

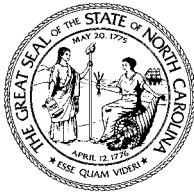
**TOWN OF BUTNER WATER
AND SEWER SYSTEM**
Butner, North Carolina

Financial Statement Audit Report

Year Ended June 30, 2004

Performed Under Contract With the
North Carolina Office of the State Auditor

Leslie W. Merritt, Jr. CPA, CFP
State Auditor



STATE OF NORTH CAROLINA
Office of the State Auditor

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

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

AUDITOR'S TRANSMITTAL

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

This report represents the results of the financial statement audit of the Town of Butner Water and Sewer System ("System") for the year ended June 30, 2004. Huntley, Sigmon, Walton & Wilson, CPAs performed this audit under contract with the Office of the State Auditor and their report is submitted herewith.

The audit of the System was conducted in accordance with the Trust Agreement between the State of North Carolina and the First-Citizens Bank & Trust Company, Trustee. This Agreement authorizes and secures the State of North Carolina Butner Water and Sewer System Revenue Bonds. The Agreement provides that the State shall cause the North Carolina Department of Health and Human Services to prepare and deliver to the Department Secretary within 180 days after the close of each fiscal year financial statements of the System. The Agreement also provides that the State shall cause the State Auditor to prepare and file annually with the Trustee, each Credit Provider and the Local Government Commission a statement by the State Auditor containing the calculation to determine compliance with the rate covenants described in Section 704 of the Agreement.

General Statute 147-64.2 provides that the State Auditor shall perform or coordinate all audit functions for the State government. General Statute 147-64.7 allows the State Auditor to obtain the services of independent public accountants to carry out its duties and functions.

North Carolina General Statutes require the State Auditor to make audit reports available to the public. Copies of all 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.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Leslie W. Merritt, Jr.".

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

TOWN OF BUTNER WATER AND SEWER SYSTEM
TABLE OF CONTENTS
Year Ended June 30, 2004

	<u>Page(s)</u>
INDEPENDENT AUDITORS' REPORT	1-2
 FINANCIAL STATEMENTS	
Exhibits	
A Statement of Net Assets	3
B Statement of Revenues, Expenses, and Changes in Fund Net Assets	4
C Statement of Cash Flows	5-6
Notes to the Financial Statements	7-20
 SUPPLEMENTARY INFORMATION	
Schedule	
1 Trust Agreement Rate Covenant Calculation	21-22
 ADDITIONAL AUDITORS' REPORT REQUIRED BY GOVERNMENT AUDITING STANDARDS	
Report on Internal Control over Financial Reporting and on Compliance and other matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	23-24
AUDIT FINDINGS AND RECOMMENDATIONS	25-27
DISTRIBUTION OF AUDIT REPORT	28

HUNTLEY
SIGMON
WALTON &
WILSON

HSW&W

Certified Public Accountants

PO Box 1406
348 Harper Avenue NW
Lenoir, North Carolina 28645
Phone: (828) 754-0777
Fax: (828) 754-1925

INDEPENDENT AUDITORS' REPORT

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 (the "System") as of June 30, 2004 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, 2004. 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, 2004, 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.

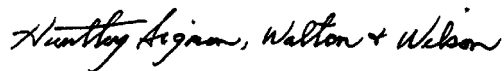
In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Town of Butner Water and Sewer System as of June 30, 2004, and the changes in its financial position and its cash flows for the year then ended in conformity with

accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2005, 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 in our audit.

Our audit was performed for the purpose of forming an opinion on the basic financial statements of the Town of Butner Water and Sewer System taken as a whole. The supplementary information in 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.

Huntley, Sigmon, Walton & Wilson, CPAs

A handwritten signature in cursive script that reads "Huntley, Sigmon, Walton & Wilson".

Lenoir, North Carolina
January 7, 2005

TOWN OF BUTNER WATER AND SEWER SYSTEM
STATEMENT OF NET ASSETS
June 30, 2004

Exhibit A

ASSETS

Current Assets:

Cash and Cash Equivalents (Note 2)	\$ 4,600,798
Restricted Investments - Held Outside the State Treasurer (Note 2)	95,264
Restricted State Treasurer's Securities Lending Collateral	3,524,000
Accounts Receivable (net of allowance for uncollectibles of \$23,131)	183,902
Interest Receivable	10,953
Inventories	<u>158,310</u>
Total Current Assets	<u>8,573,227</u>

Non-current Assets:

Cash and Cash Equivalents - Designated for Capital Improvements (Note 2)	269,235
Restricted Cash and Cash Equivalents - Customer Deposits (Note 2)	75,062
Restricted Cash and Cash Equivalents - Capital Improvements (Note 2)	1,796,194
Deferred Charges - Bond Issuance Cost	117,805
Capital Assets, net (Note 3)	<u>26,778,288</u>
Total Non-current Assets	<u>29,036,584</u>

Total Assets

37,609,811

LIABILITIES

Current Liabilities:

Accounts Payable	57,269
Obligations Under State Treasurer's Securities Lending Agreements	3,524,000
Intragovernmental Payable	1,215
Accrued Interest Payable	34,857
Deferred Revenues	1,825
Accrued Vacation Leave (Note 4)	15,734
Bonds Payable (Note 4)	<u>255,000</u>
Total Current Liabilities	<u>3,889,900</u>

Non-current Liabilities:

Customer Deposits Payable	75,062
Accrued Vacation Leave (Note 4)	130,353
Bonds Payable (Note 4)	<u>9,070,000</u>
Total Non-current Liabilities	<u>9,275,415</u>

Total Liabilities

13,165,315

NET ASSETS

Invested in Capital Assets, net of related debt	17,548,553
Restricted for Capital Improvements	1,796,194
Unrestricted	<u>5,099,749</u>
Total Net Assets	<u><u>\$ 24,444,496</u></u>

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
Year Ended June 30, 2004

Exhibit B

Operating Revenues:	
Sales and Services (net of allowances of \$999)	\$ 3,672,656
Fees, Licenses and Fines	13,763
Miscellaneous Revenues	36,691
Total Operating Revenues – (pledged as security for revenue bonds)	3,723,110
 Operating Expenses:	
Personal Services and Employee Benefits	1,361,215
Supplies and Materials	166,235
Contracted Personal Services	86,177
Travel	1,590
Communications	13,421
Utilities	454,392
Other Services	64,620
Depreciation	1,382,323
Amortization	5,416
Insurance	11,702
Other	212,420
Total Operating Expenses	3,759,511
 Operating Income (Loss)	 (36,401)
 Non-operating Revenues (Expenses):	
Investment Earnings	149,550
Debt Service Fees	(36,395)
Gain (Loss) on Disposal of Capital Assets	2,725
Insurance Recoveries	1,262
Surplus Sale	2,189
Interest Expense	(7,141)
Net Non-operating Revenues	112,190
 Net Income Before Contributions and Transfers	 75,789
Capital Contributions	862,335
Transfers Out	(288,909)
 Change in Net Assets	 649,215
Net Assets -- July 1, 2003 (Restated, Note 12)	23,795,281
 Net Assets -- June 30, 2004	 \$ 24,444,496

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
Year Ended June 30, 2004

Exhibit C

Cash Flows from Operating Activities:	
Receipts from Customers	\$ 3,213,824
Receipts from Other State Funds for Services Provided	572,425
Payments to Employees and Fringe Benefits	(1,334,290)
Payments to Vendors and Suppliers	(576,699)
Payments to Other State Funds for Services Used	(246,901)
Other Payments	(159,302)
	<hr/>
Net Cash Provided by Operating Activities	1,469,057
	<hr/>
Cash Flows from Noncapital Financing Activities:	
Transfers to Other Funds	(288,909)
	<hr/>
Net Cash Used by Noncapital Financing Activities	(288,909)
	<hr/>
Cash Flows from Capital and Related Financing Activities:	
Capital Contributions	862,335
Acquisition and Construction of Capital Assets	(5,053,046)
Proceeds from Sales of Capital Assets	4,914
Principal Paid on Capital Debt	(245,000)
Interest and Fees Paid on Capital Debt	(411,796)
Insurance Recoveries	1,262
Payments to Bond Escrow Agent	(42,458)
	<hr/>
Net Cash Used by Capital and Related Financing Activities	(4,883,789)
	<hr/>
Cash Flows from Investing Activities:	
Proceeds from Sales and Maturities of Investments	2,632,970
Interest on Investments	144,627
	<hr/>
Net Cash Provided by Investing Activities	2,777,597
	<hr/>
Net Increase (Decrease) in Cash and Cash Equivalents	(926,044)
	<hr/>
Cash and Cash Equivalents - July 1, 2003	7,667,333
	<hr/>
Cash and Cash Equivalents - June 30, 2004	\$ 6,741,289
	<hr/>

TOWN OF BUTNER WATER AND SEWER SYSTEM
STATEMENT OF CASH FLOWS (continued)
Year Ended June 30, 2004

Exhibit C

Reconciliation of Net Operating Revenues (Expenses) to Net Cash

Provided (Used) by Operating Activities:

Operating Income (Loss)	\$ (36,401)
Adjustments to Reconcile Operating Income to Net Cash	
Provided (Used) by Operating Activities:	
Depreciation and Amortization	1,387,739
Changes in Assets and Liabilities:	
Receivables, net	94,005
Inventories	2,241
Accounts Payable	(4,408)
Accrued Vacation Leave	26,925
Due to Other Funds	1,080
Deposits Payable	(1,145)
Deferred Revenues	(979)

Net Cash Provided by Operating Activities	\$ 1,469,057
-------------------------------------------	--------------

Noncash Investing, Capital and Financing Activities:

Assets Acquired through the Assumption of a Liability	\$ 3,524,000
Noncash Distributions from North Carolina Capital Management Trust	\$ 12,481
Change in Construction in Progress as a Result of Accruals	\$ (873,692)

Composition of Cash and Cash Equivalents:

Current Assets:	
Cash and Cash Equivalents	\$ 4,600,798
Non-current Assets:	
Cash and Cash Equivalents - Designated for Capital Improvements	269,235
Restricted Cash and Cash Equivalents - Customer Deposits	75,062
Restricted Cash and Cash Equivalents - Capital Improvements	1,796,194

Total Cash and Cash Equivalents - June 30, 2004	\$ 6,741,289
-------------------------------------------------	--------------

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, 2004

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.
- 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.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 1 -SIGNIFICANT ACCOUNTING POLICIES (continued)

- F. State Treasurer’s Securities Lending Collateral** -While the System does not directly engage in securities lending transactions, it deposits certain funds with the State Treasurer’s Short-Term Investment Fund which participates in securities lending activities. Based on the State Treasurer’s allocation of these transactions, the System recognizes its allocable share of the assets and liabilities related to these transactions on the accompanying financial statements as “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.
- H. Inventories** – Inventories, consisting of supplies for internal use, are stated at cost using the first-in, first-out method.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 1 -SIGNIFICANT ACCOUNTING POLICIES (continued)

- 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 (\$411,796 for June 30, 2004) 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 from these agreements, no amounts are recorded in the financial statements.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 1 -SIGNIFICANT ACCOUNTING POLICIES (continued)

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.

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

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

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, 2004, the System’s deposit in the State Treasurer’s Short-Term Investment Fund had a book balance of \$6,741,289 and a bank balance of \$6,772,000.

- 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, 2004, the investment had a cost and fair value of \$95,264. Since the System only owns shares in the fund rather than specific underlying securities, the investment has not been categorized according to custodial risk.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2004

Note 3 – CAPITAL ASSETS

A summary of changes in capital assets is presented as follows: (June 30, 2003 Balance is restated see Note 12)

	(As Restated) Balance June 30, 2003	Increases	Decreases	Balance June 30, 2004
Capital Assets, Non-Depreciable				
Construction in Progress	\$ 3,033,006	\$ 4,505,781	\$6,979,660	\$ 559,127
Total Capital Assets, Non-Depreciable	<u>3,033,006</u>	<u>4,505,781</u>	<u>6,979,660</u>	<u>559,127</u>
Capital Assets, Depreciable				
Buildings	3,277,583	-	-	3,277,583
Machinery and Equipment	590,779	85,370	-	676,149
Other Structures and Improvements	25,292,715	6,979,660	-	32,272,375
Total	<u>29,161,077</u>	<u>7,065,030</u>	<u>-</u>	<u>36,226,107</u>
Less Accumulated Depreciation:				
Buildings	1,728,018	127,172	-	1,855,190
Machinery and Equipment	385,837	36,344	-	422,181
Other Structures and Improvements	6,510,766	1,218,809	-	7,729,575
Total	<u>8,624,621</u>	<u>1,382,325</u>	<u>-</u>	<u>10,006,946</u>
Total Capital Assets, Depreciable, net	<u>20,536,456</u>	<u>5,682,705</u>	<u>-</u>	<u>26,219,161</u>
Total Capital Assets, net	<u>\$ 23,569,462</u>	<u>\$ 10,188,486</u>	<u>\$6,979,660</u>	<u>\$ 26,778,288</u>

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, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Bonds Payable	\$ 9,570,000	\$ -	\$ 245,000	\$ 9,325,000	\$ 255,000
Accrued Vacation Leave	119,164	89,232	62,307	146,089	15,734
Total Long-Term Liabilities	<u>\$ 9,689,164</u>	<u>\$ 89,232</u>	<u>\$ 307,307</u>	<u>\$ 9,471,089</u>	<u>\$ 270,734</u>

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2004

NOTE 4 –LONG-TERM LIABILITIES (continued)

B. Bonds Payable – At June 30, 2004, the System had bonds outstanding as follows:

Purpose	Series	Effective Interest Rate	Final Maturity Date	Original Amount of Issue	Principal Paid Through June 30, 2004	Principal Outstanding June 30, 2004
Water Treatment Plant Upgrade and Expansion	2001	4.21	9/1/2025	\$ 9,905,000	\$ 580,000	\$ 9,325,000

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.

Using rates of June 30, 2004, debts service requirements of the variable-rate debt, net swap payments and total debt service requirements at the effective interest rate, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
 JUNE 30, 2004

NOTE 4 –LONG-TERM LIABILITIES (continued)

Fiscal Year Ending June 30	Variable-Rate Bonds		Interest Rate Swaps, Net	Effective Interest	Total
	Principal	Interest			
2005	\$ 255,000	\$ 98,644	\$ 285,887	\$ 384,531	\$ 639,531
2006	270,000	95,768	277,554	373,322	643,322
2007	280,000	92,771	268,868	361,639	641,639
2008	295,000	89,626	259,752	349,378	644,378
2009	305,000	86,359	250,283	336,642	641,642
2010-2014	1,750,000	377,322	1,093,547	1,470,869	3,220,869
2015-2019	2,180,000	270,484	783,911	1,054,395	3,234,395
2020-2024	2,720,000	137,321	397,981	535,302	3,255,302
2025-2028	1,270,000	10,449	30,282	40,731	1,310,731
Total	\$9,325,000	\$ 1,258,744	\$ 3,648,065	\$ 4,906,809	\$ 14,231,809

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, 2005 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.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 4 –LONG-TERM LIABILITIES (continued)

C. Interest Rate Swap

Objective of the interest rate swap: In order to protect against the potential of rising interest rates, the System entered into an interest rate swap in connection with its \$9,905,000 Butner Water and Sewer System Revenue Bond Series 2001. The intention of the swap agreement was to effectively change the System's interest rate on the bonds to a fixed rate of 4.21% (plus remarketing and liquidity fees and any difference between the variable rate received by the System (65% of LIBOR) and the rate paid by the System on the variable rate bonds).

Terms: The swap agreement is with Bank of America, N.A. based on a notional amount of \$9,905,000 to mature on September 1, 2025. The swap's notional amount of \$9,905,000 matches the \$9,905,000 variable-rate bonds. Under the swap, the System pays a fixed payment of 4.21% to Bank of America, N.A. and receives a variable payment of 65% of LIBOR which was 1.36875% at June 30, 2004. On the other hand, the bond's variable rate coupons (1.08% at June 30, 2004) are closely associated with the variable BMA, which was 1.05% as of June 30, 2004.

Fair Value: Because interest rates have declined since execution of the swap, the swap has a negative fair value (the System would have to pay the counter-party if the System terminated the swap) of \$700,284 (Bank of America) as of June 30, 2004. The swap's negative fair value if terminated may be countered by a reduction in total interest payments required under a new swap creating a lower synthetic fixed rate. Because the coupons on the System's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from the counter-party representing mid-market or average estimates/quotes of the amounts that would be paid for replacement transactions (having the effect of preserving the economic benefit to the counter-party).

Credit risk: As of June 30, 2004 the System was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the System would be exposed to credit risk in the amount of the derivative's fair value.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 4 –LONG-TERM LIABILITIES (continued)

Basis risk and termination risk: The swap exposes the System to basis risk (including effects of any reduction in marginal tax rates) should the relationship between LIBOR and BMA converge, changing the synthetic rate to the System on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rate of 4.21% and the actual synthetic rate as of June 30, 2004 of (3.320% + 1.080%) 4.400% reflecting a Bond Rate/LIBOR relationship of 78.90% compared to 65% of LIBOR the System is receiving as of June 30, 2004. The swap may be terminated by either party if the other party fails to perform under the terms of the contract. If the swap is terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the System would be liable to the counterparty for that amount.

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 \$5,000,000 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.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 5 – RISK MANAGEMENT (continued)

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 System are included in the program. When an employee is injured, the System's primary responsibility is to arrange for and provide the necessary treatment for work related injury. The State is self-insured for workers' compensation. A third party administrator 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 1.82% 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.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

NOTE 6 – PENSION AND DEFERRED COMPENSATION PLANS (continued)

Benefit and contribution provisions for the Retirement System are established by North Carolina General Statute §135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2004, these rates were set at 0.22% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2004, the Town of Butner Water and Sewer System had a total payroll of \$1,259,102, all of which was covered under the Retirement System. Total employee and employer contributions for pension benefits for the year were \$2,770 and \$75,546, respectively. The Town of Butner Water and Sewer System made one hundred percent of its annual required contributions for the years ended June 30, 2004, 2003, 2002, and 2001, which were \$2,770, \$0, \$21,760, and \$55,580, respectively.

- 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 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.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

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 3.2% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal year ended June 30, 2004, the System's total contribution to the Plan was \$40,291. 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, 2004, the System contributed 0% of covered payroll, or \$0 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*.

NOTE 8 – COMMITMENTS AND CONTINGENCIES

Construction Commitments – The System had outstanding commitments of \$848,628 at June 30, 2004 for capital improvement projects.

The System is currently exchanging discovery in a suit against NCDHHS (North Carolina Department of Health and Human Services) by an electrical contractor. The claim asserts breach of contract on NCDHHS's part by holding retainage and for additional costs to the contractor of \$417,599. NCDHHS has a counterclaim totaling \$110,408. The System and NCDHHS intend to vigorously contest the case, however the outcome is not known at this time.

TOWN OF BUTNER WATER AND SEWER SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

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 \$288,405 during the year to the System’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 System to support program administration. During the year, \$504 was transferred to the general fund for this purpose.

NOTE 10 – SUBSEQUENT EVENT

On August 27, 2004 the Town of Butner Water and Sewer System purchased from Bay River Metropolitan Sewerage District its allocation of Nitrogen Credits. Total cost is \$1,681,075 to be paid in 15 annual installments of \$112,071.66 each on September 1st, the last payment will be in the year 2018. At closing of the agreement on August 27, 2004 a check for \$92,071.66 was presented and \$20,000.00 from escrow was also applied.

NOTE 11 – ARBITRAGE REBATE

The System is currently contracting to have the Arbitrage Yield Rebate calculated following IRS Code Section 148 which is due no later than 60 days after the end of every 5th bond year throughout the term of the 2001 Bond Issue. The System currently has estimated any “Arbitrage Rebate and Penalty in lieu of Arbitrage Rebate” will be immaterial. The result of falling investment rates since the inception of the 2001 Bonds should result in a yield that will not be “materially higher than the yield of the bond issue”.

NOTE 12 – NET ASSETS RESTATED

The System did not depreciate certain construction projects when the projects were determined completed. The restatement represents depreciation from June 30, 1999 thru 2003.

Net Assets – July 1, 2003 (original)	\$24,202,736
Prior period adjustment	
Depreciation 1999-2003	<u>407,455</u>
Net Assets – July 1, 2003 (restated)	<u>\$23,795,281</u>

TOWN OF BUTNER WATER AND SEWER SYSTEM
TRUST AGREEMENT RATE COVENANT CALCULATION
 JUNE 30, 2004

Schedule 1

Section 704(a) Calculation:

Calculation of Income Available for Debt Service:

Revenue from Services:

Operating Revenue (Exhibit B)	\$ 3,723,110	
Add investment earnings on revenue deposits	142,409	
Revenue from Services		\$ 3,865,519

Adjusted Current Expenses:

Operating Expenses (Exhibit B)	3,759,511	
Less Depreciation/Amortization (Exhibit B)	1,387,739	
Less Adjusted Current Expenses		2,371,772

Income Available for Debt Service		\$ 1,493,747
------------------------------------------	--	---------------------

Determination of Largest Rate Covenant Requirement:

120% of long-term debt service requirement on parity indebtedness (120% of \$663,937 – adjusted for capitalized interest)		\$ 796,724
100% of long-term debt service requirement on parity indebtedness and subordinated indebtedness		\$ 663,937
Less Largest Rate Covenant Requirement		796,724

Excess Income Available for Debt Service – in accordance with Section 704(a)		\$ 697,023
-------------------------------------------------------------------------------------	--	-------------------

Section 704(b) Calculation:

Calculation of Receipts:

Operating Revenue (Exhibit B)	\$ 3,723,110	
Add investment earnings on revenue deposits	142,409	
Receipts		\$ 3,865,519

Requirements Against Receipts:

Adjusted Current Expenses:

Operating Expenses (Exhibit B)	\$ 3,759,511	
Less Depreciation/Amortization (Exhibit B)	1,387,739	
Adjusted Current Expenses		2,371,772

TOWN OF BUTNER WATER AND SEWER SYSTEM
TRUST AGREEMENT RATE COVENANT CALCULATION (continued)
JUNE 30, 2004

Schedule 1

Section 704(b) Calculation (continued):

Deposits Required by Sections 504(a), (b) and (c):		
Section 504(a) as to payment of interest (adjusted for capitalized interest)	418,937	
Section 504(b) as to payment of principal	245,000	
Section 504(c) as to deposits to the Parity Reserve Account and the Special Reserve Account	<u>0</u>	
Section 504 Deposits		663,937
Deposits Required by Subordinated Indebtedness Resolutions		<u>0</u>
Less Requirements Against Receipts		<u>3,035,709</u>
Excess Income Available for Debt Service – In accordance with Section 704(b)		<u>\$ 829,810</u>

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.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH *GOVERNMENT AUDITING STANDARDS*

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 (the "System") as of and for the year ended June 30, 2004, and have issued our report thereon dated January 7, 2005. As discussed in Note 1, the financial statements of the Town of Butner Water and Sewer System are intended to present the financial position and results of operations and cash flows of only that portion of the State of North Carolina financial reporting entity that is attributable to the transactions of the System.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

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:

Finding

1. *Inadequate Internal Control Over Billings and Collections.*
2. *Failure to Close and Depreciate Completed Construction Projects.*

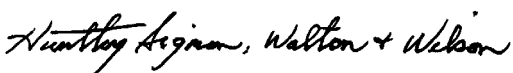
A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected 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 consider Item #2 to be a material weakness.

Compliance

As part of obtaining reasonable assurance about whether the System's financial statements are free of material misstatements, we performed tests of it 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 or other matters that are required to be reported under *Government Auditing Standards*.

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 State Auditor, 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.

Huntley, Sigmon, Walton & Wilson, CPAs



Lenoir, North Carolina
January 7, 2005

TOWN OF BUTNER WATER AND SEWER SYSTEM
AUDIT FINDINGS AND RECOMMENDATIONS
JUNE 30, 2004

Matters Related to Internal Control Over Financial Reporting

1. INADEQUATE INTERNAL CONTROL OVER BILLINGS AND COLLECTIONS

During our audit, we noted certain 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 were as follows:

- The billing system should provide information in a format needed for effective management, monitoring, and record keeping. For example, the water and sewer revenues are summarized on the daily transaction report but they are not summarized monthly or on year end reports. The system should also provide a comparison of usage of current month to previous year's same month for example, comparing February 2004 to February 2003, in order to determine unusual variations in water use. Management utilizes the Preliminary Billing report for determining the top users. However, management should also document evidence of such by initialing and dating such review.

Recommendation: While action has been taken to address many of the issues raised during the June 30, 2004, 2003 and 2002 audits of the System, we believe that the following Agency's response indicate sufficient alternative procedures to ensure the safeguarding of the System's Assets against misuse or material error.

Agency's Response: The System provides the following response:

The following internal control stages monitor water production, usage, billing and collection:

1) Water Production (Treatment Plant):

- Finished water production volume is recorded hourly with daily total used to calculate monthly production via monthly report to Public Water Supply (North Carolina Public Water Supply);
- Losses from 10 to 15% of total production volume is expected due to backwash of filters, other production procedures, plus system leakage;
- Significant water losses of water monitored through hourly storage tank level reading by 24-hour staff;
- Pressure meter indicating status of water demand in distribution system is monitored to identify any significant water loss.

2) Distribution System:

- Town issues zoning permits for any new construction or new water service;
- Utility crew/street maintenance staff oversee any new construction or new water service installed during continuous work related activities throughout Town;

TOWN OF BUTNER WATER AND SEWER SYSTEM
AUDIT FINDINGS AND RECOMMENDATIONS
JUNE 30, 2004

- Utility crew routinely inspects water mains for leaks; repairs are begun within the hour, day or night;
- Town residents keep the Town staff informed of any leaks or construction;
- Fire hydrants used by unauthorized persons is unlawful, staff reports such use;
- Observation for unusual flow in gutters, ditches and creeks are reported for investigation.

3) Water Meter Control:

- Meter reading cycle commences first workday each month with supervisor working two-man team. Handheld computerized water accounting instruments reject entered meter reading if reading is outside acceptable parameters (too high, too low) for water usage. Verified by meter reader;
- Error report created from download of handheld units into Accounting Technician computer, reviewed by Accounting Technician to determine if any accounts missed or suspected of error;
- Accounting Technician provides report to a supervisor not in charge of reading meters, or to utilities crew to verify each questionable meter reading;
- Billing corrections then made to questionable accounts if error found.

4) Monthly Billing:

- After meter reading completed, and corrections made, the Preliminary Billing Report is downloaded showing customer's name, account number, address, previous and current reading, previous and current usage amounts billed. Accounting Technician reviews each customer's billing record to determine suspected errors and creates work orders for verification by meter reader or utilities crew for correction or confirmation;
- Once all final corrections or verifications are made, the Final Billing Report is downloaded, reviewed, bills printed and mailed.
- Uncollected amounts are reviewed monthly from an Aged Trial Balance of Customer Receivables by Town Management and Staff. Water is disconnected at certain intervals for failure to pay past due water bills. The meter is locked and checked periodically by Town Staff to ensure that the meter has not been reopened by an unauthorized person.

2. FAILURE TO CLOSE AND DEPRECIATE COMPLETED CONSTRUCTION PROJECTS

During our audit, we noted that construction projects for the System had not been closed for several years. The System investigated the Construction In Progress asset and determined that for several years a number of projects were not closed due to a failure to communicate to NCDHHS's Controllars office that the projects were closed. The resulting closing and depreciation calculation required a restatement of net assets, accumulated depreciation and depreciation expense for several years. The net effect being a \$407,455 prior period adjustment and additional depreciation of \$740,488 for the year ended June 30, 2004.

TOWN OF BUTNER WATER AND SEWER SYSTEM
AUDIT FINDINGS AND RECOMMENDATIONS
JUNE 30, 2004

Recommendation: The System should review their current procedures for closing construction projects and establish a year-end CAFR procedure to ensure that projects are reviewed and closed at June 30 of each year.

Agency's Response: NCDHHS has reviewed their procedures and determined that the NC State Property and Construction Division, upon completion of the final engineering studies, will copy to both the NCDHHS – Property and Construction Division and the NCDHHS – Controller's office. In addition, a procedure will be added by the State Controller's office to the CAFR checklist to review construction in progress for any omissions at June 30 of each year.

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 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
Ms. Laketha Miller	Controller, Department of Health and Human Services

LEGISLATIVE BRANCH

Appointees to the Joint Legislative Commission on Governmental Operations

President Pro Tempore	Speaker of the House
Senator Marc Basnight, Co-Chair	Representative James B. Black, Co-Chair
Senator Charles W. Albertson	Representative Richard T. Morgan, Co-Chair
Senator Daniel G. Clodfelter	Representative Martha B. Alexander
Senator Walter H. Dalton	Representative Rex L. Baker
Senator Charlie S. Dannelly	Representative Bobby H. Barbee, Sr.
Senator James Forrester	Representative Harold J. Brubaker
Senator Linda Garrou	Representative Debbie A. Clary
Senator Fletcher L. Hartsell, Jr.	Representative E. Nelson Cole
Senator David W. Hoyle	Representative James W. Crawford, Jr.
Senator Ellie Kinnaird	Representative William T. Culpepper, III
Senator Jeanne H. Lucas	Representative W. Pete Cunningham
Senator Anthony E. Rand	Representative W. Robert Grady
Senator Eric M. Reeves	Representative Joe Hackney
Senator Robert A. Rucho	Representative Julia C. Howard
Senator R. C. Soles, Jr.	Representative Joe L. Kiser
Senator Scott Thomas	Representative Edd Nye
	Representative William C. Owens, Jr.
	Representative Wilma M. Sherrill
	Representative Thomas E. Wright

Other Legislative Officials

Mr. James D. Johnson	Director, Fiscal Research Division
----------------------	------------------------------------

ORDERING INFORMATION

Copies of this report may be obtained by contacting the:

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

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

Telephone: 919/807-7500

Facsimile: 919/807-7647