



STATE OF NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT

NORTH CAROLINA DEPARTMENT OF ENVIRONMENT AND NATURAL RESOURCES

EPA REVOLVING LOAN FUND

RALEIGH, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2002

OFFICE OF THE STATE AUDITOR

RALPH CAMPBELL, JR.
STATE AUDITOR

FINANCIAL STATEMENT AUDIT REPORT

**NORTH CAROLINA DEPARTMENT OF ENVIRONMENT AND
NATURAL RESOURCES**

EPA REVOLVING LOAN FUND

RALEIGH, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2002

**MR. WILLIAM G. ROSS, JR.
SECRETARY**

**MR. ROD DAVIS
CONTROLLER**



Ralph Campbell, Jr.
State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Mr. William G. Ross, Jr., Secretary

This report presents the results of our financial statement audit of the EPA Revolving Loan Fund of the North Carolina Department of Environment and Natural Resources (the Department) for the year ended June 30, 2002. Our audit was made by authority of Article 5A of Chapter 147 of the General Statutes.

The accounts and operations of the EPA Revolving Loan Fund are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report (CAFR)* and the State's *Single Audit Report*. In the CAFR the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor reports on the State's internal control 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 work necessary for the *CAFR* and the *Single Audit Report*, the accounts and operations of the EPA Revolving Loan Fund were subject to audit procedures as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to the EPA Revolving Loan Fund. The audit procedures were conducted in accordance with generally accepted auditing standards and *Government Auditing Standards* issued by the Comptroller General of the United States.

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

1. **Objective** – To express an opinion on the financial statements and supplementary information that relate solely to the EPA Revolving Loan Fund.

Results - The 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. The accompanying supplementary information presents information that is fairly stated in all material respects in relation to the basic financial statements taken as a whole. These matters are described in the Independent Auditor's Report on the Financial Statements.

AUDITOR'S TRANSMITTAL (CONCLUDED)

2. **Objective** – To present significant deficiencies, if any, in the internal control over financial reporting which could adversely affect the Department's ability to initiate, record, process, and report financial data in the financial statements being audited and present instances of noncompliance with laws, regulations, contracts, or grants.

Results - Our tests disclosed no material weaknesses in internal control over financial reporting or instances of noncompliance which require disclosure herein under *Government Auditing Standards*. These matters are more fully described in the Independent Auditor's Report on Compliance and on Internal Control over Financial Reporting.

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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INDEPENDENT AUDITOR'S REPORT ON THE FINANCIAL STATEMENTS

Mr. William G. Ross, Jr., Secretary
North Carolina Department of Environment and Natural Resources

We have audited the accompanying financial statements of the EPA Revolving Loan Fund of the North Carolina Department of Environment and Natural Resources (the Department) as of and for the year ended June 30, 2002, as listed in the table of contents. These financial statements are the responsibility of the Department'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 present only the EPA Revolving Loan Fund and do not purport to, and do not, present fairly the financial position of the State of North Carolina or the Department as of June 30, 2002, and the changes in financial position and cash flows, where applicable, 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 EPA Revolving Loan Fund of the North Carolina Department of Environment and Natural Resources, as of June 30, 2002 and the changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As further discussed in Note 12 to the financial statements, the State of North Carolina implemented Governmental Accounting Standards Board Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis - for State and Local Governments* (as amended by Statement No. 37), for the year ended June 30, 2002.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated May 23, 2003 on our consideration of the Department's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grants relative to the EPA Revolving Loan Fund. 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.

Our audit was conducted for the purpose of forming an opinion on the EPA Revolving Loan Fund's basic financial statements. The combining financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.



Ralph Campbell, Jr.
State Auditor
May 23, 2003

STATE OF NORTH CAROLINA**EPA Revolving Loan Fund****Statement of Net Assets****For the Fiscal Year Ended June 30, 2002****Exhibit A****ASSETS**

Current Assets:

Cash and Cash Equivalents (Note 2) \$ 143,911,339

Receivables:

Loans (Due within one year) (Note 3) 24,072,278

Accrued Interest 2,727,291

Other 96,168

State Treasurer's Securities Lending Collateral (Note 1) 117,916,634

Total Current Assets 288,723,710

Noncurrent Assets:

Loans Receivable (Due after one year) (Note 3) 349,643,581

Total Assets 638,367,291

LIABILITIES

Current Liabilities:

Accounts Payable 45,477

Accrued Payroll 66,226

Accrued Vacation Leave (Note 4) 17,347

Obligations Under State Treasurer's Securities

Lending Agreements (Note 1) 117,916,634

Other Accrued Liabilities 8,447

Total Current Liabilities 118,054,131

Noncurrent Liabilities:

Accrued Vacation Leave (Note 4) 190,714

Total Liabilities 118,244,845

NET ASSETS

Restricted for:

Program Loans (Restated) (Note 13) 520,122,446

Total Net Assets \$ 520,122,446

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

STATE OF NORTH CAROLINA
EPA Revolving Loan Fund
Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2002

Exhibit B

REVENUES

Operating Revenues:

Interest Income on Loans	\$	9,855,502
Loan Closing Fees		1,533,933
Total Operating Revenues		11,389,435

EXPENSES

Operating Expenses:

Personnel		2,464,921
Fringe Benefits		422,233
Travel		28,344
Supplies		6,464
Software		108,969
Data Processing Services		22,653
Training		1,172
Postage and Printing		1,534
Registration		2,743
Telephone		11,021
Repairs		218
Rent		10,648
Miscellaneous		3,476
Equipment		32,612
Other		183,247
Regional Offices		32,981
Contractual Services		864,394
Indirect Cost		187,082
Total Operating Expenses		4,384,712

Operating Income 7,004,723

NONOPERATING REVENUES

Federal Grants		55,801,855
Interest Income		6,209,479
Miscellaneous Income		551,626
Total Nonoperating Revenues		62,562,960

Income Before Transfers 69,567,683

Transfers In 8,632,611

Increase in Net Assets 78,200,294

NET ASSETS

Net Assets July 1, as Restated		441,922,152
Net Assets June 30	\$	520,122,446

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

STATE OF NORTH CAROLINA
EPA Revolving Loan Fund
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2002

Exhibit C

CASH FLOWS FROM OPERATING ACTIVITIES

Collections of Program Loan Principal	\$	21,991,836
Interest Received on Loans		9,694,502
Closing Fees on Loans		1,533,933
Program Loans Issued		(71,718,019)
Payments to Employees		(2,675,652)
Payments to Suppliers		(1,591,081)
Net Cash Used by Operating Activities		(42,764,481)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Federal Grants		55,801,855
State Contributions		8,632,611
Miscellaneous Income		551,626
Net Cash Provided from Noncapital Financing Activities		64,986,092

CASH FLOWS FROM INVESTMENT ACTIVITIES

Investment Income		6,116,214
Net Increase in Cash and Cash Equivalents		28,337,825
Cash and Cash Equivalents, Beginning of Year		115,573,514
Cash and Cash Equivalents, End of Year	\$	143,911,339

RECONCILIATION OF NET OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES

Operating Income	\$	7,004,723
Adjustments to Reconcile Operating Income to Net Cash Flow Provided by Operating Activities:		
Loans Issued		(71,718,019)
Loan Repayment		21,991,836
(Increase) in Current Assets		(49,657)
Increase in Liabilities		6,636
Net Cash Used by Operating Activities	\$	(42,764,481)

NONCASH INVESTING ACTIVITIES

Assets Acquired Through the Assumption of a Liability	\$	117,916,634
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The accompanying notes to the financial statements are an integral part of this statement.

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**STATE OF NORTH CAROLINA
EPA REVOLVING LOAN FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002**

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

- A. Financial Reporting Entity** - The EPA Revolving Fund (Fund) is a part of the State of North Carolina and is not a separate legal or reporting entity. The Fund is operated by the North Carolina Department of Environment and Natural Resources and includes separate accounts for two federal programs administered by the U.S. Environmental Protection Agency (EPA): Capitalization Grants for State Revolving Funds (CFDA 66.458 – “Clean Water Program”) and the Capitalization Grants for Drinking Water State Revolving Fund (CFDA 66.468 – “Drinking Water Program”).

The Fund’s accounts and transactions were previously included in the State of North Carolina’s *Comprehensive Annual Financial Report* (CAFR) along with other similar activities in a special revenue fund. In the future, the State will report the Fund discretely as an enterprise fund. The accompanying financial statements present only those accounts and transactions associated with the operations of the Fund in the newly adopted enterprise format.

- 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 20, *Accounting and Financial Reporting for Proprietary Fund Accounting*, the Fund 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

- D. Cash and Cash Equivalents** – This classification consists of cash on hand and the Fund’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.
- E. Loans Receivable** - The State operates the Clean Water Program and the Drinking Water Program as direct loan programs to communities. Loans are made to the local agencies as they expend funds for the purposes of the loan and request reimbursement. No provision for uncollectible accounts has been made as all loans are current, and management believes that all loans will be repaid according to the loan terms.
- F. State Treasurer’s Securities Lending Collateral** - While the Fund does not directly engage in securities lending transactions, it maintains deposits 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 Fund recognizes its allocable share of the assets and liabilities related to these transactions on the accompanying Statement of Net Assets 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 Fund and has been netted against investment income rather than reported as an expense.

Based on the authority provided in General Statute 147-69.3(e), the State Treasurer lends securities from its investment funds 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

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

Reports,” or by calling the State Controller’s Financial Reporting Section at (919) 981-5454.

- G. Net Assets** – The Fund’s net assets are reported as restricted because the Fund is legally or contractually obligated to spend the federal capital contributions, State matching funds, and income derived from these moneys in accordance with restrictions imposed by external parties.
- H. Revenue and Expense Recognition** – Revenues and expenses are presented as operating or nonoperating based on recognition definitions from GASB Statement 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 Fund. Loan activities are reported as operating because they are undertaken to fulfill a governmental responsibility rather than as an investment. Operating expenses are those incurred to support the Fund’s primary activities. Revenues received as part of noncapital financing activities, such as federal grants, and interest income derived from investing activities are reported as nonoperating. Transfers are considered neither operating nor nonoperating activities and are presented after nonoperating activities on the accompanying Statement of Revenues, Expenses, and Changes in Net Assets.
- I. Compensated Absences** – The Fund’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 Fund 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.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 2 - DEPOSITS

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 General Statutes 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 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 Fund’s deposits in the State Treasurer’s Short-Term Investment Fund are:

	Clean Water Program		Drinking Water Program	
	Book Amount	Bank Amount	Book Amount	Bank Amount
Cash and Cash Equivalents	\$ 136,501,827	\$ 136,556,532	\$ 7,409,512	\$ 7,432,829

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 3 - LOANS RECEIVABLE

The EPA Revolving Loan Fund makes loans to qualified agencies for projects that meet eligibility requirements. Loans are financed by capitalization grants, State match, and revolving funds. Effective interest rates on loans vary between 2.55 percent and 3.82 percent. Interest accrues from the original date that a project's contract is scheduled to be completed. Principal payments are made annually on or before May 1 or November 1 and interest payments are made semi-annually on or before May 1 and November 1. The first principal and interest payment is due not earlier than six months after the date of completion of the project. The loans are repaid over a maximum of 20 years.

Details of Clean Water Program loans receivable as of June 30, 2002 are:

Loans by Category:

<u>Projects</u>	<u>Loans Authorized</u>	<u>Disbursed</u>	<u>Repayments</u>	<u>Loans Receivable</u>	<u>Remaining Commitment</u>
Complete	\$ 376,209,281	\$ 376,209,281	\$ 103,820,769	\$ 272,388,512	\$ 0
Incomplete	120,486,987	53,520,037	1,839,997	51,680,040	66,966,950
Total	<u>\$ 496,696,268</u>	<u>\$ 429,729,318</u>	<u>\$ 105,660,766</u>	324,068,552	<u>\$ 66,966,950</u>
Less amount due within one year				<u>21,551,093</u>	
Loans Receivable – June 30, 2002				<u>\$ 302,517,459</u>	

Details of Drinking Water Program loans receivable as of June 30, 2002 are:

Loans by Category:

<u>Projects</u>	<u>Loans Authorized</u>	<u>Disbursed</u>	<u>Repayments</u>	<u>Loans Receivable</u>	<u>Remaining Commitment</u>
Complete	\$ 31,893,337	\$ 31,893,337	\$ 2,485,586	\$ 29,407,751	\$ 0
Incomplete	33,579,033	20,239,556		20,239,556	13,339,477
Total	<u>\$ 65,472,370</u>	<u>\$ 52,132,893</u>	<u>\$ 2,485,586</u>	49,647,307	<u>\$ 13,339,477</u>
Less amount due within one year				<u>2,521,185</u>	
Loans Receivable – June 30, 2002				<u>\$ 47,126,122</u>	

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 4 - LONG-TERM LIABILITIES

A summary of changes in long-term liabilities for the year is presented as follows:

	<u>Balance July 1, 2001</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2002</u>	<u>Current Portion</u>
Accrued Vacation Leave	<u>\$ 188,559</u>	<u>\$ 182,063</u>	<u>\$ 162,561</u>	<u>\$ 208,061</u>	<u>\$ 17,347</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 5 - LOANS TO MAJOR LOCAL AGENCIES

As of June 30, 2002, the Clean Water Program has made numerous loans to agencies that exceed \$5 million. These loans represent approximately 69 percent of the total loans authorized as follows:

Loan Recipients	Loans Authorized	Disbursed	Repayments	Loans Receivable	Remaining Commitment
New Bern	\$ 20,000,000	\$ 9,038,263	\$ 0	\$ 9,038,263	\$ 10,961,737
Durham	15,000,000	15,000,000	6,000,000	9,000,000	
Goldsboro	15,000,000	11,136,036		11,136,036	3,863,964
High Point	15,000,000	15,000,000		15,000,000	
Jacksonville	15,000,000	15,000,000	4,500,000	10,500,000	
W & S Auth Caba	14,747,300	13,284,529	574,415	12,710,114	1,462,771
Hickory	14,200,000	14,200,000	4,260,000	9,940,000	
Greenville U/C	13,566,459				13,566,459
Hendersonville	13,250,000	13,250,000		13,250,000	
Wilson	13,092,019	13,092,019	654,601	12,437,418	
Boone	12,800,000	12,800,000	2,560,000	10,240,000	
Shelby	11,707,388	11,707,388	3,512,216	8,195,172	
Cabarrus	10,500,000	10,500,000	3,675,000	6,825,000	
Lincolnton	10,000,000	9,729,022		9,729,022	270,978
Salisbury	9,200,000	9,200,000	920,000	8,280,000	
Goldsboro	8,434,336	8,434,336	4,498,313	3,936,023	
Raleigh	7,972,965	7,972,965	1,604,152	6,368,813	
Siler City	7,952,053	7,952,053	3,180,821	4,771,232	
Fayetteville	7,595,127	7,595,127	379,756	7,215,371	
Elizabeth City	7,714,299	7,714,299	1,542,859	6,171,440	
Graham	6,588,072	4,243,081		4,243,081	2,344,991
Brunswick Co	7,500,000				7,500,000
Gastonia	7,500,000	7,500,000	3,000,000	4,500,000	
Monroe	7,382,765	7,382,765	2,583,968	4,798,797	
High Point	7,137,854	7,137,854	2,039,619	5,098,235	
Williamston	7,000,000	5,643,384	350,000	5,293,384	1,356,616
Wilmington	6,650,000	6,650,000	6,650,000		
Wake Forest	6,450,000	6,450,000	1,612,500	4,837,500	
Raleigh	6,000,000	5,519,940	600,000	4,919,940	480,060
W/S Auth Cab	5,900,165	2,410,414		2,410,414	3,489,751
Zebulon	5,808,556	5,808,556	2,323,424	3,485,132	
Louisburg	5,361,230	5,361,230	2,144,492	3,216,738	
Havelock	5,358,687	5,358,687	1,339,672	4,019,015	
Burlington	5,159,849	5,159,849	5,159,849		
Clinton	5,134,658	5,134,658	1,797,130	3,337,528	
Burlington	5,000,000	5,000,000	1,000,000	4,000,000	
Subtotal	342,663,782	297,366,455	68,462,787	228,903,668	45,297,327
Other Recipients (Under \$5 million)	154,032,486	132,362,863	37,197,979	95,164,884	21,669,623
Total	<u>\$ 496,696,268</u>	<u>\$ 429,729,318</u>	<u>\$ 105,660,766</u>	<u>\$ 324,068,552</u>	<u>\$ 66,966,950</u>

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

As of June 30, 2002, the Drinking Water Program has made numerous loans to local agencies that exceed \$1 million. These loans to local agencies represent approximately 79 percent of the total loans authorized as follows:

Loan Recipients	Loans Authorized	Disbursed	Repayments	Loans Receivable	Remaining Commitment
Belfast-Patetown SD	\$ 3,000,000	\$ 3,000,000	\$ 168,181	\$ 2,831,819	\$ 0
Eastern Wayne SD	3,000,000	3,000,000		3,000,000	
Greenville Utilities Comm	3,000,000	2,596,910		2,596,910	403,090
Henderson, City of	3,000,000	2,720,286		2,720,286	279,714
Salisbury, City of	3,000,000	3,000,000	300,000	2,700,000	
Statesville, City of	3,000,000	3,000,000		3,000,000	
Greenville Utilities Comm	3,000,000	2,637,179		2,637,179	362,821
Havelock, City of	2,907,000	359,064		359,064	2,547,936
China Grove, Town of	2,831,784	2,831,784	176,987	2,654,797	
North Wilkesboro, Town	2,722,380	1,073,920		1,073,920	1,648,460
Durham, City of	2,700,000	2,066,824		2,066,824	633,176
Statesville, City of	2,656,590	1,865,721		1,865,721	790,869
Newport, Town of	2,250,000	2,250,000	112,500	2,137,500	
Sanford, City of	1,950,000	1,950,000		1,950,000	
Hillsborough, Town of	1,802,952				1,802,952
Yanceyville, Town of	1,800,000	1,800,000	180,000	1,620,000	
Morehead City, Town of	1,700,000	1,564,635		1,564,635	135,365
Franklin, County of	1,500,000	1,500,000	75,000	1,425,000	
Cleveland County SD	1,496,806	1,496,806	74,840	1,421,966	
West Jefferson, Town	1,166,994	1,012,505	120,000	892,505	154,489
Sampson Co W & S Dist	1,067,937				1,067,937
Mt. Airy, Town of	1,020,000	1,005,872		1,005,872	14,128
Plymouth, Town of	1,013,009	347,303		347,303	665,706
Subtotal	51,585,452	41,078,809	1,207,508	39,871,301	10,506,643
Other Recipients (Under \$1 million)	13,886,918	11,054,084	1,278,078	9,776,006	2,832,834
Total	\$ 65,472,370	\$ 52,132,893	\$ 2,485,586	\$ 49,647,307	\$ 13,339,477

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 6 - AWARDED FEDERAL CAPITALIZATION GRANTS

The Clean Water Program receives EPA grants authorized by Title VI of the Federal Water Quality Act of 1987. To receive these grants, states are required to match 20 percent of the federal capitalization grant award.

As of June 30, 2002, EPA has awarded capitalization grants of \$352,743,673 to the State of North Carolina. Of this amount, \$320,103,647 has been drawn for loans and administrative expenses. The State of North Carolina has provided matching funds of \$70,548,729. Matching funds were provided through State appropriations, except in fiscal years 1994, 1995, 1999, 2001, and 2002 when it was provided for through State bond proceeds. For fiscal years 1994 and 1995 the bond proceeds came from the Education, Clean Water, and Parks Bonds Act of 1993 while the 1999, 2001, and 2002 bond proceeds come from the Clean Water and Natural Gas Critical Needs Bonds Act of 1998.

The following table summarizes the federal capitalization grants awarded, amounts drawn from the grants as of the balance sheet date, and undrawn awards available for future use:

Year	CFDA 66.458 Federal Award		Total Award	State Match	Total Grant
	Administration	Loans			
1989	\$ 755,627	\$ 21,922,242	\$ 22,677,869	\$ 4,535,574	\$ 27,213,443
1990	1,100,232	31,919,949	33,020,181	6,604,036	39,624,217
1991	1,300,782	37,738,286	39,039,068	7,807,814	46,846,882
1992	1,168,426	33,898,364	35,066,790	7,013,358	42,080,148
1993	1,155,834	33,533,073	34,688,907	6,937,781	41,626,688
1994	717,179	20,806,807	21,523,986	4,304,797	25,828,783
1995	740,988	21,488,670	22,229,658	4,445,931	26,675,589
1996	1,209,072	35,203,803	36,412,875	7,282,573	43,695,448
1997	374,934	10,873,050	11,247,984	2,249,596	13,497,580
1998	810,087	23,492,532	24,302,619	4,860,523	29,163,142
1999	810,153	23,494,446	24,304,599	4,860,919	29,165,518
2000	807,407	23,414,824	24,222,231	4,844,446	29,066,677
2001	800,230	23,206,676	24,006,906	4,801,381	28,808,287
Total	<u>\$ 11,750,951</u>	<u>\$ 340,992,722</u>	\$ 352,743,673	<u>\$ 70,548,729</u>	<u>\$ 423,292,402</u>
Less draws through June 30, 2002			<u>320,103,647</u>		
Remaining Draw Available from Awards			<u>\$ 32,640,026</u>		

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

The Drinking Water Program receives EPA grants authorized by the Safe Drinking Water Act. To receive these grants, states are required to match 20 percent of the federal capitalization grant award. Beginning in fiscal year 2000 all funds received from the Environmental Protection Agency and the State of North Carolina are recorded as revenue.

As of June 30, 2002, EPA has awarded capitalization grants of \$86,458,800 to the State of North Carolina. Of this amount, \$50,696,185 has been drawn for loans and administrative expenses. The State of North Carolina has provided matching funds of \$17,291,760. Of this amount, \$9,222,820 was provided through State appropriations by the 1997 General Assembly. The remaining \$8,068,940 in matching funds was provided as part of the Clean Water and Natural Gas Critical Needs Bond Act of 1998.

The following table summarizes the federal capitalization grants awarded, amounts drawn from the grants as of the balance sheet date, and balances available for future use:

Year	CFDA 66.468 Federal Award		Total Award	State Match	Total Grant
	Administration	Loans			
1997	\$ 9,366,247	\$ 36,747,853	\$ 46,114,100	\$ 9,222,820	\$ 55,336,920
1998	3,146,163	9,713,237	12,859,400	2,571,880	15,431,280
1999	3,045,123	10,432,777	13,477,900	2,695,580	16,173,480
2000	3,229,284	10,778,116	14,007,400	2,801,480	16,808,880
Total	\$ 18,786,817	\$ 67,671,983	\$ 86,458,800	\$ 17,291,760	\$ 103,750,560
Less draws through June 30, 2002			50,696,185		
Remaining Draw Available from Awards			\$ 35,762,615		

NOTE 7 - LOAN CLOSING FEES

As part of each Clean Water Program and Drinking Water Program loan commitment agreement, the loan recipient agrees to pay a 2% loan fee to the Department of Environment and Natural Resources. This fee is normally paid by the recipient upon commencement of the project. The fees are restricted to a separate fund that is invested with the State Treasurer. The fees and related investment income will be used for future administrative costs of each fund after grant administrative funds are exhausted.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 8 - RISK MANAGEMENT

The Fund 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. As an indirect cost, the EPA Revolving Loan Fund maintains insurance for all risks of loss. There have not been any claims against the Clean Water Program and the Drinking Water Program since their inception in 1989 and 1997, respectively. 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.

Additional details on State-administered risk management programs are disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 9 - 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 Statutes 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.

For the year ended June 30, 2002, the Fund had a total payroll of \$2,260,054, all of which was covered under the Retirement System. Total employee and employer contributions for pension benefits for the year were \$135,603 and \$44,523 respectively. The Fund made one hundred

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

percent of its annual required contributions for the years ended June 30, 2002, 2001, and 2000, which were \$44,523, \$41,029, and \$38,870, 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 Fund 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 Fund's financial statements taken as a whole. The Fund 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 Fund.

- 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 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 Fund.

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees -

The Fund participates in State-administered programs which provide postemployment 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 Fund 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 Fund's total contribution to the Plan was \$53,111. The Fund 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 Fund 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 Fund contributed .52% of covered payroll, or \$11,752, to the DIPNC. The Fund 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*.

NOTE 11 - SUBSEQUENT EVENTS

Subsequent to year-end, the EPA awarded the 2002 Clean Water Program capitalization grant to the State. The grant provides \$24,060,366 in additional funds and requires a State match of \$4,812,073. The total amount of \$28,872,439, less \$962,414 in administrative funds, will be used for making future loans to qualified agencies.

Subsequent to year-end, the EPA awarded the 2001 Drinking Water Program capitalization grant to the State. The grant provides \$14,065,400 in additional funds and requires a State match of \$2,813,080. Of the total funds of \$16,878,480, \$13,676,916 is available for loans to qualified local agencies.

NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

The remaining \$3,201,564 may be used for administration and set-asides. As of May 23, 2003, the EPA had not awarded the 2002 Drinking Water Program capitalization grant to the State.

NOTE 12 - ACCOUNTING CHANGES

Effective July 1, 2001, the State of North Carolina implemented Governmental Accounting Standards Board Statement 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*. The implementation of the new standard primarily impacted the presentation format of the financial statements.

NOTE 13 - NET ASSET RESTATEMENT

An error occurred in prior years because cash was recognized when bonds were authorized by the General Assembly rather than when they were sold. To correct this error, fund balance as of June 30, 2002 for Clean Water Program was reduced by \$8,589,163.

STATE OF NORTH CAROLINA
EPA Revolving Loan Fund
Combining Statement of Net Assets
June 30, 2002

Exhibit 1

	Clean Water Program	Drinking Water Program	Total
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 136,501,827	\$ 7,409,512	\$ 143,911,339
Receivables:			
Loans (Due within one year)	21,551,093	2,521,185	24,072,278
Accrued Interest	1,793,301	933,990	2,727,291
Other		96,168	96,168
State Treasurer's Securities Lending Collateral	111,845,502	6,071,132	117,916,634
Total Current Assets	271,691,723	17,031,987	288,723,710
Noncurrent Assets:			
Loans Receivable (Due after one year)	302,517,459	47,126,122	349,643,581
Total Assets	574,209,182	64,158,109	638,367,291
LIABILITIES			
Current Liabilities:			
Accounts Payable	19,697	25,780	45,477
Accrued Payroll	66,226		66,226
Accrued Vacation Leave	5,489	11,858	17,347
Obligations Under State Treasurer's Securities			
Lending Agreements	111,845,502	6,071,132	117,916,634
Other Accrued Liabilities	7,550	897	8,447
Total Current Liabilities	111,944,464	6,109,667	118,054,131
Noncurrent Liabilities:			
Accrued Vacation Leave	91,230	99,484	190,714
Total Liabilities	112,035,694	6,209,151	118,244,845
NET ASSETS			
Restricted for:			
Program Loans (Restated)	462,173,488	57,948,958	520,122,446
Total Net Assets	\$ 462,173,488	\$ 57,948,958	\$ 520,122,446

STATE OF NORTH CAROLINA
EPA Revolving Loan Fund
Combining Statement of Revenues, Expenses, and
Changes in Net Assets
For the Fiscal Year Ended June 30, 2002

Exhibit 2

	Clean Water Program	Drinking Water Program	Total
REVENUES			
Operating Revenues:			
Interest Income on Loans	\$ 8,979,930	\$ 875,572	\$ 9,855,502
Loan Closing Fees	1,228,443	305,490	1,533,933
Total Operating Revenues	10,208,373	1,181,062	11,389,435
EXPENSES			
Operating Expenses:			
Personnel	1,137,267	1,327,654	2,464,921
Fringe Benefits	186,714	235,519	422,233
Travel	6,458	21,886	28,344
Supplies	3,841	2,623	6,464
Software	2,252	106,717	108,969
Data Processing Services	22,653		22,653
Training	1,172		1,172
Postage and Printing		1,534	1,534
Registration	760	1,983	2,743
Telephone	11,021		11,021
Repairs		218	218
Rent	409	10,239	10,648
Miscellaneous		3,476	3,476
Equipment		32,612	32,612
Other	183,247		183,247
Regional Offices		32,981	32,981
Contractual Services		864,394	864,394
Indirect Cost	117,752	69,330	187,082
Total Operating Expenses	1,673,546	2,711,166	4,384,712
Operating Income (Loss)	8,534,827	(1,530,104)	7,004,723
NONOPERATING REVENUES			
Federal Grants	44,542,793	11,259,062	55,801,855
Interest Income	5,921,154	288,325	6,209,479
Miscellaneous Income	551,626		551,626
Total Nonoperating Revenues	51,015,573	11,547,387	62,562,960
Income Before Transfers	59,550,400	10,017,283	69,567,683
Transfers In	7,240,338	1,392,273	8,632,611
Increase in Net Assets	66,790,738	11,409,556	78,200,294
Net Assets July 1, as Restated	395,382,750	46,539,402	441,922,152
Net Assets June 30	\$ 462,173,488	\$ 57,948,958	\$ 520,122,446

STATE OF NORTH CAROLINA
EPA Revolving Loan Fund
Combining Statement of Cash Flows
For the Fiscal Year Ended June 30, 2002

Exhibit 3

	Clean Water Program	Drinking Water Program	Total
CASH FLOWS FROM OPERATING ACTIVITIES			
Collections of Program Loan Principal	\$ 20,133,929	\$ 1,857,907	\$ 21,991,836
Interest Received on Loans	8,754,768	939,734	9,694,502
Closing Fees on Loans	1,228,443	305,490	1,533,933
Program Loans Issued	(60,898,838)	(10,819,181)	(71,718,019)
Payments to Employees	(1,232,030)	(1,443,622)	(2,675,652)
Payments to Suppliers	(357,656)	(1,233,425)	(1,591,081)
Net Cash Used by Operating Activities	(32,371,384)	(10,393,097)	(42,764,481)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Federal Grants	44,542,793	11,259,062	55,801,855
State Contributions	7,240,338	1,392,273	8,632,611
Miscellaneous Income	551,626		551,626
Net Cash Provided from Noncapital Financing Activities	52,334,757	12,651,335	64,986,092
CASH FLOWS FROM INVESTMENT ACTIVITIES			
Investment Income	5,827,889	288,325	6,116,214
Net Increase in Cash and Cash Equivalents	25,791,262	2,546,563	28,337,825
Cash and Cash Equivalents, Beginning of Year	110,710,565	4,862,949	115,573,514
Cash and Cash Equivalents, End of Year	\$ 136,501,827	\$ 7,409,512	\$ 143,911,339
RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES			
Operating Income (Loss)	\$ 8,534,827	\$ (1,530,104)	\$ 7,004,723
Adjustments to Reconcile Operating Income to Net Cash Flow provided by Operating Activities:			
Loans Issued	(60,898,838)	(10,819,181)	(71,718,019)
Loan Repayment	20,133,929	1,857,907	21,991,836
(Increase) Decrease in Current Assets	(225,161)	175,504	(49,657)
Increase (Decrease) in Liabilities	83,859	(77,223)	6,636
Net Cash Used by Operating Activities	\$ (32,371,384)	\$ (10,393,097)	\$ (42,764,481)
NONCASH INVESTING ACTIVITIES			
Assets Acquired Through the Assumption of a Liability	\$ 111,845,502	\$ 6,071,132	\$ 117,916,634

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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**

Mr. William G. Ross, Jr., Secretary
North Carolina Department of Environment and Natural Resources

We have audited the financial statements of the EPA Revolving Loan Fund of the North Carolina Department of Environment and Natural Resources (the Department) as of and for the year ended June 30, 2002, and have issued our report thereon dated May 23, 2003.

As discussed in Note 1, the financial statements present only the EPA Revolving Loan Fund and do not purport, and do not, present the financial position of the State of North Carolina or the Department as of June 30, 2002, and the changes in financial position and cash flows, where applicable of the State of North Carolina or the Department, in conformity with accounting principles generally accepted in the United States of America.

As further discussed in Note 12 to the financial statements, the Department implemented Governmental Accounting Standards Board Statement 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments (as amended by Statement No. 37)* for 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 EPA Revolving Loan Fund's financial statements are free of material misstatement, we performed tests of the Department's 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 (CONCLUDED)**

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Department's internal control over financial reporting for the EPA Revolving Loan Fund 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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of management of the Department, the Governor, the State Controller, the General Assembly, and the U.S. Environmental Protection Agency and is not intended to be, and should not be, used by anyone other than these specified parties.



Ralph Campbell, Jr.
State Auditor

May 23, 2003

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June 30, 2003

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