Cultural Resources, management and staff of the Commission, the Governor, the State Controller, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Leslie W. Merritt, Jr.

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

August 29, 2005

DISTRIBUTION OF AUDIT REPORT

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

EXECUTIVE BRANCH

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

LEGISLATIVE BRANCH

Appointees to the Joint Legislative Commission on Governmental Operations

President Pro Tempore	Speaker of the House
Senator Marc Basnight, Co-Chair	Representative James B. Black, Co-Chair
Senator Charles W. Albertson	Representative Alma S. Adams
Senator Thomas M. Apodaca	Representative Martha B. Alexander
Senator Daniel G. Clodfelter	Representative Harold J. Brubaker
Senator Walter H. Dalton	Representative Lorene T. Coates
Senator Charlie S. Dannelly	Representative E. Nelson Cole
Senator James Forrester	Representative James W. Crawford, Jr.
Senator Linda Garrou	Representative William T. Culpepper, III
Senator Kay R. Hagan	Representative W. Pete Cunningham
Senator Fletcher L. Hartsell, Jr.	Representative Beverly M. Earle
Senator David W. Hoyle	Representative Pryor A. Gibson, III
Senator John H. Kerr, III	Representative Joe Hackney
Senator Ellie Kinnaird	Representative R. Phillip Haire
Senator Jeanne H. Lucas	Representative Dewey L. Hill
Senator Anthony E. Rand	Representative Lindsey H. Holliman
Senator R. C. Soles, Jr.	Representative Julia C. Howard
Senator Richard Y. Stevens	Representative Howard J. Hunter, Jr.
Senator A. B. Swindell, IV	Representative Margaret M. Jeffus
Senator Scott Thomas	Representative Daniel F. McComas
	Representative Charles L. McLawhorn
	Representative Henry M. Michaux, Jr.
	Representative Richard T. Morgan
	Representative Edd Nye
	Representative William C. Owens, Jr.
	Representative Deborah K. Ross
	Representative Drew P. Saunders
	Representative Wilma M. Sherrill
	Representative Joe P. Tolson
	Representative Edith D. Warren
	Representative Thomas E. Wright
	Representative Douglas Y. Yongue

Other Legislative Officials

Mr. James D. Johnson	Director, Fiscal Research Division
----------------------	------------------------------------

October 31, 2005

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Internet: <http://www.ncauditor.net>

Telephone: 919/807-7500

Facsimile: 919/807-7647