

ORANGE WATER AND SEWER AUTHORITY

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

COMPREHENSIVE ANNUAL FINANCIAL REPORT

For the fiscal year ended June 30, 2008

Prepared by:

Finance Department of Orange Water and Sewer Authority

ORANGE WATER AND SEWER AUTHORITY

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ORANGE WATER AND SEWER AUTHORITY

Quality Service Since 1977

September 20, 2008

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, 2007 through June 30, 2008 (FY 2008). 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 general purpose 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 the 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 22 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 processed an average of 7.4 million gallons of wastewater a day during FY 2008.

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 of North Carolina at Chapel Hill (UNC) 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 eleven percent and Chapel Hill’s population rose in excess of 16 percent in the same period.
- ✓ The estimated value of permitted construction in Orange County in FY 2007 totaled \$114.0 million; \$20.8 million commercial and \$93.2 million residential.
- ✓ Taxable retail sales in Orange County in FY 2007 totaled \$948 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 3.0 percent compared to the North Carolina average of 4.7 percent.

With significant drought conditions in 2002 and again in 2007-08, OWASA and its customers achieved significant water savings since 2002. Water sales during FY 2008 were about 15 percent less than during the FY 2002, and peak demand declined by about 20 percent. The reduction reflects “process water” recycling at our Jones Ferry Road Water Treatment Plant. (Water used to clean treatment plant filters is recycled rather than discarded.), year-round water use restrictions in place during much of the year, prudent and water-wise conservation efforts by our customers prompted by mandatory water use restrictions during periods of water shortage and the conservation pricing signal sent to our individually metered residential customers through an increasing block rate structure implemented on October 1, 2007. Further demand reductions are expected when the OWASA/UNC reclaimed water system begins operating in 2009. In FY 2008, demand for OWASA water and wastewater services remained less than expected due primarily to customers’ conservation practices and volume decreased by 3.6 percent from FY 2007. 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	2007	2008	% change
Customer accounts (meters read)	19,887	20,003	0.6
Total water sales (thousands of gallons)	2,841,134	2,740,055	(3.6)
Water sales—average per day	7.784 MGD	7.507 MGD	(3.6)

MAJOR INITIATIVES AND ACCOMPLISHMENTS

Increased Water and Sewer Rates Effective on October 1, 2008 - In June 2008 the OWASA Board approved a combined increase of about 17 percent for monthly water and sewer rates that will become effective on October 1, 2008. The average bill for a typical individually-metered residential customer using 5,000 gallons per month will increase from \$58.18 to \$68.24, but bills for individual customers will vary according to the actual amount of water used, size of meter, etc. The rate increase was needed primarily due to a downturn in revenues associated with an expected decrease in total customer demand during the coming year and to an expected drop of 40 percent in connection fees associated with a slowdown in new development. The new rates also include revisions to OWASA's Water Shortage Surcharges ("Drought Rates") that would be implemented if Water Supply Shortages are declared.

Water Supply and Demand – Customer demand during FY 2008 reflected yet another decrease from the prior year due to reduced use during OWASA-declared Water Supply Shortage conditions in effect from September 2007 through May 2008. As of the date of this report, OWASA's reservoirs are 96 percent full, and the statistical risk of critical reservoir depletion, based on historical data, for the next 18 months is minimal. In addition to increased water in storage, OWASA's supply outlook is more positive than a year ago for the following reasons:

- The OWASA/UNC reclaimed water system now under construction is expected to reduce potable water consumption by about 0.66 mgd, or approximately 7 percent of total demand beginning in the spring of 2009.
- OWASA's aggressive conservation pricing signals will be further strengthened when recently adopted rates go into effect on October 1, 2008.
- The regional water supply picture has also improved from FY 2007, and additional backup supplies are expected to be available when a Cary-Durham interconnection upgrade is completed by the end of this calendar year.
- OWASA now has feasible contingency plans in place to pump Haw River water through a temporary above-ground pipeline to the Cane Creek Reservoir if necessary. No such plans existed at this time last year.

Long Range Water Supply Plan Update – In FY 2008 the OWASA Board directed staff to complete a thorough review of our long-term water supply strategy during FY 2009. This will involve revisiting underlying assumptions, such as community growth plans and water demand forecasts, as well as the supply and demand management alternatives that have been considered since 2000. With the aid of a consultant team, we will examine the levels of acceptable risk; and water supply and demand management alternatives that can offer additional flexibility and reliability, such as expanded reclaimed water distribution, additional conservation opportunities, and supplemental water from Jordan Lake. This project will involve interaction with local officials and other community stakeholders at key points. We expect this work to be substantially completed during FY 2009

Mason Farm Wastewater Treatment Plant (WWTP) – The three-year, \$50+ million upgrade and expansion of the wastewater treatment plant (WWTP) was completed in October 2007. The plant’s peak month capacity has been increased from 12 million gallons per day (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. These WWTP improvements will support the new reclaimed water (RCW) system and will help OWASA initially meet the proposed new nitrogen and phosphorus removal requirements of the State’s Jordan Lake Nutrient Management Rules. We also completed the construction of a new biosolids dewatering facility in October 2007, which reduces the amount of liquid in our biosolids, thereby improving the economy and long-term sustainability of our biosolids recycling program and enabling us to use a wider range of biosolids management options.

Odor Elimination at the Mason Farm Wastewater Treatment Plant – Although work still remains in OWASA’s efforts to eliminate objectionable off-site odors at the WWTP, significant investments were made to plant facilities and operational procedures during the past year, including:

- Work on a new covered “headworks,” where untreated sewage enters the WWTP, was completed in July 2007. This is a particularly odorous portion of the treatment process, so the new covered facility is a critical improvement.
- We also completed work in December 2007 to cover and treat foul air from three locations inside the WWTP site: 1) two open tanks that hold wastewater before it is pumped into the channel leading to the biological treatment or “aeration” tanks; 2) a channel that carries wastewater to the aeration tanks; and 3) two structures that carry wastewater to and from the primary settling tanks.

Design is underway for \$4.2 million of additional improvements to cover and treat the foul air from the plant’s three primary settling tanks and eight of sixteen aeration tanks.

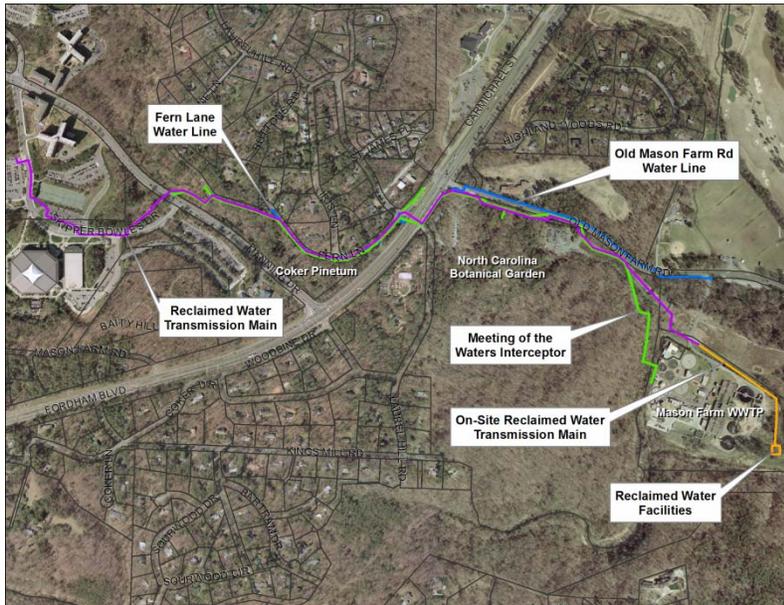
Reclaimed Water System — OWASA and UNC are developing a reclaimed water system to supply highly treated wastewater to certain campus facilities. By decreasing the amount of drinking water used for non-potable purposes, the RCW system will reduce the community’s risk to droughts. Total drinking water demand is expected to decrease by about 15 percent when the system is fully implemented. The project will also reduce the amount of nutrients and other pollutants released to Morgan Creek and Jordan Lake.

The RCW project will be financially self-supporting. UNC is paying to construct the system, and OWASA will recover all operating, maintenance, management, and overhead costs through user rates and fees. 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 about \$2.25 million in Federal and State grant funding for the project.

Construction of RCW pumping, storage and major pipeline facilities began in January 2008 and will be in operation by the spring of 2009. The University has already installed about 7,000 feet of RCW pipe on the main campus along with other construction. OWASA’s contractor has

installed about 4,000 feet of RCW pipe along Old Mason Farm Road and Skipper Bowles Drive to date.

The portion of the RCW line that remains to be completed is in the Coker Pinetum-Fern Lane area. That section will be within an existing sewer utility easement and road right-of-way. The RCW pipe is being co-constructed with the Meeting of the Waters sewer replacement project.



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.

Meeting of the Waters Creek Sewer Replacement – About 2,700 feet of the new Meeting of the Waters Creek sewer has been installed and placed into service. The remaining section is currently being installed along Fern Lane and through a utility easement in the Coker Pinetum. As discussed above, the sewer line is being co-constructed with the Reclaimed Water Transmission Main and is expected to be complete by June 2009.

Jordan Lake Nutrient Reduction Strategy and Rules – In May 2008, the NC Environmental Management Commission (EMC) approved new Jordan Lake nutrient management rules, which had been under development for several years. These are being reviewed by the NC General Assembly’s Rules Review Commission and will also be subject to approval by the 2009 General Assembly. The greatest impact on OWASA will be stricter wastewater treatment limits for Total Phosphorus (TP) and Total Nitrogen (TN). As currently adopted, the compliance dates are 2010 for the new TP discharge limits and 2014 for TN. OWASA staff is carefully reviewing our previous assessment of the operational and financial implications of the nutrient limits.

Jordan Lake Water Supply – As described at the March 31, 2008 Orange County Assembly of Governments meeting, OWASA is participating in staff discussions with Durham (City), Cary, Chatham County, and Orange County representatives about opportunities for the joint development of additional water supply capacity from Jordan Lake, which could supplement OWASA’s supply if current plans for additional conservation and reclaimed water fall short of our goal of reducing future demands before the expanded Stone Quarry Reservoir is in service by the mid-2030s. Jordan Lake could also provide a critically important back-up supply during droughts or other water supply emergencies. Two severe droughts in the past six years have further increased our awareness of the need for greater flexibility and additional water supply

options. As an important part of our Long-Range Water Supply Plan Update described above, we will fully evaluate the estimated costs, benefits, and other considerations of obtaining water from Jordan Lake either independently or in partnership with nearby communities.

Proposed Revisions to Conservation Standards – At the direction of the OWASA Board in the aftermath of the 2007/8 drought, draft revisions to OWASA’s Water Conservation Standards have been developed and distributed for public comment and stakeholder feedback. The Board will receive and consider that feedback and adopt revised Standards that will be submitted to the Carrboro, Chapel Hill, and Orange County elected boards for approval and incorporation into their respective ordinances. The current Conservation Standards were developed by OWASA and adopted locally in 2003. The overall approach of the draft revisions is to simplify the existing standards and place greater emphasis on pricing as a key conservation strategy rather than a detailed list of prescriptive water use allowances and prohibitions. Following the public feedback and stakeholder participation process, the OWASA Board is expected to adopt new Conservation Standards during FY 2008.

Sewer Service for Durham’s Blenheim Woods Subdivision – After obtaining the approval of the OWASA Board of Directors and the elected boards of Carrboro, Chapel Hill, and Orange County, OWASA entered into a wastewater transfer agreement with the City of Durham to accept wastewater flows from Durham’s Blenheim Woods subdivision, a 56-lot residential development in Durham County that will connect Kinsale Drive in the Oaks subdivision to George King Road.

The agreement is similar to that for the Piney Mountain Subdivision, where Durham accepts and treats wastewater from OWASA (Orange County) customers in that area. Under the Blenheim Woods agreement, Durham (and its customers) will pay all applicable OWASA charges for sewer service, including service availability fees, plus charges for collecting and treating the wastewater received by OWASA.

This arrangement provides Durham with the improved reliability of a gravity sewer collection system, lower operation and maintenance costs, and will decrease the potential for wastewater spills and other environmental damage (including increased noise and light pollution) associated with wastewater pumping stations.

Other Miscellaneous Capital Improvement Projects – Construction was completed in the fall of 2007 for a new drinking water pump station near Interstate 40. In combination with the new 16-inch water line on Old Durham Road, the new pump station increases OWASA’s ability to obtain treated drinking water from the City of Durham during emergency water shortages.

We continue to replace aging water mains in order to maintain a high level of water service reliability. Replacement projects were completed during the past year in part of the Colony Woods neighborhood, at Pearl Lane and Elmdale Drive, and at Brookside Condominiums in Chapel Hill. Additional water line replacement projects are being designed for North Columbia Street and Lexington Drive.

The installation of a new gravity sewer allowed us to close two sewage pump stations at Lloyd Street and Starlite Drive in December 2007. The new sewer also provides service to several properties for which service was previously unavailable.

A project to increase the capacity of the Morgan Creek sewer in Chapel Hill's Morgan Creek Preserve property began in February 2008 and was completed this past summer. Project design was closely coordinated with Chapel Hill's greenway plans.

Sewer manhole rehabilitation along Finley Golf Course Road was completed this past spring.

A project to replace the Cleland Drive sewage pump station with a new gravity sewer is underway and will be completed this fall/winter (2008). We also are replacing an old water main in the same area as part of this project.

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 judgements by management.

Management believes that generally OWASA's internal accounting controls adequately protect assets and provide reasonable assurance of the proper recording of financial transactions. However, under newly strengthened scrutiny required by auditing standards, several internal control issues were cited by the auditor during this year's audit. OWASA management takes such findings seriously and has already taken steps to eliminate the cause of the internal control findings.

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 that became effective on October 1, 2007 that includes 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 2008.

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, 2008, 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 \$584,031 in FY 2008.

To facilitate operational efficiency and to reduce costs of the accounts payable function, authorized OWASA employees use purchasing cards in accord with internal control procedures and policies. Purchasing card use comprised about seven percent of operating expenditures during FY 2008.

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. 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. A commercial insurer provides employee health and accident coverage.

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 undergo an annual independent financial audit. OWASA's auditor, Cherry, Bekaert & Holland, L.L.P., was retained following an open, competitive qualifications-based selection process. The auditor's report on the basic 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, 2008, 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, 2007. 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 2008 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, Cherry, Bekaert & Holland, L.L.P., who assisted and significantly 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, 2008, and the financial results of its operations and 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, 2007

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.



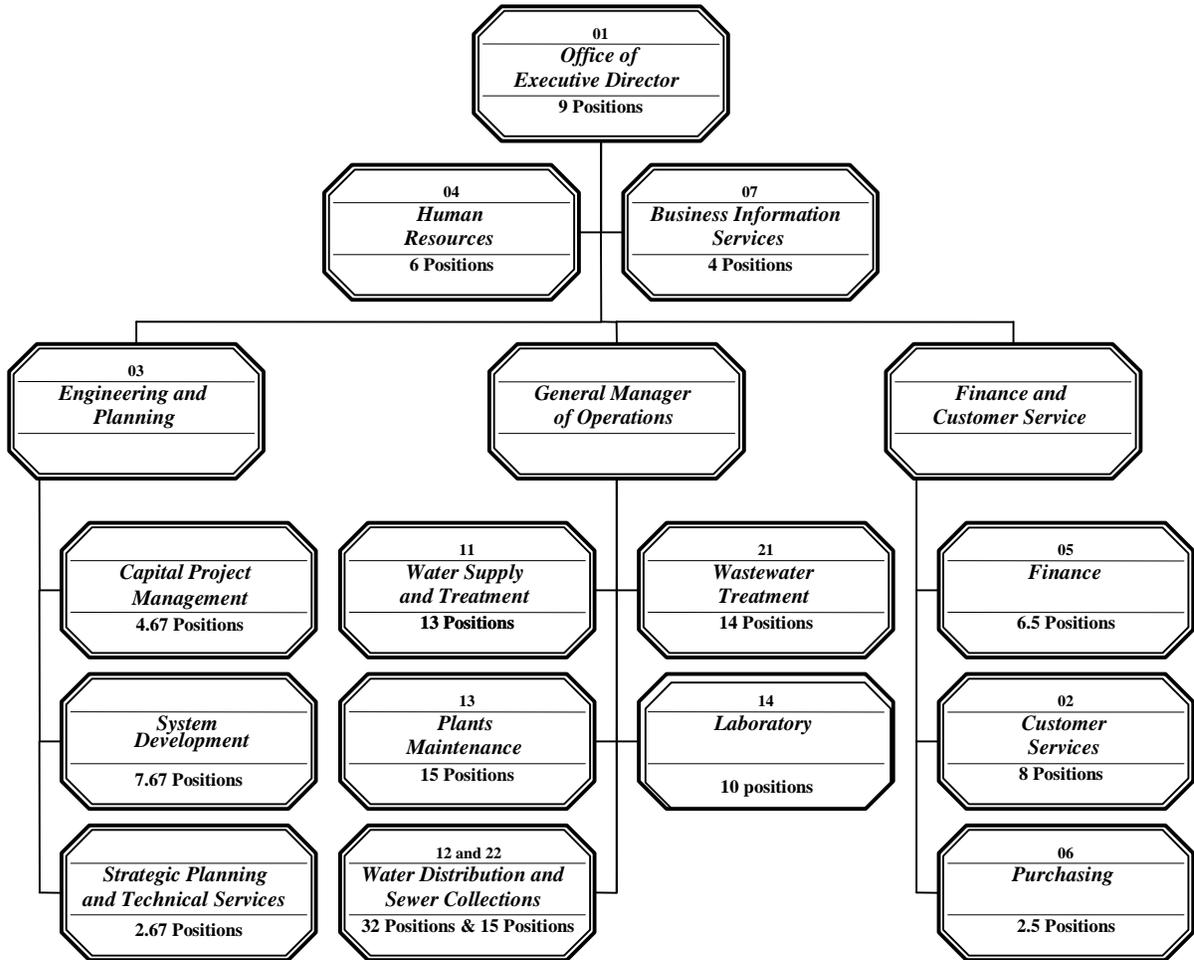
A handwritten signature in black ink, appearing to read "M. L. Post".

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director

Orange Water and Sewer Authority Staff/Department Structure



Total: 150 Positions

ORANGE WATER AND SEWER AUTHORITY

CHAIR

Randolph (Randy) M. Kabrick, P.E., Chair
207 Woodleaf Drive
Chapel Hill, NC 27514
Appointed by Chapel Hill; Term Expires 6/30/10

VICE CHAIR

Gordon Merklein, Vice Chair
504 Highgrove Drive
Chapel Hill, NC 27516
Appointed by Chapel Hill; Term Expires: 6/30/10

SECRETARY

Braxton Foushee, Secretary
100 Williams Street
Carrboro, NC 27510
Appointed by Carrboro; Term Expires 6/30/08

Fred Battle
1105 Brenda Court
Chapel Hill, N.C. 27516
Appointed by Orange County; Term Expires 6/30/09

Michael A. Clarke
Carol Woods Retirement Community
750 Weaver Dairy Road #1202
Chapel Hill, NC 27514
Appointed by Chapel Hill; Term Expires 6/30/08

Marge Anders Limbert
5816 Hideaway Drive
Chapel Hill, NC 27516
Appointed by Orange County; Term Expires 6/30/08

Gene Pease
208 Glandon Drive
Chapel Hill, NC 27514
Appointed by Chapel Hill; Term Expires 6/30/09

Alan Rimer, P.E.
519 Hooper Lane
Chapel Hill, NC 27514
Appointed by Chapel Hill; Term Expires 6/30/10

William R. Stott, III
105 Oleander Road
Carrboro, NC 27510
Appointed by Carrboro; Term Expires 6/30/09

ORANGE WATER AND SEWER AUTHORITY
OWASA SENIOR MANAGEMENT TEAM

Patricia Abernathy, Database Administrator
Sandra Bradshaw, Laboratory Manager
Jan Bryant-Berry, C.L.G.P.O., Procurement Manager
Gwen Burston, S.P.H.R., Director of Human Resources
Stuart Carson, P.E., Engineering Manager (Project Management)
Mason Crum, P.E., Director of Engineering and Planning
Mary Darr, P.E., Operations Engineer
Patrick Davis, Utility Manager Generalist
Greg Feller, Public Affairs Administrator
Damon Forney, Wastewater Treatment and Biosolids Manager
Stephanie Glasgow, M.E.S.H., P.H.R., Safety and Training Administrator
Walter Gottschalk, Wastewater Specialist
Thurman Green, Distribution and Collections Systems Manager
John Greene, P.E., General Manager of Operations
Ed Holland, A.I.C.P., Director of Planning and Development
Randy Horton, Assistant Manager of Distribution and Collection
Johnny Johnson, Maintenance Manager
Ed Kerwin, Executive Director
Kenneth Loflin, Water Supply and Treatment Manager
Andrea Orbich, Clerk to the Board/Executive Assistant
Dan Przybyl, Director of Information Services
Kevin M. Ray, Director of Finance and Customer Service
Jane Showerman, Customer Service Manager
Todd Spencer, P.E., Engineering Manager (System Development)

GENERAL COUNSEL

Robert Epting, Esquire
Epting and Hackney

INDEPENDENT AUDITORS' REPORT

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 (the "Authority"), a component unit of the Town of Chapel Hill, North Carolina, as of and for the year ended June 30, 2008, which collectively 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 audit. The financial statements of the Authority as of June 30, 2007, were audited by other auditors whose report dated October 8, 2007, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

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, 2008, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 20, 2008 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 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 this information and express no opinion on it.

Our audit was 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 the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole. The introductory section and the statistical section 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.

CHERRY, BEKAERT & HOLLAND, L.L.P.

Cherry, Bekaert & Holland, L.L.P.

Raleigh, North Carolina
September 20, 2008

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, 2008 (FY 2008). 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 1–12.

FINANCIAL HIGHLIGHTS

- At year end, OWASA's net assets totaled approximately \$185 million, reflecting a \$6.9 million increase over the previous year primarily due to the use of bond proceeds to fund infrastructure development under our Capital Improvements Plan.
- Current and restricted cash assets and investments decreased by approximately \$7.0 million, reflecting the drawdown of bond proceeds and capital improvements expenditures.
- An increase in capital assets of approximately \$9.2 million; resulting from OWASA's ongoing commitment to maintaining an adequate water and sewer infrastructure.
- Total current liabilities balance changed little during the year, reflecting well planned operational and capital budgets, and an efficient accounts payable process.
- A decrease of \$4.8 million in noncurrent liabilities resulted from principal payments on long-term debt with no new debt issued.
- OWASA enjoys credit ratings of Aa2 from Moody's, and AA+ from Standard and Poors 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* measures 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>2008</u>	<u>2007</u>	<u>2006</u>	Percentage of Change (FY07 to 08)
Current assets and restricted noncurrent assets	\$21.0	\$27.8	\$20.6	(28.1%)
Capital and other long-term assets	<u>281.4</u>	<u>272.2</u>	<u>252.2</u>	3.8%
Total assets	302.4	300.0	272.8	0.8%
Current liabilities	11.1	10.9	11.1	1.8%
Noncurrent liabilities	<u>106.7</u>	<u>111.5</u>	<u>92.4</u>	(4.3%)
Total liabilities	117.8	122.4	103.5	(3.8%)
Net assets				
Invested in capital assets, net of related debt	177.3	161.8	160.8	9.6%
Restricted	1.3	1.3	1.9	-
Unrestricted	<u>6.0</u>	<u>14.5</u>	<u>6.6</u>	(58.6%)
Total net assets	\$184.6	<u>\$177.6</u>	<u>\$169.3</u>	3.9%

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 \$185 million at June 30, 2008, compared to \$178 million and \$169 million at June 30, 2007 and 2006, 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, and reflects the fact that a significant portion of that infrastructure development is funded through cash rather than debt.

Capital assets net of related debt comprised 96%, 91% and 95% of total net assets at June 30, 2008, 2007 and 2006, 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 need to repay the associated debt must be provided by other sources. At June 30, 2008, these other resources totaled \$7.3 million. \$1.3 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 2006 and 2008 generally reflect the issuance of debt and the availability of bond proceeds for infrastructure development. The remaining \$6.0 million is unrestricted.

OWASA's overall financial position strengthened between fiscal years ended June 30, 2006 and 2008 as net assets increased by \$15.3 million. Total assets increased during the same period by \$29.6 million. However, this increase in total assets was offset somewhat by an increase in total liabilities of \$14.3 million, again reflecting the issuance of debt to pay for the cost of a significant number of capital assets. Total liabilities decreased by \$4.6 million indicating principal payments on long-term debt during FY 2008. 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>2008</u>	<u>2007</u>	<u>2006</u>	Percentage of Change (FY07 to 08)
Operating revenues	\$28.8	\$25.4	\$24.4	13.4%
Operating expenses	<u>23.9</u>	<u>23.6</u>	<u>22.6</u>	<u>1.3%</u>
Operating income	4.9	1.8	1.8	172.2%
Nonoperating revenues (expenses)	<u>(1.3)</u>	<u>(.9)</u>	<u>.1</u>	<u>(44.4%)</u>
Income before contributions	3.6	.9	1.9	300.0%
Capital contributions	<u>3.3</u>	<u>7.4</u>	<u>3.5</u>	<u>(55.4%)</u>
Increase in net assets	6.9	8.3	5.4	(16.9%)
Net assets, July 1	<u>177.6</u>	<u>169.3</u>	<u>163.9</u>	<u>4.9%</u>
Net assets, June 30	<u>184.6</u>	<u>177.6</u>	<u>\$169.3</u>	<u>3.9%</u>

The above 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 4.0% during FY 2008 and were approximately 8.0% below expectations, reflecting OWASA's continued commitment to water resource conservation and an exceptional drought during much of the year, rate adjustments in water and sewer rates of 6.25 % and 13.75%, respectively, combined with water use conservation surcharges contributed to an increase in operating revenues of about 13.3%. The increase in operating revenues equaled about \$3.4 million. OWASA implemented an increasing block rate for residential customers in FY 2008.

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 sewer commodity charge for commercial customers, 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. Sewer billings for residential customers under the new block rate structure were capped at fifteen thousand gallons. All rates, fees and charges are calculated under the cost-of-service rate making methodology.

- **Operating Expenses:** Operating expenses of \$23.9 million represent an increase of about 5.8% over the preceding two years, but only a 1.3% increase between FY 2007 and FY 2008 as OWASA managers under spent their appropriations by 8.0% in order to offset potential drought related operating revenue deficits and a significant deficit in nonoperating revenue. This is also an indication of OWASA's flexibility in addressing anomalous conditions such as droughts. Further, the operating expense includes a \$7.2 million charge for depreciation, and from a cash flow perspective, OWASA's ability to meet its operating expenses and adequately cover its debt service remained 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 \$2.0 million represented a 38.2% shortfall in comparison to expectations, reflecting a continuation of the slowdown in new housing starts that began in FY2007. While interest earnings increased in FY 2007 due to the availability of bond proceeds and improving market conditions, earnings fell by 41.3% in FY 2008 as bond proceeds were drawn down and interest rates deteriorated. Interest earnings of \$584,031 were only 75.4% 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 27.8% as the economic benefit of OWASA's patent has been fully amortized. A 12.1% decrease in interest expense corresponds to annual reductions in outstanding principal.

- **Capital Contributions:** Total capital contributions decreased by nearly 55.3% during FY2008 reflecting the slump in new construction. Capital grants of \$926,504 reflect the receipt of North Carolina Clean Water Management Trust Fund and Environmental Protection Agency 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 are not included in the budget under the modified accrual method.

Capital Assets

OWASA annually expands or places into service new capital assets. FY 2008 additions totaled 9.2 million, net of depreciation. These assets included the continued upgrade and expansion of the Jones Ferry Water Treatment Plant, pumping improvements for the Stone Quarry Reservoir, and various water and sewer renewal and replacement projects. Please refer to Note 4 for additional information on capital assets.

Orange Water and Sewer Authority				
Capital Assets				
(\$ Millions)				
	<u>2008</u>	<u>2007</u>	<u>2006</u>	Percentage of Change (FY07 to 08)
Land	\$20.0	\$20.0	\$17.3	0.0%
Construction in progress	67.3	75.2	62.5	(10.5%)
Water treatment and distribution	99.5	84.0	80.5	18.5%
Sewer collection and treatment	77.1	73.8	73.1	4.5%
Fixtures and equipment	17.5	19.2	18.8	(8.9%)
Total	<u>\$281.4</u>	<u>\$272.2</u>	<u>\$252.2</u>	<u>3.4%</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, 2008, 2007 and 2006, OWASA's outstanding debt totaled \$111.5 million, \$115.3 million, and \$96.4 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 \$6.9 million. This amount was credited in full to the trustee restricted bond service account as of June 30, 2008.

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 27% of water sales.
- The University continues to undergo one of the largest campus expansion programs in the country.
- Orange County's unemployment rate is generally much better than the State or National average.

The OWASA service area once again experienced a significant drought throughout the fiscal year. OWASA encourages water conservation through public education, voluntary and mandatory water use restrictions, and pricing structure 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, while water consumption decreased during the year by 2% and was well below expectations and availability fees were 38.2% below expectations, OWASA ended FY 2008 slightly above budget. 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. Additionally, while never intended as revenue sources, the water use restriction surcharges mitigated potential operating revenue deficits due to the drought.

Requests for Information

The 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, 2008 and 2007

Assets	<u>2008</u>	<u>2007</u>
Current assets		
Cash and cash equivalents	\$ 6,556,847	\$ 7,018,488
Receivables:		
Trade accounts (net of allowances for uncollectible accounts of approximately \$115,325 for 2008 and \$115,325 for 2007)	3,378,246	2,961,439
Other	540,102	644,158
Inventory, materials and supplies	751,178	669,415
Prepaid expenses	15,191	21,003
Restricted cash and cash equivalents:		
Cash and cash equivalents, trustee	7,077,816	5,991,959
Total current assets	<u>18,319,380</u>	<u>17,306,462</u>
Noncurrent assets		
Restricted cash and cash equivalents		
Cash and cash equivalents, authority	1,168,081	1,127,192
Cash and cash equivalents, trustee	517,768	8,272,997
Total restricted cash and cash equivalents	<u>1,685,849</u>	<u>9,400,189</u>
Capital assets:		
Non-depreciable	87,258,865	95,152,622
Depreciable	194,130,106	177,061,466
Total capital assets net, of accumulated depreciation	<u>281,388,971</u>	<u>272,214,088</u>
Unamortized bond expenses, net of accumulated amortization of \$564,133 for 2008 and \$485,284 for 2007	1,024,634	1,103,483
	<u>1,024,634</u>	<u>1,103,483</u>
Total noncurrent assets, net	<u>284,099,454</u>	<u>282,717,760</u>
Total assets	<u>302,418,834</u>	<u>300,024,222</u>

See notes to financial statements.

ORANGE WATER AND SEWER AUTHORITY
STATEMENTS OF NET ASSETS
June 30, 2008 and 2007

Liabilities and Net Assets	2008	2007
Current liabilities		
Payable from current assets:		
Trade and construction contracts payable	\$ 2,601,352	\$ 3,530,506
Customer deposits and advances	947,612	643,665
Accrued expenses	640,081	724,891
Payable from restricted cash and cash equivalents:		
Accrued interest	2,083,434	2,181,392
Current maturities of bonds payable	4,845,566	3,810,567
Current maturity of capital lease	13,430	-
Total current liabilities	11,131,475	10,891,021
Noncurrent liabilities		
Bonds payable	106,616,233	111,461,797
Capital lease	67,561	-
Total liabilities	117,815,269	122,352,818
Net assets		
Invested in capital assets, net of related debt	177,287,377	161,812,115
Restricted for maintenance reserve and power fund	1,168,081	1,127,192
Restricted for debt service	154,388	185,258
Unrestricted	5,993,719	14,546,839
Total net assets	\$ 184,603,565	\$ 177,671,404

See notes to financial statements.

ORANGE WATER AND SEWER AUTHORITY
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Water	\$ 16,378,833	\$ 14,218,387
Sewer	11,046,437	10,272,920
Service initiation fees	169,603	142,086
Other	1,199,220	780,178
Total operating revenues	<u>28,794,093</u>	<u>25,413,571</u>
Operating expenses:		
Water supply and treatment	2,441,028	2,261,394
Water distribution	2,275,756	1,962,980
Sewer treatment	2,981,891	2,865,782
Sewer collections	1,134,682	1,539,591
General and administrative	4,467,944	4,428,491
Customer relations	672,147	707,614
Maintenance	1,881,395	1,979,957
Laboratory	788,628	890,108
Depreciation and amortization	7,215,175	6,950,774
Total operating expenses	<u>23,858,646</u>	<u>23,586,691</u>
Operating income	<u>4,935,447</u>	<u>1,826,880</u>
Nonoperating revenues (expenses):		
Customer fees	1,995,415	2,514,450
Investment income, net of fair value of investments adjustment	584,031	995,354
Interest expense	(3,832,320)	(4,361,911)
Amortization of bond expense and patent	(69,940)	(96,898)
Other	2,865	16,431
Income before contributions	<u>3,615,498</u>	<u>894,306</u>
Capital contributions:		
Capital grants and contributions	926,504	650,097
Contributions in aid of construction	2,390,159	6,775,689
Total capital contributions	<u>3,316,663</u>	<u>7,425,786</u>
Increase in net assets	<u>6,932,161</u>	<u>8,320,092</u>
Net assets:		
Beginning	177,671,404	169,351,312
Ending	<u>\$ 184,603,565</u>	<u>\$ 177,671,404</u>

See notes to financial statements.

ORANGE WATER AND SEWER AUTHORITY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2008 and 2007

	2008	2007
Cash flows from operating activities		
Receipts from customers	\$ 27,178,066	\$ 24,437,615
Payments to suppliers	(13,913,039)	(7,784,202)
Payments to employees	(3,820,347)	(9,266,271)
Other receipts	1,303,276	952,933
Net cash provided by operating activities	10,747,956	8,340,075
Cash flows from capital and related financing activities		
Acquisition and construction of property, plant and equipment	(13,128,658)	(20,004,651)
Proceeds from sale of property, plant and equipment	-	132,137
Proceeds from the issuance of capital leases	86,043	-
Principal paid on bond maturities and other long-term debt	(3,810,052)	(4,060,000)
Proceeds from the issuance of bonds	-	22,924,165
Interest paid on bond maturities on other long-term debt	(4,801,519)	(4,208,245)
Customer fees received	2,302,227	2,734,935
Capital grants and contributions	926,504	650,097
Bond issuance costs, premiums and refunding charges	3,344	(251,359)
Net cash used in capital and related financing activities	(18,422,111)	(2,082,921)
Cash flows from investing activities		
Proceeds from sale and maturities of investment securities	-	7,979,400
Amount paid for purchase of investments	-	(1,368,000)
Interest and dividends on investments	584,031	1,004,633
Net cash provided by investing activities	584,031	7,616,033
Net increase (decrease) in cash and cash equivalents	(7,090,124)	13,873,187
Cash and cash equivalents:		
Beginning	22,410,636	8,537,449
Ending	\$ 15,320,512	\$ 22,410,636
Reconciliation of cash and cash equivalents:		
Current assets	\$ 6,556,847	\$ 7,018,488
Restricted assets:		
Authority	1,168,081	1,127,192
Trustee	7,595,584	14,264,956
	\$ 15,320,512	\$ 22,410,636

See notes to financial statements.

ORANGE WATER AND SEWER AUTHORITY
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2008 and 2007

	2008	2007
Reconciliation of operating income to net cash		
Provided by operating activities		
Operating income	\$ 4,935,447	\$ 1,826,880
Adjustments to reconcile operating income to net cash		
provided by operating activities:		
Depreciation and amortization	7,215,175	6,950,774
Changes in assets and liabilities:		
Trade accounts receivable	(416,807)	(195,778)
Other receivables	104,056	175,166
Inventory	(81,763)	(59,930)
Prepaid expenses	5,812	250,004
Trade and construction contracts payable	(929,154)	(648,743)
Accrued expenses	(84,810)	41,702
Net cash provided by operating activities	\$ 10,747,956	\$ 8,340,075
Supplemental schedule of noncash capital and related financing		
activities, noncapital financing activities and investing activities		
Property, plant and equipment contributed by private developers	\$ 2,390,159	\$ 6,775,689
Capitalized interest, net of investment earnings	\$ 871,241	\$ 276,738
Amortization of bond expenses, bond discounts and		
deferred refunding gains and losses	\$ (69,940)	\$ 96,898
Increase (decrease) in the fair value of the Authority's investments	\$ -	\$ 4,346

See notes to financial statements.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

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.

When both restricted and unrestricted resources are available for use, it is the Authority's policy to use unrestricted resources first, then restricted resources as they are needed.

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.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 1. Summary of Significant Accounting Policies (Continued)

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.

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. The Authority grants credit to residential, business and industrial customers, substantially all of whom are local to the Orange County, North Carolina area.

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.

5. Other assets

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.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 1. Summary of Significant Accounting Policies (Continued)

6. Capital assets

Capital assets, which include property, plant, equipment and infrastructure assets, are reported 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.

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, 2008 and 2007, the Authority had recorded a liability for accrued vacation and the salary-related payments of \$424,798 and \$404,146, 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.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 1. Summary of Significant Accounting Policies (Continued)

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 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.

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.

12. Reclassification

Certain reclassifications have been made to the 2007 financial statements to conform to the current year presentation.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 1. Summary of Significant Accounting Policies (Continued)

13. Upcoming pronouncements

GASB Statement No. 45 “Accounting and Financial Reporting by Employers for Post-employment Benefits Other Than Pensions”. It is effective in three phases based on a government’s total annual revenues in the first fiscal year ending after June 15, 1999. This Statement is effective for periods beginning after December 15, 2006, for phase 1 governments (those with total annual revenues of \$100 million or more); after December 15, 2007, for phase 2 governments (those with total annual revenues of \$10 million or more but less than \$100 million); and after December 15, 2008, for phase 3 governments (those with total annual revenues of less than \$10 million). Early implementation is encouraged. In addition to pensions, many state and local governmental employers provide other post-employment benefits (OPEB) as part of the total compensation offered to attract and retain the services of qualified employees. OPEB includes post-employment healthcare, as well as other forms of post-employment benefits (for example, life insurance) when provided separately from a pension plan. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), not disclosures, and, if applicable, required supplemental information (RSI) in the financial reports of state and local governmental employers.

GASB Statement No. 49, “Accounting and Financial Reporting for Pollution Remediation Obligations.” This statement provides guidance on how to calculate and report the costs and obligations associated with pollution cleanup efforts. The requirements of the new statement become effective for fiscal periods beginning after December 15, 2007.

GASB Statement No. 51, “Accounting and Financial Reporting for Intangible Assets.” This statement establishes accounting and financial reporting requirements for intangible assets including easements, water rights, timber rights, patents, trademarks, and computer software. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2009.

GASB Statement No. 53, “Accounting and Financial Reporting for Derivative Instruments.” Statement 53 is intended to improve how state and local governments report information about derivative instruments – financial arrangements used by governments to manage specific risks or make investments – in their financial statements. The Statement specifically requires governments to measure most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The guidance in this Statement also addresses hedge accounting requirements and is effective for financial statements for reporting periods beginning after June 15, 2009, with earlier application encouraged.

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.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 2. Stewardship and Accountability – Budgetary Information (Continued)

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 and Cash Equivalents

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, 2008, the Authority's deposits had a carrying amount of \$7,724,928 and a bank balance of \$8,616,357. Of the bank balance, \$365,592 was covered by federal depository insurance and \$8,250,765 in interest-bearing deposits were covered by collateral held under the pooling method. The Authority had cash on hand of \$1,155 at June 30, 2008.

At June 30, 2007, the Authority's deposits had a carrying amount of \$8,145,680 and a bank balance of \$8,449,600. Of the bank balance, \$204,803 was covered by federal depository insurance and \$8,244,797 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.

Cash Equivalents:

At June 30, 2008 and 2007, the Authority's cash equivalents balances at fair value were as follows:

	<u>2008</u>	<u>2007</u>
The North Carolina Capital Management Trust, a mutual fund	\$ <u>7,595,584</u>	\$ <u>14,264,956</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. The NCCMT has a weighted-average maturity of 60 days or less as of June 30, 2008, and 0.9 years as of June 30, 2007.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

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

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”). The Authority’s investment in the NCCMT Cash Portfolio carried a credit rating of AAA by Standard & Poor’s as of June 30, 2008, and AAAm as of June 30, 2007.

Note 4. Capital Assets

Capital assets activity consists of the following for the years ended June 30, 2008 and 2007:

	July 1, 2007 Beginning Balance	Increases	Decreases	June 30, 2008 Ending Balance
Capital assets, not being depreciated:				
Land	\$ 19,994,878	\$ -	\$ -	\$19,994,878
Construction in progress	<u>75,157,744</u>	<u>14,899,392</u>	<u>22,793,149</u>	<u>67,263,987</u>
Total capital assets, not being depreciated	<u>95,152,622</u>	<u>14,899,392</u>	<u>22,793,149</u>	<u>87,258,865</u>
Capital assets, being depreciated:				
Water treatment and distribution	114,969,218	18,223,992	-	133,193,210
Sewer collection and treatment	102,197,954	5,764,260	-	107,962,214
Fixtures and equipment	<u>36,343,059</u>	<u>295,563</u>	<u>-</u>	<u>36,638,622</u>
Total capital assets, being depreciated	<u>253,510,231</u>	<u>24,283,815</u>	<u>-</u>	<u>277,794,046</u>
Less accumulated depreciation for:				
Water treatment and distribution	30,926,179	2,760,014	-	33,686,193
Sewer collection and treatment	28,368,432	2,447,017	-	30,815,449
Fixtures and equipment	<u>17,154,154</u>	<u>2,008,144</u>	<u>-</u>	<u>19,162,298</u>
Total accumulated depreciation	<u>76,448,765</u>	<u>\$ 7,215,175</u>	<u>\$ -</u>	<u>83,663,940</u>
Total capital assets, being depreciated, net	<u>177,061,466</u>			<u>194,130,106</u>
Total capital assets, net	<u>\$272,214,088</u>			<u>\$281,388,971</u>

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 4. Capital Assets (Continued)

	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	<u>62,530,218</u>	<u>12,981,103</u>	<u>353,577</u>	<u>75,157,744</u>
Total capital assets, not being depreciated	<u>79,819,842</u>	<u>15,686,357</u>	<u>353,577</u>	<u>95,152,622</u>
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	<u>34,141,243</u>	<u>2,335,137</u>	<u>133,321</u>	<u>36,343,059</u>
Total capital assets, being depreciated	<u>241,920,452</u>	<u>11,724,298</u>	<u>134,519</u>	<u>253,510,231</u>
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	<u>15,278,631</u>	<u>1,894,336</u>	<u>18,813</u>	<u>17,154,154</u>
Total accumulated depreciation	<u>69,516,804</u>	<u>\$ 6,950,774</u>	<u>\$ 18,813</u>	<u>76,448,765</u>
Total capital assets, being depreciated, net	<u>172,403,648</u>			<u>177,061,466</u>
Total capital assets, net	<u>\$252,223,490</u>			<u>\$272,214,088</u>

Note 5. Long-Term Debt

Long-term debt as of June 30, 2008 and 2007 consists of the following:

	<u>2008</u>	<u>2007</u>
Revenue bonds:		
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 \$596,554 at June 30, 2008; 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	\$ 22,881,554	\$ 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 premium and deferred refunding loss of \$206,389 at June 30, 2008	18,468,611	18,451,412

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 5. Long-Term Debt (Continued)

	2008	2007
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 \$548,239 at June 30, 2008; 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 (1.55% at June 30, 2008), final maturity July 2029	39,688,239	40,810,683
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 \$417,944 at June 30, 2008	7,882,056	9,009,813
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 \$53,656 at June 30, 2008	21,153,656	22,056,812
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 \$7,682 at June 30, 2008	<u>1,387,683</u> 111,461,799	<u>2,036,523</u> 115,272,364
Less current maturities: Bonds payable, net of unamortized premiums and discounts and deferred refunding gains and losses	<u>4,845,566</u>	<u>3,810,567</u>
Long-term portion	<u>\$106,616,233</u>	<u>\$111,461,797</u>
Obligations under capital lease:		
Capitalized equipment lease obligation due in annual installments of \$24,264 which includes interest at 14.45% through February 1, 2013	\$ 80,991	\$ -
Less current maturities	<u>13,430</u>	<u>-</u>
Long-term portion	<u>\$ 67,561</u>	<u>\$ -</u>

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
 June 30, 2008 and 2007

Note 5. Long-Term Debt (Continued)

Bond payable maturities are as follows:

<u>Fiscal Year</u>	<u>Maturities</u>	<u>Amortization of Premiums and Deferred Refunding Losses</u>	<u>Total</u>	<u>Interest</u>
2009	\$ 4,840,000	\$ (5,566)	\$ 4,845,566	\$ 4,818,688
2010	4,835,000	(5,568)	4,840,568	4,630,326
2011	5,230,000	(1,726)	5,231,726	4,448,113
2012	5,450,000	(1,726)	5,451,726	4,230,213
2013	5,510,000	(1,726)	5,511,726	3,993,138
2014-2018	26,145,000	(113,111)	26,258,111	16,522,912
2019-2023	23,625,000	(233,012)	23,858,012	10,607,363
2024-2028	24,525,000	(134,146)	24,659,146	5,321,076
2029-2032	<u>10,720,000</u>	<u>(85,218)</u>	<u>10,805,218</u>	<u>983,825</u>
Total	<u>\$110,880,000</u>	<u>\$ (581,799)</u>	<u>\$111,461,799</u>	<u>\$55,555,654</u>

Capital lease maturities are as follows:

<u>Fiscal Year</u>	<u>Maturities</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 13,430	\$ 10,834	\$24,264
2010	15,504	8,760	24,264
2011	17,898	6,366	24,264
2012	20,662	3,602	24,264
2013	<u>13,497</u>	<u>658</u>	<u>14,155</u>
Total	<u>\$ 80,991</u>	<u>\$ 30,220</u>	<u>\$ 111,211</u>

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, 2008 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.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 5. Long-Term Debt (Continued)

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.

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 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, 2008 was \$1,230,000.

Long-term liability activity for the years ended June 30, 2008 and 2007 are as follows:

	July 1, 2007 Beginning Balance	Additions	Reductions	June 30, 2008 Ending Balance	Due Within One Year
Bonds payable:					
Revenue bonds	\$ 114,685,000	\$ -	\$ 3,805,000	\$ 110,880,000	\$ 4,840,000
Less deferred amounts:					
For issuance premiums	2,607,750	-	190,138	2,417,612	190,138
For issuance discounts and Deferred refunding	(2,020,386)	-	(184,573)	(1,835,813)	(184,572)
Capital Lease	-	86,043	5,052	80,991	13,430
Total long-term debt	<u>\$ 115,272,364</u>	<u>\$ 86,043</u>	<u>\$ 3,815,617</u>	<u>\$ 111,542,790</u>	<u>\$ 4,858,996</u>

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
 June 30, 2008 and 2007

Note 5. Long-Term Debt (Continued)

	July 1, 2006 Beginning <u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	June 30, 2007 Ending <u>Balance</u>	<u>Due Within One Year</u>
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	<u>(2,204,957)</u>	<u>-</u>	<u>(184,571)</u>	<u>(2,020,386)</u>	<u>(184,572)</u>
Total long-term debt	<u>\$ 96,407,882</u>	<u>\$ 22,924,165</u>	<u>\$ 4,059,683</u>	<u>\$ 115,272,364</u>	<u>\$ 3,810,567</u>

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.

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 4.88% 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, 2008, 2007, and 2006 were \$ 341,694, \$332,113, and \$322,323 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 \$7,429,000 at June 30, 2008.

ORANGE WATER AND SEWER AUTHORITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2008 and 2007

Note 8. Net Assets

At June 30, 2008 and 2007, the Board of Directors had approved the use of a portion of the restricted and unrestricted net assets for the following future project ordinances:

	<u>2008</u>	<u>2007</u>
Raw water supply sources	\$ 90,000	\$ 478,000
Water filtration	511,000	222,000
Water transmission and distribution	839,000	2,074,000
Wastewater pumping stations and force mains	866,000	1,563,000
Wastewater collection	3,316,000	8,086,000
Wastewater treatment and disposal	1,728,000	7,124,000
Reclaimed water treatment, pumping and storage	4,126,000	-
Reclaimed water transmission	1,959,000	-
Finished water pumping	50,000	50,000
Information services	275,000	330,000
Finished water storage	<u>32,000</u>	<u>160,000</u>
	<u>\$ 13,792,000</u>	<u>\$ 20,087,000</u>

ORANGE WATER AND SEWER AUTHORITY
SCHEDULE OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (MODIFIED ACCURAL BASIS)
Year Ended June 30, 2008

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	Variance Positive (Negative)
Operating revenues				
Water	\$ 15,775,000	\$ 15,775,000	\$ 16,378,833	\$ 603,833
Sewer	11,626,000	11,626,000	11,046,437	(579,563)
Service initiation fees	145,000	145,000	169,603	24,603
Other	884,000	884,000	1,199,220	315,220
Total operating revenues	<u>28,430,000</u>	<u>28,430,000</u>	<u>28,794,093</u>	<u>364,093</u>
Nonoperating revenues				
Interest income	775,000	775,000	584,031	(190,969)
Customer fees	3,229,000	3,229,000	1,995,415	(1,233,585)
Grants and contributions	-	-	926,504	926,504
Contributions in aid of construction	-	-	2,390,159	2,390,159
Total nonoperating revenues	<u>4,004,000</u>	<u>4,004,000</u>	<u>5,896,109</u>	<u>1,892,109</u>
Total revenues	<u>32,434,000</u>	<u>32,434,000</u>	<u>34,690,202</u>	<u>2,256,202</u>
Expenditures				
Water supply and treatment				
Salaries and wages	656,093	656,093	653,154	2,939
Fringe benefits	255,723	255,723	225,172	30,551
Chemicals	898,866	898,866	902,759	(3,893)
Materials and supplies	43,755	43,755	31,061	12,694
Utilities	414,645	414,645	462,773	(48,128)
Maintenance	24,153	24,153	20,695	3,458
Professional services	61,760	61,760	66,886	(5,126)
Insurance	79,113	79,113	64,123	14,990
Communication	300	300	598	(298)
Printing and production	100	100	-	100
Education and development	8,250	8,250	4,833	3,417
Miscellaneous	8,575	8,575	8,974	(399)
Total water supply and treatment	<u>2,451,333</u>	<u>2,451,333</u>	<u>2,441,028</u>	<u>10,305</u>

ORANGE WATER AND SEWER AUTHORITY
SCHEDULE OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (MODIFIED ACCURAL BASIS) (CONTINUED)
Year Ended June 30, 2008

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Expenditures (continued)				
Water distribution				
Salaries and wages	\$ 1,160,183	\$ 1,160,183	\$ 1,116,304	\$ 43,879
Fringe benefits	480,476	480,476	445,140	35,336
Materials and supplies	77,150	77,150	93,133	(15,983)
Utilities	253,150	253,150	193,842	59,308
Maintenance	531,600	531,600	560,166	(28,566)
Professional services	-	-	2,995	(2,995)
Insurance	15,099	15,099	7,504	7,595
Communication	400	400	226	174
Printing and reproduction	1,400	1,400	737	663
Education and development	12,994	12,994	12,300	694
Miscellaneous	2,600	2,600	2,019	581
Construction credit	(121,565)	(121,565)	(158,610)	37,045
Total water distribution	<u>2,413,487</u>	<u>2,413,487</u>	<u>2,275,756</u>	<u>137,731</u>
Sewer treatment				
Salaries and wages	784,258	784,258	773,498	10,760
Fringe benefits	310,013	310,013	272,778	37,235
Chemicals	674,500	674,500	735,941	(61,441)
Materials and supplies	73,500	73,500	64,048	9,452
Utilities	1,164,000	1,164,000	832,814	331,186
Maintenance	68,500	68,500	97,834	(29,334)
Professional services	35,000	35,000	94,421	(59,421)
Insurance	99,915	99,915	82,921	16,994
Communication	1,200	1,200	522	678
Education and development	7,450	7,450	7,524	(74)
Miscellaneous	58,000	58,000	19,590	38,410
Total sewer treatment	<u>3,276,336</u>	<u>3,276,336</u>	<u>2,981,891</u>	<u>294,445</u>

ORANGE WATER AND SEWER AUTHORITY
SCHEDULE OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (MODIFIED ACCURAL BASIS) (CONTINUED)
Year Ended June 30, 2008

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance Positive (Negative)</u>
Expenditures (continued)				
Sewer collections				
Salaries and wages	\$ 588,294	\$ 588,294	\$ 558,168	\$ 30,126
Fringe benefits	251,502	251,502	230,271	21,231
Chemicals	265,000	265,000	79,332	185,668
Materials and supplies	60,000	60,000	55,021	4,979
Utilities	119,200	119,200	114,324	4,876
Maintenance	310,000	310,000	158,858	151,142
Professional services	-	-	205	(205)
Insurance	13,967	13,967	7,252	6,715
Communication	800	800	224	576
Printing and reproduction	1,000	1,000	-	1,000
Education and development	10,750	10,750	5,583	5,167
Miscellaneous	6,000	6,000	5,947	53
Construction credit	-	-	(80,503)	80,503
Total sewer collections	<u>1,626,513</u>	<u>1,626,513</u>	<u>1,134,682</u>	<u>491,831</u>
General and administrative				
Salaries and wages	2,539,110	2,539,110	2,519,303	19,807
Fringe benefits	830,423	830,423	897,546	(67,123)
Materials and supplies	82,432	82,432	64,052	18,380
Utilities	183,000	183,000	170,727	12,273
Maintenance	246,700	246,700	173,405	73,295
Professional services	513,400	513,400	496,388	17,012
Insurance	53,252	53,252	36,479	16,773
Communication	108,380	108,380	60,000	48,380
Printing and reproduction	12,560	12,560	6,952	5,608
Education and development	81,260	81,260	43,648	37,612
Miscellaneous	124,828	124,828	159,242	(34,414)
Construction credit	(80,329)	(80,329)	(159,798)	79,469
Total general and administrative	<u>4,695,016</u>	<u>4,695,016</u>	<u>4,467,944</u>	<u>227,072</u>

ORANGE WATER AND SEWER AUTHORITY
SCHEDULE OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (MODIFIED ACCURAL BASIS) (CONTINUED)
Year Ended June 30, 2008

	Original Budget	Final Budget	Actual	Variance Positive (Negative)
Expenditures (continued)				
Customer relations				
Salaries and wages	\$ 310,383	\$ 310,383	\$ 308,335	\$ 2,048
Fringe benefits	113,212	113,212	95,904	17,308
Materials and supplies	3,000	3,000	2,636	364
Professional services	74,400	74,400	90,588	(16,188)
Insurance	1,080	1,080	1,968	(888)
Communication	100,000	100,000	110,657	(10,657)
Printing and reproduction	3,000	3,000	1,044	1,956
Education and development	5,800	5,800	957	4,843
Miscellaneous	81,200	81,200	60,058	21,142
Total customer relations	<u>692,075</u>	<u>692,075</u>	<u>672,147</u>	<u>19,928</u>
Maintenance				
Salaries and wages	692,752	694,252	646,978	47,274
Fringe benefits	274,212	274,212	222,781	51,431
Materials and supplies	34,953	34,953	38,556	(3,603)
Utilities	1,000	1,000	309	691
Maintenance	817,830	817,830	947,593	(129,763)
Professional services	29,000	29,000	236	28,764
Insurance	21,724	21,724	17,635	4,089
Communication	1,000	1,000	851	149
Education and development	7,700	7,700	6,086	1,614
Miscellaneous	-	-	370	(370)
Total maintenance	<u>1,880,171</u>	<u>1,881,671</u>	<u>1,881,395</u>	<u>276</u>
Laboratory				
Salaries and wages	435,531	434,031	412,440	21,591
Fringe benefits	165,425	165,425	142,460	22,965
Materials and supplies	244,710	244,710	168,705	76,005
Maintenance	46,430	46,430	36,898	9,532
Professional services	10,000	10,000	6,413	3,587
Insurance	10,352	10,352	8,524	1,828
Communication	13,500	13,500	9,087	4,413
Printing and reproduction	100	100	-	100
Education and development	6,100	6,100	2,447	3,653
Miscellaneous	2,900	2,900	1,654	1,246
Total laboratory	<u>935,048</u>	<u>933,548</u>	<u>788,628</u>	<u>144,920</u>

ORANGE WATER AND SEWER AUTHORITY
SCHEDULE OF REVENUES AND EXPENDITURES - BUDGET AND ACTUAL (MODIFIED ACCURAL BASIS) (CONTINUED)
Year Ended June 30, 2008

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>	<u>Variance Positive (Negative)</u>
Expenditures (continued)				
Debt service				
Bonded debt service	\$ 9,658,688	\$ 9,658,688	\$8,410,603	\$ 1,248,085
Capital outlay	18,764,000	18,764,000	16,102,848	2,661,152
Total expenditures	<u>46,392,667</u>	<u>46,392,667</u>	<u>41,156,922</u>	<u>5,235,745</u>
Deficiency of revenues under expenditures	<u>\$ (13,958,667)</u>	<u>\$ (13,958,667)</u>	(6,466,720)	<u>\$ 7,491,947</u>
Reconciliation of modified accrual to full accrual basis				
Principal payments on bonded debt			3,805,000	
Capital interest			871,241	
Change in interest accrual for bonded debt			(97,958)	
Depreciation and amortization			(7,215,175)	
Amortization of bond expense and patent			(69,940)	
Other revenues			2,865	
Capital outlay			<u>16,102,848</u>	
Net income - accrual basis			<u>\$6,932,161</u>	

Orange Water & Sewer Authority
Schedule of Revenues and Expenditures - Project Funds
From Inception Through June 30, 2008

	Project Budget	Cumulative Totals to June 30, 2008	Unexpended Balance as of June 30, 2008
Raw water supply sources:			
Revenues, general fund	<u>\$ 7,806,000</u>	<u>\$ 7,667,630</u>	<u>\$ 138,370</u>
Expenditures:			
Jordan Lake raw water supply intake and pumping facility	\$ 36,000	\$ 19,351	\$ 16,649
Watershed preservation	2,720,000	2,470,497	249,503
Stone quarry acquisition	1,155,000	938,455	216,545
University Lake pump station improvements	12,000	31,675	(19,675)
Stone quarry pump station	1,380,000	1,662,105	(282,105)
Stone quarry pump station 2005 rebid	2,465,000	2,514,608	(49,608)
Raw water security improvements	38,000	30,939	7,061
Total expenditures	<u>\$ 7,806,000</u>	<u>\$ 7,667,630</u>	<u>\$ 138,370</u>
Water treatment:			
Revenues, general fund	<u>\$ 13,669,000</u>	<u>\$ 13,630,749</u>	<u>\$ 38,251</u>
Expenditures:			
Water treatment plant upgrade and expansion	\$ 13,170,000	\$ 13,191,462	\$ (21,462)
Water treatment plant generator rehab	65,000	47,155	17,845
Water treatment plant rehabilitation projects	314,000	246,517	67,483
Water treatment plant security improvements	110,000	80,321	29,679
Jones Ferry Road water treatment plant - secondary containment	10,000	-	10,000
Water treatment plant fire repair	-	(32,565)	32,565
Water treatment plant fire repair	-	97,741	(97,741)
Jones Ferry Road sodium hypochlorite facility	-	119	(119)
Total expenditures	<u>\$ 13,669,000</u>	<u>\$ 13,630,749</u>	<u>\$ 38,251</u>
Finished water pumping:			
Revenues, general fund	<u>\$ 1,228,000</u>	<u>\$ 1,076,015</u>	<u>\$ 151,985</u>
Expenditures:			
Booster pump station at I-40	\$ 1,053,000	\$ 1,061,002	\$ (8,002)
Booster pump station at Barbee Chapel Road	175,000	15,013	159,987
Total expenditures	<u>\$ 1,228,000</u>	<u>\$ 1,076,015</u>	<u>\$ 151,985</u>

Orange Water & Sewer Authority
Schedule of Revenues and Expenditures - Project Funds
From Inception Through June 30, 2008

	Project Budget	Cumulative Totals to June 30, 2008	Unexpended Balance as of June 30, 2008
Finished water storage:			
Revenues, general fund	\$ 130,000	\$ 102,036	\$ 27,964
Expenditures:			
1.5 million gallon northern tank in 740 FT pressure zone	\$ 100,000	\$ 98,939	\$ 1,061
Finished water storage security improvements	30,000	3,097	26,903
Total expenditures	\$ 130,000	\$ 102,036	\$ 27,964
Water transmission & distribution:			
Revenues, general fund	\$ 5,000,000	\$ 3,652,260	\$ 1,347,740
Expenditures:			
Water main - road improvement projects	\$ 242,000	\$ 117,141	\$ 124,859
Water line rehabilitation, replacement projects	3,151,000	1,927,791	1,223,209
Abbey Road/Booth Road water main replacement	205,000	123,022	81,978
Reinforcement projects	958,000	1,023,501	(65,501)
Cleveland Drive water main replacement	-	86,706	(86,706)
12" water main - Fordham Boulevard	102,000	86,465	15,535
16" water main - East Franklin Street	102,000	65,091	36,909
Cameron Avenue water line replacement	15,000	9,699	5,301
Water distribution system hydraulic model update	225,000	212,843	12,157
Total expenditures	\$ 5,000,000	\$ 3,652,260	\$ 1,347,740
Wastewater collection lines:			
Revenues, general fund	\$ 10,459,000	\$ 8,178,946	\$ 2,280,054
Expenditures:			
Bolin Creek interceptor (Phase III)	\$ 992,000	\$ 330,064	\$ 661,936
Friday Center/meadowmont area interceptor	174,000	87,225	86,775
Morgan Creek interceptor	412,000	958,094	(546,094)
Bolin Creek Basin - rehabilitation and replacement projects	2,846,000	2,550,897	295,103
Booker Creek Basin - sewer line/manhole rehabilitation	158,000	294	157,706
Morgan Creek Basin - rehabilitation and replacement projects	-	(5,151)	5,151
Service area sewer line rehabilitation and replacement projects	910,000	690,126	219,874
Meeting of the waters interceptor	4,967,000	3,567,397	1,399,603
Total expenditures	\$ 10,459,000	\$ 8,178,946	\$ 2,280,054

Orange Water & Sewer Authority
Schedule of Revenues and Expenditures - Project Funds
From Inception Through June 30, 2008

	Project Budget	Cumulative Totals to June 30, 2008	Unexpended Balance as of June 30, 2008
Waste water pumping stations & forcemains:			
Revenues, general fund	<u>\$ 2,278,000</u>	<u>\$ 1,702,727</u>	<u>\$ 575,273</u>
Expenditures:			
Pump station improvements	\$ 164,000	\$ 71,655	\$ 92,345
Heritage Hills pump station and force main replacement	599,000	581,147	17,853
Lloyd Street/starlight pump station phase out	431,000	714,994	(283,994)
Oaks I, Cleland Drive pump station phase out project	603,000	108,967	494,033
Clayton Road pump station phase out project	310,000	99,563	210,437
Tinkerbell pump station phase out project	10,000	2,775	7,225
Piney Mountain pump station construction	161,000	123,626	37,374
Total expenditures	<u>\$ 2,278,000</u>	<u>\$ 1,702,727</u>	<u>\$ 575,273</u>
Wastewater treatment & disposal:			
Revenues, general fund	<u>\$ 66,585,438</u>	<u>\$ 62,140,877</u>	<u>\$ 4,444,561</u>
Expenditures:			
Mason Farm wastewater treatment plant 14.5 MGD upgrade and expansion	\$ 60,611,438	\$ 55,004,381	\$ 5,607,057
Mason Farm wastewater treatment plant 18.5 MGD upgrade and expansion	100,000	253	99,747
Mason Farm biosolids dewatering facilities	1,960,000	1,927,593	32,407
Wastewater Treatment Plant Odor Control	300,000	106,861	193,139
Mason Farm wastewater treatment plant - flood protection enhancement	50,000	-	50,000
Mason Farm wastewater treatment plant rehabilitation and improvement project	128,000	33,983	94,017
Mason Farm wastewater treatment plant digester system upgrades	-	40,944	(40,944)
Mason Farm wastewater treatment plant odor improvements	300,000	500,884	(200,884)
Reclaimed water treatment, pumping and storage facilities	1,776,000	2,344,230	(568,230)
Reclaimed water transmission system	1,360,000	2,181,748	(821,748)
Total expenditures	<u>\$ 66,585,438</u>	<u>\$ 62,140,877</u>	<u>\$ 4,444,561</u>
Central office & operations:			
Revenues, general fund	<u>\$ 16,000</u>	<u>\$ 14,108</u>	<u>\$ 1,892</u>
Expenditures:			
Administration building	\$ 16,000	\$ 14,108	\$ 1,892
Total expenditures	<u>\$ 16,000</u>	<u>\$ 14,108</u>	<u>\$ 1,892</u>
Information services:			
Revenues, general fund	<u>\$ 921,600</u>	<u>\$ 762,267</u>	<u>\$ 159,333</u>
Expenditures:			
Information services	\$ 921,600	\$ 762,267	\$ 159,333
Total expenditures	<u>\$ 921,600</u>	<u>\$ 762,267</u>	<u>\$ 159,333</u>

ORANGE WATER AND SEWER AUTHORITY
Net Assets by Components
Last Six Fiscal Years
(accrual basis of accounting)

	Fiscal Year					
	2008	2007	2006	2005	2004	2003
Invested in capital assets, net of related debt	\$ 177,287,377	\$ 161,812,115	\$ 160,813,755	\$ 137,441,321	\$ 110,634,726	\$ 136,790,615
Restricted for maintenance reserve and power fund	1,168,081	1,127,192	1,894,497	2,320,261	265,052	4,452,759
Restricted for future capital projects	-	-	-	16,794,642	34,552,532	6,287,943
Restricted for debt service	154,388	185,258	31,088	-	-	-
Unrestricted	5,993,719	14,546,839	6,611,972	7,373,853	15,468,674	6,076,872
	<u>\$ 184,603,565</u>	<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 Six Fiscal Years
(accrual basis of accounting)

	Fiscal Year					
	2008	2007	2006	2005	2004	2003
Operating revenues						
Water	\$ 16,378,833	\$ 14,218,387	\$ 13,946,421	\$ 12,489,800	\$ 11,873,860	\$ 10,394,529
Sewer	11,046,437	10,272,920	9,682,210	8,563,004	8,619,485	7,607,718
Service initiation fees	169,603	142,086	153,670	134,958	132,294	97,660
Other	1,199,220	780,178	649,081	703,905	530,853	573,057
Total operating revenues	<u>28,794,093</u>	<u>25,413,571</u>	<u>24,431,382</u>	<u>21,891,667</u>	<u>21,156,492</u>	<u>18,672,964</u>
Operating expenses						
Water supply and treatment	2,441,028	2,261,394	2,159,244	1,935,704	1,822,522	1,885,679
Water distribution	2,275,756	1,962,980	1,710,117	1,917,141	1,733,384	1,781,525
Sewer treatment	2,981,891	2,865,782	3,042,830	2,080,670	1,954,191	1,973,766
Sewer collections	1,134,682	1,539,591	1,352,661	1,342,978	1,329,066	1,205,400
General and administrative	4,467,944	4,428,491	3,809,200	3,689,846	3,468,158	3,458,288
Customer relations	672,147	707,614	966,972	961,862	830,284	798,852
Maintenance	1,881,395	1,979,957	1,860,938	1,600,231	1,623,525	1,538,062
Lab	788,628	890,108	821,955	780,707	722,984	651,825
Depreciation and amortization	7,215,175	6,950,774	6,871,350	6,538,782	6,312,316	5,995,331
Total operating expenses	<u>23,858,646</u>	<u>23,586,691</u>	<u>22,595,267</u>	<u>20,847,921</u>	<u>19,796,430</u>	<u>19,288,728</u>
Operating income (loss)	<u>4,935,447</u>	<u>1,826,880</u>	<u>1,836,115</u>	<u>1,043,746</u>	<u>1,360,062</u>	<u>(615,764)</u>
Nonoperating revenues (expenses):						
Customer fees	1,995,415	2,514,450	2,308,651	1,872,820	2,716,555	1,962,517
Investment adjustment	584,031	995,354	742,010	821,194	211,708	337,442
Interest expense	(3,832,320)	(4,361,911)	(2,724,951)	(3,140,164)	(1,216,166)	(1,799,578)
Amortization of bond expense and patent	(69,940)	(96,898)	(141,579)	(115,063)	(163,362)	(192,634)
Other	2,865	16,431	(58,846)	(39,569)	44,588	(106,101)
Income (loss) before contributions	<u>3,615,498</u>	<u>894,306</u>	<u>1,961,400</u>	<u>442,964</u>	<u>2,953,385</u>	<u>(414,118)</u>
Capital contributions						
Capital grants and contributions	926,504	650,097	153,232	336,404	537,571	-
Contribution in aid of construction	2,390,159	6,775,689	3,306,603	2,229,725	3,821,839	1,817,642
Total capital contributions	<u>3,316,663</u>	<u>7,425,786</u>	<u>3,459,835</u>	<u>2,566,129</u>	<u>4,359,410</u>	<u>1,817,642</u>
Increase in net assets	<u>6,932,161</u>	<u>8,320,092</u>	<u>5,421,235</u>	<u>3,009,093</u>	<u>7,312,795</u>	<u>1,403,524</u>
Net assets						
Beginning	177,671,404	169,351,312	163,930,077	160,920,984	153,608,189	152,204,665
Ending	<u>\$ 184,603,565</u>	<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
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
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
2008	3,002,669	-	2,701,000

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 Revenues to Debt Service Requirements	Net Bonded Debt Per Customer
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
2008	19,998	14,732,933	9,535,182	110,880,000	1.55	5,545.00

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
Year Ended June 30, 2008

	<u>Percent of Water Sales 2008</u>
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		Outstanding Delinquent Taxes
		Amount	Percent of Original Levy		Amount	Percentage of Adjusted Levy	
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	99.95%	*
2005	25,615,621	25,480,324	99.47%	110,800	25,591,124	99.90%	365,806 (1)
2006	27,718,753	27,578,410	99.49%	116,297	27,694,707	99.91%	20,745
2007	28,558,565	28,409,166	99.48%	108,108	28,517,274	99.86%	28,845
2008	30,412,485	30,240,782	99.44%	-	30,240,782	99.44%	171,704

*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 2005 and prior.

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)	Total Assessed Value	Total Direct Tax Rate (4)	Estimated Actual Taxable Value (5)	Ratio of Assessed Value to Estimated Actual Value (6)
1999	*	*	\$ 2,457,855,819	\$ 365,092,224	\$ 60,078,208	\$ 2,883,026,251	\$ 0.538	\$ 3,258,393,141	88.48%
2000	*	*	2,501,345,508	381,872,039	60,948,410	2,944,165,957	0.563	3,546,333,362	83.02%
2001	*	*	2,589,768,417	388,087,936	61,660,255	3,039,516,608	0.578	3,145,846,210	96.62%
2002 (2)	*	*	3,556,294,528	403,959,196	60,873,428	4,021,127,152	0.504	4,459,990,186	90.16%
2003	*	*	3,688,289,625	415,023,471	63,868,306	4,167,181,402	0.553	4,725,767,070	88.18%
2004	*	*	3,791,942,402	455,906,761	57,587,809	4,305,436,972	0.553	5,139,473,525	83.77%
2005	*	*	3,918,233,860	482,128,300	57,774,008	4,458,136,168	0.575	4,664,298,146	95.58%
2006 (1)	3,956,681,069	783,355,893	4,740,036,962	498,524,879	60,840,533	5,299,402,374	0.522	5,905,284,571	89.74%
2007	3,640,445,489	1,249,997,134	4,890,442,623	520,961,320	61,554,945	5,472,958,888	0.522	6,098,683,851	89.74%
2008	3,825,506,198	1,313,540,280	5,139,046,478	460,567,284	60,142,623	5,659,756,385	0.522	6,306,837,960	89.74%

*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.

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

	Years Taxes Payable									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Chapel Hill Within Orange County:	*			*				*		
<u>Town Direct Rates:</u>										
General Fund	0.498	0.524	0.535	0.461	0.510	0.502	0.516	0.474	0.474	0.474
Transportation	0.040	0.039	0.043	0.043	0.043	0.051	0.059	0.048	0.048	0.048
Downtown Service District	0.062	0.062	0.062	0.062	0.062	0.062	0.062	0.053	0.090	0.090
<u>Overlapping Rates:</u>										
Orange County	0.902	0.919	0.929	0.805	0.845	0.880	0.868	0.843	0.903	0.950
Chapel Hill- Carrboro School District	0.192	0.220	0.220	0.202	0.192	0.200	0.200	0.183	0.189	0.204
Total	1.694	1.764	1.789	1.573	1.652	1.695	1.705	1.601	1.704	1.766
Chapel Hill Within Durham County:										
<u>Town Direct Rates:</u>										
General Fund	0.498	0.524	0.535	0.504	0.510	0.502	0.516	0.474	0.474	0.474
Transportation	0.040	0.039	0.043	0.043	0.043	0.051	0.059	0.048	0.048	0.048
<u>Overlapping Rates:</u>										
Durham County	0.940	0.930	0.930	0.729	0.753	0.763	0.790	0.809	0.809	0.834
Total	1.478	1.493	1.508	1.276	1.306	1.316	1.365	1.331	1.331	1.356

* Revaluation year

Source: County tax departments

ORANGE WATER AND SEWER AUTHORITY
Town of Chapel Hill, NC Demographic and Economic Statistics
 Last Ten Fiscal Years

<u>Year</u>	<u>Population (1)</u>	<u>Personal Income (in thousands)(2)</u>	<u>Per Capita Personal Income (3)</u>	<u>Median Age (3)</u>	<u>Education Level in Years of Schooling (4)</u>	<u>School Enrollment (4)</u>	<u>Unemployment Rate % (5)</u>
1999	43,977	\$ 3,169,976	\$ 16,288	24.8	14.72	32,375	1.3
2000	46,019	3,327,229	24,133	24.8	14.72	33,520	1.2
2001	48,902	3,583,041	24,133	24.8	14.72	34,462	1.8
2002	50,542	3,800,280	32,126	24.0	15.82	34,628	3.1
2003	51,005	3,877,363	33,125	24.2	15.82	37,012	4.0
2004	51,485	3,902,027	33,211	24.2	15.82	37,587	3.0
2005	51,519	4,122,336	37,121	24.2	15.82	37,308	4.0
2006	52,397	4,667,922	38,629	24.2	15.82	35,260	3.9
2007	53,416	5,060,894	41,435	24.2	15.82	38,718	2.9
2008	54,903	*	41,435	24.2	15.82	39,864	4.0

* 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.

ORANGE WATER AND SEWER AUTHORITY
Miscellaneous Statistical Data
Year Ended June 30, 2008

Year Founded and Incorporated	1975
Size of Service Area:	
Square Miles	31
Miles of Water Pipe	389
Miles of Wastewater Collection Pipe	318
Customer Accounts	19,998
Budgeted Employee Positions	150
Water Treatment Plant Capacity (in MGD):	
Capacity	20.0
Production Average, FY 2007 - 2008	8.2
Production Peak, FY 2007 - 2008	9.7
Wastewater Treatment Plant Capacity (in MGD):	
Capacity	12.0
Average Daily Flow, FY 2007 - 2008	7.4
Peak Day Flow, FY 2007 - 2008	14.4
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 Equivalents
 Last Six Fiscal Years

Department	2008	2007	2006	2005	2004	2003
General and Administrative						
Office of the Executive Director	9	9	9	9	9	8
Engineering	15	15	15	15	15	15
Human Resources	6	6	6	6	6	6
Finance	7	7	7	7	7	7
Purchasing	2	2	2	2	2	2
Business Information Services	4	4	4	4	4	4
Operations						
Customer Service	8	8	13	13	13	13
Water Supply and Treatment	13	13	13	13	13	13
Water Distribution	32	32	27	27	27	27
Plants Maintenance	14	15	15	15	15	15
Laboratory	10	10	10	10	10	9
Wastewater Treatment	15	14	14	14	14	14
Sewer Collection	15	15	15	15	15	15
Total FTE's	<u>150</u>	<u>150</u>	<u>150</u>	<u>150</u>	<u>150</u>	<u>148</u>

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

Independent Auditors' 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

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 (the "Authority"), a component unit of the Town of Chapel Hill, North Carolina, as of and for the year ended June 30, 2008, which collectively comprise the Authority's basic financial statements, and have issued our report thereon dated September 20, 2008. 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 opinion 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 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 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 Authority'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 Authority's financial statements that is more than inconsequential will not be prevented or detected by the Authority's internal control. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as findings 08-01, 08-02, 08-03 and 08-04 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 Authority'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, we believe none of the significant deficiencies described above is a material weakness.

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*.

The Authority's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the Authority's responses and, accordingly, we express no opinion on them.

We noted certain matters that we reported to management of the Authority in a separate letter dated September 20, 2008.

This report is intended solely for the information and use of management, others within the organization, members of the Board of Directors, and federal 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.

CHERRY, BEKAERT & HOLLAND, L.L.P.



Raleigh, North Carolina
September 20, 2008

**Independent Auditors' Report on Compliance With Requirements
Applicable to Each Major State Program And Internal Control
Over Compliance In Accordance With Applicable Sections of OMB Circular A-133
and the State Single Audit Implementation Act**

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

Compliance

We have audited the compliance of Orange Water and Sewer Authority (the "Authority"), a component unit of the Town of Chapel Hill, North Carolina, 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 each of its major State programs for the year ended June 30, 2008. The Authority's major State programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major State programs 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, as described in the *Audit Manual for Governmental Auditors in North Carolina*, and the State Single Audit Implementation Act. Those standards, applicable sections of OMB Circular A-133, and 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 of 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 each of its major State programs for the year ended June 30, 2008.

Internal Control Over Compliance

The management of the Authority is responsible for establishing and maintaining effective internal control over compliance with the 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.

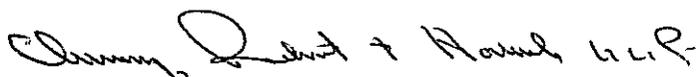
A *control deficiency* in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a State program on a timely basis. A *significant deficiency* is a control deficiency, or combination of control deficiencies, that adversely affects the Authority'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 Authority'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 the Authority's internal control.

Our consideration of 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 federal 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.

CHERRY, BEKAERT & HOLLAND, L.L.P.



Raleigh, North Carolina
September 20, 2008

ORANGE WATER AND SEWER AUTHORITY
Schedule of Findings and Questioned Costs
Year Ended June 30, 2008

Section I - Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

- Material weaknesses identified? ___ yes X no
- Significant deficiencies identified that are not considered to be material weaknesses X yes ___ none reported

Noncompliance material to financial statements noted ___ yes X no

State Awards

Internal control over major State program:

Material weaknesses identified? ___ yes X no

- Significant deficiencies identified that are not considered to be material weaknesses ___ yes X none reported

Type of auditors' report issued on compliance for major State programs: Unqualified

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

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

Section II - Financial Statement Findings

Finding 08-01

Criteria: An entity's internal controls should detect material adjustments needed to the financial statements prior to the year-end audit.

Condition and Context: During the audit, several material adjustments were proposed by the auditor and subsequently booked by the Authority. These entries specifically related to accruals of liabilities and a reclassification of entries initially posted to net assets.

ORANGE WATER AND SEWER AUTHORITY
Schedule of Findings and Questioned Costs
Year Ended June 30, 2008

Section II - Financial Statement Findings (Continued)

Effect: The auditor proposed adjusting journal entries were subsequently posted by management.

Cause: The Authority's year-end close out procedures did not properly entail appropriate adjustment of all balance sheet accounts.

Recommendation: The Authority should develop and implement controls to ensure that all accounts are properly adjusted and closed at year-end.

Views of responsible officials: See Corrective Action Plan

Finding 08-02

Criteria: An entity should have antifraud and internal controls in place.

Condition and Context: The Authority currently does not have a control or policy in place in which adjusting journal entries are required to be reviewed by someone independent of the preparation function.

Effect: Journal entries could possibly be fraudulently created and posted to the accounting records without detection.

Cause: Policies are not in place requiring adjusting journal entries to be reviewed by someone independent of the preparation function.

Recommendation: The Authority should develop and implement controls to ensure that all adjusting journal entries are reviewed and approved by someone independent of the preparation process, preferably a member of management.

Views of responsible officials: See Corrective Action Plan

Finding 08-03

Criteria: An entity should have antifraud and internal controls in place.

Condition and Context: There is a lack of segregation of duties in the cash disbursements process. An accounts payable clerk has the ability to set up a vendor, apply payments to that vendor, and apply the required dual signatures electronically on blank check stock.

Effect: Fraudulent disbursements could possibly be made without detection.

Cause: Duties surrounding the accounts payable process are not properly segregated amongst employees.

Recommendation: The Authority should segregate the duties surrounding the accounts payable disbursement process.

Views of responsible officials: See Corrective Action Plan

ORANGE WATER AND SEWER AUTHORITY
Schedule of Findings and Questioned Costs
Year Ended June 30, 2008

Finding 08-04

Criteria: An entity should have antifraud and internal controls in place.

Condition and Context: The Authority currently does not have a control or policy in place in which monthly bank reconciliations are required to be reviewed by someone independent of the preparation function.

Effect: Inappropriate transactions could occur and not be detected.

Cause: Policies are not in place requiring monthly bank reconciliations to be reviewed by someone independent of the preparation function.

Recommendation: The Authority should develop and implement controls to ensure that all monthly bank reconciliations are reviewed and approved by someone independent of the preparation process, preferably a member of management.

Views of responsible officials: See Corrective Action Plan

Section III - Findings and Questioned Costs for State Awards

None

ORANGE WATER AND SEWER AUTHORITY
Schedule of Expenditures of State Awards
 Year Ended June 30, 2008

<u>Grantor/Pass-through Grantor/Program Title</u>	<u>State/ Pass-through Grantor's Number</u>	<u>State Expenditures</u>
State Grants:		
Cash Assistance:		
Passed through N.C. Department of Environment and Natural Resources		
N.C. Clean Water Management Trust Fund		
Grant #2004A-509	DENR-4	\$ <u>926,504</u>

Note to Schedule of Expenditures of State Financial Awards

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 presented in this schedule is presented in accordance with the State Single Audit Implementation Act.

ORANGE WATER AND SEWER AUTHORITY
Corrective Action Plan
Year Ended June 30, 2008

Section II - Financial Statement Findings

Finding 08-01

Name of Contact Person: Kevin Ray, Director of Finance

Corrective Action: With recent turnover in Finance Department management, several year-end tasks historically associated with the Accounting Manager, specifically the accrual of unpaid leave and salaries liabilities, were not completed in a timely manner. The department now has a full complement and a review of tasks and responsibilities is underway to ensure appropriate knowledge retention and transfer.

Proposed Completion Date: July 21, 2008

Finding 08-02

Name of Contact Person: Kevin Ray, Director of Finance

Corrective Action: Again related to turnover in the Accounting Manager position, the managerial review of each journal entry has been a basic control for many years. Not all, but a number of entries were not reviewed after the departure of the Accounting Manager. The position is now filled and the control has been reviewed with staff and is again in place.

Proposed Completion Date: July 21, 2008

Finding 08-03

Name of Contact Person: Kevin Ray, Director of Finance

Corrective Action: All disbursements are physically reviewed and certified by the Finance Officer. Under this control, the Accounts Payable Clerk has been given the ability to create a vendor. This function has been transferred to managerial staff.

Proposed Completion Date: July 21, 2008

Finding 08-04

Name of Contact Person: Kevin Ray, Director of Finance

Corrective Action: The Accounting Manager historically has provided this review. With the recruitment of a new manager, this function has been reinstated.

Proposed Completion Date: July 21, 2008

ORANGE WATER AND SEWER AUTHORITY
Summary Schedule of Prior Audit Findings
Year Ended June 30, 2008

Section II – Financial Statement Findings

Finding 07-01

Finding: Several significant balance sheet accounts did not have their reconciliations performed in a timely manner or these reconciliations were not prepared prior to the closing of the year-end trial balance.

Corrective Action Plan: The Authority had completed reconciliations for significant balance sheet accounts as of June 30, 2008 prior to the closing of the year-end trial balance.

Finding 07-02

Finding: Several contracts were noted as not being evaluated for capital lease versus operating lease status in accordance with accounting principles generally accepted in the United States of America (“GAAP”).

Corrective Action Plan: Leases were identified by management for proper treatment in accordance with GAAP in the current year.

Finding 07-03

Finding: Certain Construction in Process (CIP) accounts were being depreciated before the assets were formally placed into service.

Corrective Action Plan: CIP is no longer being depreciated prior the assets being placed into service.