



# STATE OF NORTH CAROLINA

**USS NORTH CAROLINA BATTLESHIP COMMISSION**

**WILMINGTON, NORTH CAROLINA**

**FINANCIAL STATEMENT AUDIT REPORT**

**FOR THE YEAR ENDED SEPTEMBER 30, 2007**

**OFFICE OF THE STATE AUDITOR**

**LESLIE W. MERRITT, JR., CPA, CFP**

**STATE AUDITOR**

**USS NORTH CAROLINA BATTLESHIP COMMISSION**

**WILMINGTON, NORTH CAROLINA**

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**FOR THE YEAR ENDED SEPTEMBER 30, 2007**

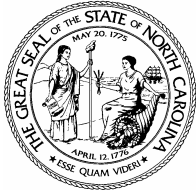
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Leslie W. Merritt, Jr., CPA, CFP  
State Auditor

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**AUDITOR'S TRANSMITTAL**

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

We have completed a financial statement audit of the USS North Carolina Battleship Commission for the year ended September 30, 2007, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

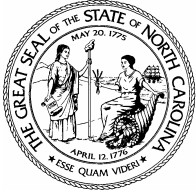
*Leslie W. Merritt, Jr.*

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

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**INDEPENDENT AUDITOR'S REPORT**

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Board of Commissioners  
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"), for the year ended September 30, 2007, 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 also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the USS North Carolina Battleship Commission and do not purport to, and do not, present fairly the financial position of the State of North Carolina as of September 30, 2007, the changes in its financial position, or, where applicable, its cash flows 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 USS North Carolina Battleship Commission as of September 30, 2007, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 22, 2008, 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 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

## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*Leslie W. Merritt, Jr.*

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

May 22, 2008

## MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of the financial report presents Management's Discussion and Analysis and provides an overview of the financial activities of the USS North Carolina Battleship Commission (the Commission) for the fiscal year ended September 30, 2007. Since 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 Commission's financial statements and notes to the financial statements. The basic financial statements include a Statement of Nets Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and Statement of Cash Flows, and 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 Commission 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 2007, the 198,378 visitors to the Battleship reflected a 4.4% increase in visitation over the previous year. The new admissions fee schedule the Commission implemented on October 1, 2006, that increased fees 33% proportionally across all classes of visitors, appeared not to have a negative impact on visitation. Also, unusually good weather with no hurricanes and relatively stable, although high, gasoline prices during the year were considered contributory to the visitation increase. By increasing revenue and continuing to closely control expenses margins were brought back to a more reasonable level.

The following chart and table summarizes the major categories of nets assets and their corresponding changes.

<b>Condensed Statement of net Assets</b>				
	<b>Net Assets As of 09/30/07 (in thousands)</b>	<b>Net Assets As of 09/30/06 (in thousands)</b>	<b>Increase (Decrease) (in thousands)</b>	<b>Percent (Change)</b>
Current Assets	\$ 2,261.89	\$ 1,242.73	\$ 1,019.16	82.01
Noncurrent Assets				
Unrestricted and Restricted Investments	4,511.86	4,310.40	201.46	4.67
Capital Assets, Nondepreciable	629.64	629.64		
Capital Assets, Depreciable, Net	<u>1,825.32</u>	<u>1,945.15</u>	<u>(119.83)</u>	<u>(6.16)</u>
Total Assets	<u>9,228.71</u>	<u>8,127.92</u>	<u>1,100.79</u>	<u>13.54</u>
Current Liabilities	100.49	83.43	17.06	20.45
Noncurrent Liabilities	83.73	61.88	21.85	35.31
Total Liabilities	<u>184.22</u>	<u>145.31</u>	<u>38.91</u>	<u>26.78</u>
Net Assets				
Invested in Capital Assets	2,454.97	2,574.79	(119.82)	(4.65)
Restricted	2,544.00	2,617.58	(73.58)	(2.81)
Unrestricted	<u>4,045.52</u>	<u>2,790.24</u>	<u>1,255.28</u>	<u>44.99</u>
Total Net Assets	<u>\$ 9,044.49</u>	<u>\$ 7,982.61</u>	<u>\$ 1,061.88</u>	<u>13.30</u>

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

For the above, the 82% increase in current assets and its direct impact on unrestricted net assets is due, primarily, to the increase in the admissions fee schedule noted in the financial highlights above coupled with the 4.4% increase in visitation.

As of September 30, 2007, the Battleship had recorded \$5.04 million invested in capital assets, \$2.6 million in accumulated depreciation, and \$2.5 million in net capital assets. The following table depicts the changes in the two years presented.

<b>Capital Assets, Net</b>				
<b>For the Years Ended September 30, 2007 and 2006</b>				
<b>(in thousands)</b>				
	<b>2007</b>	<b>2006</b>	<b>Increase (Decrease)</b>	<b>Percent Change</b>
Capital Assets				
Land	\$ 97.43	\$ 97.43	\$ 0.00	0.00
Buildings	1,114.82	1,114.82		
Machinery and Equipment	982.84	982.84		
Infrastructure	2,310.11	2,310.11		
CIP	532.22	532.22		
Total	\$5,037.42	\$5,037.42		
Less: Accumulated Depreciation	2,582.45	2,462.63	119.82	4.87
Net Capital Assets	\$ 2,454.97	\$ 2,574.79	\$ (119.82)	(4.65)

The Statement of Revenues, Expenses, and Changes in Net Assets reflects an overall increase in net assets for the current fiscal year ending September 30, 2007. This increase relates predominantly to the impact on revenue from the fee schedule change and a strong performance in sales, commissions, and rental contracts. The following table identifies variances between the two fiscal years.

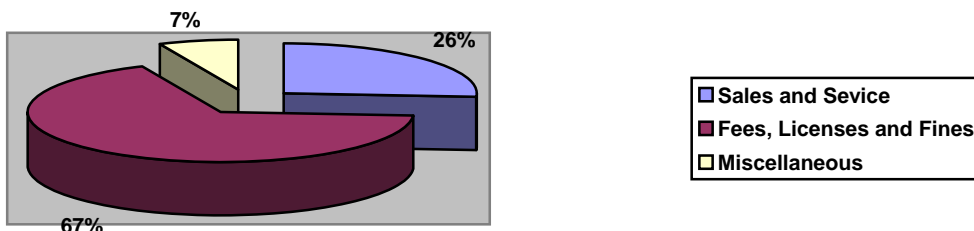
<b>Operating Revenue</b>				
<b>For the Years Ended September 30, 2007 and 2006</b>				
<b>(in thousands)</b>				
	<b>2007</b>	<b>2006</b>	<b>Increase (Decrease)</b>	<b>Percent Change</b>
Operating Revenue				
Sales and Services	\$ 763.06	\$ 663.14	\$ 99.92	15.07
Fees, Licenses and Fines	1,968.11	1,434.64	533.47	37.18
Miscellaneous	192.68	124.04	68.64	55.34
Total	2,923.85	2,221.82	702.03	31.60
Less Operating Expenses	2,401.21	2,254.31	146.90	6.52
Net Operating Income (Loss)	522.64	(32.49)	555.13	(1708.62)
Nonoperating Revenue				
Capital Gifts	28.66	24.73	3.93	15.89
Investment Income	510.58	301.94	208.64	69.10
Total	539.24	326.67	212.57	65.07
Increase in Net Assets	1,061.88	294.18	767.70	260.96
Net Assets, Beginning of Year	7,982.61	7,688.43	294.18	3.83
Net Assets, End of Year	\$ 9,044.49	\$ 7,982.61	\$ 1,061.88	13.30



## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The 37% increase in fees, licenses and fines reflects combination of an average of a 33% increase in the fee schedule and a 4.4% increase in visitation during the fiscal year. The 69% increase in investment income reflects realized gains and change in market value of the portfolio.

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



The following table identifies variances between the two fiscal years for the components of operating expense.

**Operating Expenses**  
For the Years Ended September 30, 2007 and 2006  
(in thousands)

Operating Expense	2007	2006	Increase (Decrease)	Percent Change
Personal Services	\$ 1,163.02	\$ 990.40	\$ 172.62	17.43
Supplies and Materials	48.74	55.44	(6.70)	(12.09)
Services	667.90	683.91	(16.01)	(2.34)
Cost of Goods Sold	280.95	302.18	(21.23)	(7.03)
Insurance and Bonding	19.39	18.15	1.24	6.83
Other	101.39	80.26	21.13	26.33
Depreciation	119.82	123.97	(4.15)	(3.35)
<b>Total</b>	<b>\$ 2,401.21</b>	<b>\$ 2,254.31</b>	<b>\$ 146.90</b>	<b>6.52</b>

Total operating expenses for fiscal year 2007 increased 6.5% over fiscal year 2006 primarily in personal services due to filling of vacant positions, salary restructuring for selected staff, and an annual 2.5% cost of living salary increase for all staff.

### **Financial Outlook**

The increase in the admissions fee schedule has reversed the decreasing operating margins of the past few years. If discretionary income can remain at the current levels, including relative stability in gasoline prices, the Commission is cautiously optimistic that visitation can

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)**

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continue to rebound from the drastic reductions suffered in the immediate period after September 11, 2001, which would further enhance the margins.

In the longer term, the Commission has begun initial discussions of the near term need for a drydocking of the Battleship for underwater hull maintenance and preservation. This is an ambitious undertaking that will require the Battleship to be towed to a port with a drydock capable of taking a 728 foot vessel. While off-site, a new mooring plan will need to be constructed as well as, most likely, a new visitor's center in lieu of the current structure will be nearing the end of its 30 years useful life. Funding for this capital project will require a multi-year commitment from the North Carolina General Assembly.

***USS North Carolina Battleship Commission***  
***Statement of Net Assets***  
***September 30, 2007***

***Exhibit A***

**ASSETS**

Current Assets:

Cash and Cash Equivalents	\$ 1,923,713.78
Receivables (Note 5)	29,577.06
Inventories	211,935.64
Prepaid Items	96,670.28
	<hr/>
Total Current Assets	2,261,896.76

Noncurrent Assets:

Investments	720,630.53
Restricted Investments	3,791,230.85
Capital Assets - Nondepreciable (Note 6)	629,644.98
Capital Assets - Depreciable, Net (Note 6)	1,825,326.65
	<hr/>
Total Noncurrent Assets	6,966,833.01

Total Assets	<hr/> <hr/> 9,228,729.77
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**LIABILITIES**

Current Liabilities:

Accounts Payable and Accrued Liabilities (Note 7)	84,857.08
Unearned Revenue	9,922.07
Long -Term Liabilities - Current Portion (Note 8)	5,715.67
	<hr/>
Total Current Liabilities	100,494.82

Noncurrent Liabilities:

Long-Term Liabilities (Note 8)	83,731.40
	<hr/>
Total Liabilities	184,226.22

**NET ASSETS**

Invested in Capital Assets	2,454,971.63
Restricted Expendable:	
Restoration Projects	2,544,010.95
Unrestricted	4,045,520.97
	<hr/>

Total Net Assets	<hr/> <hr/> <hr/> \$ 9,044,503.55
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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, 2007***

***Exhibit B***

**REVENUES**

Operating Revenues:	
Sales and Services	\$ 763,068.36
Admission Fees	1,968,110.00
Miscellaneous	192,676.13
	<hr/>
Total Operating Revenues	2,923,854.49
	<hr/>

**EXPENSES**

Operating Expenses:	
Personal Services	1,163,022.33
Supplies and Materials	48,741.47
Services	667,895.17
Cost of Goods Sold	280,953.16
Depreciation	119,819.48
Insurance and Bonding	19,383.93
Other Operating Expenses	101,393.24
	<hr/>
Total Operating Expenses	2,401,208.78
	<hr/>
Operating Income	522,645.71
	<hr/>

**NONOPERATING REVENUES**

Investment Earnings	510,580.73
	<hr/>
Nonoperating Revenues	510,580.73
	<hr/>
Income Before Other Revenues	1,033,226.44
	<hr/>
Capital Gifts	28,664.41
	<hr/>
Increase in Net Assets	1,061,890.85
	<hr/>
Net Assets, October 1, 2006	7,982,612.70
	<hr/>
Net Assets, September 30, 2007	\$ 9,044,503.55
	<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, 2007***

***Exhibit C***

**CASH FLOWS FROM OPERATING ACTIVITIES**

Receipts from Customers	\$ 2,897,558.68
Payments to Suppliers	(1,151,901.20)
Payments to Employees	<u>(1,124,443.19)</u>
Net Cash Provided by Operating Activities	<u>621,214.29</u>

**CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES**

Capital Gifts	<u>28,664.41</u>
Cash Provided by Capital Financing and Related Financing Activities	<u>28,664.41</u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

Proceeds from Sales and Maturities of Investments	154,841.56
Investment Earnings	<u>154,277.85</u>
Net Cash Provided by Investing Activities	<u>309,119.41</u>

Net Increase in Cash and Cash Equivalents	958,998.11
Cash and Cash Equivalents - October 1, 2006	<u>964,715.67</u>
Cash and Cash Equivalents - September 30, 2007	<u><u>\$ 1,923,713.78</u></u>

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

Operating Income	\$ 522,645.71
Adjustments to Reconcile Operating Income to Net Cash Provided By Operating Activities:	
Depreciation	119,819.48
Changes in Net Assets and Liabilities:	
Accounts Receivable	(27,369.39)
Inventories	(435.00)
Prepaid Items	(32,359.85)
Accounts Payable and Accrued Liabilities	19,156.93
Compensated Absences	18,682.83
Unearned Revenue	<u>1,073.58</u>

Net Cash Provided by Operating Activities	<u><u>\$ 621,214.29</u></u>
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**NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES**

Change in Fair Value of Investments	\$ 201,462.31
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The accompanying notes to the financial statements are an integral part of this statement.

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**USS NORTH CAROLINA BATTLESHIP COMMISSION  
NOTES TO THE FINANCIAL STATEMENTS  
SEPTEMBER 30, 2007**

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**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 the Governmental Accounting Standards Board (GASB).

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

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Commission 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.

- 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 includes undeposited receipts, petty cash, and cash on deposit with private bank accounts.
- E. Investments** - This classification includes fixed income investments, equity investments, mutual funds, and money market funds. Except for money market funds not held by a governmental external investment pool,

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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investments are accounted for at fair value, as determined by quoted market prices, or an amount determined by management if quoted market prices are not available. The net increase in the fair value of investments is recognized as a component of investment income.

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

- F. Receivables** - Receivables consist of amounts charged to accounts and amounts due from the Friends of the Battleship, a related party. Receivables of the Commission are considered fully collectable; accordingly, no allowance for doubtful accounts is required.
- G. Inventories** - Inventories, consisting of expendable supplies and merchandise for resale, are valued at the lower of cost or market.
- H. Capital Assets** - Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The Commission capitalizes assets that have a value or cost in excess of \$5,000 at the date of acquisition and an expected useful life of more than one year.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 15 to 50 years for general infrastructure, 25 years for buildings, and 3 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 be 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. Noncurrent Long-Term Liabilities** - Noncurrent long-term liabilities include compensated absences that will not be paid within the next fiscal year.
- K. 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



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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forward each January 1 or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at December 31 is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at September 30 equals the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and September 30.

In addition to the vacation leave described above, compensated absences include the accumulated unused portion of the special annual leave bonuses awarded by the North Carolina General Assembly. The bonus leave balance on December 31 is retained by employees and transferred into the next calendar year. It is not subject to the limitation on annual leave carried forward described above and is not subject to conversion to sick leave.

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

**L. 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 for which the Commission is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

**Unrestricted Net Assets** - Unrestricted net assets include resources derived from 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 for the Commission.

**M. Revenue and Expense Recognition** - The Commission classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Commission's principal ongoing operations. Operating revenues include all charges to customers. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of*

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### *Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting.*

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

#### **NOTE 2 - DEPOSITS AND INVESTMENTS**

- A. Deposits** - All funds of the Commission are deposited in board-designated official depositories and are required to be collateralized in accordance with *North Carolina General Statute 115D-58.7*. Official depositories may be established with any bank or savings and loan association whose principal office is located in North Carolina. Also, the Commission may establish time deposit accounts, money market accounts, and certificates of deposit. The amount shown on the Statement of Net Assets as cash and cash equivalents includes cash on hand totaling \$24,560.00, and deposits in private financial institutions with a carrying value of \$1,899,153.78, and a bank balance of \$1,877,262.73.

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 bank balance of demand and time deposits with the private financial institution at September 30, 2007, consisted of interest and non-interest bearing checking accounts totaling \$1,887,262.73. As of September 30, 2007, of the Commission's bank balance, \$1,787,262.73 was exposed to custodial credit risk as 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, 2007, 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	\$ 117,628.80	\$ 0.00	\$ 21,295.59	\$ 86,451.06	\$ 9,882.15
U.S. Agencies	56,947.10		28,172.73	28,774.37	
Mortgage Pass Throughs	163,002.06		20,472.95	20,925.36	121,603.75
Collateralized Mortgage Obligations	94,239.27	2,951.82	62,769.42	19,687.11	8,830.92
State and Local Government	14,666.69		2,602.83	12,063.86	
Asset-Backed Securities	22,030.53				22,030.53
Mutual Bond Funds	37,149.24			33,126.70	4,022.54
Money Market Mutual Funds	1,869,574.70	1,869,574.70			
Domestic Corporate Bonds	76,716.93		31,541.82	45,175.11	
		<u>\$ 1,872,526.52</u>	<u>\$ 166,855.34</u>	<u>\$ 246,203.57</u>	<u>\$ 166,369.89</u>
Other Securities					
Other Mutual Funds	2,059,906.06				
Total Investments	<u>\$ 4,511,861.38</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. The Commission invests in debt securities containing Collateralized Mortgage Obligations and Asset-Backed Securities that are highly sensitive to rate changes. These securities are based on cash flows from interest payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates.

*Credit Risk:* The Commission does not have a formal policy that addresses credit risk. As of September 30, 2007, the Commission's investments were rated as follows:

	Fair Value	AAA Aaa	AA Aa	A	BBB Baa	Unrated
U.S. Agencies	\$ 56,947.10	\$ 56,947.10	\$ 0.00	\$ 0.00	\$ 0.00	\$ 0.00
Mortgage Pass Throughs	163,002.06	128,401.39				34,600.67
Collateralized Mortgage Obligations	94,239.27	59,296.67	436.27	13,047.37		21,458.96
State and Local Government	14,666.69	14,666.69				
Asset-Backed Securities	22,030.53	22,030.53				
Mutual Bond Funds	37,149.24					37,149.24
Money Market Mutual Funds	1,869,574.70					1,869,574.70
Domestic Corporate Bonds	76,716.93	5,756.67	5,874.57	38,221.41	26,864.28	
Total	<u>\$ 2,334,326.52</u>	<u>\$ 287,099.05</u>	<u>\$ 6,310.84</u>	<u>\$ 51,268.78</u>	<u>\$ 26,864.28</u>	<u>\$ 1,962,783.57</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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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	\$ 117,628.80
U.S. Agencies	56,947.10
Mortgage Pass Throughs	163,002.06
Collateralized Mortgage Obligations	94,239.27
State and Local Governments	14,666.69
Asset-Backed Securities	22,030.53
Domestic Corporate Bonds	76,716.93
Total	\$ 545,231.38

### 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.

Accordingly, 50% of the authorized normal operating budget for fiscal year 2007 of \$2,494,440.00 yields a reserve requirement of \$1,247,220.00. For reporting purposes this reserve is included in unrestricted net assets. At year-end, the value of the investment portfolio, described in Note 2, exceeded the reserve requirement; therefore, the \$3,264,641.38 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 Battleship North Carolina. The first project completed was replacement of the teak deck. Currently in design is restoration of the main deck interior spaces including a major HVAC package. Funds in excess of those needed for these projects are held in the Restoration Fund to fund future restoration projects. While the capital campaign has ended, contributions continue to be made to the fund. For the fiscal year ended September 30, 2007, the Commission received donations in the amount of \$28,496.41. Because of the restricted-use nature of the Restoration Fund; the long term portion of the portfolio is managed as a separate account by Franklin Street Partners.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

At year-end, the fair value of the Franklin Street Partners Restoration Fund segment of the portfolio, summarized in Note 2, was \$717,327.42.

### NOTE 5 - RECEIVABLES

Receivables at September 30, 2007, were as follows:

	Amount
<b>Current Receivables:</b>	
Due from Related Parties	\$ 22,771.60
Accounts	6,805.46
<b>Total Current Receivables</b>	<b>\$ 29,577.06</b>

### NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended September 30, 2007, is presented as follows:

	Balance October 1, 2006	Increases	Balance September 30, 2007
Capital Assets, Nondepreciable:			
Land	\$ 97,425.80	\$ 0.00	\$ 97,425.80
Construction in Progress	532,219.18		532,219.18
<b>Total Capital Assets, Nondepreciable</b>	<b>629,644.98</b>		<b>629,644.98</b>
Capital Assets, Depreciable:			
Buildings	1,114,823.35		1,114,823.35
Machinery and Equipment	982,843.81		982,843.81
General Infrastructure	2,310,109.37		2,310,109.37
<b>Total Capital Assets, Depreciable</b>	<b>4,407,776.53</b>		<b>4,407,776.53</b>
Less Accumulated Depreciation:			
Buildings	910,439.16	44,592.91	955,032.07
Machinery and Equipment	871,088.81	22,462.65	893,551.46
General Infrastructure	681,102.43	52,763.92	733,866.35
<b>Total Accumulated Depreciation</b>	<b>2,462,630.40</b>	<b>119,819.48</b>	<b>2,582,449.88</b>
<b>Total Capital Assets, Depreciable, Net</b>	<b>1,945,146.13</b>	<b>119,819.48</b>	<b>1,825,326.65</b>
<b>Capital Assets, Net</b>	<b>\$ 2,574,791.11</b>	<b>\$ 119,819.48</b>	<b>\$ 2,454,971.63</b>

### NOTE 7 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at September 30, 2007, were as follows:

	Amount
Accounts Payable	\$ 42,452.19
Accrued Payroll	42,404.89
<b>Total Accounts Payable and Accrued Liabilities</b>	<b>\$ 84,857.08</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 8 - LONG-TERM LIABILITIES

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

	Balance October 1, 2006	Additions	Reductions	Balance September 30, 2007	Current Portion
Compensated Absences	\$ 70,764.24	\$ 68,615.49	\$ 49,932.66	\$ 89,447.07	\$ 5,715.67

### NOTE 9 - PENSION PLANS

**A. Retirement Plans** - Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System. The Teachers' and State Employees' Retirement System (System) is a cost sharing multiple-employer defined benefit pension plan 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, 2006, through June 30, 2007, these rates were set at 2.66% of covered payroll for employers and 6% of covered payroll for members. The system was funded by employer and member contributions of 3.05% and 6%, respectively, of covered payroll for the period July 1, 2007, through September 30, 2007.

For the year ended September 30, 2007, the Commission had a total payroll of \$840,960.40, of which \$778,182.73 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$45,570.05 and \$21,460.63, respectively. The Commission made 100% of its annual required contributions for the years ended September 30, 2007, 2006, and 2005, which were \$21,460.63, \$16,060.05, and \$15,274.49, respectively.

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

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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- B. Supplemental Retirement Income Plans** - IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. The voluntary contributions by employees amounted to \$4,080.00 for the year ended June 30, 2007.

### 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. For the period October 1, 2006, through June 30, 2007, the Commission contributed 3.8% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits and for the period July 1, 2007, through September 30, 2007, the Commission contributed 4.10%. For the fiscal year ended September 30, 2007, the Commission's total contribution to the Plan was \$30,156.30. 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. Disability Income** - 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 Teachers' and State Employees' Retirement System. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. The Commission contributes .52% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. For the year ended September 30, 2007, the Commission's total contribution to the DIPNC was \$4,046.55. The Commission assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the DIPNC is

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

### NOTE 11 - RISK MANAGEMENT

The Commission is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, and can include 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 State Department of Insurance. The State is self-insured for the first \$500,000 of any loss through a retrospective rate plan. Excess insurance coverage is purchased 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



## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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\$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.

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 \$75,000 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.

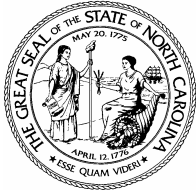
Term life insurance of \$25,000 to \$50,000 is provided to eligible workers. This self-insured death benefit program is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was .16% for the current fiscal year.

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

### **NOTE 12 - THE FRIENDS OF THE BATTLESHIP NORTH CAROLINA**

The Friends of the Battleship North Carolina, Inc. is a nonprofit organization that raises funds to provide additional resources to the USS North Carolina Battleship Commission not included in the reporting entity. During the fiscal year ended September 30, 2007, the organization made in-kind donations of \$24,072.00 to the Commission.

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STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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State Auditor

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

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Board of Commissioners  
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, 2007, and have issued our report thereon dated May 22, 2008. As discussed in Note 1, the financial statements present only the USS North Carolina Battleship Commission and do not purport to, and do not, present fairly the financial position of the State of North Carolina as of September 30, 2007, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Commission's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Commission's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Commission's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Commission's financial statements that is more than inconsequential will not be prevented or detected by the Commission's internal control.

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

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A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Commission's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commission's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management and staff of the Commission, the Board of Commissioners, the Department of Cultural Resources, the Governor, the State Controller, and the General Assembly, 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

May 22, 2008

## **ORDERING INFORMATION**

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