STATE OF
NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

MARTIN COMMUNITY COLLEGE

WILLIAMSTON, NORTH CAROLINA

FOR THE YEAR ENDED JUNE 30, 2005

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

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STATE OF NORTH CAROLINA
Office of the State Auditor

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

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Trustees, Martin Community College

We have completed a financial statement audit of Martin Community College for the year ended June 30, 2005, and our audit results are included in this report. You will note from the independent auditor's report that the financial statements referred to above include only Martin Community College. The financial statements do not include financial data for Martin Community College Foundation, Inc., a legally separate component unit, required to be reported with the financial data of Martin Community College. As a result, the financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of Martin Community College as of June 30, 2005. However, you will note that the financial statements related solely to Martin Community College are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements disclosed certain deficiencies that are detailed in the Audit Findings and Recommendations section of this report. The College's response is included following each finding.

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

September 27, 2006

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Martin Community College
Williamston, North Carolina

We have audited the accompanying financial statements of Martin Community College, a component unit of the State of North Carolina, as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the Martin Community College's management. Our responsibility is to express opinions 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 the 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 opinions.

The financial statements referred to above include only Martin Community College. The financial statements do not include financial data for Martin Community College Foundation, Inc., a legally separate component unit, which accounting principles generally accepted in the United States of America require to be reported with the financial data of Martin Community College. As a result, the financial statements do not purport to, and do not, present fairly the financial position of the reporting entity of Martin Community College as of June 30, 2005, 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 our opinion, the financial statements referred to above which relate solely to Martin Community College, present fairly, in all material respects, the financial position of Martin Community College as of June 30, 2005, 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.

As discussed in Note 16 to the financial statements, the College implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*, during the year ended June 30, 2005.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 10, 2006, on our consideration of the College's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

Leslie W. Merritt, Jr.

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

March 10, 2006

Martin Community College is one of the 58 community colleges in the North Carolina Community College System. The College's service area includes Martin, Bertie, and Washington counties. The College offers both curriculum and continuing education classes.

This section of the Martin Community College annual financial report presents Management's Discussion and Analysis of the financial performance of the College during the fiscal year which ended June 30, 2005. This discussion should be read in conjunction with the accompanying financial statements and the related notes.

Using the Annual Financial Report

The annual report consists of financial statements, prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – For Public Colleges and Universities*. The financial statements focus on the financial condition of the College, the results of operations, and cash flows of the College as a whole.

The financial statements as directed by GASB Statement No. 35 present financial information in a form similar to that used by corporations. They are prepared under the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide service, regardless of when cash is exchanged.

The College's net assets are one indicator of its financial stability. The Statement of Net Assets includes all assets and liabilities. The increase or decrease in net assets is an indicator of the movement or erosion of the College's financial condition.

The Statement of Revenues, Expenses, and Changes in Net Assets presents the revenues earned and expenses incurred during the fiscal year. Activities are reported as operating or nonoperating. A college's dependency on State aid and gifts could result in operating deficits because the financial reporting model classifies State appropriations and gifts as nonoperating revenues. The utilizations of capital assets are reflected in the financial statements as depreciation.

The Statement of Cash Flows presents information related to cash inflows and outflows summarized by operating, noncapital financing, capital financing, and related investing activities. The direct method is used to present cash flow.

The notes to the financial statements provide additional information that is essential to a full understanding of the data provided.

Financial Analysis

Condensed Statement of Net Assets
(in thousands)

	2005	2004	Variance	Percentage Change
Current Assets	$ 1,385	$ 1,178	$ 207	18 %
Capital Assets	4,201	4,550	(349)	(8) %
Other Assets	609	917	(308)	(34) %
Total Assets	6,195	6,645	(450)	(7) %
Current Liabilities	253	229	24	10 %
Noncurrent Liabilities	177	98	79	81 %
Total Liabilities	430	327	103	31 %
Invested in Capital Assets	4,201	4,550	(349)	(8) %
Restricted	711	541	170	31 %
Unrestricted	853	1,227	(374)	(30) %
Total Net Assets	$ 5,765	$ 6,318	$ (553)	(9) %

The Statement of Net Assets presents the assets, liabilities, and net assets for the College. The College's net assets decreased $553 thousand from 2004. The results of our financial operations for the year caused a $450 thousand decrease in total assets which was due in part to a $332 thousand decrease in construction bond funds in restricted due from primary government. The $349 thousand decrease in capital assets was mostly due to the depreciation of capital assets as shown below. There also appeared to be a general decrease in net assets due in part to a decline in revenues and investments in capital assets.

Total liabilities increased by $103 thousand. The largest increase was in long-term liabilities. This $70 thousand increase is the result of an increase in unused vacation leave. The remaining $33 thousand increase in liabilities was a result of normal operations.

Capital Assets
(in thousands)

	2005	2004	Variance	Total Percentage Change
Land	$ 100	$ 100	$ 0	0 %
Other	10	10		
Buildings	3,051	3,243	(192)	(6) %
Machinery and Equipment	186	343	(157)	(46) %
General Infrastructure	854	854		
Total Capital Assets, Net	$ 4,201	$ 4,550	$ (349)	(8) %

There was no significant capital asset activity during the year. The $349 thousand decrease in capital assets was mostly due to the utilization or depreciation of capital assets as noted above.

Condensed Statement of Revenues, Expenses, and Changes in Net Assets
(in thousands)

	2005	2004	Variance	Total Percentage Change
Operating Revenues:				
Student Tuition and Fees, Net	$ 315	$ 287	$ 28	10 %
Federal Grants and Contracts	1,712	1,516	196	13 %
State and Local Grants/Contracts	69	545	(476)	(87) %
Sales and Services, Net	559	551	8	1 %
Other Operating Revenues	29		29	100 %
Total Operating Revenues	2,684	2,899	(215)	(7) %
Operating Expenses:				
Personal Services	4,959	4,517	442	10 %
Supplies and Materials	996	1,386	(390)	(28) %
Services	1,160	1,627	(467)	(29) %
Scholarships and Fellowships	1,176	1,524	(348)	(23) %
Utilities	263	273	(10)	(4) %
Depreciation	379	374	5	1 %
Total Operating Expenses	8,933	9,701	(768)	(8) %
Nonoperating Revenues:				
State Aid	4,539	5,269	(730)	(14) %
County Appropriations	882	884	(2)	%
Other Nonoperating Revenues	82	233	(151)	(65) %
Total Nonoperating Revenues	5,503	6,386	(883)	(14) %
Other Revenues:				
Capital Aid and Grants	193	333	(140)	(42) %
Total Revenues	8,380	9,618	(1,238)	(13) %
Net Assets				
Change in Net Assets	(553)	(83)	(470)	566 %
Net Assets, July 1, 2004	6,318	6,401	(83)	(1) %
Net Assets, June 30, 2005	$ 5,765	$ 6,318	$ (553)	(9) %

State aid represents the largest source of revenue for the College. The largest loss of revenue for the College was in State aid which decreased $730 thousand from 2004 State aid receipts.

Total operating expenses were reduced by $768 thousand resulting from the reduction of supplies and materials, services, and scholarships and fellowships expenses. This decrease was mainly attributable to conservative spending patterns resulting from decreased revenues.

The severity of the loss relative to total revenues and total expenses resulted in a $470 thousand decrease in net assets.

Economic Forecast

Martin Community College believes that the economic future of the College looks very good. Martin Community College has managed to control rising costs with fewer funds and progress toward improvement. We have positive discussions in progress with our three service counties (Martin, Bertie, Washington) which should address our needs for future expansion of the College (through land acquisition and capital improvement). Forecasts from the Office of State Budget and Management indicate that the State's economy is slowly improving and that this should allow funding initiatives already approved by the State Legislature regarding salaries and multi-campus funding.

Martin Community College, with focus on the development of its citizens, will continue the strong commitment to its Small Business Area and professional service training. Also, Martin Community College has initiated the development of a Nursing Diploma Program with a goal to open classes in the summer of 2007. The beginning of the Nursing Diploma Program will depend on approvals from the North Carolina Community College Board, The NC Nursing Board and funding. Also, Martin Community College is partnering with Pitt Community College to bring a high tech wafer manufacturer into the Martin-Pitt Technology Park.

Martin Community College
Statement of Net Assets
June 30, 2005 ***Exhibit A-1***

ASSETS		
Current Assets:		
Cash and Cash Equivalents	$	841,248.36
Restricted Cash and Cash Equivalents		121,139.47
Receivables (Note 4)		134,351.96
Due from State of North Carolina Component Units		25,000.00
Inventories		263,429.68
Total Current Assets		1,385,169.47
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		442,074.45
Restricted Due from Primary Government		166,305.75
Capital Assets - Nondepreciable (Note 5)		109,500.00
Capital Assets - Depreciable, Net (Note 5)		4,091,686.66
Total Noncurrent Assets		4,809,566.86
Total Assets		6,194,736.33
LIABILITIES		
Current Liabilities:		
Accounts Payable and Accrued Liabilities (Note 6)		180,129.26
Deferred Revenue		15,628.70
Funds Held for Others		12,931.54
Long-Term Liabilities - Current Portion (Note 7)		43,929.41
Total Current Liabilities		252,618.91
Noncurrent Liabilities:		
Long-Term Liabilities (Note 7)		176,821.42
Total Liabilities		429,440.33
NET ASSETS		
Invested in Capital Assets		4,201,186.66
Restricted for:		
Nonexpendable:		
Scholarships and Fellowships		32,715.87
Expendable:		
Scholarships and Fellowships		110,574.04
Loans		4,520.42
Capital Projects		562,732.79
Other		99.12
Unrestricted		853,467.10
Total Net Assets	$	5,765,296.00

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

Martin Community College
Statement of Revenues, Expenses, and Changes in Net Assets
For the Fiscal Year Ended June 30, 2005

Exhibit A-2

REVENUES		
Operating Revenues:		
Student Tuition and Fees, Net (Note 9)	$	314,662.06
Federal Grants and Contracts		1,711,424.18
State and Local Grants and Contracts		68,986.64
Sales and Services, Net (Note 9)		559,343.84
Other Operating Revenues		29,186.74
Total Operating Revenues		2,683,603.46
EXPENSES		
Operating Expenses:		
Personal Services		4,958,701.23
Supplies and Materials		995,771.93
Services		1,159,826.31
Scholarships and Fellowships		1,176,320.80
Utilities		263,376.61
Depreciation		378,459.33
Total Operating Expenses		8,932,456.21
Operating Loss		(6,248,852.75)
NONOPERATING REVENUES (EXPENSES)		
State Aid		4,539,425.74
County Appropriations		882,269.00
Noncapital Grants		292,076.97
Noncapital Gifts		6,900.00
Investment Income, Net		29,143.71
Refund to Grantors		(248,894.00)
Other Nonoperating Revenues		2,593.19
Net Nonoperating Revenues (Expenses)		5,503,514.61
Loss Before Other Revenues		(745,338.14)
State Capital Aid		157,136.61
County Capital Appropriations		15,000.00
Capital Grants		20,686.60
Additions to Endowments		100.00
Decrease in Net Assets		(552,414.93)
NET ASSETS		
Net Assets, July 1, 2004		6,317,710.93
Net Assets, June 30, 2005	$	5,765,296.00

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

Martin Community College
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2005 ***Exhibit A-3***

CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Customers	$	2,595,086.58
Payments to Employees and Fringe Benefits		(4,884,920.06)
Payments to Vendors and Suppliers		(2,385,092.29)
Payments for Scholarships and Fellowships		(1,154,449.26)
Other Receipts		2,903.16
Net Cash Used by Operating Activities		(5,826,471.87)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Aid Received		4,539,425.74
County Appropriations		882,269.00
Noncapital Grants Received		267,451.68
Noncapital Gifts and Endowments Received		7,000.00
Cash Provided by Noncapital Financing Activities		5,696,146.42
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
State Capital Aid Received		240,384.81
County Capital Appropriations		15,000.00
Capital Grants Received		120,719.70
Acquisition and Construction of Capital Assets		(29,566.61)
Net Cash Provided by Capital and Related Financing Activities		346,537.90
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income		30,576.32
Cash Provided by Investing Activities		30,576.32
Net Increase in Cash and Cash Equivalents		246,788.77
Cash and Cash Equivalents, July 1, 2004		1,157,673.51
Cash and Cash Equivalents, June 30, 2005	$	1,404,462.28

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating Loss	$	(6,248,852.75)
Adjustments to Reconcile Operating Loss to Net Cash Used by Operating Activities:		
Depreciation Expense		378,459.33
Miscellaneous Nonoperating Income		2,593.19
Changes in Assets and Liabilities:		
Receivables		(66,645.34)
Inventories		(19,032.95)
Accounts Payable and Accrued Liabilities		56,613.86
Funds Held for Others		309.97
Compensated Absences		70,082.82
Net Cash Used by Operating Activities	$	(5,826,471.87)

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:		
Cash and Cash Equivalents	$	841,248.36
Restricted Cash and Cash Equivalents		121,139.47
Noncurrent Assets:		
Restricted Cash and Cash Equivalents		442,074.45
Total Cash and Cash Equivalents - June 30, 2005	$	1,404,462.28

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

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

A. Financial Reporting Entity – The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America, the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. Martin Community College is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds for which the College's Board of Trustees is financially accountable but does not include the Martin Community College Foundation, Inc., a component unit requiring discrete presentation. Audited financial statements in accordance with accounting principles generally accepted in the United States of America were not available for Martin Community College Foundation, Inc., for the current fiscal year.

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 the Governmental Accounting Standards Board (GASB).

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – For Public Colleges and Universities*, the full scope of the College's activities is considered to be a single business-type activity and accordingly, is reported within a single column in the basic financial statements.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the College does not apply Financial Accounting Standards Board (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 financial statements of the College have been 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. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

D. Cash and Cash Equivalents – This classification includes undeposited receipts, petty cash, cash on deposit with private bank accounts, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

E. Receivables – Receivables consist of tuition and fees charged to students and charges for auxiliary enterprises' sales and services. Receivables also include amounts due from the federal government, State and local governments, private sources in connection with reimbursement of allowable expenditures made pursuant to contracts and grants that are verifiable, measurable, and expected to be collected and available for expenditures for which the resource provider's conditions have been satisfied. Receivables are recorded at book value with no provision for uncollectible amounts.

F. Inventories – Inventories, consisting of expendable supplies, are valued at cost using the first-in, first-out method. Merchandise for resale is valued using the retail inventory method.

G. Capital Assets – Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The College capitalizes assets that have a value or cost in excess of $5,000 at the date of acquisition and an expected useful life of more than one year. Library books are generally not considered to have a useful life of more than one year unless part of a collection and are expensed in the year of acquisition.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 10 to 40 years for general infrastructure, 15 to 40 years for buildings, and 5 to 25 years for equipment.

The art collection is capitalized at cost or fair value at the date of donation. This collection is considered inexhaustible and is therefore not depreciated.

H. **Restricted Assets –** Unexpended capital contributions are classified as restricted assets because their use is limited by donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

I. **Noncurrent Long-Term Liabilities –** Noncurrent long-term liabilities include compensated absences that will not be paid within the next fiscal year.

J. **Compensated Absences –** The College'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 July 1 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 30 equals the leave carried forward at the previous June 30 plus the leave earned, less the leave taken between July 1 and June 30.

In addition to the vacation leave described above, compensated absences includes the accumulated unused portion of the special annual leave bonuses awarded by the College to all full-time permanent employees as of September 30, 2002, and as of July 1, 2003. The unused portion of this leave remains available until used, notwithstanding the limitation on annual leave carried forward described above.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out method.

K. **Net Assets –** The College's net assets are classified as follows:

Invested in Capital Assets – This represents the College's total investment in capital assets.

Restricted Net Assets – Nonexpendable – Nonexpendable restricted net assets include endowments and similar type assets whose use is limited by donors or other outside sources, and, as a condition of the gift, the principal is to be maintained in perpetuity.

Restricted Net Assets – Expendable – Expendable restricted net assets include resources for which the College is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted Net Assets – Unrestricted net assets include resources derived from student tuition and fees, sales and services, unrestricted gifts, and interest income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based within the departmental management system in place at the College.

L. Scholarship Discounts – Student tuition and fees revenues and certain other revenues from College charges are reported net of scholarship discounts in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. The scholarship discount is the difference between the actual charge for goods and services provided by the College and the amount that is paid by students or by third parties on the students' behalf. Student financial assistance grants, such as Pell grants, and other federal, State, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. To the extent that revenues from these programs are used to satisfy tuition, fees, and other charges, the College has recorded a scholarship discount.

M. Revenue and Expense Recognition – The College classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the College's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as (1) student tuition and fees, (2) sales and services of auxiliary enterprises, and (3) certain federal, State and local grants and contracts. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and State aid that represent subsidies or gifts to the College, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities. Capital contributions are presented separately after nonoperating revenues and expenses.

N. County Appropriations – County appropriations are provided to the College primarily to fund its plant operation and maintenance function and to fund construction projects, motor vehicle purchases, and maintenance of equipment. Unexpended county current appropriation and county capital appropriation do not revert and are available for future use by the College.

NOTE 2 - DEPOSITS AND INVESTMENTS

All funds of the College are deposited in board-designated official depositories and are required to be collateralized in accordance with *North Carolina General Statute* 115D-58.7. Official depositories may be established with any bank or savings and loan association whose principal office is located in North Carolina. Also, the College may establish time deposit accounts, money market accounts, and certificates of deposit. The amount shown on the Statement of Net Assets as cash and cash equivalents includes cash on hand totaling $703.00, and deposits in private financial institutions with a carrying value of $0.00 and a bank balance of $166,840.25.

The North Carolina Administrative Code (20 NCAC 7) requires all depositories to collateralize public deposits in excess of federal depository insurance coverage by using one of two methods, dedicated or pooled. Under the dedicated method, a separate escrow account is established by each depository in the name of each local governmental unit and the responsibility of monitoring collateralization rests with the local unit. Under the pooling method, each depository establishes an escrow account in the name of the State Treasurer to secure all of its public deposits. This method shifts the monitoring responsibility from the local unit to the State Treasurer.

Custodial credit risk is the risk that in the event of a bank failure, the College's deposits may not be returned to it. As of June 30, 2005, the College's bank balance in excess of federal depository insurance coverage was covered under the pooling method.

The College is authorized to invest idle funds as provided by G.S. 115D-58.6. In accordance with this statute, the College and the Board of Trustees manage investments to ensure they can be converted into cash when needed.

Generally, funds belonging to the College may be invested in the form of investments pursuant to G.S. 159-30(c), as follows: a commingled investment pool established and administered by the State Treasurer pursuant to G.S. 147-69.3, obligations of or fully guaranteed by the United States; obligations of the State of North Carolina; bonds and notes of any North Carolina local government or public authority; obligations of certain nonguaranteed federal agencies; prime quality commercial paper bearing specified ratings and banker's acceptances; The North Carolina Capital Management Trust, an SEC registered mutual fund; repurchase agreements; and evidences of ownership of, or fractional undivided interests in, future interest and principal payments on either direct obligations of or fully guaranteed by the United States government, which are held by a specified bank or trust company or any state in the capacity.

At June 30, 2005, the amount shown on the Statement of Net Assets as cash and cash equivalents includes $1,403,759.28 which represents the College's equity position in the State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.41 years as of June 30, 2005. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's 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*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page http://www.ncosc.net/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

NOTE 3 - DONOR RESTRICTED ENDOWMENTS

The College's endowment assets are pooled with State agencies and similar institutions in short-term investments with the State Treasurer's Cash and Investment Pool and are reported as restricted cash and cash equivalents – noncurrent on the accompanying financial statements. If a donor has not provided specific instructions, State law permits the Board of Trustees to authorize for expenditure the net appreciation, realized and unrealized, of the assets of the endowment funds. Annual payouts from the College's endowment funds are based on an adopted spending policy, which limits spending to 100% of the interest earnings unless the donor has stipulated otherwise. At June 30, 2005, net appreciation of $797.83 was available to be spent, all of which was restricted to specific purposes.

NOTE 4 - RECEIVABLES

Receivables at June 30, 2005, were as follows:

	Amount
Current Receivables:	
Students	$ 39,120.71
Accounts	82,564.43
Intergovernmental	12,666.82
Total Current Receivables	$ 134,351.96

NOTE 5 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2005, is presented as follows:

	Balance July 1, 2004	Increases	Balance June 30, 2005
Capital Assets, Nondepreciable:			
Land	$ 100,000.00	$ 0.00	$ 100,000.00
Art, Literature, and Artifacts	9,500.00		9,500.00
Total Capital Assets, Nondepreciable	109,500.00		109,500.00
Capital Assets, Depreciable:			
Buildings	6,862,137.83		6,862,137.83
Machinery and Equipment	1,377,179.07	29,566.61	1,406,745.68
General Infrastructure	1,048,055.65		1,048,055.65
Total Capital Assets, Depreciable	9,287,372.55	29,566.61	9,316,939.16
Less Accumulated Depreciation:			
Buildings	3,619,074.66	192,331.08	3,811,405.74
Machinery and Equipment	1,034,035.34	186,128.25	1,220,163.59
General Infrastructure	193,683.17		193,683.17
Total Accumulated Depreciation	4,846,793.17	378,459.33	5,225,252.50
Total Capital Assets, Depreciable, Net	4,440,579.38	(348,892.72)	4,091,686.66
Capital Assets, Net	$ 4,550,079.38	$ (348,892.72)	$ 4,201,186.66

NOTE 6 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2005, were as follows:

	Amount
Accounts Payable	$ 65,674.44
Accrued Payroll	114,454.82
Total Accounts Payable and Accrued Liabilities	$ 180,129.26

NOTE 7 - LONG-TERM LIABILITIES

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

	Balance July 1, 2004	Additions	Reductions	Balance June 30, 2005	Current Portion
Compensated Absences	$ 150,668.00	$ 235,940.46	$ 165,857.63	$ 220,750.83	$ 43,929.41

NOTE 8 - OPERATING LEASE OBLIGATIONS

Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2005:

Fiscal Year	Amount
2006	$ 29,820.00
2007	29,820.00
2008	7,455.00
Total Minimum Lease Payments	$ 67,095.00

Rental expense for all operating leases during the year was $29,820.00.

NOTE 9 - REVENUES

A summary of eliminations and allowances by revenue classification is presented as follows:

	Gross Revenues	Less Scholarship Discounts	Net Revenues
Operating Revenues:			
Student Tuition and Fees	$ 841,533.95	$ 526,871.89	$ 314,662.06
Sales and Services:			
Sales and Services of Auxiliary Enterprises:			
Dining	$ 54,318.44	$ 0.00	$ 54,318.44
Bookstore	486,492.47	30,065.13	456,427.34
Other	48,598.06		48,598.06
Total Sales and Services	$ 589,408.97	$ 30,065.13	$ 559,343.84

NOTE 10 - OPERATING EXPENSES BY FUNCTION

The College's operating expenses by functional classification are presented as follows:

	Personal Services	Supplies and Materials	Services	Scholarships and Fellowships	Utilities	Depreciation	Total
Instruction	$ 3,085,851.20	$ 520,326.56	$ 343,726.80	$ 0.00	$ 19,801.93	$ 0.00	$ 3,969,706.49
Academic Support	241,127.48						241,127.48
Student Services	288,172.99	4,466.57	29,882.29				322,521.85
Institutional Support	942,476.92	52,053.50	559,026.75				1,553,557.17
Operations and Maintenance of Plant	301,971.95	32,896.36	222,545.53		243,574.68		800,988.52
Student Financial Aid				1,176,320.80			1,176,320.80
Auxiliary Enterprises	99,100.69	386,028.94	4,644.94				489,774.57
Depreciation						378,459.33	378,459.33
Total Operating Expenses	$ 4,958,701.23	$ 995,771.93	$ 1,159,826.31	$ 1,176,320.80	$ 263,376.61	$ 378,459.33	$ 8,932,456.21

NOTE 11 - PENSION PLANS

A. Retirement Plans – Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System. The Teachers' and State Employees' Retirement System (System) is a cost sharing multiple-employer defined benefit pension plan administered by the North Carolina State Treasurer.

Benefit and contribution provisions for the Teachers' and State Employees' Retirement System are established by *North Carolina General Statutes*. 135-5 and 135-8 and may be amended only by the

North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2005, these rates were set at 2.17% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2005, the College had a total payroll of $3,914,463.05, of which $2,915,101.07 was covered under the Teachers' and State Employees' Retirement System. Total employee and employer contributions for pension benefits for the year were $174,905.46 and $63,257.48, respectively. The College made 100% of its annual required contributions for the years ended June 30, 2005, 2004, and 2003, which were $63,257.48, $6,589.99, and $0.00, respectively.

The Teachers' and State Employees' Retirement System's financial information is 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.

B. Supplemental Retirement Income Plans - IRC Section 401(k) Plan – All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. The voluntary contributions by employees amounted to $65,681.00 for the year ended June 30, 2005.

IRC Section 403(b) and 403(b)(7) Plans – Eligible College employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of colleges and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the College. The voluntary contributions by employees amounted to $17,000.00 for the year ended June 30, 2005.

NOTE 12 - OTHER POSTEMPLOYMENT BENEFITS

A. Health Care for Long-Term Disability Beneficiaries and Retirees – The College participates in State-administered programs which provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. These benefits were established by Chapter 135, Article 3, Part 3, of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The College 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, 2005, the College's total contribution to the Plan was $93,282.91. The College assumes no liability for retiree health care benefits provided by the programs other than its required contribution. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report*.

B. Long-Term Disability – The College participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, 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. The College contributes .445% of covered payroll under the Teachers' and State Employees' Retirement System to the DIPNC. For the year ended June 30, 2005, the College's total contribution to the DIPNC was $12,972.16. The College 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 13 - RISK MANAGEMENT

The College is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled via a combination of methods, and can include participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. 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 excess public officers' and employees' liability insurance up to $5,000,000 via contract with a private insurance company. The premium, based on a composite rate, is paid by the North Carolina Community College System Office directly to the private insurer.

Fire and other property losses are covered by the Public School Insurance Fund, a State-administered public entity risk pool. This fund is financed by premiums and interest and incurs a $10 million self-insured deductible per occurrence. Reinsurance is purchased by the fund to cover catastrophic events in excess of the $10 million deductible. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

State-owned vehicles used for instructional purposes are covered by liability insurance handled by the State Department of Insurance. Liability insurance for other College-owned vehicles is covered by contracts with private insurance companies.

The College is protected for losses from employee dishonesty and computer fraud for employees paid in whole or in part from State funds. The blanket honesty bond is with a private insurance company and is handled by the North Carolina Department of Insurance with coverage of $5,000,000 per occurrence and a $50,000 deductible. The College is not protected from employee dishonesty and computer fraud for employees paid entirely from county and institutional funds.

Employees and retirees are provided health care coverage by the Comprehensive Major Medical Plan (Plan), a component unit of the State. The Plan is funded by employer and employee contributions and is administered by a third-party contractor.

The State Board of Community Colleges makes the necessary arrangements to carry out the provisions of the Workers' Compensation Act which are applicable to employees whose wages are paid in whole or in part from State funds. The College purchases workers' compensation insurance for employees whose salaries or wages are paid by the Board entirely from county or institutional funds.

Term life insurance of $25,000 to $50,000 is provided to eligible workers. This self-insured death benefit program is administered by the State Treasurer and funded via employer contributions. There were no employer contributions required for the current fiscal year.

Additional details on the State-administered risk management programs are disclosed in the State's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

NOTE 14 - COMMUNITY COLLEGE GENERAL OBLIGATION BONDS

The 1999-2000 Session of the General Assembly of North Carolina authorized the issuance of $600 million of general obligation bonds of the State, as subsequently approved by a vote of qualified voters of the State, to provide funds for capital improvements for the North Carolina Community College System. The funds authorized are to be used solely to construct new buildings and to renovate and modernize existing buildings on the North Carolina Community College System campuses. The bond legislation specifies the amount of bond funding for each College campus as well as the intended amount for new construction and repair and replacement. The legislation further provides that the State Board of Community Colleges shall be responsible for the approval of projects in accordance with provisions of the legislation. The bonds were authorized for issuance over a six-year period beginning in 2001 at a level not to exceed amounts provided in the legislation. Using a cash flow financing approach, The Community College System's Office (CCSO) establishes annual amounts not to exceed for each approved project. The amounts not to exceed are subject to change due to actual cash availability and needs during the year. Subsequent to the bond sales and the availability of bond proceeds, CCSO notifies the Office of State Budget and Management (OSBM) of the amount not to exceed for the total of the approved projects. Within this amount, based on an official request of cash needs from the State Board of Community Colleges, OSBM authorizes allotments. These allotments are then recorded to specific community college allotment accounts by the CCSO. The College records the allotments as revenue on the accompanying financial statements. The College's remaining authorization of $666,963.00 is contingent on future bond sales and CCSO allotment approval. Because of uncertainty and time restrictions the remaining authorization is not recorded as an asset or revenue on the accompanying financial statements.

NOTE 15 - MARTIN COMMUNITY COLLEGE FOUNDATION, INC.

The Martin Community College Foundation, Inc. is a separately incorporated nonprofit foundation associated with the College. This organization serves as the primary fundraising arm of the College through which individuals, corporations, and other organizations support College programs by providing scholarships, fellowships, faculty salary supplements, and unrestricted funds to specific departments and the College's overall academic environment. The College's financial statements do not include the assets, liabilities, net assets, or operational transactions of the Foundation, except for the distributions made and benefits provided by the Foundation. The distributions received and/or benefits provided approximated $10,753 for the year ended June 30, 2005.

NOTE 16 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2005, the College implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures*. This Statement establishes and modifies disclosure requirements related to investment risks: credit risk, interest rate risk, and foreign currency risk. This statement also establishes and modifies disclosure requirements for deposit risks: custodial credit risk and foreign currency risk.

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INDEPENDENT AUDITOR'S 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*

Board of Trustees
Martin Community College
Williamston, North Carolina

We have audited the financial statements of Martin Community College, a component unit of the State of North Carolina, as of and for the year ended June 30, 2005 and have issued our report thereon dated March 10, 2006.

As discussed in Note 16 to the financial statements, the College implemented Governmental Accounting Standards Board Statement No. 40, *Deposit and Investment Risk Disclosures,* during the year ended June 30, 2005. As described in Note 1, the College's financial statements do not include the Martin Community College Foundation, Inc., which would be required for presentation under the guidance of GASB Statement No. 39.

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 College'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 an opinion 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 College's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the Audit Findings and Recommendations section of this report.

INDEPENDENT AUDITOR'S 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* (CONCLUDED)

Findings

1. Inadequate Management Oversight
2. Access Rights Inconsistent with Adequate Separation of Duties
3. Weak Internal Controls over Machinery and Equipment

A material weakness is a reportable 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 caused by error or fraud 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 believe none of the reportable conditions described above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the College's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 Board of Trustees, the State Board of Community Colleges, management of the College, the Governor, the State Controller, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Leslie W. Merritt, Jr.

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

March 10, 2006

AUDIT FINDINGS AND RECOMMENDATIONS

Matters Related to Financial Reporting

The following findings were identified during the current audit and describe conditions that represent significant deficiencies in internal control.

1. INADEQUATE MANAGEMENT OVERSIGHT

The College did not have adequate controls in place to assure proper segregation of duties and proper review and approval procedures. A Staff Accountant reconciled all bank accounts; however, there were no signatures or initials to indicate management review. Although the Accountant did not have duties involving cash receipting or cash disbursements, she did have access to the general ledger which provided a means of manipulating the system via journal entry as well as access to blank check stock and the check signature disk. Because the Accountant had access to blank check stock, fraudulent checks could be created and processed outside the College's Financial System without being detected.

Recommendation: To ensure proper controls over cash receipts and disbursements, bank reconciliations should be performed on a monthly basis by an employee independent of duties involving cash processing. Management oversight should be involved in the review and approval of completed bank reconciliations.

College's Response: The College agrees with the findings and recommendation. The College has taken steps to ensure adequate management oversight. The Accountant's access to blank check stock and the check signature disk has been removed. The College is reviewing System access rights and will implement appropriate controls. The position of Dean of Administrative Services has been filled, and the Dean will provide the oversight for the review and approval of completed bank statement reconciliations.

2. ACCESS RIGHTS INCONSISTENT WITH ADEQUATE SEPARATION OF DUTIES

The College granted access rights inconsistent with adequate separation of duties. The Accounts Payable Clerk and Payroll Clerk had several access rights that would allow them the opportunity to perpetrate or conceal errors or fraud.

- The Accounts Payable Clerk could create vendor address files, alter approved requisition dollars to agree with vendor invoices regardless of the amount without management approval, process vouchers, print checks (access to blank check stock), and mail checks. Management did not review any vendor exception reports, which would indicate changes to the vendor file. No one outside Accounts Payable reviewed voucher packets against printed checks prior to their release. Nothing precluded the Accounts Payable Clerk from concealing payments for personal purchases and/or manipulating the vendor files.

- The Payroll Clerk also had the access rights of a Human Resource Director. She could enter employees into the payroll system and alter their pay. Management did not review any payroll exception reports that would have indicated any new employees or changes made to payroll. Because the Payroll Clerk had these access rights, she could establish fictitious employees and/or alter their pay without it being detected.

Segregation of duties is a basic internal control that requires assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets. This would reduce the opportunities for any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of his or her duties.

Recommendation: The College should strengthen internal controls by removing the Accounts Payable Clerk's access to the vendor file and blank check stock as well as reviewing all voucher packets against checks prior to their disbursement. Management should either eliminate the Payroll Clerk's access to the Human Resource Director functions or review daily the payroll exception reports for changes made to the payroll and personnel files.

College's Response: The College agrees with the findings and has already or is in the process of implementing procedures to address the recommendations. The Accounts Payable Clerk no longer has access to the vendor file or blank check stock. Procedures for management review of all voucher packets against checks prior to disbursement have been implemented. Procedures have also been implemented for review and approval of changes made to payroll and personnel files, including reviews and approvals of payroll exception reports.

3. WEAK INTERNAL CONTROLS OVER MACHINERY AND EQUIPMENT

Internal controls over machinery and equipment are insufficient to prevent errors and safeguard assets. During our audit we noted the following:

- Responsibilities for machinery and equipment are not properly segregated. The Staff Accountant who has access to the general ledger and blank check stock oversees the annual inventory process, adds and removes assets from the accounting information system, disposes of assets, and tags equipment. Management only approves equipment and machinery requisitions. During our audit there was no indication of management review and approval of any adjustments/journal entries to capital assets.

- College personnel do not properly tag machinery and equipment or document their location. During our physical inspection of equipment, forty-two out of one hundred twenty-six items were not properly tagged or in their assigned location.

- Four items on the equipment reports were duplicates due to changing accounting systems. The subsidiary for equipment was not reconciled to the general ledger at

June 30, 2005, and the College did not perform a physical inventory of equipment at year end.

Good internal controls require management to establish and maintain effective custodial accountability procedures, adequate security over assets, and adequate segregation of duties.

Recommendation: We recommend that the College strengthen internal controls including the proper segregation of duties, enhance management oversight and implement policies and procedures to enhance accountability, ensure accurate reporting and the safeguarding of assets.

College's Response: The College agrees with the findings and recommendation. The year-end physical inventory has been completed. The College is in the process of reconciling the subsidiary for equipment to the general ledger for the period ending June 30, 2006. The College is in the process of strengthening internal controls and developing policies and procedures to improve its accountability for reporting and safeguarding assets.

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