

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

FINANCIAL STATEMENTS

As of and for the Year End June 30, 2012

(With Independent Auditors' Report Thereon)

**NORTH CAROLINA AGRICULTURAL
FINANCE AUTHORITY**
Raleigh, North Carolina

Financial Statement Audit Report

Year Ended June 30, 2012

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

Beth A. Wood, CPA
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

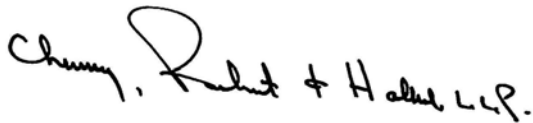
We have audited the accompanying balance sheet of the North Carolina Agricultural Finance Authority (the "Authority"), a component unit of the State of North Carolina, as of June 30, 2012 and the related statements of revenues, expenses, changes in net assets, and cash flows for the year then ended. 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, 2012, 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 October 5, 2012 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

A handwritten signature in black ink that reads "Cherry, Rickett & Hallett LLP." The signature is written in a cursive, flowing style.

Raleigh, North Carolina
October 5, 2012

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2012

Management's Discussion and Analysis ("MD&A") 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 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.

2012 Financial Highlights

- The assets of the Authority exceeded its liabilities at the close of the most recent fiscal year by \$14,792,993 (net assets). Most of 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 decreased by \$2,489,893. This decrease is primarily attributable to a write-off of notes receivable related to a delinquent loan.
- The Authority's notes receivable, net decreased by \$3,499,462 during the fiscal year. The key factor in this change was a write-off of a delinquent loan.
- Liabilities decreased by \$1,097,086. The decrease is mainly due to a \$1,100,838 decrease in the liability for land to be held for use by NC State University.

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, 2012 and 2011.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2012

Financial Statements (Continued)

Condensed Balance Sheet

	2012	2011	Variance
Assets			
Current Assets	\$ 13,892,570	\$ 14,521,338	\$ (628,768)
Capital Assets	31,332	33,779	(2,447)
Noncurrent Assets	3,325,361	6,281,125	2,955,764
	\$ 17,249,263	\$ 20,836,242	\$ (3,586,979)
Liabilities			
Current Liabilities	\$ 2,435,223	\$ 3,533,620	\$ (1,098,397)
Noncurrent Liabilities	21,047	19,736	1,311
Total liabilities	2,456,270	3,553,356	(1,097,086)
Net assets			
Invested in Capital Assets	31,332	33,779	(2,447)
Unrestricted	14,761,661	17,249,107	(2,487,446)
Total net assets	14,792,993	17,282,886	(2,489,893)
	\$ 17,249,263	\$ 20,836,242	\$ (3,586,979)

As of June 30, 2012 and 2011, the Authority's total assets were \$17.2 million and \$20.8 million, respectively, which reflects a \$3.6 million decrease between these years. Of these totals, \$3.9 million and \$7.4 million were notes receivable from borrowers for the years ended June 30, 2012 and 2011, respectively. The decrease is attributable to the write-off of a delinquent loan and a decrease in issuance of new loans during the year ended June 30, 2012.

The Authority's liabilities totaled \$2.5 million and \$3.6 million for the years ended June 30, 2012 and 2011, respectively. The total current liabilities of \$2.4 million as of June 30, 2012 and \$3.5 million as of June 30, 2011, were well covered by current assets of \$13.9 million in 2012 and \$14.5 million in 2011. This indicates the Authority's ability to pay current liabilities as they become due.

The Authority sells a portion of its notes receivable to other entities and continues to act as the collection agent for borrower payments.

The Authority's net value of capital assets is \$31,332 and \$33,779 for the years ended June 30, 2012 and 2011, respectively.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2012

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 revenues decreased from the prior year due to the Authority's reduction of notes receivable balance.

Operating expenses primarily consist of personal services and employer benefit costs, contracted personal services, bad debts, and rental expense. Operating expenses increased from the previous year primarily due to a large write off of interest related to a delinquent loan in the current year.

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. Investment earnings on pooled investment accounts and income derived from the sale of the Authority's note receivable portfolio represent the sources of non-operating revenues. Non-operating revenues decreased from the prior year due to the decrease in interest rates received on pooled investments.

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NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2012

Financial Statements (Continued)

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	<u>2012</u>	<u>2011</u>	<u>Variance</u>
Operating Revenues	\$ 286,020	\$ 297,494	\$ (11,474)
Operating Expenses			
Personal services & employee benefits	476,949	495,186	18,237
Supplies and materials	2,218	2,026	192
Contracted personal services	37,577	55,856	(18,279)
Travel	3,763	1,653	2,110
Communication	5,697	7,955	(2,258)
Other services	2,357	2,883	(526)
Depreciation	2,447	2,447	-
Insurance and bonding	526	668	(142)
Other fixed charges	11,369	12,194	(825)
Capital outlay	4,500	13,365	(8,865)
Bad debt	2,267,169	148,123	2,119,046
Rent expense	66,520	64,506	2,014
Other expenses	50,587	542	50,045
Total operating expenses	<u>2,931,679</u>	<u>807,404</u>	<u>2,124,275</u>
Operating Loss	(2,645,659)	(509,910)	(2,135,749)
Non-operating Revenues	155,766	103,473	52,293
Transfers	<u>-</u>	<u>(50,000)</u>	<u>50,000</u>
Changes in Net Assets	(2,489,893)	(456,437)	(2,033,456)
Net Assets – beginning of year	<u>17,282,886</u>	<u>17,739,323</u>	<u>(456,437)</u>
Net Assets – end of year	<u>\$ 14,792,993</u>	<u>\$ 17,282,886</u>	<u>\$ (2,489,893)</u>

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2012

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 received approximately \$57,000 from financing activities related to the sale of loans for the year ended June 30, 2012, and did not receive cash for capital financing activities during the year ended June 30, 2011.

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.

Condensed Statement of Cash Flows

	<u>2012</u>	<u>2011</u>	<u>Variance</u>
Net cash (used) provided by:			
Operating activities	\$ 919,905	\$ 452,491	\$ 467,414
Investing activities	98,932	103,857	(4,925)
Non-capital financing activities	(1,044,004)	3,400,000	4,444,004
Net (decrease) increase	(25,167)	3,956,348	(3,981,515)
Cash and cash equivalents at beginning of year	13,228,138	9,271,790	3,956,348
Cash and cash equivalents at end of year	<u>\$ 13,202,971</u>	<u>\$ 13,228,138</u>	<u>\$ (25,167)</u>

Cash was provided in operating activities from customer receipts and collections on notes receivables. Cash was used in operating activities for the payment of salaries and benefits, the issuance of additional loans, and for the normal payment to vendors. Cash was provided in financing activities from the proceeds from the sale of loans. Cash was used in financing activities for payments to NC State University. Cash flows were generated in investing activities from interest earnings on investments.

Economic Factors and Future Outlook

The Authority is affected by both U.S. and North Carolina economic conditions and policies. The Authority attempts to reduce the resultant risk to the loan portfolio by obtaining federal guarantees on loans where possible.

Perhaps the most notable impact on the food chain has been the severe drought in the Central and Midwest areas of the USA. Corn production has fallen significantly in the world's largest corn and feed grains producer. As a result the crop may have up to 40 percent decline in production from 2011. China is one of the largest buyers of USA grains. Corn export prices in 2012 have increased at least 33 percent over last year as some corn was sold for as much as \$8.00. Wheat has not increased quite as much because other nations produce a greater portion of total World wheat.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

YEAR ENDED JUNE 30, 2012

Economic Factors and Future Outlook (Continued)

Recent volatility in global financial markets will impact the volume of future lending activity. Furthermore, the global recession has many negative economic effects on American agriculture. Purchasing power of many nations has declined, thereby reducing the quantity of U.S.A. exports worldwide, with the largest loss of business transactions with Southeast Asia. This has resulted in a glut of chicken meat in the U.S.A., reducing the number of chickens needed to supply the demands of Southeast Asia.

A comparable reduction would also have been expected in pork exports. However, identification of H1N1 flu in the spring of 2009 and the possibility of a flu pandemic further exacerbated the normal recessionary effects as countries began to embargo pork imports because the term 'swine flu' was associated with H1N1 flu. This has resulted in approximately a seventeen percent decrease in global demand for pork exports from the U.S.A. This had created a dramatic decrease in prices received by growers and processors of pork products. As the second largest pork producing state in the U.S.A., the impact was devastating to North Carolina swine growers and processors. The Authority and many other agricultural lenders will be impacted through 2012 with stagnant demand and small profits in the poultry and swine production sectors. This will result in delinquent payments to lenders and loss of customers as borrowers struggle to survive the recession.

The global recession has slowed the rapid development of China's manufacturing economy. In recent years, improved incomes of Chinese consumers increased 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.

Since many countries now compete quite favorably with North Carolina as an agricultural exporter, more attention must be given to finding 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 should ultimately return an economic opportunity to North Carolina farmers that can be financed by the Authority.

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

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 North Carolina Agricultural Finance Authority at P.O. Box 27908, Raleigh, North Carolina 27611-7908.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

BALANCE SHEET

JUNE 30, 2012

ASSETS

Current assets

Cash and cash equivalents (Note 3)	\$ 13,202,971
Notes receivable, net (Note 4)	619,624
Interest receivable	69,054
Inventories	921
Total current assets	<u>13,892,570</u>

Non-current assets

Notes receivable, net (Note 4)	3,325,361
Capital assets, net (Note 5)	31,332
Total non-current assets	<u>3,356,693</u>

Total assets	<u><u>\$ 17,249,263</u></u>
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LIABILITIES AND NET ASSETS

Current liabilities

Accounts payable	613
Accrued payroll	2,471
Due to primary government	416
Accrued vacation leave (Note 6)	1,351
Land to be held for use by NCSU (Note 7)	2,430,372
Total current liabilities	<u>2,435,223</u>

Non-current liabilities

Accrued vacation leave (Note 6)	<u>21,047</u>
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Total liabilities	<u>2,456,270</u>
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Net assets

Invested in capital assets	31,332
Unrestricted	14,761,661
Total net assets	<u>14,792,993</u>

Total liabilities and net assets	<u><u>\$ 17,249,263</u></u>
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The accompanying notes are an integral part of these financial statements.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2012

Operating revenues

Interest earnings on notes receivable, net	\$	213,702
Sales and services		<u>72,318</u>
Total operating revenues		<u>286,020</u>

Operating expenses

Personal services & employee benefits		476,949
Supplies and materials		2,218
Contracted personal services		37,577
Travel		3,763
Communication		5,697
Other services		2,357
Depreciation		2,447
Insurance and bonding		526
Other fixed charges		11,369
Capital outlay		4,500
Bad debt		2,267,169
Rent expense		66,520
Other expenses		<u>50,587</u>
Total operating expenses		<u>2,931,679</u>

Operating loss

(2,645,659)

Non-operating revenues

Investment earnings		98,932
Miscellaneous		<u>56,834</u>
Total non-operating revenues		<u>155,766</u>

Change in net assets

(2,489,893)

Net assets - beginning of year

17,282,886

Net assets - end of year

\$ 14,792,993

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2012

Cash flows from operating activities	
Receipts from customers	\$ 345,585
Receipts from collections of notes receivable	1,625,715
Payments for loans issued	(393,422)
Payments to employees and fringe benefits	(473,276)
Payments to vendors and suppliers	(184,697)
Net cash provided by operating activities	919,905
Cash flows from investing activities	
Interest on investments	98,932
Net cash provided by investing activities	98,932
Cash flows from financing activities	
Proceeds from sale of loans	56,834
Payments to NCSU for land held for use	(1,100,838)
Net cash used by financing activities	(1,044,004)
Net decrease in cash	(25,167)
Cash and cash equivalents - beginning of year	13,228,138
Cash and cash equivalents - end of year	\$ 13,202,971
Reconciliation of operating income (loss) to net cash provided (used) by operating activities	
Operating loss	\$ (2,645,659)
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation expense	2,447
Bad debt	2,267,169
Change in assets and liabilities:	
Notes receivables	1,232,293
Other receivables	59,565
Inventories	338
Accounts payable	2,550
Accrued vacation leave	1,202
Net cash provided by operating activities	\$ 919,905

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

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 North Carolina Agricultural Finance 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 North Carolina Agricultural Finance 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 net income, financial position, and changes in cash flows. The accounting principles used are those generally accepted in the United States of America and applicable to similar businesses in the private sector; thus, the accompanying financial statements have been prepared in accordance with the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

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 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.

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 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 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*.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 2 – Summary of significant accounting policies (Continued)

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 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. Past due status is determined based on contractual terms.

In the normal course of business, the Authority sells notes receivable to other entities and continues to act as the collection agent for the borrower payments. Notes receivable are reported net of notes sold to other entities.

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. The Authority uses the straight line method to depreciate assets over estimated useful lives as follows:

Machinery and Equipment	5 -10 years
Vehicles	10 years

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 2 – Summary of significant accounting policies (Continued)

Compensated Absences - Employees of the Authority are permitted to accumulate earned but unused vacation pay benefits. 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 1st or for which an employee can be paid upon termination of employment. When determining the vacation pay liability due within one year, leave is considered taken on a last in, first out (LIFO) basis. Any accumulated vacation leave in excess of 30 days at December 31st is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30th equals the leave carried forward at the previous December 31st plus the leave earned, less the leave taken between January 1st and June 30th.

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

Full-time permanent, probationary and trainee employees earn vacation leave ranging from 1.17 to 2.17 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 up to 30 days. 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.

In addition to 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 part of the 30 day maximum applicable to regular vacation leave and is not subject to conversion to sick leave.

Net Assets -The Authority's net assets are classified as follows:

Invested in Capital Assets - This represents the Authority's total investment in capital assets.

Unrestricted Net Assets - Unrestricted net assets are all those not invested in capital assets.

Revenue and Expense Recognition - The Authority presents its revenues and expenses as operating or non-operating 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 non-operating since it is either investing, capital, or non-capital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital or non-capital financing activities.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 3 – Cash and cash equivalents

At June 30, 2012, the \$13,202,971 shown on the Balance Sheet as cash and cash equivalents represents the Authority's equity position in the Short-Term Investment Fund managed by the North Carolina State Treasurer (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). The Short-Term Investment Fund had a weighted average maturity of 1.5 years as of June 30, 2012. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value.

Financial statements and disclosures for the State Treasurer's Investment Pool are included in the State of North Carolina's CAFR. 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 "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Note 4 – Notes receivable, net

A summary of notes receivable is presented as follows:

Notes receivable from borrowers	\$ 7,190,816
Notes payable to holders	(3,045,831)
	<u>4,144,985</u>
Less allowance	(200,000)
Notes receivable, net	<u>3,944,985</u>
Current portion	619,624
Non-current portion	<u><u>\$ 3,325,361</u></u>

On April 2, 2009, the Authority signed two promissory notes whereby Coastal Plains Pork, LLC promised to repay the Authority a total of \$3,000,000 plus interest. The notes called for payments of principal and interest to begin April 2, 2011. On September 29, 2009, Coastal Plains Pork, LLC, filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. Coastal Plains has confirmed that the note remains payable. The promissory notes are included in the notes receivable, net balance of \$250,000. The Authority has stopped accruing interest on the loans and has determined the interest receivable balance on these loans is uncollectible. The Authority currently believes these loans are adequately collateralized as of June 30, 2012. Therefore no additional provision for loan loss has been estimated on these loans.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 5 – Capital assets

A summary of changes in capital assets for the year ended June 30, 2012 is presented below.

	<u>Balance</u> <u>June 30, 2011</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2012</u>
Capital assets, depreciable:				
Machinery and equipment	\$ 33,461	\$ -	\$ -	\$ 33,461
Vehicles	21,100	-	-	21,100
Total capital assets, depreciable	<u>54,561</u>	<u>-</u>	<u>-</u>	<u>54,561</u>
Less accumulated depreciation for:				
Machinery and equipment	(17,617)	(1,392)	-	(19,009)
Vehicles	<u>(3,165)</u>	<u>(1,055)</u>	<u>-</u>	<u>(4,220)</u>
Total accumulated depreciation	<u>(20,782)</u>	<u>(2,447)</u>	<u>-</u>	<u>(23,229)</u>
Capital assets, net	<u>\$ 33,779</u>	<u>\$ (2,447)</u>	<u>\$ -</u>	<u>\$ 31,332</u>

Depreciation expense for the year ended June 30, 2012 was \$2,447.

Note 6 – Changes in non-current liabilities

A summary of changes in accrued vacation leave for the year ended June 30, 2012 is presented as follows:

	<u>Balance</u> <u>June 30, 2011</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2012</u>	<u>Current</u> <u>Portion</u>
Accrued Vacation leave	<u>\$ 21,196</u>	<u>\$ 24,920</u>	<u>\$ (23,718)</u>	<u>\$ 22,398</u>	<u>\$ 1,351</u>

Note 7 – Non-operating revenues

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. Interest earned on these funds is included in investment earnings of \$98,932 for the year ended June 30, 2012.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 8 – Pension plans

Retirement Plans - Each permanent full-time employee, as a condition of employment, is a member of the Teacher's and State Employees' Retirement System ("TSERS"), a cost-sharing multiple-employer defined benefit pension plan administered by the State of North Carolina. Benefit and contribution provisions of the Teacher's and State Employees' Retirement System are established by *North Carolina General Assembly Statutes* 135-5 and 135-8 and may be amended by the North Carolina General Assembly.

Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2012, these rates were set at 7.44% of covered payroll for employers and 6% of covered payroll for members. For the current fiscal year, the Authority had a total payroll of \$476,949, of which \$338,983 was covered under the Teacher's and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were \$44,474 and \$22,749, respectively. Required employer contribution rates for the years ended June 30, 2012 and 2011 were 4.93% and 3.57%, respectively, while employee contributions were 6% each year. The Authority made 100% of its annual required contributions for the years ended June 30, 2012, 2011, and 2010, which were \$20,339, \$13,535, and \$12,936, respectively.

The Teacher's and State Employees' Retirement System's financial information is included in the State of North Carolina's CAFR. 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 "Proceed directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Note 9 – Other postemployment benefits

Health Benefits - The Authority participates in the Comprehensive Major Medical Plan (the "Plan"), a cost sharing, multiple-employer benefit health care plan that provides postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina ("DIPNC") and retirees of the TSERS. Coverage eligibility varies depending on years of contributory membership service in their retirement system prior to disability or retirement.

The Plan's benefit and contribution provisions are established by Chapter 135-7 and Chapter 135, Article 3A of the General Statutes and may be amended only by the North Carolina General Assembly. The Plan does not provide for automatic post-retirement benefit increases.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 9 – Other postemployment benefits (Continued)

By General Statute, a Retiree Health Benefit Fund (the "Fund") has been established as a fund in which the accumulated contributions from employers and any earnings on those contributions shall be used to provide health benefits to retired and disabled employees and applicable beneficiaries. By statute, the Fund is administered by the Board of Trustees of the TSERS and contributions to the fund are irrevocable. Also, by law, Fund assets are dedicated to providing benefits to retired and disabled employees and applicable beneficiaries and are not subject to the claims of creditors of the employees making contributions to the Fund. Contribution rates to the Fund, which are intended to finance benefits and administrative expenses on a pay-as-you-go basis, are determined by the General Assembly in the Appropriations Bill.

For the current fiscal year, the Authority contributed 5.00% of the covered payroll under the TSERS to the Fund. Required contribution rates for the year's ended June 30, 2012 and 2011, were 4.9% and 4.5%, respectively.

The Authority made 100% of its annual required contributions to the Plan for the years ended June 30, 2012, 2011, and 2010, which were \$16,949, \$18,692, and \$16,306, respectively. The Authority assumes no liability for retiree health care benefits provided by the programs other than the required contribution.

Additional detailed information about these programs can be located in the State of North Carolina's CAFR. 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 "Proceed Directly to OSC's index page," then "Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

Disability Income - The Authority participates in the DIPNC, a cost-sharing, multiple-employer defined benefit plan, to provide short-term and long-term disability benefits to eligible members of the TSERS. Benefit and contribution provisions are established by Chapter 135, Article 6, of the General Statutes, and may be amended only by the North Carolina General Assembly. The plan does not provide for automatic post-retirement benefit increases.

Disability income benefits are funded by actuarially determined employer contributions that are established in the Appropriations Bill by the General Assembly. For the fiscal year ended June 30, 2012, the Authority made a statutory contribution of 0.52% of covered payroll under the TSERS to the DIPNC. Required contribution rates for the years ended June 30, 2012, and 2011, were 0.52% and 0.52%, respectively. The Authority made 100% of its annual required contributions to the DIPNC for the years ended June 30, 2012, 2011, and 2010, which were \$1,763, \$1,972, and \$1,884, respectively. The Authority assumes no liability for long-term disability benefits under the Plan other than its contribution.

Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 10 – Risk management

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. 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.

Public Officers' 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 \$10,000,000 excess insurance over the \$1,000,000 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 \$1,000,000 if a non-general fund budget code.

For general fund budget codes, any award greater than \$150,000 but less than \$1,000,000 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 \$1,000,000 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.

Comprehensive Major Medical Plan - Authority employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the Comprehensive Major Medical Plan ("Plan"), a component unit of the State of North Carolina. The Plan is funded by employer and employee contributions and is administered by a third-party contractor.

Statewide Workers' Compensation Program - The Workers' Compensation Program (the "Program") was created by Chapter 97, Article 1, of the General Statutes to provide benefits to workers injured on the job and includes all employees of the State and its component units. An injury is covered under workers' compensation if it is caused by an accident that arose out of and in the course of employment. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable.

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

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 10 – Risk management (Continued)

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 month 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. 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. The plan requires the Authority to contribute 0.16% of covered payroll which amounted to \$542 for the year ended June 30, 2012.

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 \$75,000 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.

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 \$1,000,000.

The liability limits for losses incurring in-state are \$1,000,000 per claimant and \$10 million per occurrence. For losses incurring out-of-state, the limits are \$1 million per claimant and \$10 million per occurrence. Users of the state cars are charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention. Premiums charged are also based on the projected losses to be incurred.

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

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.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 10 – Risk management (Continued)

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.

Additional details on the State-administered risk management programs are disclosed in the State's CAFR issued by the Office of the State Controller.

Note 11 – 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, 2012, there were three series of Agricultural Development Revenue Bonds outstanding with an aggregate principal amount payable of \$6,049,691.

Note 12 – Future accounting and reporting standards

In December 2010, GASB issued Statement No. 60, "Accounting and Financial Reporting for Service Concession Arrangements." The objective of the Statement is to improve financial reporting by establishing recognition, measurement, and disclosure requirements for service concession arrangements for both transferors and governmental operators. This Statement provides guidance on whether the transferor or the operator should report the capital assets in its financial statements, when to recognize up-front payments from an operator as revenue, and how to record any obligations of the transferor to the operator. The statement also provides guidance for governments that are operators in a service concession arrangement. The Authority does not expect this standard to have a material impact on its financial statements in the future. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 12 – Future accounting and reporting standards (Continued)

In November 2010, GASB issued Statement No. 61, “The Financial Reporting Entity: Omnibus—an amendment of GASB Statements No. 14 and No. 34.” The objective of this Statement is to improve financial reporting for a governmental financial reporting entity. The requirements of Statement No. 14, *The Financial Reporting Entity*, and the related financial reporting requirements of Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, were amended to better meet user needs and to address reporting entity issues that have arisen since the issuance of those Statements. This Statement modifies certain requirements for inclusion of component units in the financial reporting entity and amends the criteria for reporting component units as if they were part of the primary government (that is, blending) in certain circumstances. This Statement also clarifies the reporting of equity interests in legally separate organizations. The Authority does not expect this standard to have a material impact on its financial statements in the future. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2012.

In December 2010, GASB issued Statement No. 62, “Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.” The objective of this Statement is to incorporate into the GASB’s authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

1. Financial Accounting Standards Board (FASB) Statements and Interpretations
2. Accounting Principles Board Opinions
3. Accounting Research Bulletins of the American Institute of Certified Public Accountants’ (AICPA) Committee on Accounting Procedure

The Authority does not expect this standard to have a material impact on its financial statements in the future. The requirements of this Statement are effective for financial statements for periods beginning after December 15, 2011.

In June 2011, GASB issued Statement No. 63, “Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.” This Statement provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. The Authority does not expect this standard to have a material impact on its financial statements in the future. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011.

In June 2011, GASB issued Statement No. 64, “Derivative Instruments: Application of Hedge Accounting Termination Provisions—an amendment of GASB Statement No. 53.” The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty’s credit support provider. The Authority does not expect this standard to have a material impact on its financial statements in the future. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011.

NORTH CAROLINA AGRICULTURAL FINANCE AUTHORITY

NOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 2012

Note 12 – Future accounting and reporting standards (Continued)

In March 2012, GASB issued Statement No. 65, "Items Previously Reported as Assets and Liabilities." The objective of this Statement to improve financial reporting by clarifying the appropriate use of the financial statement elements deferred outflows of resources and deferred inflows of resources to ensure consistency in financial reporting. This Statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Authority does not expect this standard to have a material impact on its financial statements in the future. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

In March 2012, GASB issued Statement No. 66, "Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62." The objective of this Statement is to improve accounting and financial reporting for a governmental financial reporting entity by resolving conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Authority does not expect this standard to have a material impact on its financial statements in the future. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012.

In June 2012, GASB issued Statement No. 67, "Financial Reporting for Pension Plans-an amendment of GASB Statement No. 25" and Statement No. 68, "Accounting and Financial Reporting for Pensions-an amendment of GASB Statement No. 27." The objective of these Statements is to improve financial reporting by State and local governmental pension plans that are administered through trusts or equivalent arrangements that meet certain criteria. The Authority does not expect this standard to have a material impact on its financial statements in the future. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2013.

Note 13 – Subsequent events

The Authority has evaluated subsequent events through October 5, 2012, in connection with the preparation of these financial statements which is the date the financial statements were available to be issued.

This audit required 109 audit hours at an approximate cost of \$15,293. The cost represents 0.09% and 0.5% of the Authority's total assets and total expenses subjected to audit, respectively.

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**Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***

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

We have audited the accompanying balance sheet of the North Carolina Agricultural Finance Authority (the "Authority"), a component unit of the State of North Carolina, as of June 30, 2012 and the related statements of revenues, expenses, changes in net assets, and cash flows for the year then ended and have issued our report thereon dated October 5, 2012. 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

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

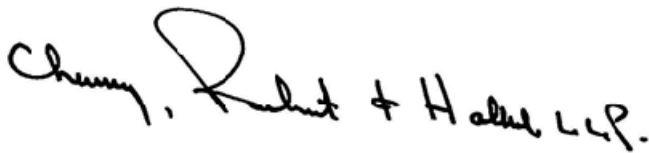
A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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 Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the loan committee, management, and others within the Authority, and is not intended to be and should not be used by anyone other than these specific parties.

Handwritten signature in cursive script that reads "Cherry, Rickett & Halden LLP."

Raleigh, North Carolina
October 5, 2012