

STATE OF NORTH CAROLINA

SPECIAL REVIEW

**NORTH CAROLINA DEPARTMENT OF CULTURAL RESOURCES
ROANOKE ISLAND COMMISSION**

FRIENDS OF ELIZABETH II, INC.

MANTEO, NORTH CAROLINA

MARCH 2013

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA

STATE AUDITOR

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AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
Members of the North Carolina General Assembly
Ms. Susan W. Kluttz, Secretary, North Carolina Department of Cultural Resources
Mr. Tod B. Clissold, Chair, Friends of Elizabeth II

Pursuant to North Carolina General Statute §147-64.6(c)(16) and as directed by Session Law 2012-87, we have completed our special review of the North Carolina Department of Cultural Resources, Roanoke Island Commission and Friends of Elizabeth II, Inc. 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). We appreciate the cooperation received from the management and employees of the Department of Cultural Resources, Roanoke Island Commission and the Friends of Elizabeth II, Inc.

Respectfully submitted,



Beth A. Wood, CPA
State Auditor

March 20, 2013

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INTRODUCTION

In January 2012, the State Auditor received a letter from a citizen requesting a review of the historical and ongoing relationship between the Roanoke Island Commission (Commission) and Friends of Elizabeth II, Inc. (Friends), a nonprofit¹ organization that was organized to support Roanoke Island Festival Park in Manteo, North Carolina. Similar concerns were raised by other community representatives including General Assembly members who contacted the State Auditor.

On June 27, 2012, the General Assembly ratified Senate Bill 661 (Session Law 2012-87) and the Governor signed the bill into law the next day. Senate Bill 661 mandated that the State Auditor “conduct an investigative audit of the Roanoke Island Commission” with instructions to “carefully examine all funds that have been received by Friends of Elizabeth II, Inc., (Friends) from the Roanoke Island Commission or any other State entity.” Specifically, the legislation required that the State Auditor “determine the following:

- (1) The balance of such funds still held by the Friends. [see page 7]
- (2) The interest earned on such funds and the rate of interest on such funds, both as of the time of the audit and over the period in which the Friends have held such funds. [see page 11]
- (3) The expenditure of funds received by the Friends from the Roanoke Island Commission or any other State entity. [see page 14]
- (4) Whether such funds have been used by the Friends for the purposes for which they were transferred. [see page 16]
- (5) Whether such funds were properly transferred by State entities to the Friends in accordance with the law. [see page 18]
- (6) Whether the use of such funds has been properly reported in accordance with the law.” [see page 21]

The legislation also mandated that the State Auditor “review any memorandums of agreement” between the Commission and the Friends. [see page 25] Finally, the law required the State Auditor to “make recommendations based on the Auditor’s findings.”

To conduct our review, we performed the following procedures:

- Examination of relevant documents and records of the North Carolina Department of Cultural Resources (Cultural Resources), the Commission, and Friends including review of bank statements, accounting records, meeting minutes, articles of incorporation, tax records, audited financial statements, and North Carolina Accounting System information
- Review of policies, procedures, and state regulations including the North Carolina General Statutes and North Carolina Administrative Code
- Interviews with employees of Cultural Resources and the Commission, Friends board members and staff, and other interested parties

This report presents the results of our special review. The review was conducted pursuant to North Carolina General Statute § 147-64.6(c)(16) and as directed by Session Law 2012-87.

¹ The Friends are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code.

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ORGANIZATION OVERVIEW AND PROGRAM HISTORY

North Carolina Department of Cultural Resources

The North Carolina Department of Cultural Resources (Cultural Resources) provides 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."²

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. The Division of State Historic Sites manages operations at 27 historical sites throughout the State dating from pre-colonial times to the 20th Century. Three Historic Commissions oversee Roanoke Island Festival Park (Park), Tryon Palace, and the Battleship North Carolina.

Roanoke Island Commission

The General Assembly created the Roanoke Island Commission (Commission) on July 16, 1994. The Commission is "located within the Department of Cultural Resources for historic resource management, organizational, and budgetary purposes."³ As such, the Commission receives state appropriations through Cultural Resources. The Commission was created to "protect, preserve, develop, and interpret the historical and cultural assets of Roanoke Island."⁴ Effective October 1, 1994, all the assets and liabilities of the previously-existing Roanoke Voyages and Elizabeth II Commission transferred to the Roanoke Island Commission.⁵

According to the enabling legislation, the Commission consists of "24 voting members"⁶ appointed by the Governor (six), the General Assembly with six recommended by the President Pro Tempore of the Senate and six recommended by the Speaker of the House, and the following ex-officio members:

- Governor
- Attorney General
- Secretary of the Department of Cultural Resources
- Secretary of the Department of Transportation
- Chair of the Dare County Board of Commissioners
- Mayor of Manteo

At least two members recommended by the President Pro Tempore and two members recommended by the Speaker of the House must be residents of Dare County. All appointed members of the Commission serve two-year terms.

² Cultural Resources website: <http://www.ncdcr.gov>

³ North Carolina General Statute §143B-131.1

⁴ North Carolina General Statute §143B-131.2

⁵ North Carolina General Statute §143B-131.5

⁶ North Carolina General Statute §143B-131.6

ORGANIZATION OVERVIEW AND PROGRAM HISTORY (CONTINUED)

Among its responsibilities, the Commission appoints an Executive Director who may also hire other employees to manage the Commission's operations. According to the Executive Director, the Commission currently employs 24 full-time staff at Roanoke Island Festival Park including a Programs Manager, Communications Manager, Visitor Services Manager, Operations Manager, Manager of Education and Interpretation, Facilities Maintenance Manager, and Captain of the Elizabeth II. The Executive Director said the Park currently utilizes 12 seasonal employees and approximately 50 volunteers that contribute to the operations and management of the historic site.

In 1995, the General Assembly amended the purpose, power, and duties of the Commission.⁷ The Commission was given responsibility "to operate and administer the Elizabeth II State Historic Site and Visitor Center, the Elizabeth II, Ice Plant Island, and all other properties...located on Roanoke Island having historical significance to the State of North Carolina, Dare County, or the Town of Manteo" that fall under the administration of Cultural Resources.

The 1995 legislative changes also created two non-reverting funds to be administered by the Commission. The "Roanoke Island Commission Fund" consisted of 75% of the revenues collected from any property operated by the Commission. The revenues included gifts, donations, grants, or bequests received. Legislation limited the use of these funds to the Commission's expenses and the operation and maintenance of properties operated by the Commission.⁸

The "Roanoke Island Commission Endowment Fund" consisted of the remaining 25% of the revenues collected from any property operated by the Commission. The revenues and interest generated by this fund were held in reserve until July 1, 2000, to establish the principal of the fund. After July 1, 2000, the Commission was directed to use 80% of the interest generated by the principal to carry out its duties. These funds could also be used for capital expenditures for properties operated by the Commission.

During the 1998 Legislative Session, the General Statutes pertaining to the Commission and its funding were amended again.⁹ North Carolina General Statute § 143B-131.2(b)(10) was changed to read, "Funds appropriated to the Commission may be transferred to the Friends of Elizabeth II, Inc., a private, nonprofit corporation. The Friends of Elizabeth II, Inc., shall use the funds transferred to it to carry out the purposes of this Part."

Session Law 2011-145 (House Bill 200) revised the law regarding the fund transfers. General Statute § 143B-131.2(b)(10) was rewritten to direct the Friends of Elizabeth II, Inc. to "use the balance of any unencumbered funds that were transferred to it...only for expenses of the Commission or the properties operated by the Commission" when "requested by the Commission."

⁷ House Bill 230, 1995 Session

⁸ North Carolina General Statute §143B-131.8

⁹ Senate Bill 1366, Session Law 1998-212

ORGANIZATION OVERVIEW AND PROGRAM HISTORY (CONTINUED)

In addition, effective July 1, 2012, the General Assembly repealed the provision related to the Roanoke Island Commission Fund and the Roanoke Island Commission Endowment Fund. In its place, the General Assembly adopted North Carolina General Statute §143B-131.8A, which established the “Historic Roanoke Island Fund” as a non-reverting fund administered by the Commission. Similar to the prior funds, the Historic Roanoke Island Fund receives operating funds generated by the Commission through various means. Likewise, these funds shall only be used for the operations and management of the Commission and its properties, including capital expenditures for the properties.

Friends of Elizabeth II, Inc.

Friends of Elizabeth II, Inc. (Friends) filed its articles of incorporation with the North Carolina Secretary of State on July 9, 1982. The Friends is a nonprofit corporation led by a board of directors and a Director who manages the daily operations and activities.

According to its articles of incorporation, the Friends’ original purpose focused on the construction and operation of a replica of a 16th Century sailing vessel to exhibit and display for educational, cultural, and historical purposes using private funds. The sailing vessel became known as the Elizabeth II (a replica of one of the seven merchant vessels that made the Roanoke Voyage in 1585) and was christened on November 22, 1983.

The Friends amended its articles of incorporation on May 19, 2000, to expand its focus. The expanded focus included acting “as the non-profit arm of the Roanoke Island Commission,” acquiring property or real estate, and operating “a museum shop and other concessions on behalf of” the Commission.

Adopted on October 14, 2009, the current by-laws indicate that the board shall be comprised of “no less than seven and no more than eleven” members. As of January 31, 2013, the Friends board consists of eight members: a Chair, a Secretary, a Treasurer, and five at-large members with a vacant Vice Chair position. Each board member, who is selected from the general membership after identification by a nominating committee, is appointed to two-year terms.

Prior by-laws adopted in January 2000 required that three board members be elected from the Friends’ general membership. The other four board members were the officers of the Roanoke Island Commission. As such, the by-laws at that time required the Commission’s Chair to serve on the Friends board and the Vice Chair, Secretary, and Treasurer of the Commission to hold the same positions on the Friends board. However, a “formal advisory opinion” rendered by the State Ethics Commission in November 2009 determined that the dual membership created a conflict of interest. As a result, these two boards ended the dual membership thereafter.

To carry out its functions, the Friends employs a Director, Museum Store Manager, and hourly, part-time employees at the Museum Store and at a dormitory it operates to house seasonal performers for Park activities.

ORGANIZATION OVERVIEW AND PROGRAM HISTORY (CONCLUDED)

Relationship between the Commission and the Friends

The Commission and the Friends were always closely connected. For example, previous Friends by-laws required that the Vice Chair, Secretary, and Treasurer of the Commission serve the same positions on the Friends board and that the Commission's President also serve on the Friends board. As such, the Commission and the Friends board leadership was significantly the same. Further, board minutes for both organizations indicated that representatives provided updates of each group's activities at the other's board meetings.

The inter-connected relationship extended to employees of both organizations. Friends employees in the Museum Store managed state employees of Roanoke Island Festival Park. The Roanoke Island Festival Park Operations Manager held the same position for the Friends. Some individuals claimed that employees worked for two separate organizations at the same time. While the General Statutes required Cultural Resources to provide administrative, budget and organizational support for the Commission, those regulations did not extend to providing services for the Friends.

This intertwined relationship underwent several changes to clearly separate the two entities. First, the Friends by-laws were revised in October 2009 to change the membership which removed the requirement for the Commission officers to also serve on the Friends board. After some original reluctance from both groups, the Friends began taking steps in 2010 to completely separate the staff members of the two organizations. The Friends hired a Director and no longer depend on the Park Operations Manager for financial matters. The Friends also hired staff to operate and manage the Museum Store at the Park.

REPLIES TO LEGISLATIVE INQUIRIES

1. WHAT IS THE BALANCE OF FUNDS RECEIVED BY THE FRIENDS OF ELIZABETH II, INC. FROM THE ROANOKE ISLAND COMMISSION AND OTHER STATE ENTITIES?

The Friends of Elizabeth II, Inc. (Friends) received \$8,313,684.53 in state funds from the Roanoke Island Commission (Commission) and other state entities. (see Table 1) Specifically, the Friends received \$6,561,214.54 in transfers from the Commission over 10 years and a \$175,000 loan that was repaid over six years. Further, in 1998, the Friends received a direct appropriation of \$1,550,000 from the North Carolina General Assembly (passing through the Commission). In 2010, the North Carolina Department of Environment and Natural Resources (DENR) provided a \$27,469.99 grant to the Friends. Because state funds (aside from restricted capital project funds) were not accounted for separately by the Friends, it is not possible to determine the actual balance of remaining state funds. However, as of December 31, 2012, the Friends maintained an overall cash balance of \$88,557.12 and an investment balance of \$7,262,672.93.¹⁰ Those balances include funds provided by the state, revenues from the Museum Store and events managed on Roanoke Island Festival Park (Park), membership dues, and donations by private individuals or organizations.

From April 1998 until June 29, 2008, the Commission transferred \$5,348,185.60 of state appropriations. These transfers complied with N.C.G.S. §143B-131.2(b)(10) (see Finding 5) which enabled a safeguarded funding stream for Commission projects. Between 1999 and 2004, the Commission also transferred \$1,213,028.94 in funds restricted for use on specified capital projects. These projects included an upgrade to the Museum Store, new exhibits at the Park and repairs to the Elizabeth II replica sailing vessel. Legislation in 1998 also set aside \$1,500,000 for the Friends to construct housing near the Park to provide temporary residence to performing artists who participated in summer performance programs. Currently, the Friends own, manage, and operate the dormitory, which is located one mile from the Park.

Finally, the Commission loaned \$175,000 to the Friends in 1998. The loan was secured by the inventory purchased for the Museum Store. The terms of the loan agreement required an annual payment of \$35,000 from 2000 through 2004. We confirmed that the Friends repaid this loan with the final payment received by the Commission on June 29, 2004.

The Friends also received state funding in 2010 from DENR. The Friends obtained \$27,469.99 in grant funds for a kayak launching ramp as part of a federally-funded recreational trails program.

¹⁰ According to the unaudited financial statements as of December 31, 2012 and investment company reports

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

TABLE 1			
STATE FUNDS RECEIVED BY FRIENDS OF ELIZABETH II, INC.			
Date Received	Amount Received	Date of Commission Approval/ Notification	Method of Communication with Commission
Transfers of Surplus Operating Funds:			
6/17/1999	\$832,400.00	6/2/1999	Executive Committee
12/6/2000	881,179.65	10/19/2000	Full Commission
10/4/2001	599,448.56	9/12/2001	Memo to Cultural Resources Business Officer
10/4/2001	200,476.89	9/12/2001	Memo to Cultural Resources Business Officer
6/28/2002	446,541.00	No documentation	No documentation
6/12/2003	235,532.00	5/28/2003	E-mail to Cultural Resources Business Officer, Commission Executive Director, and Operations Manager
8/1/2003	184,590.20	10/25/2003	Full Commission via Treasurer's Report
3/10/2004	135,445.17	No documentation	No documentation
6/29/2004	384,789.00	6/28/2004	E-mail to Commission members and Commission Executive Director
6/29/2005	500,543.13	10/14/2005	Memo to Commission members and Commission Executive Director
6/29/2006	416,000.00	8/11/2006	E-mail to Commission members, Commission Executive Director, and Cultural Resources staff
6/28/2007	238,918.00	6/27/2007	E-mail to Commission Executive Director and Cultural Resources accounting staff
6/28/2008	292,322.00	6/30/2008	E-mail to Commission Executive Director and Cultural Resources accounting staff
Subtotal	\$5,348,185.60		
Restricted Transfers for Capital Projects (Repair and Renovation funds):			
7/26/1999	\$400,000.00	6/2/1999	Executive Committee
3/8/2001	494,059.94	1/25/2001	Executive Committee
9/27/2004	318,969.00	7/23/2004	Elizabeth II Committee
Subtotal	\$1,213,028.94		
Direct Appropriations flowing through Commission earmarked for Friends:			
4/13/1998	\$50,000.00		(Museum Store renovation)
11/9/1998	1,500,000.00	7/16/1998	Executive Committee (Dorm construction)
Subtotal	\$1,550,000.00		
Loan (repaid in full on June 29,2004):			
4/8/1998	\$175,000.00	1/14/1999	Executive Committee
Subtotal	\$175,000.00		
Grant from Department of Environment and Natural Resources:			
7/13/2010	\$27,469.99	Not applicable	Not applicable
Subtotal	\$27,469.99		
Grand Total	\$8,313,684.53		
Sources: Cultural Resources Internal Auditor memos, Commission meeting minutes, e-mail communications, Commission Treasurer reports, Friends audited financial statements			

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

**TABLE 2
FRIENDS OF ELIZABETH II, INC.
REVENUES REPORTED
1998 THROUGH 2012**

	Contributions	*Grants*	Membership Dues	Museum Store Sales	Vending Income	Events Income	Voyages Income	Interest Income	Other Income	Investment Income	Rental Income	Total
1998	\$18,804	\$1,550,000	\$1,083	\$176,281	-	\$44,190	\$3,500	\$6,924	\$2,000	-	-	\$1,802,782
1999	69,822	1,232,400	11,123	248,030	-	5,944	674	42,522	10,257	-	\$9,152	1,629,924
2000	25,152	881,180	13,775	240,677	-	10,992	3,415	39,297	7,309	-	14,007	1,235,804
2001	45,691	1,293,985	14,415	278,951	-	22,689	5,879	34,314	1,756	(\$8,435)	42,220	1,731,465
2002	13,488	446,633	23,250	285,066	-	20,547	-	24,731	18,000	(188,937)	47,411	690,189
2003	44,675	455,402	23,170	290,750	\$6,659	27,840	-	14,436	-	365,947	43,955	1,272,834
2004	51,066	839,203	19,500	289,196	-	34,056	-	6,072	-	369,960	48,831	1,657,884
2005	31,613	506,543	22,385	235,449	12,343	21,314	8,500	12,722	526	262,423	38,804	1,152,622
2006	33,363	416,000	25,240	301,057	-	18,338	13,437	29,189	-	571,258	49,499	1,457,381
2007	30,547	253,455	20,020	290,485	-	27,158	-	44,981	735	703,491	34,979	1,405,851
2008	32,290	292,322	19,800	284,611	-	45,704	-	10,976	866	(1,799,765)	38,029	(1,075,167)
2009	45,026	19,374	18,030	243,741	-	20,713	-	5,033	-	1,052,160	19,685	1,423,762
2010	35,288	10,071	32,374	226,126	3,257	12,590	-	2,042	-	600,210	17,906	939,864
2011	31,825	-	11,226	102,115	4,091	1,050	-	-	-	(8,492)	58,670	200,485
2012	2,497	-	14,302	225,893	-	-	-	410	-	722,088	63,747	1,028,937
Total	\$511,147	\$8,196,568	\$269,693	\$3,718,428	\$26,350	\$313,125	\$35,405	\$273,649	\$41,449	\$2,641,908	\$526,895	\$16,554,617
% of Total	3.1%	49.5%	1.6%	22.5%	0.2%	1.9%	0.2%	1.7%	0.3%	16.0%	3.2%	100.0%

* = may include amounts from local governments or private foundations but does not include \$175,000 loan provided in April 1998

Source: Friends audited financial statements 1998 through 2011, Profit and Loss statement 2012—amounts not audited

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

At the Friends' request in late 2011, Cultural Resources researched the transfers, determined the source of transferred funds, and ascertained whether the transfers were ultimately deposited into a Friends account. The Cultural Resources Internal Auditor examined bank statements, deposit slips, audited financial statements, and general ledgers to verify the accuracy of the transfers and deposits. In a memo dated January 25, 2012, the Internal Auditor confirmed that the Friends "deposited all transfers from [Cultural Resources/Commission] into [its] bank accounts."

According to Friends board members, the Friends maintain an operating account and a money market account at Southern Bank along with another operating account at East Carolina Bank. An independent public accounting firm conducts an annual financial statement audit of the Friends. According to the Friends audited financial statements for the year ended December 31, 2011, the Friends had cash balances of \$194,798 and investment balances of \$6,840,585. According to accounting records and investment statements, the Friends cash balance was \$88,557.12 and its investment balance was \$7,262,672.93 as of December 31, 2012.

Because the Friends were not required by Cultural Resources/the Commission to account for state funds separately (except for the restricted funds for capital projects and the 2010 grant from DENR), it is not possible to determine the exact amount of state funds that remain in the Friends accounts. Table 2 on the prior page shows the total revenues reported on the Friends audited financial statements from 1998 through 2011 plus amounts for 2012 from the unaudited profit and loss statement. Based on analysis of those amounts, approximately 50% of revenues reported by the Friends during that period derived from state funds.

Because of state records retention policies applicable to both Cultural Resources and the Commission, our review revealed that documentation was not always maintained to confirm that the full Commission was aware of all transfers. Specifically, neither Cultural Resources nor the Commission maintained documentation to provide evidence of Commission notification of two transfers. In addition, documented communication about several other transfers was limited to e-mails between Cultural Resources, Commission staff or committees, and the Friends.

CONCLUSION

The Friends received \$8,313,684.53 in state funds from 1998 through 2010. The majority of those funds were transfers from the Roanoke Island Commission to the Friends to ensure a consistent funding source for projects at Roanoke Island Festival Park. While the remaining balance of state funds received cannot be determined, the Friends maintained an overall cash balance of \$88,557.12 and investment balance of \$7,262,672.93 as of December 31, 2012.

RECOMMENDATION

Cultural Resources and the Commission should continue to maintain adequate documentation to support all financial transactions in accordance with records retention policies. Minutes of Commission meetings should contain complete records of significant activities including major financial decisions and results. The Friends should also account separately for any state funds received to enable monitoring of state funds received, spent, and remaining.

2. HOW MUCH INTEREST WAS EARNED BY THE FRIENDS AND WHAT IS THE RATE OF INTEREST ON FUNDS RECEIVED FROM THE ROANOKE ISLAND COMMISSION AND OTHER STATE ENTITIES?

According to their audited financial statements and interviews with current board members, the Friends opened an investment account in 2001. The Friends board adopted an investment strategy at that time. The Friends Treasurer said the Friends' goal was to be self-sufficient using the interest income. The Commission Operations Manager (who was concurrently the Friends Operations Manager for several years) said the Friends decided to invest the transferred funds once the amounts became significant. The Friends also invested funds from other sources.

Originally, the Friends invested their funds with RBC before moving the funds to U.S. Trust in April 2003. After a bid solicitation process in 2009, the Friends transferred their investment accounts to Virginia Asset Management. According to the Friends Treasurer and our review of investment records, the investment funds are maintained in two accounts with Virginia Asset Management. According to their annual audited financial statements, the Friends received interest and investment income as shown in Table 3.

TABLE 3 INVESTMENT AND INTEREST INCOME FRIENDS OF ELIZABETH II, INC. 1998 THROUGH 2012		
Year	Interest Income	Investment Income
1998	\$6,924	-
1999	42,522	-
2000	39,297	-
2001	34,314	(\$8,435)
2002	24,731	(188,937)
2003	14,436	365,947
2004	6,072	369,960
2005	12,722	262,423
2006	29,189	571,258
2007	44,981	703,491
2008	10,976	(1,799,765)
2009	5,033	1,052,160
2010	2,042	600,210
2011	-	(8,492)
2012	410	722,088
Total	\$273,649	\$2,641,908

Source: Friends annual audited financial statements
* = 2012 amounts from year-end accounting records

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

The Friends invested more than \$1.5 million in 2001 in a variety of funds (“quality income,” “small cap,” “mid cap,” “large cap,” and money market). Investment of additional funds and consistent positive returns on investment increased the year-end value to more than \$6.3 million by December 31, 2007. Stock market losses in 2008 reduced the year-end balance to \$5.1 million but the investment funds recovered thereafter. As of December 31, 2012, the Friends investment account balance was \$7,262,672.93.¹¹

Funds invested by the Friends are constantly sold and bought through the capital markets with thousands of transactions occurring over the past 12 years. As such, it is not possible to determine the **exact interest rate** over a specified time. However, we calculated annual interest rates through two different methods presented below.

Under the first method, we calculated an annual interest rate based upon the “net investment return” reported in the annual audited financial statements. Table 4 summarizes those calculations. Overall, the Friends investments averaged 7.81% annually over the 12-year period reviewed. Due to the stock market volatility in 2008, the Friends investments suffered a significant decrease that year (28.37% loss) with minor investment losses in 2001 and 2011. However, the Friends investment accounts earned significant returns in many years especially 2003 (23.19%) and 2009 (20.24%).

TABLE 4				
INTEREST CALCULATIONS OF FRIENDS INVESTMENTS				
NET INVESTMENT RETURN METHOD				
2001 THROUGH 2012				
Calendar Year	Beginning Balance	Ending Balance	Net Investment Return	Computed Interest Rate[^]
2001	\$0	\$1,473,939	(\$8,435)	(0.57%)
2002	1,473,939	1,578,253	188,937	12.82%
2003	1,578,253	3,354,410	365,947	23.19%
2004	3,354,410	4,305,392	369,959	11.03%
2005	4,305,392	5,068,358	262,423	6.10%
2006	5,068,358	5,639,616	571,257	11.27%
2007	5,639,616	6,343,107	616,761	10.94%
2008	6,343,107	5,198,260	(1,799,765)	(28.37%)
2009	5,198,260	6,407,508	1,052,160	20.24%
2010	6,407,508	6,850,630	602,252	9.40%
2011	6,850,630	6,840,585	(8,492)	(0.12%)
2012	6,840,585	7,262,673	122,088	17.8%
Average @				7.81%
Source: Friends annual audited financial statements				
[^] = Net investment return divided by beginning balance each year				
* = 2012 amounts from year-end investment statements and accounting records				
@ = Average over 12-year period using Excel “Average” function				

¹¹ According to year-end accounting records

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

Under the second method, we calculated an imputed annual interest rate based upon the net cash flow changes in the investment account each year. To perform this calculation, we assumed that all deposits or withdrawals took place on June 30 of each year. That assumption evenly distributes the cash flow changes throughout the year and coincides with the annual transfers from the Commission to the Friends. Then, we computed the annualized geometric return rate.¹² Based on those calculations as shown in Table 5, the Friends investments averaged 5.51% annually over the 12-year period reviewed. Due to the stock market volatility in 2008, the Friends investments suffered a significant decrease that year (26.87% loss) with minor investment losses in 2001 and 2011. However, the Friends investment accounts earned significant returns in many years especially 2003 (16.21%) and 2009 (20.01%).

TABLE 5					
INTEREST CALCULATIONS OF FRIENDS INVESTMENTS					
IMPUTED INTEREST RATE METHOD					
2001 THROUGH 2012					
Calendar Year	Beginning Balance	Deposit/ (Withdrawal)	Net Investment Return	Ending Balance	Imputed Annual Rate of Return
2001	\$0	\$1,482,374	(\$8,435)	\$1,473,939	(1.13%)
2002	1,473,939	(84,623)	188,937	1,578,253	13.23%
2003	1,578,253	1,410,210	365,947	3,354,410	16.21%
2004	3,354,410	581,023	369,959	4,305,392	10.16%
2005	4,305,392	500,543	262,423	5,068,358	5.78%
2006	5,068,358	-	571,257	5,639,616	11.30%
2007	5,639,616	86,730	616,761	6,343,107	10.89%
2008	6,343,107	654,198	(1,799,765)	5,198,260	(26.87%)
2009	5,198,260	157,088	1,052,160	6,407,508	20.01%
2010	6,407,508	(159,130)	602,252	6,850,630	9.54%
2011	6,850,630	(1,553)	(8,492)	6,840,585	(0.12%)
2012	6,840,585	(300,000)	122,088	7,262,673	10.79%
Average					5.51%
Source: Friends annual audited financial statements					
* = 2012 amounts based on year-end investment statements and accounting records					

CONCLUSION

The Friends invested funds received from various sources, including transfers from the Commission. The Friends' investment portfolio had positive returns for most of the 12-year period with a computed average annual interest rate of 7.81% or an imputed annualized geometric return rate of 5.51% over the period.

¹² Annualized geometric rate of return computed using Excel "XIRR" function

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

RECOMMENDATION

Because a significant portion of the invested funds derived from transfers from the Commission, the Friends should share summary information regarding its investments to the Commission annually. In addition, the Friends should implement a system to separately account for and track any state funds received and invested.

3. HOW DID THE FRIENDS SPEND FUNDS RECEIVED FROM THE ROANOKE ISLAND COMMISSION OR OTHER STATE ENTITIES?

A review of the Friends’ audited financial statements indicated the expenditures of funds are classified into two categories: program services and supporting services. The financial statements sub-divided **program services** among the Museum Store, the Elizabeth II Support, Roanoke Island Festival Park Support, Housing, and Events. As such, the Friends operated the Museum Store, organized and directed special events on the Park grounds, managed the dormitory used by performers participating in summer performance programs, and supported the general needs of the Park. The Friends general administration and fund-raising comprised the **supporting services** expenses.

Table 6 shows the **program services** expenses during the period reviewed. Museum Store operations made up the largest expense category.

Year	Museum Store Expenditures	Elizabeth II Support	Roanoke Island Festival Park Support	Housing Expenditures	Event Expenditures	Total
1998	\$253,398	\$7,154	\$2,774	-	\$61,252	\$324,578
1999	242,106	171,210	10,369	\$39,523	26,716	489,924
2000	238,685	246,465	8,532	65,531	36,634	595,577
2001	251,518	9,274	21,250	59,570	53,814	395,426
2002	262,216	21,380	23,264	54,321	76,190	437,371
2003	277,457	6,233	35,195	59,528	76,853	455,266
2004	259,147	91,762	110,521	60,967	59,107	581,504
2005	226,485	130,042	39,849	64,211	40,179	500,766
2006	286,233	18,083	108,037	57,740	62,018	532,111
2007	307,995	5,872	56,710	56,209	93,079	519,865
2008	307,415	3,310	101,255	62,633	109,110	583,723
2009	229,409	10,773	341,590 ¹³	54,080	105,602	741,454
2010	255,429	-	89,066	68,525	-	413,020
2011	147,280	-	20,423	113,914	-	281,617
Total	\$3,544,773	\$721,558	\$968,835	\$816,752	\$800,284	\$6,852,202

Source: Friends audited financial statements
* = 2012 amounts not available

Table 7 depicts the **supporting services** expenditures during the period reviewed. Currently, supporting services expenses include professional fees for a full-time

¹³ Total includes \$125,000 paid to Town of Manteo to assist with purchase of “the Davis Lot.”

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

Director who oversees the operations and bookkeeping for the Friends, board support, and advertising. Prior to 2006, Commission staff provided administrative support (through the Operations Manager’s dual roles) to the Friends at no cost. After the administrative support was discontinued at the direction of Cultural Resources, the Friends administrative expenditures increased accordingly.

Year	General Administration	Fund Raising	Total
1998	\$4,146	\$1,642	\$5,788
1999	5,107	9,653	14,760
2000	6,505	7,650	14,155
2001	10,964	6,275	17,239
2002	8,956	6,173	15,129
2003	11,582	6,504	18,086
2004	5,713	4,766	10,479
2005	5,180	13,482	18,662
2006	22,177	13,144	35,321
2007	33,984	12,450	46,434
2008	33,532	11,080	44,612
2009	42,625	3,823	46,448
2010	29,023	-	29,023
2011	45,768	-	45,768
Totals	\$265,262	\$96,642	\$361,904

Source: Friends audited financial statements
 * = 2012 amounts not available

According to the audited financial statements, the Friends also spent \$1,116,387 for capital improvements that included renovating the Museum Store, critical restoration and maintenance of the Elizabeth II, construction of the Freedmen’s exhibit, interpretive signage, construction of costume workroom, and installation of a sidewalk and crossing lane for school bus tours.

The audited financial statements indicated that the Friends spent \$1,535,446 to buy the land and construct dormitories for student actors from the North Carolina School of the Arts. These dorms were completed in 1999 and remain in operation. The Friends are responsible for the daily management and maintenance of the dorm for use by performers, visiting artists, and scientists studying in the area.

The Friends’ financial statements are audited by independent, certified public accountants that must follow required auditing standards including determining whether funds from state entities were spent in accordance with the law. Our review of the audited financial statements revealed no reported instances of non-compliance with state regulations regarding expenditures of state funds.

CONCLUSION

From January 1, 1998 through December 31, 2011, the Friends spent \$6,852,202 for program services and \$361,904 for supporting services. In addition, the Friends spent \$1.12 million on capital projects and \$1.54 million for dormitory construction. In total, the Friends spent \$9,865,939 in support of the Commission and its associated entities during that period.

RECOMMENDATION

The Friends should continue to support Roanoke Island Festival Park as prescribed by law and to carry out its stated mission from the articles of incorporation and by-laws. The Friends should also account separately for any state funds received to enable monitoring of state funds received, spent, and remaining. For any future transfers to nonprofits of a similar nature, the General Assembly should clarify reporting requirements when the funds are appropriated.

4. WERE THE FUNDS USED FOR PURPOSES FOR WHICH THEY WERE TRANSFERRED?

As detailed in Finding 1, the Friends received \$5.34 million in operating funds transfers and \$1.21 million designated for capital improvements from the Commission.¹⁴ The Friends spent these funds in accordance with its articles of incorporation and by-laws, instructions from the Commission, and the General Statutes.

According to its articles of incorporation, the Friends' original purpose focused on the construction and operation of a replica of a 16th Century sailing vessel to exhibit and display for educational, cultural, and historical purposes. The Friends amended its articles of incorporation on May 19, 2000, to expand its focus to act "as the non-profit arm of the Roanoke Island Commission," acquiring property or real estate, and operating "a museum shop and other concessions on behalf of" the Commission. The organization's by-laws list the same purposes. Our review of audited financial statements and meeting minutes confirmed that the spending of transferred funds was in accordance with these purposes as outlined in the articles of incorporation and by-laws.

The current Friends Chair said the funds were transferred to the Friends for support of the Park "with no strings attached." However, the Friends understood that legislation required that transferred funds must be used "to carry out the purposes of this Part" such as operating and administering the historic sites and properties at the Park.

The current Friends Chair added that the Friends had never denied any funding request from the Commission.¹⁵ The Commission Operations Manager (who was concurrently the Friends Operations Manager for several years) confirmed that no additional restrictions were placed on the transfers. The Operations Manager said the

¹⁴ As shown in Table 1, the Friends also received \$1.55 million in direct appropriations passing through Cultural Resources and a \$175,000 loan from the Commission.

¹⁵ On September 12, 2012, the Friends responded to a request for \$596,759 by stating that only \$296,759 was available due to the economic downturn.

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

Friends' goal was to use the transfers to "build a nest egg" so the Park could be self-sufficient in the future. The Friends also recognized the need to spend some transferred funds for program costs, especially for areas that state funds did not cover. However, the Operations Manager said transferred funds were not accounted for separately. She said capital projects funds were the only funds treated differently; those funds were maintained in restricted accounts.

N.C.G.S. §143B-131.2(b)(10) specified that the Friends "shall use the funds transferred to carry out the purposes of this Part." Those statutes outlined the purpose, powers, and duties of the Commission. Specifically, the Commission was created to "protect, preserve, develop, and interpret the historical and cultural assets of Roanoke Island." Further, the Commission's purpose included operating and administering the Elizabeth II and its associated historic site. Based upon our review of audited financial statements and meeting minutes, the Friends spent funds for the purposes specified by these laws.

Was the Davis Lot purchase allowable?

In 2007, the Town of Manteo agreed to purchase a piece of undeveloped land (known as the "Davis Lot"). Previously, the Commission identified the Davis Lot for purchase in its long-term plan adopted in 2001. On November 8, 2001, the Park's former Executive Director sent a letter to two members of the Davis family regarding the property which faces Queen Elizabeth Avenue (the main waterfront street) in Manteo and provides a clear sightline of the Elizabeth II. The former Executive Director informed the Davis family that, if they ever considered selling the property, the Commission wanted the "first right of refusal" to purchase the property.

The family chose not to sell the property until 2007. On April 25, 2007, the Friends passed a motion to provide purchase assistance. At the Commission's Maritime History Committee meeting on April 26, 2007, the Commission was informed of the Friends' support of assisting with the purchase of the property. However, the Town determined that purchasing one-half of the property itself at that time would be the best option. On May 10, 2007, the Town purchased one-half of the property from the Davis family for \$350,000.¹⁶

The other portion of the property was not available for purchase until 2009. At that time, Town officials contacted the Friends board to inquire whether the Friends would provide financial assistance to the Town to purchase the remainder of the property. A Friends letter to the Town on April 9, 2009, outlined the Friends' agreement to provide \$125,000 toward the purchase. The Town originally requested the Friends commit \$175,000 to the project, but the Friends board believed that amount would be paying too much for the property based on an updated appraisal dated January 8, 2009 that indicated a current fair market value of \$450,000. The

¹⁶ At a Town board meeting on June 3, 2009, the Town's attorney said that the original appraised value was \$700,000.

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

Friends board Chair told us that the Friends provided \$125,000 for the purchase of the Davis Lot at the request of the Commission.

Prior to providing the funding, the Friends requested that certain conditions be met including that the property receive a “Permanent Conservation Easement” to ensure the clear sightline to the Elizabeth II. On June 19, 2009, the final parcel of the Davis Lot was purchased by the Town for \$350,000, the same price the Town paid for the first parcel in 2007. To assist with the purchase, the Town also received financial assistance from the Dare County Tourism Bureau. According to Dare County tax records, the last tax value listed for the Davis Lot was \$601,900 as of the last appraisal in March 2011.

Our review determined that the Commission, the Friends, and the Town worked collaboratively to purchase the property. Given that the Commission actually contacted the Davis family in reference to purchasing the lot in 2001, the property had been identified as important to the mission of the Commission. The Friends’ Articles of Incorporation note that part of their purpose is “(g) to publish, *acquire* [emphasis added], dispose of and rent property or real estate and any other materials and equipment to enhance its goals.” The purchase of this property by the Town with assistance from the Friends met the purpose and goals of both the Commission and the Friends.

CONCLUSION

The Friends used the funds transferred from the Commission for the purposes identified. Further, we did not identify any Friends expenditures that did not comply with its articles of incorporation and by-laws, guidance from the Commission, and the General Statutes.

RECOMMENDATION

The Friends should continue to spend state funds in accordance with laws and regulations. The Friends should account separately for any state funds received to enable monitoring of state funds received, spent, and remaining. For any future transfers to similarly situated nonprofit organizations, the General Assembly should specify how the funds should be used.

5. WERE THE FUNDS PROPERLY TRANSFERRED BY STATE ENTITIES TO THE FRIENDS IN ACCORDANCE WITH THE LAW?

Permissibility of Transfers

In 1998, the General Assembly made changes to the General Statutes that govern the Commission’s operations. Senate Bill 1366 of the 1998 Session rewrote N.C.G.S. §143B-131.2(b)(10) to read, “...Funds appropriated to the Commission may be transferred to the Friends of Elizabeth II, Inc., a private, nonprofit corporation. The

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

Friends of Elizabeth II, Inc., shall use the funds transferred to it to carry out the purposes of this Part.” The amended law clearly allowed transfers to the Friends of any state-appropriated funds.

On June 2, 1999, the Commission’s Executive Committee voted to transfer \$832,400 from the operating fund to the Friends. On June 7, 1999, a former Roanoke Island Festival Park Executive Director sent a letter to Cultural Resources to request the funds transfer. Between June 1999 and June 2008, the Commission transferred \$5.34 million in general appropriations and another \$1.21 million in funds restricted for capital improvements to the Friends. The General Assembly stopped the funds transfers in July 2011 through legislation that prohibited any future transfers.

Although the first transfer of funds associated with this legislation occurred in June 1999, accounting records revealed the Commission provided funds to the Friends in April 1998 as well. The Commission loaned the Friends \$175,000 to purchase merchandise for the Museum Store¹⁷ and passed through a direct appropriation of \$50,000 to renovate the Museum Store. The Commission passed through another direct appropriation of \$1.5 million in November 1998 to construct dorms.

A review of Commission meeting minutes confirmed that the Commission’s Executive Committee voted in June 1999 to approve the first transfer of funds. On October 19, 2000, the full Commission voted to transfer \$881,479.65 to the Friends. On January 25, 2001, the Executive Committee voted to transfer \$494,059.94 to the Friends for capital projects.

Because Commission members believed that future transfers of funds would be a recurring activity, the Commission Treasurer made a motion at the April 20, 2001, meeting to grant authorization to the Roanoke Island Festival Park Finance Officer to “routinely request in July of each year” that the Commission transfer 80% of the prior year’s earned interest to the Friends. The motion required that the transfers would “be regularly reported to the Commission and the Friends.” Further, the motion limited the expenditure of these funds to the purposes outlined in the General Statutes. The motion passed as confirmed by the Commission meeting minutes. The Treasurer told us that she believed that only appropriated funds could be transferred. Therefore, the Treasurer thought the April 2001 motion specifically applied only to surplus appropriated funds instead of only the earned interest as indicated in the minutes. Despite the confusion regarding the intent of the April 2001 motion, the motion was unnecessary because legislation gave the Commission the authority to transfer appropriated funds without specific approval of each transfer.

The Commission Operations Manager said she prepared the Treasurer’s reports to the Commission, which included the transferred amounts “most of the time.” She admitted that information was not always included in the Treasurer’s reports based on the preferences of a given Treasurer. In addition, the Operations Manager said all

¹⁷ The balance of the \$175,000 loan was repaid on June 29, 2004.

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

transfers were performed with the knowledge of the Park Executive Director, the Commission Chair, Cultural Resources accounting staff, and Office of State Budget and Management (State Budget). She recalled the Cultural Resources accounting staff saying that State Budget approval was required prior to the check being written to the Friends.

The Treasurer also said that, during the Commission Finance Committee meeting following any transfer, the Roanoke Island Festival Park Finance Officer informed the Finance Committee of the amount transferred. Then, the Finance Officer or the Treasurer would provide that information to the full Commission at the next full board meeting. The Commission meeting minutes were inconclusive as to whether the full Commission was always informed of the amount of funds transferred to the Friends. Documentation reviewed indicated that the transfers sometimes were reported at Commission meetings, sometimes at committee meetings, sometimes through memos to various staff, and sometimes through e-mails to staff.

Transfers of Endowment Funds

When establishing the Commission, the General Assembly created two separate accounts from which the Commission and Roanoke Island Festival Park would operate. The Roanoke Island Commission Fund, consisting of 75% of the revenue generated from ticket sales, funded the daily operations. Similarly, the Roanoke Island Commission Endowment Fund consisted of 25% of the revenue generated from ticket sales. Legislation provided additional guidelines for the Endowment Fund. After July 1, 2000, 80% of the interest generated by the principal of the Endowment Fund could be used for operations or capital expenditures if deemed necessary by the Commission.¹⁸

However, the legislation¹⁹ that permitted the transfer of allocated funds from the Commission to the Friends did not address the Endowment Fund as it specifically noted “funds appropriated to the Commission.” The Endowment Fund did not contain any funds appropriated to the Commission. On July 24, 2011, the Secretary of Cultural Resources requested that the Attorney General advise whether the Commission “may transfer to the Friends of Elizabeth II, Inc.: 1) the balance of the Roanoke Island Commission Fund carried over from the 2010-11 fiscal year; and 2) the accumulated interest in the Roanoke Island Endowment Fund pursuant to the recent statutory amendments.” On August 8, 2011, an Assistant Attorney General issued an “advisory letter,” which stated that statutory changes prohibited the future transfer of appropriated funds to the Friends. In addition, the Assistant Attorney General’s letter stated that “interest in the RIC Endowment Fund may not be transferred to the Friends...because there is no statutory authority to do so.”

¹⁸ N.C.G.S. §143B-131.8(b) (House Bill 230, 1995 Session)

¹⁹ N.C.G.S. §143B-131.2(b)(10) (Senate Bill 1366, 1997 Session)

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

At the Friends' request, the Internal Auditor and the Chief Financial Officer for Cultural Resources researched all transfers between the Commission and the Friends. Records obtained from the North Carolina Accounting System revealed two transfers from the Endowment account. On October 4, 2001, the Commission issued two checks to the Friends (\$100,478.59 and \$99,998.30, for a total of \$200,476.89) from the Endowment account. On August 1, 2003, the Commission transferred \$52,059.20 of Endowment funds to the Friends. At the time these transfers occurred, no one questioned the authority to transfer the funds because the legislation allowed for 80% of the interest earned in the Endowment account to be used for operations. In total, the Commission transferred \$252,536.09 of Endowment funds to the Friends.

After Cultural Resources staff provided this information, the Commission and the Friends began discussions to resolve the situation. The board chairs of both entities realized that transfers of interest earned in the Endowment account had occurred and both agreed that the matter should be resolved. On April 23, 2012, the Friends presented a check for \$252,536.09 to the Commission to correct the erroneous transfers that occurred during 2001 and 2003.

CONCLUSION

Pursuant to N.C.G.S. §143B-131.2(b)(10) (Senate Bill 1366, 1997 Session) passed in 1998, the Commission had full authority to transfer appropriated funds to the Friends. As such, the majority of funds were properly transferred in accordance with the law which did not require formal Commission approval before each transfer.

However, two transfers from the Roanoke Island Endowment Fund to the Friends in 2001 and 2003 were not properly transferred. Legislation permitted only appropriated funds to be transferred. As a result, the Friends returned \$252,536.09 to the Commission in April 2012 to rectify those errors.

RECOMMENDATION

The Commission should establish policies and procedures that outline methods for handling funds provided to and/or received from the Friends and any other nonprofit entity.

6. WAS THE USE OF FUNDS PROPERLY REPORTED IN ACCORDANCE WITH THE LAW?

As shown in Table 1, the Friends received transfers of surplus operating funds from the Commission, restricted transfers for capital projects from the Commission, direct appropriations flowing through the Commission, a loan from the Commission, and a grant from DENR. The Friends reported state funds received from the Commission as "Government contributions (grants)" on their annual IRS Form 990 "Return of Organization Exempt From Income Tax." Because that federal tax form used the

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

word “grants” in its description, some board members and citizens believed that the Friends were intentionally mischaracterizing the transfers. In addition, the audited financial statements classified the funds received from the Commission as “grants.” When the funds transfers began, Cultural Resources/the Commission and the Friends did not consider the transactions “grants.” However, the Cultural Resources Internal Auditor concluded in January 2012 that the transfers should be classified as grants. Regardless of whether the funds transfers should be characterized as “grants,” state funds provided to a nonprofit entity had specific reporting requirements.

Reporting Requirements

Until 2005, N.C.G.S. §143-6.1 required that any private organization receiving, using, or expending state funds of \$15,000 or more had to file specified documents regarding the use of funds. Organizations receiving between \$15,000 and \$300,000 should have filed “annually with the State Auditor and the state agency that disbursed the funds a sworn accounting of receipts and expenditures and a description of activities and accomplishments”²⁰ with the state funds. If the organization received, used, or spent more than \$300,000, the organization should have also filed an audited financial statement with the Office of the State Auditor.

On July 1, 2005, the North Carolina Administrative Code was amended to adjust the funding levels at which the reporting requirements change. Title 09 NCAC 03M.0205 established three thresholds with varying reporting requirements: (1) less than \$25,000; (2) \$25,000 to \$500,000; and (3) greater than \$500,000. Depending on the funding level, the reporting requirements ranged from signing a statement certifying the funds were spent in accordance with a grant contract to submitting a financial statement audit completed by an independent, licensed Certified Public Accountant. The North Carolina General Statutes were also amended to reflect the increased responsibility placed on the grantees and grantors of state funds. The 2005 requirements became more restrictive due to another legislative revision on July 1, 2007. To comply with the revised law, the Office of the State Auditor²¹ created new reporting forms and a new electronic reporting database [the Grants Information Center (GIC)]. A review of the GIC revealed that the Friends did not report any grant funds received. In addition, neither Cultural Resources nor the Commission entered information into GIC that would have required the Friends to file reports electronically.

Discussions regarding Reporting Requirements

In an e-mail dated June 23, 2005, between a Cultural Resources staff member and the Operations Manager for the Park, the possibility of handling the transfers as a “grant” was first acknowledged. The staff member indicated the need to contact State Budget or the Office of the State Controller to determine how to properly record the fund transfers.

²⁰ N.C.G.S. §143-6.1(c)

²¹ Responsibility for monitoring the grants database was transferred from the Office of the State Auditor to the Office of State Budget and Management effective July 1, 2009.

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

The issue remained unresolved until July 2007 when a representative from the President Pro Tempore's office e-mailed the Park's Executive Director to notify him that State Budget indicated that a contract between the Friends and the Commission was not necessary. Instead, she informed the Executive Director that the Friends would be subject to reporting requirements for nonprofits receiving state funds. The e-mail exchange indicated changes occurred "because the legislature tightened up reporting requirements for nonprofits last year or two years ago."

In a follow-up email dated July 18, 2007, the Executive Director asked if State Budget considered transfers from the Commission to the Friends a "grant." The President Pro Tempore's representative responded that State Budget "did not call it a grant specifically – he just said that anytime a nonprofit receives state funds they must report it – this is consistent with our statutes."

Conversations later took place between State Auditor staff and Cultural Resources staff. As a result of these conversations, Cultural Resources informed the Friends they would need to report on any recent transfer of funds from the Commission. In 2008, the Friends were instructed to report on the "transferred" funds in 2007 and 2008.

On January 11, 2012, the Cultural Resources Internal Auditor sent a memorandum ("Follow-up to the Review of Transfers to Friends of Elizabeth II") to the Cultural Resources Secretary acknowledging the use of the term "transfer" when referring to any funds that were conveyed from the Commission to the Friends. The Internal Auditor concluded that Cultural Resources "did not require the Friends to follow state grant rules" as a result. However, the Internal Auditor wrote "we have subsequently determined that the transfers...were funds granted by the State and should comply with state grant requirements." The memorandum stated that State Budget "confirmed" that the transfers should be considered grants. Therefore, the Internal Auditor recommended that the Friends "immediately determine the remaining balance for each year going back to fiscal year 2008" and enter into two separate grant agreements: one for the capital improvement funds and another for general funds transferred. Finally, the memo recommended that the Friends "submit the required annual reports through the North Carolina Grants System" for fiscal years 2008 forward. (The Friends had already filed the "State Grants Compliance Reporting: Receipt of \$25,000 or more" with the Office of the State Auditor as required on March 7, 2009.)

The Commission's Operations Manager said the Friends' Certified Public Accountant did not consider the transfers "a grant" despite their classification as "grants" in the audited financial statements. In a letter dated February 17, 2012, the Friends attorney wrote Cultural Resources to dispute that the transfers should be considered grants. The attorney noted that these transfers "were not 'grants' and cannot be retroactively characterized as such."

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

Reports Filed

Until 2007, the transfers were not considered grants and the Friends had not been formally told to report on state funds received from the Commission. Therefore, the Friends did not file reports regarding funds transferred from the Commission from 1998 through 2006. Nevertheless, the Friends received an annual financial statement audit as required at the highest threshold for receiving state funds. Based on our review of available documentation, the Friends submitted these audited financial statements to the Office of the State Auditor as required. Beginning in 2004, the Friends prepared a "Program Activities and Accomplishments Report" to comply with N.C.G.S. § 143-6.1 regarding reporting on the use of state funds by non-state entities. This report was filed annually with the Office of the State Auditor to cover all funds received from January 1, 2004, through December 31, 2008.

During 2007, discussions between Cultural Resources, State Budget, the Senate Pro Tempore's staff, and the Office of the State Auditor determined that state funds received by the Friends were subject to reporting requirements. As such, the Friends submitted the "State Grants Compliance Reporting: Receipt of \$25,000 or more" for calendar years 2007 and 2008. The Friends reported that, during the 2007 and 2008 calendar years, they expended all funds received from the Commission during those years. The detail of those expenditures was captured in the annual financial statement audit the Friends continued to provide to the Office of the State Auditor as required by N.C.G.S. § 143C-6-23.

Further, the Friends submitted a certification of funds use statement on August 27, 2009, for calendar year 2008. Although no certification of funds use was located for 2007, the Cultural Resources former Chief Financial Officer said in an e-mail on February 4, 2009, that, after discussions with Office of the State Auditor staff, "we are now up to date with all Friends of Elizabeth II reporting requirements."

The Friends have not received any additional funding from the Commission since June 2008. However, the Friends received a grant from DENR in 2010. The Friends properly recorded that grant in the GIC as required.

CONCLUSION

For state funds received from 1998 through 2004, the Friends should have filed with the State Auditor a sworn accounting of receipts and expenditures, a description of activities and accomplishments, and audited financial statements. The Friends properly filed the audited financial statements for all years and the activities and accomplishments report for 2004. However, the Friends did not file a sworn accounting of receipts and expenditures during that period and did not file an activities and accomplishments report from 1998 through 2003.

For state funds received during 2005 and 2006, the Friends should have filed the sworn accounting of receipts and expenditures, a description of activities and

REPLIES TO LEGISLATIVE INQUIRIES (CONTINUED)

accomplishments, and an audited financial statement. The Friends properly filed the audited financial statements and activities and accomplishments reports. However, the Friends did not file a sworn accounting of receipts and expenditures.

For state funds received during 2007 and 2008, the Friends should have filed the sworn accounting of receipts and expenditures and a description of activities and accomplishments. The Friends filed those documents in addition to audited financial statements which were not required.

Finally, the Friends completed the necessary reporting requirements in the Grants Information Center database maintained by State Budget regarding the grant received from DENR in 2010.

See Appendix A for a graphic presentation of the reporting requirements and the reports filed by the Friends during this period.

RECOMMENDATION

Cultural Resources should continue to monitor all state funds provided to non-state entities to ensure that grantees properly provide reports as required by law. The General Assembly should clarify the reporting requirements for all state funds provided to nonprofits for which there are state appropriations without a grant agreement. State Budget and the grantor agencies should specify rules related to reporting requirements for these situations.

7. WERE THERE MEMORANDUMS OF AGREEMENT OR SIMILAR ARRANGEMENTS BETWEEN THE COMMISSION AND FRIENDS?

The current Friends Director said there are no “active” memorandums of agreement between the Friends and the Commission. She believed that the last memorandum of agreement (drafted in 2002) was not signed by both parties. In addition, the Director thought the last signed memorandum of agreement was completed in 1998 but had long expired.

According to the 1998 audited financial statements, “a new memorandum of understanding was drafted” between the Friends and the Commission. Under that agreement, the Friends operated the Museum Store until December 31, 2002. The agreement stipulated that the Friends restrict 25% of the Museum Store profit for use by the Commission. However, the Commission waived the 25% restriction for 1998 until the Friends repaid the \$175,000 loan.²²

According to the notes to the audited financial statements for 2003 through 2009, the 1998 “agreement” was updated and approved on December 31, 2002. The new

²² The balance of the loan was paid in full on June 29, 2004.

REPLIES TO LEGISLATIVE INQUIRIES (CONCLUDED)

agreement did not require payment for the use of the operating facility and extended the Friends operation of the Museum Store through December 31, 2006. As a result of this agreement, a \$30,000 non-cash contribution and expense was recorded to represent the fair value of rent. The unsigned agreement expired and was never renewed.

The Commission Operations Manager did not have copies of any memorandums of agreement. She recalled that the first memorandum of agreement was signed but that later versions were not signed. The Friends' audited financial statements for 2011 noted that "there is currently no memorandum of understanding in place between the two entities."

CONCLUSION

Currently, the Friends and the Commission are operating without a signed memorandum of agreement that specifies each entity's role regarding operation of the Museum Store and organization and management of events taking place at the Park. Our review revealed that the last signed and approved memorandum of agreement covered the period 1998 through 2002.

RECOMMENDATION

The Friends and the Commission should adopt a new memorandum of agreement. The memorandum of agreement should outline the roles of each organization regarding the operation, management, and funding of all facilities, programs, and activities occurring at Roanoke Island Festival Park. In addition, the agreement should specify which operations should be directed by Commission/state employees and which should be handled by Friends staff or volunteers. Finally, the memorandum of agreement should describe the process for handling receipts from Museum Store operations and events held at the Park as well as how funds should be requested by the Commission and provided by the Friends for the management, operation, and maintenance of all properties and activities at the Park.

APPENDIX

STATE FUNDS RECEIVED REPORTING REQUIREMENTS 1998 THROUGH 2012										
Year	Amount Received	Audited Financial Statement			Sworn Accounting of Receipts and Expenditures			Description of Activities and Accomplishments		
		Required?	Filed?	Met Requirement?	Required?	Filed?	Met Requirement?	Required?	Filed?	Met Requirement?
1998	\$1,725,000	Yes	Yes	Yes	Yes	No	No	Yes	No	No
1999	1,232,400	Yes	Yes	Yes	Yes	No	No	Yes	No	No
2000	881,180	Yes	Yes	Yes	Yes	No	No	Yes	No	No
2001	1,293,985	Yes	Yes	Yes	Yes	No	No	Yes	No	No
2002	446,541	Yes	Yes	Yes	Yes	No	No	Yes	No	No
2003	420,122	Yes	Yes	Yes	Yes	No	No	Yes	No	No
2004	839,203	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes
2005	500,543	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes
2006	416,000	Yes	Yes	Yes	Yes	No	No	Yes	Yes	Yes
2007	238,912	No	Yes	N/A	Yes	Yes	Yes	Yes	Yes	Yes
2008	292,322	No	Yes	N/A	Yes	Yes	Yes	Yes	Yes	Yes
2009	-	No	Yes	N/A	No	No	N/A	No	N/A	N/A
2010	27,470	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
2011	-	No	Yes	N/A	No	No	N/A	No	N/A	N/A
2012	-	No	Yes	N/A	No	No	N/A	No	N/A	N/A

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

Governor Pat McCrory

Secretary Susan Kluttz

March 19, 2013

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Dear Ms. Wood:

The Department of Cultural Resources (Department) appreciates the State Auditor's special review report regarding funds received by the Friends of Elizabeth II, Inc. from the Roanoke Island Commission or any other state entity. Going forward, the current administration will use this review to address organizational structure and authority over Roanoke Island Commission. The Department encourages the Friends and Commission to implement the State Auditors' recommendations. The Department would like to highlight certain recommendations from the report and expound upon a few items.

The Department seeks a change in legislation to clarify its oversight authority over the Roanoke Island Commission. As stated in the special review report, "Pursuant to N.C.G.S. §143B-131.2(b)(10) (Senate Bill 1366, 1997 Session) passed in 1998, the Commission had full authority to transfer appropriated funds to the Friends." The Department made recommendations in January 2012 for the Friends to follow state grant reporting requirements to account for the funds; however, the Friends responded with an attorney letter stating that "funds received from the Roanoke Island Commission were not funds received from the Department of Cultural Resources..." The chair of the Friends also stated that, "Our [the Friends] sole financial relationship is with the Roanoke Island Commission." Furthermore, the Attorney General's Office communicated to the Department in March of 2012 that the responsibility for the funds transferred from the Roanoke Island Commission to the Friends of Elizabeth II, Inc. lies with the Commission.

As identified in the special review report, by 2007 the Friends had been informed to follow state grant reporting requirements by multiple state entities. If the Friends had followed these requirements and properly completed and submitted the *State Grants Compliance Reporting Receipt of Greater than \$25,000 Report*, some of the concerns could have been addressed. For example, the unexpended balance of the funds would have been reported each year. However, this did not happen. The Internal Auditor and CFO (both newly hired) made recommendations in January 2012 for the Friends to determine the remaining balance of funds and follow state reporting requirements for non-state entities receiving state funds.

MAILING ADDRESS:
4601 Mail Service Center
Raleigh, NC 27699-4601

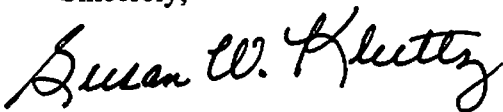
Telephone: (919) 807-7250
Fax: (919) 733-1564

LOCATION:
109 East Jones Street
Raleigh, NC

The Department would like to emphasize report recommendation 6, where the auditors recommend the General Assembly clarify the state reporting requirements for all state funds provided to non-profits. The 2009-02 PED report titled *Accountability Gaps Limit State Oversight of \$694 Million in Grants to Non-Profit Organizations* made specific recommendations for action by the General Assembly to improve grant oversight for non-profit organizations. The PED report finds that “statewide reporting requirements do not require sufficient documentation, do not adequately address program performance outcomes, fail to produce timely reporting, and lack sufficient enforcement.”

Thank you for allowing the Department to respond. We greatly value the role the Friends play in preserving Roanoke Island Festival Park for the State of North Carolina. We look forward to future discussions to define roles and responsibilities going forward to promote efficient and effective use of the property.

Sincerely,

A handwritten signature in cursive script that reads "Susan W. Kluttz".

Susan Kluttz, Secretary



Roanoke Island Commission

North Carolina Department of Cultural Resources

The mission of the Roanoke Island Commission is to involve residents and visitors of all ages in a creative and stimulating exploration of Roanoke Island's historical, cultural and natural resources

Pat McCrory, Governor
Susan W. Kluttz, Secretary

Ellen S. Newbold, Chair
Kimberly A. Sawyer, Executive Director

March 15, 2013

The Honorable Beth A. Wood, State Auditor
Office of the State Auditor
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina, 27699-0601

Dear Ms. Wood:

The NC Department of Cultural Resources provided a copy of the Special Review report conducted by your office. We are providing responses to recommendations one, five and seven in this report.

1. Cultural Resources and the Commission should continue to maintain adequate documentation to support all financial transactions in accordance with records retention policies. Minutes of the Commission meetings should contain complete records of significant activities including major financial decisions and results. The Friends should also account separately for any state funds received to enable monitoring of state funds received, spent, and remaining.

RESPONSE:

The Commission agrees with the recommendation and corrective action has been taken. In October 2009, the Commission approved new bylaws which established a finance committee to oversee the budget of the Commission. All financial recommendations brought to the Commission are duly recorded in the minutes.

5. The Commission should establish policies and procedures that outline methods for handling funds provided to and/or received from the Friends and any other non profit entity.

ROANOKE ISLAND FESTIVAL PARK

One Festival Park • Manteo, North Carolina 27954 • (252) 475-1500 • FAX (252) 475-1507
<http://www.roanokeisland.com>

RESPONSE:

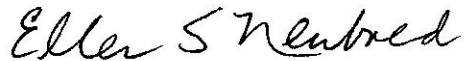
The Commission agrees with the recommendation. In April 2012 the Roanoke Island Commission adopted a recommendation of the Finance Committee regarding a policy/procedure for funds requested from the Friends of Elizabeth II, Inc.

7. The Friends and Commission should adopt a new memorandum of agreement. The memorandum of agreement should outline the roles of each organization regarding the operation, management, and funding of all facilities, programs, and activities occurring at Roanoke Island Festival Park. In addition, the agreement should specify which operations should be directed by Commission/state employees and which should be handled by Friends staff or volunteers. Finally, the memorandum of agreement should describe the process for handling receipts from Museum Store operations and events held at the Park as well as how funds should be requested by the Commission and provided by the Friends for the management, operation, and maintenance of all properties and activities at the Park.

RESPONSE

The Commission agrees with the recommendation.

On behalf the Roanoke Island Commission I would like to thank the Office of the State Auditor and its staff for their efforts in compiling this report.



Ellen Newbold, Chair
Roanoke Island Commission



PO Box 324 · Manteo, NC 27954 · Office: 252-473-3524 · Fax 252-473-2623 · friendse2@centurylink.net

To: NC Auditors Office
From: Friends of Elizabeth II, Inc.
Date: March 18, 2013
Re: Response to Special Review

The Friends of Elizabeth II, Inc. (Friends) supports the recommendations specified in the March 2013 Special Report of the Office of The State Auditor. The Friends Board of Directors will work with the Roanoke Island Commission and Roanoke Island Festival Park to implement the suggestions made in the report.

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ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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

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

Telephone: 919/807-7500

Facsimile: 919/807-7647

This special review required 902 hours at an approximate cost of \$64,944. The cost represents 0.78% of the total state funds received by the Friends of Elizabeth II, Inc. from 1998 through 2012.