TOWN OF CHAPEL HILL, NORTH CAROLINA
NOTES TO THE FINANCIAL STATEMENTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2004

A. Summary of Significant Accounting Policies

The accounting policies of the Town of Chapel Hill, North Carolina (the "Town") and its discretely presented component unit have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP") as applicable to governments. The most significant of the accounting policies are described below.

1. Reporting Entity

The Town is located in the north-central portion of North Carolina on the Piedmont Plateau. The Town is a municipal corporation governed by a Council-Manager form of government with a nine member elected Town Council. As required by generally accepted accounting principles, these financial statements present financial position and results of operations of the Town and its component unit, Orange Water and Sewer Authority "OWASA". Of the nine OWASA board members, five are appointed by the Mayor and Town Council of Chapel Hill. These five members are a voting majority for OWASA. State statutes provide that any board member of OWASA may be removed, with or without cause, by the governing body appointing said member. Thus, OWASA falls within the definition of a component unit and is discretely presented and reported in a separate column in the Town's combined financial statements in order to emphasize that it is legally separate from the Town.

Orange Water and Sewer Authority ("OWASA") – OWASA has the authority to adopt its own budget without approval of the Chapel Hill Town Council and has the authority to issue its own debt, which is not an obligation of the Town. Its operations are financed through water and sewer usage fees and it is presented as an enterprise fund. Complete financial statements for OWASA can be obtained from OWASA's administrative offices at 400 Jones Ferry Road, Carrboro, North Carolina, 27510.

2. Basis of Presentation – Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government and its component unit. For the most part, the effect of interfund activity has been removed from these statements. Governmental activities, which normally are supported by taxes and intergovernmental revenues, are reported separately from business-type activities, which may rely to a significant extent on fees and charges for support. Alternatively, an enterprise fund is used in cases where the governing body has decided that periodic determination of revenues earned, expenses incurred and net income is appropriate for capital maintenance, public policy, management control and accountability. Likewise, the primary government is reported separately from its legally separate component unit.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function or segment and grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported instead as general revenues.

Separate financial statements are provided for governmental funds and proprietary funds. The Town has no fiduciary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

3. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Amounts reported as program revenues include (1) charges to customers or applicants for goods, services or privileges provided, (2) operating grants and contributions, and (3) capital grants and contributions. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements.

In accordance with North Carolina General Statutes, all governmental funds of the Town are maintained during the year using the modified accrual basis of accounting. The governmental fund financial statements are reported on this same basis and use the current financial resources measurement focus. Under the modified accrual basis, revenues are recognized in the accounting period when they become susceptible to accrual (i.e., when they are "measurable" and "available"). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to pay the liabilities of the current period. In addition, expenditures are recorded when the related fund liability is incurred, if measurable, except for unmatured principal and interest on general long-term debt, which is recognized when due, and certain compensated absences and claims and judgments, which are recognized when the obligations are expected to be liquidated with expendable available financial resources.

The Town considers all revenues available if they are collected within 60 days after year-end, except for property taxes. Ad valorem taxes receivable are not accrued as revenue because the amount is not susceptible to accrual. At June 30, taxes receivable are materially past due and are not considered to be an available resource to finance the operations of the subsequent year.

Durham and Orange Counties are responsible for billing and collecting the property taxes on registered motor vehicles on behalf of all municipalities and special tax districts in the County, including the Town of Chapel Hill. For motor vehicles registered under the staggered system, property taxes are due the first day of the fourth month after the vehicles are registered. The billed taxes are applicable to the fiscal year in which they become due. Therefore, the Town's vehicle taxes for vehicles registered in Durham and Orange Counties from March 2003 through February 2004 apply to the fiscal year ended June 30, 2004. Uncollected taxes, which were billed during this period, are shown as a receivable in these financial statements and are offset by deferred revenues. Those taxes for vehicles registered from March 1 through the fiscal year-end apply to the 2004-2005 fiscal year and are not shown as receivables at June 30, 2004. For vehicles registered under the annual system, taxes are due on May 1 of each year. For those vehicles registered and billed under the annual system, uncollected taxes are reported as a receivable on the financial statements and are offset by deferred revenues because the due date and the date upon which interest begins to accrue passed prior to June 30. The taxes for vehicles registered annually that have already been collected as of year-end are also reflected as deferred revenues at June 30, 2004, because they are intended to finance the Town's operations during the 2005 fiscal year.

Sales taxes collected and held by the State at year-end on behalf of the Town are recognized as revenue. Intergovernmental revenues and sales and services are not susceptible to accrual because generally they are not measurable until received in cash.

Grant revenues, which are unearned at year-end, are recorded as deferred revenues.

The Town reports the following major governmental funds:

General Fund - The General Fund is the general operating fund of the Town. It is used to account for all financial resources except those required to be accounted for in another fund. The primary revenue sources are ad valorem taxes, State grants, and various other taxes and charges for services. The primary expenditures are for general government, environment and development, public safety, and leisure activities.

The Capital Projects Ordinance Fund - These funds are used to account for capital asset acquisition and construction of various Town projects including several major capital projects financed by government bonds.

Proprietary funds are presented in the financial statements on the accrual basis of accounting, similar to the basis used by government-wide statements and are accounted for on a flow of economic resources measurement focus. Under this basis, revenues are recognized in the accounting period when earned and expenses are recognized in the period they are incurred. As permitted by accounting principles generally accepted in the United States of America, the Town of Chapel Hill and the OWASA have elected to apply only applicable FASB Statements and Interpretations issued before November 30, 1989 in their accounting and reporting practices for their proprietary operations, as well as the government-wide statements.

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 Town enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Proprietary funds are used to account for operations that are financed and operated where the intent of the government's board is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or where the government's board has decided that periodic determination of net income is appropriate for accountability purposes. The Town reports two major proprietary funds:

Transportation Fund - This fund is used to account for the operations of the Town's public transit system.

Parking Facilities Fund - This fund is used to account for the operations of the Town's public parking facilities.

Additionally, the Town reports on three non-major proprietary funds:

Internal Service Funds – Internal Service Funds account for operations that provide services to other departments or agencies of the government, or to other governments on a cost-reimbursement basis. The Vehicle Replacement Fund, the Vehicle Maintenance Fund and the Computer Equipment Replacement Fund are the Town's Internal Service Funds.

4. Budgetary Control

As required by North Carolina General Statutes, balanced budgets are adopted for every fund on either an annual or project life basis. A chart follows, organized by fund type, showing each fund's budget period.

Governmental Fund Types	Annual Budget	Project Life Budget
General Fund	X	
Special Revenue Funds		
Community Development Entitlement Grant Projects Ordinance Fund		X
Transit Grant Projects Ordinance Fund		X
Public Housing Operating Fund	X	
Public Housing Grant Projects Ordinance Funds		X
Transitional Housing Fund		X
Revolving Acquisition Fund		X
Downtown Service District Fund	X	
Cable Public Access Reserve Fund	X	
Disaster Recovery Initiative Fund		X
Land Trust Fund		X
Housing Loan Trust Fund	X	
Library Gift Fund	X	
Debt Service Fund	X	
Capital Projects Funds		
Capital Projects Ordinance Fund		X
Capital Projects Fund	X	
Capital Reserve Fund	X	
Proprietary Fund Types		
Enterprise Funds	X	
Internal Service Funds	X	

The annual budget, which is prepared on the modified accrual basis of accounting as required by North Carolina law, is amended from time to time by the Town Council. The budgets in the supplemental section represent the budget as amended through June 30, 2004.

OWASA also operates under an annual budget ordinance administered in accordance with the provisions of North Carolina state laws. The budget is adopted using the modified accrual method of accounting. In addition, North Carolina General Statutes Section 159 places certain directions and limitations on the budget preparation. Revenues are reflected by source and expenditures by department. The budget is amended on a periodic basis as required by changing conditions. All annual appropriations lapse at fiscal year end.

The Council's schedule for developing the 2003-04 budget included forums and hearings for citizens to express their views, raise questions and concerns and make comments on services, policies and funding items related to the budget. Forums were held in January and March. A public hearing was held on the proposed budget in May. Additional work sessions were held in May and June. The budget was adopted by the Council on June 9, 2003.

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

5. <u>Deposits and Investments</u>

State law [G.S. 159-30(c)] authorizes the Town and OWASA to invest in obligations of the United States or obligations fully guaranteed both as to principal and interest by the United States; obligations of the State of North Carolina; bonds and notes of any North Carolina local government or public authority; obligations of certain nonguaranteed federal agencies; certain high quality issues of commercial paper and bankers' acceptances and the North Carolina Capital Management Trust (NCCMT).

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

6. <u>Cash and Cash Equivalents</u>

The Town has pooled the cash resources of its funds in order to maximize investment opportunities. Each fund's portion of total cash and investments is summarized by fund type in the combined balance sheet as "cash and cash equivalents." A portion of the cash of the Housing Operations Special Revenue Fund is classified as restricted, because the cash represents tenant security deposits. Restricted cash in the Vehicle Replacement Internal Service Fund represents unspent loan proceeds restricted for the future purchase of equipment. Bond proceeds in the Capital Projects Ordinance Fund are restricted for capital projects.

7. Restricted assets

Certain unspent proceeds of the revenue bonds and installment purchase agreements, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because they are maintained in separate bank accounts and their use is limited by applicable bond covenants.

8. Property Tax Receivable

In accordance with State statutes (G.S. 105-347 and G.S. 159-13(a)), property taxes levied on July 1, the beginning of the fiscal year, are due September 1; however, penalties do not accrue until the following January 6, and property becomes subject to lien. Liens are published the following May. The taxes levied are based on the assessed values as of January 1.

9. Allowances for doubtful accounts

Allowances for doubtful accounts are maintained on all types of receivables which have historically experienced uncollectible accounts. This amount is estimated by analyzing the percentage of receivables that were written off in prior years.

10. Inventories

The Town's inventories are maintained for the supplies, fuel and parts of the General Fund, the Public Housing Operating Fund, the Vehicle Maintenance Fund and the Transportation Fund. The General Fund and the Public Housing Operating Fund use the consumption method for inventories under which inventory items are considered expenditures when used, rather than when purchased. The Town's inventories are valued at cost (first-in, first-out) or weighted average method, which approximates market.

OWASA's materials and supplies inventories are valued at average cost.

11. Deferred Charges

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

The cost of OWASA's patent development is being amortized on a straight-line basis over the remaining useful life, not to exceed fifteen years.

12. Capital Assets

Capital assets, which include property, plant, equipment and infrastructure assets, are reported under governmental or business-type activities in the government-wide financial statements. Capital assets are defined as assets with an initial, individual cost of more than $5,000 and an estimated useful life in excess of one year for the Town and as having an individual cost of more than $1,000 and an estimated useful life in excess of two years for OWASA. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

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

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets is included as part of the capitalized value of the assets constructed by OWASA. The Town does not capitalize interest during the construction phase due to the insignificance of amounts.

Capital assets are depreciated using the straight-line method by groups or classes of property over the following expected service lives:

Land improvements	10 – 30 years
Buildings	5 – 20 years
Equipment	3 – 20 years
Buses	12 – 20 years
Other vehicles	3 – 15 years
Fixtures and equipment	5 – 20 years
Water treatment and distribution	20 – 60 years
Sewer collection and treatment	40 – 60 years

13. Long-term Obligations

In the government-wide financial statements, and proprietary fund types in the fund financial statements, long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund type statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method that approximates the effective interest method. Bonds payable are reported net of the applicable bond premiums or discounts. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

In fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

14. Compensated Absences

It is the Town's and OWASA's policy to permit employees to accumulate earned but unused vacation and sick pay benefits. There is no liability for unpaid accumulated sick leave since neither the Town nor OWASA has a policy to pay any amounts when employees separate from service. All vacation pay is accrued when incurred in the government-wide financial statement, but is limited to thirty days.

15. Deferred and Unearned Revenues

Governmental funds report deferred revenue in connection with receivables for revenues that are not considered to be available to liquidate liabilities of the current period. Governmental funds also defer revenue recognition in connection with resources that have been received, but not yet earned. At the end of the current fiscal year, the various components of unavailable and unearned revenues reported in the governmental funds and deferred revenues on the government-wide statements were as follows:

	Unavailable	Unearned	Deferred
Reserve for taxes receivable	$ 128,535	$ -	$ 835,243
Reserve for other receivables	231,355	55,256	-
	$ 359,890	$ 55,256	$ 835,243

16. Net Assets and Fund Balances

Net assets in governmental-wide and proprietary fund financial statements are classified as invested in capital assets, net of related debt; restricted; and unrestricted. 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. At year-end, restricted net assets consisted of restricted cash and investment held for payment of future construction contracts.

In the fund financial statements, governmental funds report reservations or restrictions of equity for amounts that are not appropriable or are legally segregated for a specific purpose. Designations of equity represent tentative management plans that are subject to change.

State statute (G.S. 159-13(b)(16)) restricts appropriation of fund balance or fund equity for the subsequent year's budget to an amount not to exceed the sum of cash and investments minus the sum of liabilities, encumbrances, and deferred revenues arising from cash receipts as those amounts stand at the close of the fiscal year preceding the budget year.

The governmental fund types classify fund balances as follows:

Reserved:
Reserved for encumbrances - represents fund balance available for appropriation to pay for commitments related to unperformed contracts.

Reserved by State statute - represents the amount of revenue that has been recognized on a modified accrual basis for financial statement purposes, but which is not available for appropriation in accordance with State law [G.S. 159-8(a)].

Reserved for capital improvements - represents amounts of fund balances reserved for future expenditures for capital improvements.

Reserved for police - represents the amount of fund balance reserved for certain future police expenditures.

Reserved for inventories - represents total amount of inventories in the General Fund and Special Revenue Funds.

Reserved for debt service - represents the amount of fund balance reserved for future debt service.

Reserved for special revenue purposes - represents amounts of fund balances reserved for certain future special revenue expenditures, including reserves for community development, interest subsidies, land in trust and aid to library operations.

Unreserved:
Designated for subsequent year's expenditures - represents the amount of fund balance appropriated that has been designated for the adopted 2004-05 budget ordinance.

Undesignated - represents the amount of fund balance which is available for future appropriations.

17. Use of Estimates

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

B. Reconciliation of Government-Wide and Fund Financial Statements

The governmental funds reconciliation of the balance sheet to the statement of net assets includes a reconciling item that relates to unearned revenue susceptible to full accrual on the entity-wide statements. In the governmental funds, property taxes and certain license charges were not accrued as revenues and were reported as unearned revenue. The adjustment reflected on the reconciliation represents these taxes and license charges outstanding at year end.

C. Cash and Investments

All deposits of the Town and OWASA are made in official depositories and are collateralized as required by North Carolina General Statute 159-31. The Town and OWASA may designate as an official depository any bank or savings and loan association whose principal office is located in North Carolina. Also, the Town and OWASA may establish time deposit accounts such as NOW and SuperNOW accounts, money market accounts and certificates of deposit.

All of the Town's and OWASA's deposits are either insured or collateralized by using one of two methods. Under the Dedicated Method, all deposits that exceed the federal depository insurance coverage are collateralized with securities held by the Town's or OWASA's agents in these units' names.

Under the Pooling Method, 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 Town and OWASA, these deposits are considered to be held by their agents in the entities' names. The amount of the pledged collateral is based on an approved averaging method for noninterest-bearing deposits and the actual current balance for interest-bearing deposits. Depositories using the Pooling Method report to the State Treasurer the adequacy of their pooled collateral covering uninsured deposits. The State Treasurer does not confirm this information with the Town or OWASA or the escrow agent. Because of the inability to measure the exact amount of collateral pledged for the Town or OWASA under the Pooling Method, the potential exists for undercollateralization, and this risk may increase in periods of high cash flows. However, the State Treasurer of North Carolina enforces strict standards of financial stability for each Pooling Method depository.

At year-end, the Town's deposits had a carrying amount of $19,438,635 and a bank balance of $20,105,437. Of the bank balance, $100,228 was covered by federal depository insurance, $805,532 was covered by collateral held under the Dedicated Method and $19,199,677 was covered by collateral held under the Pooling Method. The Town had cash on hand of $6,230 at year end.

At year-end, the OWASA's deposits had a carrying amount of $14,482,354 and a bank balance of $14,564,365. Of the bank balance, $149,658 was covered by federal depository insurance and $14,414,707 in interest-bearing deposits were covered by collateral held under the pooling method. The OWASA had cash on hand of $675 at June 30, 2004.

All investments are stated at cost, which approximates fair value. The Town distributes interest earned to the various funds based on each fund's proportionate equity in pooled cash and investments during each month of the year.

North Carolina General Statute 159-30(c) authorizes the Town and OWASA 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 banker's acceptance; and The North Carolina Cash Management Trust, a SEC registered mutual fund.

The Town's and OWASA's investments are generally categorized to give an indication of the level of risk assumed by the entity at year-end. None of the Town's investments are categorized at June 30, 2004 since mutual funds and pools managed by other governments are exempt from risk categorization.

At year-end, the Town's investments consist of pools managed by the State of North Carolina in the amount of $1,720,829.

OWASA's investments are shown in the table below. Column A includes investments that are insured or registered, or for which securities are held by OWASA or its agent in OWASA's name. Column B includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in OWASA's name. Column C includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by its counterparty or agent but not in OWASA's name. All of OWASA's investments are categorized in Column A.

At year-end, OWASA's investments consist of the following:

	Carrying Value	Fair Value
Government and Agency Securities	$ 265,052	$ 265,052
The North Carolina Capital Management Trust, a mutual fund	38,321,375	38,321,375
	$ 38,586,427	$ 38,586,427

Restricted cash and cash equivalents of OWASA at June 30, 2004 are as follows:

Power Account Fund	$ 265,052
Construction Fund	34,552,532
Bond Service Fund	3,768,843
	$ 38,586,427

D. Receivables and Allowances for Uncollectible Amounts

Receivables as of year-end for the governmental and the proprietary funds are as follows:

	Governmental Funds	Proprietary Funds
Property taxes, net	$ 128,535	$ -
Due from other governmental agencies	3,728,030	933,722
Due from other funds	33,003	262,740
Other, net	474,731	16,432
	$ 4,364,299	$ 1,212,894

Receivables as of year end also include the following allowances for uncollectible accounts:

Governmental activities, allowance for uncollectible property taxes	$ 389,075
Governmental activities, allowance for doubtful other receivables	$ 2,927

E. Capital Assets

A summary of changes in the value of the Town's capital assets for the year ended June 30, 2004 follows:

	July 1, 2003 (as restated)	Increases	Decreases	June 30, 2004
Governmental activities:				
Capital assets, not being depreciated:				
Land	$ 21,907,620	$ 2,207,251	$ 252,318	$ 23,862,553
Construction in progress	8,510,089	2,337,371	3,535,573	7,311,887
Total capital assets, not being depreciated	30,417,709	4,544,622	3,787,891	31,174,440
Capital assets, being depreciated:				
Land improvements	4,182,486	1,027,618	-	5,210,104
Infrastructure	24,494,712	803,088	-	25,297,800
Buildings and building improvements	33,438,761	2,591,564	-	36,030,325
Equipment and vehicles	15,048,493	1,182,033	479,662	15,750,864
Total capital assets, being depreciated	77,164,452	5,604,303	479,662	82,289,093
Accumulated depreciation:				
Land improvements	575,701	201,698	-	777,399
Infrastructure	8,498,242	1,011,912	-	9,510,154
Buildings and building improvements	19,810,614	1,450,104	3,731,211	17,529,507
Equipment and vehicles	10,677,024	1,440,943	757,923	11,360,044
Total accumulated depreciation	39,561,581	4,104,657	4,489,134	39,177,104
Total capital assets, being depreciated, net	37,602,871	1,499,646	(4,009,472)	43,111,989
Governmental activities capital assets, net	$ 68,020,580	$ 6,044,268	$ (221,581)	$ 74,286,429

	July 1, 2003	Increases	Decreases	June 30, 2004
Business-type activities:				
Transportation Fund:				
Capital assets, not being depreciated:				
Land	$ 1,440,412	$ 599,175	$ -	$ 2,039,587
Total capital assets, not being depreciated	1,440,412	599,175	-	2,039,587
Capital assets, being depreciated:				
Land improvements	3,721,748	-	-	3,721,748
Buildings and building improvements	1,363,410	-	7,770	1,355,640
Equipment	21,487,039	-	126,245	21,360,794
Total capital assets, being depreciated	26,572,197	-	134,015	26,438,182
Accumulated depreciation:				
Land improvements	1,541,945	210,788	-	1,752,733
Buildings and building improvements	1,284,325	13,540	7,770	1,290,095
Equipment	10,185,402	1,356,761	126,245	11,415,918
Total accumulated depreciation	13,011,672	1,581,089	134,015	14,458,746
Total capital assets, being depreciated, net	13,560,525	(1,581,089)	-	11,979,436
Transportation fund capital assets, net	$ 15,000,937	$ (981,914)	$ -	$ 14,019,023
Parking Facilities Fund:				
Capital assets, not being depreciated:				
Land	$ 2,749,838	$ -	$ -	$ 2,749,838
Total capital assets, not being depreciated	2,749,838	-	-	2,749,838
Capital assets, being depreciated:				
Land improvements	382,210	-	-	382,210
Buildings and building improvements	7,274,132	-	-	7,274,132
Equipment	189,318	59,650	-	248,968
Total capital assets, being depreciated	7,845,660	59,650	-	7,905,310
Accumulated depreciation:				
Land improvements	267,970	11,797	-	279,767
Buildings and building improvements	3,098,390	363,108	-	3,461,498
Equipment	163,271	22,250	-	185,521
Total accumulated depreciation	3,529,631	397,155	-	3,926,786
Total capital assets, being depreciated, net	4,316,029	(337,505)	-	3,978,524
Parking facilities fund capital assets, net	$ 7,065,867	$ (337,505)	$ -	$ 6,728,362
Business-type activities capital assets, net	$ 22,066,804	$ (1,319,419)	$ -	$ 20,747,385

Depreciation expense was charged to function/programs of the Town as follows:

Governmental activities:		
General government	$	190,034
Environment and development		2,041,769
Public safety		293,542
Leisure activities		535,671
Capital assets held by the government's internal service funds are charged to the various functions based on their usage of the assets		1,043,641
Total depreciation expense - governmental activities	$	4,104,657
Business-type activities:		
Transportation	$	1,581,089
Parking facilities		397,155
Total depreciation expense - business-type activities	$	1,978,244

A summary of changes in the value of OWASA's capital assets for the year ended June 30, 2004, follows:

	July 1, 2003	Increases	Decreases	June 30, 2004
Capital assets, not being depreciated:				
Land	$ 14,695,229	$ 1,701,068	$ -	$ 16,396,297
Construction in progress	19,359,183	18,379,203	8,761,030	28,977,356
Total capital assets, not being depreciated	34,054,412	20,080,271	8,761,030	45,373,653
Capital assets, being depreciated:				
Water treatment and distribution	96,474,076	6,208,175	-	102,682,251
Sewer collection and treatment	91,555,842	3,190,383	-	94,746,225
Fixtures and equipment	21,338,921	1,852,707	104,531	23,087,097
Assets under capital lease obligation	260,596	-	-	260,596
Total capital assets, being depreciated	209,629,435	11,251,265	104,531	220,776,169
Less accumulated depreciation for:				
Water treatment and distribution	20,689,368	2,435,140	-	23,124,508
Sewer collection and treatment	19,079,622	2,251,833	-	21,331,455
Fixtures and equipment	10,598,668	1,625,343	68,328	12,155,683
Assets under capital lease obligation	260,596	-	-	260,596
Total accumulated deprecation	50,628,254	6,312,316	68,328	56,872,242
Total capital assets, being depreciated, net	159,001,181	4,938,949	36,203	163,903,927
Total capital assets, net	$ 193,055,593	$ 25,019,220	$ 8,797,233	$ 209,277,580

F. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities for the Town's governmental and proprietary funds are as follows:

	Governmental Funds	Proprietary Funds
Accounts payable	$ 1,635,153	$ 264,642
Accrued payroll and payroll related liabilities	1,079,814	341,275
Deposits	175,616	-
Other accrued liabilities	61,695	-
	$ 2,952,278	$ 605,917

G. Long-Term Debt

Long-term debt for the Town's governmental activities and the business-type activities for the year ended June 30, 2004 are as follows:

Governmental Activities:	
General obligation bonds	
$7,190,000 - 1996 serial bonds payable in annual installments of $360,000 to $1,380,000 through 2007; interest at 4.6%	$ 3,045,000
$1,800,000 - 1996 serial bonds payable in annual installments of $100,000 through 2015; interest at 4.8% to 5.55%	1,100,000
$4,550,000 - 1998 serial bonds payable in annual installments of $100,000 to $400,000 through 2015; interest at 4.5% to 4.7%	3,400,000
$4,700,000 - 2000 serial bonds payable in annual installments of $75,000 to $300,000 through 2019; interest at 5.2% to 5.4%	3,875,000
$3,365,000 -2002 refunding serial bonds payable in annual installments of $230,000 to $815,000 through 2010; interest at 3% to 4%	2,880,000
$4,250,000 - 2003 serial bonds payable in annual installments of $75,000 to $300,000 through 2021; interest at 2% to 4 %	4,100,000
Total general obligation bonds	$ 18,400,000
Installment Notes Payables	
Various installment purchase contracts to finance equipment additions; contracts between two and ten years; interest rates between 2.65% and 5.4%; debt secured by the equipment	$ 3,018,267
Various installment purchase contracts to finance equipment additions; contracts between three and seven years; interest rates between 2.0% and 5.07%; debt secured by the equipment	3,508,507
Total installment notes payables	$ 6,526,774
Business-type Activities:	
$7,340,000 - Certificates of Participation due in annual installments of $220,000 to $445,000 through 2024; interest due in semi-annual installments at 3.7% to be paid from the Parking Facilities Fund	$ 6,380,000

In addition to the general obligation bonds, installment notes payable and certificates of participation, the Town also includes in their long-term debt an estimated liability for the Town employees' compensated absences and the law enforcement officers' special separation allowance.

Annual debt service requirements to maturity for general obligation bonds are as follows:

Year Ending June 30,	Principal	Interest	Total
2005	$ 1,675,000	$ 809,970	$ 2,484,970
2006	1,980,000	739,000	2,719,000
2007	1,665,000	652,558	2,317,558
2008	1,665,000	581,063	2,246,063
2009	1,650,000	511,550	2,161,550
2010-2014	6,040,000	1,617,125	7,657,125
2015-2019	3,300,000	514,575	3,814,575
2020-2021	425,000	22,000	447,000
	$ 18,400,000	$ 5,447,841	$ 23,847,841

Annual debt service requirements to maturity for installment note payable are as follows:

Year Ending June 30,	Principal	Interest	Total
2005	$ 1,515,398	$ 218,397	$ 1,733,795
2006	1,096,359	165,988	1,262,347
2007	875,136	131,502	1,006,638
2008	747,156	102,292	849,448
2009	761,929	74,513	836,442
2010-2014	1,530,796	103,415	1,634,211
	$ 6,526,774	$ 796,107	$ 7,322,881

Annual debt service requirements to maturity for certificates of participation are as follows:

Year Ending June 30,	Principal	Interest	Total
2005	$ 220,000	$ 234,025	$ 454,025
2006	235,000	225,793	460,793
2007	245,000	217,005	462,005
2008	250,000	207,848	457,848
2009	265,000	198,505	463,505
2010-2014	1,465,000	971,805	2,436,805
2015-2019	1,785,000	474,433	2,259,433
2020-2024	1,915,000	114,608	2,029,608
	$ 6,380,000	$ 2,644,022	$ 9,024,022

Long-term debt activity for the year ended June 30, 2004 was as follows:

	July 1, 2003	Additions	Reductions	June 30, 2004	Due Within One Year
Governmental activities:					
General obligation bonds	$ 20,070,000	$ -	$ 1,670,000	$ 18,400,000	$ 1,675,000
Installment notes payable	5,442,139	2,613,100	1,528,465	6,526,774	1,515,398
Separation allowance	411,568	8,212	-	419,780	-
Compensated absences	1,598,413	1,122,106	1,188,304	1,532,215	82,566
Long-term debt	$ 27,522,120	$ 3,743,418	$ 4,386,769	26,878,769	3,272,964
Business-type activities:					
Certificates of participation	$ 6,350,000	$ 6,690,000	$ 6,660,000	$ 6,380,000	$ 220,000
Compensated absences	328,076	310,980	339,770	299,286	16,889
Long-term debt	$ 6,678,076	$ 7,000,980	$ 6,999,770	$ 6,679,286	$ 236,889

The Town issued $6,690,000 of certificates of participation for the refinancing of the 1994 parking certificates of participation. As a result, the 1994 certificates of participation are considered to be defeased and the liability has been removed from the proprietary activities column of the statement of net assets. The reacquisition price exceeded the net carrying amount of the old debt by $340,000. This amount is being amortized over the life of the new certificates of participation. The refinancing was undertaken to reduce total debt payments over the next 20 years by approximately $2 million and resulted in a net present value savings of approximately $1.4 million.

In accordance with the provisions of the State Constitution and the Local Government Bond Act, as amended, the Town may not, with certain exceptions, have outstanding net bonded debt exceeding 8% of the appraised value of the property subject to taxation. At June 30, 2004, the legal debt margin for the Town was approximately $326 million.

For governmental activities, compensated absences are generally liquidated by the general fund.

OWASA's long-term debt as of June 30, 2004 consists of the following:

Revenue bonds payable, Series 2004A Revenue Bonds in the amount of $21,265,000, issued June 1, 2004, with coupon rates of 3.0% and 5.25%, final maturity July 2021, net of unamortized premium of $718,015 at June 30, 2004; Revenue bonds payable, Series 2004B Revenue Bonds in the amount of $20,000,000, issued June 1, 2004, bearing a weekly interest rate determined by a remarketing agent (1.05% at June 30, 2004), final maturity July 2029, net of unamortized premium of $718,015 at June 30, 2004	$ 41,983,015
Revenue and revenue refunding bonds payable, Series 2003 Revenue and Revenue Refunding Bonds, issued April 9, 2003, with coupon rates of 2.0% to 5.0%, final maturity July 2016, net of unamortized premium and deferred refunding loss of $626,915 at June 30, 2004	13,208,085

Revenue and revenue refunding bonds payable, Series 2001 Revenue and Revenue Refunding Bonds, issued September 13, 2001, with coupon rates of 3.5% to 5.0%, final maturity July 2026, net of unamortized premium and deferred refunding loss of $94,563 at June 30, 2004	33,749,563
Revenue and revenue refunding bonds payable, Series 1999 Revenue and Revenue Refunding Bonds, issued April 15, 1999, with coupon rates of 3.5% to 5.25%, final maturity July 2019, net of unamortized premium of $98,882 at June 30, 2004	13,113,882
Revenue and revenue refunding bonds payable, Series 1993 Revenue and Revenue Refunding Bonds, issued December 1, 1993, with coupon rates of 4.25% to 5.2%	-
Notes payable, collateralized by land, payable in installments through February 2005, with interest of 8.0%	23,606
	102,078,151
Less current maturities:	
Bonds payable, net of unamortized premiums and deferred refunding gains and losses	2,373,605
Notes payable	23,606
	2,397,211
Total long-term debt	$ 99,680,940

OWASA debt maturities are as follows:

	Maturities	Amortization of Premiums and Deferred Refunding Losses	Total	Interest
2005	$ 2,393,606	$ (3,605)	$ 2,397,211	$ 2,661,626
2006	3,290,000	13,760	3,276,240	4,294,178
2007	4,060,000	21,910	4,038,090	4,093,199
2008	3,805,000	(850)	3,805,850	3,960,014
2009	4,285,000	16,440	4,268,560	3,820,235
2010-2014	23,040,000	(24,734)	23,064,734	16,363,024
2015-2019	21,875,000	(202,009)	22,077,009	11,254,631
2020-2024	18,820,000	21,733	18,798,267	2,942,475
2025-2029	17,595,000	(127,190)	17,722,190	2,173,625
2030-2034	2,630,000	-	2,630,000	92,050
Total	$ 101,793,606	$ (284,545)	$ 102,078,151	$ 51,655,057

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

In 2003, OWASA issued $13,875,000 of debt, at a premium of $683,018 in Series 2003 Revenue Refunding Bonds to refund all but two installments of the remaining Series 1993 Revenue Bonds. OWASA irrevocably deposited with a trustee, securities that were used to retire the principal and interest of the refunded bonds as they become due. As of June 30, 2004, the refunded Series are fully redeemed.

In 2001, OWASA issued $34,540,000 of debt, at a premium of $318,749 in Series 2001 Revenue and Revenue Refunding Bonds to finance construction and improvement projects, as well as provide for the refunding of $3,995,000 in Series 1993 Revenue Bonds. OWASA irrevocably deposited with a trustee, securities that were used to retire the principal and interest of the refunded bonds as they become due. As of June 30, 2004, the refunded Series are fully redeemed.

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

In 1993, OWASA issued $32,028,500, net of a discount of $136,500 in Series 1993 Revenue and Revenue Refunding Bonds to provide for the refunding of Series 1985A and Series 1986A Revenue Bonds and to finance construction and improvement projects. OWASA irrevocably deposited with a trustee, securities that were used to retire the principal and interest of the Series 1985A and Series 1986A Revenue Bonds as they become due. As of June 30, 2004, both series were fully redeemed.

The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of approximately $2,809,000. In accordance with GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, this loss, net of accumulated amortization, is reported in the accompanying financial statements as a deduction from bonds payable and is being amortized over the life of the new debt, using the effective interest method.

In 1985, OWASA defeased Series 1977A Revenue Bonds by placing the proceeds of new bonds, Series 1985A Revenue Bonds, in an irrevocable trust to provide for all future debt service payments on the old bonds. The gain of $1,517,000, resulting from the refunding is being amortized over the life of the new issue. In addition to the amounts held in the trust, the trustee also has a security interest in the revenues of OWASA, after provisions have been made for the payment of current expenses, as defined in the Bond Order dated March 7, 1985. The par value of the defeased Series 1977A Revenue Bonds at June 30, 2004 was $2,200,000.

OWASA's long-term debt activity for the year ended June 30, 2004 is as follows:

	July 1, 2003	Additions	Reductions	June 30, 2004	Due Within One Year
Bonds payable:					
Revenue bonds	$ 63,570,000	$ 41,265,000	$ 3,065,000	$ 101,770,000	$ 2,370,000
Less deferred amounts:					
For issuance premium	1,100,407	721,553	86,600	1,735,360	112,060
For issuance discounts and deferred refunding	(1,588,826)	-	(138,011)	(1,450,815)	(108,455)
Total bonds payable	63,081,581	41,986,553	3,013,589	102,054,545	2,373,605
Notes payable	68,084	-	44,478	23,606	23,606
	$ 63,149,665	$ 41,986,553	$ 3,058,067	$ 102,078,151	$ 2,397,211

H. Interfund Receivables, Payables and Transfers

A schedule of interfund receivables and payables at June 30, 2004 is as follows:

Receivable Fund	Payable Fund	Amount
General fund	Nonmajor governmental fund	$ 2,473
Nonmajor governmental fund	Nonmajor governmental fund	30,260
Transportation fund	Nonmajor governmental fund	262,740
		$ 295,473

A schedule of interfund transfers at June 30, 2004 is as follows:

Transfers To	Transfers From	Amount
General fund	Parking facility fund	$ 200,159
General fund	Nonmajor governmental fund	45,000
Nonmajor governmental fund	General fund	3,804,171
Transportation fund	General fund	1,225
Capital projects ordinance fund	Nonmajor governmental fund	41,250
Nonmajor governmental fund	Transportation fund	151,924
		$ 4,243,729

I. Employees' Retirement System

1. North Carolina Local Governmental Employees' Retirement System

The Town of Chapel Hill and OWASA contribute to the State-wide Local Governmental Employees' Retirement System (LGERS), a cost-sharing multiple-employer defined benefit pension plan administered by the State of North Carolina. LGERS provides retirement and disability benefits to plan members and beneficiaries. Article 3 of G.S. Chapter 128 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly.

The Local Governmental Employees' Retirement System is included in the Comprehensive Annual Financial Report (CAFR) for the State of North Carolina. The State's CAFR includes financial statements and required supplementary information for LGERS. That report may be obtained by writing to the Office of the State Controller, 1410 Mail Service Center, Raleigh, North Carolina, 27699-1410 or by calling (919) 981-5454.

Plan members are required to contribute six percent of their annual covered salary. The Town and OWASA are required to contribute at an actuarially determined rate. For the Town, the current rate for employees not engaged in law enforcement and for law enforcement officers is respectively, 4.90% and 4.78% of annual covered payroll. For OWASA, the current rate for employees is 4.89% of annual covered payroll. The contribution requirements of the Town of Chapel Hill and OWASA are established and may be amended by the North Carolina General Assembly.

The Town's contributions to LGERS for the years ended June 30, 2004, 2003, and 2002 were $1,238,062, $1,172,362 and $1,128,974, respectively. OWASA's contributions to LGERS for the years ended June 30, 2004, 2003, and 2002 were $290,891, $295,896 and $277,840, respectively. The contributions made by the Town and OWASA equaled the required contribution for each year.

2. Law Enforcement Officers Special Separation Allowance

The Town of Chapel Hill administers a public employee retirement system (the "Separation Allowance"), a single-employer defined benefit plan that provides retirement benefits to the Town's qualified sworn law enforcement officers.

The Separation Allowance is equal to .85% of the annual equivalent of the base rate of compensation most recently applicable to the officer multiplied by the number of years of creditable service. The retirement benefits are not subject to any increases in salary or retirement allowances that may be authorized by the General Assembly. Article 12D of G.S. Chapter 143 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly.

All full-time law enforcement officers of the Town are covered by the Separation Allowance. At December 31, 2003, the Separation Allowance's membership consisted of:

Retirees receiving benefits	17
Active Plan members	103
TOTAL	120

A separate report was not issued for the plan.

The Town is required by Article 12D of N.C.G.S. Chapter 143 to provide these retirement benefits and has chosen to fund the benefit payments on a pay-as-you-go basis through annual appropriations made in the General Fund operating budget. The Town's obligation to contribute to this plan is established and may be amended by the North Carolina General Assembly. There is no contribution made by employees.

The annual required contribution for the current year was determined as part of the December 31, 2003 actuarial valuation using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 7.25% investment rate of return (net of administrative expenses) and (b) projected salary increases of 5.9% to 9.8% per year. Item (b) included an inflation component of 3.75%. The assumptions did not include postretirement benefit increases.

The Town's annual pension cost and net pension obligation to the Separation Allowance for the current year were as follows:

a	Employer annual required contribution	$	197,234
b	Interest on net pension obligation		28,892
c	Adjustment to annual required contribution		(21,863)
d	Annual pension cost	$	204,263
e	Employer contributions made for fiscal year ended 6/30/04		182,994
f	Increase in net pension obligation (d) – (e)	$	21,269
g	Net pension obligation, beginning of fiscal year		398,511
h	Net pension obligation, end of fiscal year (f) + (g)	$	419,780

Three-Year Trend Information

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation, End of Year
6/30/2002	172,463	92.04%	391,539
6/30/2003	195,967	89.78%	411,568
6/30/2004	204,263	89.59%	419,780

3. Supplemental Retirement Income Plan for Law Enforcement Officers

The Town contributes to the Supplemental Retirement Income Plan (Plan), a defined contribution pension plan administered by the Department of State Treasurer and a Board of Trustees. The Plan provides retirement benefits to law enforcement officers employed by the Town. Article 5 of G.S. Chapter 135 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly.

Article 12E of G.S. Chapter 143 requires the Town to contribute each month an amount equal to five percent of each officer's salary and all amounts contributed are vested immediately. Also, the law enforcement officers may make voluntary contributions to the plan. Contributions for the year ended June 30, 2004 were $390,884, which consisted of $246,035 from the Town and $144,849 from law enforcement officers.

J. Deferred Compensation Plan

The Town offers its employees a deferred compensation plan in accordance with Internal Revenue Code Section 401(k). Branch Banking and Trust Company administered the plan until September 2003. Currently, the plan is administered by Prudential Investment Management Services. The Town contributes up to 5% of qualified salary. For the year ended June 30, 2004, the contribution of the Town totaled $1,024,282.

K. Other Post-Employment Benefits

In addition to providing pension benefits, the Town has elected to provide post-retirement health benefits to retirees of the Town who participate in the North Carolina Local Governmental Employees' Retirement System (System) and have at least five years of creditable service with the Town. The Town pays all or a portion of the cost of coverage for these benefits based on years of service. Also, retirees can purchase coverage for their dependents at the Town's group rates. Currently, 134 retirees are eligible for post-retirement health benefits. For the fiscal year ended June 30, 2004, the Town made payments for post-retirement health benefit premiums of $456,174 and the retirees made payments of $165,222.

The Town has elected to provide death benefits to employees through the Death Trust Plan for members of the Local Governmental Employees' Retirement System (Death Trust Plan), a multiple-employer, State administered plan funded on a one-year term cost basis. Lump-sum death benefits are provided to employees 1) who die in active service after one year of contributing membership in the System, or 2) who die within 180 days after retirement or termination of service and have at least one year of contributing membership service in the System at the time of death. Currently, the Town has nineteen retirees and terminated employees who are eligible to receive death benefits.

The death benefit payment is equal to the employee's 12 highest consecutive months salary during the 24 months prior to his/her death, but the benefit may not exceed $20,000. All death benefit payments are made from the Death Trust Plan. The Town has no liability beyond the payment of monthly contributions for the death benefit. Annually, the State sets the Town's monthly contribution rate for death benefits.

Separate rates are set for employees not engaged in law enforcement and for law enforcement officers. For the fiscal year ended June 30, 2004, the Town made contributions to the State for death benefits of $33,478. The Town's required contribution is based on covered payroll: 0.14% for law enforcement officers and 0.13% for other employees. The contributions to the Death Trust Plan cannot be separated between the post-employment benefit amount and the other benefit amount. Because the benefit payments are made by the various State-administered plans and not by the Town, the Town does not determine the number of eligible participants.

L. **Fund Balance Reserves**

At year-end, the general fund's fund balance included the following reserves:

Fund Balance Reserves	
General:	
Reserve for encumbrances	$ 858,238
Reserve by State Statute	3,251,528
Reserve for capital improvements	427,112
Reserve for police	100,000
Reserve for inventory	2,209
	$ 4,639,087
Capital Projects Ordinance:	
Reserve by State Statute	$ 160,672
Reserve for capital improvements	1,161,166
	$ 1,321,838
Other Governmental Funds:	
Reserve for encumbrances	$ 50,203
Reserve by State Statute	952,099
Reserve for community development	96,751
Reserve for capital improvements	914,590
Reserve for debt service	176,247
Reserve for inventory	170,443
Reserve for land in trust	28,957
Reserve for interest subsidies	387,872
Reserve for aid to Library operations	128,152
	$ 2,905,314

M. Commitments and Contingencies

The Town has commitments related to capital improvements of approximately $2,326,000 at June 30, 2004.

OWASA is committed under various contracts for the completion of water and wastewater treatment facilities and other water and sewer projects. OWASA's management estimates the cost to complete these contracts to be approximately $40,387,000 at June 30, 2004.

The Town and OWASA have received proceeds from several federal and State grants. 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 monies to the grantor agencies. Managements of the Town and OWASA believe that any required refunds would be immaterial. No provision has been made in the accompanying financial statements for the refund of grant monies.

N. Risk Management

The Town 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 Town protects itself from potential loss through participation in the Interlocal Risk Financing Fund of North Carolina for general liability, automobile liability, public officials' liability, law enforcement liability and property losses; and through participation in the Interlocal Risk Management Pool of North Carolina for workers' compensation. The Town maintains insurance coverage of $3,000,000 for comprehensive general liability, $5,000,000 for automobile liability, $2,000,000 for law enforcement liability and public officials' liability, and a replacement cost coverage for property loss. The Town's potential loss for liability coverage is limited to the deductible amount of $2,500 per claim for all coverage except public officials' liability, which is limited to the deductible amount of $5,000 per claim. The Town's potential loss for workers' compensation loss is limited to the deductible amount of $5,000 per occurrence. There are no significant reductions in insurance coverage in the past year for any major risk category.

The Town currently reports its risk management activities and insurance costs by operating fund. Claims expenditures falling within the retention coverage are generally reported when amounts are paid or, in the event of significant losses, when such amounts are probable and the amounts can be determined. The amounts due at June 30, 2004 for outstanding claims and incurred but not reported claims are not considered material and, therefore, no provision is recorded within the financial statements. The amount of settlements has not exceeded insurance coverage in any of the past three years.

OWASA has property, general liability, workers' compensation, and employee health coverage. OWASA's claims have not exceeded coverage in any of the past three fiscal years.

O. Restatement

Non-depreciable capital assets at June 30, 2003 have been restated by an increase of $7,744,188. This correction was made to account for management's identification of certain land underlying the general governmental infrastructure of the Town that had previously not been accounted for. The adjustment resulted in a $7,744,188 increase in the capital assets, net of related debt reported for the governmental activities of the Town as of June 30, 2003. This correction had no effect on the change in net assets for the governmental activities of the Town for the year ended June 30, 2003.

P. Pronouncements Issued, Not Yet Effective

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2004 that have effective dates that may impact future financial presentations.

Management has not currently determined what, if any, impact implementation of the following statements may have on the financing statements of the Town.

- GASB Statement Number 42, "Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries."
- GASB Statement Number 43, "Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans."
- GASB Statement Number 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions."

Additionally, the Governmental Accounting Standards Board issued Statement Number 40, "Deposit and Investment Risk Disclosures, an amendment of GASB Statement Number 3" and Statement Number 44, "Economic Condition Reporting: The Statistical Section" which amends portions of previous guidance related to the preparation of a statistical section when presented as a required part of a comprehensive annual financial report (CAFR).

TOWN OF CHAPEL HILL, NORTH CAROLINA

Exhibit 12

LAW ENFORCEMENT OFFICERS' SPECIAL SEPARATION ALLOWANCE SUPPLEMENTAL INFORMATION ANALYSIS OF FUNDING PROGRESS

Last Six Fiscal Years

ACTUARIAL VALUATION DATE	ACTUARIAL VALUE OF ASSETS (a)	ACTUARIAL ACCRUED LIABILITY PROJECTED UNIT CREDIT (b)	UNFUNDED AAL (UAAL) (b-a)	FUNDED RATIO (a/b)	COVERED PAYROLL (c)	UAAL AS A % OF COVERED PAYROLL ((b-a)/c)
12/31/1998	$ -	$ 1,153,044	$ 1,153,044	-	$ 3,325,225	34.7 %
12/31/1999	-	1,290,755	1,290,755	-	3,710,978	34.8
12/31/2000	-	1,754,732	1,754,732	-	3,783,389	46.4
12/31/2001	-	1,926,984	1,926,984	-	4,429,208	43.5
12/31/2002	-	2,066,393	2,066,393	-	4,331,188	47.7
12/31/2003	-	2,162,511	2,162,511	-	4,364,190	49.5

LAW ENFORCEMENT OFFICERS' SPECIAL SEPARATION ALLOWANCE SUPPLEMENTAL INFORMATION SCHEDULE OF EMPLOYER CONTRIBUTION

Last Six Fiscal Years

Year Ended June 30,	Annual Required Contribution	Percentage Contributed
1999	$ 126,328	40.70 %
2000	148,037	96.48
2001	160,296	99.64
2002	164,966	96.22
2003	188,613	93.27
2004	197,234	92.78

Notes to the Required Schedules:

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

Valuation date	December 31, 2003
Actuarial cost method	Projected unit credit
Amortization method	Level percent of pay closed
Remaining amortization period	27 years
Asset valuation method	Market value
Actuarial assumptions:	
Investment rate of return*	7.25%
Projected salary increases*	5.9% to 9.8%

*Includes inflation at	3.75%
Cost-of-living adjustments	None