

# STATE OF NORTH CAROLINA

## FINANCIAL STATEMENT AUDIT REPORT OF TOWN OF BUTNER WATER AND SEWER SYSTEM

BUTNER, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2001

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.

STATE AUDITOR

**FINANCIAL STATEMENT AUDIT REPORT OF**

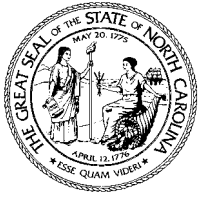
**TOWN OF BUTNER WATER AND SEWER SYSTEM**

**BUTNER, NORTH CAROLINA**

**FOR THE YEAR ENDED JUNE 30, 2001**

**NORTH CAROLINA DEPARTMENT OF HEALTH AND HUMAN SERVICES**

**CARMEN HOOKER BUELL, SECRETARY**



Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

---

## AUDITOR'S TRANSMITTAL

---

The Honorable Michael F. Easley, Governor  
The Members of the North Carolina General Assembly  
Secretary Carmen Hooker Buell, Department of Health and Human Services

This report presents the results of our financial statement audit of the Town of Butner Water and Sewer System (System) for the year ended June 30, 2001. Our audit was made by authority of Article 5A of G.S. §147.

The accounts and operations of the System are a 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 to comply with Trust Agreement, dated as of April 1, 2001, between State of North Carolina and First-Citizens Bank & Trust Company, Trustee (Revenue Bond Trust Agreement), we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to the System. 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. These financial statements are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the System. A summary of our reporting objectives and audit results are:

**1. Objective** - Express an opinion on the accompanying financial statements.

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

## AUDITOR'S TRANSMITTAL (CONCLUDED)

---

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

**Results** - The following significant deficiencies in internal control over financial reporting were noted as a result of our audit:

### **Findings**

1. *Poor Internal Controls Over Utility Billings, Collections and Accounts Receivable*
2. *Lack of Communication, Documentation and Authorization Related to Bond Transactions*

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.

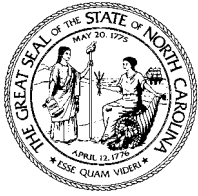


Ralph Campbell, Jr.  
State Auditor

# TABLE OF CONTENTS

---

	PAGE
INDEPENDENT AUDITOR’S REPORT ON THE FINANCIAL STATEMENTS .....	1
FINANCIAL STATEMENTS	
Exhibits	
A    Balance Sheet.....	3
B    Statement of Revenues, Expenses and Changes in Fund Equity.....	4
C    Statement of Cash Flows .....	5
Notes to the Financial Statements .....	6
SUPPLEMENTARY INFORMATION	
Schedule	
1    Trust Agreement Rate Covenant Calculation .....	17
INDEPENDENT AUDITOR’S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i> .....	19
AUDIT FINDINGS AND RECOMMENDATIONS .....	22
DISTRIBUTION OF AUDIT REPORT.....	30



Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

---

**INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS**

---

Secretary Carmen Hooker Buell, Department of Health and Human Services  
Town of Butner Water and Sewer System  
Butner, North Carolina

We have audited the accompanying Balance Sheet of the Town of Butner Water and Sewer System (System) as of June 30, 2001 and the related Statement of Revenues, Expenses and Changes in Fund Equity and the Statement of Cash Flows. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

As discussed in Note 1, the financial statements of the Town of Butner Water and Sewer System are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the System.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Town of Butner Water and Sewer System as of June 30, 2001, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2001, on the results of our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants. This report is an integral part of an audit performed in

**INDEPENDENT AUDITOR'S REPORT  
ON THE FINANCIAL STATEMENTS (CONCLUDED)**

---

accordance with *Government Auditing Standards* and should be read in conjunction with the independent auditor's report in considering the results of our audit.

Schedule 1 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ralph Campbell, Jr.  
State Auditor

December 11, 2001

**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**Balance Sheet**  
**June 30, 2001**

**Exhibit A**

**ASSETS**

**Current Assets:**

Cash and Cash Equivalents (Note 2)	\$ 4,279,208
Investments - Held Outside the State Treasurer (Note 2)	9,976,853
State Treasurer's Securities Lending Collateral	1,908,389
Accounts Receivable (Net of allowance for uncollectibles of \$26,687)	285,474
Interest Receivable	12,853
Inventories	<u>170,232</u>
Total Current Assets	<u>16,633,009</u>

**Noncurrent Assets:**

Prepaid Item - Bond Issuance Cost	<u>134,053</u>
Total Noncurrent Assets	<u>134,053</u>

**Fixed Assets: (Note 3)**

Buildings	3,277,583
Other Structures and Improvements	10,144,512
Machinery and Equipment	538,829
Construction in Progress	9,354,597
Accumulated Depreciation	<u>(7,078,973)</u>
Total Fixed Assets	<u>16,236,548</u>

<b>Total Assets</b>	<b><u>\$ 33,003,610</u></b>
---------------------	-----------------------------

**LIABILITIES AND FUND EQUITY**

**Current Liabilities:**

Accounts Payable	\$ 131,789
Obligations Under State Treasurer's Securities Lending Agreements	1,908,389
Intragovernmental Payable	125,245
Deposits Payable	78,626
Accrued Vacation Leave	102,676
Bonds Payable (Note 4)	<u>100,000</u>
Total Current Liabilities	<u>2,446,725</u>

**Noncurrent Liabilities:**

Bonds Payable (Note 4)	<u>9,805,000</u>
Total Noncurrent Liabilities	<u>9,805,000</u>

<b>Total Liabilities</b>	<b><u>12,251,725</u></b>
--------------------------	--------------------------

**Fund Equity:**

Contributed Capital	12,630,581
Retained Earnings	<u>8,121,304</u>

<b>Total Fund Equity</b>	<b><u>20,751,885</u></b>
--------------------------	--------------------------

<b>Total Liabilities and Fund Equity</b>	<b><u>\$ 33,003,610</u></b>
--	-----------------------------

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



**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**Statement of Revenues, Expenses and Changes in Fund Equity**  
**For the Fiscal Year Ended June 30, 2001**

**Exhibit B**

<b>Operating Revenues:</b>	
Sales and Services	\$ 3,758,159
Fees, Licenses and Fines	<u>13,858</u>
Total Operating Revenues	<u>3,772,017</u>
<b>Operating Expenses:</b>	
Personal Services and Employee Benefits	1,268,876
Supplies and Materials	206,416
Contracted Personal Services	42,543
Travel	7,067
Communication	9,256
Utilities	259,782
Other Services	42,479
Depreciation / Amortization	603,190
Insurance	6,460
Other	<u>247,559</u>
Total Operating Expenses	<u>2,693,628</u>
<b>Operating Income</b>	<u>1,078,389</u>
<b>Nonoperating Revenues (Expenses):</b>	
Federal Revenues	131,501
Investment Earnings	131,607
Miscellaneous Revenues	3,643
Interest Expense	<u>(84,218)</u>
Total Nonoperating Revenues	<u>182,533</u>
<b>Income (Loss) Before Operating Transfers</b>	<u>1,260,922</u>
<b>Operating Transfers:</b>	
Transfers In	740,498
Transfers Out	<u>(109,946)</u>
Total Operating Transfers In	<u>630,552</u>
<b>Net Income</b>	1,891,474
Fund Equity -- July 1, 2000	18,742,595
Increase in Contributed Capital	<u>117,816</u>
<b>Fund Equity -- June 30, 2001</b>	<u>\$ 20,751,885</u>

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

**TOWN OF BUTNER WATER AND SEWER SYSTEM**

**Statement of Cash Flows**

**For the Fiscal Year Ended June 30, 2001**

**Exhibit C**

**Cash Provided From (Used For) Operations:**

Operating Income	\$ 1,078,389
Adjustments to Reconcile Operating Income to Net Cash Flows from Operating Activities	
Depreciation / Amortization	603,190
Nonoperating Miscellaneous Income / Expense	3,643
(Increases) Decreases in Assets:	
Receivables	(247,930)
Inventories	127
Increases (Decreases) in Liabilities:	
Accounts Payable and Accrued Liabilities	(14,985)
Intragovernmental Payable	123,763
Deposits Payable	4,476
Accrued Vacation Leave	(380)
Total Cash Provided From (Used For) Operations	<u>1,550,293</u>

**Cash Provided From (Used For) Noncapital Financing Activities:**

Operating Transfers In	740,498
Operating Transfers Out	(109,946)
Total Cash Provided From (Used For) Noncapital Financing Activities	<u>630,552</u>

**Cash Provided From (Used For) Capital Financing Activities:**

Acquisition of Fixed Assets	(811,774)
Proceeds from Sale of Bonds	9,905,000
Interest Payments on Bonds	(84,218)
Bond Issuance Costs	(133,776)
Capital Grants	131,501
Increase in Contributed Capital	117,816
Total Cash Provided From (Used For) Capital Financing Activities	<u>9,124,549</u>

**Cash Provided From (Used For) Investment Activities:**

Purchase of Non-State Treasurer Investments	(9,976,853)
Investment Earnings	118,754
Total Cash Provided From (Used For) Investment Activities	<u>(9,858,099)</u>

**Net Increase in Cash and Cash Equivalents**

1,447,295

**Cash and Cash Equivalents at Beginning of Year**

2,831,913

**Cash and Cash Equivalents at End of Year**

\$ 4,279,208

**Noncash Investing, Capital and Financing Activities:**

Assets Acquired through the Assumption of a Liability	\$ 1,908,389
---	--------------

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

**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**JUNE 30, 2001**

---

**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

- A. Financial Reporting Entity** - The Town of Butner Water and Sewer System (System) is a part of the State of North Carolina and is not a separate legal or reporting entity. The System's accounts and transactions, along with other Town of Butner accounts and transactions, are included in the State of North Carolina's *Comprehensive Annual Financial Report* (CAFR) as an enterprise fund. The accompanying financial statements present only those accounts and transactions associated with the operations of the System.
- B. Basis of Presentation** - The accompanying financial statements are presented in accordance with generally accepted accounting principles as prescribed by Governmental Accounting Standards Board (GASB), which consist of GASB Statements and Interpretations, as well as American Institute of Certified Public Accountants (AICPA) and Financial Accounting Standards Board (FASB) pronouncements specifically made applicable to state and local government entities by GASB Statements and Interpretations. In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Fund Accounting*, the System does not apply FASB pronouncements issued after November 30, 1989 for proprietary activities, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.
- C. Basis of Accounting** - The accompanying financial statements were prepared on the accrual basis of accounting.
- D. Cash and Cash Equivalents** - This classification consists of cash on hand and the System's equity position in the short-term investment fund managed by the North Carolina State Treasurer. The funds on deposit with the State Treasurer are available on demand. This classification also appears on the accompanying statement of cash flows.
- E. Investments** - This classification represents deposits in the North Carolina Capital Management Trust cash portfolio, a SEC-registered 2(a)(7) money market mutual fund. The investment value is determined by the portfolio's share price and number of shares owned.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

- F. State Treasurer's Securities Lending Collateral** - While the System does not directly engage in securities lending transactions, it deposits certain funds with the State Treasurer's Short-Term Investment Fund which participates in securities lending activities. Based on the State Treasurer's allocation of these transactions, the System recognizes its allocable share of the assets and liabilities related to these transactions on the accompanying financial statements as "State Treasurer's Securities Lending Collateral" and "Obligations Under State Treasurer's Securities Lending Agreements." The allocable share of the costs arising from these transactions is immaterial to the System and has been netted against investment income rather than reported as an expense.

Based on the authority provided in G.S. §147-69.3(e), the State Treasurer lends securities from its investment pools to broker-dealers and other entities (borrowers) for collateral that will be returned for the same securities in the future. The Treasurer's securities custodian manages the securities lending program. During the year, the custodian lent U.S. government securities, corporate bonds, notes, and common stock for collateral. The custodian is permitted to receive cash, U.S. government securities, or irrevocable letters of credit as collateral for the securities lent. The collateral is initially pledged at 102 percent of the market value of the securities lent, and additional collateral is required if its value falls to less than 100 percent of the market value of the securities lent. There are no restrictions on the amount of loans that can be made. Substantially all security loans can be terminated on demand by either the State Treasurer or the borrower.

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

- G. Fixed Assets and Depreciation** – The System capitalizes all assets that have a value or cost greater than or equal to \$5,000 at the date of acquisition. Depreciation is computed using the straight-line method over the following useful lives: buildings range from 20-50 years, other structures and improvements from 10-40 years, and equipment from 3-15 years.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

- H. Vacation and Sick Leave** - The System's policy is to record the cost of vacation leave when earned. The policy provides for a maximum accumulation of unused vacation leave of 30 days which can be carried 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 year-end 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 value of this leave has been reported as a current liability.

The System 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. Consequently, no liability has been reported for unused sick leave.

- I. Bonds Payable** – The amount of outstanding bonds payable maturing within one year of the balance sheet date is reported as a current liability. All of the bonds are subject to purchase on demand of the holder; however, the System has arranged for a letter of credit that will provide alternative financing for a period exceeding one year. Consequently, the balance of bonds payable which mature more than one year from the balance sheet date is reported as a noncurrent liability.

The bond proceeds are used for the construction of capital assets. The net difference between interest costs on the bonds and investment earnings on the proceeds is immaterial to the financial statements taken as a whole. Consequently, there has been no provision for interest capitalization (either positive or negative) in the financial statements.

The System enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenses resulting from these agreements, no amounts are recorded in the financial statements.

Detailed information about bond issuances is presented in Note 4.

- J. Contributed Capital** – This classification represents capital grants or contributions received from other sources.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

### NOTE 2 - DEPOSITS AND INVESTMENTS

**A. State Treasurer's Short-Term Investment Fund** – Unless specifically exempt, state agencies are required by General Statute §147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. These moneys are invested in accordance with G.S. §147-69.1(c) and 147-69.2, and as required by law are “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. The fund’s uninvested cash is either covered by federal depository insurance or, pursuant to 20 NCAC 7, is collateralized under either the dedicated or pooling method. Under the dedicated method, deposits are individually collateralized. Under the pooling method, each depository establishes an escrow account in the name of the State Treasurer to secure all of its public deposits. The financial statements and disclosures for the State Treasurer’s Cash and Investment Pool (which includes the State Treasurer’s Short-Term Investment Fund) are included in the State of North Carolina’s *Comprehensive Annual Financial Report*.

At June 30, 2001, the System’s deposit in the State Treasurer’s Short-Term Investment Fund had a book balance of \$4,279,208 and a bank balance of \$3,034,817.

**B. Investments** – House Bill 1629 authorized the System to issue revenue bonds to finance improvements to the water and sewer system. The Revenue Bond Trust Agreement allows unexpended bond proceeds to be invested in obligations that will mature on or before the date funds are expected to be required for expenditure or withdrawal. The System has invested all of the unexpended bond proceeds in the North Carolina Capital Management Trust (NCCMT). The NCCMT is a liquid money market mutual fund maintaining a \$1 per share value. The fund is invested in AAA commercial paper, U.S. Treasury notes and corporate securities. At June 30, 2001, the investment had a cost and fair value of \$9,976,853. Since the System only owns shares in the fund rather than specific underlying securities, the investment has not been categorized according to custodial risk.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 3 - FIXED ASSETS

A summary of changes in fixed assets is presented as follows:

	Balance <u>July 1, 2000</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2001</u>
Buildings	\$ 3,277,583	\$ 0	\$ 0	\$ 3,277,583
Other Structures and Improvements	10,144,512			10,144,512
Machinery and Equipment	532,969	5,860		538,829
Total Depreciable Assets	13,955,064	5,860	0	13,960,924
Accumulated Depreciation	(6,477,137)	(601,836)		(7,078,973)
Construction in Progress	8,544,126	810,471		9,354,597
<b>Total Fixed Assets</b>	<u>\$ 16,022,053</u>	<u>\$ 214,495</u>	<u>\$ 0</u>	<u>\$ 16,236,548</u>

### NOTE 4 - BONDS PAYABLE

**A. Changes in Bonds Payable** - A summary of changes in bonds payable for the year is presented as follows:

	Balance <u>July 1, 2000</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>June 30, 2001</u>
Bonds Payable	\$ 0	\$ 9,905,000	\$	\$ 9,905,000

**B. Description of Bonds Payable** – At year-end, the System was indebted for bonds payable as described below:

Purpose	Series	Effective Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2001	Principal Outstanding June 30, 2001
Water Treatment Plant Upgrade and Expansion	2001	4.21	9/1/2025	\$ 9,905,000	\$	\$ 9,905,000
<b>Total Bonds Payable</b>						<u>\$ 9,905,000</u>

The bonds were issued pursuant to House Bill 1629 ratified by the North Carolina General Assembly in June 2000. Bond proceeds are to be used to pay the costs of the project to renovate and expand the wastewater treatment plant and water treatment plant; the construction, extension, and replacement of water and sanitary sewer mains and lines and other improvements to the water and sewer system; and certain costs in connection with issuance of the bonds.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Revenue generated by System operations has been pledged for payment of bond principal and interest. The bonds, which are tax exempt, bear variable interest rates; however, the System has entered into an interest rate swap agreement that effectively results in the System paying interest at a fixed rate. Based on the swap agreement, the System owes the counterparty interest calculated at a rate of 4.21%. In return, the counterparty pays the System interest based on a variable rate that matches the rate required by the bonds. The agreement is executed by the System actually paying interest to bondholders at the variable rate and then the difference between the variable and fixed rate interest amount is exchanged with the counterparty. The bond principal amount is not exchanged; it is only the basis on which the interest payments are calculated.

The debt service requirements to maturity presented below are based on the effective fixed rate of the bonds. The System will be exposed to variable rates if the counterparty to the swap defaults or if the swap is terminated. A termination of the swap agreement may also result in the System making or receiving a termination payment.

Fiscal Year	<u>Annual Requirements – Revenue Bonds</u>	
	<i>Principal</i>	<i>Interest</i>
2002	\$ 100,000	\$ 413,843
2003	235,000	405,370
2004	245,000	395,161
2005	255,000	384,531
2006	270,000	373,322
2007-2011	1,535,000	1,680,369
2012-2016	1,910,000	1,315,099
2017-2021	2,380,000	860,524
2022-2026	<u>2,975,000</u>	<u>292,963</u>
<b>Total Requirements</b>	<b><u>\$9,905,000</u></b>	<b><u>\$6,121,182</u></b>

The bonds are subject to purchase on demand of the holder at a price equal to principal plus accrued interest upon seven days' notice and delivery to the System's tender agent, First-Citizens Bank and Trust Company. Under an irrevocable letter of credit and reimbursement agreement issued by Bank of America, N.A., the tender agent is entitled to draw amounts sufficient to pay the purchase price of the bonds delivered. The letter of credit is valid through April 15, 2002 and automatically extends for an additional period of 364 days, unless otherwise terminated in accordance with the provisions of the agreement.

Upon notice from the tender agent, the remarketing agent, Banc of America Securities LLC, has agreed to exercise its best efforts to remarket



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

the bonds, also at a price equal to principal plus accrued interest. The sales proceeds are used to reimburse Bank of America, N.A. for amounts drawn on the letter of credit. If the remarketing agent is unable to resell the bonds within 367 days, the System must pay off the letter of credit outstanding balance.

The System is required to pay an annual fee for the letter of credit of .28% of the amount of bonds outstanding plus 35 days of accrued interest assuming a maximum interest rate of 12% per annum. In addition, the remarketing agent receives an annual fee of .10% (10 basis points) of the weighted average daily outstanding principal amount of the bonds.

### NOTE 5 - RISK MANAGEMENT

The System 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. The System carries insurance through the North Carolina Department of Insurance for risks of loss.

Tort claims of up to \$500,000 are self insured under the authority of the State Tort Claims Act. In addition, the State provides an additional \$11,000,000 public officers' and employees' liability insurance via contract with a private insurance company. The premium, based on a composite rate, is paid by the System directly to the insurer.

The State Property Fire Insurance Fund (Fund), an internal service fund of the State, insures all State owned buildings and contents for fire and various other property losses up to \$2,500,000 per occurrence. The Fund purchases excess insurance from private insurers to cover losses over the amounts insured by the Fund. Losses covered by the Fund are subject to a \$500 per occurrence deductible except for theft losses which carry a \$1,000 per occurrence deductible. There have been no significant reductions in insurance coverage from the previous year, and settled claims have not exceeded coverage in any of the past three fiscal years.

All State owned vehicles are covered by liability insurance handled by the North Carolina Department of Insurance. The State is self-insured for the first \$500,000 of any loss through a retrospective rating plan. Excess insurance coverage is purchased through a private insurer to cover losses greater than \$500,000. The liability limits for losses occurring in state are \$500,000 per claimant and \$5,000,000 per occurrence. The System is charged premiums to cover the cost of excess insurance and to pay for those losses falling under the self-insured retention.

Blanket public employee dishonesty and computer fraud insurance is provided for agencies of the State with a limit of \$5 million per occurrence, subject to a

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

\$50,000 deductible and a 10% participation in each loss above the deductible. The coverage is placed with a private insurance company and is handled by the North Carolina Department of Insurance.

Employees and retirees are provided health care coverage by the Comprehensive Major Medical Plan, a component unit of the State. The Plan is funded by employer and employee contributions and is administered by a third party contractor. Health care coverage is optionally available through contractual agreements with three health maintenance organizations.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State are included in the program. When an employee is injured, the System's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The State is self-insured for workers' compensation. A third party administrator handles workers' compensation claims. State agencies, including the System, contribute to a fund administered by the Office of the State Controller to cover their workers' compensation claims. The third party administrator receives a per case administration fee and draws down State funds to make medical and indemnity payments on behalf of the State in accordance with the North Carolina Workers' Compensation Act.

Term life insurance of \$25,000 to \$50,000 is provided to eligible employees. This self-insured death benefit program is administered by the Department of the State Treasurer and funded via employer contributions. Additional details on the state-administered risk management programs are disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

### NOTE 6 - PENSION AND DEFERRED COMPENSATION PLANS

**A. Retirement Plan** – All full-time employees participate in the Teachers' and State Employees' Retirement System (the Retirement System) of North Carolina. The Retirement System is a multiple-employer, cost sharing defined benefit pension plan administered by the North Carolina State Treasurer.

After five years of creditable service, members of the Retirement System qualify for a vested deferred benefit. Employees who retire on or after age 65 and complete 5 years of membership service, reach age 60 with 25 years of membership service, or complete 30 years of creditable service receive a retirement allowance of 1.81% of an average final compensation (based on the four consecutive years that produce the highest average) multiplied by the number of years of creditable service. Employees may retire with reduced benefits if they reach age 50 with 20 years of creditable service or reach age 60 with 5 years of creditable service.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

Benefit and contribution provisions for the Retirement System are established by North Carolina General Statute §135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2001, these rates were set at 5.33% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2001, the Town of Butner Water and Sewer System had a total payroll of \$1,042,784, all of which was covered under the Retirement System. Total employee and employer contributions for pension benefits for the year were \$62,567 and \$55,580, respectively. The Town of Butner Water and Sewer System made one hundred percent of its annual required contributions for the years ended June 30, 2001, 2000, and 1999, which were \$55,580, \$74,604, and \$62,036, respectively.

In accordance with constitutional provisions requiring a balanced budget for the State of North Carolina, the Governor issued an executive order requiring the employers' share of retirement contributions for the months February 2001 through June 2001 to be transferred to a reserve account rather than paid to the Retirement System. A portion of those funds were ultimately used by the State of North Carolina for general fund purposes and not released to the retirement system. The total amount of employer contributions paid by the Town of Butner Water and Sewer System has been recognized as pension costs in the financial statements. The contributions, which were not released to the Retirement System, are considered immaterial to the Town of Butner Water and Sewer System's financial statements taken as a whole. The Town of Butner Water and Sewer System has no liability for pension costs beyond the contributions already made. The Retirement System's financial information is included in the State of North Carolina's *Comprehensive Annual Financial Report*.

- B. Supplemental Retirement Income Plan - IRC Section 401(k) Plan -** All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan created under Internal Revenue Code Section 401(k). All costs of administering the plan are the responsibility of plan participants. No costs are incurred by the System.
  
- C. Deferred Compensation Plan - IRC Section 457 Plan -** The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability,

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

---

retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, the North Carolina Public Employee Deferred Compensation Trust Fund. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All cost of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the System.

### NOTE 7 - OTHER POSTEMPLOYMENT BENEFITS

- A. Health Care for Long-Term Disability Beneficiaries and Retirees -** The System participates in state administered programs which provide post employment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The System contributed 1.28% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended June 30, 2001, the System's total contribution to the Plan was \$13,348. The System assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.
- B. Long-Term Disability -** The System participates in the Disability Income Plan of North Carolina (the Plan). Established by Chapter 135, Article 6, of the General Statutes, the Plan provides disability income to eligible members of the Teachers' and State Employees' Retirement System. Long-term disability income benefits are advance funded on an

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

---

actuarially determined basis using the one-year term cost method. For the fiscal year ended June 30, 2001, the System contributed .52% of covered payroll, or \$5,422, to the Plan. The System assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about the Plan is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

### **NOTE 8 - COMMITMENTS AND CONTINGENCIES**

**Construction Commitments** – The System had outstanding commitments of \$4,695,008 at June 30, 2001 for capital improvement projects.

### **NOTE 9 - SUBSEQUENT EVENTS**

In June 2001, the General Assembly of North Carolina passed Senate Bill 432, an act to allow nonprofit water corporations and the State of North Carolina to join certain water and sewer authorities. The Town of Butner Water and Sewer System has subsequently begun to explore the possibility of joining such an authority.

**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**Trust Agreement Rate Covenant Calculation**  
**June 30, 2001**

**Schedule 1**

**Section 704(a) Calculation**

**Calculation of Income Available for Debt Service:**

**Revenue from Services:**

Operating Revenue (Exhibit B)	\$ 3,772,017
Add investment earnings on revenue deposits	<u>37,487</u>
Revenue from Services	\$ 3,809,504

**Adjusted Current Expenses:**

Operating Expenses (Exhibit B)	2,693,628
Less Depreciation / Amortization (Exhibit B)	<u>603,190</u>
Less Adjusted Current Expenses	<u>2,090,438</u>

**Income Available for Debt Service** \$ 1,719,066

**Determination of Largest Rate Covenant Requirement:**

120% of long-term debt service requirement on parity indebtedness (120% of \$84,218)	\$ 101,062
100% of long-term debt service requirement on parity indebtedness and subordinated indebtedness	\$ 84,218
<b>Less Largest Rate Covenant Requirement</b>	<u>101,062</u>

**Excess Income Available for Debt Service - in accordance with Section 704(a)** \$ 1,618,004

**Section 704(b) Calculation**

**Calculation of Receipts:**

Operating Revenue (Exhibit B)	\$ 3,772,017
Add investment earnings on revenue deposits	<u>37,487</u>
<b>Receipts</b>	\$ 3,809,504

**TOWN OF BUTNER WATER AND SEWER SYSTEM**

**Trust Agreement Rate Covenant Calculation**

**June 30, 2001**

**Schedule 1 (continued)**

**Requirements Against Receipts:**

**Adjusted Current Expenses:**

Operating Expenses (Exhibit B)	\$ 2,693,628
Less Depreciation / Amortization (Exhibit B)	<u>603,190</u>
Adjusted Current Expenses	\$ 2,090,438

**Deposits Required by Sections 504(a), (b) and (c):**

Section 504(a) as to payment of interest	84,218
Section 504(b) as to payment of principal	0
Section 504(c) as to deposits to the Parity Reserve Account and the Special Reserve Account	<u>0</u>
Section 504 Deposits	84,218

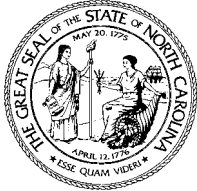
**Deposits Required by Subordinated Indebtedness Resolutions** 0

**Less Requirements Against Receipts** 2,174,656

**Excess Income Available for Debt Service - in  
accordance with Section 704(b)**

\$ 1,634,848

**Note:** The above calculations have been prepared using terms defined in the Revenue Bond Trust Agreement. These terms are defined differently under generally accepted accounting principles. All amounts have been measured in accordance with generally accepted accounting principles.



Ralph Campbell, Jr.  
State Auditor

STATE OF NORTH CAROLINA  
Office of the State Auditor

2 S. Salisbury Street  
20601 Mail Service Center  
Raleigh, NC 27699-0601  
Telephone: (919) 807-7500  
Fax: (919) 807-7647  
Internet <http://www.osa.state.nc.us>

**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**

---

Secretary Carmen Hooker Buell, Department of Health and Human Services  
Town of Butner Water and Sewer System  
Butner, North Carolina

We have audited the financial statements of the Town of Butner Water and Sewer System (System) as of and for the year ended June 30, 2001, and have issued our report thereon dated December 11, 2001. As discussed in Note 1, the financial statements of the Town of Butner Water and Sewer System are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the System. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the System'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*.



**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 (CONTINUED)**

---

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System’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 our judgment, adversely affect the System’s ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The following reportable conditions noted as a result of our audit are described in the Audit Findings and Recommendations section of this report:

**Findings**

1. *Poor Internal Controls Over Utility Billings, Collections and Accounts Receivable*
2. *Lack of Communication, Documentation and Authorization Related to Bond Transactions*

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, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses. The following reportable conditions described in the Audit Findings and Recommendations section of this report are considered material weaknesses:

**Findings**

1. *Poor Internal Controls Over Utility Billings, Collections and Accounts Receivable*
2. *Lack of Communication, Documentation and Authorization Related to Bond Transactions*

**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)**

---

This report is intended solely for the information and use of the management of the System, the Governor, the Office of State Budget 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 those specified parties.



Ralph Campbell, Jr.  
State Auditor

December 11, 2001

## **AUDIT FINDINGS AND RECOMMENDATIONS**

---

### **Matters Related to Financial Reporting**

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

#### **1. POOR INTERNAL CONTROLS OVER UTILITY BILLINGS, COLLECTIONS AND ACCOUNTS RECEIVABLE**

We noted numerous and serious weaknesses over the System's utility billings, collections, and accounts receivable system:

- a. There are no formal written policies and procedures outlining the billing, collection and accounts receivable process. Some informal procedures outlining the duties of the cashier and billing accountants were written by staff; however, the procedures have not been formalized, reviewed and approved by management and are not as complete and thorough as needed. Lack of written policies and procedures makes it difficult to adequately direct the operation and management of the organization. It could also contribute to confusion, frustration and poor performance of staff members.
- b. The System does not have a disaster recovery plan for its utility billing system. Without a comprehensive disaster recovery plan, the loss of vital data could result in substantial monetary losses and operational problems.
- c. The System does not keep its backup tapes for the billing system at an offsite location. The billing system files are backed up on a daily basis but kept in an unlocked desk drawer in the same office that houses the billing system. Failure to maintain the data at an offsite location may make it difficult, if not impossible, to recover from a disaster. At a minimum, it may require an extensive amount of staff time to re-create customer files.
- d. There is unimpeded access to the file server dedicated to the billing system. File server protection should be implemented to protect system files and data from theft, damage, and environmental problems.
- e. The billing system is not configured to require users to change their passwords at regular intervals. The failure to change passwords on a regular basis makes the billing system vulnerable to misuse. The billing system allows passwords to be changed on a regular basis; however, management was not aware of this feature.
- f. Each of the two persons responsible for billing and collection of utility receipts has access to all system screens and functions and serves as backup for the other.

Correcting this deficiency is made more difficult because the System failed to purchase the security software that it needs to assign screen access rights to users. Failure to limit screen access enables staff to perform incompatible functions, permitting one person to independently control a transaction from start to finish.

- g. There is no separation of duties between the collection, processing, depositing and recording of water and sewer receipts. The cashier is responsible for receipting the water and sewer payments, making the deposit of the receipts, recording them in the billing system, and preparing the journal vouchers for the general ledger and cash management control system. Lack of separation of duties increases the risk of misappropriation of receipts and concealment of errors and irregularities.
- h. The System does not perform monthly reconciliations between utility amounts collected and amounts billed. Lack of monthly reconciliations could allow errors and unauthorized adjustments to go undetected.
- i. The System has failed to actively seek collection of some very old delinquent accounts totaling \$26,000. The System has not evaluated the collectibility of its accounts nor has it written off uncollectible accounts. Furthermore, the System has not established a related allowance for doubtful accounts. Failure to write-off uncollectible accounts causes a misstatement of accounts receivable on the System's financial statements. Failure to actively and expeditiously seek payment of accounts receivable balances jeopardizes their ultimate collection.

We also noted several system problems with the utility billing system that, in addition to contributing to the poor internal controls in evidence at the System, indicate that there may be serious shortcomings with the billing system itself. The billing system was recently purchased by the System from an outside vendor.

- a. The billing system prints aging reports in both detail and summary formats. Although the grand totals on both formats agree, at any given date the detail aging distributions between the summary and detail formats do not agree. Neither System officials nor a programmer from the system vendor were able to explain this disparity.
- b. The billing system is not properly computing the bill for Lyons Station. This resulted in an under-billing of \$826 for one month. It appears from a review of billings for other months that those months' calculations were also in error. System officials could not provide us with an explanation.
- c. Not all transactions are visible when viewing a customer's history of transactions. We noted examples of a payment and an adjustment not appearing on the history screen, leading in one case to the cutoff of a customer's water for the supposed failure to pay the customer's water bill. The payment, however, was displayed on the daily transaction report.

- d. The billing system does not always provide information in a format often needed for effective management and record keeping. For example, water and sewer revenues are summarized on daily transaction reports but they are not summarized monthly or on year-end reports. The daily transaction report also reports deposits and late fees, but fails to report other revenues of the billing system such as the collection of tap and availability fees. Also, the daily transaction report fails to report adjustments correcting a customer's account.

We noted several management issues that also impacted one or more components of the system of internal controls:

- a. System staff have not been adequately trained in the use of the billing system. Staff appeared unsure or unfamiliar with many aspects of the billing system. For instance, there were several menu options within the billing system that the staff did not know how to use or their purpose.
- b. Because the billing system does not permit customization by the staff, the System purchased another software package called Crystal Reports, the purpose of which was to create custom reports. We were told that the staff has received no training in the use of this software.
- c. The System failed to involve Department of Health and Human Services Computer Services system personnel to assist in the installation of the billing system when it was purchased. The involvement of Computer Services personnel would have provided the System with a better opportunity to evaluate the billing system, make decisions and resolve problems.

*Recommendation:* We provide the following recommendations:

- a. Management should develop formal policies and procedures outlining the billing, collection and accounts receivable process.
- b. Management should work with the Department of Health and Human Services Computer Services section and, as needed, with the billing system's vendor to develop a comprehensive step-by-step disaster recovery plan. The plan should ensure that critical data and processes are identified and protected for future recovery. Once a comprehensive plan has been developed, it should be tested to ensure all assumptions made during the development of the plan are correct and will work. A copy of the disaster recovery plan should be located at a primary offsite storage location.
- c. Management should back up the billing system on a daily basis and store the back up disks at an offsite secure location.
- d. Management should take steps to secure the file server dedicated to the billing system from unauthorized access by locating the server in a locked room and by limiting access to only authorized personnel.

- e. System management should work with a system administrator from the Department's Computer Services section to assist in implementing password and system security.
- f. Management should divide the roles and responsibilities of its staff, in particular, ensuring that personnel who have access to assets do not also have access to accounting records. Management should consider purchasing the system security package that would allow for the assignment of computer screens to employees based upon job duties. The System should consult and work with the Department's Computer Services section to determine which access rights can be assigned based upon compatibility with job duties.
- g. Management should segregate the various functions involved with the collection, recording, and processing of water and sewer receipts. Allowing the administrative assistant to perform and/or review some of the above-mentioned functions helps to accomplish this.
- h. The System should reconcile utility amounts collected with amounts billed on a regular monthly basis.
- i. Customer account balances should be evaluated, legal remedies for collection exhausted, and balances written off as appropriate. The System should also establish an allowance for doubtful accounts as an offset to the financial statement receivable.
- j. Management should consult with the utility system's vendor and require adequate explanation and resolution of the system issues disclosed herein.
- k. The staff should be provided training on both the basic utility system as well as the Crystal Reports system.
- l. The System should involve the Department's Computer Services section as much as needed to ensure the efficient, effective and secure operation of the utility billing system.

*Agency Response:* The System provides the following responses:

- a. The Department agrees that formal written policy and procedures should be developed. An administrative assistant has recently been hired to supervise the billing, collections and accounts receivable processes for the Town and will develop a formal set of written policy and procedures.

Proposed compliance date: May 1, 2002;

30 days to review current procedures (February 1, 2002);

60 days to develop and write policy/procedures manual (April 1, 2002);

30 days to train, test, refine and implement (May 1, 2002).

- b. The Department is in agreement with the recommendation. Since our 12/19/01 exit conference, ICS Systems, Inc. (ICS) has been contacted to assist us in developing a comprehensive step-by-step disaster recovery plan. DHHS Computer Services (Murdoch Center) has been contacted and has agreed to assist us in this. We expect to have this plan in place by March 1, 2002. The offsite location of the disaster recovery plan will be located at the North Central Controller's Office (NCCO).
- c. The Department is in agreement with the recommendation. A daily tape backup will be run by closing time of the cashier window by having the system reprogrammed to change back-up time from 2:00 a.m. to 4:00 p.m. Arrangement for off-site storage at the NCCO has been confirmed and is now in effect. Backup tapes are being sent to the NCCO on a daily basis. Change of back-up time is expected by March 1, 2002.
- d. The Department agrees with the recommendation and will review with DHHS Computer Services and ICS the feasibility of moving the file server into the locked cashier's office. This will limit access to designated personnel only. ICS will also be contacted regarding configuring the software to provide for a screen saver when the system has not been used for a period of time (i.e., 15 minutes). A password will be required to enter the system once the screen saver is displayed. Proposed compliance date is March 1, 2002.
- e. The Department is in agreement with the recommendation. Since our 12/19/01 exit conference, ICS has been contacted to configure the software to require automatically the changing of passwords on a regular basis. Since we operate from a proprietary system, ICS will be responsible for adjustments to security issues. The Department's Computer Services section will be involved as necessary. Proposed compliance date is March 1, 2002.
- f. The Department agrees with the recommendation. Since our 12/19/01 exit conference, ICS has been contacted concerning feasibility of purchase of security software. Due to limited staffing, it is imperative that the cashier and billing clerk have access to all related system screens and serve as backups for each of the functions related to collections and billing. The supervisor for these positions will provide an increased amount of oversight of these functions and unannounced reviews by the supervisor, utilities director and town manager will be done on a periodic basis. Proposed compliance date is immediate for increased supervision. These issues will be resolved with ICS at a tentative mid-January 2002 meeting now being coordinated.
- g. The Department is in agreement with the recommendation. Due to limited staffing, it is imperative that the cashier and billing clerk have access to all related functions related to collections. However, a process will be developed where, on a regular basis, there is segregation of the receipt of funds and the depositing of funds. The billing clerk will be involved in part of this on a daily basis as well as the supervisor periodically reviewing daily record of receipts and recording prior

to the deposit being made. A formal plan for this will be included in the policy and procedures to be developed by May 1, 2002.

- h. The Department agrees with the recommendation. Since our 12/19/01 exit conference, ICS has been consulted regarding incorporating additional reports to indicate reconciliation between amounts billed and amounts collected on a monthly basis. Proposed compliance date is March 1, 2002.
- i. The Department is in agreement with the recommendation. The Town will follow the State's Bad Debt Collection Process. A meeting is being scheduled with the Department Controller's Office for guidance in this process. Proposed compliance date is March 1, 2002.
- j. The Department agrees with the recommendation. After the 12/19/01 exit conference, the System contacted ICS to initiate resolution of the aforementioned items. A tentative meeting has been arranged in mid-January to begin discussions.
- k. The Department agrees with the recommendation. Staff has not been thoroughly trained in all aspects of the system due to insufficient backup staffing. We now have an individual on staff who will be working through ICS to coordinate and schedule staff for refresher training as well as training on any expansion of billing and system features. ICS will be approached to schedule and provide additional training. Proposed compliance date is April 1, 2002. Appropriate staff will be receiving the necessary training by ICS for Crystal Reports. The administrative assistant will be trained on ICS billing software and Crystal Report software to enable access to data and custom reports. Proposed compliance date is May 1, 2002.
- l. The Department agrees with the recommendation. When the system was purchased, Computer Services indicated because this was a proprietary program, they were unable to help. Since our 12/19/01 exit conference, we have already received their commitment for involvement in the system operation where they have the expertise.



2. LACK OF COMMUNICATION, DOCUMENTATION AND AUTHORIZATION RELATED TO BOND TRANSACTIONS

We noted several weaknesses related to the flow of documentation and processing of bond related transactions:

- a. The System does not have written policies and procedures to govern the flow of documentation and processing of bond related transactions. The System has not established and mandated the use of one centralized system of receipt of documentation from third parties (banks, contractors, etc.). The lack of formal procedures for the flow of documentation has exposed the System to the danger of making improper payments. We noted instances where multiple copies of invoices were submitted for payment to the finance officer in the North Central Controller's Office (NCCO) and payments that were not made from the original invoice.
- b. The System did not always submit proper supporting documentation to NCCO when it requested payment of project expenses. In some cases, "documentation" would consist of only a request for payment by the Town manager. We also noted one case from our test work in which the wrong vendor was paid because the System failed to submit supporting documentation from the correct vendor.
- c. The first three cash requisitions from bond proceeds were signed by an unauthorized official.
- d. Because the System failed to make timely cash requisitions from the Trustee, some bond project invoices were paid from the System's sewer budgetary fund rather than from the appropriate capital improvements fund.
- e. Documentation related to investment earnings for the months of April through June was not forwarded to NCCO in a timely manner. This resulted in the failure to record any investment earnings for the fiscal year and required an audit adjustment.

These conditions result largely from the lack of communication between the different levels of personnel responsible for approving and processing transactions and the failure to implement a system governing the flow of documentation and processing of bond related transactions. Management has failed to provide the oversight and monitoring to ensure that proper communication is occurring and that transactions are being properly approved, processed and recorded in a timely manner. A good system of internal control requires that System personnel understand their responsibilities for internal control as well as be informed of their duties and procedures for recording and processing financial transactions and documentation.

*Recommendation:* The System should develop formal written procedures establishing one method for the processing of bond related transactions. The written procedures should be communicated to all personnel. All documentation submitted for payment should be routed in the same manner. Multiple copies of invoices should not be

forwarded to NCCO. Payments should be made only when accompanied by documentation that is both original and complete. Cash requisitions submitted to the Trustee should be signed by an authorized official. Project expenses should be charged to the correct fund. NCCO should be kept informed of all matters impacting the financial condition of the project.

*Agency Response:* The System provides the following responses:

The Department agrees with the recommendation.

A comprehensive procedure, including a written narrative and flow chart, which documents the Butner bond cash flow was implemented 11/20/01. We expect further formal written procedures to be in place and communicated to all affected personnel by March 1, 2002.

We now have a centralized system of receipt of documentation from third parties, which has been used effectively for several months. Payment will only be made from original invoices.

The issue of unauthorized signatures for requisitions has been resolved. The trustee has been advised in a 9/4/01 letter from the DHHS Controller that only requisitions signed by an "Authorized Officer" as provided in the Trust Agreement, will be accepted and processed.

Section 403(e) of the Trust Agreement provides for the State to be reimbursed for payments in connection with the Project or any Additional Project expenditures paid initially with non-Project funds. The payment of invoices from non-Project funds to be reimbursed by the Project Fund is a business decision based on prevailing circumstances. However, the System's intent and current practice is to submit requisitions for funding from the Project Fund in a time frame that will allow invoices to be paid initially from the Project Fund.

The Trustee was asked, and has been providing monthly financial statements that reflect investment earnings. These financial statements are being provided to the NCCO in a timely manner. This procedure ensures that investment earnings will be recorded properly.

## **DISTRIBUTION OF AUDIT REPORT**

---

In accordance with G.S. §147-64.5 and G.S. §147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

### **EXECUTIVE BRANCH**

The Honorable Michael Easley	Governor of North Carolina
The Honorable Beverly Perdue	Lieutenant Governor of North Carolina
The Honorable Richard Moore	State Treasurer
The Honorable Roy Cooper	Attorney General
Mr. David McCoy	State Budget Officer
Mr. Robert Powell	State Controller
Ms. Carmen Hooker Buell	Secretary, Department of Health and Human Services
Mr. Gary Fuquay	Controller, Department of Health and Human Services

### **LEGISLATIVE BRANCH**

Appointees of the Joint Legislative Commission on Governmental Operations

Senator Marc Basnight, Co-Chairman	Representative James B. Black, Co-Chairman
Senator Charlie Albertson	Representative Martha B. Alexander
Senator Frank W. Ballance, Jr.	Representative Flossie Boyd-McIntyre
Senator Charles Carter	Representative E. Nelson Cole
Senator Daniel G. Clodfelter	Representative James W. Crawford, Jr.
Senator Walter H. Dalton	Representative William T. Culpepper, III
Senator James Forrester	Representative W. Pete Cunningham
Senator Linda Garrou	Representative Beverly M. Earle
Senator Wilbur P. Gulley	Representative Ruth M. Easterling
Senator Kay R. Hagan	Representative Stanley H. Fox
Senator David W. Hoyle	Representative R. Phillip Haire
Senator Luther H. Jordan, Jr.	Representative Dewey L. Hill
Senator Ellie Kinnaird	Representative Mary L. Jarrell
Senator Howard N. Lee	Representative Maggie Jeffus
Senator Jeanne H. Lucas	Representative Larry T. Justus
Senator R. L. Martin	Representative Edd Nye
Senator William N. Martin	Representative Warren C. Oldham
Senator Stephen M. Metcalf	Representative William C. Owens, Jr.
Senator Fountain Odom	Representative E. David Redwine
Senator Aaron W. Plyler	Representative R. Eugene Rogers
Senator Eric M. Reeves	Representative Drew P. Saunders
Senator Dan Robinson	Representative Wilma M. Sherrill
Senator Larry Shaw	Representative Ronald L. Smith
Senator Robert G. Shaw	Representative Gregg Thompson
Senator R. C. Soles, Jr.	Representative Joe P. Tolson
Senator Ed N. Warren	Representative Russell E. Tucker
Senator David F. Weinstein	Representative Thomas E. Wright
Senator Allen H. Wellons	Representative Douglas Y. Yongue

## DISTRIBUTION OF AUDIT REPORT (CONCLUDED)

---

### Other Legislative Officials

Representative Philip A. Baddour, Jr.  
Senator Anthony E. Rand  
Senator Patrick J. Ballantine  
Representative N. Leo Daughtry  
Representative Joe Hackney  
Mr. James D. Johnson

Majority Leader of the N.C. House of Representatives  
Majority Leader of the N.C. Senate  
Minority Leader of the N.C. Senate  
Minority Leader of the N.C. House of Representatives  
N. C. House Speaker Pro-Tem  
Director, Fiscal Research Division

January 30, 2002

## 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  
Raleigh, North Carolina

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

Telephone: 919/807-7500

Facsimile: 919/807-7647