

**TOWN OF HIGHLANDS  
NORTH CAROLINA**

**COMPLIANCE LETTERS**

**FOR THE YEAR ENDED JUNE 30, 2011**

**MARTIN ♦ STARNES  
& ASSOCIATES, CPAs, P.A.**

---

*"A Professional Association of Certified Public Accountants and Management Consultants"*

**TOWN OF HIGHLANDS, NORTH CAROLINA**

**COMPLIANCE SECTION  
FOR THE YEAR ENDED JUNE 30, 2011**

**TABLE OF CONTENTS**

	<u>Page</u>
Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With <i>Government Auditing Standards</i>	1-2
Report On Compliance With Requirements That Could Have A Direct And Material Effect On Each Major Federal Program And On Internal Control Over Compliance In Accordance With OMB Circular A-133 And The State Single Audit Implementation Act	3-5
Schedule of Findings and Questioned Costs	6-10
Summary Schedule of Prior Year Findings	11
Schedule of Expenditures of Federal Awards	12

# MARTIN ♦ STARNES & ASSOCIATES, CPAs, P.A.

*"A Professional Association of Certified Public Accountants and Management Consultants"*

## **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 Honorable Mayor and  
Town Commissioners  
Town of Highlands, North Carolina

We have audited the basic financial statements of the governmental activities, the business-type activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of the Town of Highlands, North Carolina, as of and for the year ended June 30, 2011, which collectively comprises the Town's basic financial statements, and have issued our report thereon dated September 15, 2011. Our report includes a reference to other auditors. 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. Other auditors audited the financial statements of the Town of Highlands ABC Board, as described in our report on the Town of Highlands' financial statements. The financial statements of the Town of Highlands ABC Board were not audited in accordance with *Government Auditing Standards*.

### **Internal Control Over Financial Reporting**

Management of the Town of Highlands is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Town of Highlands' internal control over financial reporting as a basis for designing 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 Town of Highlands' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Town's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and; therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 a 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. We consider the deficiencies described in the accompanying Schedule of Findings and Questioned Costs as items 11-1, 11-2, 11-3, and 11-4 to be to be material weaknesses.

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Town of Highlands' financial statements are free of material misstatement, we performed tests of its compliance and other matters with certain provisions of laws, regulations, contracts and grants, and non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance and other matters 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 non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

The Town of Highlands' responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Town of Highlands' responses and; accordingly, we express no opinion on it.

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

*Martin Starnes & Associates, CPAs, P.A.*

Martin Starnes & Associates, CPAs, P.A.  
September 15, 2011

# MARTIN ♦ STARNES & ASSOCIATES, CPAs, P.A.

*"A Professional Association of Certified Public Accountants and Management Consultants"*

## **Report On Compliance With Requirements That Could Have A Direct And Material Effect On Each Major Federal Program And On Internal Control Over Compliance In Accordance With OMB Circular A-133 And The State Single Audit Implementation Act**

To the Honorable Mayor and  
Town Commissioners  
Town of Highlands, North Carolina

### **Compliance**

We have audited the compliance of the Town of Highlands with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* and the Audit Manual for Governmental Auditors in North Carolina, issued by the Local Government Commission, that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. The Town of Highlands' major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants, applicable to each of its major federal programs is the responsibility of the Town of Highlands' management. Our responsibility is to express an opinion on the Town of Highlands' compliance based on our audit.

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

In our opinion, the Town of Highlands complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

## **Internal Control Over Compliance**

Management of the Town of Highlands is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants, applicable to federal programs. In planning and performing our audit, we considered the Town of Highlands' internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Town of Highlands' internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and; therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, non-compliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material non-compliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items 11-1, 11-3, and 11-4 to be material weaknesses.

The Town of Highlands' responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the Town of Highlands' responses and, accordingly, we express no opinion on the responses.

## **Schedule of Expenditures of Federal Awards**

We have audited the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component unit, each major fund, and the aggregate remaining fund information of the Town of Highlands, as of and for the year ended June 30, 2011, which collectively comprise the Town of Highlands' basic financial statements, and have issued our report thereon dated September 15, 2011 which contained an unqualified opinion on those financial statements. We did not audit the financial statements of the Town of Highlands ABC Board. Those financial statements were audited by other auditors whose report thereon has been furnished to us and, our opinion, insofar as it relates to the amounts included for the Town of Highlands ABC Board is based solely on the report of the other auditors. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Town of Highlands' basic financial statements. The accompanying Schedule of Expenditures of Federal and State Awards is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State Single Audit Implementation

Act, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditure of Federal and State Awards is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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

*Martin Starnes & Associates, CPAs, P.A.*

Martin Starnes & Associates, CPAs, P.A.

September 15, 2011

**TOWN OF HIGHLANDS, NORTH CAROLINA**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

**1. Summary of Auditors' Results**

**Financial Statements**

- A. An unqualified opinion was issued on the financial statements of the Town of Highlands.
- B. Our audit of the basic financial statements disclosed material weaknesses in internal controls.
- C. No significant deficiencies identified that are not considered to be material weaknesses.
- D. Our audit of the basic financial statements disclosed no instances of non-compliance with laws, regulations and the provisions of contracts and grant agreements that are material to the basic financial statements.

**Federal Awards**

- E. Our audit of compliance with the types of compliance requirements applicable to the Town's major programs disclosed material weaknesses in internal controls over major programs.
- F. Our audit of compliance with the types of compliance requirements applicable to the Town's major programs did not disclose any significant deficiencies that were not considered material weaknesses.
- G. An unqualified opinion was issued on the Town of Highlands' compliance with the types of compliance requirements applicable to its major federal programs.
- H. Our audit disclosed no reportable compliance findings which related to federal awards.
- I. Major federal programs for the Town of Highlands for the fiscal year ended June 30, 2011 are:

<u>Program Name</u>	<u>CFDA#</u>
Clean Water State Revolving Fund (CWSRF) – ARRA	66.458

- J. The threshold for determining Type A programs for the Town of Highlands is \$300,000.
- K. The Town of Highlands did not qualify as a low risk auditee under Section .530 of Circular No. A-133.

**State Awards**

N/A. A State single audit was not required.

**TOWN OF HIGHLANDS, NORTH CAROLINA**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

**2. Findings Related to the Audit of the Basic Financial Statements**

**Finding 11-1**

**Criteria:** Management should have a system in place to reduce the likelihood of errors in financial reporting.

**Condition:** Due to the limited number of personnel in the Town office, there are inherent limitations to the segregation of duties among Town personnel.

**Context:** While performing documentation and testing of major systems of internal controls, we noted the condition described above.

**Effect:** Errors in financial reporting could occur and not be detected.

**Cause:** There are a limited number of personnel for certain functions.

**Recommendation:** Access to the books and records of the Town should be separated from access to the assets of the Town as much as possible. Alternative controls should be used to compensate for any lack of segregation of duties. The Town Commissioners should provide some of these controls.

**Name of Contact Person:** Bob Zoellner

**Corrective Action:** Management is aware of the weakness, but due to the cost benefit analysis, hiring additional personnel does not appear feasible.

**TOWN OF HIGHLANDS, NORTH CAROLINA**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

**Finding 11-2**

**Criteria:** Management should have a system in place to reduce the likelihood of errors in financial reporting.

**Condition:** Financial reporting under the accounting standards promulgated by the Financial Accounting Standards Board and Governmental Accounting Standards Board requires a level of technical expertise not possessed by the Town's personnel with regards to drafting full accrual, full disclosure financial statements.

**Context:** The external auditor prepared a draft of the basic financial statements, all required note disclosures, and supplemental schedules.

**Effect:** Errors in financial reporting could occur.

**Cause:** There are limited Town resources as it relates to the preparation of full accrual, full disclosure year-end financial statements.

**Recommendation:** The cost of acquiring the technical expertise to comply with the financial reporting requirements discussed above appears cost prohibitive. Therefore, the Town should exercise due care in reviewing the financial statements drafted by the external auditor as the Town is responsible for the accuracy of the audited financial statements.

**Name of Contact Person:** Bob Zoellner

**Corrective Action:** Management is aware of the weakness, but due to the cost benefit analysis, they will continue to rely on the external auditor to draft the year-end financial statements.

**TOWN OF HIGHLANDS, NORTH CAROLINA**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

**Finding 11-3**

**Criteria:** Management should have a system in place to reduce the likelihood of errors in financial reporting.

**Condition:** A significant audit adjustment is a proposed correction of the basic financial statements that, in our judgment, may not have been detected except through our auditing procedures. The existence of such material adjustments indicates that the Town's system of controls did not detect and prevent such errors. We have provided management with a report of these adjustments.

**Context:** The external auditor identified significant audit adjustments as defined above.

**Effect:** Errors in financial reporting could occur.

**Cause:** There are limited Town resources as it relates to the preparation of all necessary year-end adjustments for financial reporting purposes.

**Recommendation:** Management should examine the adjustments required as a result of our audit and assess the cost/benefit of improving the internal control system to prevent the adjustments in the future, given the units available financial and intellectual resources. Management should acknowledge inherent limitations in the internal control system caused by limited resources, and modify their oversight function accordingly.

**Name of Contact Person:** Bob Zoellner

**Corrective Action:** Management is aware that year-end audit adjustments are typically required. Management will examine controls in place to see if they can be strengthened, given available resources, thus reducing the number of audit adjustments required at year-end. In the areas where the cost/benefit does not justify improving the control system, management will exercise due caution in performing their oversight function.

**TOWN OF HIGHLANDS, NORTH CAROLINA**  
**SCHEDULE OF FINDINGS AND QUESTIONED COSTS**  
**FOR THE YEAR ENDED JUNE 30, 2011**

**Finding 11-4**

**Criteria:** Management should have a control system in place to reduce the likelihood that violations of General Statutes occur and go undetected.

**Condition:** In the current year, there were several violations of the General Statutes regarding the balanced budget requirement, expenditures exceeding appropriations, and funds operating in a deficit.

**Context:** While reviewing financial statements and budget reports, we noted the condition described above.

**Effect:** The Town was in violation of North Carolina General Statutes

**Cause:** Previous Town Manager submitted an original budget that was not in compliance with General Statutes. There was a lack of monitoring and insufficient controls over budget compliance.

**Recommendation:** Implement stringent budgetary preparation controls, as well as monitoring controls, to prevent an unbalanced budget and/or expenditures exceeding appropriations.

**Name of Contact Person:** Bob Zoellner

**Managements Response:** Management concurs with the condition and the recommendation. Management also adds that procedures have been put in place to monitor overspending of departments and the adoption of a balanced budget.

**3. Findings and Questioned Costs Related to the Audit of Federal Awards**

See Findings 11-1, 11-3, and 11-4 above.

**4. Findings and Questioned Costs Related to the Audit of State Awards**

N/A. A State single audit was not required.

**TOWN OF HIGHLANDS, NORTH CAROLINA**

**SUMMARY SCHEDULE OF PRIOR YEAR FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2011**

**Finding 10-01 was repeated as 11-1.**

**Finding 10-02 was repeated as 11-2.**

**Finding 10-03 was repeated as 11-3.**

**TOWN OF HIGHLANDS, NORTH CAROLINA**

**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2011**

<u>Grantor / Pass-through Grantor / Program Title</u>	<u>CFDA Number</u>	<u>Federal Expenditures</u>
<b>Federal Awards:</b>		
<b>U.S. Environmental Protection Agency:</b>		
Passed-through the N.C. Department of Environment and Natural Resources, Division of Water Quality		
Clean Water State Revolving Fund -ARRA Fed Project #2W370507-04	66.458	\$ 1,248,524
Clean Water State Revolving Fund -ARRA Fed Project #2W3706507-05	66.458	<u>309,416</u>
<b>Total Federal Awards</b>		<u>\$ 1,557,940</u>

**Notes to the Schedule of Expenditures of Federal Awards:**

**1. Basis of Presentation**

The accompanying Schedule of Expenditures of Federal and State awards includes the federal and State grant activity of the Town of Highlands 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, Non-Profit Organizations. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the financial statements.