

COMPREHENSIVE ANNUAL FINANCIAL REPORT



ORANGE WATER AND SEWER AUTHORITY
CARRBORO, NORTH CAROLINA

A COMPONENT UNIT OF THE
TOWN OF CHAPEL HILL, NORTH CAROLINA

FISCAL YEAR ENDED JUNE 30, 2007

**Orange Water and Sewer Authority
Carrboro, North Carolina**

**(A component unit of the Town of
Chapel Hill, North Carolina)**

Comprehensive Annual Financial Report

For the fiscal year ended June 30, 2007

Prepared by:

Finance Department of Orange Water and Sewer Authority

Orange Water and Sewer Authority
 Comprehensive Annual Financial Report
 For the Fiscal Year Ended June 30, 2007

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ORANGE WATER AND SEWER AUTHORITY

Quality Service Since 1977

October 8, 2007

To the OWASA Board of Directors, Bondholders, and Customers:

We are pleased to present our Comprehensive Annual Financial Report for the Fiscal Year from July 1, 2006 through June 30, 2007 (FY 2007). This report conforms with the reporting and accounting standards of the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board, and the Government Finance Officers Association's (GFOA's) *Governmental Accounting, Auditing and Financial Reporting* document.

OWASA is responsible for the accuracy, completeness and fairness of the information presented, including all disclosures.

This report has four sections:

- The Introductory Section (unaudited) contains this letter of transmittal and information about OWASA's organizational structure, principal officers, major initiatives, accomplishments, and future projects.
- The Financial Section includes the independent auditor's report, OWASA management's discussion and analysis, the basic financial statements, and supplementary schedules. The general purpose financial statements can be issued separately for securities offerings or other purposes.
- The Statistical Section (unaudited) presents fiscal and other data to provide a more complete understanding of OWASA, the community we serve and the local economy.
- The Compliance Section presents the independent auditor's report on compliance with various internal control and other requirements related to certain forms of financial assistance.

The financial reporting entity is the Enterprise Fund of OWASA.

For financial reporting purposes under GASB Statement 14, *The Financial Reporting Entity*, OWASA is considered a component unit of the Town of Chapel Hill, N.C. because the Town Council appoints a majority of the OWASA Board and may remove them without cause. The Comprehensive Annual Financial Report of the Town of Chapel Hill therefore includes OWASA's financial data.

BACKGROUND

Creation and Governance of OWASA

Before OWASA was established, the University of North Carolina at Chapel Hill (The "University") and the Towns of Chapel Hill and Carrboro provided public water and sewer services in the Carrboro-Chapel Hill community.

In November 1971 the Governor appointed a Utilities Study Commission to examine the feasibility of retaining, selling, or otherwise disposing of the water, sewer and other utility systems owned by the University; to make recommendations to the University's Board of Trustees; and, in consultation with the University, to negotiate terms of sale or other disposition of the utilities. On May 28, 1976, the Utilities Study Commission determined that the interests of the State and all concerned would be best served by the divestiture of the majority of the University's utility holdings.

On June 11, 1976, the University's Board of Trustees approved the conveyance of the University's water and wastewater systems to OWASA. On August 9, 1976, the Governor and Council of State approved conveyance of the University's water and wastewater utilities to OWASA in accord with Agreements of Sale and Purchase among the University, the Towns and OWASA.

The Town of Carrboro, Town of Chapel Hill and Orange County governing boards incorporated OWASA as a water and sewer authority under Chapter 162A of State law. OWASA is a public (non-profit) agency, a special purpose unit of local government.

OWASA began serving the community on February 16, 1977 upon transfer of the municipal and University systems to OWASA.

A nine-member Board of Directors governs OWASA. The Chapel Hill Town Council appoints five, the Carrboro Board of Aldermen appoints two and the Orange County Board of Commissioners appoints two Board members. The OWASA Board adopts the annual budget; sets rates, fees, and charges based on cost-of-service principles; adopts policies and makes policy decisions; and appoints the Executive Director, General Counsel and independent auditor.

Water System

Our raw water comes from two primary sources: the Cane Creek Reservoir, a 3 billion gallon supply eight miles west of Carrboro; and University Lake, a 450 million gallon reservoir on the west side of Carrboro. A 200 million gallon stone quarry reservoir three miles west of Carrboro is available as a backup water source. OWASA maintains a State allocation of storage capacity in Jordan Lake that will yield about 5 million gallons of water per day. OWASA does not currently receive water from Jordan Lake nor does it have facilities to do so.



The Cane Creek Reservoir is the Chapel Hill-Carrboro community's primary water source.

The raw water is processed into drinking water at the Jones Ferry Road Water Treatment Plant, which has a treatment capacity of 20 million gallons per day (MGD). The drinking water is then pumped to the water storage and distribution system, which has a storage capacity of 8.1 million gallons and about 390 miles of water lines serving about 80,000 people in the OWASA service area. OWASA also has emergency-only water system connections with the City of Durham, the Town of Hillsborough and Chatham County's public water systems.

Wastewater System

OWASA maintains about 333 miles of sewer mains and 26 pump stations to collect and carry the community's wastewater to the Mason Farm Wastewater Treatment Plant, which has a peak month treatment capacity of 14.5 MGD.

Highly treated wastewater ("effluent") is recycled to the natural environment at Morgan Creek on the southeast side of Chapel Hill. Morgan Creek is a tributary of Jordan Lake, a water source for several communities in the region.



The Mason Farm Wastewater Treatment Plant following a three-year, \$50 million upgrade and expansion project substantially completed in July, 2007

ECONOMIC CONDITION AND OUTLOOK

The economy of the Chapel Hill-Carrboro area continues to be strong, reflecting the substantial size and stability of the University and UNC Hospitals as public entities serving the entire state and as the largest local employers. The University continues to actively plan and develop facility and infrastructure construction on the main and the Carolina North campus areas.

- ✓ The population of Orange County increased by 7.1 percent between 2000 and 2006, Carrboro grew by more than six percent and Chapel Hill's population rose in excess of 14 percent in the same period.
- ✓ The estimated value of construction for which the Town of Chapel Hill issued building permits in FY 2007 totaled \$86,576,281; \$40,896,523 commercial and \$45,679,758 residential.
- ✓ Retail sales in Orange County in FY 2006 totaled \$908 million. Although 56 percent of Orange County's population is in Chapel Hill and Carrboro, retail sales in the two towns accounted for 74 percent of the County-wide total.
- ✓ The 2007 unemployment rate for Orange County was 3.3 percent compared to the North Carolina average of 4.7 percent.

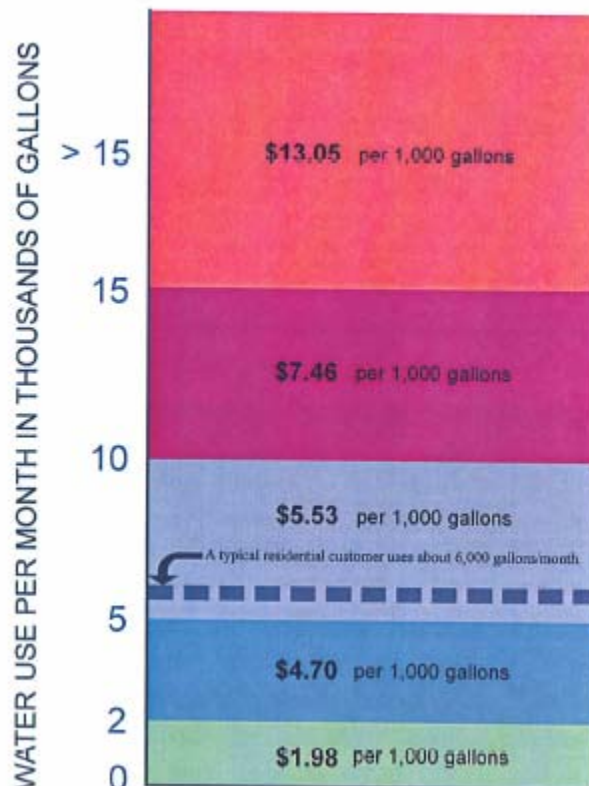
OWASA and its customers have achieved significant water savings since the record drought of 2002. Water pumped from our reservoirs from January through the summer of 2007 has been about 20 percent less than during the same period of 2002. This reduction also reflects “process water” recycling at our Jones Ferry Road Water Treatment Plant. (Water used to clean treatment plant filters is now recycled rather than discarded.) Further demand reductions are expected when the OWASA/UNC reclaimed water system begins operating in 2009. In FY 2007, demand for OWASA water and wastewater services remained less than expected due primarily to customers’ conservation practices. Water sales volume decreased by about 2.0 percent from FY 2006. Please refer to *Management’s Discussion and Analysis* for greater detail on the effect of conservation efforts and weather conditions on OWASA’s fiscal performance.

Fiscal year	2006	2007	% change
Customer accounts (meters read)	19,687	19,887	2.2
Total water sales (thousands of gallons)	2,900,258	2,841,134	(2.0)
Water sales—average per day	7.946 MGD	7.784 MGD	(2.0)

MAJOR INITIATIVES AND ACCOMPLISHMENTS

OWASA initiated and/or continued several major projects in FY 2007:

New Residential Water Rates to Encourage Further Conservation – With the assistance of a consultant, OWASA completed a detailed study this year of all customer rates and fees. The Board of Directors adopted an increasing block rate structure for individually-metered residential customers to be effective October 1, 2007 while maintaining seasonal water conservation rates for other customers.



The Board also instituted a monthly 15,000 gallon sewer billing cap to address the issue of irrigation water that is not returned to the sewer system. The adopted rates represent an overall increase of about 9.5 percent, which will help pay for capital improvements and to strengthen OWASA's overall financial position. The Board also approved higher water and sewer service availability fees (connection/capacity charges) to ensure that new customers and new development pay their fair share of OWASA's capacity to serve that new development.

Mason Farm Wastewater Treatment Plant (WWTP) – Construction began in May 2004 on the more than \$50 million upgrade and expansion of OWASA's wastewater plant and was substantially complete as of early July, 2007. The plant's capacity has been increased from 12 mgd to 14.5 mgd. The project included the addition of filters to improve treated water quality, a second large generator for back-up electrical power, odor elimination improvements, better solids and nutrients removal, ultraviolet light disinfection, and an improved system for capturing and using methane gas. The WWTP improvements will support the new reclaimed water (RCW) system and, with the associated increases in operating costs, will enable OWASA to meet the proposed nitrogen and phosphorus removal requirements in the State's Jordan Lake Nutrient Management Strategy until wastewater flows reach the plant's 14.5 mgd capacity.



The new enclosed headworks at our Mason Farm Wastewater Treatment Plant eliminated a significant odor source.

Construction of a new biosolids dewatering facility is nearly complete, which will reduce the amount of liquid in our biosolids, thereby improving the economy and long-term sustainability of our biosolids recycling program.

Odor Elimination at the Mason Farm Wastewater Treatment Plant – In July, 2007, OWASA's contractor completed the new covered headworks, where untreated sewage enters the WWTP. This represents a major milestone in our odor elimination program.

Installation of a new above-ground gas handling system for the biosolids digesters has resolved odor releases due to deficiencies of the previous underground pipe system.

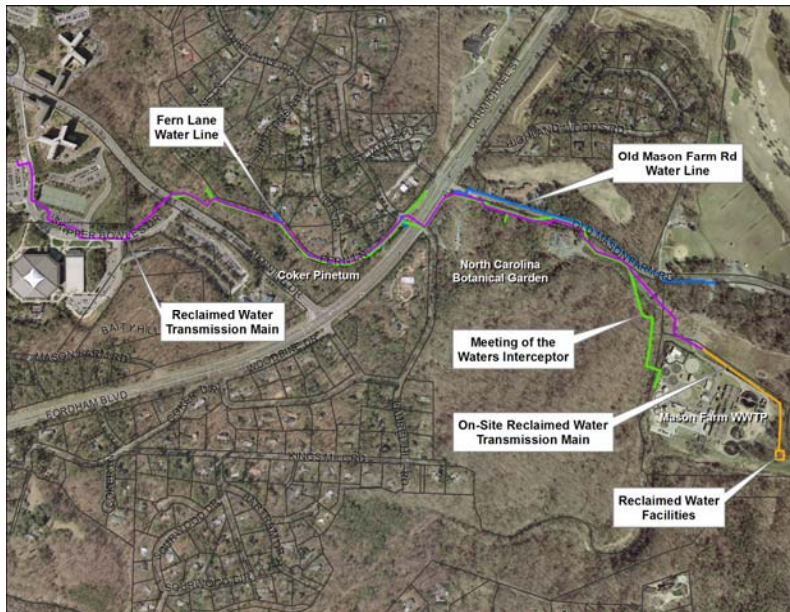
Biosolids Management – OWASA's practice of applying liquid biosolids (highly treated wastewater sludge) to agricultural land is limited by weather conditions, farmers' planting and harvesting schedules, availability of land, transportation costs, and other factors. It became evident during the past year that several emerging issues and trends could affect the viability and capability of our present approach, suggesting the need for a more diversified program. A *Draft Phase I Biosolids Master Plan* was completed this past spring. The plan will form the basis of a comprehensive long-term biosolids strategy and will discuss technical options, regulatory issues, markets for biosolids recycling, and the overall feasibility of different approaches. The draft plan includes a short list of promising options which will be carefully evaluated. As noted above, the installation of new biosolids dewatering equipment at the WWTP is nearly complete. We have partnered with a third party to provide composting services for dewatered biosolids and to market the composted material.

Reclaimed Water System – OWASA and the University are developing a reclaimed water (RCW) system to supply highly treated wastewater to certain campus facilities. By reducing the amount of drinking water used for non-potable purposes, the RCW system will provide additional drought protection. Total drinking water demand is expected to decrease by 10 to 15 percent when the system is fully implemented and will also reduce the amount of nutrients and other pollutants released to Morgan Creek.

Our new dewatering press (right) increases our biosolids management options today and for the future.



The RCW project will be financially self-supporting. UNC will fund the capital improvements, and OWASA will recover all operating, maintenance, management, and overhead costs through user rates and fees. Detailed financial responsibilities, including the basis for determining the new rates and fees and other technical matters, are specified in a contract signed by OWASA and UNC in April, 2006. OWASA obtained a \$1.8 million grant from the North Carolina Clean Water Management Trust Fund and a \$645,000 grant from the U.S. Environmental Protection Agency.



The map at left shows the planned location of the reclaimed water transmission line from the Mason Farm Wastewater Treatment Plant to the southern campus of the University of North Carolina at Chapel Hill. The Meeting of the Waters Sewer Replacement project will be partially collocated and done at the same time to minimize environmental impacts.

Construction of RCW pumping, storage and major pipeline facilities will begin after final design and permitting are completed in late 2007 or early 2008. Town of Chapel Hill approval will be needed for some of these facilities. The University has already installed about 7,000 feet of RCW lines on the main campus in conjunction with other ongoing campus construction work.

The major RCW transmission line will be installed along with OWASA's Meeting of the Waters sewer line replacement in the Old Mason Farm Road-Fordham Boulevard-Coker Pinetum area. The route of the RCW transmission main and sewer line in the Pinetum-Fern Lane area was approved by the OWASA Board in January, 2006 after discussions with nearby neighbors, North Carolina Botanical Garden staff, and other stakeholders during a series of neighborhood and Board meetings. The RCW project is expected to be completed in 2009.

Meeting of the Waters Creek Sewer Replacement – The OWASA Board selected the existing sewer line corridor through the **Coker Pinetum** as the preferred route for the Meeting of the Waters sewer replacement and the RCW transmission main projects as indicated above. Design has been completed and construction will begin in conjunction with the RCW pipeline. Work is expected to be complete in 2009.

Sustainability Goal and Objectives – The OWASA Board adopted a *Statement of OWASA's Sustainability Goal and Objectives* on April 26, 2007. The policy statement establishes OWASA's commitment to integrate into our services and facilities – the "triple bottom line" of sustainability – environmental stewardship, economic strength, and social equity.

Water Conservation Strategies for Joint Local Consideration – We have continued meeting with Carrboro, Chapel Hill, and Orange County staff to evaluate alternative conservation strategies that can be pursued in partnership with the Towns and County. A draft report will be presented this fall (2007).

University Lake and Cane Creek Watershed Protection – In September, 2006 OWASA purchased 74 acres of land adjoining University Lake near the intersection of Jones Ferry Road and Old Greensboro Highway to help protect the University Lake water supply. The North Carolina Clean Water Management Trust Fund approved a \$1,189,000 grant to help pay for the \$2.2 million purchase. OWASA remains interested in pursuing opportunities with the Towns and County for low impact recreational use of this property.

Local Greenhouse Gas Inventory and Forecast – In April, 2006 the Board of Directors adopted a resolution committing OWASA to participate with Carrboro, Chapel Hill and Orange County in an interlocal initiative to reduce greenhouse gas emissions through the International Council of Local Environmental Initiatives (ICLEI) - Cities for Climate Protection Program. OWASA staff has provided information and technical support for the project as a participant in the Joint Staff Committee. 2005 was selected as the baseline year for the greenhouse gas inventory, with 2030 as the target year for achieving emission reduction objectives. OWASA will consider the findings and recommendations of the proposed Action Plan when it is submitted for consideration by the local governing boards in late spring of 2008.

Proposed Jordan Lake Nutrient Reduction Rules and Strategy – In 2002 OWASA decided to construct new facilities at the Mason Farm Wastewater Treatment Plant that would provide nitrogen and phosphorus removal capability to the current limits of technology. Those improvements were completed for a cost of about \$11 million as part our more than \$50 million WWTP upgrade/expansion, and our treatment plant can now remove nitrogen and phosphorus to the State's proposed regulatory limits – at least until the WWTP reaches its new capacity of 14.5 mgd. Additional energy and chemicals to achieve the proposed nitrogen limit will cost more than \$500,000 per year at our current wastewater flow rates, and well over \$1 million per year in today's dollars when the plant reaches full capacity in the next 15 to 20 years.

Without significant advances in nitrogen removal technology, OWASA may not be able to achieve the proposed limit when average day wastewater flows exceed 14.5 million gallons per day, when we may need to restrict additional connections to the wastewater system. This information, along with additional comments, was provided to the NC Environmental Management Commission in a public hearing on July 12, 2007.

Capital Improvement Projects – OWASA's capital improvements program includes a number of projects that will involve local permits and/or may affect local neighborhoods. Highlights of these and other 2006-2007 projects are described below.

Construction began in the fall of 2006 for a new treated water pump station near Interstate 40. Along with the new 16-inch water line on Old Durham Road, this will increase OWASA's ability to obtain treated drinking water from the City of Durham during emergencies or for system maintenance purposes.

We continue to replace aging water mains in order to maintain the high level of water service reliability expected by OWASA customers. Replacement projects were completed during the past year along Highway 54 at Hatch Road and in part of the Colony Woods neighborhood. Additional water line replacement projects are underway in Colony Woods and are being designed for Sunrise Lane, Laurel Hill Circle, and Pearl Lane.

A project is underway to remove the Lloyd Street and Starlite Drive sewage pump stations by installing a new gravity sewer that will also serve additional properties in that downtown neighborhood. This project will include some work in Carrboro's Baldwin Park. Construction is expected to be completed this fall (2007).

Approximately seven miles of sewer mains and 437 manholes in the Bolin Creek area of Chapel Hill have been renovated, replaced or repaired in a project completed this past spring (2007).

A sewer and water main replacement project near Fetzer Lane and 206 West Cameron Avenue in Chapel Hill was completed in February, 2007.

Two new pumps have increased raw water pumping capacity from 1 mgd to 6 mgd at OWASA's existing Stone Quarry Reservoir. This represents a significant improvement in operational flexibility and reliability, especially during droughts or system maintenance, by allowing us to pump directly from the Quarry Reservoir to our Jones Ferry Road Water Treatment Plant, rather than pumping Quarry water via University Lake.

Annual Update of OWASA's *Comprehensive Water and Sewer Master Plan* – OWASA staff updated its *2001 Master Plan* with recent data, strategic trends, and commentary in October 2006. Printed copies and supporting graphics of the full update report are available on request from OWASA.

FINANCIAL INFORMATION

The annual budget is an integral part of OWASA's accounting system and financial operations. Appropriations are set at the departmental level. The annual budget and capital project ordinances are adopted by the OWASA Board of Directors, creating a legal limit on annual spending. Multi-year project ordinances may be adopted for capital projects. OWASA's operations are accounted for, and reported as, an enterprise fund because our services are primarily funded with user fees and occasional grants.

OWASA's management is responsible for the accounting system and for establishing and maintaining internal financial controls. The internal control system is designed to provide reasonable but not absolute assurance regarding (1) the safeguarding of assets against loss from unauthorized use or disposition and (2) the reliability of financial records for preparing financial statements in conformity with accounting principles generally accepted in the United States of America and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed its likely benefits and the evaluation of costs and benefits requires estimates and judgments by management.

Management believes that OWASA's internal accounting controls adequately protect assets and provide reasonable assurance of the proper recording of financial transactions.

Because OWASA is a self-supporting and self-sustaining entity, the measurement focus of its financial accounting system is on the flow of total economic resources. With this measurement focus, all assets and liabilities associated with our operations are included in the *Statement of Net Assets*. Closely related to the measurement focus is the basis of accounting, which determines when transactions are recognized. OWASA uses the accrual basis of accounting, in which revenues are recognized in the period in which they are earned and expenses are recognized in the period in which they are incurred, regardless of the actual date of receipt or disbursement of cash.

OWASA uses seasonal water rates to encourage conservation during peak demand periods. Customers pay a higher commodity rate (charge per thousand gallons) during the peak demand months of May through September, and a lower rate in the remaining months. The Board of Directors adopted a schedule of rates, fees and charges on June 14, 2007 that will include a block rate conservation pricing structure for our individually metered residential customers. Annual adjustment of water and sewer rates, charges and fees normally occurs on October 1.

Please refer to *Management's Discussion and Analysis* and the basic financial statements for detailed information on OWASA's financial performance in FY 2007.

Cash Management

OWASA's cash management policy is part of our *Strategic Financial Planning and Management Document* adopted by the Board of Directors in 1996 and updated in 2001 and 2007. This policy is designed to ensure safety of principal, liquidity for current operations, and market-average rates of return on investments. Cash and cash equivalents include deposits and investments with an original term of three months or less.

All cash deposits are made in Board-designated official depositories and are collateralized as required by State law. OWASA may designate, as an official depository, any bank or savings association whose principal office is in North Carolina. At June 30, 2007, OWASA's cash was invested in the N.C. Capital Management Trust, Treasury Securities and public fund money market accounts. Investment earnings, net of fair value of investment adjustments totaled \$995,354 in FY 2007.

To facilitate operational efficiency and to reduce costs of the accounts payable function, authorized OWASA employees use purchasing cards in accordance with internal control procedures and policies. Purchasing card use comprised about four percent of operating expenditures during FY 2007.

To further reduce costs, OWASA uses a web-based banking service for fund transfers including direct deposit of payroll, customer bank drafts, debt service payments and interfund transfers.

OWASA provides customers with various options for making payments. In addition to the traditional methods of mail and walk-in service, customers may make payments through automatic bank drafts and credit cards. Credit card transactions can be initiated through OWASA's Website (www.owasa.org), over the phone, or at our cashier's desk.

Risk Management

OWASA employs a combination of traditional insurance coverage and an active safety program to manage risk. OWASA maintains insurance coverage for property damage, general liability (including liability for OWASA vehicles and public officials), and workers' compensation. A commercial insurer provides employee health and accident coverage.

To consolidate coverage and to take advantage of the benefits of a state-wide insurance risk pool, OWASA participates in the N.C. League of Municipalities' Interlocal Risk Financing Fund for property damage, general liability and workers' compensation insurance.

OWASA's Safety Committee and Senior Safety Committee are actively engaged in reducing risks in the workplace. An employee from each department is appointed by the department head to represent his/her respective department for a term of two years. The Safety Committee meets once a month to review all accidents and discuss safety issues. The Committee also reviews safety policies and makes recommendations for revisions and/or additions. All employees are required to attend safety training related to their jobs. In addition, regularly scheduled safety-training sessions utilizing video programs provide safety and health training to all employees.

OWASA also uses employee awards and incentives to encourage safe work practices and awareness.

Independent Audit

OWASA is required by State law (G.S. 159-34) to have an annual independent financial audit. OWASA's auditor, McGladrey & Pullen, LLP, was retained following an open, competitive qualifications-based selection process. The auditor's report on the General Purpose Financial Statements is included in the Financial Section of this report.

Certificate of Achievement for Excellence in Financial Reporting

OWASA prepared this Comprehensive Annual Financial Report for the fiscal year ended June 30, 2007, using the GFOA's guidelines.

The GFOA awarded a Certificate of Achievement for Excellence in Financial Reporting to OWASA for its comprehensive annual financial report for the fiscal year ended June 30, 2006. To receive a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and legal requirements.

The Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Distinguished Budget Presentation Award

OWASA received its sixth Distinguished Budget Presentation Award from the GFOA for our FY 2007 budget.

This award program recognizes governments that prepare high quality budget documents to meet the needs of decision-makers and citizens.

Acknowledgements

Preparation of this report could not have been accomplished without the efficient and dedicated work of the OWASA staff.

We express our appreciation to the independent certified public accountants, McGladrey & Pullen, LLP, who assisted and contributed to this report.

We thank the OWASA Board of Directors for their strong policy guidance in financial management and of OWASA's overall services to the community.

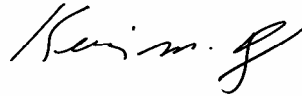
CONCLUSION

We believe the accompanying financial statements fairly present OWASA's financial position as of June 30, 2007, and the financial results of its operations and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Respectfully submitted,



Ed Kerwin
Executive Director



Kevin M. Ray
Director of Finance & Customer Service

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Orange Water and Sewer
Authority, North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2006

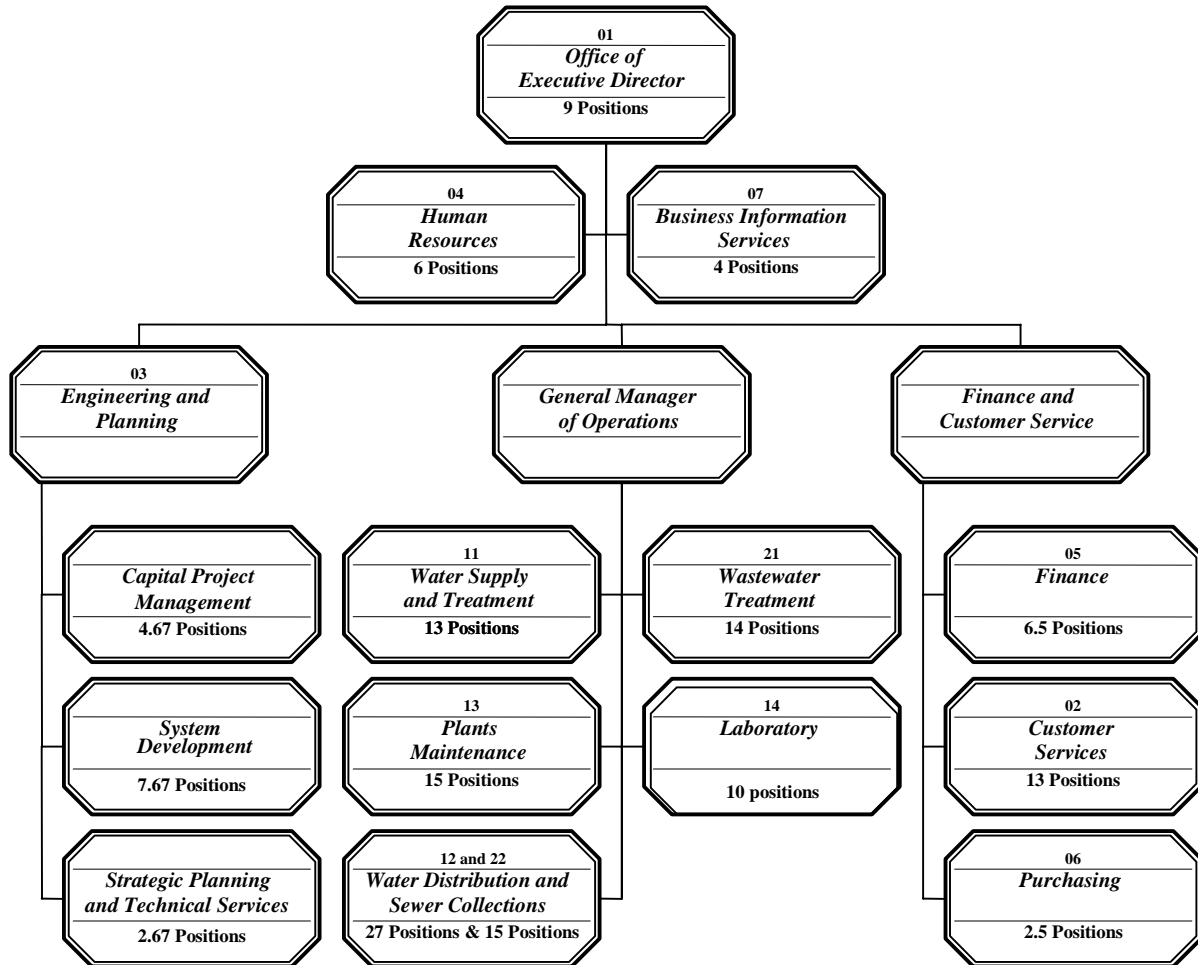
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

Orange Water and Sewer Authority Staff/Department Structure



Total: 150 Positions

**ORANGE WATER AND SEWER AUTHORITY
FISCAL YEAR 2006-2007
OFFICERS**

Michael A. (Mac) Clarke, Chair
Randolph M. Kabrick, P.E., Vice Chair
Gordon Merklein, Secretary

BOARD OF DIRECTORS

<u>Member</u>	<u>Appointed By</u>	<u>Term Expiration</u>
Fred Battle	Orange County	2009
Michael A. Clarke	Chapel Hill	2008
Braxton Foushee	Carrboro	2008
Randolph M. Kabrick, P. E.	Chapel Hill	2010
Marge Anders Limbert	Orange County	2008
Gordon Merklein	Chapel Hill	2010
Gene Pease	Chapel Hill	2009
Penny Rich	Chapel Hill	2007
William Stott	Carrboro	2009

SENIOR MANAGEMENT TEAM

Sandra Bradshaw, Laboratory Manager
Tammy Brown, Customer Service Manager
Jan Bryant-Berry, CLGPO, Procurement Manager
Gwen Burston, S.P.H.R., Director of Human Resources
F. Stuart Carson, P.E., Engineering Manager – Capital Projects
Mason Crum, Director of Engineering and Planning
Mary Darr, P.E., Operations Engineer
Patrick K. Davis, Utility Manager
Greg Feller, Public Affairs Administrator
Stephanie Glasgow, MESH, PHR, Safety and Training Administrator
Walter Gottschalk, Wastewater Treatment and Biosolids Recycling Manager
Thurman Green, P.E., Distribution and Collection Systems Manager
John Greene, P.E., General Manager of Operations
Edward Holland, A.I.C.P., Director of Planning and Development
Johnny Johnson, Plants Maintenance Manager
Ed Kerwin, Executive Director
Ken Loflin, Water Supply and Treatment Manager
Andrea Orbich, Executive Assistant
Dan Przybyl, Director of Business Information Services
Kevin M. Ray, Director of Finance and Customer Service
Todd Spencer, P.E., Engineering Manager – System Development
Judy Weller, Accounting Manager

GENERAL COUNSEL

Robert Epting, Esquire, Epting and Hackney

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report

To the Board of Directors
Orange Water and Sewer Authority
Carrboro, North Carolina

We have audited the accompanying financial statements of Orange Water and Sewer Authority, North Carolina (the "Authority"), a component unit of the Town of Chapel Hill, North Carolina, as of and for the years ended June 30, 2007 and 2006, which comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2007 and 2006, and the respective changes in financial position and cash flows thereof for the years 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 October 8, 2007 on our consideration of the Authority's internal control over financial reporting and 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 on pages 16 through 21 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Authority's basic financial statements. The supplementary schedules listed in the table of contents, as well as the accompanying schedule of expenditures of state awards as required by the State Single Audit Implementation Act, are presented for the purpose of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole. The introductory section and the statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

McGladrey & Pullen, LLP

Greensboro, North Carolina
October 8, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

The management of Orange Water and Sewer Authority (OWASA) offers to the readers of OWASA's financial statements the following discussion and analysis of the Authority's financial performance for the fiscal year ended June 30, 2007 (FY 2007). This presentation is intended to further the readers' understanding of the financial statements which follow, and should be read in conjunction with those statements and the introductory letter of transmittal found on pages i-ii.

FINANCIAL HIGHLIGHTS

- At year end, OWASA's net assets totaled \$178 million, reflecting an \$8.3 million increase over the previous year primarily due to remaining Series 2006 bond proceeds and other cash restricted for future capital projects.
- Current and restricted cash assets and investments increased by approximately \$7.3 million, reflecting the same bond proceeds and cash restricted for future capital projects.
- An increase in capital assets of approximately \$20.0 million, resulting from OWASA's ongoing commitment to maintaining an adequate water and sewer infrastructure.
- Current liabilities changed little during the year, reflecting well planned operational and capital budgets, and an efficient accounts payable process.
- An increase of \$19.1 million in noncurrent liabilities resulted from the issuance of \$22.3 million in Series 2006 bonds.
- OWASA enjoys credit ratings of Aa2 from Moody's, and AA+ from Standard & Poor's and Fitch.

OVERVIEW OF THE FINANCIAL STATEMENTS

OWASA's primary mission is to provide water and sewer services to Chapel Hill, Carrboro and portions of southeastern Orange County. OWASA does not provide other general purpose government services or programs. OWASA's operations, capital expansion program and debt payments are funded almost entirely through rates, fees and other charges for these water and sewer services. As such, OWASA is considered to be, and therefore presents its financial report, as a stand-alone enterprise fund.

As a stand-alone enterprise fund, OWASA's basic financial statements consist of a *Statement of Net Assets*, a *Statement of Revenues, Expenses and Changes in Net Assets* (Equity) and a *Statement of Cash Flows*. These statements, together with the *Management's Discussion and Analysis*, provide both short-term and long-term financial information about, and implications for, OWASA's financial position. Presentation of two-year and three-year comparative data in these schedules further enhances the reader's ability to gauge OWASA's fiscal strength and provides useful trend information. To further illuminate the information contained in these statements, *Notes to the Financial Statements* and a *Statement of Revenues and Expenditures – Budget and Actual*, appear immediately following the basic financial statements. In addition to this discussion and analysis, other required supplementary information, generally statistical and demographic in nature, is presented.

The *Statement of Net Assets*, similar to a balance sheet, presents OWASA's basic financial position through disclosure of information about OWASA's assets and liabilities. Net assets represent the difference between total assets and total liabilities. Net assets may serve over time as one useful indicator of OWASA's financial condition.

The *Statement of Revenues, Expenses and Changes in Net Assets*, similar to private sector statements, provides information regarding OWASA's total economic resource inflow and outflow (accrual method of accounting). The difference between these inflows and outflows represents the change in net assets, which links this statement to the *Statement of Net Assets*.

The *Statement of Cash Flows* deals specifically with the flow of cash and cash equivalents arising from operating, capital and related financing and investing activities. Because OWASA's *Statement of Revenues, Expenses and Changes in Net Assets* is a measurement of the flow of total economic resources, operating income usually differs from net cash flow from operations. To enhance the reader's understanding of this difference, the *Statement of Cash Flows* also includes a reconciliation between these two amounts. In accordance with accounting principles generally accepted in the United States of America, a reconciliation of cash and cash equivalents is also presented in this statement.

The *Notes to the Financial Statements* provide additional information critical to the understanding of the basic financial statements.

FINANCIAL ANALYSIS

Orange Water and Sewer Authority Schedule of Net Assets (\$ millions)				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	Percentage of Change (FY06 to 07)
Current assets and restricted noncurrent assets	\$27.8	\$20.6	\$36.7	34.9%
Capital and other long-term assets	<u>272.2</u>	<u>252.2</u>	<u>232.9</u>	7.9%
Total assets	<u>300.0</u>	<u>272.8</u>	<u>269.6</u>	10.0%
Current liabilities	10.9	11.1	9.3	(1.8%)
Noncurrent liabilities	<u>111.5</u>	<u>92.4</u>	<u>96.4</u>	20.7%
Total liabilities	<u>122.4</u>	<u>103.5</u>	<u>105.7</u>	18.3%
Net assets				
Invested in capital assets, net of related debt	161.8	160.8	137.4	.6%
Restricted	9.3	1.9	19.1	389%
Unrestricted	<u>6.5</u>	<u>6.6</u>	<u>7.4</u>	(1.5%)
Total net assets	<u>\$177.6</u>	<u>\$169.3</u>	<u>\$163.9</u>	<u>5.0%</u>

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial condition. OWASA's assets exceeded liabilities by \$178 million at June 30, 2007, compared to \$169 million and \$164 million at June 30, 2006 and 2005, respectively. This trend of increased net worth is indicative of OWASA's commitment to maintaining an infrastructure to meet the water and sewer needs of its customers now and in the future.

Capital assets net of related debt comprised 84%, 95% and 91% of total net assets at June 30, 2005, 2006 and 2007, respectively. These capital assets are essential in providing water and sewer services to our customers and consequently, these assets are not available for future spending. The resources needed to repay the associated debt must be provided by other sources. At June 30, 2007, these other resources totaled \$15.8 million. \$9.3 million of these assets are subject to external restrictions as to how they may be used, but these restrictions primarily require that they be used to pay for capital assets. The change in restricted balances between 2005 and 2007 generally reflects the issuance of debt and the availability of bond proceeds for infrastructure development. The remaining \$6.5 million is unrestricted.

OWASA's overall financial position strengthened between fiscal years ended June 30, 2005 and 2007 as net assets increased by \$13.7 million. Total assets increased during the same period by \$30.4 million. However, this increase in total assets was offset somewhat by an increase in total liabilities of \$16.7 million, again reflecting the issuance of debt to pay for the cost of a significant number of capital assets. Current liabilities changed little during the same comparative three-year period, reflecting well planned operational and capital budgets, and an efficient accounts payable process.

OWASA anticipates continued increases in its net worth arising from our planned capital improvements development program and projected surpluses of revenues over operating expenses.

Orange Water and Sewer Authority				
Revenues, Expenses and Change in Net Assets				
(\$ Millions)				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	Percentage of Change (FY06 to 07)
Operating revenues	\$25.4	\$24.4	\$21.9	4.1%
Operating expenses	<u>23.6</u>	<u>22.6</u>	<u>20.8</u>	<u>4.4%</u>
Operating income	1.8	1.8	1.1	0.0%
Nonoperating revenues (expenses)	<u>(.9)</u>	<u>.1</u>	<u>(.6)</u>	<u>(1000%)</u>
Income before contributions	.9	1.9	.5	(57.9%)
Capital contributions	<u>7.4</u>	<u>3.5</u>	<u>2.6</u>	<u>112%</u>
Increase in net assets	8.3	5.4	3.0	154%
Net assets, July 1	<u>169.3</u>	<u>163.9</u>	<u>160.9</u>	<u>3.3%</u>
Net assets, June 30	<u>\$177.6</u>	<u>\$169.3</u>	<u>\$163.9</u>	<u>4.9%</u>

The condensed three-year comparison of Revenues, Expenses and Changes in Net Assets, combined with the following discussion provides insight as to the causes affecting net assets.

- **Operating Revenues:** OWASA is not empowered to levy or collect taxes, nor does OWASA receive funding from the taxing authorities within our service area. OWASA's operations, capital expansion program and debt service are funded almost entirely from fees charged to our customers for water and sewer services, and other related services. As such, OWASA's revenue stream is impacted by fluctuations in demand for our services and other economic factors.

Although overall water sales volume declined about 2.0% during FY 2007 and were approximately 6.0% below expectations, reflecting OWASA's continued commitment to water resource conservation and a deepening drought during the fourth quarter, rate adjustments in water and sewer rates of 6.0 % and 6.5%, respectively, contributed to an increase in operating revenues of about 4.0 %. The increase in operating revenues equaled about \$1.0 million.

Revenues derived from water and sewer services are comprised of two components; a fixed monthly service charge based on the size of the installed water meter and a monthly volume usage (commodity) charge per thousand gallons of water consumed. The commodity charge for sewer, although based on water consumption, incorporates the assumption that not all water consumed is returned to the sewer system and is calculated at a lower rate to accommodate this assumption. All rates, fees and charges are calculated under the cost-of-service rate making methodology.

- **Operating Expenses:** Operating expenses of \$23.6 million represent an increase of about 13.5% over the preceding two years. Nevertheless, OWASA managers underspent their appropriations by 6.0%, providing a significant offset to the operating revenue deficit. This is also an indication of OWASA's flexibility in addressing anomalous conditions such as droughts. Further, the operating expense includes a \$7.0 million charge for depreciation, and from a cash flow perspective, OWASA's ability to meet its operating expenses and adequately cover its debt service remains strong.
- **Nonoperating Revenues (Expense):** Nonoperating revenues are comprised primarily of service availability fees and interest earnings. Service availability fees, similar to impact fees, are calculated to recover from new customers the fair share cost of system capacity when a new connection is made to the system. Nonoperating expenditures are made up primarily of interest expense on debt.

Availability fees of \$2.5 million were very close to projections, reflecting the inclusion of fees from the University of North Carolina at Chapel Hill that historically was exempt from these fees for development on its main campus. The availability for investment of significant cash balances in the form of bond proceeds, combined with improved market conditions, resulted in a 34% increase in fund performance. Interest earnings of \$995,354 were within 0.5% of projections. Other income includes items such as gains on the disposal of surplus property and is generally not of a material amount.

Bond and patent amortization decreased by 32.0% as the economic benefit of OWASA's patent has been fully amortized. Interest expense increased significantly with the issuance of Series 2006 Bonds.

- **Capital Contributions:** Total capital contributions increased by a significant 115.0% during FY2007. Capital grants of \$650,000 reflect the receipt of North Carolina Clean Water Management Trust Fund grants for OWASA's watershed protection efforts and for reimbursement of certain costs associated with a reclaimed water project currently under construction.

Contributions in aid of construction in the form of dedicated service lines are reclassified as contributions after net income. Although OWASA receives such contributions annually, these transactions are not of a cash nature and OWASA does not include them in the budget under the modified accrual method. The \$3.5 million increase in contributions in aid of construction reflects the completion of a new high school, a new town operations center, several University projects and various smaller projects.

Capital Assets

In FY 2007, OWASA expanded or placed into service new capital assets with a total value, net of depreciation, of \$19.9 million. These projects included the continued upgrade and expansion of the Mason Farm Wastewater Treatment Plant, the construction or replacement of water mains and finished water pump stations, the renovation of more than seven miles of sewer mains and a six-fold increase in pumping capacity from OWASA's Stone Quarry Reservoir.

Orange Water and Sewer Authority				
Capital Assets				
(\$ Millions)				
	<u>2007</u>	<u>2006</u>	<u>2005</u>	Percentage of Change (FY06 to 07)
Land	\$20.0	\$17.3	\$16.7	15.6%
Construction in progress	75.2	62.5	42.9	20.3%
Water treatment and distribution	84.0	80.5	80.1	4.4%
Sewer collection and treatment	73.8	73.1	73.1	1.0%
Fixtures and equipment	19.2	18.8	20.1	1.2%
Total	<u>\$272.2</u>	<u>\$252.2</u>	<u>\$232.9</u>	<u>7.9%</u>

Debt Administration

OWASA policy dictates that approximately 30%-40% of capital projects be funded with cash from operations, with the remainder funded through borrowing. At June 30, 2007, 2006 and 2005, OWASA's outstanding debt totaled \$115.3 million, \$96.4 million, and \$112.9 million, respectively, net of applicable premiums, discounts and deferred refunding costs. This amount consists of water and sewer system revenue and refunding bonds issued in 1999, 2001, 2003, 2004, 2005 and 2006. At year end, OWASA owed an accrued debt service liability of approximately \$6.0 million. This amount was fully funded in the trustee restricted bond service account.

OWASA enjoys credit ratings for its bonds of Aa2 by the Moody's rating agency. Standard & Poor's and Fitch rate OWASA's creditworthiness as AA+. These "double A" ratings reflect OWASA's strong fiscal policy and standards and are considered excellent for an entity that does not have taxing authority.

Please refer to Note 5 in the Notes to Financial Statements section for greater detail on OWASA's outstanding debt obligations.

Economic Factors

OWASA, located in Orange County, North Carolina, enjoys the benefit of several key factors within its service area.

- The University of North Carolina at Chapel is OWASA's largest principal customer, generating nearly 30% of water sales.
- Orange County's unemployment rate was 3.3 percent compared to the North Carolina average of 4.7 percent.
- The University is undergoing one of the largest campus expansion programs in the country.

As of June 30, 2007, the OWASA service area once again is experiencing a drought. Just as have other purveyors in the area, OWASA has encouraged water conservation to ensure adequate water supplies. Such conservation beyond OWASA's normal year-round conservation policies carries significant implications for projected revenue streams. As described earlier in this document, OWASA ended FY 2007 approximately \$1.6 million, or six percent below projections. To its credit, OWASA has been able to successfully manage its operational spending budget to create significant offsets to these deficits without notable degradation of services or programs. The drought has continued into FY 2008 and OWASA anticipates that it will be able to continue to offset any deficits through spending reductions.

Requests for Information

This report is designed to provide an overview of the Authority's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be directed to the Director of Finance & Customer Service, 400 Jones Ferry Road, Carrboro, North Carolina 27510.

Orange Water and Sewer Authority

Statements of Net Assets June 30, 2007 and 2006

Assets	2007	2006
Current Assets		
Cash and cash equivalents	\$ 33,488	\$ 801,354
Investments, Authority	6,985,000	6,615,746
Receivables:		
Trade accounts (net of allowances for uncollectible accounts of approximately \$115,325 for 2007 and \$58,590 for 2006)	2,961,439	2,765,661
Interest	-	4,933
Other	644,158	819,324
Inventory, materials and supplies	669,415	609,485
Prepaid expenses	21,003	271,007
Restricted cash, cash equivalents and investments:		
Cash and cash equivalents, Trustee	5,991,959	5,792,668
Total current assets	17,306,462	17,680,178
Noncurrent Assets		
Restricted Cash, Cash Equivalents and Investments		
Cash and cash equivalents, Authority	1,127,192	1,656,500
Cash and cash equivalents, Trustee	8,272,997	286,927
Total restricted cash, cash equivalents and investments	9,400,189	1,943,427
Capital assets:		
Non-depreciable	95,152,622	79,819,842
Depreciable	177,061,466	172,403,648
Total capital assets net of accumulated depreciation	272,214,088	252,223,490
Patent, net of accumulated amortization of \$844,779 for 2007 and \$824,173 for 2006	-	20,606
Unamortized bond expenses, net of accumulated amortization of \$485,284 for 2007 and \$409,788 for 2006	1,103,483	927,620
	1,103,483	948,226
Total noncurrent assets, net	282,717,760	255,115,143
Total assets	\$ 300,024,222	\$ 272,795,321

See Notes to Financial Statements.

Liabilities and Net Assets	2007	2006
Current Liabilities		
Payable from current assets:		
Trade and construction contracts payable	\$ 3,530,506	\$ 4,179,249
Customer deposits and advances	643,665	423,180
Accrued expenses	724,891	683,189
Payable from restricted cash, cash equivalents and investments:		
Accrued interest	2,181,392	1,750,509
Current maturities of bonds payable	3,810,567	4,042,159
Total current liabilities	10,891,021	11,078,286
Noncurrent Liabilities		
Long-term debt	111,461,797	92,365,723
Total liabilities	122,352,818	103,444,009
Net Assets		
Invested in capital assets, net of related debt	161,812,115	160,813,755
Restricted for maintenance reserve and power fund	1,127,192	1,894,497
Restricted for future capital projects	8,093,307	-
Restricted for debt service	185,258	31,088
Unrestricted	6,453,532	6,611,972
Total net assets	\$ 177,671,404	\$ 169,351,312

Orange Water and Sewer Authority

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended June 30, 2007 and 2006

	2007	2006
Operating revenues:		
Water	\$ 14,218,387	\$ 13,946,421
Sewer	10,272,920	9,682,210
Service initiation fees	142,086	153,670
Other	777,767	649,081
Total operating revenues	25,411,160	24,431,382
Operating expenses:		
Water supply and treatment	2,261,394	2,159,244
Water distribution	1,961,162	1,710,117
Sewer treatment	2,865,782	3,042,830
Sewer collections	1,539,591	1,352,661
General and administrative	4,420,873	3,809,200
Customer relations	714,639	966,972
Maintenance	1,979,957	1,860,938
Laboratory	890,108	821,955
Depreciation and amortization	6,950,774	6,871,350
Total operating expenses	23,584,280	22,595,267
Operating income	1,826,880	1,836,115
Nonoperating revenues (expenses):		
Customer fees	2,514,450	2,308,651
Investment income, net of fair value of investment adjustment	995,354	742,010
Interest expense	(4,361,911)	(2,724,951)
Amortization of bond expense and patent	(96,898)	(141,579)
Other	16,431	(58,846)
Income before contributions	894,306	1,961,400
Capital contributions:		
Capital grants and contributions	650,097	153,232
Contributions in aid of construction	6,775,689	3,306,603
Total capital contributions	7,425,786	3,459,835
Increase in net assets	8,320,092	5,421,235
Net assets:		
Beginning	169,351,312	163,930,077
Ending	\$ 177,671,404	\$ 169,351,312

See Notes to Financial Statements.

Orange Water and Sewer Authority

Statements of Cash Flows
Years Ended June 30, 2007 and 2006

	2007	2006
Cash Flows From Operating Activities		
Receipts from customers	\$ 24,437,615	\$ 24,450,175
Payments to suppliers	(7,784,202)	(6,123,673)
Payments to employees	(9,266,271)	(8,930,475)
Other receipts	952,933	734,895
Net cash provided by operating activities	8,340,075	10,130,922
Cash Flows From Capital and Related Financing Activities		
Acquisition and construction of property, plant and equipment	(20,004,651)	(21,712,438)
Proceeds from sale of property, plant and equipment	132,137	17,288
Principal paid on bond maturities and other long-term debt	(4,060,000)	(3,290,000)
Proceeds from the issuance of bonds	22,924,165	-
Interest paid on bond maturities on other long-term debt	(4,208,245)	(3,648,745)
Customer fees received	2,734,935	2,236,399
Capital grants and contributions	650,097	153,232
Bond issuance costs and capitalized expenses	(251,359)	(3,394)
Net cash used in capital and related financing activities	(2,082,921)	(26,247,658)
Cash Flows From Investing Activities		
Proceeds from sale and maturities of investment securities	994,400	29,897,261
Amount paid for purchase of investments	(1,368,000)	(29,982,824)
Interest and dividends on investments	1,004,633	977,553
Net cash provided by investing activities	631,033	891,990
Net increase (decrease) in cash and cash equivalents	6,888,187	(15,224,746)
Cash and cash equivalents:		
Beginning	8,537,449	23,762,195
Ending	\$ 15,425,636	\$ 8,537,449
Reconciliation of Cash and Cash Equivalents:		
Current assets	\$ 33,488	\$ 801,354
Restricted assets:		
Authority	1,127,192	1,656,500
Trustee	14,264,956	6,079,595
	\$ 15,425,636	\$ 8,537,449

(Continued)

Orange Water and Sewer Authority

Statements of Cash Flows (Continued)
Years Ended June 30, 2007 and 2006

	2007	2006
Reconciliation of Operating Income to Net Cash		
Provided By Operating Activities		
Operating income	\$ 1,826,880	\$ 1,836,115
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	6,950,774	6,871,350
Changes in assets and liabilities:		
Trade accounts receivable	(195,778)	667,874
Other receivables	175,166	85,814
Inventory	(59,930)	(86,840)
Prepaid expenses	250,004	5,507
Trade and construction contracts payable	(648,743)	774,265
Accrued expenses	41,702	(23,163)
Net cash provided by operating activities	\$ 8,340,075	\$ 10,130,922
Supplemental Schedule of Noncash Capital and Related Financing Activities, Noncapital Financing Activities and Investing Activities		
Property, plant and equipment contributed by private developers	\$ 6,775,689	\$ 3,306,603
Capitalized interest, net of investment earnings	\$ 276,738	\$ 1,298,437
Amortization of bond expenses, bond discounts, deferred refunding gains and losses, and a wastewater phosphorus removal process patent	\$ 96,898	\$ 141,579
Increase (decrease) in the fair value of the Authority's investments	\$ 4,346	\$ (225,575)

See Notes to Financial Statements.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

a. Reporting entity

Orange Water and Sewer Authority (the "Authority") was created pursuant to Chapter 162A of the North Carolina General Statutes by the Board of Commissioners of Orange County, and the Boards of Aldermen of the Towns of Chapel Hill and Carrboro in June 1975, as a public entity, politic and corporate, for the purpose of acquiring, consolidating, improving and operating the existing water and sewer systems serving the above governmental jurisdictions and certain contiguous areas. The Authority is a separate governmental unit granted independent authority by the North Carolina General Statutes to allow the Authority's Board of Directors to set rates, fees and charges without oversight, supervision, or direction from any other state or local entity or agency.

Because the Town Council of Chapel Hill appoints a majority of the Authority's Board of Directors, and may remove them without cause, the Authority falls within the definition of a "Component Unit" provided in applicable accounting standards. For this reason, the Authority's financial data is incorporated into the Comprehensive Annual Financial Report of the Town of Chapel Hill.

b. Measurement focus, basis of accounting, and financial statement presentation

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board ("GASB"). Authorities also have the option of following subsequent private-sector guidance for their business-type activities, subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

c. Assets, liabilities, and net assets

1. Deposits and investments

The Authority's cash and cash equivalents are considered to be cash on hand, demand deposits, and short-term investments with original maturities of three months or less from the date of acquisition.

All deposits of the Authority are made in board-designated official depositories and are secured as required by State statute. The Authority may designate, as an official depository, any bank or savings association whose principal office is located in North Carolina. Also, the Authority may establish time deposit accounts such as NOW and SuperNOW accounts, money market accounts, and certificates of deposits.

State statute authorizes the Authority to invest in obligations of the United States or obligations fully guaranteed both as to principal and interest 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; certain high quality issues of commercial paper and bankers' acceptances; and the North Carolina Capital Management Trust ("NCCMT"), an SEC-registered mutual fund.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

The Authority's investments with a maturity of more than one year at acquisition and nonmoney market investments are reported at cost or amortized cost, which approximates their fair value as determined by quoted market prices. The NCCMT Cash Portfolio's securities, a SEC-register (2a7) money market mutual fund, are valued at fair value, which is the NCCMT's share price. Money market investments that have a remaining maturity at the time of purchase of one year or less are reported at amortized cost.

2. Receivables

All trade receivables are shown net of an allowance for uncollectibles. Trade receivables that are determined to be uncollectible by the client are based on their knowledge of collection history for similar customers.

3. Inventory – materials and supplies

Materials and supplies are valued at average cost.

4. Restricted assets

Certain proceeds of the Authority's revenue bonds, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because they are maintained in separate bank accounts and their use is limited by applicable bond covenants. The "maintenance reserve and power fund" accounts are used to report resources set aside to subsidize potential deficiencies from the Authority's operation that could adversely affect debt service payments. The "future capital projects" account is used to report those proceeds of revenue bond issuances that are restricted for use in construction.

5. Other assets

The cost of patents is being amortized on a straight-line basis over its remaining estimated useful life, not to exceed fifteen years.

Unamortized bond expenses represent the difference between the reacquisition price and the net carrying amount of debt that is being deferred and amortized when new debt is issued for current or advanced refunding of existing debt. Costs incurred attributable to the issuance of revenue bonds have been deferred and are being amortized over the life of the bonds using the effective interest method.

6. Capital assets

Capital assets, which include property, plant, equipment and infrastructure assets, are reported in the applicable business-type activities in the financial statements. Capital assets are defined by the Authority as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Property, plant and equipment is depreciated using the straight-line method by groups or classes of property over the following expected service lives:

	<u>Years</u>
Water treatment and distribution	20 - 60
Sewer collection and treatment	40 - 60
Fixtures and equipment	5 - 20

Assets under capitalized lease obligations are recorded at the discounted present value of the future minimum lease payments at the inception of the respective leases. The amounts capitalized are being amortized by the straight-line method over the lesser of the term of the lease or the estimated life of the asset. Amortization of these assets is included in depreciation expense.

7. Compensated Absences

It is the Authority's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since the Authority does not have a policy to pay any amounts when employees separate from service with the Authority. All vacation pay is accrued when incurred in the financial statements, but is limited to thirty days. At June 30, 2007 and 2006, the Authority had recorded a liability for accrued vacation and the salary-related payments of \$404,146 and \$410,063, respectively.

8. Long-Term Debt

Long-term debt is reported net of applicable bond premium or discount, which are deferred and amortized over the life of the bonds using the effective interest method.

9. Net Assets

Invested in capital assets, net of related debt net assets consist of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Restricted net assets for maintenance reserve and power fund and future capital projects represent the Authority's portion of net assets that are restricted by externally imposed constraints by creditors that relate to the Authority's revenue bonds.

Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt".

10. Operating Revenues and Expenses

Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations, which is the sale of water and treatment of wastewater for its customers. The Authority also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the system. Operating expense for the Authority includes the cost of services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

11. Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 2. Stewardship and Accountability – Budgetary Information

Annual budgets are adopted on a basis consistent with provisions of the Local Government Budget and Fiscal Control Act, which is the modified accrual method of accounting. All annual appropriations lapse at fiscal year end.

In March of each year, the Authority requests information from various departments to project the amount of appropriations for each department so that a budget may be prepared. The proposed budget is presented to the Authority's board for review and approval before the end of April.

Budgeted revenues are reflected by source and budgeted expenses by department. On a periodic basis, as required by changing conditions, the budgeted amounts are amended. The budgeted amounts shown in the supplemental schedules reflect the governing board's amendments through the fiscal year end.

Note 3. Cash, Cash Equivalents and Investments

Deposits - All of the Authority's deposits are either insured or collateralized by using one of two methods. Under the dedicated method, all deposits exceeding the federal depository insurance coverage level are collateralized with securities held by the Authority's agents in the unit's name. Under the pooling method, which is a collateral pool, all uninsured deposits are collateralized with securities held by the State Treasurer's agent in the name of the State Treasurer. Since the State Treasurer is acting in a fiduciary capacity for the Authority, these deposits are considered to be held by the Authority's agent in the Authority's name. The amount of the pledged collateral is based on an approved averaging method for noninterest-bearing deposits and the actual current balance for interest-bearing deposits. Depositories using the pooling method report to the State Treasurer the adequacy of their pooled collateral covering uninsured deposits. The State Treasurer does not confirm this information with the Authority or with the escrow agent. Because of the inability to measure the exact amount of collateral pledged for the Authority under the pooling method, the potential exists for undercollateralization, and this risk may increase in periods of high cash flows. However, the State Treasurer of North Carolina enforces strict standards of financial stability for each depository that collateralizes public deposits under the pooling method. The Authority has no policy regarding custodial credit risk for deposits.

At June 30, 2007, the Authority's deposits had a carrying amount of \$1,160,105 and a bank balance of \$1,464,600. Of the bank balance, \$204,803 was covered by federal depository insurance and \$1,259,797 in interest-bearing deposits were covered by collateral held under the pooling method. The Authority had cash on hand of \$575 at June 30, 2007.

Orange Water and Sewer Authority

Notes to Financial Statements

Note 3. Cash, Cash Equivalents and Investments (Continued)

Cash Equivalents and Investments:

At June 30, 2007 and 2006, the Authority's cash equivalents and investment balances at fair value were as follows:

	2007	2006
Commercial Paper	\$ 6,985,000	\$ 6,615,746
The North Carolina Capital Management Trust, a mutual fund	14,264,956	5,841,598
	<u>\$ 21,249,956</u>	<u>\$ 12,457,344</u>

Interest Rate Risk. The Authority does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. At June 30, 2007, the Authority's maturities for the commercial paper are less than six months. The NCCMT has a weighted-average maturity of 0.9 years as of June 30, 2007.

Credit risk. The Authority has no policy regarding credit risk. State law limits investments in commercial paper to the top rating issued by nationally recognized statistical rating organizations ("NRSROs"). As of June 30, 2007, the Authority's investments in commercial paper were rated P1 by Standard & Poor's, F1 by Fitch Ratings, and A1 by Moody's Investors Service. The Authority's investment in the NCCMT Cash Portfolio carried a credit rating of AAAM by Standard & Poor's as of June 30, 2007.

At June 30, 2007 and 2006, cash, cash equivalents and investments administered by the Authority consist of the following:

	2007	2006
Authority:		
Current:		
General Fund	\$ 6,925,515	\$ 7,345,929
Revenue Fund	92,973	71,171
Total current	<u>\$ 7,018,488</u>	<u>\$ 7,417,100</u>
Restricted:		
Capital Reserve Fund	\$ 1,127,192	\$ 1,656,500
Power Account Fund	-	237,997
Total restricted	<u>\$ 1,127,192</u>	<u>\$ 1,894,497</u>
Trustee:		
Restricted:		
Construction Fund	\$ 8,093,307	\$ -
Bond Service Fund	6,171,649	5,841,598
Total restricted	<u>\$ 14,264,956</u>	<u>\$ 5,841,598</u>

Orange Water and Sewer Authority

Notes to Financial Statements

Note 4. Capital Assets

Capital assets activity consists of the following for the years ended June 30, 2007 and 2006:

	July 1, 2006 Beginning Balance	Increases	Decreases	June 30, 2007 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 17,289,624	\$ 2,705,254	\$ -	\$ 19,994,878
Construction in progress	62,530,218	12,981,103	353,577	75,157,744
Total capital assets, not being depreciated	79,819,842	15,686,357	353,577	95,152,622
Capital assets, being depreciated:				
Water treatment and distribution	108,722,751	6,247,665	1,198	114,969,218
Sewer collection and treatment	99,056,458	3,141,496	-	102,197,954
Fixtures and equipment	33,880,647	2,335,137	133,321	36,082,463
Assets under capital lease obligations	260,596	-	-	260,596
Total capital assets, being depreciated	241,920,452	11,724,298	134,519	253,510,231
Less accumulated depreciation for:				
Water treatment and distribution	28,258,182	2,667,997	-	30,926,179
Sewer collection and treatment	25,979,991	2,388,441	-	28,368,432
Fixtures and equipment	15,018,035	1,894,336	18,813	16,893,558
Assets under capital lease obligations	260,596	-	-	260,596
Total accumulated depreciation	69,516,804	6,950,774	18,813	76,448,765
Total capital assets, being depreciated, net	172,403,648			177,061,466
Total capital assets, net	\$ 252,223,490			\$ 272,214,088
	July 1, 2005 Beginning Balance	Increases	Decreases	June 30, 2006 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 16,698,207	\$ 591,417	\$ -	\$ 17,289,624
Construction in progress	42,897,990	20,787,144	1,154,916	62,530,218
Total capital assets, not being depreciated	59,596,197	21,378,561	1,154,916	79,819,842
Capital assets, being depreciated:				
Water treatment and distribution	105,811,097	2,937,771	26,117	108,722,751
Sewer collection and treatment	96,731,521	2,326,437	1,500	99,056,458
Fixtures and equipment	33,408,377	829,626	357,356	33,880,647
Assets under capital lease obligations	260,596	-	-	260,596
Total capital assets, being depreciated	236,211,591	6,093,834	384,973	241,920,452
Less accumulated depreciation for:				
Water treatment and distribution	25,669,009	2,599,914	10,741	28,258,182
Sewer collection and treatment	23,637,303	2,342,688	-	25,979,991
Fixtures and equipment	13,387,384	1,928,748	298,097	15,018,035
Assets under capital lease obligations	260,596	-	-	260,596
Total accumulated depreciation	62,954,292	6,871,350	308,838	69,516,804
Total capital assets, being depreciated, net	173,257,299			172,403,648
Total capital assets, net	\$ 232,853,496			\$ 252,223,490

Orange Water and Sewer Authority

Notes to Financial Statements

Note 5. Long-Term Debt

Long-term debt as of June 30, 2007 and 2006 consists of the following:

	2007	2006
Revenue bonds payable, Series 2006 Revenue Serial Bonds in the amount of \$15,500,000, issued October 26, 2006, with coupon rates of 4.0% and 5.0%, final maturity July 2026, net of unamortized premium of \$622,121 at June 30, 2007; Revenue bonds payable, Series 2006 Revenue Term Bonds in the amount of \$6,785,000, issued October 26, 2006, with an interest rate of 5.0%, due in full July 2031	\$ 22,907,121	-
Revenue and revenue refunding bonds payable, Series 2005 Revenue and Revenue Refunding Bonds, issued June 9, 2005, with coupon rates of 3.5% to 5.0%, final maturity July 2020, net of unamortized discount of \$223,587 at June 30, 2007	18,451,412	\$ 18,434,213
Revenue bonds payable, Series 2004A Revenue Bonds in the amount of \$21,265,000, issued June 1, 2004, with coupon rates of 3.0% and 5.25%, final maturity July 2021, net of unamortized premium of \$590,683 at June 30, 2007; Revenue bonds payable, Series 2004B Revenue Bonds in the amount of \$20,000,000, issued June 1, 2004, bearing a weekly interest rate determined by a remarketing agent (4% at June 30, 2007), final maturity July 2029	40,810,683	41,898,127
Revenue and revenue refunding bonds payable, Series 2003 Revenue and Revenue Refunding Bonds, issued April 9, 2003, with coupon rates of 2.5% to 5.0%, final maturity July 2016, net of unamortized premium and deferred refunding loss of \$470,187 at June 30, 2007	9,009,813	10,477,571
Revenue and revenue refunding bonds payable, Series 2001 Revenue and Revenue Refunding Bonds, issued September 13, 2001, with coupon rates of 3.5% to 5.0%, final maturity July 2026, net of unamortized premium and deferred refunding loss of \$56,812 at June 30, 2007	22,056,812	22,934,968
Revenue and revenue refunding bonds payable, Series 1999 Revenue and Revenue Refunding Bonds, issued April 15, 1999, with coupon rates of 4.0% to 5.25%, final maturity July 2009, net of unamortized premium of \$11,523 at June 30, 2007	2,036,523	2,663,003
	<u>115,272,364</u>	<u>96,407,882</u>
Less current maturities:		
Bonds payable, net of unamortized premiums and discounts and deferred refunding gains and losses	3,810,567	4,042,159
Long-term portion	<u><u>\$ 111,461,797</u></u>	<u><u>\$ 92,365,723</u></u>

Orange Water and Sewer Authority

Notes to Financial Statements

Note 5. Long-Term Debt (Continued)

Debt maturities are as follows:

Fiscal Year	Maturities	Amortization of Premiums and Deferred Refunding Losses	Total	Interest
2008	\$ 3,805,000	\$ (5,567)	\$ 3,810,567	\$ 3,880,387
2009	4,840,000	(5,567)	4,845,567	4,755,033
2010	4,835,000	(5,567)	4,840,567	4,570,845
2011	5,230,000	(1,726)	5,231,726	4,374,964
2012	5,450,000	(1,726)	5,451,726	4,148,876
2013-2017	26,900,000	(60,861)	26,960,861	17,353,018
2018-2022	25,375,000	(258,258)	25,633,258	11,466,509
2023-2027	23,860,000	(137,306)	23,997,306	6,038,920
2028-2032	14,390,000	(110,786)	14,500,786	1,589,250
Total	\$ 114,685,000	\$ (587,364)	\$ 115,272,364	\$ 58,177,802

In 2006, the Authority issued \$22,285,000 of debt, at a premium of \$639,165, in Series 2006 Water and Sewer System Revenue Bonds to finance construction and improvements.

In 2005, the Authority issued \$18,675,000, net of a discount of \$257,985, in Series 2005 Revenue and Revenue Refunding Bonds to provide for a partial refunding of Series 2001 and Series 1999 Revenue Bonds. The Authority irrevocably deposited with a trustee, securities that were used to retire the principal and interest of the Series 2001 and Series 1999 Revenue Bonds as they become due. The par value of the defeased Series 2001 and Series 1999 Revenue Bonds at June 30, 2007 was \$18,325,000.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately \$1,000,000. In accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, this gain, net of accumulated amortization, is reported in the accompanying financial statements and is being amortized over the life of the new debt, using the effective interest method.

In 2004, the Authority issued \$41,265,000 of debt, at a premium of \$721,553 in Series 2004 Revenue Bonds to finance construction and improvements.

In 2003, the Authority issued \$13,875,000 of debt, at a premium of \$683,018 in Series 2003 Revenue Refunding Bonds to refund all but two installments of the remaining Series 1993 Revenue Bonds. The Authority irrevocably deposited with a trustee, securities that were used to retire the principal and interest of the refunded bonds as they became due. As of June 30, 2005, the refunded Series were fully redeemed.

In 2001, the Authority issued \$34,540,000 of debt, at a premium of \$318,749 in Series 2001 Revenue and Revenue Refunding Bonds to finance construction and improvement projects, as well as to provide for the refunding of \$3,995,000 in Series 1993 Revenue Bonds. The Authority irrevocably deposited with a trustee, securities that were used to retire the principal and interest of the refunded bonds as they became due. As of June 30, 2005, the refunded Series were fully redeemed.

Orange Water and Sewer Authority

Notes to Financial Statements

Note 5. Long-Term Debt (Continued)

In 1999, the Authority issued \$15,120,000 of debt, at a premium of \$133,026 in Series 1999 Revenue and Revenue Refunding Bonds to assist in the funding of a five-year Capital Improvement Plan that includes improvements to the Authority's water and sewer system of approximately \$48,300,000.

In 1985, the Authority defeased Series 1977A Revenue Bonds by placing the proceeds of new bonds, Series 1985A Revenue Bonds, in an irrevocable trust to provide for all future debt service payments on the old bonds. The gain of \$1,517,000, resulting from the refunding is being amortized over the life of the new issue. In addition to the amounts held in the trust, the trustee also has a security interest in the revenues of the Authority, after provisions have been made for the payment of current expenses, as defined in the Bond Order dated March 7, 1985. The par value of the defeased Series 1977A Revenue Bonds at June 30, 2007 was \$1,495,000.

Long-term liability activity for the years ended June 30, 2007 and 2006 are as follows:

	July 1, 2006			June 30, 2007	
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 96,460,000	\$ 22,285,000	\$ 4,060,000	\$ 114,685,000	\$ 3,805,000
Less deferred amounts:					
For issuance premiums	2,152,839	639,165	184,254	2,607,750	190,139
For issuance discounts and deferred refunding	(2,204,957)	-	(184,571)	(2,020,386)	(184,572)
Total long-term debt	\$ 96,407,882	\$ 22,924,165	\$ 4,059,683	\$ 115,272,364	\$ 3,810,567
	July 1, 2005			June 30, 2006	
	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 99,750,000	\$ -	\$ 3,290,000	\$ 96,460,000	\$ 4,060,000
Less deferred amounts:					
For issuance premiums	2,319,569	-	166,730	2,152,839	166,731
For issuance discounts and deferred refunding	(2,389,528)	-	(184,571)	(2,204,957)	(184,572)
Total long-term debt	\$ 99,680,041	\$ -	\$ 3,272,159	\$ 96,407,882	\$ 4,042,159

Note 6. Pension Plan Obligations

Local Governmental Employees' Retirement System

Plan description: The Authority contributes to the statewide Local Governmental Employees' Retirement System ("LGERS"), a cost-sharing multiple-employer defined benefit pension plan administered by the State of North Carolina. LGERS provides retirement and disability benefits to plan members and beneficiaries. Article 3 of G. S. Chapter 128 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly. The Local Governmental Employees' Retirement System is included in the Comprehensive Annual Financial Report ("CAFR") for the State of North Carolina. The State's CAFR includes financial statements and required supplementary information for LGERS. That report may be obtained by writing to the Office of the State Controller, 1410 Mail Service Center, Raleigh, North Carolina 27699-1410, or by calling (919) 981-5454.

Notes to Financial Statements

Note 6. Pension Plan Obligations (Continued)

Funding policy: Plan members are required to contribute six percent of their annual covered salary. The Authority is required to contribute at an actuarially determined rate. For the Authority, the current rate is 6.82% of annual covered payroll. The contribution requirements of members and the Authority are established and may be amended by the North Carolina General Assembly. The Authority's contributions to LGERS for the years ended June 30, 2007, 2006 and 2005 were \$332,113, \$322,323 and \$307,420, respectively. The contributions made by the Authority equaled the required contributions for each year.

Note 7. Risk Management and Commitments

Risk management: The Authority is exposed to various risks of losses related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disasters. The Authority has property, general liability, workers' compensation, and employee health coverages. Claims have not exceeded coverage in any of the past three fiscal years.

Commitments: The Authority is committed under various contracts for the completion of water and wastewater treatment facilities and other water and sewer projects. Management estimates the cost to complete these contracts to be approximately \$9,408,000 at June 30, 2007.

Note 8. Net Assets

At June 30, 2007 and 2006, the Board of Directors had approved the use of a portion of the restricted and unrestricted net assets for the following future project ordinances:

	2007	2006
Raw water supply sources	\$ 478,000	\$ 5,012,000
Water filtration	222,000	272,000
Water transmission and distribution	2,074,000	2,077,000
Wastewater pumping stations and force mains	1,563,000	941,000
Wastewater collection	8,086,000	4,238,000
Wastewater treatment and disposal	7,124,000	13,823,000
Finished water pumping	50,000	931,000
Information services	330,000	490,000
Finished water storage	160,000	30,000
	<u>\$ 20,087,000</u>	<u>\$ 27,814,000</u>

Note 9. Accounting Pronouncements Issued But Not Yet Adopted

In September 2006, the Governmental Accounting Standards Board ("GASB") issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. GASB 48 establishes criteria to ascertain whether the proceeds received in an exchange of an interest in expected cash flows from collecting specific receivables or specific future revenues for immediate cash payments should be reported as revenue or as a liability. The criteria should be used to determine the extent to which a transferor government either retains or relinquishes control over the receivables or future revenues through its continuing involvement with those receivables or future revenues. GASB 48 is effective for financial statements for periods beginning after December 15, 2006 (the Authority's fiscal year ending June 30, 2008). The Authority has not yet determined the impact that implementation of GASB 48 will have on its financial statements.

Notes to Financial Statements

Note 9. Accounting Pronouncements Issued But Not Yet Adopted (Continued)

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB 49 addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities. GASB 49 specifies five obligating events, which upon the occurrence of one such event, the government is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are required. In government-wide and proprietary fund financial statements, the liability should be recorded at the current value of the costs the government expects to incur to perform the work. GASB 49 also requires remeasurement of the liability (and its components) when new information indicates increases or decreases in estimated outlays. GASB 49 is effective for financial statements for periods beginning after December 15, 2007 (the Authority's fiscal year ended June 30, 2009). The Authority has not yet determined the impact that implementation of GASB 49 will have on its financial statements.

In May 2007, the GASB issued Statement No. 50, *Pension Disclosures - an amendment of GASB Statements No. 25 and No. 27*. GASB 50 more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits ("OPEB") and, in doing so, enhances the information disclosed in notes to financial statements or presented as required supplementary information ("RSI") by pension plans and by employers that provide pension benefits. GASB 50 conforms note disclosure and RSI requirements with the requirements of GASB 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and GASB 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. GASB 50 is effective for periods beginning after June 15, 2007 (the Authority's fiscal year ended June 30, 2008). The Authority has not yet determined the impact that implementation of GASB 50 will have on its financial statements.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB 51 requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. Additionally, GASB 51 establishes a specified-conditions approach to recognizing intangible assets that are internally generated and establishes criteria for when such expenditures should be capitalized. GASB 51 is effective for periods beginning after June 15, 2009 (the Authority's fiscal year ended June 30, 2010) and generally requires its provisions to be applied retroactively. The Authority has not yet determined the impact that implementation of GASB 51 will have on its financial statements.

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis)
 Year Ended June 30, 2007

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Operating revenues:				
Water	\$ 15,423,000	\$ 15,423,000	\$ 14,218,387	\$ (1,204,613)
Sewer	10,785,000	10,785,000	10,272,920	(512,080)
Service initiation fees	145,000	145,000	142,086	(2,914)
Other	688,900	688,900	777,767	88,867
Total operating revenues	27,041,900	27,041,900	25,411,160	(1,630,740)
Nonoperating revenues:				
Interest income	1,000,000	1,000,000	995,354	(4,646)
Customer fees	2,538,506	2,538,506	2,514,450	(24,056)
Grants and contributions	-	-	650,097	650,097
Contributions in aid of construction	-	-	6,775,689	6,775,689
Total nonoperating revenues	3,538,506	3,538,506	10,935,590	7,397,084
Total revenues	30,580,406	30,580,406	36,346,750	5,766,344
Expenditures:				
Water supply and treatment:				
Salaries and wages	649,296	649,296	637,808	11,488
Fringe benefits	266,222	266,222	234,634	31,588
Chemicals	840,750	840,750	799,697	41,053
Materials and supplies	42,325	42,325	29,485	12,840
Utilities	418,900	418,900	401,279	17,621
Maintenance	25,275	25,275	29,035	(3,760)
Professional services	62,600	62,600	58,540	4,060
Insurance	71,921	71,921	56,643	15,278
Communication	200	200	578	(378)
Printing and production	100	100	-	100
Education and development	6,525	6,525	8,343	(1,818)
Miscellaneous	8,670	8,670	5,352	3,318
Total water supply and treatment	2,392,784	2,392,784	2,261,394	131,390

(Continued)

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis) (Continued)
 Year Ended June 30, 2007

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Water distribution:				
Salaries and wages	\$ 1,173,411	\$ 1,173,411	\$ 1,055,038	\$ 118,373
Fringe benefits	551,852	491,852	435,486	56,366
Materials and supplies	82,327	82,327	74,881	7,446
Utilities	238,300	238,300	171,000	67,300
Maintenance	612,600	524,600	479,462	45,138
Professional Services	20,000	20,000	12,010	7,990
Insurance	11,635	11,635	8,071	3,564
Communication	400	400	627	(227)
Printing and reproduction	1,500	1,500	109	1,391
Education and development	14,345	14,345	8,757	5,588
Miscellaneous	2,700	2,700	4,467	(1,767)
Construction credit	(233,165)	(233,165)	(288,746)	55,581
Total water distribution	2,475,905	2,327,905	1,961,162	366,743
Sewer treatment:				
Salaries and wages	684,133	684,133	689,850	(5,717)
Fringe benefits	296,683	296,683	304,517	(7,834)
Chemicals	706,001	706,001	729,725	(23,724)
Materials and supplies	78,500	78,500	52,801	25,699
Utilities	937,000	937,000	885,930	51,070
Maintenance	45,500	45,500	53,243	(7,743)
Professional services	40,000	40,000	15,664	24,336
Insurance	90,832	90,832	73,934	16,898
Communication	600	600	822	(222)
Printing and reproduction	250	250	-	250
Education and development	7,050	7,050	3,637	3,413
Miscellaneous	47,000	47,000	55,659	(8,659)
Total sewer treatment	2,933,549	2,933,549	2,865,782	67,767

(Continued)

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis) (Continued)
 Year Ended June 30, 2007

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Sewer collections:				
Salaries and wages	\$ 546,915	\$ 546,915	\$ 591,003	\$ (44,088)
Fringe benefits	248,249	248,249	252,878	(4,629)
Chemicals	261,700	261,700	316,323	(54,623)
Materials and supplies	55,000	55,000	57,400	(2,400)
Utilities	141,000	141,000	103,951	37,049
Maintenance	299,500	299,500	238,418	61,082
Professional services	-	-	600	(600)
Insurance	12,697	12,697	7,438	5,259
Communication	800	800	1,229	(429)
Printing and reproduction	1,000	1,000	190	810
Education and development	10,700	10,700	7,746	2,954
Miscellaneous	4,600	4,600	3,605	995
Construction credit	-	-	(41,190)	41,190
Total sewer collections	1,582,161	1,582,161	1,539,591	42,570
General and administrative:				
Salaries and wages	2,392,626	2,392,626	2,457,540	(64,914)
Fringe benefits	807,412	807,412	783,807	23,605
Materials and supplies	82,509	82,509	88,152	(5,643)
Utilities	182,200	182,200	168,029	14,171
Maintenance	247,100	247,100	201,821	45,279
Professional services	574,280	574,280	623,015	(48,735)
Insurance	48,411	48,411	37,954	10,457
Communication	104,936	104,936	102,167	2,769
Printing and reproduction	13,660	13,660	13,030	630
Education and development	80,825	80,825	45,087	35,738
Miscellaneous	123,675	123,675	114,677	8,998
Construction credit	(171,754)	(171,754)	(214,406)	42,652
Total general and administrative	4,485,880	4,485,880	4,420,873	65,007

(Continued)

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis) (Continued)
 Year Ended June 30, 2007

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Customer relations:				
Salaries and wages	\$ 313,992	\$ 313,992	\$ 282,646	\$ 31,346
Fringe benefits	108,387	108,387	105,731	2,656
Materials and supplies	2,600	2,600	4,212	(1,612)
Professional services	80,000	80,000	76,111	3,889
Insurance	3,072	3,072	2,152	920
Communication	73,000	73,000	87,029	(14,029)
Printing and reproduction	5,000	5,000	2,152	2,848
Education and development	5,800	5,800	5,209	591
Miscellaneous	35,460	123,460	149,397	(25,937)
Total customer relations	627,311	715,311	714,639	672
Maintenance:				
Salaries and wages	660,338	660,338	633,746	26,592
Fringe benefits	276,742	276,742	250,705	26,037
Materials and supplies	40,087	40,087	37,954	2,133
Utilities	1,000	1,000	717	283
Maintenance	893,076	953,076	1,037,579	(84,503)
Professional Services	20,000	20,000	-	20,000
Insurance	19,749	19,749	15,819	3,930
Communication	1,000	1,000	358	642
Education and development	11,950	11,950	2,789	9,161
Miscellaneous	-	-	290	(290)
Total maintenance	1,923,942	1,983,942	1,979,957	3,985
Laboratory:				
Salaries and wages	409,096	409,096	433,500	(24,404)
Fringe benefits	161,886	161,886	159,084	2,802
Materials and supplies	229,900	229,900	198,634	31,266
Utilities	500	500	-	500
Maintenance	50,930	50,930	53,296	(2,366)
Professional services	24,100	24,100	22,173	1,927
Insurance	9,411	9,411	7,671	1,740
Communication	7,500	7,500	7,374	126
Printing and reproduction	100	100	-	100
Education and development	6,035	6,035	5,644	391
Miscellaneous	2,800	2,800	2,732	68
Total laboratory	902,258	902,258	890,108	12,150

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis) (Continued)
 Year Ended June 30, 2007

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Debt service:				
Bonded debt service	\$ 9,477,000	\$ 9,477,000	\$ 8,267,766	\$ 1,209,234
Capital outlay	27,940,000	27,940,000	26,780,340	1,159,660
Total expenditures	54,740,790	54,740,790	51,681,612	3,059,178
Deficiency of revenues under expenditures	\$ (24,160,384)	\$ (24,160,384)	(15,334,862)	\$ 8,825,522
Reconciliation of modified accrual to full accrual basis:				
Principal payments on bonded debt			4,060,000	
Capital interest			276,738	
Change in interest accrual for bonded debt			(430,883)	
Depreciation and amortization			(6,950,774)	
Amortization of bond expense and patent			(96,898)	
Gain on sale of equipment and other revenues			16,431	
Capital outlay			26,780,340	
Net income - accrual basis			\$ 8,320,092	

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Project Funds
Inception to Date - Ended June 30, 2007

	Project Budget	Cumulative Totals to June 30, 2007	Unexpended Balance as of June 30, 2007
Raw water supply sources:			
Revenues, General Fund	\$ 8,719,000	\$ 7,151,709	\$ 1,567,291
Expenditures:			
Watershed Preservation	\$ 2,720,000	\$ 2,465,787	\$ 254,213
Stone Quarry Pump Station	2,710,000	1,580,679	1,129,321
Stone Quarry Pump Station 2006 Rebid	2,560,000	2,481,063	78,937
Stone Quarry Acquisition	655,000	585,449	69,551
University Lake Pump Station Improvements	12,000	12,675	(675)
Raw Water Security Improvements	38,000	6,705	31,295
Jordan Lake Raw Water Supply Intake/Pump Facility	24,000	19,351	4,649
Total expenditures	\$ 8,719,000	\$ 7,151,709	\$ 1,567,291
Water treatment:			
Revenues, General Fund	\$ 13,669,000	\$ 13,485,171	\$ 183,829
Expenditures:			
Water Treatment Plant Upgrade and Expansion	\$ 13,170,000	\$ 13,173,836	\$ (3,836)
Water Treatment Plant Rehabilitation Projects	314,000	199,959	114,041
Water Treatment Plant Security Improvements	110,000	64,221	45,779
Water Treatment Plant Generator Rehabilitation	65,000	47,155	17,845
Jones Ferry WTP - Secondary Containment	10,000	-	10,000
Total expenditures	\$ 13,669,000	\$ 13,485,171	\$ 183,829
Finished water pumping:			
Revenues, General Fund	\$ 721,000	\$ 508,768	\$ 212,232
Expenditures:			
Booster Pump Station at I 40	546,000	493,755	52,245
Booster Pump Station at Barbee Chapel Road	175,000	15,013	159,987
Total expenditures	\$ 721,000	\$ 508,768	\$ 212,232

(Continued)

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Project Funds (Continued)
Inception to Date - Ended June 30, 2007

	Project Budget	Cumulative Totals to June 30, 2007	Unexpended Balance as of June 30, 2007
Finished water storage:			
Revenues, General Fund	\$ 130,000	\$ 100,817	\$ 29,183
Expenditures:			
1.5 Million Gallon Northern Tank in 740 FT Pressure Zone	\$ 100,000	\$ 97,720	\$ 2,280
Finished Water Storage Security Improvements	30,000	3,097	26,903
Total expenditures	\$ 130,000	\$ 100,817	\$ 29,183
Water transmission and distribution:			
Revenues - General Fund	\$ 3,082,000	\$ 1,241,504	\$ 1,840,496
Expenditures:			
Water Main Road Improvements	\$ 242,000	\$ 37,378	\$ 204,622
Water Line Rehabilitation/Replacement	1,233,000	152,817	1,080,183
Reinforcement Projects	958,000	930,685	27,315
Abbey Road/Booth Road Water Main Replacement	205,000	28,366	176,634
Water Distribution System Hydraulic Model Update	225,000	-	225,000
Fordham Boulevard 12"	102,000	38,234	63,766
Cameron Avenue Water Line Replacement	15,000	-	15,000
Dobbins Drive 16"	102,000	54,024	47,976
Total expenditures	\$ 3,082,000	\$ 1,241,504	\$ 1,840,496
Wastewater collection lines:			
Revenues - General Fund	\$ 6,648,000	\$ 3,951,284	\$ 2,696,716
Expenditures:			
Bolin Creek Interceptor Phase III	\$ 992,000	\$ 330,064	\$ 661,936
Morgan Creek Interceptor	412,000	306,738	105,262
Bolin Creek Basin Rehabilitation and Replacement Proj.	2,846,000	2,163,049	682,951
Booker Creek Basin - Sewer Line/Manhole Rehab.	158,000	294	157,706
Sewer Line Rehabilitation and Replacement	910,000	477,673	432,327
Friday Center/Meadowmont Area Interceptor	174,000	87,225	86,775
Meeting of the Waters Interceptor	1,156,000	586,241	569,759
Total expenditures	\$ 6,648,000	\$ 3,951,284	\$ 2,696,716

(Continued)

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Project Funds (Continued)
Inception to Date - Ended June 30, 2007

	Project Budget	Cumulative Totals to June 30, 2007	Unexpended Balance as of June 30, 2007
Wastewater pump stations and force mains:			
Revenues, General Fund	\$ 2,278,000	\$ 1,088,453	\$ 1,189,547
Expenditures:			
Pump Station Improvements	\$ 164,000	\$ 70,430	\$ 93,570
Heritage Hills Pump Station and Force Main Repl.	599,000	581,147	17,853
Lloyd Street/Starlight Pump Station Phaseout	431,000	117,733	313,267
Clayton Road Pump Station Phaseout	310,000	99,563	210,437
Tinkerbell Pump Station Phaseout	10,000	2,775	7,225
Oak I Cleveland Drive Pump Station Phaseout	603,000	93,179	509,821
Piney Mountain Pump Station	161,000	123,626	37,374
Total expenditures	\$ 2,278,000	\$ 1,088,453	\$ 1,189,547
Wastewater treatment and disposal:			
Revenues, General Fund	\$ 59,116,438	\$ 54,427,309	\$ 4,689,129
Expenditures:			
Mason Farm 14.5 MGD Upgrade and Expansion	\$ 53,142,438	\$ 52,095,525	\$ 1,046,913
Mason Farm 18.5 MGD Upgrade and Expansion	100,000	253	99,747
Biosolids Dewatering Facilities at Mason Farm	1,960,000	1,211,757	748,243
Mason Farm Odor Control Project	300,000	106,861	193,139
Mason Farm Flood Protection Enhancement	50,000	-	50,000
Mason Farm Rehabilitation/Improvement Projects	128,000	33,983	94,017
Mason Farm Odor Improvements	300,000	59,041	240,959
Reclaimed Water Treatment, Pumping and Storage	1,776,000	627,460	1,148,540
Reclamation and Reuse Transmission System	1,360,000	292,429	1,067,571
Total expenditures	\$ 59,116,438	\$ 54,427,309	\$ 4,689,129

(Continued)

Orange Water and Sewer Authority

Schedule of Revenues and Expenditures - Project Funds (Continued)
 Inception to Date - Ended June 30, 2007

	Project Budget	Cumulative Totals to June 30, 2007	Unexpended Balance as of June 30, 2007
<hr/>			
Central Office and Operations:			
Revenues, General Fund	\$ 16,000	\$ 14,108	\$ 1,892
	<hr/>	<hr/>	<hr/>
Expenditures, Administration Building	\$ 16,000	\$ 14,108	\$ 1,892
	<hr/>	<hr/>	<hr/>
Information services:			
Revenues, General Fund	\$ 921,600	\$ 515,804	\$ 405,796
	<hr/>	<hr/>	<hr/>
Expenditures, Information Services	\$ 921,600	\$ 515,804	\$ 405,796
	<hr/>	<hr/>	<hr/>

Orange Water and Sewer Authority

Net Assets by Component
 Last Five Fiscal Years
 (accrual basis of accounting)

	Fiscal Year				
	2007	2006	2005	2004	2003
Invested in capital assets, net of related debt	\$ 161,812,115	\$ 160,813,755	\$ 137,441,321	\$ 110,634,726	\$ 136,790,615
Restricted for maintenance reserve and power fund	1,127,192	1,894,497	2,320,261	265,052	4,452,759
Restricted for future capital projects	8,093,307	-	16,794,642	34,552,532	6,287,943
Restricted for debt service	185,258	31,088	-	-	-
Unrestricted	6,453,532	6,611,972	7,373,853	15,468,674	6,076,872
	<u>\$ 177,671,404</u>	<u>\$ 169,351,312</u>	<u>\$ 163,930,077</u>	<u>\$ 160,920,984</u>	<u>\$ 153,608,189</u>

Note: Information for the Authority as a whole is available back to 2003 only, the year GASB 34 was implemented.

Orange Water and Sewer Authority

Changes in Net Assets Last Five Fiscal Years (accrual basis of accounting)

	Fiscal Year				
	2007	2006	2005	2004	2003
Operating revenues:					
Water	\$ 14,218,387	\$ 13,946,421	\$ 12,489,800	\$ 11,873,860	\$ 10,394,529
Sewer	10,272,920	9,682,210	8,563,004	8,619,485	7,607,718
Service initiation fees	142,086	153,670	134,958	132,294	97,660
Other	777,767	649,081	703,905	530,853	573,057
Total operating revenues	25,411,160	24,431,382	21,891,667	21,156,492	18,672,964
Operating expenses:					
Water supply and treatment	2,261,394	2,159,244	1,935,704	1,822,522	1,885,679
Water distribution	1,961,162	1,710,117	1,917,141	1,733,384	1,781,525
Sewer treatment	2,865,782	3,042,830	2,080,670	1,954,191	1,973,766
Sewer collections	1,539,591	1,352,661	1,342,978	1,329,066	1,205,400
General and administrative	4,420,873	3,809,200	3,689,846	3,468,158	3,458,288
Customer relations	714,639	966,972	961,862	830,284	798,852
Maintenance	1,979,957	1,860,938	1,600,231	1,623,525	1,538,062
Lab	890,108	821,955	780,707	722,984	651,825
Depreciation and amortization	6,950,774	6,871,350	6,538,782	6,312,316	5,995,331
Total operating expenses	23,584,280	22,595,267	20,847,921	19,796,430	19,288,728
Operating income (loss)	1,826,880	1,836,115	1,043,746	1,360,062	(615,764)
Nonoperating revenues (expenses):					
Customer fees	2,514,450	2,308,651	1,872,820	2,716,555	1,962,517
investment adjustment	995,354	742,010	821,194	211,708	337,442
Interest expense	(4,361,911)	(2,724,951)	(3,140,164)	(1,216,166)	(1,799,578)
Amortization of bond expense and patent	(96,898)	(141,579)	(115,063)	(163,362)	(192,634)
Other	16,431	(58,846)	(39,569)	44,588	(106,101)
Income (loss) before contributions	\$ 894,306	\$ 1,961,400	\$ 442,964	\$ 2,953,385	\$ (414,118)

(Continued)

Orange Water and Sewer Authority

Changes in Net Assets
 Last Five Fiscal Years
 (accrual basis of accounting)
 (Continued)

	Fiscal Year				
	2007	2006	2005	2004	2003
Capital contributions:					
Capital grants and contributions	\$ 650,097	\$ 153,232	\$ 336,404	\$ 537,571	\$ -
Contribution in aid of construction	6,775,689	3,306,603	2,229,725	3,821,839	1,817,642
Total capital contributions	7,425,786	3,459,835	2,566,129	4,359,410	1,817,642
Increase in net assets	8,320,092	5,421,235	3,009,093	7,312,795	1,403,524
Net assets:					
Beginning	169,351,312	163,930,077	160,920,984	153,608,189	152,204,665
Ending	\$ 177,671,404	\$ 169,351,312	\$ 163,930,077	\$ 160,920,984	\$ 153,608,189

Note: Information for the Authority as a whole is available back to 2003 only, the year GASB 34 was implemented.

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Orange Water and Sewer Authority

Water Processed and Wastewater Treated
(thousands of gallons)
Last Ten Fiscal Years

Fiscal Year Ended June 30,	Water Processed and Pumped to System	Portion of Processed Water Pumped to Hillsborough	Wastewater Treated
1998	3,023,279	-	2,924,826
1999	3,149,261	-	2,733,971
2000	3,247,807	1,337	3,162,218
2001	3,418,741	-	3,107,328
2002	3,822,000	-	2,922,000
2003	2,945,900	-	2,955,127
2004	3,067,524	-	2,831,033
2005	3,053,404	-	2,982,831
2006	3,142,494	-	2,721,662
2007	3,126,917	-	2,854,787

Source: Orange Water And Sewer Authority's Records

Orange Water and Sewer Authority

Ratio of Bonded Debt to Net Operating Revenues and Net Bonded Debt per Customer
Last Ten Fiscal Years

Fiscal Year Ended June 30,	Customer Estimate	Net Operating Revenues	Debt Service Requirements	Net Bonded Debt	Ratio of Net Operating Revenues to Debt Service Requirements	Net Bonded Debt Per Customer
1998	15,560	\$ 7,307,604	\$ 3,126,460	\$ 27,100,000	2.34	\$ 1,741.65
1999	16,577	7,547,469	3,060,113	40,790,000	2.47	2,460.64
2000	16,963	7,777,972	3,463,240	39,355,000	2.25	2,320.05
2001	17,696	7,535,344	3,821,600	37,365,000	1.97	2,111.49
2002	18,436	10,785,421	5,527,785	65,845,000	1.95	3,571.54
2003	18,844	7,573,425	5,970,183	63,570,000	1.27	3,373.49
2004	19,229	10,645,229	5,936,269	101,770,000	1.79	5,292.53
2005	19,467	10,236,973	7,317,151	81,075,000	1.40	4,164.74
2006	19,687	11,758,126	8,073,572	76,740,000	1.46	3,898.00
2007	19,554	12,287,458	8,268,245	114,685,000	1.49	5,865.04

Note: Before fiscal year ended June 30, 2001, net operating revenues were calculated as operating income before depreciation and amortization plus investment income. In 2002, the Authority's new bond order defined net operating revenues as income before contributions plus depreciation, amortization and interest expense.

Orange Water and Sewer Authority

Principal Water and Sewer Customers
For the Fiscal Year Ended June 30, 2007

	Percent of Water Sales 2007
University of North Carolina at Chapel Hill	*27%
Abbey Court Condos	<1%
Carol Woods Retirement Center	<1%
University Mall	<1%
The Villages Apartments	<1%
Triangle Communities	<1%
Granville Towers (student housing)	<1%
Chapel Hill - Carrboro Schools	<1%
Tarheel Manor Associates	<1%

* Approximate

Source: Orange Water and Sewer Authority Records

Orange Water and Sewer Authority

Town of Chapel Hill, NC Property Tax Levies and Collections
Last Ten Fiscal Years

Fiscal Year Ended June 30,	Taxes Levied for the Fiscal Year	Collected within the Fiscal Year of the Levy		Collections in Subsequent Years	Total Collections to Date	
		Amount	Percent of Original Levy		Amount	Percentage of Adjusted Levy
1998	\$ 14,935,217	\$ 14,840,691	99.37%	*	*	*
1999	15,534,727	15,413,292	99.22%	*	*	*
2000	16,598,182	16,453,207	99.13%	*	*	*
2001	17,594,559	17,466,542	99.27%	*	*	*
2002	20,417,001	20,271,201	99.29%	*	*	*
2003	23,067,472	22,919,205	99.36%	*	*	*
2004	23,775,375	23,653,530	99.49%	111,079	23,764,609	99.93%
2005	25,615,621	25,480,324	99.47%	106,946	25,587,270	99.84%
2006	27,718,753	27,578,410	99.49%	107,786	27,686,196	99.49%
2007	28,558,565	28,409,166	99.48%	-	28,409,166	99.48%

* Data not available. The Town contracts with the counties to maintain the tax records and must rely on the records provided.

Notes:

(1) This represents the total delinquent taxes for years 2004 and prior.

Outstanding
Delinquent
Taxes

*

*

*

*

*

*

350,486 (1)

21,839

30,396

149,399

Orange Water and Sewer Authority

Town of Chapel Hill, NC Assessed Value and Actual Value of Taxable Property
Last Ten Fiscal Years

Fiscal Year Ended June 30,		Residential Property	Commercial Property	Combined Real Property	Personal Property	Public Service Companies (3)
1998	(1)	*	*	\$ 2,362,338,074	\$ 348,375,791	\$ 57,982,816
1999		*	*	2,457,855,819	365,092,224	60,078,208
2000		*	*	2,501,345,508	381,872,039	60,948,410
2001		*	*	2,589,768,417	388,087,936	61,660,255
2002	(2)	*	*	3,556,294,528	403,959,196	60,873,428
2003		*	*	3,688,289,625	415,023,471	63,868,306
2004		*	*	3,791,942,402	455,906,761	57,587,809
2005		*	*	3,918,233,860	482,128,300	57,774,008
2006	(1)	3,956,681,069	783,355,893	4,740,036,962	498,524,879	60,840,533
2007		3,640,445,489	1,249,997,134	4,890,442,623	520,961,320	61,554,945

* The breakdown between residential and commercial property is not available for fiscal years prior to 2006

Notes:

- (1) Revaluation year
- (2) Increase due to revaluation and the addition of \$200 million from a major annexation
- (3) Public service companies valuations are provided by the North Carolina Department of Revenue.
These amounts include both real and personal property
- (4) Per \$100 of value. Includes taxes for general fund and transportation fund.
- (5) The estimated market value is calculated by dividing the assessed value by an assessment-to-sales ratio determined by the Department of Revenue. The ratio is based on actual property sales which took place during the fiscal year.
- (6) Source is the Property Tax Division of the North Carolina Department of Revenue.

Total Assessed Value	Total Direct Tax Rate (4)	Estimated Actual Taxable Value (5)	Ratio of Assessed Value to Estimated Actual Value (6)
\$ 2,768,696,681	\$ 0.538	\$ 2,974,214,993	93.09%
2,883,026,251	0.538	3,258,393,141	88.48%
2,944,165,957	0.563	3,546,333,362	83.02%
3,039,516,608	0.578	3,145,846,210	96.62%
4,021,127,152	0.504	4,459,990,186	90.16%
4,167,181,402	0.553	4,725,767,070	88.18%
4,305,436,972	0.553	5,139,473,525	83.77%
4,458,136,168	0.575	4,664,298,146	95.58%
5,299,402,374	0.522	5,905,284,571	89.74%
5,472,958,888	0.522	6,098,683,851	89.74%

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Orange Water and Sewer Authority

Town of Chapel Hill, NC Direct and Overlapping Property Tax Rates (Per \$100 of Assessed Value)
Last Ten Fiscal Years

	Year Taxes Payable									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Chapel Hill Within Orange County:										
<u>Town Direct Rates:</u>										
General Fund	0.495	0.498	0.524	0.535	0.461	0.510	0.502	0.516	0.474	0.474
Transportation	0.043	0.040	0.039	0.043	0.043	0.043	0.051	0.059	0.048	0.048
Downtown Service District	0.062	0.062	0.062	0.062	0.062	0.062	0.062	0.062	0.053	0.090
<u>Overlapping Rates:</u>										
Orange County	0.873	0.902	0.919	0.929	0.805	0.845	0.880	0.868	0.843	0.903
Chapel Hill- Carrboro School District	0.179	0.192	0.220	0.220	0.202	0.192	0.200	0.200	0.183	0.189
Total	1.652	1.694	1.764	1.789	1.573	1.652	1.695	1.705	1.601	1.704
Chapel Hill Within Durham County:										
<u>Town Direct Rates:</u>										
General Fund	0.495	0.498	0.524	0.535	0.504	0.510	0.502	0.516	0.474	0.474
Transportation	0.043	0.040	0.039	0.043	0.043	0.043	0.051	0.059	0.048	0.048
<u>Overlapping Rates:</u>										
Durham County	0.960	0.940	0.930	0.930	0.729	0.753	0.763	0.790	0.809	0.809
Total	1.498	1.478	1.493	1.508	1.276	1.306	1.316	1.365	1.331	1.331

* Revaluation year

Source: County tax departments

Orange Water and Sewer Authority

Town of Chapel Hill, NC Demographic and Economic Statistics
Last Ten Fiscal Years

Year	Population (1)	Personal Income (in thousands) (2)	Per Capita Personal Income (3)	Median Age (3)	Education Level in Years of Schooling (4)
1998	43,423	\$ 3,042,049	\$ 16,288	24.8	14.7
1999	43,977	3,169,976	16,288	24.8	14.7
2000	46,019	3,327,229	16,288	24.8	14.7
2001	48,902	3,583,041	16,288	24.8	14.7
2002	50,542	3,800,280	24,133	24.0	15.8
2003	51,005	3,877,363	24,133	24.2	15.8
2004	51,485	3,902,027	24,133	24.2	15.8
2005	51,519	4,122,336	24,133	24.2	15.8
2006	52,397	4,667,922	24,133	24.2	15.8
2007	53,416	*	24,133	24.2	15.8

* - Data not yet available

Notes:

- (1) N.C. State Data Center. Estimates are as of beginning of fiscal year.
- (2) U.S. Department of Commerce, Bureau of Economic Analysis data available for Orange County only.
Prior calendar year data used.
- (3) U.S. Department of Commerce, most recent available census data.
- (4) Chapel Hill-Carrboro Public Schools and University of North Carolina at Chapel Hill
- (5) N.C. Employment Security Commission.

School Enrollment (4)	Unemployment Rate % (5)
32,375	1.6
32,375	1.3
33,520	1.2
34,462	1.8
34,628	3.1
37,012	4.0
37,587	3.0
37,308	4.0
35,260	3.9
38,718	2.9

Orange Water and Sewer Authority

Miscellaneous Statistical Data For the Fiscal Year Ended June 30, 2007

Year Founded and Incorporated	1975
Size of Service Area:	
Square Miles	31
Miles of Water Pipe	387
Miles of Wastewater Collection Pipe	314
Customer Accounts	19,554
Budgeted Employee Positions	150
Water Treatment Plant Capacity (in MGD):	
Capacity	20.0
Production Average, FY 2006 - 2007	9.0
Production Peak, FY 2006 - 2007	12.0
Wastewater Treatment Plant Capacity (in MGD):	
Capacity	12.0
Average Daily Flow, FY 2006 - 2007	8.8
Peak Day Flow, FY 2006 - 2007	15.5
Number of Water Supply Resources	3
Total Capacity of Water Supply Resources:	
Cane Creek Reservoir (Billions of gallons)	3
University Lake (Millions of Gallons)	450
Quarry Reservoir (Millions of Gallons)	200

Source: Orange Water and Sewer Authority Records

Orange Water and Sewer Authority

Full Time Equalivants Last Five Fiscal Years

Department	Fiscal Year				
	2007	2006	2005	2004	2003
General and Administrative					
Office of the Executive Director	9	9	9	9	8
Engineering	15	15	15	15	15
Human Resources	6	6	6	6	6
Finance	7	7	7	7	7
Purchasing	2	2	2	2	2
Business Information Services	4	4	4	4	4
Operations					
Customer Service	8	13	13	13	13
Water Supply and Treatment	13	13	13	13	13
Water Distribution	32	27	27	27	27
Plants Maintenance	15	15	15	15	15
Laboratory	10	10	10	10	9
Wastewater Treatment	14	14	14	14	14
Sewer Collection	15	15	15	15	15
Total FTE's	150	150	150	150	148

Note: Information for the Authority as a whole is available back to 2003 only, the year GASB 34 was implemented.

Source: Orange Water And Sewer Authority's Human Resource Department

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McGladrey & Pullen

Certified Public Accountants

**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***

To the Board of Directors
Orange Water and Sewer Authority
Carrboro, North Carolina

We have audited the accompanying financial statements of Orange Water and Sewer Authority, North Carolina (the "Authority"), as of and for the year ended June 30, 2007, which collectively comprises the Authority's basic financial statements, and have issued our report thereon dated October 8, 2007. 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 Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential, will not be prevented or detected by the entity's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as findings 07-01, 07-02 and 07-03 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we believe that finding 07-01 and 07-02 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority'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 management, others within the organization, members of the Board of Directors, and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Greensboro, North Carolina
October 8, 2007

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report on Compliance with Requirements Applicable to Each Major State Program and on Internal Control over Compliance in Accordance with Applicable Sections of OMB Circular A-133 and the State Single Audit Implementation Act

To the Board of Directors
Orange Water and Sewer Authority
Carrboro, North Carolina

Compliance

We have audited the compliance of Orange Water and Sewer Authority, North Carolina (the "Authority"), with the types of compliance requirements described in the *Audit Manual for Governmental Auditors in North Carolina*, issued by the Local Government Commission, that are applicable to the major State program for the year ended June 30, 2007. The Authority's major State program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to the major State program is the responsibility of the Authority's management. Our responsibility is to express an opinion on the Authority's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and applicable sections of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*; and the State Single Audit Implementation Act. Those standards and applicable sections of the State Single Audit Implementation Act require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major State program occurred. An audit includes examining, on a test basis, evidence about the Authority's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Authority's compliance with those requirements.

In our opinion, the Authority complied, in all material respects, with the requirements referred to above that are applicable to the major State program for the year ended June 30, 2007.

Internal Control Over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to State programs. In planning and performing our audit, we considered the Authority's internal control over compliance with requirements that could have a direct and material effect on a major State program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over compliance.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a State program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a State program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a State program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a State program will not be prevented or detected by an entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of management, others within the organization, members of the Board of Directors, and state awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Greensboro, North Carolina
October 8, 2007

Orange Water and Sewer Authority, North Carolina

Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 2007

Section I. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

- Material weakness(es) identified? yes no
- Significant deficiency (ies) identified that are not considered to be material weaknesses? yes none reported

Noncompliance material to financial statements noted? yes no

State Awards

Internal control over major State program:

- Material weakness(es) identified? yes no
- Significant deficiency (ies) identified that are not considered to be material weaknesses? yes none reported

Type of auditor's report issued on compliance for the major State program: Unqualified.

Any audit findings disclosed that are required to be reported in accordance with the State Single Audit Implementation Act yes no

Identification of major State program: NC Clean Water Management Trust Fund

Section II. Financial Statement Findings

Finding 07-01

Criteria:

Adequate internal control structure requires regular reconciliations to be performed to ensure proper recording and reporting of transactions and balances.

Condition and Context:

During the course of the audit we noted several significant balance sheet accounts did not have their reconciliations performed in a timely manner or that these reconciliations were not prepared prior to closing of the year end trial balance.

Effect:

Several differences between the Authority's trial balance and our audit work performed were noted that required investigation by the Authority and resulted in additional entries to the original trial balance.

(Continued)

Orange Water and Sewer Authority, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2007

Section II. Financial Statement Findings (Continued)

Cause:

No procedures are established by the Authority to require timely reconciliations of certain accounts and supervisor review of reconciliations that are prepared for other accounts.

Recommendation:

We recommend that the Authority adopt a policy requiring reconciliations be prepared for all significant accounts prior to month end and annual closing of the trial balance that includes a review of these reconciliations by a supervisor in the accounting department and review of documentation supporting these accounts. By implementing this policy and performing these reconciliations, journal entries to correct errors should be eliminated and more accurate financial information should be available for the Authority's management and Board members.

Views of responsible officials:

The finance staff was short by two members for much of the year-end process, necessitating some delay in account reconciliation. Such policy as recommended need not require a Board level action; rather it should be an objective of the Finance Department.

Completion:

Will be in place as of 6/30/2008.

Finding 07-02

Criteria:

Accounting principles generally accepted in the United States of America ("GAAP") require that lease agreements that meet certain criteria be recorded as an asset and a liability for the present value of future lease payments at inception of the lease.

In addition, General Statutes 159 of North Carolina requires that all disbursements made by governmental entities have a pre-audit performed to ensure that the Authority has enough available funds to cover the disbursements and that certain bidding procedures are being performed to ensure that the Authority is dealing with vendors who can provide required services or product.

Condition and Context:

While reviewing new contracts entered into by the Authority during the year, we noted that several contracts for leased equipment were not evaluated for capital lease versus operating lease status in accordance with GAAP.

Effect:

In reviewing the capital lease criteria for these leases, it was determine that several leases in the amount of approximately \$47,000 did qualify as capital leases. In addition, some of these lease agreements were only signed by the department manager and not approved by the Authority's Finance Director as required by current purchasing policies.

Cause:

The Authority did not have established procedures and policies requiring an evaluation of all lease agreements to determine whether they qualify as a capital lease or an operating lease in accordance with GAAP.

Also, attention by the department head was insufficient to ensure that the required purchasing procedures and policies were being performed on these leases prior to signing the lease agreements with the vendor.

(Continued)

Orange Water and Sewer Authority, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2007

Section II. Financial Statement Findings (Continued)

Recommendation:

We recommend that the Authority establish policies and procedures to evaluate all lease agreements for determining if these agreements meet the criteria for capital leases in accordance with GAAP.

We also recommend that the Authority review and evaluate the current purchasing processes relating to these contract types to make sure they are being reviewed by the appropriate personnel and that North Carolina bidding requirements are being followed before such agreements are signed.

Views of responsible officials:

As stated in the finding, OWASA's purchasing policies contain the requirement that all contracts be reviewed by General Counsel, the Executive Director (in most cases) and the Finance Officer. These leases were arranged by a member of management that is no longer with us, and represent an anomaly. However, we will reiterate the requirement, and will review all underlying documentation for recurring payment agreements in the finance office to ensure that such leases are appropriately reviewed in accordance with OWASA's purchasing policies in the future.

Completion:

Expected implementation date is 10/31/07.

Finding 07-03

Criteria:

Fiduciary responsibility requires assigned individuals to monitor certain activity to ensure that they are being applied in accordance with the Authority's established policies and procedures and GAAP.

Condition and Context:

During the course of auditing the Authority's capital assets, we identified that certain Construction in Process (CIP) accounts were being depreciated before the assets were formally placed into service.

Effect:

Based on an analysis of the Authority's capital asset records, approximately \$29,000 in depreciation was recorded by the Authority during the year on CIP accounts.

Cause:

The assigned individual was inadequately trained to performed required duties relating to capital assets.

Recommendation:

We recommend that the Authority provide additional training to accounting personnel assigned to maintain and account for capital assets to ensure that these assets are being recorded at the appropriate amounts and are receiving proper accounting treatment.

Views of responsible officials:

Additional training has been provided; no assets will be depreciated until the associated capital project is completed.

Completion:

9/15/07

Section III. Findings and Questioned Costs for State Awards

None

**ORANGE WATER AND SEWER AUTHORITY, NORTH CAROLINA
SCHEDULE OF EXPENDITURES OF STATE AWARDS
For the Year Ended June 30, 2007**

<u>Grantor/Pass-through Grantor/Program Title</u>	<u>State/ Pass-through Grantor's Number</u>	<u>State Expenditures</u>
State Grants:		
Cash Assistance:		
<u>N.C. Clean Water Management Trust Fund</u>		
Grant # 2004A-509	DENR-4	\$ 524,174

Note to the Schedule of Expenditures of State Financial Awards:

1. The accompanying schedule of expenditures of state awards includes the state grant activity of the Authority and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the State Single Audit Implementation Act.

McGladrey & Pullen

Certified Public Accountants

October 8, 2007

To the Board of Directors
Orange Water and Sewer Authority
Carrboro, North Carolina

This letter is intended to inform the Board of Directors of Orange Water and Sewer Authority, North Carolina (the "Authority") about significant matters related to the conduct of the annual audit so it can appropriately discharge its oversight responsibility and that we comply with our professional responsibilities to the Board.

In addition to our report on your financial statements, we have provided a letter dated October 8, 2007, concerning significant deficiencies and material weaknesses in internal control that we noted during our audit of the Authority's financial statements for the year ended June 30, 2007.

The following summarizes various matters which must be communicated to you under auditing standards generally accepted in the United States of America.

The Auditor's Responsibility Under Auditing Standards Generally Accepted in the United States of America

Our audit of the financial statements of Orange Water and Sewer Authority for the year ended June 30, 2007 was conducted in accordance with auditing standards generally accepted in the United States of America, *Government Auditing Standards* issued by the Comptroller General of the United States, the applicable provisions of the Single Audit Act, OMB Circular A-133 and OMB's Compliance Supplement and the State Single Audit Implementation Act. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error, fraudulent financial reporting or misappropriation of assets. 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. Accordingly, the audit was designed to obtain reasonable, rather than absolute, assurance about the financial statements. We believe that our audit accomplished that objective.

In accordance with *Government Auditing Standards*, we have also performed tests of controls over internal control over financial reporting and tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements that contribute to the evidence supporting our opinion on the financial statements. However, they do not provide a basis for opining on the Authority's internal control over financial reporting or on compliance and other matters.

Management Judgments and Accounting Estimates

Accounting estimates are an integral part of the preparation of financial statements and are based upon management's current judgment. The process used by management encompasses their knowledge and experience about past and current events and certain assumptions about future events. Management has informed us that they used all the relevant facts available to them at the time to make the best judgments about accounting estimates, and we considered this information in the scope of our audit. Estimates significant to the financial statements include unbilled service revenues, lives for depreciable assets, allowance for uncollectible accounts and accruals for certain payroll items. The Board of Directors may wish to monitor throughout the year the process used to compute and record these accounting estimates.

Audit Adjustments

There were eight audit adjustments made to the original trial balance presented to us to begin our audit. Of those adjustments, none, in our judgment, either individually or in the aggregate, could have a significant effect on the Authority's financial reporting process.

Uncorrected Misstatements

We also accumulated three uncorrected misstatements which were discussed with management and were determined by management to be immaterial, both individually and in the aggregate, to the opinion units of the financial statements. Therefore, the adjustments to correct these misstatements were not made to the financial statements. These uncorrected misstatements are summarized in the accompanying schedule.

Accounting Policies and Alternative Treatments

Management and the Board of Directors have the ultimate responsibility for the appropriateness of the accounting policies used by the Authority. The Authority did not adopt any significant new accounting policies nor have there been any changes in existing significant accounting policies during the current period which should be brought to your attention for approval.

We did not identify any significant or unusual transactions or significant accounting policies in controversial or emerging areas for which there is a lack of authoritative guidance or consensus.

Other Information in Documents Containing Audited Financial Statements

In connection with the Authority's Comprehensive Annual Financial Report ("CAFR"), we did not perform any procedures or corroborate other information included in this report. However, we read the Authority's CAFR and Management's Discussion and Analysis and considered whether the information or the manner in which it was presented was materially inconsistent with information or the manner of presentation of the financial statements. Based on our reading, we concluded that the information did not require revision.

We are not aware of any other documents that contain the audited basic financial statements. If such documents were to be published, we would have a responsibility to determine that such financial information was not materially inconsistent with the audited statements of the Authority.

Disagreements With Management

We encountered no disagreements with management over the application of significant accounting principles, the basis for management's judgments on any significant matters, the scope of the audit or significant disclosures to be included in the financial statements.

Consultations With Other Accountants

We are not aware of any consultations management had with other accountants about accounting or auditing matters.

Major Issues Discussed With Management Prior to Retention

No major issues were discussed with management prior to our retention to perform the aforementioned audit.

Difficulties Encountered in Performing the Audit

We did not encounter any difficulties in dealing with management relating to the performance of the audit.

Closing

We will be pleased to respond to any questions you have about the foregoing. We appreciate the opportunity to continue to be of service to the Orange Water and Sewer Authority.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Orange Water and Sewer Authority, North Carolina
SUMMARIZED SCHEDULE OF UNCORRECTED MISSTATEMENTS
June 30, 2007

<u>DESCRIPTION</u>	<u>ASSETS</u>	<u>LIABILITIES</u>	<u>Debit (Credit) NET ASSETS</u>	<u>REVENUE</u>	<u>EXPENSES</u>
<u>CURRENT YEAR MISSTATEMENTS:</u>					
<i>Known Errors:</i>					
Unrecorded capital leases	\$ 44,094	\$ (47,159)	\$ -	\$ -	\$ 3,065
Unknown difference between the general ledger and accounts receivable subsidiary ledger	50,477	-	-	(50,477)	-
Depreciation incorrectly taken on assets located in CIP	29,380	-	-	-	(29,380)
			<u>(76,792)</u>	<u>\$ (50,477)</u>	<u>\$ (26,315)</u>
Total Cumulative Misstatement Errors	<u>\$ 123,951</u>	<u>\$ (47,159)</u>	<u>\$ (76,792)</u>		

McGladrey & Pullen

Certified Public Accountants

To the Board of Directors
Orange Water and Sewer Authority
Carrboro, North Carolina

We have audited, in accordance with auditing standards generally accepted in the United States of America, the basic financial statements of Orange Water and Sewer Authority (the "Authority") as of and for the year ended June 30, 2007, and have issued our report thereon, dated October 8, 2007.

In connection with our audit, nothing came to our attention that caused us to believe that the Authority failed to comply with the terms, covenants, provisions, or conditions of Section 7.04 contained in the amended and restated bond order, dated September 13, 2001 with Bank of New York and the North Carolina Local Government Commission, insofar as they relate to accounting matters.

This report is intended solely for the information and use of the Boards of Directors and management of the Authority, Bank of New York and the North Carolina Local Government Commission and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Greensboro, North Carolina
October 8, 2007

ORANGE WATER AND SEWER AUTHORITY MISSION STATEMENT

OWASA will provide our customers with high quality water and wastewater services through responsible, sustainable, and creative stewardship of the resources and assets we manage. We will do this with a productive, empowered, talented, and diverse work force, which strives for excellence.

OUR VALUES

- **Quality Drinking Water**
We will provide the highest quality drinking water for our customers through proactive and sustainable watershed management, and the effective and reliable operations and maintenance of the water supply, treatment, and distribution system.
- **Environmental Responsibility**
We will protect the environment through the effective and reliable operation and maintenance of the wastewater collection, treatment, and recycling systems. We will manage our resources and assets in an environmentally responsible manner, maintaining or exceeding any regulatory requirements or mandates.
- **Excellence in Customer Service**
We are dedicated to excellence in serving customers in all aspects of our business services. We will be leaders in keeping our customers informed and will provide them meaningful opportunities to participate in decisions that are important to the community.
- **Employees**
We value our employees as our most important resource and we will provide them competitive compensation and benefits, and maintain a safe and rewarding work environment. We will promote diversity and equal opportunity for development and advancement for all employees.
- **Efficiency and Value**
We will perform all services in a financially sound and responsible manner with sufficient revenues to properly operate and fully maintain the water and wastewater system. As OWASA relies solely on user fees, we will continue to be guided by cost-of-service principles with regards to our rates, fees, and charges, and operate the water and sewer system at the lowest rates consistent with our obligation to provide proper and efficient services, now and in the future. We remain committed to continuous improvement in all of our services and will provide high value to our customers.
- **Sustainability**
We will proactively plan, construct, operate, maintain, and finance the water and wastewater system in a manner consistent with the principles of environmental, social and economic sustainability. We will work hard to meet the needs of our current and future customers, community, and environment without compromising the ability of future generations to meet their needs. We will strive to make the highest and best use of our local water resources and we will adopt practices which encourage conservation of water, energy, and other natural resources.
- **Local Government Compatibility**
We will manage our responsibilities in a manner consistent and compatible with the adopted growth management policies and land use plans of the Town of Carrboro, the Town of Chapel Hill, and Orange County. We will maintain open and positive communications with our local governments. We will also maintain open and positive communications with neighboring water utilities and cooperate in regional initiatives where appropriate and consistent with OWASA's commitment to its member governments.
- **Innovation and Creativity**
We will seek innovation and creativity in accomplishing our mission and enhancing our services. We will invest in ongoing research and development for new and improved ways to accomplish our mission.

