

STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

NORTH CAROLINA RURAL REHABILITATION CORPORATION

RALEIGH, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2000

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT

NORTH CAROLINA RURAL REHABILITATION CORPORATION

RALEIGH, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2000

BOARD MEMBERS OF THE CORPORATION

WELDON B. DENNY, PRESIDENT

**JAMES O. BUCHANAN
CARMEN HOOKER BUELL
HERBERT L. CAMERON
ROBERT C. COCHRAN**

**ALEX M. LEWIS
LYCUROUS LOWRY
DR. JON F. ORT
WAYNE B. WALKER**

ADMINISTRATIVE OFFICERS

MAURICE WEAVER, SECRETARY-TREASURER



Ralph Campbell, Jr.
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
The Board Members, North Carolina Rural Rehabilitation
Corporation

This report presents the results of our financial statement audit of the North Carolina Rural Rehabilitation Corporation (the Corporation), a component unit of the State of North Carolina, for the year ended June 30, 2000. Our audit was made by authority of Article 5A of G.S. §147.

The accounts and operations of the Corporation are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report* (CAFR) and the State's *Single Audit Report*. In those reports the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the audit results on the State's internal controls and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs.

As part of the audit work necessary for the CAFR and the *Single Audit Report*, the accounts and operations of the Corporation were subject to audit procedures, as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to the Corporation. The audit procedures were conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is to present the results of our audit on the accompanying financial statements. A summary of our reporting objectives and audit results are:

- 1. Objective** - Express an opinion on the financial statements that relate solely to the Corporation.

Results - The financial statements present fairly the amounts and disclosures made in accordance with generally accepted accounting principles. These matters are described in the Independent Auditor's Report on the Financial Statements.

AUDITOR'S TRANSMITTAL (CONCLUDED)

2. **Objective** – Present instances of noncompliance, if any, with laws, regulations, contracts, or grants and present significant deficiencies, if any, in the internal control which could adversely affect the Corporation's ability to record, process, summarize, and report financial data in the financial statements.

Results – Our tests disclosed no instances of noncompliance and the following three instances of significant deficiencies in internal control which requires disclosure herein under *Government Auditing Standards*.

Findings:

1. Control Environment
2. Loan Process
3. Payroll Charges Inappropriate

These matters are described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting and the Audit Findings and Recommendations section of this report.

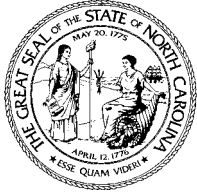
North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.



Ralph Campbell, Jr.
State Auditor

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Ralph Campbell, Jr.
State Auditor

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INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

The Board Members, North Carolina Rural Rehabilitation
Corporation

We have audited the accompanying Balance Sheet of the North Carolina Rural Rehabilitation Corporation (the Corporation), a component unit of the State of North Carolina, as of and for the year ended June 30, 2000 as listed in the table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Carolina Rural Rehabilitation Corporation as of June 30, 2000, and the results of its operations and the cash flows for the year then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 23, 2001 on our consideration of the North Carolina Rural Rehabilitation Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

A handwritten signature in black ink that reads "Ralph Campbell, Jr." in a cursive script.

Ralph Campbell, Jr.
State Auditor

April 23, 2001

***North Carolina Rural Rehabilitation Corporation
Balance Sheet
June 30, 2000***

Exhibit A

ASSETS

Cash and Cash Equivalents	\$ 3,489,271.76	
Interest Receivable	142,082.16	
Notes Receivable	5,123,224.25	
Fixed Assets - net of accumulated depreciation (Note 3)	<u>106,249.98</u>	
Total Assets		<u><u>\$ 8,860,828.15</u></u>

LIABILITIES AND FUND EQUITY

Liabilities:

Intergovernmental Payables	\$ 284,708.59	
Claims and Benefits Payable	16,113.72	
Deferred Revenue	<u>38,956.97</u>	
Total Liabilities		339,779.28

Fund Equity:

Contributed Capital	\$ 1,120,187.27	
Retained Earnings	<u>7,400,861.60</u>	
Total Fund Equity		<u><u>8,521,048.87</u></u>
Total Liabilities and Fund Equity		<u><u>\$ 8,860,828.15</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

North Carolina Rural Rehabilitation Corporation
Statement of Revenues, Expenses, and Changes in Fund Equity
Year Ended June 30, 2000

Exhibit B

Operating Revenues:		
Investment Earnings	\$ 38,442.59	
Interest Earnings on Loans	377,716.28	
Rental and Lease Earnings	14,440.00	
		<u>14,440.00</u>
Total Operating Revenues		\$ 430,598.87
Operating Expenses:		
Personal Services	\$ 32,145.50	
Employee Benefits	6,330.22	
Supplies and Materials	10.50	
Travel	3,206.66	
Other Services	956.60	
Depreciation/Amortization	4,166.67	
Insurance and Bonding	1,819.91	
Other Fixed Charges	100.00	
Other Expenditures	363.71	
		<u>363.71</u>
Total Operating Expenses		49,099.77
Operating Income		381,499.10
Nonoperating Expenses:		
Other Aids & Grants		<u>(27,400.00)</u>
Income Before Operating Transfer		354,099.10
Operating Transfers:		
Transfer from Primary Government	\$ 400,000.00	
Transfer to Primary Government	(8.01)	
		<u>(8.01)</u>
Total Operating Transfers In		399,991.99
Net Income		754,091.09
Fund Equity - July 1, 1999		<u>7,766,957.78</u>
Fund Equity - June 30, 2000		\$ 8,521,048.87

The accompanying notes to the financial statements are an integral part of this statement.

North Carolina Rural Rehabilitation Corporation
Statement of Cash Flows
Year Ended June 30, 2000

Exhibit C

Cash Provided From (Used For) Operations:	
Operating Income	\$ 381,499.10
Adjustments to reconcile operating income to net cash flows from operating activities:	
Depreciation/Amortization	4,166.67
Investment Earnings	(38,442.59)
Mortgage/Loan/Note Principal Repayments	1,094,480.00
Mortgage/Loans/Notes Issued	(796,472.14)
Changes in Assets and Liabilities:	
Decrease in Interest Receivable	6,757.09
Decrease in Accounts Payable	(204.00)
Increase in Intergovernmental Payables	7,497.38
Increase in Deferred Revenue	3,642.70
	<u>3,642.70</u>
Total Cash Provided From (Used For) Operations	\$ 662,924.21
Cash Provided From (Used For) Noncapital Financing Activities:	
Grants, Aid and Subsidies	\$ (27,400.00)
Operating Transfers In	400,000.00
Operating Transfers Out	(8.01)
	<u>(8.01)</u>
Total Cash Provided From (Used For) Noncapital Financing Activities	372,591.99
Cash Provided From (Used For) Investment Activities:	
Investment Earnings	42,989.71
	<u>42,989.71</u>
Net Increase in Cash and Cash Equivalents	\$ 1,078,505.91
Cash and Cash Equivalents at July 1, 1999	<u>2,410,765.85</u>
Cash and Cash Equivalents at June 30, 2000	<u><u>\$ 3,489,271.76</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

NORTH CAROLINA RURAL REHABILITATION CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2000

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Organization** - The North Carolina Rural Rehabilitation Corporation (the Corporation) was organized in 1934 by the North Carolina Emergency Relief Commission at the direction of the federal government primarily for the purpose of facilitating the legal and financial transactions involved in the rural rehabilitation program then being administered by the North Carolina Emergency Relief Administration for North Carolina farm families left destitute by the depression. At that time the federal government was handling the farm relief through grants of money to state agencies charged with responsibility for administering the program in the respective states. The Corporation was chartered by the State as a benevolent and non-profit corporation, and it was recognized and designated as a state agency by the 1935 General Assembly (Chapter 314, Public Laws of 1935).

All of the funds of the Corporation (other than earned income) were granted to the State of North Carolina by the federal government during 1934 and 1935, and earmarked for rural rehabilitation, under authority of the Federal Emergency Relief Act of 1933. The rural rehabilitation program was federalized under the Emergency Relief Appropriation Act of 1935 and the Corporation received no grants after May of that year.

During the 1936 and 1937 crop years the Corporation, in order not to overlap the federal program, made its funds available for subsistence and operating loans only to needy families unable to obtain aid from federal agencies or from any other source.

Because of duplication of effort and confusion among farm relief clients resulting from the operation of similar programs by the Corporation and the federal government, the Corporation in 1938 discontinued its program of farm loans for subsistence and operating expenses and transferred approximately \$1,000,000 of its assets to the federal government for use by the U.S. Department of Agriculture for rural rehabilitation in North Carolina under a trust management agreement. The federal government used the trust assets for farm operating loans and farm purchase and improvement loans in North Carolina.

At the time of the 1938 transfer to the federal government, the Corporation retained for its own use in rural rehabilitation the sum of \$360,000. In 1958 the government decided to terminate all existing State

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Corporation trust agreements and to return the trust assets to the respective states over a period of time under orderly liquidation procedures agreed to by the States. The North Carolina Corporation negotiated a liquidation agreement effective December 28, 1959, and the assets valued at \$770,183.27, were returned to the Corporation during the period of January 7, 1960 to January 25, 1965. By such an agreement, these funds are now being used for insured farm ownership loans serviced by Farm Services Administration of the U. S. Department of Agriculture.

In 1971 the State Government Reorganization Act, passed by the Legislature, transferred the Corporation to the North Carolina Department of Agriculture. Currently, the Corporation makes these funds available to North Carolina farmers for operating loans, farm purchases and improvement loans.

- B. Financial Reporting Entity** - The North Carolina Rural Rehabilitation Corporation is an integral part of the State's reporting entity and is included as a component unit in North Carolina's *Comprehensive Annual Financial Report* (CAFR). Component units are legally separate entities for which the State is financially accountable. Accountability is defined as the State's substantive appointment of a majority of the component unit's governing board. Furthermore, the State must be able to impose its will upon the component unit or there must be a possibility that the component unit may provide specific benefits to, or impose specific financial burdens on, the State.

As required by General Statute 137-31.3, the governing body of the North Carolina Rural Rehabilitation Corporation shall be a board of directors consisting of nine members, of whom the Commissioner of Agriculture, the Director of the Cooperative Agricultural Extension Service of North Carolina State University, the Secretary of Human Resources, and the North Carolina State Director of the Farmers Home Administration of the United States Department of Agriculture, or in the event of a change of name of any of said offices, the persons performing the principal duties of said offices, by whatever name called, shall be ex officio members, and the remaining five members shall be named by the Governor of North Carolina.

- C. Basis of Presentation** - The North Carolina Rural Rehabilitation Corporation is accounted for as a proprietary fund type (enterprise fund) in conformity with the accounting and reporting requirements of the Governmental Accounting Standards Board. The accompanying financial statements have been prepared in accordance with the accrual basis of accounting.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- D. Cash and Cash Equivalents** - This classification includes budget code cash on deposit with the State Treasurer as well as short-term investments with the State Treasurer's Cash and Investment Pool, (a governmental external investment pool).
- E. Notes/Loans Receivable** - The State operates the North Carolina Rural Rehabilitation Corporation (the Corporation) as a direct loan program, whereby loans made to borrowers and/or county boards of education are 100% state funds. Loans are disbursed from the Corporation for the purpose of farm ownership, refinancing debts, purchasing equipment, purchase of livestock, improving, equipping, and operating farms, as well as for the purpose of equipping vocational agricultural and home economics buildings. These loans are normally secured by a first lien on collateral. The loan committee determines the interest rate on the loans and the interest accrues from the original date that the loan is closed. Principal payments can be made either annually, quarterly, or monthly. The loans are repaid over a maximum of 20 years.
- F. Receivables and Allowance for Doubtful Accounts** - Notes/Loans Receivable in the Proprietary Fund is shown in the accompanying financial statements at book value with no provision for doubtful accounts considered necessary.
- G. Fixed Assets and Depreciation** - Fixed assets are stated at cost. The Corporation capitalizes fixed asset items with a cost equal to or greater than \$5,000 and a life in excess of one year. Depreciation is computed over the estimated useful life of the assets, using the straight-line method.
- I. Compensated Absences** - The Corporation's policy is to record the cost of vacation leave when earned. The policy provides for the maximum accumulation of unused vacation leave of 30 days which can be carried forward each January 1st or for which an employee can be paid upon termination of employment. Also, any accumulated vacation leave in excess of 30 days at December 31st is converted to sick leave. Under this policy, the accumulated vacation leave for each employee at June 30th equals the leave carried forward at the previous December 31st plus the leave earned, less the leave taken between January 1st and June 30th.

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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 2 - DEPOSITS

The Corporation deposits to the accounts of the State Treasurer. The cash on deposit with the State Treasurer is pooled with state agencies and similar institutions in short-term investments with the State Treasurer's Cash and Investment Pool. These moneys are invested in accordance with G.S. 147-69.1(c) and 147-69.2, and as required by law is "readily convertible into cash." All investments of the fund are held either by the Department of State Treasurer or its agent in the State's name. Information on the investments is more fully explained in the State of North Carolina's *Comprehensive Annual Financial Report*. At year-end, the carrying amount of cash on deposit was \$3,489,271.76 and the bank balance was \$3,489,271.76.

NOTE 3 - CHANGES IN FIXED ASSETS

A summary of changes in fixed assets for the year ended June 30, 2000 is presented below:

	<u>Balance</u> <u>July 1, 1999</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2000</u>
Buildings	<u>\$ 125,000.00</u>	<u>\$ 0.00</u>	<u>\$ 0.00</u>	<u>\$ 125,000.00</u>

A summary of fixed assets by classification at June 30, 2000 is presented below.

Buildings	\$ 125,000.00
Less: Accumulated depreciation	<u>(18,750.02)</u>
Total Fixed Assets	<u>\$ 106,249.98</u>

NOTE 4 - RETIREMENT PLANS

Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System of North Carolina. This plan is a cost-sharing multiple-employer defined benefit pension plan that is administered by the North Carolina State Treasurer. The plan was established by the State of North Carolina to provide pension benefits for employees of the State, its component units, and local boards of education not in the State's reporting entity.

Benefit and actuarially based contribution provisions are established by G.S. 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Additional detail information about the plan is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Employees contributed 6% of gross wages and the Corporation contributed 8.15% of covered payroll for the period July 1, 1999 through June 30, 2000.

NOTE 5 - OTHER POSTEMPLOYMENT BENEFITS

Health Care of Long-Term Disability Beneficiaries and Retirees – The Corporation participates in State administered programs that provide health care benefits to eligible former employees. The Corporation contributes 2% of covered payroll under the Teachers’ and State Employees’ Retirement System for health care benefits. The Corporation assumes no liability for these health care benefits provided by the programs other than its contribution.

Long-Term Disability - The Corporation participates in the Disability Income Plan of North Carolina (the Plan). The Plan provides disability income to eligible participants. Eligible participants are employees that are members of the Teachers’ and State Employees’ Retirement System. Additional detailed information about the Plan is disclosed in North Carolina’s *Comprehensive Annual Financial Report*. The Corporation contributed to the Plan .52% of the eligible payroll under the Teachers’ and State Employees’ Retirement System. For the fiscal year ended June 30, 2000, the Corporation’s total contribution to the Plan was \$141.16. The Corporation assumes no liability for long-term disability benefits under the Plan other than its contribution.

NOTE 6 - RISK MANAGEMENT AND INSURANCE

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

State Health Plan - The Comprehensive Major Medical Plan of North Carolina provides health care coverage to active and retired state employees. The Plan is funded by employer and employee contributions and is administered by a third party contractor. Additionally, health care coverage is optionally available through contractual agreements with several Health Maintenance Organizations.

Death Benefit Plan of North Carolina - Term life insurance (death benefits) is provided through the Death Benefit Plan to all members of the Teachers’ and State Employees’ Retirement System who have completed at least one full calendar year (12 consecutive months) of membership in the System. The Plan is administered by the North Carolina Department of State Treasurer and is

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

funded by employer contributions. The Plan provides term life insurance of \$25,000 to \$50,000 for eligible workers.

Disability Income Plan of North Carolina - Short-term and long-term disability benefits are provided to eligible members of the Teachers' and State Employees' Retirement System. Short-term benefits are payable after a waiting period of 60 continuous calendar days from the onset of disability. Long-term disability benefits are payable as an other postemployment benefit from the Disability Income Plan of North Carolina after the conclusion of the short-term disability period or after salary continuation payments cease, whichever is later, for as long as an employee is disabled. These benefits are established by Chapter 135, Article 6, of the General Statutes and may be amended only by the North Carolina General Assembly. The North Carolina Department of State Treasurer administers the Plan.

Fire and Other Property Loss - The Corporation is protected for losses from fire by the State Property Fire Insurance Fund administered by the North Carolina Department of Insurance. The State maintains the Property Fire Insurance Fund as a means of self-insurance against fire losses which may occur in State buildings. The fund insures State owned buildings and contents for fire losses, extended coverage, and other property losses. Coverage for fire losses is free for all operations that are supported by the State's General Fund. Those operations that are not supported by the State's General Fund are charged for fire coverage.

Employee and Computer Fraud - The Corporation is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from State funds. The blanket honesty bond is with a private insurance company and is administered by the North Carolina Department of Insurance with coverage of \$5,000,000 per occurrence and a \$10,000 deductible.

Workers' Compensation Program - The Workers' Compensation Program, (Program) administered by the North Carolina Department of Administration, was created to provide benefits to workers injured on the job. All employees of the Corporation are included in the Program. An employment related injury (accident) is covered under the Program. Also, certain occupational diseases specifically designated in the North Carolina Workers' Compensation Act are compensable. Losses payable by the Program include medical claims, loss of wages, disability, and death benefits.

Automobile Liability Insurance - The State provides automobile liability insurance on every State-owned motor vehicle. The State is self-insured for the first \$250,000 of any loss through a retrospective rated plan administered by the North Carolina Department of Insurance. The plan purchases excess insurance through a private insurer to cover losses greater than \$250,000. The

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

Corporation is charged premiums to cover the cost of the excess insurance and to pay for those losses falling under the self-insured retention.

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

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

The Board Members, North Carolina Rural Rehabilitation
Corporation

We have audited the financial statements of the North Carolina Rural Rehabilitation Corporation, a component unit of the State of North Carolina, as of and for the year ended June 30, 2000, and have issued our report thereon dated April 23, 2001. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Corporation's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in

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

our judgment, could adversely affect the Corporation's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable conditions noted as a result of our audit are described in the Audit Findings and Recommendations section of this report:

Findings:

1. Control Environment
2. Loan Process
3. Payroll Charges Inappropriate

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described above, we consider items 1 and 2 to be material weaknesses.

This report is intended solely for the information and use of the management of the Corporation, the Governor, the Office of State Budget, Planning and Management, the Office of the State Controller, and the General Assembly and is not intended to be, and should not be used by anyone other than these specified parties.



Ralph Campbell, Jr.
State Auditor

April 23, 2001

AUDIT FINDINGS AND RECOMMENDATIONS

Findings and Recommendations - The following findings and recommendations were identified during the audit and represent significant deficiencies in internal control.

1. SIGNIFICANT DEFICIENCIES IN CONTROL ENVIRONMENT OF THE NORTH CAROLINA RURAL REHABILITATION CORPORATION

The North Carolina Rural Rehabilitation Corporation (Corporation) has not established written policies and procedures governing the operations of its loan program. There have not been adequate controls over the accounting for loans nor has there been adequate monitoring of loans made. Documentation to support loan applications, loan approvals, loan closings, and monitoring of delinquent loans was not consistent among borrowers. Oversight of loans by the Board of Directors of the Corporation and its loan committee was not adequately documented.

A. General Control Environment:

- The Corporation does not have written policies and procedures governing the processes of loan initiation/application, loan approval, loan closing, and loan monitoring.
- Since November 1999, the internal auditor for the North Carolina Department of Agriculture and Consumer Services (NCDACS) has been serving as the loan officer of the Corporation. As of February 2001, the internal auditor was also designated the Secretary-Treasurer for the Corporation. These duties appear to present a conflict of interest.

Recommendation: We recommend that the Corporation establish written policies and procedures governing all phases of the loan process. We also recommend that any potential conflict of interest be eliminated between the assignment of the NCDACS internal auditor to be the loan officer/Secretary-Treasurer of the Corporation.

Agency's Response: The Department agrees with the recommendation that the Board of Directors establish written policies and procedures governing all phases of the loan process.

The Department agrees that having its Internal Auditor serve as the NCRRC's Secretary-Treasurer presents a conflict of interest. Therefore, I will recommend to the Board of Directors that they take the appropriate action to eliminate this conflict.

B. Accounting Control Environment:

- The loan officer of the Corporation relies on a combination of manual ledger cards and the NCDACS mainframe based subsystem for loan information. There was no reconciliation performed between these two systems.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- Loan balances per the loan subsystem were not being reconciled to the general ledger. At June 30, 2000, the subsystem reflected \$405,279 less than the amount recorded on the general ledger; however, we were able to reconcile to within \$6,279.
- The NCDACS loan subsystem was not being fully utilized by the loan officer of the Corporation. This system can produce “payment due” and “past due” letters, as well as detailed account information. The loan officer was not aware of these capabilities.

Recommendation: An adequate accounting control environment would include the periodic reconciliation between the manual ledger cards, the mainframe based subsystem, and the general ledger. The loan subsystem has the capabilities to enhance the accounting controls over the loan program and should be fully utilized.

Agency's Response: The Board of Directors will be made aware of the need for a reconciliation process between the manual ledger account cards and the mainframe subsystem information.

The reconciliation of the subsystem loan balances to the general ledger will be done monthly or no later than quarterly.

C. Board of Directors:

We reviewed the Corporation's Board of Directors minutes from February 19, 1980 through March 1, 2001. Our review revealed the following:

- The By-laws of the Corporation require that notices of annual or special meetings be mailed ten days prior to such meetings. The Corporation routinely did not mail out these notices.
- The Board of Directors has not documented any loan approvals in their minutes since the February 15, 1994 meeting. However, they did begin documenting discussions on loans during their last annual meeting on February 12, 2001.
- The loan committee of the Corporation has not been keeping minutes since August 1, 1995.

Recommendation: We recommend that notices of board meetings be mailed to comply with the By-laws of the Corporation. We also recommend that written minutes be maintained on all board meetings and that the loan approval process be documented.

Agency's Response: The Department agrees that the Corporation will abide by its By-laws and notify all Board members of the annual meeting or any special meetings a minimum of ten days prior to the meeting.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

The Department agrees that all meetings of the Board of Directors include a review of approved loans and be in the Board minutes.

The Department agrees that the Corporation's loan committee should keep minutes.

2. SIGNIFICANT DEFICIENCIES IN THE LOAN PROCESS

We reviewed thirty-one (46 percent) of sixty-seven loan files representing \$3,296,170 (64 percent) of the total loans receivable balance of \$5,123,224 at June 30, 2000. Our review revealed no standard methodology or consistency of treatment in the processing of loans. We found inadequate or insufficient documentation to support all phases of the loan process, which include: initiation/application, approval, closing, and monitoring.

A. Loan Initiation/Application:

We determined that eleven (35 percent) of the thirty-one files reviewed had inadequate application documentation, including no formal application and/or no certified real estate appraisal. In our opinion, in order for the Corporation to determine whether to grant a loan, a formal written application and an appraisal would be necessary.

B. Loan Approval:

Twenty (65 percent) of the thirty-one loan files reviewed did not have evidence in the Board minutes and/or loan committee minutes of appropriate authorization to support initial loans, subsequent loans, or the re-amortization/re-scheduling of existing loans. Because the Corporation has not been adequately documenting the loan committee's meetings, we were unable to determine if they had convened and discussed specific loan applications.

C. Loan Closing:

We reviewed thirty-one (46 percent) of sixty-seven loan accounts. All files had executed deeds of trust and promissory notes for initial loans. Eleven files (35 percent) of the thirty-one reviewed did not include a HUD-1 Settlement Statement, which in our opinion, should be a required closing document. This statement is now being obtained on current loans.

We also determined that eight (26 percent) of the thirty-one accounts reviewed had received subsequent loans and/or re-amortized/re-scheduled existing loans. The only documentation for these subsequent loan actions was a promissory note signed by the borrower. Deeds of trust were not updated to reflect the new amounts. We are of the

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

opinion that in order for the Corporation to ensure that they have first lien to collateral, the deed of trust should agree to the loan amount.

D. Loan Monitoring:

We found five (16 percent) of the thirty-one accounts reviewed were delinquent loans without adequate evidence of follow-up attempts. There was evidence in some of the files that the Corporation did contact delinquent borrowers, but there was no consistent methodology applied between borrowers. Oftentimes, the Corporation would allow the borrower to re-amortize or re-schedule their payoff amount. The borrower could then begin making payments without being considered delinquent. Inadequate follow-up on delinquent loans could result in loan defaults and loss of funds for the Corporation.

Recommendation: The Corporation should establish and adopt written policies and procedures governing the entire loan process to include: initiation, approval, closing, and monitoring. Adopted policies and procedures should be consistently applied on all loans. We also recommend that legal services are consulted to ensure that necessary and required documentation is obtained to ensure the Corporation's interests are being fully protected.

Agency's Response: As previously mentioned, the Department agrees with the establishment and adoption of written policies and procedures for the entire loan process and apply them consistently to all loans.

3. PAYROLL CHARGES INAPPROPRIATE

The total cost for a computer consultant position was charged to the Corporation, however, the position provided very little support to the Corporation. Currently, the internal auditor for the NCDACS is also the loan officer for the Corporation, but none of his salary is being charged to the Corporation. The prior loan officer was paid from Corporation funds.

Recommendation: The Corporation should implement adequate internal controls to ensure payroll charges are properly allocated to appropriate areas of responsibility.

Agency's Response: I concur completely and will recommend that the Board of Directors take the appropriate action regarding staff salary allocation.

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August 7, 2001

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