

**FINANCIAL STATEMENT AUDIT REPORT**  
**NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY**

**RALEIGH, NORTH CAROLINA**

**YEAR ENDED JUNE 30, 2005**

**Performed Under Contract with  
The North Carolina Office of the State Auditor  
Leslie W. Merritt, Jr., CPA, CFP  
State Auditor**

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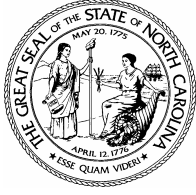
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STATE OF NORTH CAROLINA  
Office of the State Auditor

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**AUDITOR'S TRANSMITTAL**

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

This report presents the results of the financial statement audit of North Carolina Agricultural Finance Authority, a component unit of the State of North Carolina, for the year ended June 30, 2005. Cherry, Bekaert, and Holland, L.L.P. performed this audit under contract with the Office of the State Auditor.

You will note from the independent auditor's report that an unqualified opinion was given on the fairness of presentation of the financial statements. Consideration of internal control over financial reporting and tests of compliance and other matters resulted in one reportable audit finding that is described in the Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*.

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

*Leslie W. Merritt, Jr.*

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of the North Carolina Agricultural Finance Authority (the "Authority") as of and for the year ended June 30, 2005, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2005, and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 9, 2006, on our consideration of the Authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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

*Cherry, Bekaert & Holland L.L.P.*

Raleigh, North Carolina  
June 9, 2006

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
Year Ended June 30, 2005

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

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

**2005 Financial Highlights**

- The assets of the Authority exceeded its liabilities at the close of the most recent fiscal year by \$15,754,795 (net assets). This amount is unrestricted and may be used to meet the Authority's ongoing obligations to citizens and creditors.
- The Authority's total net assets increased by \$155,375. This increase is primarily attributable to interest earnings on notes receivable and investment earnings on cash investments.
- The Authority's liabilities decreased by \$73,415 during the fiscal year. The key factor in this change was the decrease in intergovernmental payables.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
Year Ended June 30, 2005

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**Financial Statements**

Balance Sheet

The Balance Sheet reports all assets and liabilities of the Authority; additionally the Statement classifies those assets and liabilities as current and non-current depending on the availability of the assets or satisfaction of the obligation within twelve months (current) or longer. This statement also reports the net assets, which is the difference between the total assets and total liabilities. The reader may use the net assets to gauge the financial position of the Authority as of June 30, 2005 and 2004.

**Condensed Balance Sheet**

	<u>2005</u>	<u>2004</u>	<u>Variance</u>
<b>Assets</b>			
Current Assets	\$ 7,493,267	\$ 6,111,701	\$1,381,566
Other Noncurrent Assets	8,447,778	9,747,384	(1,299,606)
	<u>\$15,941,045</u>	<u>\$15,859,085</u>	<u>\$81,960</u>
 <b>Liabilities</b>			
Current Liabilities	\$ 146,461	\$ 222,671	\$ (76,210)
Noncurrent Liabilities	39,789	36,994	2,795
<b>Total Liabilities</b>	<u>186,250</u>	<u>259,665</u>	<u>(73,415)</u>
 <b>Net Assets</b>			
Unrestricted	<u>15,754,795</u>	<u>15,599,420</u>	<u>155,375</u>
	<u>\$15,941,045</u>	<u>\$15,859,085</u>	<u>\$ 81,960</u>

As of June 30, 2005 and 2004, the Authority's total assets were \$15.9 million and \$15.8 million, respectively, which reflects an \$81,960 increase between these years. Of these totals, \$10 million and \$11 million were notes receivable from borrowers for the years ended June 30, 2005 and 2004, respectively.

The Authority's liabilities totaled \$186,250 and \$259,665 for the years ended June 30, 2005 and 2004, respectively. The total current liabilities of \$146,461 as of June 30, 2005 and \$222,671 as of June 30, 2004, were well covered by current assets of \$7.5 million in 2005 and \$6.1 million in 2004. This indicates the Authority's ability to pay current liabilities as they become due.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
Year Ended June 30, 2005

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**Financial Statements (continued)**

Statement of Revenues, Expenses and Changes in Net Assets

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

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

Non-operating revenues stem from transactions that occur outside of the primary scope of the Authority's existence and for which no goods or services are provided. Operating grants from the primary government and interest earnings on pooled investment accounts primarily represent non-operating revenues.

Operating expenses increased from the prior year primarily due to the write off of a delinquent loan. Non-operating revenues increased primarily from the growth in interest earned on pooled investments.

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

	<u>2005</u>	<u>2004</u>	<u>Variance</u>
<b>Operating Revenues</b>	\$ 759,866	\$ 778,415	\$ (18,549)
<b>Operating Expenses</b>	<u>1,197,491</u>	<u>761,457</u>	<u>436,034</u>
<b>Operating Income (Loss)</b>	(437,625)	16,958	(454,583)
<b>Non-operating Revenues</b>	<u>593,000</u>	<u>467,186</u>	<u>125,814</u>
<b>Changes in Net Assets</b>	155,375	484,144	(328,769)
<b>Net Assets – July 1</b>	15,599,420	15,240,180	359,240
<b>Restatements</b>	<u>-</u>	<u>(124,904)</u>	<u>124,904</u>
<b>Net Assets – June 30</b>	<u><u>\$ 15,754,795</u></u>	<u><u>\$ 15,599,420</u></u>	<u><u>\$ 155,375</u></u>



NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
Year Ended June 30, 2005

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**Financial Statements (continued)**

Statement of Cash Flows

A very useful measure of financial operations is the Statement of Cash Flows. This statement provides the sources of cash inflows and outflows for four major activities: operating, noncapital financing, capital and related financing, and investing activities. The Authority did not use cash for capital financing activities during the years ended June 30, 2005 and 2004.

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

The net cash provided by operating activities shows net inflows of \$816,293 and \$90,670 for the years ended June 30, 2005 and 2004, respectively. The major outflows were payments to borrowers for loans issued, which were \$ 764,685 and \$ 898,615 for the years ended June 30, 2005 and 2004, respectively. The major sources of operating inflows were receipts from collections on loans (\$1.6 million and \$1.2 million for the years ended June 30, 2005 and 2004, respectively).

The Authority has cash inflows from investing activities of \$528,086 and \$386,558 for the years ended June 30, 2005 and 2004. These result from investment income.

**Economic Factors and Future Outlook**

The Authority is affected by both U.S. and North Carolina economic conditions and policies. Federal policy changes such as NAFTA (North American Fair Trade Act) affect the prices farmers receive for their products thereby affecting their ability to repay loans. The Authority attempts to reduce the resultant risk to the loan portfolio by obtaining federal guarantees on loans where possible. The rapid development of China's manufacturing economy improves incomes of Chinese consumers which increases export opportunities for United States agriculture. At the same time, their trade increases contribute to an increasing balance of payments deficit in the United States. This trade imbalance weakens the economic strength of the US economy.

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**MANAGEMENT'S DISCUSSION AND ANALYSIS**  
Year Ended June 30, 2005

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

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

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

**Request for Information**

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**BALANCE SHEET**  
June 30, 2005

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<b><u>ASSETS</u></b>	
<b>Current Assets</b>	
Cash and cash equivalents (Note 3)	\$ 5,679,241
Notes receivable, net (Note 4)	1,584,209
Interest receivable	222,449
Other receivable	4,303
Inventories	3,065
<b>Total Current Assets</b>	7,493,267
<b>Non-current Assets</b>	
Notes receivable, net (Note 4)	8,276,278
Land held for investment (Note 5)	171,500
<b>Total Non-current Assets</b>	8,447,778
<b>TOTAL ASSETS</b>	\$ 15,941,045
 <b><u>LIABILITIES AND NET ASSETS</u></b>	
<b>Current Liabilities</b>	
Intergovernmental payables (Note 6)	\$ 140,710
Accounts payable	1,701
Accrued vacation leave (Note 7)	4,050
<b>Total Current Liabilities</b>	146,461
<b>Non-current Liabilities</b>	
Accrued vacation leave (Note 7)	39,789
<b>TOTAL LIABILITIES</b>	186,250
<b>Net Assets - Unrestricted</b>	15,754,795
<b>TOTAL LIABILITIES AND NET ASSETS</b>	\$ 15,941,045

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS**  
Year Ended June 30, 2005

<b>Operating Revenues</b>	
Interest earnings on notes receivable	\$ 630,197
Sales and services	122,934
Fees, licenses and fines	6,075
Rental and lease earnings	660
<b>Total Operating Revenues</b>	<b>759,866</b>
 <b>Operating Expenses</b>	
Personal services and employee benefits	487,919
Contracted personal services	164,490
Equipment	66,693
Rental expense	44,789
Bad debts	380,812
Travel	18,035
Other expenses	19,363
Supplies and materials	3,417
Communications	7,876
Postage	4,097
<b>Total Operating Expenses</b>	<b>1,197,491</b>
<b>Operating Income (Loss)</b>	<b>(437,625)</b>
 <b>Non-operating Revenues</b>	
Investment earnings	528,086
Miscellaneous	64,914
<b>Total Non-operating Revenues</b>	<b>593,000</b>
<b>Change in Net Assets</b>	<b>155,375</b>
<b>Beginning Net Assets</b>	<b>15,599,420</b>
<b>Ending Net Assets</b>	<b>\$ 15,754,795</b>

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**STATEMENT OF CASH FLOWS**  
Year Ended June 30, 2005

<b>Cash Flows from Operating Activities</b>	
Receipts from customers	\$ 777,632
Receipts from collection of notes receivable	1,599,271
Payments for loans issued	(764,685)
Payments to employees and fringe benefits	(487,919)
Payments to vendors and suppliers	(308,006)
<b>Net Cash Flows from Operating Activities</b>	816,293
 <b>Cash Flows from Non-capital Financing Activities</b>	
Other (payments) receipts	4,561
 <b>Cash Flows from Investing Activities</b>	
Interest on investments	528,086
<b>Net Increase in Cash and Cash Equivalents</b>	1,348,940
<b>Cash and Cash Equivalents - July 1</b>	4,330,301
<b>Cash and Cash Equivalents - June 30</b>	\$ 5,679,241
 <b>Reconciliation of Net Operating Income to Net Cash</b>	
<b>Provided by Operating Activities</b>	
Operating Income (Loss)	\$ (437,625)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities	
Changes in Assets and Liabilities	
Receivables	1,268,349
Inventories	(1,369)
Intergovernmental payables	(955)
Accounts Payable	(12,107)
<b>Net Cash Provided by Operating Activities</b>	\$ 816,293

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 1 – The Organization**

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

**Note 2 – Summary of Significant Accounting Policies**

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

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

**Basis of Presentation** – The Authority is accounted for as a proprietary fund type (enterprise fund) in conformity with the accounting and reporting requirements of the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989 for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date. The measurement focus is upon determination of financial position, and changes in operations and cash flows. The accounting principles used is those generally accepted in the United States of America and applicable to similar businesses in the private sector; thus, the accompanying financial statements have been prepared in accordance with the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 2 – Summary of Significant Accounting Policies (continued)**

**Use of Estimates** – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The determination of the adequacy of the allowance for loan losses is based on estimates that are particularly susceptible to significant changes in the economic environment and market conditions. In connection with the determination of the estimated losses on loans, management obtains independent appraisals for significant collateral.

While management uses available information to recognize losses on loans, further reductions in the carrying amounts of loans may be necessary based on changes in local economic conditions. It is reasonably possible that the estimated losses on loans may change materially in the near term. However, the amount of the change that is reasonably possible cannot be estimated.

**Cash and Cash Equivalents** – Cash and cash equivalents include short-term investments with the State Treasurer’s Cash and Investment Pool (a governmental external investment pool). The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit additional cash at any time and also may withdraw cash at any time without prior notice or penalty.

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

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

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

*Agricultural Facilities Disaster Loans* – Loans are made to assist agricultural property owners who have suffered property damage due to natural disasters to repair or replace structures and to return to normal

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 2 – Summary of Significant Accounting Policies (continued)**

work routines as quickly as possible. These loans are designed to provide for damages to farm facilities (structures) not fully covered for replacement costs or covered by federal disaster funds. Interest rates are fixed for the life of the loan and established on criteria tied to the Prime Rate. Maximum length of the loan cannot exceed 10 years.

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

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

The allowance for loan losses is established as losses are estimated to have occurred through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectibility of a loan balance is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is evaluated on a regular basis by management and is based upon management's periodic review of the collectibility of the loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available.

**Inventories** – Inventories held by the Authority are priced at the lower of cost or market value using the first-in, first-out method. The inventories consist of expendable supplies and postage.

**Capital Assets** – It is the policy of the Authority to capitalize all capital assets costing more than \$5,000 with an estimated useful life of two or more years. In addition, other items that are purchased and used in large quantities are capitalized. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. There were no assets in excess of the capitalization threshold as of June 30, 2005.

**Lease Obligations** – Operating lease payments are recorded as expenses when incurred. All leases contain specific appropriation clauses indicating that continuation of each lease is subject to continued funding by the Legislature.

**Compensated Absences** – The Authority's policy is to record the cost of vacation leave when earned. The policy provides for the maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1<sup>st</sup> or for which an employee can be paid upon termination of employment.



NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 2 – Summary of Significant Accounting Policies (continued)**

Also, any accumulated vacation leave in excess of 30 days at December 31<sup>st</sup> is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30<sup>th</sup> equals the leave carried forward at the previous December 31<sup>st</sup> plus the leave earned, less the leave taken between January 1<sup>st</sup> and June 30<sup>th</sup>.

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

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

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

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

**Revenue and Expense Recognition** – The Authority presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. Operating activities are those activities that are necessary and essential to the mission of the Authority. Investment income is considered nonoperating since it is investing, capital or noncapital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital or noncapital financing activities.

**Note 3 – Deposits and Investments**

At June 30, 2005, the \$5,679,241 shown on the Balance Sheet as cash and cash equivalents represents the Authority’s equity position in the State Treasurer’s Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer’s Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.41 years as of June 30, 2005. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer’s Investment Pool (which includes the State Treasurer’s

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 3 – Deposits and Investments (continued)**

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.

**Note 4 – Notes Receivable, Net**

A summary of changes in notes receivable is as follows:

Notes receivable from borrowers	\$25,849,530
Notes payable to holders	<u>(15,789,043)</u>
	10,06,0,487
Less allowance	<u>(200,000)</u>
Notes receivable, net	9,860,487
Current portion	<u>(1,584,209)</u>
Non-current portion	<u>\$ 8,276,278</u>

**Note 5 – Land Held for Investment**

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

**Note 6 – Intergovernmental Payables**

- A. North Carolina State University Agreement** – The Authority administers funds on behalf of the North Carolina State University College of Natural Resources (the University) for approved projects that rehabilitate or educate the people of rural North Carolina. The funds originated from proceeds of a sale of federal forestland held by the North Carolina Rural Rehabilitation Corporation. These funds are invested with the State Treasurer’s Cash and Investment Pool.
  
- B. Farm Pilot Project** – The enactment of the Agricultural, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of Fiscal Year 2002 (the Act) appropriated funds to the United States Department of Agriculture Natural Resources Conservation Service (NRCS) for pilot projects demonstrating innovative treatment technologies which result in at least a 75% reduction in the nutrient content of wastewater discharged by animal feeding operations. The Act identified the Authority and a Florida not-for-profit corporation, as entities authorized to create and implement the pilot project. For its services, the Authority receives cash payments to cover project and administrative costs.

The Authority received and disbursed \$77,205 and \$78,348 for these projects during the year ended June 30, 2005.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 7 – Changes in Non-Current Liabilities**

A summary of changes in accrued vacation leave for the year ended June 30, 2005, is presented as follows:

	July 1, 2004	Additions	Reductions	June 30, 2005	Current Portion
Accrued Vacation Leave	\$ 40,582	\$ 43,839	\$ (40,582)	\$ 43,839	\$ 4,050

**Note 8 – Operating Leases**

The Authority leases its office space. Future minimum rental payments required under leases that have noncancelable lease terms as of June 30, 2005 were \$51,324, and \$31,960 for fiscal years 2006 and 2007, respectively.

Rental expense for the year was \$44,789.

**Note 9 – Retirement Plans**

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

**Funding Policy** – Employers and members are required to contribute to the Plan at rates set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2005, these rates were set at 2.17% of covered payroll for employers and 6% of covered payroll for members. The Authority’s contributions to TSERS for the years ended June 30, 2005, 2004, and 2003 were \$8,747, \$850, and \$0, respectively, equal to the required contributions.

**Note 10 – Post-employment Benefits**

**Health Care for Long-Term Disability Beneficiaries and Retirees** – The Authority participates in State administered programs that provide health care benefits to eligible former employees. The State Health Plan provides postemployment health insurance to former employees of the State. Those former employees who are eligible to receive health care as another postemployment benefit are long-term disability beneficiaries of the Disability Income Plan of North Carolina (DIPNC) and retirees of the

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 10 – Post-employment Benefits (continued)**

Teachers' and State Employees' Retirement System (TSERS), with five or more years of contributory membership service in the Retirement System prior to disability or retirement. The health insurance plan is the same as for active employees, except that coverage becomes secondary when former employees become eligible for Medicare. These former employees are eligible to participate in the self-funded Comprehensive Major Medical Plan (Plan).

The funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. These health care benefits are funded by employer contributions that are established in the biennial appropriation bill by the General Assembly. The Authority contributed a monthly amount equal to 3.20% of active employees' salaries to the General Fund's Reserve for Retirees' Health Premium Account (Reserve).

The Authority's total contribution to the Plan was \$12,899 for the year ended June 30, 2005. The Reserve pays the full cost of coverage for long-term disability beneficiaries and retirees enrolled in the Plan.

These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

**Disability Income** – Short-term and long-term disability benefits are provided to the eligible members of the TSERS through the Disability Income Plan of North Carolina (DIPNC). Long-term disability benefits are payable as an other postemployment benefit from DIPNC after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. An employee is eligible to receive long-term disability benefits provided he/she meets specified requirements. There was no contribution made to the plan for the year ended June 30, 2005. Contributions to the plan cannot be separated between the amounts that relate to other postemployment benefits and employment benefits for active employees. These benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Additional detailed information about the above postemployment benefits is disclosed in North Carolina's Comprehensive Annual Financial Report.

**Note 11 – Risk Management and Insurance**

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled by a combination of methods, including participation in various State-administered risk pools, purchase of commercial insurance and self-retention of certain risks.

**State Health Plan** – In accordance with Chapter 135, Article 3, Part 3, of the General Statutes, the State of North Carolina provides comprehensive major medical care for employees and retirees of the State and its participating component units, as well as their dependents. Coverage is self-funded by contributions to the State Health Plan (the Plan). Contributions for employee and retiree coverage are made by the State while employees and retirees make contributions for dependent coverage. Coverage is

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
NOTES TO FINANCIAL STATEMENTS  
Year Ended June 30, 2005

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**Note 11 – Risk Management and Insurance (continued)**

also extended to certain individuals as another postemployment benefit. The Plan is administered by a third party contractor who is responsible for the processing of claims and administration of cost containment.

The Plan pays most expenses that are medically necessary and eligible for coverage based on usual, customary and reasonable allowances. Claims are subject to specified annual deductible and co-payment requirements. The Plan disallows claims in excess of a lifetime maximum of \$5 million.

**Death Benefit Plan of North Carolina** – Term life insurance (death benefits) is provided through the Death Benefit Plan to all members of the Teachers’ and State Employees’ Retirement System who have completed at least 12 consecutive months of membership in the System. Lump sum death benefit payments to beneficiaries are equal to the employee’s highest 12 months salary in a row during the 24 months prior to his/her death, with a minimum benefit of \$25,000 and a maximum of \$50,000.

Death benefits are funded by actuarially based employer contributions that are established in the biennial appropriation bill by the General Assembly. However, no contributions were required for the year ended June 30, 2005. The benefits are established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly.

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

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

**Automobile, Fire and Other Property Losses** – The State of North Carolina is required by Chapter 58, Article 31, Part 50, of the General Statutes to provide liability insurance on every state-owned motor vehicle. The State is self-insured for the first \$500,000 of any loss through a retrospective rated plan. The plan purchases excess insurance through a private insurer to cover losses greater than \$500,000.

The liability limits for losses incurring in state are \$500,000 per claimant and \$5 million per occurrence. For losses incurring out-of-state, the limits are \$1 million per claimant and \$5 million per occurrence. Users of the state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 11 – Risk Management and Insurance (continued)**

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

The State Property Fire Insurance Fund (the Fund) was also created by Chapter 58, Article 31, of the General Statutes. The Fund insures State owned buildings and contents for fire, extended coverage, and other property losses. Coverage for fire losses is free for all operations that are supported by the State’s General Fund. Those operations that are not supported by the State’s General Fund are charged for fire coverage. Extended coverage and other property coverage such as sprinkler leakage, business interruption, vandalism, theft, and “all risk” for buildings and contents can be purchased through the Fund at premiums discounted from industry manual rates.

The fund insures losses up to \$2.5 million per occurrence. All losses covered by the Fund are subject to a \$500 per occurrence deductible except for theft, which carries a \$1,000 per occurrence deductible. The Fund purchases excess insurance from a private insurer to cover losses over the amounts insured by the Fund. Settled claims have not exceeded coverage in any of the past three fiscal years.

**Public Officer’s and Employees’ Liability Insurance** – In accordance with Chapter 58, Article 32, Part 15, of the General Statutes, public officers’ and employees’ liability insurance is provided by private insurers for all employees of the State and participating component units. The policy provides \$5 million excess insurance over the \$500,000 statutory limit payable for any one claim under the State Tort Claims Act. The first \$150,000 of an award against a State agency is the responsibility of the state agency’s general fund budget code or up to \$500,000 if a non-general fund budget code.

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

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

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY  
**NOTES TO FINANCIAL STATEMENTS**  
Year Ended June 30, 2005

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**Note 11 – Risk Management and Insurance (continued)**

Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable.

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

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

**Note 12 – Commitments and Contingencies**

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

As of June 30, 2005, there were five series of Agricultural Development Revenue Bonds outstanding with an aggregate principal amount payable of \$17,500,000.

**Loans Not Fully Dispersed** – The Authority had loan commitments of \$6,781,870 that were not fully dispersed at June 30, 2005.

**Litigation**

The Authority is involved in lawsuit which it intends to defend vigorously. The Authority estimates that the potential liability resulting from this litigation is not material and would not have a material adverse effect on the financial position of the Authority at June 30, 2005.



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

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

We have audited the financial statements of the North Carolina Agricultural Finance Authority (the "Authority") as of and for the year ended June 30, 2005 and have issued our report thereon dated June 9, 2006. 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 a certain matter involving the internal control over financial reporting and its operation that we consider to be a material weakness. In our judgment, this weakness, described below, could adversely affect the Authority's ability to record, process, summarize and report financial data consistent with assertions of management in the financial statements.

**Finding - Material Weakness**

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



### **Recommendation**

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

### **Management Response**

Management agrees with our finding and recommendation. The Authority is currently working with the State of North Carolina Department of Agriculture to resolve this issue.

### **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*.

We noted certain other matters that we reported to management of the Authority in a separate letter dated June 9, 2006.

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

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

*Cherry, Bekaert & Holland L.L.P.*

Raleigh, North Carolina  
June 9, 2006

## ORDERING INFORMATION

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Audit reports issued by the Office of the State Auditor can be obtained from the web site at [www.ncauditor.net](http://www.ncauditor.net). Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports 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

Telephone: 919/807-7500

Facsimile: 919/807-7647