



Cape Fear
Public Utility Authority

Stewardship. Sustainability. Service.

Comprehensive Annual Financial Report
Cape Fear Public Utility Authority
Wilmington, North Carolina

FOR THE FISCAL YEAR ENDED
JUNE 30, 2010



COMPREHENSIVE ANNUAL FINANCIAL REPORT

CAPE FEAR PUBLIC UTILITY AUTHORITY WILMINGTON, NORTH CAROLINA For The Fiscal Year Ended June 30, 2010

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Contents

Introductory Section (Unaudited)	
Letter of Transmittal	1 - 6
Organizational Chart	7
Certificate of Achievement for Excellence	8
Financial Section	
Independent Auditor's Report	9 - 10
Management's Discussion and Analysis (Unaudited)	11 - 17
Basic Financial Statements:	
Statement of Net Assets	19
Statement of Revenues, Expenses and Changes in Net Assets	20
Statement of Cash Flows	21 - 22
Notes to the Financial Statements	23 - 44
Required Supplementary Information - Other Post-Employment Benefits	45
Supplementary Schedules:	
Schedule of Revenues and Expenditures – Budget and Actual - Operating Fund	46 - 47
Schedule of Revenues and Expenditures – Capital Project Funds - Water and Sewer	48 - 49
Statistical Section (Unaudited)	
Statistical Section Overview	51
Net Assets by Component	52
Change in Net Assets	53
Schedule of User Rates	54
Principal Customers	56 - 57
Consumption by Customer Group	58
Schedule of New Connections	59
Pledged-Revenue Coverage	60
Demographic Statistics	61
Full Time Equivalent Employees	62
Water Production and Wastewater Treatment	63
Operating Statistics	64
Compliance Section	
Independent Auditor's Report	
on Internal Control Over Financial Reporting and on Compliance and Other Matters Based	
on an Audit of Basic Financial Statements Performed in Accordance With	
<i>Government Auditing Standards</i>	65
Schedule of Findings and Responses	66
Schedule of Prior Audit Findings	67
Schedule of Expenditures of Federal and State Awards	68

Introductory Section (Unaudited)

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October 29, 2010

To the Cape Fear Public Utility Authority Board, Customers, and Bondholders:

We are pleased to submit the Comprehensive Annual Report (CAFR) of the Cape Fear Public Utility Authority (CFPUA) for the fiscal year ended June 30, 2010. This report conforms to 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).

CFPUA'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 assurance regarding (1) the safeguarding of assets against loss from unauthorized use or disposition and (2) the reliability of financial records for preparing financial statements in conformity with accounting principles generally accepted in the United States of America and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed its likely benefits and the evaluation of costs and benefits requires estimates and judgments by managements.

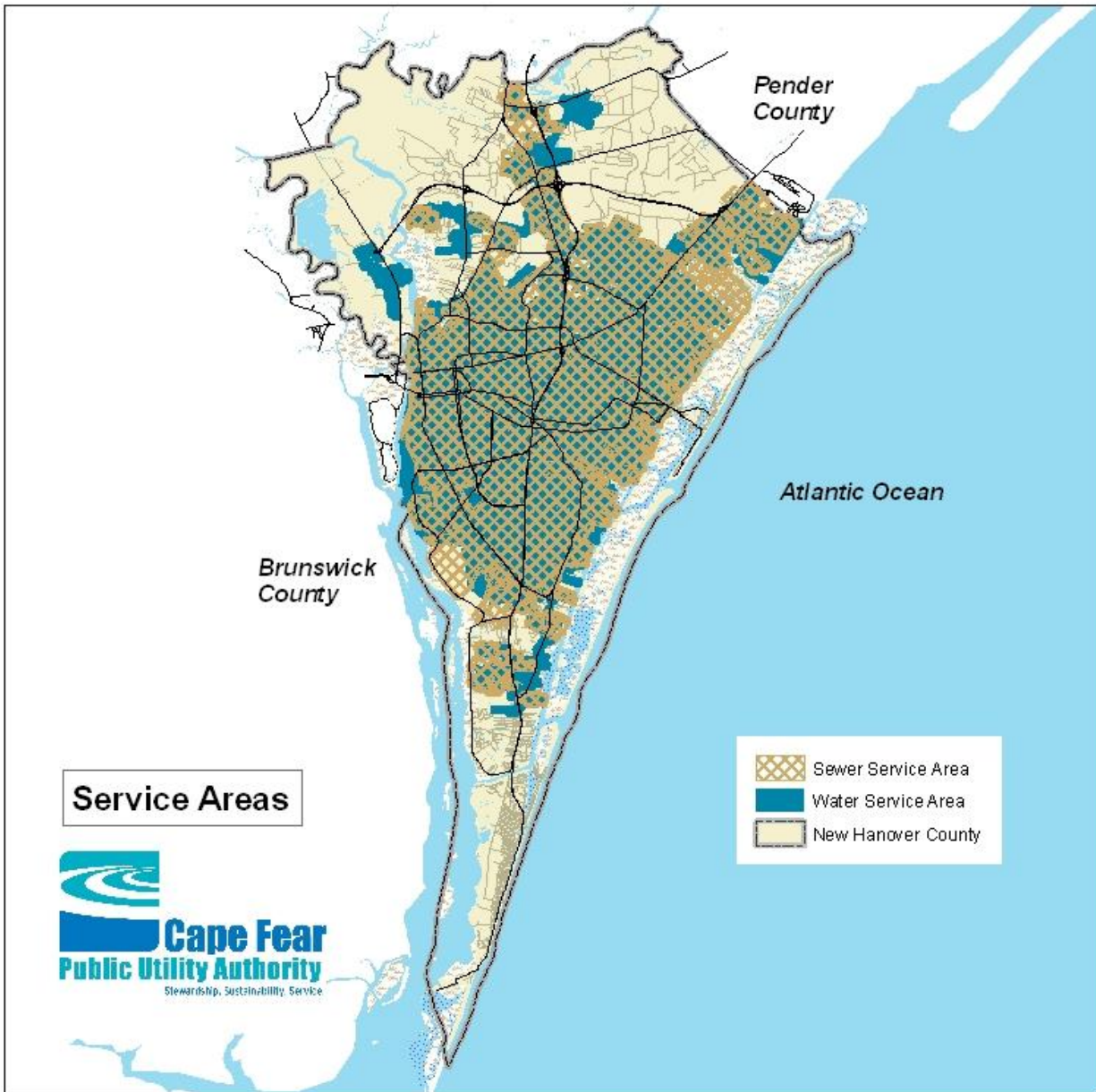
Management assumes full responsibility for both the accuracy of the data presented and the completeness and fairness of the presentation, including all disclosures. To the best of our knowledge and belief, the enclosed financial data is accurate in all material aspects and fairly presents the financial position of the Authority. All disclosures necessary to enable the reader to gain an understanding of the Authority's financial activities have been included.

Please refer to the Management's Discussion and Analysis (MD&A) and the basic financial statements for detailed information on CFPUA's financial performance in FY 2010. The basic financial statements have been audited by our independent auditors, McGladrey & Pullen, LLP, who issued an unqualified opinion on the financial statements of the Authority for the year ending June 30, 2010. Their audit was performed in accordance with generally accepted auditing standards and government auditing standards, and accordingly, included such tests of the accounting records and other such auditing procedures as they considered necessary. The independent auditor's report is presented as the first component of the financial section of this report.

The Authority was formed by the City of Wilmington and New Hanover County to combine the water and sewer operations of the two entities on July 1, 2008. The Cape Fear Public Utility Authority was established pursuant to the Chapter 162A, Article 1 of the North Carolina General Statutes, known as the North Carolina Water and Sewer Authorities Act. The Authority's service area consists of the City of Wilmington and areas of New Hanover County served by the New Hanover County Water and Sewer District (District). It does not include the municipalities of Carolina Beach, Kure Beach, and the Town of Wrightsville Beach. The population in the service area is approximately 184,000 in an area encompassing approximately 100 square miles. New Hanover County is the second smallest county in North Carolina by land area and is also the second most densely populated of the 100 counties.

An eleven-member board governs the Authority. The City and County appoint five members each, with two of those appointments coming from their respective governing boards. The eleventh member is jointly appointed. The Authority board is responsible for the adoption of the annual budget, setting water and sewer rates, making policy decisions; and appoints the Executive Director, Clerk to the Board, and Authority's General Counsel.

The annual budget serves as the foundation for the Authority's financial planning and control. The annual operating budget is adopted by the Authority board at a functional level with capital projects ordinances adopted on a multi-year basis. The Authority's operations are accounted for and reported as an enterprise fund, as provided services are funded by user fees and charges. Budget-to-actual comparisons are provided in this report for the annually appropriated operating fund. Multi-year capital projects are presented on a separate schedule with year to date and project to date information.



System Description

The water system is comprised of the City's former surface water system and the District's former groundwater system. Although there are currently no interconnects between the systems, the Capital Improvement Program (CIP) includes several interconnects to integrate the two systems. There are a total of 65,899 water connections and 1,129 miles of distribution lines at June 30, 2010.

The surface water system is served by the Sweeney treatment plant with a current permitted capacity of 27.5 million gallons per day (MGD). Raw water for the plant comes from an intake on the Cape Fear River in Bladen County and is transported 24 miles by pipeline to the plant. The Sweeney plant is currently under construction to replace the 1943 section of the plant with improved treatment processes and to increase capacity to 35 MGD initially and eventually to 44MGD without any additional capital expense. Average production during the year was 13.3 MGD.

The groundwater system is currently served by 36 wells and a new groundwater plant. The system has a capacity of approximately 6.7 MGD, with average production during the year of 3.3 MGD. This new plant provides high quality water through a nano-filtration system.

The wastewater system consists of 881 miles of gravity mains, 504 miles of force mains, and 142 lift stations to collect and carry the communities' wastewater to two treatment plants. A third wastewater package plant serves a very small portion of the service area. The plants currently can treat up to 22.1 MGD and both discharge treated effluent to the Cape Fear River. Average daily flow during the year was 16.8 MGD. There were a total of 65,047 wastewater connections at June 30, 2010. The Authority also treats the discharge from the Town of Wrightsville Beach collection system.

Economic Condition and Outlook

The service area of the Authority, comprising most of New Hanover County, continues to be the economic, medical, and educational hub for the surrounding counties that comprise southeastern North Carolina. The area has been one of the fastest growing in the nation with a population increase of over 21% since 2000. Tourism is the area's largest economic component in terms of employment and revenues. New Hanover County was ranked eighth out of 100 counties in the state with over \$390 million in travel-related revenues in calendar year 2009. Tourism provided over 5,200 jobs with an annual payroll of almost \$92 million in New Hanover County.

Major employers in New Hanover County with 1,000 or more employees include New Hanover Regional Medical Center, New Hanover County Board of Education, University of North Carolina at Wilmington, New Hanover County, Verizon Wireless, PPD Inc, Cape Community College, Corning Incorporated, and the City of Wilmington.

The area has been significantly affected by the current economic crisis. Sales tax receipts in New Hanover County are down approximately 16% for the year ending June 30, 2010 with room occupancy tax receipts down 2.6%. In recent years, the building industry has also been impacted. For the fiscal year ended June 30, 2010, New Hanover County has reported a 20% increase in the number of building permits and a 49% reduction in project costs compared to the prior year. The unemployment rate at June 30, 2010 of 9.4% remained about the same, compared to North Carolina's 10.2% and United States' 9.6%. The effect of the economic downturn on the Authority has been felt both in water and sewer consumption, as water consumption decreased 10.8% and sewer consumption decreased 4.5%.

Major Initiatives and Accomplishments for FY 2010

In the Authority's second year of operations a number of initiatives were undertaken. These initiatives embrace the Authority's guiding principles of Stewardship, Sustainability, and Service.

Capital Projects: The Authority currently has in excess of fifty active capital projects. During the year ending June 30, 2010 over \$51 million in expenditures on capital projects were incurred. A number of the projects were underway by the City and County when CFPWA began operations. The Capital Improvement Plan (CIP) for the eight-year period from FY 2011 to FY 2018 totals over \$285 million. The largest capital expenditures during the year were for the following projects:

- Sweeney Water Treatment – \$73.9 million project begun to replace the 1943 section of the plant and increase capacity from 25.9MGD to 35 MGD. Ongoing project.
- Nano Water Treatment Plant and Well Field – \$43.5 million project to construct a new 6 MGD treatment plant and supporting well field was completed in November 2009.
- Northern Route Force Main – \$28.3 million project to install a 24" force main will allow the Authority to send much of the northeast interceptor flow to the Northside Waste Water treatment plant in 2011. Ongoing project.
- New Environmental Services Building – The Sweeney Water Treatment plant displaced the Authority's laboratory. This \$4.6 million project constructed a new lab and building adjacent to the new Nano Water Treatment Plant. Completed 2010.
- Northern Campus Regional Wastewater System – \$17.2 million project to provide utilities to two new schools and construct a regional pump station. Completed 2010.
- Ogden Interceptor Replacement - \$5.5 million project to replace approximately 9,500 feet of 36" pipe that failed prematurely. Ongoing project.
- Southside Wastewater Treatment Plant Rehab & Upgrade – Design of an upgrade of treatment processes and capacity expansion. Ongoing Project.
- Repair existing infrastructure –Various emergency sewer repairs totaling \$1.4 million.
- Pump Station 2 Improvements - \$1.1 million project. Completed 2010.

Interlocal Agreements – The Authority entered into an interlocal agreement with the Pender County to design and permit a wastewater treatment plant to serve portions of the U.S. 421 corridor in New Hanover and Pender Counties.

Cash Management

The Authority's investment policy is designed to minimize credit and market risk while maintaining a competitive yield on its portfolio. Available cash is invested in interest bearing demand deposits, certificates of deposit, obligations of the U.S Treasury, and the North Carolina Capital Management Trust (an SEC registered money market fund), in accordance with North Carolina General Statute 159-30. Deposits are either insured by federal depository insurance or are collateralized by securities held by the State Treasurer's agent in the name of the State Treasurer. Note 2 of the Notes to the Financial Statements provides additional information on Cash and Investments.

Risk Management

The Authority has a self-insured medical insurance program with administration of the program by BlueCross and Blue Shield of North Carolina. The Authority's program maintains stop-loss coverage for claims on an individual basis once a claim reaches \$85,000 during a contract period. The Authority has established a reserve for estimated claims incurred but not reported as of June 30, 2010 of \$343,533.

The Authority is also self-insured for workers' compensation claims. Specific and Aggregate Excess Workers Compensation and Employers Liability Indemnity insurance provides protection against compensable claims during the policy year above the self insured specific retention of \$350,000, up to the maximum limits provided under the North Carolina Workers' Compensation Act and up to \$1,000,000 each accident or disease for Employer's Liability. In addition, the insurance would provide protection against cumulative retained losses after the Authority's aggregate costs reach a minimum of \$972,083 for claims occurring during the policy period and would then provide an additional \$1,000,000 of coverage, with any losses beyond the \$1,000,000 limit being retained by the Authority. The Authority has established a reserve for existing claims as of June 30, 2010 of \$201,000.

For other risk the Authority maintains insurance coverage for property damage and general liability (including liability for vehicles and public officials). The coverages are placed by New Hanover County Risk Management pursuant to an interlocal agreement with the Authority.

Certificate of Achievement for Excellence in Financial Reporting

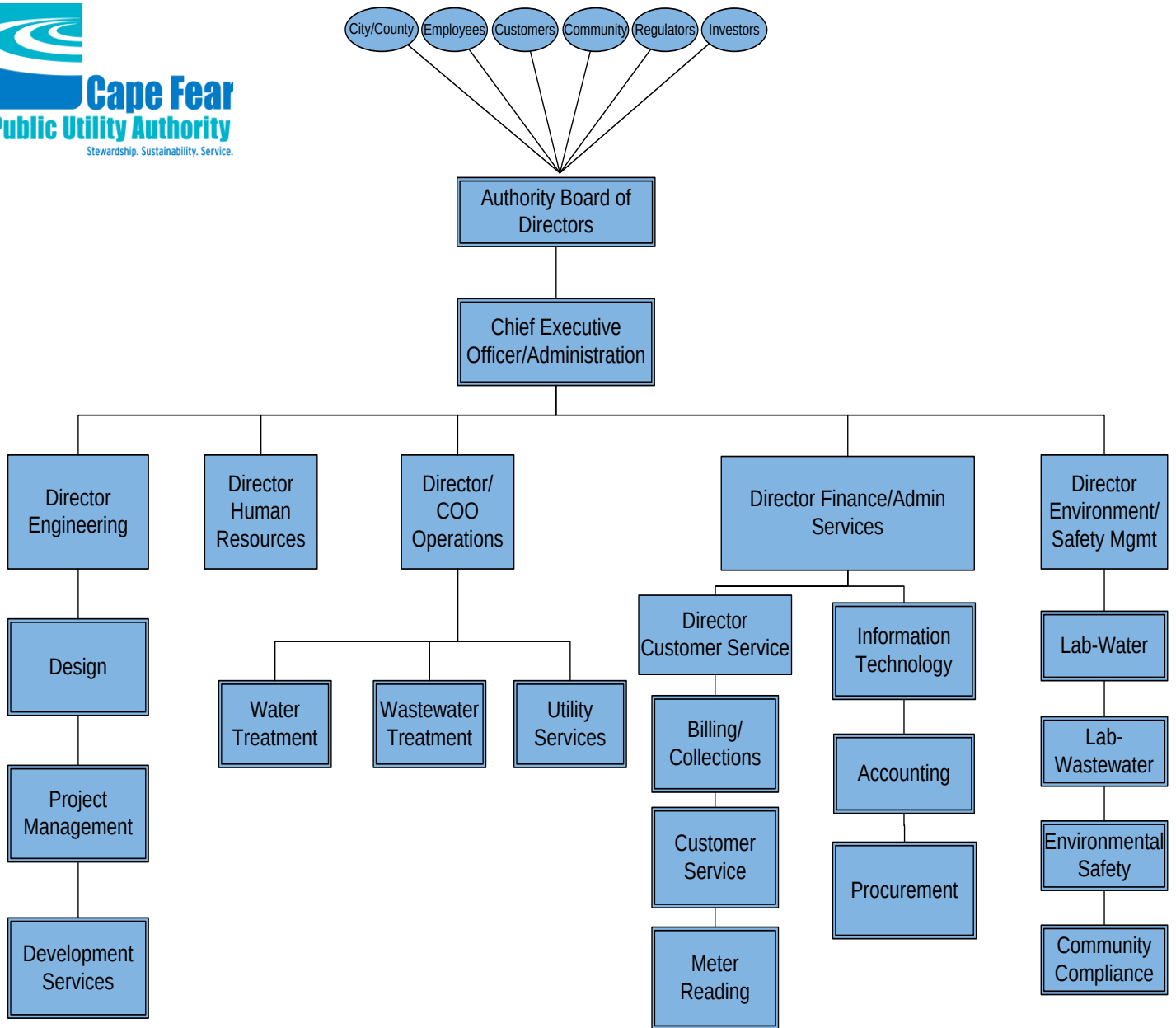
The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Authority for the first year for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended June 30, 2009. The Certificate of Achievement is a prestigious national award, recognizing conformance with the highest standards for preparation of state and local government financial reports. To receive the award, the government must publish an easily readable and efficiently organized CAFR whose contents conform to program standards. The Certificate is valid for one year only. We believe our current report continues to conform to the program requirements, and are submitting it to GFOA for review.

Acknowledgements

Appreciation is expressed for the support of the Authority members for their policy guidance in financial matters. Preparation of this report was accomplished through the dedicated efforts of the entire staff of the Finance department. I would like to especially express my appreciation to Julie McLawhon for her contribution.

Respectfully submitted,

Cheryl J. Spivey
Chief Financial Officer



Certificate of Achievement for Excellence in Financial Reporting

Presented to
Cape Fear Public Utility Authority
North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2009

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



President

Executive Director

Financial Section

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Independent Auditor's Report

To the Board of Directors
Cape Fear Public Utility Authority, North Carolina
Wilmington, North Carolina

We have audited the accompanying basic financial statements of Cape Fear Public Utility Authority (the "Authority") as of and for the year ended June 30, 2010, 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.

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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate to the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Cape Fear Public Utility Authority as of June 30, 2010, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 13 to the financial statements, the Authority adopted new methods of accounting and financial reporting for intangible assets and derivative instruments during the year ended June 30, 2010.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 29, 2010 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Management's Discussion and Analysis on pages 11 through 17 and the Other Post-Employment Benefits Schedule of Funding Progress and Schedule of Employer Contributions on page 45 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements of Cape Fear Public Utility Authority taken as a whole. The supplementary schedules listed in the table of contents on pages 46 through 49 and the introductory section and statistical sections are presented for purposes of additional analysis and are not a required part of the basic financial statements. The accompanying schedule of expenditures of federal and State awards is presented for purposes of additional analysis as required by the OMB Circular A-133, and the State Single Audit Implementation Act, and is not a required part of the basic financial statements. The supplementary schedules and the schedule of expenditures of federal and State awards have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying introductory and statistical sections, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

McGladrey & Pullen, LLP

Wilmington, North Carolina
October 29, 2010

Management's Discussion and Analysis - Unaudited

(Cape Fear Public Utility Authority)

The management of Cape Fear Public Utility Authority, (the "Authority"), offers readers of our financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2010. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal, which can be found on pages 1 through 6 of this report.

Financial Highlights

- The overall financial condition of the Authority improved during the year ending June 30, 2010. Assets of the Authority exceeded its liabilities at the close of the fiscal year by \$359.6 million (net assets). Of this amount, \$64.3 million is unrestricted net assets that may be used to meet the Authority's ongoing obligations to customers and creditors.
- The Authority's net assets increased by \$5.7 million in fiscal year 2010 with the increase in unrestricted assets accounting for \$3.8 million.
- Total operating revenues were \$49.8 million, an increase of \$7.0 million or 16% over the prior year. Rates for water and sewer charges were increased in January 2010 and in May 2010.
- Total operating expenses (including depreciation and amortization) were approximately \$43.5 million, a decrease of \$1.4 million, or 3.1% from fiscal 2009.
- Operating income increased to \$6.4 million from an operating loss of \$2.0 million in the prior year.
- Overall debt coverage increased from 1.05 to 1.47 for fiscal year 2010, remaining above the 1.0 ratio required by bond covenants. Coverage on revenue bond debt increased from 2.59 to 3.27 for fiscal 2010, with a minimum 1.2 ratio required by revenue bond covenants.
- The Authority maintained a credit rating of AA from Standard & Poor's for the Series 2008 Revenue Bonds that were issued in August 2008. The Authority's rating with Moody's was recalibrated to AA2.

Overview of the Financial Statements

The Authority's primary mission is to provide water and sewer services to the City of Wilmington and to the unincorporated areas of New Hanover County. The Authority does not provide other general purpose government services or programs. The Authority'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, the Authority is considered to be, and therefore presents the Authority's financial report, as a stand-alone enterprise fund.

Enterprise fund financial statements. As a stand-alone enterprise fund, the Authority'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 the Authority's financial position. To provide a better understanding of 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* presents information on the Authority's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Authority is improving or deteriorating.

Management's Discussion and Analysis - Unaudited

(Cape Fear Public Utility Authority)

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the Authority's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods.

The basic enterprise fund financial statements can be found on pages 19 through 22 of this report.

Notes to Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 23 through 44 of this report.

Financial Analysis

Table A presents the Condensed Statement of Net Assets for the years ended June 30, 2010 and June 30, 2009.

The Cape Fear Public Utility Authority's Condensed Statement of Net Assets

Table A

	June 30, 2010	June 30, 2009 (Restated)
Current assets	\$ 91,442,506	\$ 85,079,887
Noncurrent assets-restricted and other	76,055,828	130,195,049
Noncurrent assets-capital	534,154,033	488,053,290
Total assets	701,652,367	703,328,226
Current liabilities	32,293,356	29,758,914
Noncurrent liabilities	309,770,739	319,641,564
Total liabilities	342,064,095	349,400,478
Net Assets		
Invested in capital assets, net of related debt	295,307,938	293,467,066
Unrestricted	64,280,334	60,460,682
Total net assets	\$ 359,588,272	\$ 353,927,748

As noted earlier, net assets may serve over time as a useful indicator of an Authority's financial position. In the case of the Authority, assets exceeded liabilities by \$359.6 million at June 30, 2010. The Authority's net assets increased by \$5.7 million for fiscal year ending June 30, 2010. Capital assets net of related debt comprised 82.1% of total net assets at June 30, 2010. These capital assets are essential in providing water and sewer services to our customers and consequently, these assets are not available for future spending. The resources needed to repay the associated debt must be provided by other sources. At June 30, 2010, these other resources totaled \$64.3 million, an increase of 6.3%, or \$3.8 million over the prior year. As mentioned earlier, the increase in operating revenues associated with decreased operating expenditures was primarily responsible for the increase in unrestricted assets in the current year.

Management's Discussion and Analysis - Unaudited

(Cape Fear Public Utility Authority)

Table B presents for the reader the Condensed Statement of Revenues, Expenses and Changes in Net Fund Assets for the years ended June 30, 2010 and June 30, 2009. Contributions from other governments in 2009 reflect the transfer of assets from the City of Wilmington and New Hanover County at the formation of the Authority.

Condensed Statement of Revenues, Expenses and Change in Net Assets

Table B

	Year Ended June 30, 2010	Year Ended June 30, 2009 (Restated)
Revenue		
Operating revenue		
Charges for services	\$ 49,837,887	\$ 42,726,268
Other operating revenue	-	139,595
Nonoperating revenue		
Investment earnings	4,105,897	5,970,732
Contributions from the City of Wilmington and New Hanover County	1,900,000	64,627,498
Capital contributions		
Capital contributions from the City of Wilmington and New Hanover County	-	285,873,980
Capital contributions-other	7,982,758	9,551,179
Total revenue	63,826,542	408,889,252
Expenses		
Operating expenses	30,357,906	32,454,018
Depreciation and amortization	13,096,230	12,400,153
Nonoperating expense		
Interest expense	10,909,406	9,674,421
Amortization	235,208	432,912
Impairment of capital assets	3,567,268	-
Total expenses	58,166,018	54,961,504
Increase in net assets	5,660,524	353,927,748
Net assets, July 1	353,927,748	-
Net assets, June 30	\$ 359,588,272	\$ 353,927,748

Management's Discussion and Analysis - Unaudited

(Cape Fear Public Utility Authority)

The condensed two-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:** The Authority is not empowered to levy or collect taxes. The Authority did receive a contribution of \$1.9 million from New Hanover County in fiscal year 2010. This contribution will continue at the \$1.9 million level through fiscal year 2013 and then gradually reduce over the next five years with a final contribution of \$.3 million in fiscal year 2018. Except for this contribution, which accounted for 3% of total revenues in fiscal year 2010, the Authority's operations, capital expansion program, and debt service are funded almost entirely from fees charged to our customers. As such, the Authority's revenue stream is impacted by fluctuations in demand for our services and other economic factors.
- **Charges for services:** Revenues increased by \$7.0 million from the prior fiscal as a result of rate changes implemented in January 2010 and in May 2010. The January rate change affected only the fixed monthly charge for water and sewer service and resulted in an increase of approximately 7% in total charges on an annualized basis. The May 2010 rate change increased both fixed and volumetric charges by 14%.
- **Decreased demand:** The rate increases were partially offset by a decrease in billed volumes. Overall water volumes consumed decreased by 10.8% from the prior year. Residential demand, which constituted 70% of water demand in the prior year declined by 12% while non-residential demand was down 7.8%. Billed volumes for sewer service declined by 4.5% from fiscal year 2009. Sewer volumes for residential customers are capped at 30,000 gallons and as a result declines in water volumes do not result in the same decrease for sewer. Residential sewer volumes were down 6.2% from the prior fiscal year while non-residential was declined by .5%.
- **Operating expenses:** Operating expenses (excluding depreciation and amortization) decreased 6.5% from the prior year and on a budgetary basis, expenditures for operations were 12% below the adopted budget. The Schedule of Revenues and Expenditures on pages 46 - 47 provides additional budgetary information presented on a modified accrual basis. Several factors contributed to the decrease in expenses, including a reduction in authorized positions, maintaining vacant positions, and improved purchasing processes for goods and services.
- **Other revenues:** Investment earnings decreased from \$6.0 million to \$4.1 million as yields declined and bond proceeds were drawn down for capital project expenditures. Capital contributions from developers declined from \$9.6 million to \$8.0 million. Cash contributions included in this category in the form of impact fees were \$2.3 million in fiscal year 2010, down from \$2.7 million collected in 2009.

Management's Discussion and Analysis - Unaudited

(Cape Fear Public Utility Authority)

Capital Assets and Debt Administration

Capital Assets. The Authority's investment in capital assets totals \$534.2 million (net of accumulated depreciation and amortization) at June 30, 2010. Table C presents the Changes in Net Capital Assets for the year ended June 30, 2010. The major assets include water plants, wastewater treatment plants, pump stations, water distribution systems, and the wastewater collection system.

Cape Fear Public Utility Authority's Capital Assets Net of Depreciation and Amortization

Table C

	Beginning Balances, as Restated (1) July 1, 2009	Increases	Retirements	Transfers	Ending Balances June 30, 2010
Capital assets not being depreciated:					
Land	\$ 7,182,245	\$ -	\$ -	\$ -	\$ 7,182,245
Intangible Asset-Easements	-	1,096,042	-	-	1,096,042
Construction in progress	71,936,983	36,619,051	-	(48,815,999)	59,740,035
Total capital assets not being depreciated or amortized	79,119,228	37,715,093	-	(48,815,999)	68,018,322
Capital assets being depreciated or amortized:					
Plant, Structures and Improvements	150,587,308	9,841,277	(2,437,930)	44,590,576	202,581,231
Water and Sewer Lines	264,880,842	12,585,094	(1,323,582)	4,225,423	280,367,777
Furniture, Fixtures and Machinery	3,594,302	2,592,094	-	-	6,186,396
Intangible Asset-Computer Software	480,992	30,683	-	-	511,675
Intangible Asset-Water Availability Rights	1,988,116	-	-	-	1,988,116
Total capital assets being depreciated or amortized	421,531,560	25,049,148	(3,761,512)	48,815,999	491,635,195
Less:					
Accumulated depreciation	(12,400,153)	(12,892,748)	194,244	-	(25,098,657)
Accumulated amortization	(197,345)	(203,482)	-	-	(400,827)
Net depreciable assets	(12,597,498)	(13,096,230)	194,244	-	(25,499,484)
Total capital assets, net	\$ 488,053,290				\$ 534,154,033

- (1) Certain amounts presented in prior year's data have been reclassified to be consistent with the current year's presentation. In addition, refer to Note 13 to the financial statements for discussion of retroactive adoption of certain accounting standards that impact these balances.

Management's Discussion and Analysis - Unaudited

(Cape Fear Public Utility Authority)

Major capital asset events during the current fiscal year included the following:

- The NANO water treatment plant was put into service, representing \$47.2 million of the \$52 million increase in plants and structures at June 30, 2010. This plant's raw water supply is provided by 25 wells and can treat up to 6 million gallons per day utilizing a nano filtration process.
- Construction in progress increased by \$36.6 million with \$26.7 million related to the Sweeney water treatment plant expansion.
- Retirements of \$3.8 million were related to the impairment of two capital assets. A portion of the Ogden gravity sewer line (\$1.3 million) was replaced after less than 11 years in service. Certain existing facilities at the Northside Wastewater Treatment Plant are not being fully utilized with the upgrade in the treatment process and were reduced in carrying value by \$2.5 million as a result.
- Developer contributions of \$5.3 million are included in the increases in capital assets.

Additional information on the Authority's capital assets can be found in Note 4 on page 31 of this report.

Debt Administration The Authority's long term debt, presented in Table D below, totaled \$318.5 million at June 30, 2010, net of applicable premiums, discounts and deferred refunding charges. Except for an increase of \$.5 million for a capitalized lease, no new long term debt was issued by the Authority in 2010. A \$1.5 million loan from the State of North Carolina has been approved but no funds had been drawn as of June 30, 2010. The Authority's bond coverage on pledged revenue debt was 3.27 at June 30, 2010, with a minimum 1.2 coverage required.

Cape Fear Public Utility Authority's Outstanding Long-Term Debt

Table D

	2010	2009
Revenue Bonds	\$ 259,225,928	\$ 261,888,896
General Obligation Bonds:		
Locality compensation payment	16,371,000	21,605,709
Installment Obligations:		
Locality compensation payment	42,475,207	45,007,970
Capitalized Leases	413,381	155,324
Totals	\$ 318,485,516	\$ 328,657,899

The Authority assumed the long term obligations of the City of Wilmington and New Hanover County on July 1, 2008 for water and sewer related debt. At that time, the total debt assumed was \$184.6 million with \$67.2 million of that amount in outstanding revenue bonds.

The Authority issued \$187,765,000 in revenue bonds in August 2008 to pay for water and sewer capital improvements and to refund \$42 million in New Hanover County Certificates of Participation that the Authority had assumed on July 1, 2008. The capital improvements funded by this debt issuance included the Sweeney plant expansion, NANO water treatment facility, and improvements to the Northeast Interceptor sewer force main. The City and County had either started construction or were in final design on these projects when the Authority began operations on July 1, 2008.

Additional information on the Authority's long term debt can be found in Note 8 beginning on page 36 of this report.

Management's Discussion and Analysis - Unaudited
(Cape Fear Public Utility Authority)

Budget Highlights for the Fiscal Year Ending June 30, 2011

The Authority's adopted FY 2011 budget for operations is \$37.4 million as compared to \$38 million in FY 2010. This decrease comes despite the first full year of operation of the new NANO water treatment plant. Reductions in personnel costs offset this and other increases in operating costs. Full-time positions have been reduced to 291 from 304 in FY 2010 and from 309 in the FY 2009.

Revenues are projected to increase to \$58.5 million in FY 2011 from \$55.4 million in the adopted FY 2010 budget. Revenues reflect the 14% increase in May 2010 but contain no increase in water consumption over FY 2010. The rate increase was primarily required to fund increased debt service. Debt service in FY 2011 increases significantly as the first principal payment on the 2008 revenue bonds comes due and capitalized interest used to offset interest expense on these bonds is reduced. FY 2011 net debt service is \$20.3 million compared to \$16.6 million in FY 2010. Full debt service on the 2008 bonds begins in FY 2012 with total debt service reaching \$26 million with no capitalized interest offset.

The Authority will continue to closely monitor revenues and consumption patterns in FY 2011 and will make adjustments to expenditure levels as needed.

Requests for Information

This report is designed to provide an overview of the Authority's finances for those with an interest in this area. Questions concerning any of the information found in this report or requests for additional information should be addressed to the Cape Fear Public Utility Authority, Finance Department, 235 Government Center Drive, Wilmington, NC 28403.

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Cape Fear Public Utility Authority

Statement of Net Assets

June 30, 2010

ASSETS

Current assets

Cash and cash equivalents	\$ 62,257,666
Receivables, net	15,365,807
Due from other governments	3,130,724
Restricted cash and cash equivalents	7,768,094
Restricted receivables	256,059
Prepays	45,198
Inventories	1,462,885
Deferred outflow of resources	1,156,073
Total current assets	91,442,506

Noncurrent assets

Restricted cash and cash equivalents	71,871,327
Unamortized bond issuance costs	4,184,501
Capital assets:	
Land and construction in progress	68,018,322
Other capital assets, net	466,135,711
Total capital assets	534,154,033
Total noncurrent assets	610,209,861
Total assets	701,652,367

LIABILITIES

Current liabilities

Current maturities of long-term obligations	11,062,073
Accrued interest payable	4,564,512
Customer deposits	559,169
Due to other governments	3,903,547
Accounts payable and accrued liabilities	2,469,240
Compensated absences	762,781
Unearned revenue	47,867
Accounts payable from restricted assets	7,768,094
Derivative instrument - interest rate swap	1,156,073
Total current liabilities	32,293,356

Noncurrent Liabilities

Compensated absences	260,320
Other postemployment benefits (OPEB)	2,086,976
Long-term obligations, net of current maturities	307,423,443
Total noncurrent liabilities	309,770,739
Total liabilities	342,064,095

NET ASSETS

Invested in capital assets, net of related debt	295,307,938
Unrestricted:	
Designated for post employment benefits	4,242,871
Undesignated	60,037,463
Total net assets	\$ 359,588,272

See Notes to Financial Statements.

Cape Fear Public Utility Authority

**Statement of Revenue, Expenses and Changes in Net Assets
For the Year Ended June 30, 2010**

Operating revenue	
Charges for services	<u>\$ 49,837,887</u>
Total operating revenue	<u>49,837,887</u>
Operating expenses	
Personnel and benefits	17,038,778
Services and utilities	10,888,068
Materials	2,431,060
Depreciation and amortization	<u>13,096,230</u>
Total operating expenses	<u>43,454,136</u>
Operating income	<u>6,383,751</u>
Nonoperating revenue (expense)	
Investment earnings	4,105,897
Interest expense	(10,909,406)
Amortization	(235,208)
Contributions from New Hanover County	<u>1,900,000</u>
Total nonoperating (expense)	<u>(5,138,717)</u>
Income before capital contributions, special items and extraordinary items	<u>1,245,034</u>
Capital contributions - other	7,982,758
Special impairment of capital assets	(2,275,200)
Extraordinary impairment of capital assets	<u>(1,292,068)</u>
Total capital contributions, special items and extraordinary items	<u>4,415,490</u>
Increase in net assets	<u>5,660,524</u>
Net assets	
Beginning, as previously reported	353,712,985
Change in accounting principle (Note 13)	<u>214,763</u>
Beginning, as restated	<u>353,927,748</u>
Ending	<u><u>\$ 359,588,272</u></u>

See Notes to Financial Statements.

Cape Fear Public Utility Authority

**Statement of Cash Flows
For the Year Ended June 30, 2010**

Cash Flows From Operating Activities	
Cash received from customers	\$ 49,568,527
Cash paid to suppliers	(13,247,674)
Cash paid to or on behalf of employees	(15,960,688)
Other operating income	3,861
Net cash provided by operating activities	20,364,026
Cash Flows from Noncapital Financing Activities	
Contributions from other governments	3,167,613
Net cash provided by noncapital financing activities	3,167,613
Cash Flows From Capital and Related Financing Activities	
Acquisition and construction of capital assets	(52,889,881)
Principal paid on long-term obligations	(8,480,282)
Interest paid on long-term obligations	(15,048,223)
Capital contributions	2,950,176
Net cash used for capital and related financing activities	(73,468,210)
Cash Flows From Investing Activities	
Investment earnings	5,405,593
Net cash provided by investing activities	5,405,593
Net decrease in cash and cash equivalents	(44,530,978)
Balances, beginning	186,428,065
Balances, ending	\$ 141,897,087
Reconciliation of statement of fund net assets:	
Cash and cash equivalents	\$ 62,257,666
Restricted cash and cash equivalents (current and noncurrent)	79,639,421
Total cash and cash equivalents	\$ 141,897,087

(Continued)

Cape Fear Public Utility Authority

Statement of Cash Flows (Continued)
For the Year Ended June 30, 2010

Reconciliation of Operating Income to Net Cash

Provided by Operating Activities

Operating income	<u>\$ 6,383,751</u>
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Adjustments to reconcile operating income to net cash

provided by operating activities:

Depreciation and amortization	13,096,230
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Changes in assets and liabilities:

(Increase) in receivables and due from other governments	(424,041)
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Decrease in inventories	52,129
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Decrease in prepaids	2,278
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(Decrease) in accounts payable and accrued liabilities	(106,205)
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Increase in customer deposits	281,794
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Increase in compensated absences and OPEB	<u>1,078,090</u>
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Total adjustments	<u>13,980,275</u>
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Net cash provided by operating activities	<u>\$ 20,364,026</u>
--	-----------------------------

Supplemental Schedule of Noncash Activities

Contributions of capital assets from developers	\$ 5,122,845
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Debt payment reduction from New Hanover County	\$ 1,900,000
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See Notes to Financial Statements.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies

The accounting policies and financial statements of the Cape Fear Public Utility Authority ("Authority") have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to governmental units. The Governmental Accounting Standards Board ("GASB") is the accepted standard-setting body for establishing accounting and financial reporting principles. The more significant of the Authority's accounting policies are described below.

Reporting Entity:

Cape Fear Public Utility Authority (the "Authority") was created in 2007 pursuant to Chapter 162A of the North Carolina General Statutes, by the governing bodies of New Hanover County and the City of Wilmington, for the purpose of providing water and sewer services to residents of New Hanover County. The assets and related liabilities of the City of Wilmington and New Hanover County water and sewer systems were transferred to the Authority on July 1, 2008. The Authority is empowered to set rates, fees and charges without oversight, supervision, or direction from any other state or local entity or agency, but has no taxing authority. The Governing Board consists of eleven directors who hold office for staggered terms. The directors are appointed by the governing bodies of New Hanover County and the City of Wilmington. Each of the governing bodies appoints five members and they jointly appoint the eleventh member. The five appointed members from each governing bodies include two current members from those governing bodies.

Accounting principles generally accepted in the United States require that the reporting entity include (1) the primary government, (2) organizations for which the primary government is financially accountable and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete. The criteria provided in Government Accounting Standards Board Codification Section 2100 have been considered and the Authority has identified two blended component units, described below, which are in substance part of the Authority's operations, and so data from these units is combined with data of the Authority. Also, the Authority is not included in any other reporting entity. The Authority is a jointly governed organization, i.e. an entity governed primarily by representatives from other governments. The participants do not retain any ongoing financial interest in or financial responsibility for the Authority.

Blended Component Units:

Cape Fear Utilities, Inc. and Quality Water Supplies, Inc.:

Cape Fear Utilities, Inc. and Quality Water Supplies, Inc., North Carolina nonprofit corporations, exist to provide and maintain a ground water utility system for citizens of Wilmington, North Carolina and the surrounding community. The Authority is the sole shareholder of each corporation and each of the corporations is governed by a board comprised of members of the Authority Board. The corporations have no other operations except for services provided to the Authority and are exempt from income taxes under Section 501(c)(3) of the Internal Revenue Code. The rates for user charges and the annual budget of the ground water utility system are approved by the Authority Board. Therefore the operations of these corporations are combined and reported as an enterprise fund. The corporations do not issue separate financial statements.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Basis of Presentation:

All activities of the Authority are accounted for within a single business-type activity and within a single proprietary (enterprise) fund. Enterprise Funds are used to account for operations that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. An Enterprise Fund is required to be used when an activity is financed with debt that is secured solely by pledges of the net revenues from fees and charges of the activity.

Measurement Focus and Basis of Accounting:

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. Concurrent with the commencement of providing water/sewer services on July 1, 2008, the Authority elected to be treated as a "special-purpose government engaged only in business-type activities" as described in accounting principles generally accepted in the United States of America. The Authority's business-type activities are considered to be undertaken in a single enterprise fund. Enterprise activities are accounted for on the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenue is recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flows take place. Non-exchange transactions, in which the Authority gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants and donations. Revenue from grants and donations is recognized in the fiscal year in which all eligibility requirements have been satisfied.

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the Authority's funds are charges to customers for sales and services. The Authority also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water and sewer system. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

As permitted by accounting principles generally accepted in the United States, the Authority has elected to apply only applicable Financial Accounting Standards Board ("FASB") statements and interpretations issued before November 30, 1989 in its accounting and reporting practices, to the extent that those standards do not conflict with or contradict guidance of the GASB.

Budgets

Budgets are adopted utilizing the modified accrual basis of accounting as required by State statute. An annual budget ordinance is adopted for the operating subfunds. All annual appropriations lapse at fiscal year end. Project ordinances are adopted for capital projects subfunds, which are consolidated with the operating funds for reporting purposes.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Expenditures may not legally exceed appropriations at the functional level for the operating subfund and at the project level for the capital projects subfunds. The budget may be amended as necessary by the governing board. A budget calendar is included in the North Carolina General Statutes which prescribes the last day on which certain steps of the budget procedure are to be performed. The following schedule lists the tasks to be performed and the date by which each is required to be completed.

April 30	Each department head will transmit to the budget officer the budget requests as estimates for their department for the budget year.
June 1	The budget and the budget message shall be submitted to the governing board. The public hearing on the budget should be scheduled at this time.
July 1	The budget ordinance shall be adopted by the governing board.

Assets, Liabilities, and Net Assets

Deposits and Investments

All deposits of the Authority are made in board-designated official depositories and are collateralized as required by State law (G.S. 159-31). The Authority may designate, as an official depository, any bank or savings and loan 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 deposit.

State law [G.S. 159-30(c)] 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 non-guaranteed federal agencies; certain high quality issues of commercial paper and bankers' acceptances; and the North Carolina Capital Management Trust ("NCCMT"), an SEC registered (2a-7) money market mutual fund. The securities of the NCCMT cash portfolio are valued at fair value, which is the NCCMT's share price.

Cash and Cash Equivalents

The Authority pools moneys from several subfunds to facilitate disbursement and investment and to maximize investment income. The Authority considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash and cash equivalents.

Restricted Assets

The unexpended bond proceeds of revenue bonds, certificates of participation and other long-term obligations issued by the Authority are classified as restricted assets under Restricted cash and cash equivalents because their use is restricted to the purpose for which the bonds were originally issued.

Allowance for Doubtful Accounts

All receivables that historically experience uncollectible accounts are shown net of an allowance for doubtful accounts. This amount is estimated by analyzing the aging of account balances.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Inventories

Inventories of materials and supplies are maintained for major items used by the Authority. Inventories are valued at the lower of cost (first-in, first-out method) or market. Inventories are recorded as an asset and materials and supplies are not recorded as an expense until consumed.

Capital Assets

Capital assets are defined by the Authority as assets with an initial, individual cost of more than \$5,000 and estimated useful life in excess of one year. Purchased capital assets are valued at original cost at the time of acquisition. The cost of normal maintenance and repairs which do not add to the value of the asset or materially extend assets' lives are not capitalized. Donated capital assets are recorded at their estimated fair value at the time of donation.

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. The construction interest capitalized during the year ended June 30, 2010 totaled \$4,547,465.

Capital assets, which include buildings, plant, furniture, fixtures, equipment and infrastructure assets, are depreciated using the straight-line method by groups or classes of property over the following expected service lives:

	Years
Plant, Structures and Improvements	20-40
Water and Sewer Lines	50
Furniture, Fixtures and Machinery	5

The Authority may consider capital assets impaired if both; (a) the decline in service utility of the capital asset is large in magnitude and (b) the event or change in circumstances is outside the normal life cycle of the capital asset. Impaired assets will be appropriately reduced in value or discarded if idle.

During the year ended June 30, 2010, the Authority recorded extraordinary impairment charges of \$1,292,068 for a portion of a gravity main that required early replacement due to what appears to be a product defect and special impairment charges of \$2,275,200 for certain assets that were removed from service when a treatment plant expansion was completed at the discretion of management.

Intangible assets consist of water availability rights, easements, and software. The water availability rights are available under an agreement the City of Wilmington entered into with a regional public authority. The agreement makes available fifteen million gallons per day of raw water. The availability rights are being amortized over forty years, the life of the agreement. Easements are recorded at fair value and are not amortized. In accordance with GASB Codification Section 1400, computer software is capitalized with a minimum capitalization cost of \$25,000 and is amortized over a period of 3 to 8 years.

Note 1. Summary of Significant Accounting Policies (Continued)

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. Significant estimates to the financial statements include the unbilled receivables, allowance for doubtful accounts, the estimated useful lives of capital assets, compensated absences, other post employment benefits, medical IBNR reserve, workers' compensation self-insurance, unamortized bond issuance costs, and interest rate swaps.

Long-Term Obligations

Long-term debt is reported as a liability in the statement of net assets, net of applicable bond premiums or discounts. Bond premiums and discounts are deferred and amortized over the life of the bonds using the effective interest method. Bond issuance costs are reported as deferred charges and amortized over the life of the bonds using the straight-line method.

Compensated Absences

The vacation policy of the Authority provides for the accumulation of up to 320 hours earned vacation leave with such leave being fully vested when earned. Accrued vacation at year end totaled \$1,023,101 and is included as compensated absences.

The Authority has adopted a first-in first-out method of using accumulated compensated time. An expense and a liability for compensated absences and the salary related payments are recorded as the personal leave is earned. The portion of the accumulated vacation pay which is expected to be liquidated during the next fiscal year is recorded as a current liability on the statement of net assets.

The Authority's sick leave policy provides for an unlimited accumulation of earned sick leave. Sick leave does not vest, but any unused sick leave accumulated at the time of retirement may be used in the determination of length of service for retirement benefit purposes. Since the Authority does not have any obligation for the accumulated sick leave until it is actually taken, no accrual for sick leave has been made.

Medical Self-Insurance

The Authority is self-insured for group medical insurance and has contracted with Blue Cross and Blue Shield of North Carolina to administer the program. The Authority's program provides for individual stop-loss coverage for claims above a specific amount. The individual stop-loss insurance provides reimbursement to the group plan of all eligible claims paid above \$85,000 on behalf of any participant during the contract period. The stop-loss insurance policy is underwritten by Blue Cross and Blue Shield of North Carolina. A provision of \$343,533 for estimated claims incurred but not reported as of June 30, 2010 has been accrued.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 1. Summary of Significant Accounting Policies (Continued)

Workers' Compensation Self-Insurance

The Authority is self-insured for workers' compensation and employers' liability insurance, and purchases Specific and Aggregate Excess Workers Compensation and Employers Liability Indemnity insurance. The Authority contracted with PMA, Inc., a provider of claims administrative services, to administer the program. The program provides that the Authority is responsible for the first \$350,000 of cost and/or benefits payable to employees resulting from any one accident or event, regardless of the number of persons injured.

Specific and Aggregate Excess Workers Compensation and Employers Liability Indemnity insurance provides protection against compensable claims during the policy year above the self insured specific retention of \$350,000, up to the maximum limits provided under the North Carolina Workers' Compensation Act and up to \$1,000,000 each accident or disease for Employer's Liability. In addition, the insurance would provide protection against cumulative retained losses after the Authority's aggregate costs reach a minimum of \$972,083 for claims occurring during the policy period and would then provide an additional \$1,000,000 of coverage, with any losses beyond the \$1,000,000 limit being retained by the Authority.

A provision of \$201,000 for estimated claims incurred as of June 30, 2010 has been accrued.

Net Assets

Net assets are classified as invested in capital assets, net of related debt, restricted, or unrestricted. Unrestricted net assets are designated for post-employment benefits and undesignated. Invested in capital assets, net of related debt represents the amounts invested in capital asset less any outstanding debt used in the acquisition of those assets. Restricted net assets represent constraints on resources that are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or imposed by law through state statute. Unrestricted net assets consist of net assets that do not meet the definition of "invested in capital assets" or "restricted". Designated for post-employment benefits, unrestricted represents the amount of fund balance available for appropriation that has been designated by the governing board to fund a trust to be established in the next fiscal year for future costs of post-employment benefits.

Significant Violations of Finance-Related Legal and Contractual Provisions

Noncompliance with North Carolina General Statutes

At the fiscal year end, an expenditure was posted to the Workers Compensation Claims account to record estimates for potential workers compensation claims that were incurred. This violates State law because this expenditure causes an excess over the amount in the budget ordinance for Non-departmental appropriations. The Authority has budgeted more adequate funding in fiscal year 2011 for these expenditures.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 2. Cash, Cash Equivalents, Deposits and Investments

Deposits

Custodial credit risk for deposits is the risk that in the event of bank failure, a government's deposit may not be returned to it. The Authority has no policy on custodial credit risk, but all of the Authority's deposits are to be either insured or collateralized by using one of two methods. Under the Dedicated Method, all deposits that exceed the federal depository insurance coverage level are separately collateralized with securities held by the governments' agents in the governments' names. Under the Pooling Method, which is a statewide 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 governments, these deposits are considered to be held by the governments' agents in their name. The amount of the pledged collateral is based on an approved averaging method for non-interest 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 governments or the escrow agents. Because of the inability to measure the exact amounts of collateral pledged for governments under the Pooling Method, the potential exists for under-collateralization, 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 State Treasurer enforces standards of minimum capitalization for all pooling method financial institutions.

At June 30, 2010, the carrying amount of the Authority deposits was \$121,410,161 and the bank balance was \$121,493,992. Of the bank balance, \$250,000 was covered by FDIC insurance and \$121,243,992 was collateralized using the Pooling Method. Cash on hand at June 30, 2010 was \$2,200.

Investments

At June 30, 2010, the Authority had the following investments:

	Fair Value	Maturity Less Than 3 Months
US Government Agencies	\$ 13,456,208	\$ 13,456,208
NC Capital Management Trust - Cash Portfolio	7,028,518	N/A
	<u>\$ 20,484,726</u>	<u>\$ 13,456,208</u>

Interest Rate Risk

As a means of limiting its exposure to fair value losses arising from rising interest rates, the Authority's investment policy limits the weighted average maturity of the investment portfolio to no more than one year. Also, the investment policy requires purchases of securities to have staggered maturities and limits all securities to a final maturity of no more than five years.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 2. Cash, Cash Equivalents, Deposits and Investments (Continued)

Credit Risk and Concentration of Credit Risk

The Authority has no formal policy on managing credit risk. The Authority's investment policy limits investments to the provisions of North Carolina G.S. 159-30(c) and requires the investment security types to be no more than 25% of the total portfolio in a single security type. As of June 30, 2010 the Authority's investments in the NCCMT Cash Portfolio carried a credit rating of AA+ by Standard & Poor's.

The Authority's investments in U.S. Agencies (Federal National Mortgage Association) are rated AAA by Standard & Poor's and Aaa by Moody's Investor's Service.

Custodial Credit Risk

The Authority has no policy on custodial credit risk. However, the Authority contracts with the trust department of a financial institution to hold its investments in the Authority's name.

The Authority has no policy on foreign currency risk.

Note 3. Receivables

The Authority estimates the revenue value of water consumed by its customers near year end but not billed by the last day of the fiscal year. This is done by multiplying the estimated unbilled water usage by the appropriate rates for water and sewer. As of June 30, 2010, the Authority had approximately \$6,737,358 of unbilled receivables included in Accounts receivable – customers, below.

The amounts presented in the Statement of Net Assets are as follows:

Accounts receivable - customers	\$ 18,646,248
Receivable - other	469
Total receivables	18,646,717
Allowance for doubtful accounts	(3,280,910)
Total receivables, net of allowance	\$ 15,365,807

The amounts due from other governments consist of the following:

Refund of sales and use tax paid	\$ 1,557,440
New Hanover County	1,000,000
Other grants and reimbursements	573,284
	\$ 3,130,724

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 4. Capital Assets

Capital assets activity consists of the following for the year ended June 30, 2010. Current depreciation and amortization expense was \$12,892,748 and \$203,482, respectively.

	Beginning Balances as Restated (1)	Increases	Decreases	Transfers	Ending Balances
Capital assets not being depreciated:					
Land	\$ 7,182,245	\$ -	\$ -	\$ -	\$ 7,182,245
Intangible Asset-Easements	-	1,096,042	-	-	1,096,042
Construction in progress	71,936,983	36,619,051	-	(48,815,999)	59,740,035
Total capital assets not being depreciated or amortized	79,119,228	37,715,093	-	(48,815,999)	68,018,322
Capital assets being depreciated or amortized:					
Plant, Structures and Improvements	150,587,308	9,841,277	(2,437,930)	44,590,576	202,581,231
Water and Sewer Lines	264,880,842	12,585,094	(1,323,582)	4,225,423	280,367,777
Furniture, Fixtures and Machinery	3,594,302	2,592,094	-	-	6,186,396
Intangible Asset-Computer Software	480,992	30,683	-	-	511,675
Intangible Asset-Water Availability Rights	1,988,116	-	-	-	1,988,116
Total capital assets being depreciated or amortized	421,531,560	25,049,148	(3,761,512)	48,815,999	491,635,195
Less accumulated depreciation or amortization for:					
Plant, Structures and Improvements	2,525,272	4,872,245	(162,730)	-	7,234,787
Water and Sewer Lines	8,817,860	6,873,717	(31,514)	-	15,660,063
Furniture, Fixtures and Machinery	1,057,021	1,146,786	-	-	2,203,807
Intangible Asset-Computer Software	110,905	117,042	-	-	227,947
Intangible Asset-Water Availability Rights	86,440	86,440	-	-	172,880
Total accumulated depreciation and amortization	12,597,498	13,096,230	(194,244)	-	25,499,484
Total capital assets being depreciated or amortized, net	408,934,062				466,135,711
Capital assets, net	\$ 488,053,290				\$ 534,154,033

- (1) Certain amounts presented in prior year's data have been reclassified to be consistent with the current year's presentation. In addition, refer to Note 13 to the financial statements for discussion of retroactive adoption of certain accounting standards that impact these balances.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 5. Operating Lease

The Authority leases building, office facilities and land under two operating lease arrangements. One lease covers a period of 120 months, with the option to extend the lease for two additional five year periods. A second lease covers a remaining period of 12 months. Total costs for such leases were \$832,518 for the year ended June 30, 2010. The future minimum lease payments as of June 30, 2010 are as follows:

Year Ending June 30	Amount
2011	\$ 859,290
2012	650,785
2013	670,308
2014	690,417
2015	711,130
Thereafter	2,197,440
Total	<u>\$ 5,779,370</u>

Note 6. Benefit 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 Center Service, Raleigh, North Carolina 27699 - 1410, or by calling (919) 981-5454.

Funding policy: Plan members are required to contribute 6% of their annual covered salary. The Authority is required to contribute at an actuarially determined rate. For the Authority, the current rate is 4.80% 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, 2010 and June 30, 2009 were \$630,628 and \$627,104, respectively. The contributions made by the Authority equaled the required contributions for the year.

Supplemental Retirement Income Plan and Deferred Compensation Plan

Plan Descriptions. The Authority offers its employees to participate in the Supplemental Retirement Income Plan, a defined contribution pension plan administered by the Department of State Treasurer and a Board of Trustees. The plan provides retirement benefits to employees of the Authority. Article 5 of G.S. Chapter 135 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly.

The Authority also offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all Authority employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All assets of the plan are held in trust for the exclusive benefit of the participants and their beneficiaries.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 6. Benefit Plan Obligations (Continued)

Funding Policy. The Authority has elected to make contributions on behalf of all employees to the Supplemental Retirement Income Plan or the 457 Deferred Compensation Plan. The Authority's contribution is 2% of covered payroll and contributions are made to the plan selected by the employee. The Authority also matches the contributions made by employees up to 2% of covered payroll. If the employee does not elect either plan, the Authority's contribution is placed into the Supplemental Retirement Income Plan on behalf of the employee.

Employer contributions to the Supplemental Retirement Income Plan totaled \$363,348 and employee contributions and loan repayments were \$370,511 for the year ended June 30, 2010.

Employer contributions to the 457 Deferred Compensation Plan totaled \$145,789 and employee contributions and loan repayments were \$137,582 for the year ended June 30, 2010.

Other Post-employment Benefits

Plan Description. According to the Authority's personnel policy, the Authority provides post-employment health care benefits to retirees of the Authority as a single-employer defined benefit plan, provided they participate in the North Carolina Local Government Employees' Retirement System and were employed by the City or County prior to July 1, 2008 as the years of service were transferred from participating member governments during the initial transition phase of the Authority. Employees transferred from the City of Wilmington must have at least five years of creditable service. Employees transferred from New Hanover County must have at least fifteen years of creditable service. The Authority shares the cost of coverage for these benefits through private insurers with the retiree by paying claims under its medical self-insurance program and charging participants a co-payment amount. Also, the Authority's retirees can purchase coverage for their dependents at the Authority's group rates. A separate report was not issued for the plan.

Membership consisted of 266 active plan members at December 31, 2008, the date of the latest actuarial valuation.

Funding Policy. The Authority's contribution towards the plan is based on a set amount or percentage of the cost of the individual insurance coverage. The Authority is not required to fully fund the annual required contribution (ARC); however, the Authority is required to disclose the unfunded ARC, which must be amortized over future periods. To date, the Authority has chosen to fund these benefits on a pay-as-you-go basis.

The current ARC is 9.04% of annual covered payroll. No contributions were made by the Authority for the current year. Employees contributed \$586 for the current year.

Summary of Significant Accounting Policies. Postemployment benefits are made as they come due from the Authority's operating fund. Assets have been accumulated for OPEB purposes but have not yet been placed in an irrevocable trust fund.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 6. Benefit Plan Obligations (Continued)

Annual OPEB Cost and Net OPEB Obligation. The Authority's annual OPEB cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that if paid on an ongoing basis is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the Authority's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the Authority's net OPEB obligation for the healthcare benefits:

Annual required contribution	\$ 1,043,781
Contributions made	(586)
Increase in net OPEB obligation	1,043,195
Net OPEB obligation, beginning of year	1,043,781
Net OPEB obligation, end of year	<u>\$ 2,086,976</u>

The Authority's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010 and 2009 were as follows:

For The Year Ended June 30	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligations
2010	\$ 1,043,781	0.056%	\$ 2,086,976
2009	1,043,781	0.00%	1,043,781

Funded Status and Funding Progress. As of December 31, 2008, the most recent actuarial valuation date, the plan was not funded. The actuarial accrued liability for benefits and, thus, the unfunded actuarial accrued liability (UAAL) was \$7,167,107. The covered payroll (annual payroll of active employees covered by the plan) was \$11,551,913, and the ratio of the UAAL to the covered payroll was 62.04%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents information about the actuarial value of plan assets and the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions. Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 6. Benefit Plan Obligations (Continued)

In the December 31, 2008 actuarial valuation, the projected unit credit method was used. The actuarial assumptions included a 4.0% investment rate of return, medical cost trend rate varied between 10.5% and 5.0%, and a 3.75% inflation assumption. The UAAL is being amortized as a level percentage of projected unit credit on a level dollar amount, open basis. The remaining amortization period at December 31, 2008 was 30 years.

Note 7. Risk Management

The Authority is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Authority has chosen to establish a risk financing fund for risks associated with the employee's health insurance program and workers' compensation coverage. The Authority carries commercial coverage for all other risks of loss including property and general liability coverage. Claims did not exceed coverage for any category for the fiscal year ending June 30, 2010.

The Authority also carries flood insurance coverage for its facilities with a blanket limit of \$1,000,000 and a deductible of \$100,000 on properties not located within a 100-year flood plain.

The Authority's Chief Financial Officer is individually bonded for \$250,000. The remaining employees that have access to funds are bonded under a blanket bond for \$1,000,000.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported (IBNR). Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends including the frequency and amount of payouts.

Changes in claims liability for the years ended June 30, 2010 and 2009 are as follows:

	2010	2009
Medical Self-Insurance Program		
Unpaid Claims, July 1, 2009	\$ 202,884	\$ -
Incurred Claims (including IBNR)	2,648,456	2,092,061
Claim payments (including fees)	(2,507,807)	(1,889,177)
Unpaid Claims, June 30, 2010	<u>\$ 343,533</u>	<u>\$ 202,884</u>
Workers' Compensation Self-Insurance Program		
Unpaid Claims, July 1, 2009	\$ 20,768	\$ -
Incurred Claims (including IBNR)	262,347	98,663
Claim payments	(82,115)	(77,895)
Unpaid Claims, June 30, 2010	<u>\$ 201,000</u>	<u>\$ 20,768</u>

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 8. Long-Term Obligations

Capital Lease

The Authority has entered into an agreement to lease certain equipment. The lease agreement qualifies as a capital lease for accounting purposes and, therefore, has been recorded at the present value of the future minimum lease payments as of the date of its inception.

The agreement was executed on April 23, 2008 for the lease of computer equipment for a period of 48 months and requiring a monthly payment of \$14,236. At June 30, 2010 the Authority's leased equipment was valued at \$612,731, net of accumulated depreciation of \$293,600, for a net carrying value of \$319,131. The equipment is recorded as Furniture, Fixtures and Machinery.

The future minimum lease obligations and the net present value of these minimum lease payments as of June 30, 2010 are as follows:

Year Ending June 30,	
2011	\$ 170,832
2012	170,832
2013	14,236
Total minimum lease payments	355,900
Less: amount representing interest	20,181
Present value of the minimum lease payments	<u>\$ 335,719</u>

Installment Agreement

In August 2008, the Authority entered into a three-year agreement to pay an annual license fee of \$77,662 for the use of computer software. The final payment of \$77,662 under the licensing agreement is due in September 2011.

Changes in Long-Term Obligations

	July 1, 2009 (1)	Additions	Retirements	(Charges) Premiums (Discounts) Unamortized	Balance June 30, 2010	Current Portion of Balance
Revenue Bonds	\$ 252,741,645	\$ -	\$ 2,320,562	\$ 8,804,845	\$ 259,225,928	\$ 3,329,579
General Obligation Bonds:						
Locality compensation payment	22,561,532	-	5,421,532	(769,000)	16,371,000	4,830,000
Installment Obligations:						
Locality compensation payment	45,202,188	-	2,638,188	(88,793)	42,475,207	2,654,000
Capital lease/installment agreement	155,324	483,846	225,789	-	413,381	248,494
Compensated absences	988,206	797,676	762,781	-	1,023,101	762,781
Other postemployment benefits	1,043,781	1,043,781	586	-	2,086,976	-
Totals	<u>\$ 322,692,676</u>	<u>\$ 2,325,303</u>	<u>\$ 11,369,438</u>	<u>\$ 7,947,052</u>	<u>\$ 321,595,593</u>	<u>\$ 11,824,854</u>

(1) Balance at July 1, 2009 is not net of unamortized charges, premiums, and discounts of \$7,997,210.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 8. Long-Term Obligations (Continued)

The payments of the bonded debt and installment debt for the future years are as follows:

Year Ending June, 30	Bonded Debt		Installment Debt		Total	
	Principal	Interest	Principal	Interest	Principal (1)	Interest
2011	\$8,159,579	\$12,793,562	\$2,654,000	\$1,894,738	\$10,813,579	\$14,688,300
2012	11,029,114	12,397,844	2,712,400	1,799,976	13,741,514	14,197,820
2013	10,124,183	11,987,622	2,781,000	1,701,510	12,905,183	13,689,132
2014	9,149,806	11,589,996	2,847,000	1,598,120	11,996,806	13,188,116
2015	7,831,005	11,236,474	2,920,600	1,470,975	10,751,605	12,707,449
2016-2020	37,567,396	51,064,079	13,969,000	5,286,707	51,536,396	56,350,786
2021-2025	44,435,000	40,674,425	11,350,000	2,199,736	55,785,000	42,874,161
2026-2030	56,855,000	28,265,288	3,330,000	308,026	60,185,000	28,573,314
2031-2035	69,285,000	12,263,250	-	-	69,285,000	12,263,250
2036	13,125,000	328,125	-	-	13,125,000	328,125
Total	267,561,083	\$192,600,665	42,564,000	\$16,259,788	310,125,083	\$208,860,453
Unamortized charges	(1,429,145)		(1,042,768)		(2,471,913)	
Unamortized premiums	9,464,990		953,975		10,418,965	
Net carrying value	\$275,596,928		\$42,475,207		\$318,072,135	

(1) Principal balances do not reflect reduction of debt payments to New Hanover County, as described in the following paragraph.

Pursuant to the inter-local agreement transferring New Hanover County's water and sewer system to the Authority, the Authority assumed responsibility for all of the related debt. However, certain debt instruments could not be transferred to the Authority or refinanced due to the nature of the agreements. Accordingly, the County has retained and is servicing those obligations with the Authority making payments to the County equal to the principal and interest payments required under those debt instruments. Under Section 2.10 of the inter-local agreement, the County agreed to a reduction in the amount of the debt service payments made by the Authority to the County (debt payments reduction amounts) for a period of 10 years, starting with the year ended June 30, 2009. The debt payment reduction amount which reduces the debt service payments to be paid to the County by the Authority was \$1.9 million in both the prior and current year and will be an additional \$1.9 million each year for the next three years. Beginning in the sixth year (2014), the debt payment reduction amounts will consist of \$1.577 million for the sixth year, \$1.254 million for the seventh year, \$950,000 for the eighth year, \$627,000 for the ninth year, and \$304,000 for the tenth year. If at any time the debt payments reduction amounts in a given year are greater than the amounts required to be paid by the Authority to the County, the County will pay the Authority the difference.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 8. Long-Term Obligations (Continued)

Details of the Authority's outstanding long-term obligations at June 30, 2010 are as follows:

Revenue Bonds

\$6,508,316 Refunding Water and Sewer Revenue Bonds, Series 2003 issued to refund Water and Sewer Revenue bonds, the proceeds of which were used for water and sewer system improvements; principal installments due semiannually on June 1 and December 1 in varying amounts from \$195,506 to \$261,107 plus interest through December 1, 2018; interest at a fixed rate of 3.65%. \$ 3,856,083

\$62,400,000 Water and Sewer Revenue and Refunding Revenue Bonds, Series 2005 issued for a wastewater plant expansion, other water and sewer system improvements and to refund \$9,235,000 of Water and Sewer Revenue Bonds, the proceeds of which were used for like improvements; principal installments due annually on June 1 in varying amounts of \$1,725,000 to \$2,875,000 plus interest through June 1, 2034; interest at fixed rates from 3.5% to 5.0%. 58,800,000

\$187,765,000 Water and Sewer Revenue bonds, Series 2008 issued for water and sewer improvements and to refund \$42 million of New Hanover County Certificates of Participation; principal payments due annually on August 1 in varying amounts of \$1,120,000 to \$3,400,000 plus interest through August 1, 2035; interest at rates ranging from 3.5% to 5.0%. 187,765,000

Total Revenue Bonds 250,421,083

General Obligation Bonds

Locality compensation payment payable to City of Wilmington due in annual principal payments on June 1 in varying amounts from \$2,355,000 to \$3,025,000 through June 1, 2015; variable rate semiannual interest payments due June 1 and December 1. 14,210,000

Locality compensation payment payable to New Hanover County due in annual principal payments on June 1 in varying amounts from \$1,125,000 to \$1,805,000 through June 1, 2012; semiannual interest payments due June 1 and December 1 from 2.875% to 3%. 2,930,000

Total General Obligation Bonds 17,140,000

(Continued)

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 8. Long-Term Obligations (Continued)

Installment Obligations

Locality compensation payment to City of Wilmington due in annual principal payments on June 1 ranging from \$850,000 to \$1,550,000 through June 1, 2024; semiannual interest payments due June 1 and December 1 at fixed rates from 4.0% to 5.0%. **\$ 16,265,000**

Locality compensation payment to New Hanover County due in annual principal payments on February 23 ranging from \$1,110,000 to \$1,115,000 through February 23, 2028; semiannual interest payments due August 26 and February 23 at rates ranging from 3.0% to 5.0%. **20,020,000**

Locality compensation payment to New Hanover County due in annual principal payments on August 26 ranging from \$689,000 to \$891,800 through August 26, 2017; semiannual interest payments due August 26 and February 23 at rates ranging from 3.5% to 4.0%. **6,279,000**

Total Installment Obligations **42,564,000**

Total Long-Term Obligations **310,125,083**

Plus Unamortized Charges, Premiums and Discounts **7,947,052**

Net Carrying Value of Long-Term Obligations **\$ 318,072,135**

Unexpended proceeds from the issuance of revenue bonds and certificates of participation are currently held by an escrow agent in the name of the Authority. The proceeds held in the escrow account have been classified as restricted assets because their use is restricted to the purpose for which they were originally issued. The unexpended proceeds will be used for various water and sewer improvement capital projects.

Certain covenants are contained in the revenue bond orders, among the most restrictive of which provides that the Authority maintain a long-term debt service coverage ratio, as defined, of not less than 1.20. The Authority was in compliance with the covenants during the fiscal year ended June 30, 2010.

ARRA Loan

During the year ended June 30, 2010, the Authority was approved for a loan from the State of North Carolina, Department of Environment and Natural Resources (DENR). The loan will be drawn down as expenditures are paid on a certain capital project, to a maximum of \$2,716,357. Half of the loan amount is subject to immediate principal forgiveness under an American Recovery and Reinvestment Act of 2009 (ARRA) program awarded by the Environmental Protection Agency (EPA) through the State Revolving Fund program administered by DENR. The remaining \$1,358,179 will be due in twenty equal, annual installments, commencing on May 1 immediately following the completion of the project. The loan does not bear interest. No amounts are outstanding under this loan as of June 30, 2010.

Interest Rate Swap Agreement

The Interlocal Transition and Operating Agreement established the terms and conditions of the transfer of water and sewer assets of the City and County to the Authority on July 1, 2008. Under that Agreement, the Authority is responsible for reimbursement of payments on water and sewer-related long-term debt that could not be assumed by the Authority. Included in those long-term debt obligations retained by the City was the outstanding balance on Variable Rate General Obligation Bonds, Series 2002, for which the City entered into an interest rate swap agreement (the "swap agreement"). Based on the agreement with the City, after July 1, 2008, the Authority is responsible for payments made and received under this swap agreement. Details on the swap agreement are presented below.

Note 8. Long-Term Obligations (Continued)

Interest Rate Swap Agreement

Objective of the interest rate swap. As a means to lower its borrowing costs and increase its savings, when compared against fixed-rate refunding bonds at the time of issuance in February 2002; the City entered into a pay-fixed, receive variable interest rate swap in connection with its \$28,825,000 Variable Rate General Obligation Refunding Bonds, Series 2002. The intention of the swap agreement was to effectively change the interest rate on the bonds to a synthetic fixed rate of 3.815%. The swap is accounted for as a cash flow hedge and is determined to be effective using the synthetic instrument method.

Terms. The bonds and the related swap agreement mature on June 1, 2015 and the swap's June 30, 2010 notional amount of \$14,210,000 matches the face amount of the variable-rate bonds. The swap was entered into at the same time the bonds were issued (February 2002). The notional value of the swap declines with the principal amount of the associated debt. Under the swap the City (as assumed by the Authority) pays the counterparty a fixed payment of 3.815% and receives a variable payment computed at 67% of the LIBOR. Conversely, the bonds' variable-rate coupons are based on the actual float rate coupons marketed weekly.

Fair value. Because interest rates have declined since execution of the swap, the swap has a negative fair value of \$1,156,073 as of June 30, 2010 which is reported on the government-wide Statement of Net Assets as a governmental activities derivative liability offset by a deferred outflow of resources. The swap's negative fair value may be countered by a reduction in total interest payments required under the variable rate bonds, creating a lower synthetic interest rate. Because the coupons on the variable-rate bonds are adjusted every seven days to changing interest rates, the bonds do not have a corresponding fair value increase. The mark-to-market valuations were established by market quotations from the counterparty representing estimates of the amounts that would be paid for replacement transactions.

Credit risk. As of June 30, 2010 the Authority was not exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the City would be exposed to credit risk in the amount of the derivative's fair value. The swap counterparty was rated A3 by Moody's Investors Service (Moody's), A by Standard and Poor's (S&P) and A+ by Fitch Ratings (Fitch). To mitigate the potential for credit risk, if the counterparty's credit quality falls to A1 by Moody's or A+ by either S&P or Fitch and their exposure exceeds \$5,000,000 the fair value of the swap will be fully collateralized by the counterparty with U.S. government securities. Collateral would be posted with a third party custodian.

Basis risk. The swap agreement exposes the Authority to basis risk should the relationship between LIBOR and the average rate paid on the floating rate coupon converge, changing the synthetic rate on the bonds. The effect of this difference in basis is indicated by the difference between the intended synthetic rates of 3.815% and the synthetic rate as of June 30, 2010 of 3.81%. As of June 30, 2010, the rate on the variable rate Bonds was .23% whereas 67% of LIBOR was .234%.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 8. Long-Term Obligations (Continued)

Termination risk. The City or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. An additional termination event occurs if the counterparty's credit rating falls below Baa1 (Moody's) or BBB+ (S&P and Fitch) by at least two of the rating agencies. The swap may be terminated by the City with 30 days notice and the counterparty can only terminate the swap if the City falls below BBB- with any of the three major rating services. Also, if at the time of termination the swap has a negative fair value, the Authority would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt. Using rates as of June 30, 2010, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for the term of the bonds, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Fiscal Year Ending June 30,	Principal	Interest	Interest Rate Swap, Net	Total
2011	\$ 3,025,000	\$ 32,683	\$ 508,932	\$ 3,566,615
2012	2,985,000	25,726	400,591	3,411,317
2013	2,945,000	18,860	293,683	3,257,543
2014	2,900,000	12,087	188,208	3,100,295
2015	2,355,000	5,417	84,344	2,444,761
Total	<u>\$ 14,210,000</u>	<u>\$ 94,773</u>	<u>\$ 1,475,758</u>	<u>\$ 15,780,531</u>

In connection with the creation of the Authority on July 1, 2008, the interest rate swap agreement continues to be an obligation of the City and all payments required to be made by the City under the agreement are reimbursed to the City by the CFPUA.

The following sets forth a summary of the Authority's derivative instrument as of June 30, 2010: The pay-fixed, receive variable interest rate swap is a cash flow hedge with a notional amount of \$14,210,000 and a negative fair value of \$1,156,073 at June 30, 2010. The negative fair value at June 30, 2010 represents a \$69,396 increase from the prior year and is reported on the Statement of Net Assets as a derivative liability offset by a deferred outflow of resources.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 8. Long-Term Obligations (Continued)

Debt Service Coverage

The Authority has been compliance with the covenants as to the rates, fees, rentals, and charges in Article VI, Section 6.6 of the General Trust Indenture, authorizing the issuance of the Water and Sewer Revenue Bonds, Series 1998. The General Trust Indenture dated as of December 1, 1998 and four series indentures under which the City of Wilmington had issued revenue bonds were assigned to the Authority on July 1, 2008 as provided for in Section 6.11(a) of the General Trust Indenture. Section 6.6 of the General Trust Indenture requires the debt service coverage to be no less than 120% or 1.20 times on revenue bond indebtedness and to be no less than 100% or 1.00 times on total long-term indebtedness. The debt service coverage ratio calculation for the year ended June 30, 2010, is as follows:

Revenues

Operating revenues (1)	\$ 49,837,887
Impact fees	2,287,015
Investment earnings	1,841,500
	<u>53,966,402</u>

Expenses

Operating expenses (2)	43,454,136
Less depreciation and amortization	(13,096,230)
Less OPEB expense	(1,043,781)
	<u>29,314,125</u>

Income available for debt service	<u><u>\$ 24,652,277</u></u>
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Debt Service, principal and interest paid (Revenue bond only)	<u><u>\$ 7,541,016</u></u>
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Debt service, principal and interest paid (Includes all long-term debt) (3)	<u><u>\$ 16,798,861</u></u>
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Debt Service coverage ratio - Revenue bonds only	327%
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Debt Service coverage ratio - All long-term debt	147%
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(1)"Operating Revenues" from the Statement of Revenue, Expenses, and Changes in Net Assets on page 20 of this report.

(2)"Operating Expenses" from Statement of Revenue, Expenses, and Changes in Net Assets on page 20 of this report.

(3)Total long term debt includes revenue bonds, and locality compensation payments for general obligation bonds and installment obligations.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 9. Contributions From Other Governments

Contributions from other governments consist of the following contributions from New Hanover County at June 30, 2010:

Noncapital contributions:

Reduction in debt service payments	\$ 1,900,000
Total contributions from other governments	<u>\$ 1,900,000</u>

Note 10. Pending GASB Statements

The GASB has issued several pronouncements prior to June 30, 2010 that has effective dates that may impact future financial presentations.

Statement No. 57 OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans will be effective for the Authority beginning with its year ending June 30, 2012.

Statement No. 59 Financial Instruments will be effective for the Authority beginning with its year ending June 30, 2011.

Management has not currently determined what, if any, impact implementation of the above statements may have on the financial statements of the Authority.

Note 11. Litigation

The Authority is a party to a number of civil lawsuits and other legal actions. There are also several claims for damages that have not yet resulted in litigation. In the opinion of the Authority attorney and management, the ultimate outcome of these claims is not expected to have a significant impact on the Authority's financial position.

The City of Wilmington (City) and the New Hanover County Water and Sewer District (District) were notified by the Environmental Protection Agency (EPA) prior to the transfer of assets to the Authority on July 1, 2008 that the City and District were in violation of the Clean Water Act (Act). The EPA contention is that the City and District experienced numerous Sanitary Sewer Overflows (SSO's) that violated state and federal regulations. As the owner and operator of the wastewater system formerly operated by the City and District, the Authority has been included in the EPA action.

A tolling agreement was entered into with the EPA that extended the time to settle the claim until October 31, 2010. No admission of violation has been made by the City, District, or the Authority. The City and District retained a total of \$3.0 million for payment of any fine that may eventually be levied. In the opinion of the Authority attorney any fine that may be levied will be substantially less than the amount retained and the final agreement with the EPA will not have a material effect on the Authority's financial position.

Note 12. Commitments and Contingencies

The Authority has active water and sewer capital projects as of June 30, 2010. The Authority's remaining commitments with contractors, developer and professional firms related to these projects is approximately \$66.5 million. The remaining commitments will be funded from the proceeds of revenue bonds and funds generated from operations.

Cape Fear Public Utility Authority

Notes to Financial Statements

Note 12. Commitments and Contingencies (Continued)

The Authority and the City of Wilmington entered into an interlocal agreement on May 6, 2009 to share jointly in the cost of providing water and sewer services to an area that the City is annexing pursuant to North Carolina General Statutes. The agreement calls for the City to install water distribution lines and sewer collection lines to properties in the annexation area that are not served. The City and the Authority are going to share in the upgrade of water distribution mains and sewer pump stations that serve the area. The City's share is estimated at \$9.9 million with the Authority's share estimated at \$7.7 million. The City will transfer ownership for all installed improvements to the Authority upon completion. In addition the City has agreed to the payment of \$393,500 in impact fees for the 88 water and sewer connections. All water and sewer improvements are to be completed by April 2012. The Authority's share of the cost is included in the total construction commitments disclosed above.

Federal and State Assisted Programs

The Authority has been approved to receive proceeds from federal grants under the American Recovery and Reinvestment Act of 2009 (ARRA). Periodic audits of these grants are required and certain costs may be questioned as not being appropriate expenditures under the grant agreements. Such audits could result in the refund of grant moneys to the grantor agencies. Management believes that any required refunds will be immaterial. No provision has been made in the accompanying financial statements for the refund of grant moneys.

Note 13. Change in Accounting Principle

During the year ended June 30, 2010, the Authority adopted GASB Statement No 51, Accounting and Financial Reporting for Intangible Assets. As a result of adoption, the Authority has recorded an increase of \$480,992 for software that was placed into service in prior periods and \$110,905 of prior period accumulated amortization on that software. In addition, the Authority has adjusted opening balances to record a \$155,324 capital lease obligation related to such software. The net impact on opening net asset balances as a result of the adoption of this standard is an increase of \$214,763.

During the year ended June 30, 2010, the Authority adopted GASB Statement No. 53, Accounting and Financial Reporting for Derivative Instruments. As a result of adoption, there was no impact on opening net asset balances.

Cape Fear Public Utility Authority

**Required Supplementary Information
Other Post-Employment Benefits
Schedule of Funding Progress
2009-2010**

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) -Projected Unit Credit	Excess (Deficit) of Assets over AAL	Funded Ratio	Covered Payroll for Year Ending on Valuation Date	Excess (Deficit) as a Percentage of Covered Payroll
12/31/08	\$0	\$7,167,107	(\$7,167,107)	0.00%	\$11,551,913	-62.04%

**Required Supplementary Information
Schedule of Employer Contributions
2009-2010**

Fiscal Years Ended	Annual Required Contribution	Percentage Contributed
2009	\$1,043,781	0.000%
2010	\$1,043,781	0.056%

Notes to the Required Schedules:

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the latest actuarial valuation follows:

Valuation date	12/31/08
Actuarial cost method	Projected unit credit
Amortization method	Level dollar amount, open
Remaining amortization period	30 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return*	4.0%
Medical cost trend rate	10.5%-5.0%
* Includes inflation at	3.75%

Cape Fear Public Utility Authority

**Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis) -
Operating Fund
For Year Ended June 30, 2010**

	Final Budget	Actual	Variance Positive (Negative)
Operating revenues			
Water charges	\$ 23,513,835	\$ 23,455,892	\$ (57,943)
Sewer charges	23,618,474	24,072,451	453,977
Connection fees	445,000	484,058	39,058
Miscellaneous revenue	1,268,000	1,825,965	557,965
Total operating revenues	48,845,309	49,838,366	993,057
Nonoperating revenues			
Customer impact fees	2,110,000	2,287,015	177,015
Investment earnings	1,539,380	1,388,266	(151,114)
Total nonoperating revenues	3,649,380	3,675,281	25,901
Total revenues	52,494,689	53,513,647	1,018,958
Operating expenditures			
General - administrative	3,833,560	3,438,527	395,033
Operations - water and sewer	23,503,500	19,870,805	3,632,695
Environment & safety management	2,193,627	1,897,585	296,042
Customer service	2,674,369	2,639,569	34,800
Nondepartmental	1,650,730	1,720,451	(69,721)
Debt service and fees	23,643,118	23,632,720	10,398
Capital outlay	1,925,617	923,123	1,002,494
Contingency	500,000	-	500,000
Total operating expenditures	59,924,521	54,122,780	5,801,741

(Continued)

Cape Fear Public Utility Authority

**Schedule of Revenues and Expenditures - Budget and Actual (Modified Accrual Basis) -
Operating Fund (Continued)
For Year Ended June 30, 2010**

	Final Budget	Actual	Variance Positive (Negative)
Other financing sources (uses)			
Capital contributions	\$ -	\$ 3,028	\$ 3,028
Transfers out - Capital Projects Funds	(7,900,000)	(7,900,000)	-
Appropriated fund balance	15,329,832	-	(15,329,832)
Total financing sources (uses)	7,429,832	(7,896,972)	(15,326,804)
Revenue and other financing sources over (under) expenditures	\$ -	(8,506,105)	\$ (8,506,105)
Reconciliation of modified accrual basis to full accrual basis:			
Revenue and other financing sources (under)			
expenditures - capital projects funds water and sewer		(38,994,751)	
Capital contributions		5,032,582	
Depreciation		(12,892,748)	
Amortization		(438,690)	
Capital and intangible assets		53,815,971	
Long-term obligations:			
Unamortized charge-interest expense		(403,742)	
Unamortized bond discount/premium-interest income		453,900	
Accrued interest income		(1,753,596)	
Accrued interest expense		45,511	
Other postemployment benefits (OPEB)		(1,043,195)	
Compensated absences accrual		(34,895)	
Principal payment on long-term debt		10,380,282	
Increase in net assets		\$ 5,660,524	

Cape Fear Public Utility Authority

**Schedule of Revenue and Expenditures - Budget and Actual (Modified Accrual Basis) -
Capital Projects Funds - Water and Sewer
From Inception and For the Fiscal Year Ended June 30, 2010**

	Project		Actual	
	Ordinance	Prior	Current	Total to
		Years	Year	Date
Revenue				
Investment earnings	\$ 4,219,230	\$ 2,415,574	\$ 4,017,327	\$ 6,432,901
Total revenue	4,219,230	2,415,574	4,017,327	6,432,901
Expenditures				
Capacity Mgmt Ops Maintenance	94,451	94,451	-	94,451
Northern School Site	5,192,756	1,585,435	2,886,466	4,471,901
Barnards Creek Outfall	74,456	10,340	49,009	59,349
Hydraulic Model/Cap Study	407,718	187,586	203,663	391,249
Burnt Mill Creek Outfall	6,895,626	3,232,943	139,993	3,372,936
Infiltration Inflow I&E	619,182	-	307,835	307,835
GIS Asbuilt Entry/Mapping	47,990	10,706	37,139	47,845
Ogden Interceptor Manhole	750,000	-	-	-
NSWWTP Force Main	4,557,011	8,750	146,986	155,736
Northern Route Force Main	17,294,784	149,377	3,083,311	3,232,688
SSWWTP Rehab & Upgrade	8,359,113	918,187	1,500,738	2,418,925
GIS & CMMS Updates	94,231	30,785	45,761	76,546
Asset Mgmt Implementation Study	2,035,984	203,911	407,777	611,688
WW Pump Station Replacement	84,008	76,067	7,940	84,007
Sewer Emergency Repair	1,679,819	28,704	1,408,682	1,437,386
Northside Heat Exchanger	184,350	184,350	-	184,350
System Wide Flow Monitor	44,106	44,106	-	44,106
Downtown Sewer Rehab/Assessment	981,258	683,791	56,940	740,731
General W&S Projects-NHC	881,781	596,811	195,186	791,997
Middle Sound Sewer-NHC	2,051,971	15,665	17,818	33,483
Equipment Purchases-Sewer Maint	1,291,844	401,878	889,966	1,291,844
PS 2 Improvements	1,177,909	84,261	1,089,383	1,173,644
Relocate Utility Lines Per DOT	2,650,039	1,389,508	-	1,389,508
Annex 98-Sewer Extensions	690,408	35,425	39,188	74,613
NSWWTP Expansion//Upgrade	7,249,236	5,400,511	401,754	5,802,265
NEI Rehab Project-PS 34-35	6,971,733	1,540,656	673,178	2,213,834
Murrayville Rd Sewer Line	696,734	681,970	14,764	696,734
River Road Force Main	1,218,746	145,772	97,996	243,768
PS 10 Exhaust Fan	59,000	59,000	-	59,000
Woodlake Developer Payment	219,230	219,230	-	219,230
System Wide OCCP Facility	2,240,530	38,298	550,512	588,810
Country Haven PS Upgrade	2,322,919	11,599	123,584	135,183
PS 34 Barscreen Replacement	1,428,504	36,805	103,915	140,720
PS 10-12	113,200	-	113,200	113,200
N Front St Streetscape - Sewer	625,005	-	340,784	340,784
Downtown Water Line Rehab	1,188,599	752,638	404,749	1,157,387
Water Valve Replacement	200,000	-	-	-
Phase I CB Rd Trans Main	650,500	94,558	-	94,558
Murrayville Rd Water Line	374,231	359,338	14,893	374,231

(Continued)

Cape Fear Public Utility Authority

**Schedule of Revenue and Expenditures - Budget and Actual (Modified Accrual Basis) -
Capital Projects Funds - Water and Sewer (Continued)
From Inception and For the Fiscal Year Ended June 30, 2010**

	Project Ordinance	Prior Years	Actual Current Year	Total to Date
COW-NHC Water System Study	\$ 236,191	\$ 172,654	\$ 26,568	\$ 199,222
GIS Asbuilt Integration	141,211	34,011	11,074	45,085
Kerr Ave Waterline	616,912	69,245	7,667	76,912
Market & Futch Waterline	417,810	417,810	-	417,810
CFPUA Building Upfit & Equipment	606,391	605,923	468	606,391
Heritage Park Water	771,428	-	16,765	16,765
Northern School Site	2,006,854	1,620,501	143,061	1,763,562
Water Emergency Repair	2,292,622	12,709	53,128	65,837
Alum Sludge Line Relocate	17,670	17,670	-	17,670
Annex 95 & 98 Water Lines	206,574	5,286	-	5,286
Water System Enhancements-NHC	991,610	671,184	286,825	958,009
Wellfield & Water Treatment Plant-NHC	28,355,422	24,526,869	3,352,318	27,879,187
Sweeney WTP Exp To 40 MGD	73,879,522	12,107,741	24,442,393	36,550,134
Environmental Services Building	4,606,390	668,646	3,486,481	4,155,127
30" Raw Water Main Assessment	313,366	293,524	19,703	313,227
30" Raw Water Main Rehab	5,192,127	5,170,438	14,733	5,185,171
Meter Replacement Program	248,741	6,092	93,524	99,616
Aquifer Storage Retrieval	3,001,964	27,183	387,922	415,105
Annex 1195 Area Water System	136,275	37,259	18,651	55,910
Kings Grant Rehab-H2O Line	444,085	373,492	70,593	444,085
N Front St Streetscape - Water	625,014	-	340,973	340,973
N Third St Streetscape - Sewer	1,206,817	-	173,078	173,078
Heritage Park Pump Station	410,000	-	-	-
Find It/Fix it Repairs	500,000	-	-	-
Scada Telemetry Enhancement	30,819	-	29,150	29,150
US 421 Regional WWTP	788,571	-	547,241	547,241
Vactor Bay Building	150,000	-	-	-
ARV Replacement	100,000	-	-	-
Pump Station-Bernards & Motts Creek	1,153,803	-	120,032	120,032
Myrtle Landing Subdivision	327,000	-	-	-
Ogden Interceptor	5,510,893	-	1,723,505	1,723,505
Riverside Subdivision Project	160,055	-	-	-
Barclay Hills & Princess Place	241,000	-	954	954
Wrightsville Avenue	241,000	-	-	-
N. Third St. Streetscape - Water	1,200,000	-	-	-
System Interconnects	1,000,000	-	75	75
Aquifer Sustain & Monitor	30,000	-	15,000	15,000
Porters Neck Water System	984,741	-	695,056	695,056
Raw Water Pump Station	1,215,068	-	111,019	111,019
Toomers Creek Water Line	250,716	-	31,144	31,144
Total expenditures	224,307,624	66,151,649	51,572,211	117,723,860
Revenue (under) expenditures	(220,088,394)	(63,736,075)	(47,554,884)	(111,290,959)
Other financing sources				
Long-term obligations issued	163,645,484	152,024,732	-	152,024,732
Capital contributions revenue	2,246,413	365,434	660,133	1,025,567
Transfers in - Operating Fund	7,900,000	-	7,900,000	7,900,000
Appropriated fund balance	46,296,497	-	-	-
Total other financing sources	220,088,394	152,390,166	8,560,133	160,950,299
Revenue and other financing sources over (under) expenditures	\$ -	\$ 88,654,091	\$ (38,994,751)	\$ 49,659,340

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Statistical Section

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Statistical Section Overview

Financial Trends:

These charts and schedules identify the trends in changes over time of Cape Fear Public Utility Authority's financial functional effectiveness and financial strength.

Net Assets by Component
Change in Net Assets

Revenue Capacity:

These schedules contain information to help the reader assess the Authority's revenue sources.

Schedule of User Rates
Principal Customers
Consumption by Customer Group
Schedule of New Connections

Debt Capacity:

The schedule represents the ratio of debt to revenue.

Pledged-Revenue Coverage

Demographic and Economic Information:

These schedules show the demographic and economic picture of the environment in which Cape Fear Public Utility Authority provides its services.

New Hanover County, NC Demographic Statistics
CFPUA Full Time Equivalent Employees

Operating Information:

These schedules contain operating and capital asset data to show how operations and assets have changed as CFPUA grows.

Water Production and Wastewater Treatment
Operating Statistics

Sources:

Unless otherwise noted, the information included in these schedules and charts is derived for the comprehensive annual financial reports (CAFR) for GASB 34 in the fiscal year ending June 30, 2010 and is provided for additional analysis purposes only and has not been verified by audit as presented.

Cape Fear Public Utility Authority

Net Assets By Component

Fiscal Years Ended June 30, 2010 and 2009

(Accrual Basis of Accounting)

	Fiscal Year 2010	Fiscal Year 2009, Restated (1)
Invested in capital assets net of related debt	\$ 295,307,938	\$ 293,467,066
Unrestricted:		
Designated for post employment benefits	4,242,871	4,200,000
Undesignated	60,037,463	56,260,682
Total net assets	<u>\$ 359,588,272</u>	<u>\$ 353,927,748</u>

Source: Cape Fear Public Utility Authority's Accounting Records.

- (1) Fiscal year 2009 was the first year of operations for the Authority; amount presented includes change in accounting principle.

Cape Fear Public Utility Authority

Change in Net Assets

Fiscal Years Ended June 30, 2010 and 2009

(Accrual Basis of Accounting)

	Fiscal Year 2010	Fiscal Year 2009, Restated (1)
Operating revenue		
Charges for services	\$ 49,837,887	\$ 42,726,268
Other operating revenue	-	139,595
Total operating revenue	49,837,887	42,865,863
Operating expenses		
Personnel and benefits	17,038,778	17,714,505
Services and utilities	10,888,068	11,475,219
Materials	2,431,060	3,264,294
Depreciation and amortization	13,096,230	12,400,153
Total operating expenses	43,454,136	44,854,171
Operating income (loss)	6,383,751	(1,988,308)
Nonoperating revenue (expense)		
Investment earnings	4,105,897	5,970,732
Interest expense	(10,909,406)	(9,674,421)
Amortization	(235,208)	(432,912)
Contributions from the City of Wilmington and New Hanover County	1,900,000	64,627,498
Total nonoperating (expense)	(5,138,717)	60,490,897
Income before capital contributions, special items and extraordinary items	1,245,034	58,502,589
Capital contributions from the City of Wilmington and New Hanover County	-	285,873,980
Capital contributions - other	7,982,758	9,551,179
Special impairment of capital assets	(2,275,200)	-
Extraordinary impairment of capital assets	(1,292,068)	-
Total contributions	4,415,490	295,425,159
Increase in net assets	5,660,524	353,927,748
Net assets		
Beginning	353,927,748	-
Ending	\$ 359,588,272	\$ 353,927,748

Source: CFPUA Water and Sewer Authority's Accounting Records.

(1) Fiscal year 2009 was the first year of operations for the Authority

Cape Fear Public Utility Authority

Schedule of User Rates

Fiscal Years Ended June 30, 2010 and 2009

	2010 (2)	2009 (1)
Water Rates		
Water Fixed Rate (bi-monthly)	\$ 21.89	\$ 15.20
Water Variable Rate:		
0 - 9,000 gallons	2.22	1.95
9,001 - 18,000 gallons	3.36	2.95
18,001+ gallons	4.50	3.95
Non-residential	3.36	2.95
Average bi-monthly residential bill (4)	45.23	35.70
Sewer Rates		
Sewer Fixed Rate (bi-monthly)	23.37	16.50
Sewer Variable Rate (3)	3.14	2.75
Sewer Flat Rate (4)	98.73	82.50
Average bi-monthly residential bill (5)	54.77	44.00

(1) Fiscal year 2009 was the first year of operations for the Authority

(2) Rates effective May 1, 2010.

(3) Sewer volume charges are capped at 30,000 gallons for residential customers.

(4) Sewer flat rate charge when Authority water is not available.

(5) Average bi-monthly bill calculated at usage of 10,000 gallons

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Cape Fear Public Utility Authority

Principal Customers

Fiscal Years Ended June 30, 2010 and 2009

	2010	
	Thousand Gallons	% of System
Ten Largest Users of the Water System Annual Consumption		
1 UNC Wilmington	163,315	2.96%
2 New Hanover County	73,218	1.33%
3 New Hanover Regional Medical Center	67,919	1.23%
4 New Hanover County Schools	63,502	1.15%
5 Wilmington Housing Authority	40,977	0.74%
6 College Manor Apartments	34,430	0.62%
7 Lake Forest Apartments	28,292	0.51%
8 Mayfaire Complex	25,804	0.47%
9 Tribute Properties	24,038	0.45%
10 Wilmington Hilton	22,340	0.41%
Total Consumption	543,835	9.87%
Total system annual consumption	5,510,880	

Ten Largest Users of the Sewer System Annual Consumption

1 Town of Wrightsville Beach	234,303	4.87%
2 UNC Wilmington	105,698	2.20%
3 New Hanover County Schools	68,385	1.42%
4 New Hanover Regional Medical Center	66,552	1.38%
5 New Hanover County	41,169	0.86%
6 Wilmington Housing Authority	40,881	0.85%
7 College Manor Apartments	29,694	0.62%
8 Lake Forest Apartments	28,292	0.59%
9 Mayfaire Complex	27,000	0.56%
10 Tribute Properties	23,274	0.48%
Total Consumption	665,248	13.83%
Total system annual consumption	4,809,470	

(1) Fiscal year 2009 was the first year of operations for the Authority

	2009, Restated (1)	
	Thousand Gallons	% of System
1 UNC Wilmington	135,005	2.21%
2 New Hanover County	63,491	1.04%
3 New Hanover Regional Medical Center	71,800	1.18%
4 Mayfaire Complex	54,782	0.90%
5 New Hanover County Schools	48,853	0.80%
6 Wilmington Housing Authority	40,961	0.67%
7 Lake Forest Apartments	30,109	0.49%
8 College Manor Apartments	23,411	0.38%
9 Elementis Chromium	22,469	0.37%
10 Wilmington Hilton	18,194	0.30%
	<u>509,075</u>	<u>8.34%</u>
	<u>6,103,977</u>	
1 Town of Wrightsville Beach	214,743	4.26%
2 UNC Wilmington	87,395	1.74%
3 New Hanover Regional Medical Center	69,080	1.37%
4 Mayfaire Complex	54,999	1.09%
5 New Hanover County Schools	46,910	0.93%
6 Wilmington Housing Authority	40,657	0.81%
7 New Hanover County	37,267	0.74%
8 Lake Forest Apartments	30,101	0.60%
9 College Manor Apartments	23,411	0.46%
10 Wilmington Hilton	17,935	0.36%
	<u>622,498</u>	<u>12.36%</u>
	<u>5,036,632</u>	

Cape Fear Public Utility Authority

Consumption by Customer Group

Fiscal Years Ended June 30, 2010 and 2009

	2010		2009, Restated (1)	
	Thousand Gallons	% of Consumption	Thousand Gallons	% of Consumption
Water Customers				
Residential	3,633,792	69.76%	4,131,252	70.74%
Commercial	1,045,278	20.07%	1,114,311	19.08%
Industrial	78,645	1.51%	102,770	1.76%
Institutional and Governmental	451,160	8.66%	491,663	8.42%
Total	5,208,875	100.00%	5,839,996	100.00%
Sewer Customers				
Residential	3,314,590	68.91%	3,533,625	70.16%
Commercial	857,850	17.84%	898,623	17.84%
Town of Wrightsville Beach	234,303	4.87%	214,743	4.26%
Industrial	22,981	0.48%	25,011	0.50%
Institutional and Governmental	379,746	7.89%	364,630	7.24%
Total	4,809,470	100.00%	5,036,632	100.00%

(1) Fiscal year 2009 was the first year of operations for the Authority

Cape Fear Public Utility Authority

Schedule of New Connections

Fiscal Years Ended June 30, 2010 and 2009

Fiscal Year Ended June 30	Water Connections (2)	Cumulative Connections	% Water Growth	Sewer Connections	Cumulative Connections	% Sewer Growth	Total Services
2010	1,542	65,899	2.4%	1,539	65,047	2.4%	130,946
2009 (1)		64,357	N/A		63,508	N/A	127,865

(1) Fiscal year 2009 was the first year of operations for the Authority

(2) Water Connections include domestic and irrigation connections

Cape Fear Public Utility Authority

Pledged-Revenue Coverage

Fiscal Years Ended June 30, 2010 and 2009

Fiscal Year Ended June 30,	Gross Revenues (1)	Less Operating Expenses (2)	Net Available Revenue	Debt Service Principal	Debt Service Interest	Coverage
<u>Water and Sewer Revenue Bonds</u>						
2010	\$ 53,966,402	\$ 29,314,125	\$ 24,652,277	\$ 2,320,562	\$ 5,220,454	\$ 3.27
Total Coverage				\$ 8,706,072	\$ 8,092,789	\$ 1.47
2009 (1)	\$ 47,787,127	\$ 31,517,799	\$ 16,269,328	\$ 2,232,043	\$ 4,040,420	\$ 2.59
Total Coverage				\$ 7,987,738	\$ 7,508,261	\$ 1.05

(1) Fiscal year 2009 was the first year of operations for the Authority

(2) Gross revenues include all fees (including impact and connection fees), other charges and investment income.

(3) Operating expenses do not include interest, OPEB, depreciation and amortization expenses.

Cape Fear Public Utility Authority

Demographic Statistics

Fiscal Years Ended June 30, 2010 and 2009

Fiscal Year Ended June 30,	City of Wilmington Population (2)	New Hanover County Population (2)	Median Age (2)	Public School Enrollment (3)	Local Unemployment Rate % (4)	Personal Income(5)	Per Capita Income(5)
2010	102,207	194,054	38.5	23,643	9.4%	N/A	N/A
2009 (1)	101,526	192,235	38	23,614	9.0%	N/A	N/A

(1) Fiscal year 2009 was the first year of operations for the Authority

(2) N. C. State Demographics.

(3) Figures are provided by the NHC Public Schools.

(4) North Carolina Employment Security Commission.

(5) Income information not available for year ending June 30, 2009

Cape Fear Public Utility Authority

Full Time Equivalent Employees

Fiscal Years Ended June 30, 2010 and 2009

Department	2010	2009 (1)
General and Administrative		
Administration	6	7
Human Resources	4	4
Finance/Information Technology	15	16
Engineering	24	25
Operations		
Administration/Warehouse	9	9
Utility Services - Lines and Meters	55	55
Water Treatment	31	31
Wastewater Treatment	41	41
Sewer Collections	49	49
Environmental/Safety Management	29.5	30.5
Billings&Collections	41	42
Total FTE's	304.5	309.5

(1) Fiscal year 2009 was the first year of operations for the Authority

Cape Fear Public Utility Authority

**Water Production and Wastewater Treatment
(thousands of gallons)
For the Past Five Fiscal Years**

Fiscal Year Ended June 30,	Water Processed and Pumped to System (1)	Wastewater Treated (1)
2010	5,989,700	6,122,662
2009 (2)	6,375,455	5,696,412
2008	6,590,075	5,429,210
2007	6,906,195	6,132,272
2006	6,940,475	6,004,330

(1) Information for fiscal years ended June 30, 2006, 2007, 2008 provided by City of Wilmington and New Hanover County.

(2) Fiscal year 2009 was the first year of operations for the Authority

Cape Fear Public Utility Authority

Operating Statistics

Fiscal Years Ended June 30, 2010 and 2009

Year Founded and Incorporated	2010	2009 (1)
Water System		
Number of service connections	65,899	64,357
Number of treatment plants - surface water system	1	1
Treatment capacity (mgd) - surface water	27.5	27.5
Average production (mgd) - surface water	13.3	14.3
Number of groundwater systems	3	3
Number of treatment plants - groundwater system (Note 2)	1	-
Number of wells - groundwater system	36	36
Treatment capacity (mgd) - groundwater plant	6	-
Treatment capacity (mgd) - other groundwater systems	0.7	7.0
Average production (mgd) - groundwater	3.3	3.1
Miles of water mains	1,129	1,103
Wastewater System		
Number of service connections	65,047	63,508
Number of treatment plants	3	3
WPC plant permit (mgd)	22.1	22.1
Average annual daily flow (mgd)	16.8	15.6
Number of lift stations	142	142
Miles of sewer gravity mains	881	877
Miles of sewer force mains	504	503

Source: Cape Fear Public Utility Authority Records

(1) Fiscal year 2009 was the first year of operations for the Authority

(2) During FY 2010 a groundwater treatment plant began operations providing advanced treatment for the largest of the three groundwater systems and resulted in a .3 mgd reduction in total treatment capacity.

Compliance Section

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Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

To the Board of Directors
Cape Fear Public Utility Authority
Wilmington, North Carolina

We have audited the financial statements of Cape Fear Public Utility Authority (the "Authority") as of and for the year ended June 30, 2010, and have issued our report thereon dated October 29, 2010. Our report contained a reference to changes in accounting principles by the Authority. 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.

A *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Authority's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the board of directors, others within the entity, and the North Carolina Department of State Treasurer and is not intended to be and should not be used by anyone other than those specified parties.

McGladrey & Pullen, LLP

Wilmington, North Carolina
October 29, 2010

Cape Fear Public Utility Authority

**Schedule of Findings and Responses
For the Year Ended June 30, 2010**

None.

Cape Fear Public Utility Authority

Summary Schedule of Prior Audit Findings For the Year Ended June 30, 2010

Finding (for the fiscal year ended June 30, 2009) which related to the audit of the financial statements.

Finding: 2009-1

Condition: Depreciation expense on assets placed into service during the year ended June 30, 2009 as recorded at an amount equal to a full year of depreciation, despite the fact that assets had not been in service for a full year.

Status: In the current reporting period, the fixed asset software applied the half-year convention to all additions in this fiscal year to correct this condition.

Finding: 2009-2

Condition: A lease was recorded as an operating lease when it met the criteria for a capital lease.

Status: In the current reporting period, the Authority strictly applied the criteria for evaluation of all leases to determine if they meet a capital lease or operating lease in accordance with Generally Accepted Accounting Principles to correct this condition.

Cape Fear Public Utility Authority

Schedule of Expenditures of Federal and State Awards For the Year Ended June 30, 2010

Grantor/Pass-through Grantor/Program Title	Federal CFDA Number	State/ Pass-through Grantor's Number	Federal (Direct & Pass-through) Expenditures	State Expenditures	Local Expenditures
Federal Awards:					
<u>U.S. Environmental Protection Agency</u>					
Passed-through the N.C. Dept. of Environment and Natural Resources:					
Division of Environmental Health:					
ARRA - DWSRF Revolving Loan	66.468	DEH-1314	\$ 190,204	\$ -	\$ -
State Revolving Fund:					
ARRA - DWSRF Principal Forgiveness Loan	66.468	DEH-1314	190,203	-	-
			380,407	-	-
Total U.S. Environmental Protection Agency			380,407	-	-
Total federal awards			\$ 380,407	\$ -	\$ -

Notes to the Schedule of Expenditures of Federal and State Financial Awards:

- Basis of Presentation

The accompanying schedule of expenditures of federal and State awards includes the federal and State grant activity of Cape Fear Public Utility Authority and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations and the State Single Audit Implementation Act. Therefore, some amounts presented in schedule may differ from amounts presented in or used in the preparation of the basic financial statements.
- Loans Outstanding

During the year ended June 30, 2010, the Authority was approved for a loan from the State of North Carolina, Department of Environment and Natural Resources (DENR). The loan will be drawn down as expenditures are paid on a certain capital project, to a maximum of \$2,716,357. Half of the loan amount is subject to immediate principal forgiveness under an American Recovery and Reinvestment Act of 2009 (ARRA) program awarded by the Environmental Protection Agency (EPA) through the State Revolving Fund program administered by DENR. The remaining \$1,358,179 will be due in twenty equal, annual installments, commencing on May 1 immediately following the completion of the project. The loan does not bear interest. No amounts are outstanding under this loan as of June 30, 2010.