



STATE OF NORTH CAROLINA

FISCAL CONTROL AUDIT REPORT ON
DEPARTMENT OF HEALTH AND HUMAN SERVICES
DIVISION OF MENTAL HEALTH, DEVELOPMENTAL
DISABILITIES AND SUBSTANCE ABUSE SERVICES
BROUGHTON HOSPITAL
MORGANTON, NORTH CAROLINA
FOR THE PERIOD JULY 1, 2004, THROUGH DECEMBER 31, 2004

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

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Department of Health and Human Services
Mr. Michael Moseley, Director
Division of Mental Health, Developmental Disabilities and Substance Abuse Services
Mr. Seth P. Hunt, Jr., Hospital Director/CEO,
Broughton Hospital

This report presents the results of our fiscal control audit of Broughton Hospital for the period July 1, 2004, through December 31, 2004. Our work was performed by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes* and was conducted in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States. The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources.

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance or other matters that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report.

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

Leslie W. Merritt, Jr.

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

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BACKGROUND INFORMATION

Broughton Hospital is the largest psychiatric institution operated by the State of North Carolina. The facility provides care to individuals with psychiatric disorders in the 35 westernmost counties of North Carolina, which have approximately 3 million residents, or 36% of the State's total population. The hospital maintains an acute medical unit in addition to providing psychiatric care. It provides services to over 4,000 people per year and has approximately 1,200 employees. The hospital has an annual operating budget of approximately \$65 million. It is certified by the Centers for Medicaid and Medicare Services and accredited by the Joint Commission on Accreditation of Healthcare Organizations.

Management at Broughton Hospital reports to the Division of Mental Health, Developmental Disabilities, and Substance Abuse Services. The Division is part of the Department of Health and Human Services.

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OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS

OBJECTIVES

As authorized by Article 5A of Chapter 147 of the *North Carolina General Statutes* and in accordance with the standards contained in *Government Auditing Standards* issued by the Comptroller General of the United States, we have conducted a fiscal control audit at Broughton Hospital.

The objective of a fiscal control audit is to gather and evaluate evidence about internal control over selected fiscal matters, such as financial accounting and reporting; compliance with finance-related laws, regulations, and provisions of contracts or grant agreements; and/or management of financial resources. Our audit does not provide a basis for issuing an opinion on internal control, and consequently, we have not issued such an opinion.

Management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that relevant objectives are achieved. Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

SCOPE

Our audit scope covered the period of July 1, 2004, through December 31, 2004, and included selected internal controls from the following accounts:

Hospital and Medical Diagnostics Revenues – These revenues represent the fees collected by the hospital for the rental of bed space to outside mental health organizations. The hospital reported \$1.9 million in funds collected from the mental health organizations during the audit period. We examined internal controls designed to ensure that the facility properly accounted for and reported these revenues.

Payroll Expenditures – We reviewed expenditures for shift premium, on-call and callback pay. Shift premium is paid when employees work before or after traditional business hours. On-call pay is for employees who must be available to return to work if called back in case of emergency. Callback pay is for employees who are called into work outside of their regular work schedule. The hospital reported these types of payroll expenditures to be approximately \$1.2 million during the audit period. We examined internal controls designed to ensure that payroll expenditures were made in compliance with state personnel policies and properly recorded.

OBJECTIVES, SCOPE, METHODOLOGY, AND RESULTS (CONCLUDED)

Supplies and Materials Expenditures – These expenditures represent the supplies and materials needed by the hospital, including medical and pharmaceutical supplies. During the period under audit, the hospital reported purchases of supplies and materials of approximately \$2.6 million. We examined internal controls designed to ensure that the hospital’s supplies and materials inventory system complies with state inventory policies and that these expenditures were properly accounted for and recorded.

Food and Vending Revenue – This account consists of the funds collected from breakfast and lunch sales in the employee’s cafeteria at Broughton Hospital. The hospital reported approximately \$72,000 in revenues collected from the cafeteria during the audit period. We examined internal controls designed to ensure that the revenues were properly accounted for and reported in the financial records.

Petty Cash – The hospital utilizes petty cash to make small purchases, make change, provide emergency assistance to denied or discharged patients, pay for patient outings, or other miscellaneous items. Approximately \$4,000 is held in the various petty cash funds throughout the facility. We reviewed internal controls to determine whether petty cash practices complied with state cash management and hospital policies and whether the hospital properly accounted for and recorded petty cash transactions.

METHODOLOGY

To accomplish our audit objectives, we gained an understanding of internal control, performed tests of control effectiveness, and/or performed direct tests of the accounts and transactions as we considered necessary in the circumstances. Specifically, we performed procedures such as interviewing personnel, observing operations, reviewing policies, analyzing accounting records and examining documentation supporting recorded transactions and balances.

RESULTS

The results of our audit disclosed deficiencies in internal control and/or instances of noncompliance that are considered reportable under *Government Auditing Standards*. These items are described in the Audit Findings and Recommendations section of this report.

AUDIT FINDINGS AND RECOMMENDATIONS

1. PHYSICAL INVENTORY COUNTS REVEALED INTERNAL CONTROL WEAKNESSES

There were weaknesses in Broughton Hospital's controls over inventory and physical inventory counts obtained during the annual inventory. An analysis of purchase and usage reports for non-controlled substances and tests of the perpetual inventory records for other inventory types revealed a high rate of error:

Section	Inventory Items Tested	Inventory Items in Error
Central Warehouse – Medical Supplies	31	12
Central Warehouse – Pharmacy – Controlled Substances	7	1
Central Warehouse – Pharmacy – Non-Controlled Substances	5	5
Main Warehouse – Dry Goods	21	3
Main Warehouse – Food section	21	1
Post Office – Office Supplies	30	11

Although most of the individual differences between the perpetual inventory records and the actual inventory on hand at the time of the count were not very large nor equated to a large dollar amount, there were a few exceptions (see discussion below) but, more importantly, the incidence of error indicates that controls over the hospital's inventory needs strengthening.

Other control weaknesses were noted during the course of the audit:

- Non-controlled substances are not tracked in any type of perpetual inventory system, as are controlled substances, medical supplies, and other types of supplies. Additionally, counts of non-controlled substances at the annual inventory are not always based on the actual number of inventory items on hand. For instance, one drug was understated by 475 pills; another overstated by 2,871 pills. A key cause for errors is the practice of pharmacy personnel to estimate the number of pills in open containers. Although not required to be tracked by the Drug Enforcement Agency, non-controlled substances are considered inventoriable items and should be tracked in an inventory system;

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

- The medical supply room in the Central Warehouse – Medical Supplies section is within the pharmacy and is generally locked. However, when the inventory clerk is away from the medical supply room, it is unlocked and accessible by all persons in the pharmacy. Pharmacists can obtain medical supplies without a usage order form and without logging the items taken while the inventory clerk is unavailable. The inventory clerk has additional job responsibilities within the pharmacy, which cause him to be away from the supply room for a portion of the day. Additionally, when medical supplies are delivered to the wards, a signature is not required for receipt of the items;
- Employees receiving supplies from the Post Office – Office Supplies section were not required to sign the pick ticket to verify receipt of supplies.

The Office of the State Controller requires that controls be designed such that access to assets is limited to those individuals authorized by management. Also, good controls require that receipt and delivery of supplies be documented. Perpetual inventory records should be compared with actual amounts on hand to maintain accuracy and differences, if any, should be investigated and reconciled.

Recommendation: Management should reiterate the importance of following internal control policies and should monitor adherence to them. Management should establish procedures to ensure that the inventory on hand agrees with the perpetual inventory records and that recorded quantities are based on actual counts rather than estimates. The hospital should implement a system to adequately account for non-controlled substances, which may include adding non-controlled substances to the perpetual inventory system.

Agency's Response: Management concurs with the findings. Management has reiterated to all warehouse managers the importance of following internal control policies and will monitor adherence to them. The hospital has implemented many new controls procedures and policies to strengthen internal controls and reduce the amount of inventory discrepancies.

To ensure that the inventory on hand agrees with the perpetual inventory records, management will require the main warehouse, post office and central warehouse-medical supply areas to perform cycle counts on 10% of their inventory items each month. Differences between the actual counts and the perpetual records will be investigated and reconciled. Records of the cycle counts will be maintained for a period of three years. This process will begin July 2005.

In the Pharmacy area relating to controlled and non-controlled substances, an actual count of all items, including open containers, will be conducted for year-end inventory in June 2005. Management will compare the additional cost associated with completing this inventory against previous year's cost to determine the cost effectiveness for future years. Management's finding and decisions will be documented for future reference.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

In the Pharmacy area relating to an inventory system for non-controlled substances, Management will explore the options available, including additions to NCAS inventory system, and evaluate the cost associated with each by December 31, 2005. By May 31, 2006, Management will have fully implemented a system to account for non-controlled substances more adequately.

There have also been controls put in place for the Medical Supply room inside the pharmacy. A sign-out form has been developed to allow non-Central Supply Pharmacy personnel to procure items from the Central Supply inventory during nights, weekends and holidays to meet the patient care needs of the facility. There is usually only one person on call at a time after normal business hours so the inventory clerk will be responsible for verifying the items listed on the sign-out form when he returns. This will allow patient care needs to be met while maintaining tighter control over the Central Supply inventory process. Furthermore, all inventory returned from the hospital to Central Supply will be maintained in a return area. The goods returned will be documented on the Central Supply dispensing and return form described earlier, along with the item number and quantity.

2. INTERNAL CONTROL WEAKNESSES OVER EMPLOYEE CAFETERIA RECEIPTS

There are weaknesses in Broughton Hospital's controls over receipts in the employee cafeteria. Cash register receipts from the cafeteria are not being reconciled to the daily deposit slips. An examination of 40 deposits revealed the following:

- The hospital was unable to locate documentation consisting of cash register receipts and deposit slips for six deposits;
- The amounts recorded as deposited for 12 deposits did not agree with the supporting documentation. For 11 deposits, the recorded deposit ranged from \$1.08 to \$13.90 more than the cash register receipt. One item was found to be \$20.00 less than the supporting cash register receipt.

There is the risk that errors will be made when cash is counted, collected or when change is disbursed. Additionally, items could be purchased and cash collected, but the transaction not recorded in the cash register. These weaknesses increase the risk of misappropriation of assets and may result in an over or understatement of receipts.

The Cash Management Section of the Department of State Treasurer Policies Manual requires that adequate records for daily receipts and deposits be maintained.

Recommendation: Management should enhance controls over cafeteria receipts in an effort to safeguard assets against misuse or theft. Supporting documentation should be kept for the daily cafeteria deposits. The daily total from the cafeteria's cash register receipts should be reconciled with the deposit slips before the cashier's office issues a receipt for the cash. If there is any discrepancy between the amount on the deposit slip

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

and the cash register receipt, the cafeteria's cashier should attach documentation reconciling the discrepancy.

Agency's Response: Management concurs with the findings and recommendations. In an effort to enhance controls over cafeteria receipts, the following procedures have been put in place:

- 1). Daily cash register receipts and deposit slips/receipts from the cafeteria are being stored in a secure location and will be maintained for a period of three years effective April 1, 2005.
- 2). A daily reconciliation and deposit form has been developed to assist the cafeteria in identifying and reconciling cash overages/shortages.
- 3). The daily total from the cafeteria's cash register tape is reconciled with the cash in the cash register by the cafeteria's cashier and cafeteria supervisor daily on a Cafeteria Reconciliation & Deposit Form. A copy of this form, along with the cash register receipts and the money from the cafeteria, will be given to the Cashier II for deposit. Effective May 24, 2005, the Cashier II will compare the cash register tape and Cafeteria Deposit form with the cash. Any discrepancies will be recorded as an entry in the Cash Over/Short account and identified. At the end of the fiscal year the Cash Over/Short account will be zeroed.

3. IMPROVE CONTROLS OVER PETTY CASH TRANSACTIONS AND FUNDS

Control weaknesses were identified during the audit of petty cash at Broughton Hospital:

- The hospital's policies and procedures lacked the specific guidelines to indicate the type of expenditures that should be paid from petty cash. Without proper guidelines, it is possible that funds can be misused or misappropriated;
- In an examination of 25 petty cash transactions in the Special Revenue fund, we noted four petty cash disbursements with no supporting documentation, ranging from \$24.00 to \$96.00 each. This lack of documentation may allow a misappropriation of assets or theft to go undetected. The cash management policy requires that petty cash vouchers, supporting receipts, and a summary sheet indicating the code numbers and amounts to be charged to each account be attached to the requests for petty cash reimbursements;
- One petty cash fund in the cashier's office was short by \$11.40 and the hospital was unable to explain the shortage.

Recommendation: The hospital should improve internal controls over petty cash in an effort to reduce the risk of misuse or misappropriation of assets. The hospital should implement changes to improve the process for obtaining supporting receipts for petty

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

cash transactions. Additionally, management should describe in its policies the types and amounts of expenditures that can be paid from its petty cash funds.

Agency's Response: Management concurs with the findings and recommendations.

Effective March 15, 2005, procedures were reinforced that require supporting receipts for all petty cash transactions. Division Director and/or immediate supervisor will be notified by the cashier if receipts and/or cash are not returned to the cashier's office within 2 business days. Appropriate disciplinary action will be followed if necessary. The Budget Officer will verify that receipts are attached before approving transactions for reimbursement.

Management has developed a list to describe the types and amounts of expenditures that can be paid from each petty cash fund. The list will be attached to Administrative Policy 5-4 Petty Cash as attachment PC-1.

Management will review policies and procedures annually and make changes as necessary to reduce the risk of misuse or misappropriation of assets.

4. LACK OF ADEQUATE INTERNAL CONTROLS OVER ON-CALL AND EMERGENCY CALLBACK PAYMENTS

Broughton Hospital is not in compliance with the policy that requires on-call hours be reduced by emergency callback hours. This has caused the hospital to over-compensate its employees for on-call time since July 2004, the date when a new State Personnel policy took effect. Additionally, the hospital does not have an independent verification of emergency callbacks to ensure the accuracy of emergency callback time reported. The employee completes a report the day after the callback documenting that the callback was performed. This report is the only documentation needed by payroll to process the payment. The lack of verification gives the employee the opportunity to falsely report emergency callbacks.

According to the State Personnel policy, employees can either be compensated for being on-call or granted one hour of compensatory leave for every eight hours spent on-call. If compensatory time is granted, it must be used within 12 months or the employee should be paid for the time at the employee's normal hourly pay rate. Also, on-call time should be reduced by the amount of emergency callback time realized when computing the amount of compensation for being on-call.

The hospital is aware of the failure to compute on-call and emergency callback compensation in accordance with State Personnel Policies. It is in the process of determining the amount of over-compensation. Effective with the March 2005 pay period, the hospital adjusted its computation procedures to comply with the policy.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

Recommendation: The hospital should determine the amount of on-call over compensation and make adjustments as necessary. The hospital should also strengthen controls over payroll transactions by requiring management to monitor and verify emergency callbacks. Consideration should be given to the maintenance of a log of emergency callbacks, or some other method, that would include dates, times, personnel called, person requesting the call. The log could be used to verify the hours reported on the emergency callback report.

Agency's Response: Management concurs with the findings and is taking measures to comply with the recommendation.

The amount of on-call over-compensation has been calculated and all adjustments will be completed on May 2005 timesheets as end of month balances are calculated.

Currently, our Admitting Office maintains an admission log that includes dates, times, personnel called, patient called for, and time the physician arrived. This log is faxed to and reviewed by the Clinical Director on a daily basis and provides an independent verification for clinical staff's calls. The returning physician completes an Emergency Call Back Report stating time of call back, person requesting the call back, time arrived, time left, patient's name and ward number. This form is sent to and reviewed by the Clinical Director's office staff daily. The Telecommunications Center maintains a daily Log File Report of all pages that were sent out indicating date, time, person(s) paged, and location for which they were paged.

With the processing of the June 2005 payroll the following steps will be implemented in order to monitor and verify emergency callbacks.

Clinical Staff: The secretary for the Clinical Director's Office will compare the Emergency Call Back Report for each clinical staff to the daily admissions log completed by the Admitting Office to verify actual call backs occurred. Copies of the Telecommunications Log File Report may also be used to verify time of call backs. These logs will remain part of the official timekeeping record and initialed by the secretary indicating verification was completed. Any discrepancies will be brought to the attention of the Clinical Director.

Non-Clinical Staff: The timekeeper for the assigned area will randomly select dates of the month to verify the call backs. The timekeeper will pull the Log File Report from Telecommunications for the dates selected and compare to the emergency callback reported on the timesheet to verify date and time of the actual call back. Timekeeper will initial the callback on the timesheet and attach the Log File Report to the timesheet indicating verification was completed. Discrepancies will be brought to the attention of the immediate supervisor.

AUDIT FINDINGS AND RECOMMENDATIONS (CONTINUED)

5. IMPROPER ACCESS TO COMPUTER SYSTEMS

Three former Broughton Hospital employees continued to have access, and a currently employed person had unneeded access, to the North Carolina Accounting System and were listed on its various security reports. Control procedures for terminating access to the accounting system were not followed. Supervisors did not inform the security administrator that these individuals no longer were authorized and/or needed access to the accounting system. Improper access to computer systems can result in alteration, unauthorized use, or loss of information.

Recommendation: The hospital should terminate user access to the State's computer systems in a timely manner for users no longer authorized and/or needing access. Supervisors, or other appropriate officials, should inform the system security administrator immediately and in writing of any changes in a user's status. Periodic security access reviews should be conducted to ensure that access is restricted to users authorized and/or needing access.

Agency's Response: Management concurs with the recommendations.

Procedures were put in place April 1, 2005, whereby Human Resources will notify the IT Department and Budget Office in writing of separated/terminated employees on a regular basis in order for computer access to be terminated. Security access reviews will be conducted of all users at the same time to ensure access is restricted to only authorized users. The Budget Office will notify DHHS Purchasing of any users requiring changes to their NCAS security.

6. HOSPITAL BED-DAY BILLING ERRORS

The Department of Health and Human Services did not bill the Piedmont Area Mental Health, Developmental Disabilities and Substance Abuse Authority correctly for the number of bed days utilized by the Authority at state-owned mental health facilities. Based on a recalculation of the billings in question to the Authority, the Authority owes the State \$47,866 that was never recognized and billed. Also, even though Broughton received the proceeds from the Authority billings, other state institutions actually cared for some of the patients and should have been credited with some of the proceeds. As of December 31, 2004, Broughton received \$289,087 that should have been credited to other institutions.

The billing calculations were not performed in accordance with the rates specified in the memorandum of understanding between the Department and the Authority. There was a misinterpretation in how to apply rates for bed days utilized at the various state facilities.

Recommendation: The Department and Division should implement those controls needed to ensure that bills are calculated correctly. Adjustments should be made to correctly record revenues at the various institutions impacted by these errors. The Division should bill and collect from the Authority the remaining amount owed for the

AUDIT FINDINGS AND RECOMMENDATIONS (CONCLUDED)

bed days used at State facilities. Additionally, management should communicate to persons responsible for these transactions the importance of accuracy and the proper interpretation and application of rates.

Agency's Response: The Accounts Receivable Section of the DHHS Controller's Office agrees with the audit finding.

Understated invoices were sent to Piedmont Area MH/DD/SAS Authority by the Remittance Processing and Other Accounts Receivable Branch in the Accounts Receivable Section based on billing calculations that were programmatically summarized in error. For the period audited, the Authority owes the State \$47,866 that was not recognized and billed until May 18, 2005. After being notified by the State Auditor's Office, the Accounts Receivable Section and DMH/DD/SAS Management collaborated to revise the incorrect billings through dates of service ending March 31, 2005. On May 18, 2005, corrected invoices and a cover letter were sent to the Authority requesting payment in the amount totaling \$56,957.86. This amount includes the \$47,866 determined by the State Auditor's Office for dates of service ending December 31, 2004. Further invoicing for months after March 2005 has been suspended until billing calculation summaries received from DIRM can be reviewed and corrected.

In addition, proceeds from the Authority billings were incorrectly credited to Broughton Hospital's revenue accounts, which should have been credited to other institutions that actually provided the services. The Accounts Receivable Section intends to correct revenue classification errors amounting to at least \$289,087 for Broughton Hospital before fiscal year ending June 30, 2005. Furthermore, the Accounts Receivable Section and DMH/DD/SAS Management have taken steps to strengthen communication efforts to ensure that written instructions related to billing and receiving of these types of revenues are acknowledged and followed accurately. The Accounts Receivable Section has obtained the Memorandum of Understanding between DMH/DD/SAS and Piedmont and will take measures to ascertain proper interpretation and application of rates before invoices are prepared and sent to payer.

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.

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July 15, 2005

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