



# 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, 2002

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, 2002**

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

**CARMEN HOOKER ODOM, SECRETARY**



Ralph Campbell, Jr.  
State Auditor

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## AUDITOR'S TRANSMITTAL

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The Honorable Michael F. Easley, Governor  
The Members of the North Carolina General Assembly  
Secretary Carmen Hooker Odom, 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, 2002. 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 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 audit standards generally accepted in the United States of America 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 accounting principles generally accepted in the United States of America. These matters are more fully described in the Independent Auditor's Report on the Financial Statements.

## AUDITOR'S TRANSMITTAL (CONCLUDED)

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2. **Objective** - Present significant deficiencies, if any, in internal control over financial reporting which 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** - Significant deficiencies in internal control over financial reporting were noted as a result of our audit and are discussed in audit findings titled as follows:

1. *Inadequate Internal Control Over Utility Billings, Collections and Account Receivables*
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

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Ralph Campbell, Jr.  
State Auditor

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

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

We have audited the accompanying Statement of Net Assets of the Town of Butner Water and Sewer System (System) as of June 30, 2002 and the related Statement of Revenues, Expenses, and Changes in Fund Net Assets and the Statement of Cash Flows for the year ended June 30, 2002. 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. They do not purport to, and do not, present fairly the financial position of the State of North Carolina as of June 30, 2002, and the changes in its financial position and its cash flows, where applicable, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2002, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

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As discussed in Note 10 to the financial statements, the System implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and Statement No. 38, *Certain Financial Statement Note Disclosures* during the year ended June 30, 2002.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 28, 2002, on 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. 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.

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

October 28, 2002

**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**Statement of Net Assets**  
**June 30, 2002**

**Exhibit A**

**ASSETS**

**Current Assets:**

Cash and Cash Equivalents (Note 2)	\$ 3,628,299
Restricted Investments - Held Outside the State Treasurer (Note 2)	25,086
Restricted State Treasurer's Securities Lending Collateral	2,926,845
Accounts Receivable (net of allowance for uncollectibles of \$28,019)	309,904
Interest Receivable	15,547
Inventories	165,820
Total Current Assets	<u>7,071,501</u>

**Noncurrent Assets:**

Cash and Cash Equivalents - Designated for Capital Improvements (Note 2)	1,229,153
Restricted Cash and Cash Equivalents - Customer Deposits (Note 2)	77,799
Restricted Cash and Cash Equivalents - Capital Improvements (Note 2)	1,068,371
Restricted Investments - Held Outside the State Treasurer (Note 2)	5,690,091
Deferred Charges - Bond Issuance Cost	128,637
Capital Assets, net of accumulated depreciation (Note 3)	20,204,783
Total Noncurrent Assets	<u>28,398,834</u>

**Total Assets** 35,470,335

**LIABILITIES**

**Current Liabilities:**

Accounts Payable	71,070
Obligations Under State Treasurer's Securities Lending Agreements	2,926,845
Intragovernmental Payable	288
Accrued Interest Payable	24,758
Deferred Revenues	2,385
Accrued Vacation Leave (Note 4)	7,061
Bonds Payable (Note 4)	235,000
Total Current Liabilities	<u>3,267,407</u>

**Noncurrent Liabilities:**

Customer Deposits Payable	77,799
Accrued Vacation Leave (Note 4)	94,562
Bonds Payable (Note 4)	9,570,000
Total Noncurrent Liabilities	<u>9,742,361</u>

**Total Liabilities** 13,009,768

**NET ASSETS**

Invested in Capital Assets, Net of Related Debt	16,114,960
Restricted for Capital Improvements	1,068,371
Unrestricted	5,277,236

**Total Net Assets** \$ 22,460,567

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 Net Assets  
For the Year Ended June 30, 2002***

***Exhibit B***

**Operating Revenues:**

Sales and Services (net of allowances of \$3,812)	\$ 3,608,048
Fees, Licenses and Fines	16,969
Miscellaneous Revenues	3,318
Total Operating Revenues - (pledged as security for revenue bonds)	<u>3,628,335</u>

**Operating Expenses:**

Personal Services and Employee Benefits	1,323,913
Supplies and Materials	158,480
Contracted Personal Services	176,499
Travel	2,236
Communication	9,130
Utilities	354,475
Other Services	75,892
Depreciation / Amortization	618,785
Insurance	5,860
Other	216,291
Total Operating Expenses	<u>2,941,561</u>

**Operating Income**

686,774

**Nonoperating Revenues (Expenses):**

Investment Earnings	375,423
Debt Service Fees	(46,896)
Interest Expense	(193,838)
Net Nonoperating Revenues	<u>134,689</u>

**Net Income Before Contributions and Transfers**

821,463

Capital Contributions - Federal  
Transfers Out

1,068,371  
(113,395)

**Change in Net Assets**

1,776,439

Net Assets -- July 1, 2001  
Restatements (Note 11)

20,751,881  
(67,753)

**Net Assets -- June 30, 2002**

\$ 22,460,567

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 Year Ended June 30, 2002**

*Exhibit C*

<b>Cash Flows from Operating Activities</b>	
Receipts from Customers	\$ 3,136,753
Receipts from Other State Funds for Services Provided	468,710
Payments to Employees and Fringe Benefits	(1,324,967)
Payments to Vendors and Suppliers	(775,944)
Payments to Other State Funds for Services Used	(32,288)
Other Payments	(192,291)
	<u>1,279,973</u>
Net Cash Provided by Operating Activities	
<b>Cash Flows from Noncapital Financing Activities</b>	
Transfers to Other Funds	(238,395)
	<u>(238,395)</u>
Net Cash Used by Noncapital Financing Activities	
<b>Cash Flows from Capital and Related Financing Activities</b>	
Capital Contributions - Federal	1,068,371
Acquisition and Construction of Capital Assets	(4,459,983)
Principal Paid on Capital Debt	(100,000)
Interest and Fees Paid on Capital Debt	(459,958)
	<u>(3,951,570)</u>
Net Cash Used by Capital and Related Financing Activities	
<b>Cash Flows from Investing Activities</b>	
Proceeds from Sales and Maturities of Investments	4,455,515
Interest on Investments	178,891
	<u>4,634,406</u>
Net Cash Provided by Investing Activities	
Net Increase in Cash and Cash Equivalents	1,724,414
Cash and Cash Equivalents - July 1, 2001	4,279,208
	<u>6,003,622</u>
Cash and Cash Equivalents - June 30, 2002	<u>\$ 6,003,622</u>

### **Reconciliation of Net Operating Revenues (Expenses) to Net Cash Provided (Used) by Operating Activities:**

Operating Income	\$ 686,774
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:	
Depreciation / Amortization	618,785
Changes in Assets and Liabilities:	
Receivables (net)	(24,431)
Inventories	4,412
Accounts Payable and Accrued Liabilities	(7,168)
Due to Other Funds	43
Deposits Payable	(827)
Deferred Revenue	2,385
	<u>2,385</u>
Net Cash Provided by Operating Activities	<u>\$ 1,279,973</u>

***TOWN OF BUTNER WATER AND SEWER SYSTEM***  
***Statement of Cash Flows***  
***For the Year Ended June 30, 2002***

*Exhibit C*

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

Assets Acquired through the Assumption of a Liability	\$ 2,926,845
Noncash Distributions from North Carolina Capital Management Trust	193,837

**Composition of Cash and Cash Equivalents:**

Current Assets:	
Cash and Cash Equivalents	\$ 3,628,299
Noncurrent Assets:	
Cash and Cash Equivalents - Designated for Capital Improvements	1,229,153
Restricted Cash and Cash Equivalents - Customer Deposits	77,799
Restricted Cash and Cash Equivalents - Capital Improvements	<u>1,068,371</u>

Total Cash and Cash Equivalents - June 30, 2002 \$ 6,003,622

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, 2002**

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**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 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 accounting principles generally accepted in the United States of America 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 using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned and expenses are recorded when an obligation has been incurred.
- 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 appears on the accompanying Statement of Net Assets and Statement of Cash Flows.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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- 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.
- 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 "Restricted 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. Accounts Receivable** – This classification consists of charges to customers for water and sewer services. Accounts receivable are recorded net of estimated uncollectible amounts and are expected to be collected within one year.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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- H. Inventories** – Inventories, consisting of supplies for internal use, are stated at cost using the first-in, first-out method.
- I. Capital Assets** – Capital Assets are stated at cost at date of acquisition or construction net of accumulated depreciation. The System capitalizes all assets that have a value or cost greater than or equal to \$5,000 at the date of acquisition and an expected useful life of more than one year. Net interest expense incurred during the construction of capital assets has been capitalized. 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.
- J. Restricted Assets** – Restricted assets represent assets whose use is restricted by external parties or by law through constitutional provisions or enabling legislation.
- K. Compensated Absences** – 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. When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out method.

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.

- L. 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 System enters into interest rate swap agreements to modify interest rates on outstanding debt. Other than the net interest expenses resulting

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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from these agreements, no amounts are recorded in the financial statements.

Detailed information about bond issuances is presented in Note 4.

**M. Net Assets** – The System’s net assets are classified as follows:

**Invested in Capital Assets Net of Related Debt** – This represents the System’s total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets net of related debt.

**Restricted Net Assets** – Restricted net assets are those in which the System is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

**Unrestricted Net Assets** – Unrestricted net assets are all those not invested in capital assets or restricted by external parties.

Restricted and unrestricted resources are tracked separately in the accounting system. When both restricted and unrestricted funds are available for expenditure, management decides on a case-by-case basis which funds to use.

**N. Revenue and Expense Recognition** – The System presents its revenues and expenses as operating or nonoperating based on recognition definitions from GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. Operating activities are those activities that are necessary and essential to the mission of the System. Operating revenues include all charges to water and sewer customers. Investment income is considered nonoperating since it is either investing, capital or noncapital financing activities. Operating expenses are all expense transactions incurred other than those related to investing, capital or noncapital financing activities. Revenues received for capital financing activities, as well as related expenses, are considered neither operating nor nonoperating activities and are presented after nonoperating activities on the accompanying Statement of Revenues, Expenses, and Changes in Fund Net Assets.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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

### NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits in 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, 2002, the System's deposit in the State Treasurer's Short-Term Investment Fund had a book balance of \$6,003,622 and a bank balance of \$6,091,024.

- 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, 2002, the investment had a cost and fair value of \$5,715,177. 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 - CAPITAL ASSETS

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

	Balance July 1, 2001	Increases	Decreases	Balance June 30, 2002
<b>Capital Assets, Non-Depreciable</b>				
Construction in Progress	\$ 9,354,597	\$ 4,600,481	\$ 332,552	\$ 13,622,526
Total Capital Assets, Non-Depreciable	9,354,597	4,600,481	332,552	13,622,526
<b>Capital Assets, Depreciable</b>				
Buildings	3,277,583	0	0	3,277,583
Machinery and Equipment	538,829			538,829
Other Structures and Improvements	10,144,512	332,552		10,477,064
	13,960,924	332,552	0	14,293,476
Less Accumulated Depreciation:				
Buildings	1,473,674	127,172		1,600,846
Machinery and Equipment	452,946	32,435		485,381
Other Structures and Improvements	5,152,353	472,639		5,624,992
	7,078,973	632,246	0	7,711,219
Total Capital Assets, Depreciable, net	6,881,951	(299,694)	0	6,582,257
<b>Total Capital Assets, net</b>	<b>\$ 16,236,548</b>	<b>\$ 4,300,787</b>	<b>\$ 332,552</b>	<b>\$ 20,204,783</b>

### NOTE 4 - LONG-TERM LIABILITIES

**A. Changes in Long-Term Liabilities** - A summary of changes in long-term liabilities for the year is presented as follows:

	Balance July 1, 2001	Additions	Reductions	Balance June 30, 2002	Current Portion
Bonds Payable	\$ 9,905,000	\$	\$ 100,000	\$ 9,805,000	\$ 235,000
Accrued Vacation Leave	102,676	74,246	75,299	101,623	7,061
<b>Total Long-Term Liabilities</b>	<b>\$ 10,007,676</b>	<b>\$ 74,246</b>	<b>\$ 175,299</b>	<b>\$ 9,906,623</b>	<b>\$ 242,061</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

**B. Bonds Payable** – At year-end the System had bonds outstanding as described below:

Purpose	Series	Effective Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2002	Principal Outstanding June 30, 2002
Water Treatment Plant Upgrade and Expansion	2001	4.21	9/1/2025	\$ 9,905,000	\$ 100,000	\$ 9,805,000
<b>Total Bonds Payable</b>						<u>\$ 9,805,000</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.

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. Under the agreement the System pays 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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Fiscal Year	Annual Requirements – Revenue Bonds	
	<i>Principal</i>	<i>Interest</i>
2003	\$ 235,000	\$ 405,370
2004	245,000	395,161
2005	255,000	384,531
2006	270,000	373,322
2007	280,000	361,639
2008-2012	1,605,000	1,613,535
2013-2017	1,995,000	1,232,004
2018-2022	2,490,000	756,853
2023-2026	<u>2,430,000</u>	<u>184,924</u>
<b>Total Requirements</b>	<b><u>\$9,805,000</u></b>	<b><u>\$5,707,339</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, 2003 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 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.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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### 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. These exposures to loss are handled via a combination of methods, including participation in state-administered insurance programs. 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.

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.

All State owned vehicles are covered by liability insurance administered 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 \$50,000 deductible and a 10% participation in each loss above the deductible. The coverage is placed with a private insurance company and is administered by the North Carolina Department of Insurance.

Employees and retirees are provided health care coverage by the Comprehensive Major Medical Plan. This employee benefit plan is funded by employer and employee contributions.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State are included in the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 processes 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 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.

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, 2002, these rates were set at 1.97% of covered payroll for employers and 6% of covered payroll for members.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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For the year ended June 30, 2002, the Town of Butner Water and Sewer System had a total payroll of \$1,104,546, all of which was covered under the Retirement System. Total employee and employer contributions for pension benefits for the year were \$66,273 and \$21,760, respectively. The Town of Butner Water and Sewer System made one hundred percent of its annual required contributions for the years ended June 30, 2002, 2001, and 2000, which were \$21,760, \$55,580, and \$74,604, 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 included in the amount reported above for the fiscal year June 30, 2001. 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 full-time employees are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution 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, 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**

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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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 2.35% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended June 30, 2002, the System's total contribution to the Plan was \$25,957. 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 (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, the DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. For the fiscal year ended June 30, 2002, the System contributed .52% of covered payroll, or \$5,744, to the DIPNC. The System assumes no liability for long-term disability benefits under the plan other than its contribution. Additional detailed information about the DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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**NOTE 8 - COMMITMENTS AND CONTINGENCIES**

**Construction Commitments** – The System had outstanding commitments of \$5,925,327 at June 30, 2002 for capital improvement projects.

**NOTE 9 - TRANSFERS**

Transfers are routinely used to move revenues that the System is legally required to collect to a fund that is legally authorized to expend them. Accordingly, the System transferred \$113,131 during the year to the State's special revenue funds to support other Town of Butner operations. Also in accordance with legal provisions, the System routinely transfers employer tax savings generated from employee withholding under the North Carolina Flex Benefit Program to a special revenue fund of the State to support program administration. During the year, \$264 was transferred to the general fund for this purpose.

**NOTE 10 - ACCOUNT CHANGES**

Effective July 1, 2001, the System implemented Governmental Accounting Standards Board Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and Statement 38, *Certain Financial Statement Note Disclosures*. The implementation of these new standards impacted the presentation format of the financial statements and added additional disclosures about financial statement amounts.

**NOTE 11 - NET ASSET RESTATEMENTS**

Net assets at July 1, 2001 have been restated to make corrections to the following amount recognized in prior years:

Interest Capitalization	\$ (60,594)
Depreciation Expense	(18,873)
Construction in Progress	<u>11,714</u>
Net Decrease in Net Assets Reported	<u>\$ (67,753)</u>

**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**Trust Agreement Rate Covenant Calculation**  
**June 30, 2002**

**Schedule 1**

**Section 704(a) Calculation**

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

<b>Revenue from Services:</b>		
Operating Revenue (Exhibit B)	\$ 3,628,335	
Add investment earnings on revenue deposits	<u>181,586</u>	
Revenue from Services		\$ 3,809,921
<b>Adjusted Current Expenses:</b>		
Operating Expenses (Exhibit B)	2,941,561	
Less Depreciation / Amortization (Exhibit B)	<u>618,785</u>	
Less Adjusted Current Expenses		<u>2,322,776</u>
<b>Income Available for Debt Service</b>		<b>\$ 1,487,145</b>

**Determination of Largest Rate Covenant Requirement:**

120% of long-term debt service requirement on parity indebtedness (120% of \$531,333 - adjusted for capitalized interest)	\$ 637,600	
100% of long-term debt service requirement on parity indebtedness and subordinated indebtedness	\$ 531,333	
<b>Less Largest Rate Covenant Requirement</b>		<u>637,600</u>
<b>Excess Income Available for Debt Service - in accordance with Section 704(a)</b>		<b>\$ <u>849,545</u></b>

**Section 704(b) Calculation**

**Calculation of Receipts:**

Operating Revenue (Exhibit B)	\$ 3,628,335	
Add investment earnings on revenue deposits	<u>181,586</u>	
<b>Receipts</b>		<b>\$ 3,809,921</b>

**TOWN OF BUTNER WATER AND SEWER SYSTEM**  
**Trust Agreement Rate Covenant Calculation**  
**June 30, 2002**

**Schedule 1**

**Requirements Against Receipts:**

**Adjusted Current Expenses:**

Operating Expenses (Exhibit B)	\$ 2,941,561
Less Depreciation / Amortization (Exhibit B)	<u>618,785</u>
Adjusted Current Expenses	\$ 2,322,776

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

Section 504(a) as to payment of interest (adjusted for capitalized interest)	431,333
Section 504(b) as to payment of principal	100,000
Section 504(c) as to deposits to the Parity Reserve Account and the Special Reserve Account	<u>0</u>
Section 504 Deposits	531,333

**Deposits Required by Subordinated Indebtedness Resolutions** 0

**Less Requirements Against Receipts** 2,854,109

**Excess Income Available for Debt Service - in accordance with Section 704(b)** \$ 955,812

**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

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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**

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Secretary Carmen Hooker Odom, 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, 2002, and have issued our report thereon dated October 28, 2002. 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.

As discussed in Note 10 to the financial statements, the System implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* and Statement No. 38, *Certain Financial Statement Note Disclosures* during the year ended June 30, 2002.

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)**

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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, could 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. *Inadequate Internal Control Over Utility Billings, Collections and Account Receivables*
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. *Inadequate Internal Control Over Utility Billings, Collections and Account Receivables*
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)**

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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 these specified parties.



Ralph Campbell, Jr.  
State Auditor

October 28, 2002

## **AUDIT FINDINGS AND RECOMMENDATIONS**

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

*Current Year Findings and Recommendations Also Reported in Prior Audit* - The following findings and recommendations were identified during the current and prior audits and represent significant deficiencies in internal control.

#### 1. INADEQUATE INTERNAL CONTROL OVER UTILITY BILLINGS, COLLECTIONS AND ACCOUNT RECEIVABLES

In our prior year audit, we noted a number of weaknesses over the System's utility billings, collections, and accounts receivable system. Generally, management has taken action to correct the weaknesses; however, the problems continued to exist during a significant portion of the current audit period. The specific weaknesses and corrective actions taken by management during the year are as follows:

- a. There were no formal written policies and procedures outlining the billing, collection and accounts receivable process. System management developed and implemented the needed policies and procedures in April 2002.
- b. The System did not have a disaster recovery plan for its utility billing system. System management developed and implemented a disaster recovery plan in April 2002.
- c. Daily backup tapes for the billing system were not stored at an offsite location. The daily backup tapes for the billing system are now being stored in a separate building, but within the same office complex.
- d. There was unimpeded access to the file server dedicated to the billing system. A new door to the office that houses the file server has been installed and remains locked at all times. Additionally, the building is locked to limit access to only authorized personnel.
- e. The billing system did not require users to change passwords regularly. System management established a policy requiring that passwords be changed every ninety days. A log is maintained to document password changes.
- f. The two persons responsible for billing and collection of utility receipts have access to all system screens and functions and serve as backup for the other. There is a lack of separation of duties between the collection, processing, depositing and recording of water and sewer receipts. The limited staff size available for billing and collections precludes complete segregation of duties. System management has implemented monitoring controls to compensate for the weakness. The Administrative Assistant now reconciles the daily transaction reports, cash deposits,

receipt logs and journal vouchers for the general ledger and cash management control system.

- g. Certain monitoring and review procedures remain inadequate. Key operational matters such as the reasonableness of total billings, total water volume produced compared with previous and/or comparable months, and large or unusual billings are not being sufficiently analyzed and investigated.
- h. The System had failed to actively seek collection of delinquent accounts, establish an allowance for doubtful accounts, and write off uncollectible accounts. Procedures to estimate an allowance for doubtful accounts and write off accounts deemed uncollectible are now in place. Management has also implemented improved procedures to collect delinquent accounts. Those procedures include discontinuing service, sending written notices of past due accounts, and submitting accounts to the North Carolina Department of Revenue to garnish state tax refunds.
- i. The billing system had improperly computed the Lyons Station bill. During the year management determined that the Lyons Station error was due to an incorrect amount in the rate table. The rate was corrected in December 2001. Billing problems were noted, however, during the current year for two other customers resulting in net under billings. Management was unable to explain the errors.
- j. The billing system does not always provide information in a format 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 lists 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. The billing system does not have a screen that allows the viewing of all transactions to date in a customer's account. Since the history update occurs monthly, it is possible for an adjustment or payment on an account to be reflected in the customer's account balance but the transaction not be displayed in the history screen.
- k. System staff were not adequately trained in the use of the billing system. The System staff has received refresher and additional training on the billing system, specifically on the work order portion of the system. One staff member has received limited training in the use of the reporting software used to generate custom reports.

*Recommendation:* While action has been taken to address many of the issues raised in our previous audit, we believe that further enhancements are needed. We recommend the following:

- a. Management should enhance the disaster recovery plan by specifying detailed testing procedures. Management should consider the risks associated with storing daily backups within the same office complex as the originals and adding a procedure to store a backup at an outside secure location at least weekly.

- b. Monitoring procedures should be implemented to determine the reasonableness of billings. An example of a monitoring procedure is to compare total water volume provided by the water plant to the total usage billed and investigating unusual variations; another one is to review customer billing amounts for errors and unusual fluctuations.
- c. To ensure completeness and accuracy, rate tables should be thoroughly reviewed on a periodic basis and whenever changes are made.
- d. Management should continue to enhance the staff's knowledge about the accounting system and improve the usefulness of information provided by it. This likely will require additional training on the system and reporting software, consultation with the system vendor, and involvement of the Department of Health and Human Services' computer services section.

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

- a. Arrangements have been made for the backup tape of the last working day of each week to be taken to the Cashier's Office at John Umstead Hospital and stored in the fireproof safe.
- b. A Usage Analysis Report will be reviewed each month to compare total billing to the previous month as well as the same month from the previous year to determine unusual variations in water use. A Top Users Listing Report will be reviewed and billing verified for industrial and institutional customers. A Billing Analysis Report has been developed to compare monthly actual billing to expected billing to review for billing errors.
- c. Rates will be verified monthly via the Billing Analysis Report.
- d. Training will be provided to staff as needed. The Town will consult with the vendor and DHHS Computer Services as appropriate.

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

In our prior year audit, we noted a number of weaknesses related to the flow of documentation and processing of bond related transactions. Generally, management has taken action to correct the weaknesses; however, the problems continued to exist during a significant portion of the current audit period. The specific weaknesses and corrective actions taken by management during the year are as follows:

- a. The System did not have written policies and procedures to govern the flow of documentation and processing of bond related transactions. A central collection point for specific types of documentation had not been established. Initial written procedures and a flow chart to document the flow of documentation and processing of

bond transactions were implemented in November 2001. More comprehensive procedures went into effect in March 2002. Management is continuing to evaluate the procedures to identify needed enhancements.

- b. In the prior year, the System did not always submit proper supporting documentation to the North Central Controller's Office when requesting payment of project expenses. Our audit procedures applied in the current audit period revealed no continuing documentation problems.
- c. The first three cash requisitions from bond proceeds were signed by an unauthorized official. The System submitted a letter dated September 4, 2001 to First-Citizens Bank and Trust Company, Trustee, to authorize the first three cash requisitions and establish that only requisitions signed by an authorized officer be accepted and processed.

*Recommendation:* Management has taken action to address the issues raised in our previous audit. However, we urge System management to continue expansion and enhancement of the written procedures for the processing of bond related transactions to ensure that the process is clearly established and communicated to all personnel.

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

Management concurs and will continue to pursue expansion and enhancement of the written procedures for the processing of bond related transactions to ensure that the process is clearly established and communicated to all personnel.

## **DISTRIBUTION OF AUDIT REPORT**

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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 F. Easley	Governor of North Carolina
The Honorable Beverly M. Perdue	Lieutenant Governor of North Carolina
The Honorable Richard H. Moore	State Treasurer
The Honorable Roy A. Cooper, III	Attorney General
Mr. David T. McCoy	State Budget Officer
Mr. Robert L. Powell	State Controller
Ms. Carmen Hooker Odom	Secretary, Department of Health and Human Services
Mr. Gary H. Fuquay	Controller, Department of Health and Human Services

### **LEGISLATIVE BRANCH**

Appointees of the Joint Legislative Commission on Governmental Operations

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## DISTRIBUTION OF AUDIT REPORT (CONCLUDED)

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### Other Legislative Officials

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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

December 20, 2002

## ORDERING INFORMATION

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