

# STATE OF NORTH CAROLINA

## SPECIAL REVIEW

**NORTH CAROLINA DEPARTMENT OF CULTURAL RESOURCES  
NORTH CAROLINA MARITIME MUSEUM**

**FRIENDS OF THE MUSEUM, NORTH CAROLINA MARITIME MUSEUM, INC.  
PEPSI AMERICAS' SAIL 2006, LLC**

**GALLANT'S CHANNEL PROPERTY TRANSACTION**

**BEAUFORT, NORTH CAROLINA**

**APRIL 2007**

**OFFICE OF THE STATE AUDITOR**

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

**STATE AUDITOR**

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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  
Lisbeth C. Evans, Secretary, North Carolina Department of Cultural Resources  
Eddy Myers, President, Friends of the Maritime Museum, North Carolina Maritime  
Museum, Inc.  
Britt Cobb, Secretary, North Carolina Department of Administration  
J. Robert Gordon, Chairman, Natural Heritage Trust Fund  
Members of the North Carolina General Assembly

Ladies and Gentlemen:

Pursuant to General Statute § 147-64.6(c)(16), we have completed our special review of the Gallant's Channel property transaction in Beaufort, North Carolina and the Pepsi Americas' Sail 2006 event. The results of our review, along with recommendations for corrective action, are contained in this report.

Copies of this report have been provided to the Governor, the Attorney General and other appropriate officials in accordance with North Carolina General Statute § 147-64.6 (c) (12) which requires the State Auditor to provide written notice of apparent instances of violations of penal statutes or apparent instances of malfeasance, misfeasance, or nonfeasance by an officer or employee.

Respectfully submitted,

*Leslie W. Merritt, Jr.*

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

April 16, 2007

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## INTRODUCTION

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On October 3, 2006, the Council of State approved a transfer of property in Beaufort, North Carolina from the Friends of the Museum, North Carolina Maritime Museum, Inc., a 501(c)(3) non-profit organization that supports the activities of the North Carolina Maritime Museum, to the State of North Carolina. Following the October 3, 2006 Council of State meeting, some Council members expressed concerns about the property transfer. These concerns included the lack of disclosure of outstanding debts against the property, including liens filed by private contractors, questions regarding the value of the property, and the possibility that the State was paying for the land a second time. In addition, the Secretary of the Department of Cultural Resources asked the State Auditor on October 25, 2006 to “examine the use of funds by the Friends of the Maritime Museum...for the Tall Ships event in Beaufort.” The “Tall Ships event” was a boat race and festival known as “Pepsi Americas’ Sail 2006” that was held in Beaufort and Morehead City, North Carolina from June 30 through July 5, 2006.

To conduct a review of the property transaction and the Pepsi Americas’ Sail 2006 event, we performed the following procedures:

- Interviews with employees of the North Carolina Department of Cultural Resources (Cultural Resources), the North Carolina Department of Transportation (DOT), the North Carolina Department of Justice, and the North Carolina Department of Administration (Administration) as well as employees and board members of the Friends of the Maritime Museum, North Carolina Maritime Museum, Inc. (Friends of the Museum) and Pepsi Americas Sail 2006, LLC;
- Examination of relevant documents and records of Cultural Resources, Friends of the Museum, DOT, and Administration including review of contracts, bank statements, check registers, deeds, appraisals, by-laws, invoices, and financial statements;
- Review of policies and procedures and State regulations including the North Carolina General Statutes and North Carolina Administrative Code;
- Interviews with individuals external to North Carolina state government.

This report presents the results of our special review. The review was conducted pursuant to North Carolina General Statute § 147-64.6(c)(16) rather than as a financial audit. The Department of Cultural Resources is subject to financial audit procedures within the Office of the State Auditor’s audit of the State’s Comprehensive Annual Financial Report. An independent public accounting firm conducts annual cash receipts and disbursements audits of the Friends of the Museum.

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## BACKGROUND

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### *North Carolina Department of Cultural Resources:*

The North Carolina Department of Cultural Resources (Cultural Resources) was formed in 1971 to provide historical and cultural experiences to the State's citizens to promote North Carolina's economic and social well-being. Cultural Resources "was the first state organization to include all agencies for arts and culture under one umbrella."<sup>1</sup> Cultural Resources consists of two primary offices: the Office of Archives and History and the Office of Arts and Libraries. The Office of Archives and History strives to preserve and maintain North Carolina's cultural heritage and includes the Division of State History Museums. The Division of State History Museums includes the North Carolina Museum of History and six regional museums including the North Carolina Maritime Museum in Beaufort and its two branches in Manteo and Southport.

### *North Carolina Maritime Museum:*

The North Carolina Maritime Museum's (Maritime Museum) mission is to "preserve and interpret all aspects of North Carolina's rich maritime heritage through educational exhibits, programs, and field trips."<sup>2</sup> The Maritime Museum displays exhibits at museums in Beaufort, Manteo, and Southport. Annually, over 265,000 people visit the museums including over 10,000 school children. The museums are open 360 days per year and admission is free in Beaufort and Manteo with a nominal fee in Southport. The Maritime Museum also sponsors over 300 public programs each year including a boatbuilding program at the Watercraft Center, field trips, special events, and environmental education programs such as the Cape Lookout Studies Program. Some of these outreach programs charge a fee for participation and the Friends of the Maritime Museum, North Carolina Maritime Museum, Inc. (Friends of the Museum) provides funding, administrative support, and operational oversight for some programs.

The Maritime Museum emerged around 1904 when an original collection of artifacts was first put on display at the U.S. Fisheries Laboratory in Beaufort. The collection grew over the next 50 years until the funding and organization of the Maritime Museum was established under the North Carolina Department of Agriculture in 1959. In 1975, the Maritime Museum's first full-time curator expanded the goals of the Maritime Museum to include both maritime history and coastal natural history.

In 1985, the Maritime Museum moved into its first permanent location in a newly constructed building on Front Street in Beaufort on property donated by Evelyn Chadwick Smith. In 1997, Senate Bill 352 transferred the Maritime Museum from the Department of Agriculture to the Department of Cultural Resources. In 1999, the Maritime Museum expanded operations to include branch museums in Manteo and Southport.

Currently, the Maritime Museum has a full-time paid staff of 24 and volunteer staff of over 100. The Maritime Museum is led by a director who is a full-time State employee. The director reports to the State Museums of History director who also oversees the Museum of History. The

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<sup>1</sup> Department of Cultural Resources website (<http://www.ncdcr.gov/ataglace.asp#>)

<sup>2</sup> North Carolina Maritime Museum website (<http://www.ah.dcr.state.nc.us/sections/maritime/default.htm>)

## BACKGROUND (CONTINUED)

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Maritime Museum is organized into six major branches: education, maritime, exhibits, administrative, Southport facility, and Roanoke Island facility. The administrative branch also includes a business manager for the Maritime Museum and the Maritime Museum's bookstore and staff.

### ***Friends of the Museum, North Carolina Maritime Museum, Inc.:***

The Friends of the Museum, North Carolina Maritime Museum, Inc. (Friends of the Museum) is a private, non-profit organization classified as a 501(c)(3) corporation for federal tax purposes. The Friends of the Museum exists to “assist, promote, and enhance the programs and functions of the North Carolina Maritime Museum.”<sup>3</sup> The Friends of the Museum organization was incorporated on June 6, 1979 as a way to help the Maritime Museum grow and prosper.

In addition to fund-raising for the Maritime Museum, the Friends of the Museum also provides volunteer services to support Maritime Museum programs. In some cases, the Friends of the Museum administers Maritime Museum programs and provides equipment for the programs. For example, it provides tools for the Watercraft Center, donates boats to the Maritime Museum's collection, and oversees the Junior Sailing Program. The Friends of the Museum has also been involved in planning for the future expansion of the Maritime Museum. These plans include the creation of “Olde Beaufort Seaport” with an expansion of the Maritime Museum, educational classrooms, a shipwreck hall, working maritime village, nature trails, conference center, hotel, amphitheatre, and potential retail opportunities.

The Friends of the Museum is led by a board of directors elected annually by the membership. According to its by-laws, the board has 13 members with at least three members from each region (Beaufort, Southport, and Manteo). In addition, the former Friends of the Museum president, current Maritime Museum director, and current Maritime Museum business manager serve as ex-officio members. Board members serve three-year staggered terms and may serve two consecutive terms.

The board appoints an executive director to oversee the daily operations of the Friends of the Museum and act under the guidance of the board. The Friends of the Museum also employs a part-time membership coordinator and a part-time administrative assistant. While the Friends of the Museum supports Maritime Museum activities, the two organizations are distinct entities. As such, the Friends of the Museum has separate offices across the street from the Maritime Museum in Beaufort and maintains its own financial records. (See Appendix A for financial information for the Friends of the Museum.)

### ***Gallant's Channel:***

#### Initial Purchase

In 1995, the North Carolina Maritime Museum and the Friends of the Museum were approached by the Evelyn Chadwick Smith estate about purchasing waterfront property along Taylor's Creek

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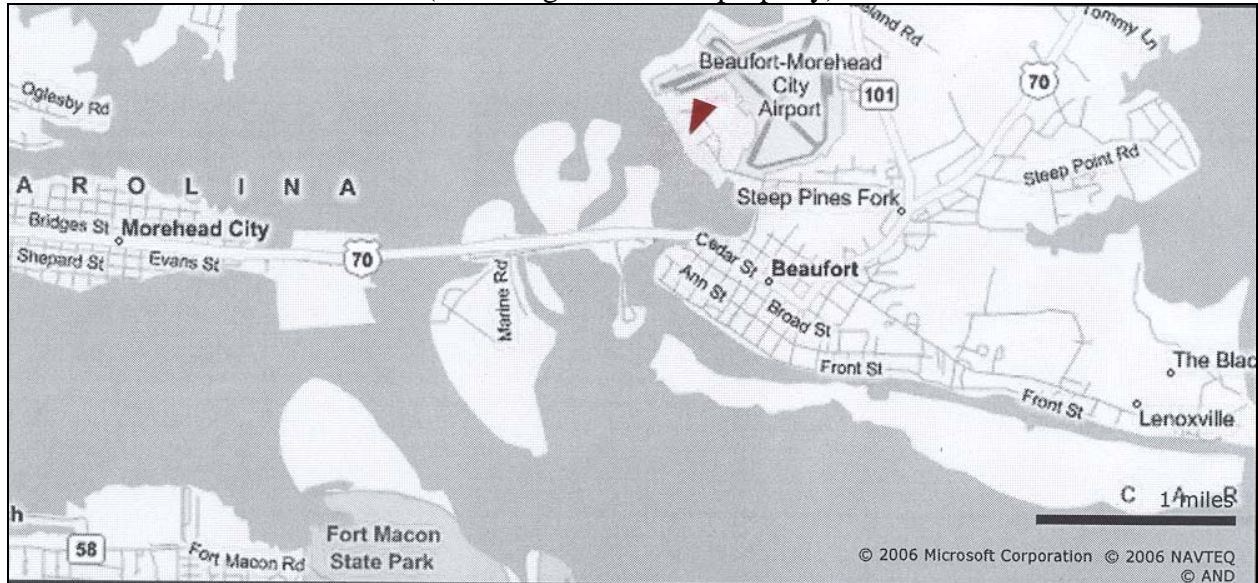
<sup>3</sup> Friends of the Maritime Museum, North Carolina Maritime Museum, Inc. by-laws



## BACKGROUND (CONTINUED)

and Gallant's Channel, the former site of the Fish Meal Company (See Exhibit 1, below). The Friends of the Museum was interested in purchasing the property for the future expansion of the Maritime Museum but was unable to raise the \$3.2 million purchase price. The Friends of the Museum raised \$100,000 and sought assistance from the North Carolina Department of Agriculture and local representatives in the North Carolina General Assembly. The Department of Agriculture was successful in obtaining two grants totaling \$450,000 from the Natural Heritage Trust Fund and the North Carolina General Assembly provided \$3 million in appropriations. The Friends of the Museum used these funds to purchase the property from the estate on July 31, 1997 as well as for initial site clean-up, surveys, and permits associated with the purchase. The Friends of the Museum planned to develop the property and created various long-range development plans including both 10-year and 20-year plans. Some initial site clean-up was performed including demolition of remaining structures and clearing of some natural areas.

Exhibit 1  
Map of Gallant's Channel  
(red triangle identifies property)



Source: <http://local.live.com>

### Transfer of Ownership Discussions

After the transfer of the Maritime Museum from the Department of Agriculture to the Department of Cultural Resources in 1997, questions arose regarding Natural Heritage Trust Fund grant restrictions and ownership of the property. Cultural Resources withheld the \$250,000 payment on the second grant while the Friends of the Museum were having difficulties meeting financial obligations. On September 11, 1998, the Friends of the Museum board voted to transfer the entire 36 acres to the State. The Council of State approved the transfer on October 6,

## **BACKGROUND (CONTINUED)**

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1998 but the deed for the transfer was never recorded. The Friends of the Museum received the second grant payment on October 16, 1998. In 1999, Cultural Resources and the Friends of the Museum negotiated the transfer of a portion of the property and the Friends of the Museum recorded a deed transferring 5.629 acres to the State on November 12, 1999.

During the next two years, the Friends of the Museum and Cultural Resources continued to negotiate the transfer of the remainder of the property. On June 13, 2001, the Friends of the Museum drafted a letter outlining their attorney's opinion regarding what would constitute "the appropriate time" for the transfer. Afterward, the issue fell from the priority list and no further discussions ensued. The Friends of the Museum continued to hold the property and made some improvements such as the transformation of an existing building into a repository for the Queen Anne's Revenge artifacts, the addition of trailers for the junior sailing program and educational classroom, site cleanup, and the demolition of buildings that remained from the fish meal plant.

### Site Development for Pepsi Americas' Sail 2006

Once the Beaufort/Morehead City area was selected as the location of Pepsi Americas' Sail 2006 (Tall Ships), the Friends of the Museum saw the event as an opportunity to publicize the Gallant's Channel property as well as use it as a fundraising tool. In addition, the Friends of the Museum realized some site clean-up and development of the property was necessary to serve as one of the three sites (along with the State Ports Authority site in Morehead City and the downtown Beaufort waterfront) for the Tall Ships event. During March 2005, the Friends of the Museum sought support from local legislative representatives who introduced bills in the General Assembly in an attempt to obtain \$2.5 million in state appropriations for capital improvements and operating expenses for museum expansion.

To expedite property development, the Friends of the Museum pursued private financing anticipating that future appropriations would extinguish short-term construction loans. On July 12, 2005, First Citizens Bank provided a \$995,000 line of credit using the property as collateral. The General Assembly ultimately approved \$1,650,000 for "transportation infrastructure for the Friends of the N.C. Maritime Museum/Tall Ships Event" but the Friends of the Museum did not receive these funds directly; rather, the funds were appropriated to the Department of Transportation. On October 20, 2005, the Friends of the Museum obtained an additional \$3,900,000 construction line of credit from First Citizens Bank. Improvements made to the property from these funds included addition of waterfront docks, shoreline stabilization, utility connections, on-site parking, and bulkhead at a total cost of \$4,413,585.

### Gallant's Channel Property Development and Valuation

The Gallant's Channel property was originally purchased using appropriated funds and grants by the Friends of the Museum for \$3.2 million on July 31, 1997. Since 1997, the Friends of the Museum paid \$5,100,276 (See Table 1) to develop the property. The Friends of the Museum have cleared land, demolished remaining structures from the Fish Meal Company site, provided buildings for the Queen Anne's Revenge repository, junior sailing program, and educational

## BACKGROUND (CONTINUED)

programs, constructed a 20-boat storage building, repaired existing bulkheads, and constructed new docks and bulkheads.

Type	Description	Development Dates	Amount
Closing	Surveys	1997	\$11,066
	Closing/Title insurance	1997	6,597
Site Prep/Clean-up	Engineering	1998-2000	15,466
	Site clean-up	1997	27,210
	Gazebo	1997	37,148
	Septic/water/parking	1998	13,803
	Topographic surveys	2000-2001	11,400
	Site design	1998-2000	134,266
Improvements	Mobile classroom	1998	14,158
	Conservation lab prep	1998	56,943
	Dock/ramp	1998	63,650
	Capital development	1998-1999	35,311
	Shoreline stabilization	2002	113,420
	Mobile office site	2003	4,000
	Grading	2003-2005	49,589
	Boat storage	2003	60,000
	Rowing club facility	2004	32,664
	Engineering	Design/permits	2005-2006
Surveys/Assessments	Environmental assessment	2005	1,800
Waterfront	Bulkhead, boardwalk, dredging, walkways, wall	2006	3,427,609
Uplands	Clearing, removing structures, new entrance, parking lot	2006	473,341
Site Prep	Sidewalk, road, parking, grading	2006	49,346
Utilities	Power, water	2006	170,259
Total			\$5,100,276
Source: Friends of the Museum			

The State provided \$3,450,000 for the purchase and initial site clean-up of Gallant's Channel through appropriations of \$3 million and two grants from the Natural Heritage Trust Fund totaling \$450,000. When the State accepted the Gallant's Channel property as a gift on October 3, 2006, the property transferred subject to two deeds of trust totaling \$4,895,000. In addition, the Department of Cultural Resources agreed to pay private contractors for improvements to the property. On January 3, 2007, Cultural Resources agreed to pay four contractors \$434,215.74 to settle outstanding balances. The State made interest payments on loans for \$73,943.29 on November 3, 2006 and \$66,318.49 on January 4, 2007. In total, the State ultimately will pay \$8,919,478 for the Gallant's Channel property over a 10-year period. (See Table 2)

## BACKGROUND (CONTINUED)

Table 2 State Investment in Gallant's Channel Property			
Check Date	Amount	Source of Funds	Use of Funds
October 30, 1996	\$1,000,000	Appropriation -- State House of Representatives Discretionary Funds	Acquisition
December 27, 1996	500,000	Appropriation—State Senate Discretionary Funds	Acquisition
June 25, 1997	200,000	Natural Heritage Trust Fund grant	Acquisition
October 9, 1997	1,500,000	Appropriation—Senate Bill 352	Acquisition
October 16, 1998	250,000	Natural Heritage Trust Fund grant	Acquisition, site preparation, and surveys
November 3, 2006	73,943	Cultural Resources	Interest payment
January 3, 2007	434,216	Cultural Resources	Outstanding obligations to contractors for property improvements
January 4, 2007	66,319	Cultural Resources	Interest payment
April 1, 2007	4,895,000	Cultural Resources	Extinguishing of debt related to property improvements and Tall Ships event
<b>Total</b>	<b>\$8,919,478</b>		
Source: Department of Cultural Resources			

Multiple appraisals have been performed on the Gallant's Channel property during the past two years. Prior to loaning funds to the Friends of the Museum, First Citizens Bank acquired an appraisal on 26.98 acres. The bank appraised the property at \$16,650,000 (\$617,124 per acre) on July 21, 2005. At the October 3, 2006 Council of State meeting, the Governor and the director of the State Property Office said the property's value was \$36,000,000 based on preliminary estimates provided by the Department of Transportation. After the State's acquisition, the State Property Office hired a private appraiser who valued 27.37 acres including improvements for the newly-constructed bulkhead and pier, floating docks, existing wood piers, boat storage facility, and ramps at \$27,515,000<sup>4</sup> (\$1,005,298 per acre) on November 28, 2006. The Department of Transportation Right-of-Way Division conducted an appraisal of 4.51 acres that may be condemned for the future US 70 bridge relocation. The DOT appraisal for the 4.51 acres was \$2,672,000 (\$592,461 per acre). In our opinion, the commercial bank's appraisal was the most independent and objective valuation of the property. Therefore, using the bank's \$16,650,000 for the land and the State Property Office's \$3,808,000 for improvements made after the bank's appraisal, the most conservative estimate of the value of the Gallant's Channel property is \$20,458,000.

A Carteret County tax assessment re-valuation became effective January 1, 2007. The tax assessment yielded a valuation of \$3,686,647 for 26.98 acres (\$136,644 per acre). However, the county tax administrator indicated this does not represent the market value of the property. Since state-owned property is exempt from local property taxes, the tax administrator's office

<sup>4</sup> The State Property Office's total appraisal consists of \$23,578,000 (\$861,475 per acre) for the land, \$3,808,000 for improvements made in 2005 and 2006, and \$129,000 in prior improvements.

## BACKGROUND (CONTINUED)

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did not devote much time to the valuation. Rather, the tax assessment was based on historical values and values of similar properties without regard to fair market value. The tax administrator emphasized the tax valuation for exempt property should not be used when considering the actual market value of the property.

### *Pepsi Americas' Sail 2006 Event:*

#### America's Sail, Inc.

Americas' Sail was created in 1988 as an international sailing competition. The idea was conceived to initiate international tall ship races in the Western Hemisphere and promote the "brotherhood of the sea." The parent organization, Four Sisters Project Americas' Sail, Inc. (Americas' Sail) was incorporated on September 10, 1992 in Hudson, New York. Currently, the organization is headquartered in Glen Cove, New York. The first Americas' Sail event occurred in 1995 with subsequent competitions in 1998 and 2002. The 2006 competition included events in Brazil, the Dominican Republic, and Beaufort, North Carolina. In June 2002, Beaufort resident Captain Horatio Sinbad won the Tall Ship Class "B" boat race in Jamaica. As part of his prize-winnings, Sinbad was permitted to select the location of the next race. Sinbad chose his home port of Beaufort, North Carolina for the 2006 race.

On April 14, 2004, the Friends of the Museum entered into an agreement with the Americas' Sail group based in New York. The agreement required the event be held in July 2006. The host port was responsible for dockage, utilities, liaisons for each participating vessel, security and crowd control, entertainment including a fireworks show, event publicity, accommodations for Americas' Sail representatives during the event, and event liability insurance. Further, the agreement stated Americas' Sail would receive \$50,000 for use of the Americas' Sail name, copyrights, and trademarks payable in three installments prior to the event. In addition, the Friends of the Museum agreed to pay Americas' Sail 20% of the "gross ticket sales revenue from the event." The agreement stated the host port "shall receive credit for the \$50,000 already paid within 30 days after the conclusion of the event." The agreement stipulated Americas' Sail "shall utilize its best efforts in securing the presence of the tall ships event." However, the agreement recognized Americas' Sail "under no circumstance can guarantee the number of vessels attending." Americas' Sail committed to coordinating ship invitations and decisions regarding participants. Americas' Sail also agreed to provide consultants for event planning, fundraising, and news conferences.

#### Pepsi Americas' Sail 2006, LLC

Originally, the North Carolina Maritime Museum planned to organize the event in a joint effort with the Friends of the Museum. However, the Maritime Museum director said the Secretary of Cultural Resources decided planning the event would take away from his responsibilities with the Maritime Museum. As a result, the Friends of the Museum took over control for planning the event. The Friends of the Museum sought corporate sponsorships for the event and were successful in obtaining large donations from corporations such as Minges Bottling Company, Lexus Companies, and Capitol Broadcasting Company. In total, the Friends of the Museum raised \$1,382,129 for the event in corporate and community sponsorships.

## BACKGROUND (CONTINUED)

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The Friends of the Museum formed several committees to plan the event. Thereafter, the Friends of the Museum recognized the need to protect the organization from potential losses should a catastrophic event occur. As a result, the Friends of the Museum created Pepsi Americas' Sail 2006, LLC (Pepsi Americas' Sail) which was incorporated on June 28, 2005. This limited liability company was wholly-owned by the Friends of the Museum and had a five-member board of directors. The board included the Director of the Maritime Museum and the Friends of the Museum President and Executive Director were included as ex-officio members. Pepsi Americas' Sail was classified as a 501(c)(3) corporation and was created to "carry on the objectives of the Friends of the Museum, North Carolina Maritime Museum, Inc...by organizing and operating an educational event to be called 'Pepsi Americas' Sail 2006,' in Beaufort, North Carolina."

The Friends of the Museum and Pepsi Americas' Sail hired multiple contractors to assist with the event planning and coordination. Among the primary contractors were Sondra Reed for event organization, Don Holloway as event coordinator, Tribble Creative Group for event production, Fitzpatrick Communications for public relations and media contact, Capitol Sports for vending, and Butch Robertson for distribution. E-tix oversaw ticket sales with prices ranging from \$15 for children to \$40 for adults for a one-day pass. Several of the decisions to enter into contracts were made prior to the creation of Pepsi Americas' Sail, LLC. On January 25, 2006, a cooperative agreement was formed between the North Carolina Department of Transportation, Cultural Resources, and the Friends of the Museum to use the \$1.65 million in funding from the North Carolina General Assembly for "transportation infrastructure for the Friends of the N.C. Maritime Museum/Tall Ships Event in Beaufort." Under this agreement, Cultural Resources was responsible for providing transportation services for the event.

The Tall Ships event took place June 30, 2006 through July 5, 2006. During the third day of the event, long lines formed while attendees waited to board the eight ships that were open to the public. As the temperatures increased and lines continued to form, many attendees started to complain. The event organizers made a decision to stop ticket sales and offer refunds to those who were dissatisfied. Consequently, the event lost over \$92,000 as a result of ticket refunds. In addition to the costs incurred by Pepsi Americas Sail and the Friends of the Museum, Cultural Resources also incurred expenses. Specifically, Cultural Resources paid \$200,000 to various entertainers for the event. Early event estimates created expectations of profits between \$2 million and \$4 million. However, due to the reduced number of ships, the long lines to board the ships, inadequate flow of attendees through the ships, summer heat, customer complaints, ticket refunds, and ineffective control over costs, the event ultimately lost \$1,824,453 (See Appendix B).

### *Transfer of Property from Friends of the Museum to State of North Carolina*

In March 2006, Cultural Resources again raised the subject of ownership of the Gallant's Channel property. The Maritime Museum business manager sent an e-mail to Cultural Resources management indicating the property would remain under the ownership of the Friends of the Museum until development was complete and that the only written documentation for when the transfer should take place was the letter from the former State Budget Officer that the transfer would occur "at the appropriate time." In June 2006, the

## BACKGROUND (CONCLUDED)

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Executive Director of the Friends of the Museum informed Cultural Resources management of the \$4,895,000 of outstanding debt encumbering the property.

After the Pepsi Americas' Sail 2006 event, the Friends of the Museum privately acknowledged their financial loss on the event and their difficulty in meeting obligations. A series of meetings was held between the Friends of the Museum and Cultural Resources management to determine the best course of action for transferring ownership of the property and paying off the outstanding loans. Representatives from the Attorney General's Office recommended the State take possession of the property before further debt could encumber the property. The Friends of the Museum wrote a letter to the Secretary of Cultural Resources on August 21, 2006 detailing their desire to transfer the property to the State and requesting assistance in paying off the debt. On September 29, 2006, the Friends of the Museum sent another letter to Cultural Resources management. This letter noted the Friends of the Museum "has completed the initial development phase" and acknowledged the debt attached to the property. The letter was attached to the deed to the property.

On October 2, 2006, the deed was recorded with the Carteret County Register of Deeds transferring ownership of the entire property from "Friends of The Museum, N.C. Maritime Museum, Inc." to the "State of North Carolina."<sup>5</sup> On October 3, 2006, the Council of State accepted the property from the Friends of the Museum in two pieces: the 31-acre tract with the deed recorded on the prior day *and* the 5.629 acre tract that had been deeded to the State on November 12, 1999. North Carolina General Statute § 146-22 requires land acquisitions by "purchase, condemnation, lease, or rental" be approved by the Governor and Council of State with further approval by the Joint Legislative Commission on Governmental Operations if the purchase exceeds \$25,000. Since this land acquisition was by gift, approval by the Joint Legislative Commission on Governmental Operations was not required. As set forth in General Statute § 146-26, acquisitions by gift only require approval by the Governor and Council of State:

*"No devise or donation of land or any interest therein to the State or to any State agency shall be effective to vest title to the land or any interest therein in the State or in any State agency until the devise or donation is accepted by the Governor and Council of State."*

When the State received the donation of the 36-acre property, the Council of State accepted it subject to the deeds of trust attached. Cultural Resources made two interest payments on the loans and the maturity date on the deeds of trust is April 1, 2007. In addition, Cultural Resources settled debts with four contractors through payments of \$434,215.74.

The Gallant's Channel property will also be affected by the future relocation of the US 70 bridge connecting Morehead City and Beaufort. Bridge relocation plans have been considered for almost 10 years and current plans show the bridge connecting in Beaufort on the Gallant's Channel property. As a result, DOT must condemn a portion of the property for the bridge. An appraisal performed for DOT valued the property at \$2,672,000 for 4.51 acres (\$592,461.20 per acre).

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<sup>5</sup> Carteret County Register of Deeds, Book 1192, Page 241.

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## FINDINGS AND RECOMMENDATIONS

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### **1. THERE WAS NO SIGNED AGREEMENT BETWEEN THE STATE OF NORTH CAROLINA AND THE FRIENDS OF THE MUSEUM REGARDING THE OWNERSHIP OR DEVELOPMENT OF THE GALLANT'S CHANNEL PROPERTY.**

In 1995, the Evelyn Chadwick Smith estate offered to sell waterfront property along Taylor's Creek and Gallant's Channel to the Friends of the Museum. The Friends of the Museum was initially unable to secure funding for the purchase of the property which was offered at \$3.2 million. However, the Chadwick estate indicated it would take the property off the market for one year to allow time for fund-raising. The Friends of the Museum raised \$100,000 and formed a committee to proceed with the property acquisition.

In November 1995, September 1996, and January 1997, the North Carolina Department of Agriculture sought grants from the Natural Heritage Trust Fund<sup>6</sup> to assist with the property acquisition. The Natural Heritage Trust Fund awarded grants for the Gallant's Channel acquisition to the Department of Agriculture on September 25, 1996 and March 26, 1997. The Natural Heritage Trust Fund transferred funds to the Department of Agriculture in June 1997 (\$200,000) and July 1997 (\$250,000). Funds from the second grant were also used for initial site clean-up, surveys, and permits associated with the purchase.

The North Carolina Department of Agriculture requested funding for the property acquisition in its 1996-97 budget and the Governor included a \$1 million request in the capital improvement budget for the 1996-97 fiscal year. The North Carolina General Assembly provided funding through a \$1 million appropriation from the House of Representatives' discretionary funds and a \$500,000 appropriation from the Senate's discretionary funds. A \$1 million check dated October 30, 1996 to the "Friends of the Museum, Inc." was issued from the Office of the Governor. On December 27, 1996, a \$500,000 check was issued to the Friends of the Museum from the Office of the Governor.

On July 31, 1997, the Friends of the Museum purchased the entire 36-acre Gallant's Channel property from the Evelyn Chadwick Smith estate for \$3.2 million and the deed to the property was transferred to the "Friends of the Museum, NC Maritime Museum, Inc." The Friends of the Museum paid \$1.5 million on July 31, 1997 with an agreement to pay the remaining balance on July 31, 1998. The deed to the property was transferred to "Friends of The Museum, N.C. Maritime Museum, Inc." by "Trustees under the will of Evelyn Chadwick Smith" on July 31, 1997.<sup>7</sup> Senate Bill 352 of the 1997 Session of the General Assembly authorized another \$1.5 million for the purchase of the land. On October 9, 1997, the Department of Cultural Resources issued a check to the "Friends of the Museum" for the appropriated amount.

Throughout the history of the purchase and development of the land, an understanding existed that the property would ultimately transfer to the State. However, no legal document was drafted to ensure the State's eventual ownership. The Friends of the Museum assumed it

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<sup>6</sup> The General Assembly established the Natural Heritage Trust Fund in 1987 to provide supplemental funding to select state agencies for the acquisition and protection of important natural areas, to preserve the state's ecological diversity and cultural heritage, and to inventory the natural heritage resources of the state.

<sup>7</sup> Carteret County Register of Deeds, Book 802, Page 480.

## FINDINGS AND RECOMMENDATIONS (CONTINUED)

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would develop the property before transferring it to the State. However, there was no written documentation specifying a time frame for the transfer. The Friends of the Museum created various development plans since the initial purchase and each plan included an expansion of the Maritime Museum. Yet, there was no agreement that addressed the State's involvement with the development of the property.

The only written statement regarding the conveyance of the land to the State was in the form of a letter from the former State Budget Officer to the Friends of the Museum on October 7, 1997. The letter notes "*at the appropriate time, the Friends will transfer title of the 38 [sic] acre site to the State for the North Carolina Maritime Museum.*" There is no definition of "the appropriate time" and no consensus as to what that phrase means. Some individuals believed "the appropriate time" was after full development of the land, others after the building of the new Maritime Museum, and others after the completion of the land acquisition.

Without a written agreement requiring the property to transfer to the State at a specified time or after a specified event, the Friends of the Museum maintained legal title. As a result, the Friends of the Museum could have refused to transfer the property, sold the property, or developed the site without recourse from the State.

### RECOMMENDATION

For future property acquisitions in which the State does not have legal title at the time of purchase, written agreements or contracts that explicitly document when the property will transfer to the State should be drafted. These agreements should establish either a specific date for property transfer or a set of identifiable circumstances that must occur to prompt the transfer. Further, the agreement or contract should clearly define the roles of both the State and any other organization regarding management and development of the property during the period in which the State does not hold legal title to the property. In addition, the State Property Office should conduct reviews of its files and contact all state agencies to determine whether similar property arrangements exist and resolve any outstanding issues.

## 2. THE DEPARTMENTS OF AGRICULTURE AND CULTURAL RESOURCES VIOLATED NATURAL HERITAGE TRUST FUND REGULATIONS.

In November 1995, the Department of Agriculture requested \$3.2 million from the Natural Heritage Trust Fund to purchase the 36-acre Gallant's Channel property. The request was denied because the Trust Fund believed the request was outside the scope of projects provided for in legislation. The Department of Agriculture made another presentation to the Natural Heritage Trust Fund in September 1996 and was awarded \$200,000 to acquire the property. The Department of Agriculture provided these grant funds on June 25, 1997 in a check made payable to "Friends of the Museum." On January 22, 1997, the Department of Agriculture submitted another grant application to the Natural Heritage Trust Fund. On March 26, 1997, the Natural Heritage Trust Fund awarded another \$250,000 to the Department of Agriculture. As noted previously, the Maritime Museum was transferred from the Department of Agriculture to the Department of Cultural Resources in 1997. As a result,

## **FINDINGS AND RECOMMENDATIONS (CONTINUED)**

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the Friends of the Museum received these grant funds from Cultural Resources on October 16, 1998.

North Carolina General Statute § 113-77.9(d) states “title to any land acquired pursuant to this Article shall be vested in the State.” However, these grant funds were used for the Friends of the Museum, a non-state entity, to purchase the property. Further, there was no mechanism in place such as an agreement or contract to ensure the State would ultimately hold title to the property.

In addition, North Carolina General Statute § 113-77.9(a)(7) requires the State to manage land acquired pursuant to this statute. State law permits a State agency to enter into a management agreement with a local government or private non-profit organization to manage the land acquired. The Friends of the Museum managed the property and performed some site development from 1997 through 2006 yet no management agreement existed between either the Department of Agriculture or the Department of Cultural Resources and the Friends of the Museum. Consequently, the Department of Agriculture and the Department of Cultural Resources violated Natural Heritage Trust Fund regulations regarding ownership and management of the land.

Officials with the Natural Heritage Trust Fund were not aware the State of North Carolina did not acquire the Gallant’s Channel property after the grants were awarded. Since the presentations were made to the Trust Fund’s board by a state agency, the board believed the State would own the property. Trust Fund officials acknowledged their organization does not require copies of deeds prior to awarding of grants; rather, the board relies upon the State Property Office to ensure properties are acquired by the State. Trust Fund representatives noted that State agencies must now meet with the State Property Office prior to meeting with the Trust Fund board to resolve any ownership issues.

### **RECOMMENDATION**

The Natural Heritage Trust Fund should establish procedures to ensure grants are awarded only for properties for which title will vest in the State. The Trust Fund should consider requiring a copy of the deed to any property for which grants are awarded. In addition, the Natural Heritage Trust Fund should institute procedures to verify the State manages the land or has a signed management agreement between the state agency and a local government or private non-profit organization. State agencies should not provide pass-through funding to non-state organizations without specific agreements for the management, development, and ownership of the property.

### **3. THE STATE PROPERTY OFFICE FAILED TO COMPLETE THE PROPERTY ACQUISITION PROCESS AFTER COUNCIL OF STATE APPROVAL IN 1998.**

After the Maritime Museum was organizationally transferred from the Department of Agriculture to the Department of Cultural Resources in 1997, discussions began regarding the funding for the purchase of the Gallant’s Channel property. Cultural Resources management expressed concerns over the legality of providing Natural Heritage Trust Fund

## **FINDINGS AND RECOMMENDATIONS (CONTINUED)**

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monies to a non-state agency for the acquisition of the property. Negotiations began to find a method by which a portion of the property could be transferred to the State to allow the second Natural Heritage Trust Fund grant to be provided to the Friends of the Museum. The Trust Fund informed Cultural Resources that the State must own property valued at \$450,000 before the final grant transfer could be made to the Friends of the Museum.

During this time, the Friends of the Museum needed the other \$250,000 in grant funds to meet ongoing financial obligations. As a result, the Friends of the Museum board held a special meeting on September 11, 1998 and voted to transfer the entire 36 acres to the State in an effort to secure the grant funds. On October 6, 1998, the Council of State approved the transfer of the Gallant's Channel property from the Friends of the Museum to the State. The State Property Office informed Cultural Resources of the approval and Cultural Resources in turn notified the Friends of the Museum. However, the deed for this transfer was never recorded and no further action was taken by the State Property Office.

When an individual or organization intends to convey property to the State, the State Property Office receives a request from a state agency informing it of the intent to receive a gift. The State Property Office reviews the gift to determine if it is beneficial to the State and proceeds to perform a title examination to ensure the donor actually owns the property. The State Property Office presents the gift to the Council of State for approval. If approved by the Council of State, the State Property Office proceeds to close the transaction. A title attorney is obtained through the Department of Justice (Attorney General's Office) to prepare the title transfer and provide closing instructions to the State Property Office. Upon receipt of the recorded deed, the State Property Office closes the file. The State Property Office designates an agent to complete the acquisition.

We inquired about the failure to complete the property transaction with current and former representatives from the State Property Office, Department of Cultural Resources, the Friends of the Museum, and the Attorney General's Office. We were unable to obtain an explanation for the failure to obtain and record the deed to the Gallant's Channel property.

The Friends of the Museum held the title to the property until October 2006. The State had no oversight authority for the property and could not control the development process. As a result, the Friends of the Museum managed the property and incurred significant development costs. Ultimately, the Friends of the Museum was able to place mortgages of \$4,895,000 on the property that the State assumed in October 2006.

### **RECOMMENDATION**

The State Property Office should implement procedures to ensure completion of all property acquisitions by the Council of State. The State Property Office should require copies of deeds for all property acquisitions before closing the file. In addition, periodic reviews of files should be conducted to ensure the State has title to all approved property acquisitions.

## **FINDINGS AND RECOMMENDATIONS (CONTINUED)**

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### **4. THE DEPARTMENT OF CULTURAL RESOURCES DID NOT NOTIFY THE STATE PROPERTY OFFICE WHEN PROPERTY WAS DEEDED TO THE STATE IN 1999 BY THE FRIENDS OF THE MUSEUM.**

On October 16, 1998, the Friends of the Museum received \$250,000 from Cultural Resources from the second Natural Heritage Trust Fund grant. Cultural Resources justified the payment of these funds as reimbursement for costs incurred by the Friends of the Museum for site acquisition and environmental requirements. Cultural Resources and the Friends of the Museum continued to negotiate the transfer of a portion of the property. On November 12, 1999, a special warranty deed transferring 5.629 acres from “the Friends of the Museum, N.C. Maritime Museum, Inc.” to “the State of North Carolina c/o North Carolina Department of Cultural Resources”<sup>8</sup> was recorded. The Friends of the Museum and Cultural Resources selected 5.629 acres as an approximation of the value of the land to equal \$450,000 in Natural Heritage Trust Fund grants. In a letter dated November 9, 1999 to the Cultural Resources business officer, the Friends of the Museum President included a copy of the deed to the property. However, the State Property Office was unaware of this transfer and the Council of State never approved the land acquisition of 5.629 acres (although the entire 36-acre tract had been approved on October 6, 1998).

We were unable to determine how Cultural Resources proceeded after receiving a copy of the deed. According to officials with the State Property Office, title can not be given to the State until approved by the Council of State. The State Property Office did not include this tract of land in its database and the Department of Cultural Resources did not include the property on its fixed asset listing.

### **RECOMMENDATION**

The State Property Office should require notification from all state agencies concerning any property transfers. Whenever a state agency receives a deed to any property, that agency should forward a copy of the deed to the State Property Office to ensure acceptance of the transfer.

### **5. THE COUNCIL OF STATE WAS NOT INFORMED DURING ITS OCTOBER 2006 MEETING OF LIENS FILED AGAINST THE GALLANT’S CHANNEL PROPERTY.**

The Council of State voted to accept a gift of property from the Friends of the Museum to the State at its October 3, 2006 meeting. The Director of the State Property Office (Director) presented the acquisition to the Council of State and some discussion ensued regarding the property, its value, and outstanding debts against the property. The Director informed the Council of State of the \$4,895,000 deeds of trust against the property. However, he did not mention the recording of liens against the property by private contractors. On the same date the deed to the property was recorded in Carteret County (October 2, 2006), T.D. Eure Construction Co. filed a lien of \$190,273.70 against the property and Port City Electric Company filed a lien for \$144,926 plus interest and attorney’s fees. The Director said the

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<sup>8</sup> Carteret County Register of Deeds, Book 870, Page 577.

## FINDINGS AND RECOMMENDATIONS (CONTINUED)

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failure to mention these liens was simply an oversight. Another lien was filed on the property on October 4, 2006, by Thomas Simpson Construction Co., Inc. for \$74,031.00 plus interest.

It is important to note that the Council of State discussion on October 3, 2006 concerning the Gallant's Channel property acquisition was longer than most other property acquisition discussions at Council of State meetings. The Gallant's Channel acquisition was discussed separately from the 22 other land transactions approved during that meeting. Those 22 transactions were sub-divided into five different categories and were approved by the Council of State after less than four minutes of discussion combined. By comparison, the discussion concerning the Gallant's Channel property lasted over five minutes. One Council member expressed concern about the complexity of the issue characterizing it as "a very complicated transaction" but the Governor replied, "Well, not really" before providing some additional explanation. Ultimately, the Council voted unanimously (with the recusal of the Lieutenant Governor) to approve the transaction.

The State's receipt of the gift of the 36-acre property was subject to the outstanding debt attached to the property. Cultural Resources made interest payments of \$73,943.29 on November 3, 2006 and \$66,318.49 on January 4, 2007 on the two lines of credit with a current maturity date of April 1, 2007. In addition, Cultural Resources made payments totaling \$434,215.74 to four contractors to settle outstanding obligations for property development. (See Table 3)

Contractor	Amount Paid
T.D. Eure Construction Co., Inc.	\$190,273.70
Moffatt & Nichol	18,482.08
Thomas Simpson Construction Co., Inc.	80,533.96
Port City Electric	144,926.00
Total	\$434,215.74
Source: Department of Cultural Resources	

### RECOMMENDATION

For property transactions subject to liens, deeds of trust, or other encumbrances, the State Property Office should ensure that all relevant facts are adequately presented to the Council of State. For complex property transactions, the State Property Office should consider providing the details of the transaction in writing to Council members prior to meetings.

#### **6. PEPSI AMERICAS' SAIL 2006, LLC DID NOT HAVE SIGNED CONTRACTS WITH VENDORS FOR MAJOR SERVICES FOR THE TALL SHIPS EVENT.**

We requested copies of the contracts for major services provided for the Pepsi Americas' Sail 2006 event. The Friends of the Museum Executive Director provided a list of the major contractors and associated documentation. Our analysis of this documentation revealed that no signed contract existed for seven vendors. Contracts for major services such as

## FINDINGS AND RECOMMENDATIONS (CONTINUED)

promotional products, equipment rental, communications, public relations, food, and event production were not completed. We determined these services were provided through “agreements,” proposals, and invoices. Table 4 summarizes the amounts invoiced and paid for seven major service providers for which no signed contract existed.

The absence of signed contracts allowed major service providers to escalate costs throughout the planning of the event and prevented event organizers from controlling costs. In addition, the lack of signed contracts put both the organization and the event at risk. Contractors could have terminated their services or provided inferior quality goods and services without contractual language ensuring the requested good or service was actually provided.

Vendor	Good/Service Type	Invoice Amount	Amount Paid
Brand Fuel	Promotional products	\$218,201.43	\$102,950.00
Chair & Equipment Rental	Equipment rentals	311,132.59	267,314.19
Fitzpatrick Communications, Inc.	Event management and public relations	176,389.77	130,065.58
Lema Creative	Public relations	115,982.51	115,982.51
Mitchell’s Catering	Food	132,058.18	109,335.35
MRPP	Advertising	137,480.80	95,635.86
Total Event Productions	Event coordination	143,251.69	89,737.50
Total		\$1,234,496.97	\$911,020.99

Source: Pepsi Americas’ Sail and Friends of the Museum contract files

### RECOMMENDATION

The Friends of the Museum should always utilize contracts for all goods and services provided from vendors for major events and activities.

#### **7. INSUFFICIENT REVENUE AND INADEQUATE COST CONTROL RESULTED IN FINANCIAL LOSSES FOR THE TALL SHIPS EVENT.**

Ten independent committees were established and began working on the Pepsi Americas’ Sail (Tall Ships) event in December 2004. Each of these committees worked independently and was provided broad decision-making authority. No single individual within the Friends of the Museum organization oversaw the activities of the committees. As a result, decisions were made without proper oversight and coordination. Further, many event organizers did not have experience with events of this magnitude or financial backgrounds. Therefore, early revenue estimates for the event resulted in unrealistic expectations of profits between \$2 million and \$4 million.

## FINDINGS AND RECOMMENDATIONS (CONTINUED)

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Representatives from the Friends of the Museum and Pepsi Americas' Sail acknowledged they lost control of costs after contracting with others for event management, public relations, advertising, and event production. Some of these agreements were entered into by the organizing committees prior to the creation of the Pepsi Americas' Sail, LLC.

We reviewed financial statements, check registers, bank statements, and vendor listings associated with the Pepsi Americas' Sail 2006 event. Based on our review, we found several expenditures that did not appear reasonable and necessary. The following costs appear questionable:

- Pepsi Americas' Sail incurred \$26,596.44 in food costs for meetings. Pepsi Americas' Sail routinely paid for meals for event planners including Pepsi Americas' Sail representatives, contractors, and committee chairs. The Friends of the Museum Executive Director said meals for entire committees of up to 40 persons were sometimes paid by Pepsi Americas' Sail but that practice was later discontinued.
- The event coordinator signed 14 checks totaling \$21,700.39 made payable to himself. In all but one instance, the checks were co-signed by a Pepsi Americas' Sail board member. However, the final salary check to the event coordinator for \$1,523.80 was only signed by him. The Friends of the Museum Executive Director, who is also a Pepsi Americas' Sail board member, did not know why that payment included only one authorizing signature.
- Security costs for the event exceeded \$373,000. Representatives from the Pepsi Americas' Sail and the Friends of the Museum noted excess security was obtained due to inaccurate attendance estimates, the decision to hold the event at three sites, and the insistence by the Beaufort Police Chief that security levels be maintained in order for the town to provide necessary permits.
- Media and public relations costs approached \$750,000. As noted in a prior finding, three contractors involved with advertising and public relations operated without signed contracts. Those three contractors invoiced Pepsi Americas' Sail \$429,853 for their services.

In addition to the inability to control costs, the Friends of the Museum and Pepsi Americas' Sail also experienced revenue shortfalls. The Friends of the Museum estimated ticket sales of up to \$2.6 million but actual sales were only about \$700,000 for 27,658 tickets sold. Event organizers initially expected at least three class "A"<sup>9</sup> ships would be present at the event. By March 2006, the Friends of the Museum realized only one class "A" ship (the 249-foot Cisne Branco) and three class "B" ships<sup>10</sup> were committed to the event and available for boarding by event attendees. The Friends of the Museum believed they received inadequate assistance from the Americas' Sail group and began to seek out other ships on their own with the assistance of State and Federal officials. The lack of ships led to long lines to board the few ships available. As complaints mounted, ticket sales were stopped during the second day of the Tall Ships event. Then, event management decided to provide refunds to customers who were dissatisfied with the Tall Ships event. According to records obtained from the Friends of the Museum, over 4,400 ticket refunds were made totaling over \$92,000.

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<sup>9</sup> Class "A" ships are defined as all square-rigged vessels and other vessels over 40 meters (131 feet) length overall.

<sup>10</sup> Class "B" ships are defined as traditional-rigged vessels with a length overall of less than 40 meters (131 feet) and with a waterline length of at least 9.14 meters (30 feet).



## FINDINGS AND RECOMMENDATIONS (CONCLUDED)

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Finally, the Friends of the Museum believed they would have another revenue source through direct appropriations from the North Carolina General Assembly for construction improvements to the Gallant's Channel property for the Tall Ships event. Two bills were introduced in the North Carolina General Assembly to provide \$2.5 million to the Friends of the Museum for the expansion of the Maritime Museum. The Friends of the Museum believed these funds would help pay for necessary improvements for the Tall Ships event. However, neither bill passed in its introduced form and, instead, the General Assembly provided "up to...\$1,650,000" to "enhance transportation infrastructure for the Friends of the N.C. Maritime Museum/Tall Ships Event in Beaufort"<sup>11</sup> within the Department of Transportation's budget.

In summary, several factors contributed to the Tall Ships event losses of almost \$2 million. (See Appendix B) The Friends of the Museum and Pepsi Americas' Sail failed to limit costs through inadequate planning, unrealistic attendance estimates, and failing to designate one individual or committee to ultimately manage and control the event. Then, external forces including weather, the lack of ships available for boarding, and customer complaints led to discontinuing ticket sales and providing refunds which ultimately resulted in revenue shortfalls.

### RECOMMENDATION

The Department of Cultural Resources should establish procedures for organizing and managing cultural and entertainment events that support North Carolina arts and history. These procedures should provide guidelines for both state agencies and private or non-profit groups that sponsor events to help ensure the event's success while minimizing the risk of financial loss.

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<sup>11</sup> Session Law 2005-276, Section 28.28

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## CONCLUSION

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The Pepsi Americas' Sail 2006 (Tall Ships) event and the transfer of the Gallant's Channel property from the Friends of the Museum, North Carolina Maritime Museum, Inc. to the State of North Carolina generated unanticipated scrutiny, criticism, and debate. The two events were inseparably connected as the Tall Ships event was the impetus for further development of the Gallant's Channel property. To characterize the State of North Carolina's ultimate acquisition of the property as a "double-payment" or "bailout for the Tall Ships event" oversimplifies a series of events that spanned a nine-year period. It is doubtful ownership of the Gallant's Channel property would have transferred to the State in October 2006 without the Tall Ships event and the associated development of the property. In all likelihood, the property would have remained undeveloped for the foreseeable future although the Friends of the Museum would have continued with plans for the expansion of the North Carolina Maritime Museum. The absence of a written agreement between the State of North Carolina and the Friends of the Museum left the issue of ownership and management of the property unresolved until the Tall Ships event exposed legal and financial problems.

The State of North Carolina provided \$3,450,000 in appropriations and grants to the Friends of the Museum in 1997 for the initial purchase of the Gallant's Channel property. Over the next nine years the Friends of the Museum paid approximately \$5 million (primarily from borrowed funds) for site development. With the Council of State's acceptance of the property transfer subject to \$4,895,000 in deeds of trust, payments of \$434,216 to contractors to satisfy outstanding obligations, and interest payments of \$140,262, the State ultimately provided \$8,919,478 for the acquisition and improvement of the property. Although the fair market value of the Gallant's Channel property conservatively exceeds \$20,000,000, there are no plans for the disposition of the property, as the State intends to preserve it for the eventual expansion of the Maritime Museum.

As outlined in this report, the State provided approximately \$3.5 million for the expansion of the Maritime Museum through the acquisition of the Gallant's Channel property in 1997, yet the property was not transferred to the State until October 2006. Without legal title to the property, the State in effect allowed the Friends of the Museum to spend over \$5 million to develop the property without State input or control. According to a representative from the Attorney General's Office, the State expedited the transfer of the property in October 2006 to legally establish the State's ownership, prevent the sale of the property, and prevent the Friends of the Museum from using the property as collateral for new loans.

Finally, it is clear the Tall Ships event did not meet the expectations of attendees, event organizers, local merchants, and State officials. A variety of factors led to the event's financial losses, including the lack of ships for boarding, security and medical concerns, cutting off ticket sales early, providing refunds to dissatisfied customers, poor event planning, unrealistic budgeting, and not putting one individual in charge of the event. The financial losses for the Tall Ships event ultimately resulted from a series of poor decisions and unrealistic expectations.

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**APPENDIX A**

<b>FRIENDS OF THE MUSEUM BALANCE SHEETS</b>					
	12/31/2006*	12/31/2005	12/31/2004	12/31/2003	12/31/2002
<b>ASSETS</b>					
Cash and Equivalents	\$138,525.95	\$153,917.74	\$199,906.40	\$235,217.82	\$285,949.93
Fixed Assets	167,375.08	5,211,161.95	3,527,131.12	3,511,437.24	3,492,172.55
Other Assets	753,435.48	112,564.84	102,562.71	93,323.19	63,619.20
Total Assets	<u>\$1,059,336.51</u>	<u>\$5,477,644.53</u>	<u>\$3,829,600.23</u>	<u>\$3,839,978.25</u>	<u>\$3,841,741.68</u>
<b>LIABILITIES</b>					
Accounts Payable	\$512,034.35	\$1,726,358.50	\$7,561.90	\$7,561.90	\$9,795.58
Other Current Liabilities	901.55	294.16	2,795.37	553.47	0.02
Notes Payable	<u>69,364.92</u>	<u>69,364.92</u>	<u>68,411.87</u>	<u>76,724.02</u>	<u>82,219.69</u>
Total Liabilities	<u>582,300.82</u>	<u>1,796,017.58</u>	<u>78,769.14</u>	<u>84,839.39</u>	<u>92,015.29</u>
<b>FUND BALANCE</b>					
Opening Balance Equity	3,831,866.29	3,750,773.00	3,755,143.50	3,779,915.40	3,770,806.28
Excess/(Deficit) of Revenues/Expenditures	(3,354,830.60)	(69,146.05)	(4,312.41)	(24,776.54)	(21,079.89)
Ending Fund Balance	<u>477,035.69</u>	<u>3,681,626.95</u>	<u>3,750,831.09</u>	<u>3,755,138.66</u>	<u>3,749,726.39</u>
Total Liabilities and Equity	<u>\$1,059,336.51</u>	<u>\$5,477,644.53</u>	<u>\$3,829,600.23</u>	<u>\$3,839,978.25</u>	<u>\$3,841,741.68</u>

Source: Friends of the Museum financial reports, unaudited  
\* Preliminary draft amounts prepared by accounting firm

**APPENDIX A (CONCLUDED)**

<b>FRIENDS OF THE MUSEUM OPERATING STATEMENTS</b>					
	12/31/2006*	12/31/2005	12/31/2004	12/31/2003	12/31/2002
<b>REVENUES</b>					
Membership Income	\$107,675.75	\$113,632.25	\$72,570.00	\$49,248.71	\$39,170.00
Donations	141,437.02	236,469.57	283,314.05	79,375.64	95,632.07
Sponsorship Income	5,670.00	4,750.00	--	--	--
Fundraising Income	22,124.80	34,714.00	38,214.17	42,801.75	19,115.00
Grants	242,494.80	--	7,448.04	--	--
Program Income	165,718.96	232,314.55	234,135.98	172,098.83	126,914.28
Rental Income	19,611.00	24,362.50	48,845.00	15,235.00	29,166.00
Sales	28,451.79	21,525.16	33,063.96	11,152.34	11,390.00
Refunds	(1,421.04)	(2,017.20)	(9,730.00)	(8,060.00)	(6,731.00)
Interest Income	3,551.54	3,563.60	4,692.34	6,382.48	3,717.06
Other Income	1,025.65	26,716.29	41,900.71	24,287.29	15,584.75
<b>Total Revenues</b>	<b>\$736,340.27</b>	<b>\$696,030.72</b>	<b>\$754,454.25</b>	<b>\$392,522.04</b>	<b>\$333,958.16</b>
<b>EXPENSES</b>					
Advertising/promotion	\$11,909.73	\$16,738.23	\$26,951.42	\$9,264.66	\$8,236.03
Capital assets	382,747.99	37,022.58	88,719.82	53,314.21	62,973.09
Disposition of assets	3,262,537.11	--	--	--	--
Equipment	2,632.73	7,629.26	1,714.50	2,234.73	2,306.39
Fundraising	9,033.70	6,053.51	11,406.99	16,362.44	4,973.08
Grants	--	26,918.14	35,936.87	24,741.29	14,928.85
Insurance	36,650.99	24,900.85	19,363.80	15,658.41	17,465.08
Interest	--	4,138.70	--	--	--
Labor	153,765.03	189,964.84	200,941.77	105,002.81	80,612.56
Membership	4,585.09	2,798.66	4,611.90	4,362.30	3,042.49
Miscellaneous	1,458.38	3,438.42	1,807.64	5,482.96	2,541.39
Office expenses	106,858.29	117,699.49	145,447.58	88,394.73	85,468.72
Professional services	14,110.00	115,626.75	29,423.22	10,062.00	17,691.57
Program expenses	42,046.54	106,949.52	85,401.98	11,003.50	24,363.35
Purchases	--	--	17,869.21	8,500.00	499.50
Rent	7,375.00	10,876.25	7,464.00	3,600.00	8,400.00
Repair/maintenance	32,411.85	40,943.59	51,401.36	42,439.93	7,907.93
Taxes	15,628.36	17,596.55	16,860.46	7,230.01	7,135.13
Training	911.00	3,793.00	3,449.00	740.00	--
Travel	4,403.17	8,093.04	4,609.14	4,663.83	4,133.68
Vehicle expenses	2,105.91	23,995.39	5,386.00	4,240.77	2,359.21
<b>Total Expenses</b>	<b>\$4,091,170.87</b>	<b>\$765,176.77</b>	<b>\$758,766.66</b>	<b>\$417,298.58</b>	<b>\$355,038.05</b>
Excess revenue over/(under) expenses	(\$3,354,830.60)	(\$69,146.05)	(\$4,312.41)	(\$24,776.54)	(\$21,079.89)
Source: Friends of the Museum financial reports, unaudited					
* Preliminary draft amounts provided by accounting firm					

## APPENDIX B

Pepsi Americas' Sail 2006 (Tall Ships) Event Financial Information	
<b>REVENUES</b>	
Advertising	\$1,250
Donations	188,805
Miscellaneous	2,382
Passport (Ticket) Sales	675,084
Retail Sales	219,826
Special Events	48,232
Sponsorships	1,382,129
Vendor Space Rental	16,655
<b>TOTAL REVENUES</b>	<b>\$2,534,363</b>
<b>EXPENSES</b>	
Accommodations	\$240,463
Accounting Services	9,815
Americas' Sail contract	114,600
Beaufort Site	303,105
NC State Port Site	30,921
Olde Beaufort Seaport Site	313,676
Special Events	310,164
Insurance	63,542
Media and Public Relations	748,935
Entertainment	240,852
Operating Expenses	205,847
Payroll and Contract Labor	740,938
Beverages	153,155
Purchases for Resale	282,948
Ships Contracts and Support	207,342
Security	373,977
Transportation	15,654
Volunteers	2,882
<b>TOTAL EXPENSES</b>	<b>\$4,358,816</b>
<b>NET LOSS</b>	<b>(\$1,824,453)</b>
Source: Friends of the Museum	

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# RESPONSE FROM NORTH CAROLINA DEPARTMENT OF CULTURAL RESOURCES



## North Carolina Department of Cultural Resources Office of the Secretary

Michael F. Easley, Governor

Lisbeth C. Evans, Secretary

April 10, 2007

Mr. Leslie W. Merritt, Jr.  
State Auditor  
North Carolina Office of the State Auditor  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

Dear Auditor Merritt:

The Department of Cultural Resources (the "Department") has received, in confidential draft form, the April 2007 Special Review of the North Carolina Department of Cultural Resources, North Carolina Maritime Museum, Friends of the Museum, North Carolina Maritime Museum, Inc., Pepsi Americas' Sail 2006, LLC, Gallant's Channel Property Transaction. We appreciate the opportunity to respond to the Special Review. After careful and thoughtful review of the Findings and Recommendations, the Department offers the following responses:

- 1. THERE WAS NO SIGNED AGREEMENT BETWEEN THE STATE OF NORTH CAROLINA AND THE FRIENDS OF THE MUSEUM REGARDING THE OWNERSHIP OR DEVELOPMENT OF THE GALLANT'S CHANNEL PROPERTY. (Special Review, p. 13)**

### RECOMMENDATION

For future property acquisitions in which the State does not have legal title at the time of purchase, written agreements or contracts that explicitly document when the property will transfer to the State should be drafted. These agreements should establish either a specific date for property transfer or a set of identifiable circumstances that must occur to prompt the transfer. Further, the agreement or contract should clearly define the roles of both the State and any other organization regarding management and development of the property during the period in which the State does not hold legal title to the property. In addition, the State Property Office should conduct reviews of its files and contact all state agencies to determine whether similar property arrangements exist and resolve any outstanding issues. (Special Review, p. 14)

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Raleigh, NC 27699-4601

Telephone: (919) 807-7250  
Fax: (919) 733-1564

LOCATION:  
109 East Jones Street  
Raleigh, NC

## **DEPARTMENT OF CULTURAL RESOURCES RESPONSE**

With regard to this finding, although the meaning of “appropriate time” is subject to various interpretations, it was clearly the intent of the Council of State that the transfer be completed when it voted to accept the property through a deed by gift at the October 6, 1998 Council of State Meeting.

The Department of Cultural Resources accepts the recommendation of the Auditor. The Department is not aware that any similar property arrangements exist and will work to ensure that this arrangement does not arise in the future.

### **2. THE DEPARTMENTS OF AGRICULTURE AND CULTURAL RESOURCES VIOLATED NATURAL HERITAGE TRUST FUND REGULATIONS. (Special Review, p. 14)**

#### **RECOMMENDATION**

The Natural Heritage Trust Fund should establish procedures to ensure grants are awarded only for properties for which title will vest in the State. The Trust Fund should consider requiring a copy of the deed to any property for which grants are awarded. In addition, the Natural Heritage Trust Fund should institute procedures to verify the State manages the land or has a signed management agreement between the state agency and a local government or private non-profit organization. State agencies should not provide pass-through funding to non-state organizations without specific agreements for the management, development, and ownership of the property. (Special Review, p. 15)

## **DEPARTMENT OF CULTURAL RESOURCES RESPONSE**

Early in September of 1998, the Department notified the Friends of the Maritime Museum that it could not forward payment from the Natural Heritage Trust Fund because the State was not an owner of the land. In a September 8, 1998 letter from Dr. Jeffrey Crow to Graydon Paul, Dr. Crow explained the legal requirement that the State be the owner of the property and that “transfer of the funds could not be made until the State owned a portion of the Gallant’s Channel tract. . . .” On September 18, 1998, the Department notified the Office of State Property that the Friends wished to deed the entire 36 acre piece of land to the State. On October 6, 1998, the Council of State voted to accept the deed of gift for the Gallant’s Channel property. After the Council’s acceptance, the Department forwarded a check in the amount of \$250,000 to the Friends of the Maritime Museum on October 16, 1998 for the remaining Natural Heritage Trust Fund payment.

Notwithstanding this, the Department accepts the recommendation. The Department has made significant personnel and administrative changes in order to strengthen internal control and to ensure that proper checks and balances are in place with regard to the monitoring and disbursement of funds. The process by which the Department handles Natural Heritage Trust Fund matters and all land transactions has been restructured and reassigned. We have implemented procedures where all grant requirements are verified prior to receipt of funds. Consistent with new legislation in G.S. 143-6.2 and the corresponding administrative rules, the department does not provide pass through funding to non-state organizations without specific agreements for the management, development, and ownership of the property.

4. **THE DEPARTMENT OF CULTURAL RESOURCES DID NOT NOTIFY THE STATE PROPERTY OFFICE WHEN PROPERTY WAS DEEDED TO THE STATE IN 1999 BY THE FRIENDS OF THE MUSEUM. (Special Review, p. 17)**

#### **RECOMMENDATION**

The State Property Office should require notification from all state agencies concerning any property transfers. Whenever a state agency receives a deed to any property, that agency should forward a copy of the deed to the State Property Office to ensure acceptance of the transfer. (Special Review, p. 17)

#### **DEPARTMENT OF CULTURAL RESOURCES RESPONSE**

As stated above, the process by which land transactions are handled has been completely restructured and has been reassigned within Cultural Resources. Although the Department maintains records of each property transaction, the Department was unable to locate this particular deed and could not determine whether the deed was forwarded to the State Property Office. To avoid any recurrence such as this, the Department is working cooperatively with the Office of State Property prior to any property transaction.

The Department accepts the recommendation and will ensure that all requisite information will be provided to the State Property Office in a timely and professional manner.

**7. INSUFFICIENT REVENUE AND INADEQUATE COST CONTROL RESULTED IN FINANCIAL LOSSES FOR THE TALL SHIPS EVENT. (Special Review, p. 19)**

**RECOMMENDATION**

The Department of Cultural Resources should establish procedures for organizing and managing cultural and entertainment events that support North Carolina arts and history. These procedures should provide guidelines for both state agencies and private or non-profit groups that sponsor events to help ensure the event's success while minimizing the risk of financial loss. (Special Review, p. 21)

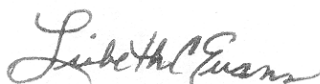
**DEPARTMENT OF CULTURAL RESOURCES RESPONSE**

The Department accepts the Recommendation of the Auditor. The Department has established procedures whereby all private non-profits affiliated with our agency who sponsor or host any type of event will work cooperatively with the Department to ensure full disclosure of all financial obligations as well as compliance with all applicable State rules and requirements. We have implemented various personnel and administrative changes to strengthen internal control and to ensure accountability in the reporting of all relevant information, particularly financial information, through the appropriate chain of command to the most senior staff.

While the Director of the Maritime Museum served on the Friends of the Maritime Museum and the Pepsi Americas' Sail, LLC, Boards, the Friends of the Maritime Museum is a distinct entity from the Maritime Museum as noted in the Special Review. As a distinct, non-public entity, they made decisions that were outside the control of this Department. To avoid this situation in the future, no Department employee may sit on a Board or Commission in any capacity except *ex officio* without express approval from the Secretary.

Thank you for the opportunity to address this Special Review. Please feel free to contact me with any questions you may have.

Sincerely,



Lisbeth C. Evans, Secretary  
North Carolina Department of Cultural Resources



# Friends of the Museum, North Carolina Maritime Museum

## **Response of the Friends of the Museum, North Carolina Maritime, Inc. to the State Auditor's Special Review April 9, 2007**

Eddy Myers  
*President*

Amy Thullen  
*Vice President*

Steve Harris  
*Treasurer*

John Warrington  
*Secretary*

### **Roanoke Island:**

Stephen Sawyer  
Kermit Skinner  
Dwight Gregory

### **Beaufort:**

Dave Dubuisson  
George Ellinwood  
Polly Hagle  
Steve Harris  
Eddy Myers  
Amy Thullen  
John Warrington

### **Southport:**

Walter Madsen  
Cecil Rhodes  
Wayne Strickland

### **Ex-officio:**

Mike Bradley  
*Past FOM  
President*

Dr. David Nateman  
*Museum Director*

Bobby Springle  
*NCMM Business  
Manager*

### **Friends of the Museum Staff:**

Brent Creelman  
*Executive Director*

Valerie Peterson  
*Membership Coordinator*

Patti Owens  
*Administrative Assistant*

On behalf of the Friends of the North Carolina Maritime Museum, the Board of Directors welcomes release of the Special Review of the Friends, the Museum and the Department Cultural Resources by the Office of State Auditor Leslie W. Merritt, Jr. This audit of property transactions and the 2006 tall ships event in Beaufort offers a sound basis for going forward with one of North Carolina's most popular and successful museums.

As the Special Review confirms, the Museum has exemplified the best kind of private-public partnership since its beginning a century ago. For a long time, friends of the Museum, who were incorporated as a 501(c) (3) non-profit organization in 1979, have been the driving force in molding a collection of marine artifacts into an institution housed in handsome, substantial buildings in the heart of Historic Beaufort, with 265,000 visitors a year.

Friends of the Museum facilitated gifts of land on which sit the main museum and its boat-building shop. Friends raised private funds to help complete the main museum building and to equip the boat shop. Friends secured a key waterfront site on Taylor's Creek for expansion of the Watercraft Center. And the Friends had the vision in 1995-97 to secure for the Museum's future use the former Fish Meal Co. site consisting of 36 acres with deep water frontage on Town Creek.

Each of these turning points in the Maritime Museum's evolution has required a boldness of vision and a willingness to gamble that just isn't found – and probably shouldn't be – in a state agency. The Fish Meal Co. tract is a perfect example. When the Smith family and its heirs offered the property to the museum, it took local residents with a sense of the community and its future to appreciate the implications of this opportunity. The Department of Agriculture, which then operated the Museum, was not able to justify budgeting \$3 million-plus for this long-range acquisition. So the Friends raised \$100,000 privately and then went to the General Assembly to secure the balance of the money. And the Friends resolved to maintain ownership of the property until it was certain the state was serious about making the investment necessary to develop the site's full potential as a public institution with precious public access to navigable salt water.

In 1998, when the Friends "were having difficulties meeting financial obligations" (Audit, page 5), the difficulty arose for no other reason than because, on a firm assurance that \$250,000 in grant money was on its way within hours from the Department of Cultural Resources, the Friends had drained their bank account to pay off the last dollars owed the Smith family for the land. When the Friends' board voted on Sept. 11, 1998, to deed the entire tract to the state, it was on the condition that no less drastic action would succeed in freeing the remaining \$250,000 in Natural Heritage Trust Funds to repay the Friends for the money they had advanced (Report, p. 16). In the end, though that conveyance was formally

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Phone: 252-728-1638 [www.ncmm-friends.org](http://www.ncmm-friends.org) email: [boating@ncmm-friends.org](mailto:boating@ncmm-friends.org)

**Response of the Friends of the Museum, North Carolina Maritime, Inc.  
to the State Auditor's Special Review (continued)**

accepted by the Council of State, further negotiations arrived at the alternative, executed a year later, of conveying about 5.6 acres to satisfy the requirements of the Natural Heritage grant. It is strange that the state agencies involved never even bothered to accept that conveyance. As far as the Friends knew, it was done. The deed was recorded in Carteret County.

The Special Review quite correctly concludes that when the State of North Carolina accepted ownership of the Maritime Museum's Gallants Channel Property from the Friends, it acquired an asset worth many times the sum total of public money invested. Thanks to the 12-year effort of the Friends of the Museum, the state now owns a public facility, designed and dedicated both to celebrate the state's maritime heritage and – no less important – to preserve increasingly scarce public access to the waterways. The Auditor's research concludes that, as it sits today, "the most conservative estimate of the value of the Gallants Channel property is \$20,458,000." This should lay to rest all of the nonsensical claims that the State "paid twice" or that the property was "palmed off on the State by the Friends," or that this tax-exempt public property has a "tax value" roughly equal to its purchase price a decade ago.

We do disagree with the State Property Office's estimate of \$3.8 million as the worth of 2005-2006 improvements to the property. The contract price of the improvements was \$4.4 million and, absent some evidence of overcharges, that figure represents the true value of the construction. The work was closely overseen on behalf of the Friends by a recognized expert, the CEO of a major commercial construction company. Donating one day a week of his time for roughly 12 months, he saw that the work was done on time and on budget. There has been no depreciation of the facilities.

The Friends' purpose in acquiring and owning the Gallants Channel tract was simply to create something of great value for the people of North Carolina, a seaport museum of national caliber. The state is now, finally, committed to expanding and developing its extremely popular Maritime Museum. Had it not been for the vision and hard work of the Friends, there would be no place for this growth to take place.

**It should be emphasized that when, in January, 2005, the Friends requested a grant of \$2.5 million from the General Assembly, the purpose was specified to be construction of "infrastructure at the Gallants Channel Annex." An accompanying memo broke down the intended uses: Engineering work, bulkhead and dock construction and site preparation at Gallants Channel plus docks and decks adjoining the Museum's Watercraft Center on Taylors Creek in downtown Beaufort. Although Pepsi Americas' Sail was mentioned as a focal point of the year – the reason for finishing construction by July, 2006 -- there was never any suggestion that the legislature fund operations expenses for the tall ships event.**

When the fruits of that effort appeared in the state budget in August, as a \$1.65 million line item in the Department of Transportation budget, the Friends naturally assumed that the money was available for Gallants Channel construction. Contracts were signed and a bank loan was obtained in reliance on the belief that this was the requested funding. Leaders of the Friends were astonished to learn subsequently that the DOT and the DCR intended to use the money for event parking and shuttle buses.

The audit report paints a generally accurate picture of Pepsi Americas' Sail 2006. The event fell short of expectations in several ways, though it was far from a total flop. Thousands of visitors enjoyed themselves despite the heat and disappointing turnout of ships. The various public safety agencies that took part reported that both the planning process and execution of their plan provided practice in mutual cooperation that will prove invaluable in the event of a disaster in the region.

From the vantage point of the Friends of the Museum, the verdict is mixed. The primary objective of the project was to kick-start development of the long-fallow Gallants Channel Annex site. That objective was met on a remarkably accelerated timetable, enabling the Gallants Channel waterfront to be the central tall ships venue. It was the site of an unforgettable outdoor North Carolina Symphony concert as well as other popular entertainment. Prospective financial supporters of the museum, individual and corporate, got a first-hand experience of Gallants Channel with a chance to visualize its potential. Indeed, hundreds of thousands of dollars of private support was raised for the project.

**Response of the Friends of the Museum, North Carolina Maritime, Inc.  
to the State Auditor's Special Review (continued)**

On the negative side, expenses of Pepsi Americas Sail, LLC, outstripped revenues by a large margin. The Friends have felt a moral obligation to assume those debts and are raising the funds to settle the remaining accounts. This is obviously a financial setback, but one the Friends are prepared to overcome.

Several aspects of Pepsi Americas Sail 2006 need clarification:

- The contract with Americas Sail, Inc., called for that organization to conduct a tall ships race from Brazil to the Dominican Republic as the first phase of a cruise that would terminate in Beaufort. In fact, only one ship, the Brazilian Cisne Branco, was recruited, and so there was no race and no Class A fleet present at the North Carolina event. This was a major blow to ticket sales and the root cause of excessive ticket refunds.
- Friends of the Museum did not quite “take over control for planning the event” (Report, p. 9). In the spring of 2004, the Friends’ board and staff enthusiastically joined the Museum Director in the planning process and recruited hundreds of volunteers. In the summer of 2005, the Friends formed a subsidiary single-purpose LLC, Pepsi Americas Sail, to operate the event. The purpose was to insulate the Friends’ principal asset, the Gallants Channel property, from catastrophic liability beyond the limits of the ample insurance in place. The Museum Director was a member of the LLC board and continued to be an integral part of the planning.
- Only the contracts with Americas Sail, Inc., and with Sondra Reed as event coordinator were negotiated by the Friends before Pepsi Americas Sail, LLC, was created. Don Holloway, who took over as event coordinator in August, 2005, was contracted by the LLC. E-Tix, the ticket sales contractor, was hired by the LLC but insisted on having a contract with the Friends. (Report, p. 10)
- The agreement signed on Jan. 25, 2006, between DOT, DCR and the Friends of the Museum, permitting the \$1.65 million to be used for event transportation and parking, was entered into by the Friends as an unwilling participant. It remained the Friends’ position that the \$1.65 million should only be used for permanent improvements to the museum site.
- The Auditor’s point regarding the lack of firm Pepsi Americas’ Sail contracts with some vendors and the implications thereof is well-taken (Report, p. 19). There is no question that some expenses seemed excessive, including media and public relations. It has been pointed out, however, that Carteret County’s vital tourism economy reaped and will continue to reap benefits from the exposure. It should be kept in mind that several of the service providers were, in effect, subcontractors of Tribble Creative, which was under contract as overall event coordinator. It is worth emphasizing that the auditors found no evidence that anyone took advantage of the financial structure for personal gain.
- The audit’s conclusions regarding management authority and control (Report, p. 19) are not entirely accurate. Authority granted to volunteer planning committees was subject to supervision by professional staff members hired by the Friends and the LLC, respectively.

The Friends of the N.C. Maritime Museum have learned a great deal from this experience, and will take pains to retain this knowledge for future undertakings. (Corporate memory is always a challenge for voluntary organizations whose officers and directors come and go.) The first lesson is clearly that communications between the Friends and the top management of the Department of Cultural Resources must be frequent, comprehensive and two-way. This kind of communication is already more frequent and frank than ever before, and promises to continue improving. In this new working climate, the Friends of the Museum look forward to continuing their 30-year record of advancing the North Carolina Maritime Museum from a humble storefront to a multifaceted public institution of national stature.

**Eddy Myers, President**

**Brenton Creelman, Executive Director**

**Friends of the Museum, North Carolina Maritime Museum, Inc.**

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North Carolina  
Department of Administration

Michael F. Easley, Governor

Britt Cobb, Secretary

April 10, 2007

Hon. Leslie W. Merritt, Jr., CPA, CFP  
State Auditor  
Office of the State Auditor  
20601 Mail Service Center  
Raleigh, NC 27699-0601

***Re: State Property Office Response to Special Review of Gallant's Channel  
Property Transaction***

Dear Mr. Merritt:

Please find attached the State Property Office response to the Special Review of Gallant's Channel Property Transaction. We appreciate the opportunity to address this matter and thank you for the conscientious work of your staff members.

If there are questions or comments, please let me know.

Sincerely,

A handwritten signature in cursive script that reads "Britt Cobb".

Britt Cobb

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**Telephone: (919) 807-2425**  
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**Location Address:**  
116 West Jones Street  
Raleigh, North Carolina



**State Property Office Response to  
Special Review of Gallant's Channel Property Transaction  
April 2007**

The report makes four recommendations applicable to the State Property Office. Each recommendation and the State Property Office's response are listed below.

**Recommendation No. 1: For future property acquisitions in which the State does not have legal title at the time of purchase, written agreements or contracts that explicitly document when the property will transfer to the State should be drafted. These agreements should establish either a specific date for property transfer or a set of identifiable circumstances that must occur to prompt the transfer. Further, the agreement or contract should clearly define the roles of both the State and any other organization regarding management and development of the property during the period in which the State does not hold legal title to the property. In addition, the State Property Office should conduct reviews of its files and contact all state agencies to determine whether similar property arrangements exist and resolve any outstanding issues.**

**Response:** The State Property Office concurs with the Auditor's recommendation that written agreements should be utilized in circumstances where the State enters into relationships for the management and development of property for which it does not hold legal title. To that end, the State Property Office requires written agreements with entities that acquire interest in real property on behalf of the State. The State Property Office also concurs with the Auditor's recommendation that the State Property Office should contact all state agencies to determine if any arrangements similar to the instant arrangement exist. If any are revealed, the State Property Office will take appropriate action.

**Recommendation No. 3: The State Property Office should implement procedures to ensure completion of all property acquisitions by the Council of State. The State Property Office should require copies of deeds for all property acquisitions before closing the file. In addition, periodic reviews of files should be conducted to ensure the State has title to all approved property acquisitions.**

**Response:** Many years ago, the State Property Office implemented procedures to insure completion of all transactions (Project Tracking). As part of Project Tracking and in accordance with N.C. Gen. Stat. § 143-341(4)(c), the State Property Office retains a copy in its files of all deeds which it receives and files a copy with the Secretary of State. It is acknowledged that some transactions approved by the Council of State are not finalized despite the best intentions of the parties. This is especially so in cases of gifts to the State.

The State Property Office concurs with the Auditor's recommendation and has taken the necessary steps to ensure that the Council of State is advised of all transactions that are not finalized as anticipated.

**Recommendation No. 4: The State Property Office should require notification from all state agencies concerning any property transfers. Whenever a state agency receives a deed to any property, that agency should forward a copy of the deed to the State Property Office to ensure acceptance of the transfer.**

**Response:** The State Property Office concurs with the Auditor's recommendation and notes that N.C. Gen. Stat. § 146-1 *et seq.* requires all subject agencies to consult the State Property Office prior to the acquisition of an interest in real property. Consistent with the Auditor's recommendation, the State Property Office will take steps to remind agencies of this requirement.

**Recommendation No. 5: For property transactions subject to liens, deeds of trust, or other encumbrances, the State Property Office should ensure that all relevant facts are adequately presented to the Council of State. For complex property transactions, the State Property Office should consider providing the details of the transactions in writing to Council members prior to meetings.**

**Response:** The State Property Office concurs with the Auditor's recommendation and notes that the omission of the lien filed by T. D. Eure Construction Co. was simply an oversight that occurred when the Director departed from his presentation to respond to questions regarding the transaction. At the time of the Council of State meeting, the State Property Office was unaware of any other lien filings related to the Gallants Channel Property. Consistent with the Auditor's recommendation, the State Property Office will continue to provide supplemental information to the Council of State.

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April 10, 2007

The Honorable Leslie W. Merritt, State Auditor  
2 South Salisbury Street  
20601 Mail Service Center  
Raleigh, North Carolina 27699-0601

Mr. J. Robert Gordon,  
Chairman  
Scotland County

Mr. Alan D. Briggs  
Wake County

Mr. Charles E. Clement  
Watauga County

Ms. Portia Hawes  
Warren County

Mr. Thomas D. Hunter, III  
Henderson County

Mr. William Joslin  
Wake County

Mr. Henry L. Kitchin  
Richmond County

Mr. R. Michael Leonard  
Forsyth County

Mr. Thomas W. Reese  
Catawba County

Ms. Elizabeth D. Taft,  
Ph.D  
Pitt County

Mr. Dewey W. Wells  
Avery County

Ms. Lois McIver Winstead  
Person County

*RE: Natural Heritage Trust Fund  
Response to Draft Gallant's Channel Property Transaction Report*

The Honorable Leslie W. Merritt:

Thank you for the opportunity to review and comment on the draft report of your special review of the Gallant's Channel property acquisition in Beaufort, North Carolina. This is the property that Natural Heritage Trust Fund (NHTF) refers to as the "Town Creek Preserve."

First, let me emphasize agreement with your comments on page 15. As stated in our grant/funding agreements, we expect the Department of Administration – State Property Office (SPO) to initiate and conduct all land acquisitions on behalf of the state agencies to which we award funds. Further, as you noted, the Trustees of the NHTF expected and assumed that title to the land at the Town Creek Preserve/Maritime Museum was vested in the State as required by the NHTF statute 113-77.9(d), "title to any land acquired pursuant to this Article shall be vested in the State."

The main finding relating to NHTF is Finding 2. The recommendation addressing Finding 2 on page 15 is that NHTF establish procedures to ensure grants are awarded only for properties for which title will vest in the state, such as requiring copies of the deed and management agreements. Although we think the Gallant's Channel transaction is an anomaly, we will implement your recommendations and make additional modifications to avoid any future problems. We will emphasize in our grant application and grant/funding agreements that the lands must be owned by the state either in fee simple or interest (easement). We will modify our funding/grant agreements to clearly:

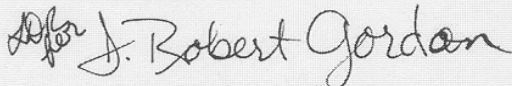
- require that SPO manage all land acquisitions funded by NHTF;
- require that when SPO sends a copy of the recorded deed to the agency that NHTF also receive a copy of the deed;
- require that a copy of the management agreement (if applicable) be submitted to NHTF; and
- require that SPO execute any such management agreement pursuant to G.S. 143-341.

Lisa Riegel, Executive Director, Natural Heritage Trust Fund  
1601 Mail Service Center, Raleigh, NC 27699-1601  
Lisa.Riegel@ncmail.net

Some program improvements have already been made, prior to this audit report. Our grant application process was revised recently and it now specifies that SPO must be involved. In addition, new procedures require that NHTF be notified of the Council of State meeting to discuss a proposed NHTF-funded acquisition and we require an invoice from SPO prior to the transfer of funds for land acquisition.

Again, thank you for sharing your findings and allowing us the opportunity to respond to the draft report. Should you have any additional questions, please feel free to contact me at (910) 276-7825 or Lisa Riegel, Executive Director at (919) 715-8014.

Sincerely,



J. Robert Gordon, Chairman  
Natural Heritage Trust Fund

cc: Lisa Riegel, Executive Director, NHTF  
Trustees, NHTF

Lisa Riegel, Executive Director, Natural Heritage Trust Fund  
1601 Mail Service Center, Raleigh, NC 27699-1601  
Lisa.Riegel@ncmail.net

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