

**GATES COUNTY
NORTH CAROLINA**

COMPLIANCE LETTERS

FOR THE YEAR ENDED JUNE 30, 2009

GATES COUNTY, NORTH CAROLINA

COMPLIANCE LETTERS FOR THE YEAR ENDED JUNE 30, 2009

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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

Board of Commissioners
Gates County, North Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregated remaining fund information of Gates County, North Carolina, as of and for the year ended June 30, 2009, not presented here, which collectively comprises Gates County's basic financial statements and have issued our report thereon dated September 30, 2009. We did not audit the financial statements of the Gates County ABC Board. Those financial statements were audited by other auditors whose reports thereon have been furnished to us and, our opinion, insofar as it relates to the amounts included for the Gates County ABC Board, is based solely on the reports of the 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. The financial statements of Gates County ABC Board were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Gates County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Gates County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the County's financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We consider the deficiencies described in the accompanying Schedule of Findings, Responses, and Questioned Costs as items 2009-01, 2009-02, 2009-03, and 2009-04 to be significant deficiencies in internal control over financial reporting.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider 2009-01, 2009-02, 2009-03, and 2009-04 to be material weaknesses.

Compliance

As part of obtaining reasonable assurance about whether Gates County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, non-compliance 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 non-compliance or other matters that are required to be reported under *Government Auditing Standards*.

The County's response to the findings identified in our audit is described in the accompanying Schedule of Findings, Responses, and Questioned Costs. We did not audit the County's response and, accordingly, we express no opinion on it.

Other Matters

The County budgets and reports administrative expense reimbursements in the General Fund as revenue, rather than as a contra-expenditure. Generally accepted accounting principles require these type transactions to be reported as a reduction of expenditures rather than revenue. Management should amend the 2009-2010 budget to properly report these transactions.

The County does not utilize a purchase order system, therefore, exposing itself to expenditures that exceed appropriations. The County is not required to maintain an encumbrance system, but it is required to prevent expenditures from occurring that exceed appropriations. Management should investigate the cost/benefit of implementing a purchase order/encumbrance system.

Currently, daily collections are turned over to the Finance Officer for deposit. Given the lack of reconciliation controls in place at the County, the County should require a pre-deposit control and a comparison of the validated deposit slip control to be implemented.

The County collects and remits taxes for Town of Gatesville and three drainage districts. These funds should be reported as Agency Funds, rather than be accounted for as balance sheet transactions in the General Fund.

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

Martin Starnes + Associates CPAs, P.A.

Martin Starnes & Associates, CPAs, P.A.
September 30, 2009

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

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR FEDERAL PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133 AND THE STATE SINGLE AUDIT IMPLEMENTATION ACT

Board of Commissioners
Gates County, North Carolina

Compliance

We have audited the compliance of Gates County, North Carolina, with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* and the *Audit Manual for Governmental Auditors in North Carolina*, issued by the Local Government Commission, that are applicable to each of its major federal programs for the year ended June 30, 2009. Gates County, North Carolina's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings, Responses, 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 Gates County's management. Our responsibility is to express an opinion on Gates County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State Single Audit Implementation Act. 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 Gates County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Gates County's compliance with those requirements.

In our opinion, Gates County, North Carolina complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2009.

Internal Control Over Compliance

The management of Gates County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Gates County's internal control over compliance with 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, 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 County's internal control over compliance.

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

A control deficiency in the County's internal control over compliance exists when the design or operation of a control does not allow management or employees in the normal course of performing their assigned functions, to prevent or detect non-compliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to administer a federal program such that there is more than a remote likelihood that non-compliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the County's internal control. We consider the deficiency in internal control over compliance as described in the accompanying Schedule of Findings, Responses, and Questioned Costs as items 2009-03 to be a significant deficiency.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material non-compliance with a type of compliance requirement of a federal program will not be prevented or detected by the County's internal control. The significant deficiency in internal control over compliance described in the accompanying Schedule of Findings, Responses, and Questioned Costs, we consider to be material weaknesses.

Gates County's responses to the findings identified in our audit are described in the accompanying Schedule of Findings, Responses, and Questioned Costs. We did not audit Gates County's responses and, accordingly, we express no opinion on them.

Schedule of Expenditures of Federal and State Awards

We have audited the 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 Gates County, North Carolina, as of and for the year ended June 30, 2009, which collectively comprise Gates County's financial statements, and have issued our report thereon dated September 30, 2009. We did not audit the financial statements of the Gates County ABC Board. Those financial statements were

audited by other auditors whose reports thereon have been furnished to us and, our opinion, insofar as it relates to the amounts included for the Gates County ABC Board, is based solely on the reports of the other auditors. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise Gates County's financial statements. The accompanying Schedule of Expenditures of Federal and State Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and the State Single Audit Implementation Act and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Commissioners, management, 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 30, 2009

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR STATE PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH APPLICABLE SECTIONS OF OMB CIRCULAR A-133 AND THE STATE SINGLE AUDIT IMPLEMENTATION ACT

Board of Commissioners
Gates, North Carolina

Compliance

We have audited the compliance of Gates County, North Carolina, with the types of compliance requirements described in the *Audit Manual for Governmental Auditors in North Carolina*, issued by the Local Government Commission, that are applicable to each of its major State programs for the year ended June 30, 2009. Gates County's major State programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings, Responses, and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major State programs is the responsibility of Gates County's management. Our responsibility is to express an opinion on Gates County, North Carolina's compliance based on our audit.

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

In our opinion, Gates County, North Carolina complied, in all material respects, with the requirements referred to above that are applicable to each of its major State programs for the year ended June 30, 2009.

Internal Control Over Compliance

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

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

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A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material non-compliance with a type of compliance requirement of a State program will not be prevented or detected by the County's internal control. The significant deficiency in internal control over compliance described in the accompanying Schedule of Findings, Responses, and Questioned Costs, we consider to be material weaknesses.

Gates County's responses to the findings identified in our audit are described in the accompanying Schedule of Findings, Responses, and Questioned Costs. We did not audit Gates County's responses and, accordingly, we express no opinion on them.

Schedule of Expenditures of Federal and State Awards

We have audited the 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 Gates County, North Carolina, as of and for the year ended June 30, 2009, which collectively comprise Gates County's financial statements, and have issued our report thereon dated September 30, 2009. We did not audit the financial statements of the Gates County ABC Board. Those financial statements were

audited by other auditors whose reports thereon have been furnished to us and, our opinion, insofar as it relates to the amounts included for the Gates County ABC Board, is based solely on the reports of the other auditors. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise Gates County's financial statements. The accompanying Schedule of Expenditures of Federal and State Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and the State Single Audit Implementation Act, and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the financial statements taken as a whole.

This report is intended solely for the information and use of the Board of Commissioners, management, 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 30, 2009

GATES COUNTY, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009

1. Summary of Auditors' Results

Financial Statements

Type of auditors' report issued Unqualified

Internal control over financial reporting:

- Material weakness identified Yes
- Significant deficiency identified that is not considered to be a material weakness No

Non-compliance material to financial statements noted No

Federal Awards

Internal control over major federal programs:

- Material weakness identified Yes
- Significant deficiency identified that is not considered to be a material weakness No

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

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133 Yes

State Awards

Internal control over major State programs:

- Material weakness identified Yes
- Significant deficiency identified that is not considered to be material weaknesses No

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

Any audit findings disclosed that are required to be reported in accordance with the State Single Audit Implementation Act Yes

GATES COUNTY, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009

2. Financial Statements Findings

Finding 2009-01: Social Services Trust Fund Findings and Violations

Criteria: Management should have a system in place to reduce the likelihood of errors in financial reporting and to insure compliance with the General Statutes and other Administrative Codes (DSS and SSA).

Condition: The Director of Social Services maintains the Social Services Trust Fund. There are numerous internal control weaknesses and General Statute violations and Administrative Code violations regarding the Trust Fund.

- The Trust Fund is not reconciled to the bank statement on a timely basis. When the account is reconciled, the unidentified errors are not properly investigated.
- The Trust Fund is not reconciled to a subsidiary listing of the trustees. (Note: This step insures the County of proper ownership of the trust assets.)
- The Director is not duly authorized as a Deputy Finance Officer to execute checks.
- The Director possesses a debit card and uses the card for transactions that do not possess proper authorization.
- The Director co-mingled professional association transactions with the Trust Fund while serving in an officer capacity of the association.
- Upon the death of a beneficiary of the Trust Fund, the Director did not turn over the beneficiary's account balance to the Clerk of Court or other designee of the Estate.
- After the death of a beneficiary, the Director authorized transactions and charged the transactions against the deceased beneficiary's trust account.
- The Gates County Department of Social Services was the named beneficiary of a life insurance policy. The proceeds were deposited into the Trust Fund, rather than the General Fund.

Effect: Federal, State, and local funds may be expended improperly. Trust funds held by the County may be expended improperly

Cause: Inadequate internal controls over DSS trust funds; inadequate training over the requirements of maintaining a trust fund on behalf of Social Security Administration; lack of local authority given to County Manager and Finance Officer to force the DSS Director to comply with County directives, general statutes, and SSA administrative rules.

GATES COUNTY, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009

Finding 2009-01: Social Services Trust Fund Findings and Violations (continued)

Recommendation: The Finance Officer of the County should take over control of the Trust Fund and order the Director to discontinue executing transactions related to the Trust Fund. The County should investigate the propriety of all transactions regarding the Trust Fund and establish assurance that the beneficiaries' funds are intact and properly accounted for. The County should contact North Carolina Department of Social Services and the Social Security Administration and report the findings related to the Trust Fund. The County should investigate the propriety of being a named beneficiary of life insurance for its Trust Fund beneficiaries and determine if the practice has existed in the past; if so, the disposition of the funds, and if they are named beneficiary on other life insurance policies. The County should turn over the funds of the deceased beneficiary and establish a policy to require this to be done in a timely manner in the future.

Name of Contact Person: Sandy Pittman, Finance Officer

Management's Response: Management has obtained control over the Trust Fund as of August 4, 2009. Management has notified the proper agencies regarding the matter and the investigation is ongoing. Management will implement stringent controls over the Trust Fund to prohibit debit card transactions, require timely reconciliations, and other applicable controls. As of August 4, 2009, all transactions related to the Trust Account are processed through the County purchasing/cash disbursement internal control system.

Finding 2009-02: Financial Reporting

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 the Governmental Accounting Standards Board requires a technical training in financial reporting that is not typically consistent with the training required to perform the functions of Finance Officer.

Cause: The County does not require the Finance Officer position to possess both the financial reporting expertise discussed above and the technical ability to carry out the role of Finance Officer.

Effect: The County engages the external auditor to draft the financial statements.

Recommendation: The County should exercise due care in reviewing the financial statements drafted by the external auditor as the County is responsible for the accuracy of the audited financial statements.

Name of Contact Person: Toby Chappell, Finance Officer

Management's Response: Management concurs and will diligently review financial data to ensure agreement with audited financial records. Management also emphasizes that the engaging of the external auditor to perform the financial reporting function is common practice among numerous counties in North Carolina.

GATES COUNTY, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009

Finding 2009-03: Proper Approval of Journal Entries

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

Condition: Journal entries are posted to the general ledger by the Finance Officer without approval. We did not detect any improper transactions; however, there are no controls in place to prevent the Finance Officer from circumventing the internal controls that are in place by recording unauthorized journal entries. The County Manager and the Board of Commissioners receive budget-to-actual reports on a monthly basis, which provides a mitigating control over this area.

Effect: Unauthorized and/or improper journal entries may be posted to the accounting system, which in effect, overrides other accounting controls that management is relying on.

Cause: Due to the limited number of personnel in the County office, there are inherent limitations to the segregation of duties among County personnel.

Recommendation: Require the County Manager to approve all journal entries by the Finance Officer on a monthly basis. Require the Finance Officer to approve journal entries posted by other County employees. Management should continue the monthly review of the budget to actual reports and be reminded that their review is a critical function of the internal control system.

Name of Contact Person: Toby Chappell, County Manager

Management's Response: Management has implemented the recommendation discussed herein and agrees with the finding.

Finding 2009-04 Reconciliation of Subsidiary Ledgers and Segregation of Duties

Criteria: Management should design a system of internal controls that limits the same personnel from having access to assets and having access to the general ledger.

Condition: The County's taxes receivable nor water receivables are reconciled to the general ledger on a monthly basis. The County's tax bills are not recorded in the general ledger when billed, rather they are recorded upon receipt. This process does not allow the tax office and the finance office to reconcile the general ledger, collections, and the outstanding tax receivable.

The tax and water collection employees process collections out of the same drawer, rather than each collection employee having their own drawer. This weakness prevents management from identifying the specific employee that caused an overage/shortage or is involved in theft from the collection drawer. The collection drawers do not have locks, therefore, the County's cash collections cannot be secured during the day.

Tax, water, and landfill collection employees can process an adjustment to a customer's account and post the adjustment without supervisor approval. This weakness, coupled with the lack of reconciliations discussed herein, creates the opportunity for misappropriation without detection.

GATES COUNTY, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009

Finding 2009-04 Reconciliation of Subsidiary Ledgers and Segregation of Duties (continued)

Effect: Misappropriation of County assets and errors in the revenue collection cycle could occur and go undetected.

Cause: Lack of segregation of duties over cash receipts and the general ledger. Lack of reconciling controls over subsidiary records and general ledger control accounts.

Recommendation: Require the tax bills to be recorded in the general ledger (offset by deferred revenues) upon the mailing of the tax bills. Require the tax, water, and landfill receivables to be reconciled to their respective subsidiary ledgers on a monthly basis. Require each collection employee to use a singular drawer, rather than a “community” drawer. Prohibit collection employees from authorizing and processing “adjustments” to customer accounts. This process should always require two County employees, regardless of how inconvenient it may be.

Contact Person: Toby Chappell, County Manager

Management’s Response: Management concurs with the finding and will investigate the logistic changes required to address the cash drawer and “adjustments” issue. Management will implement a requirement to reconcile the subsidiary ledgers during the current fiscal year.

GATES COUNTY, NORTH CAROLINA

**SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2009**

3. Federal Award Findings, Responses, and Questioned Costs

2009-03

4. State Award Findings, Responses, and Questioned Costs

2009-03

GATES COUNTY, NORTH CAROLINA

**SUMMARY SCHEDULE OF PRIOR YEARS' AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2009**

Finding: 2008-01

Repeated with changes as 2009-04.

Finding: 2008-02

Status: Corrected

Finding: 2008-03

Status: Repeated with numerous findings as 2009-01