



**TOWN OF HOLDEN BEACH
BOARD OF COMMISSIONERS
SPECIAL MEETING
FRIDAY, FEBRUARY 15, 2019 – 10:00 A.M.**

The Board of Commissioners of the Town of Holden Beach, North Carolina met for a Special Meeting on Friday, February 15, 2019 at 10:00 a.m. in the Town Hall Public Assembly. Present were Mayor J. Alan Holden; Mayor Pro Tem John Fletcher; Commissioners Mike Sullivan, Pat Kwiatkowski, Joe Butler and Peter Freer; Town Manager David W. Hewett; Town Clerk Heather Finnell; Assistant Town Manager Christy Ferguson; Planning Director Tim Evans; Public Works Director Chris Clemmons; Detective Jeremy Dixon; Fiscal Operations Clerks Margaret Lancaster and Mandy Lockner; and Town Attorney Noel Fox.

Mayor Holden called the meeting to order.

Motion by Commissioner Sullivan to reverse items #2 and #3 on the agenda; second by Mayor Pro Tem Fletcher; approved by unanimous vote.

DISCUSSION AND POSSIBLE ACTION – INTERNAL CONTROL REPORT AND PROPOSAL PRESENTED BY RSM

Robbie Bittner from RSM introduced himself and Landon Vick. He provided background information on his firm. They were approached last June to do an internal control review. The process covered six areas: overall financial reporting, accounts payable process, fixed assets process, payroll process, accounts receivable and debt. They did not perform an audit. Procedures included what Town staff does on a regular basis, observations of individual processes and inquiries to Town staff. Page six has a matrix of the individual controls they were looking for. Mr. Bittner said areas in green are controls that they feel are in place and are operating effectively. There could be errors in the yellow area, deficiencies in internal control. Being yellow there are also compensating controls in that area. Red areas indicate areas where there are deficiencies in internal control. They came up with several recommendations from their procedures.

1 – Currently the Town is setup that the town manager is also the finance manager. They are recommending the Town hire a fulltime finance director. He said this would allow the town manager to focus his efforts on higher level talent activities as well as bring in a finance director that has the qualifications to better move the Town forward from a financial prospective. He said there is a Q&A section of the report that specifically outlines the items having a separate finance officer would help alleviate.

2 – Segregation of duties would also be helped by having a separate finance officer. You would have multiple people over a specific area, that way one person doesn't have control over initiation, authorization and disbursement.

3 – Vendor listing: currently the Town doesn't have a set policy or procedure related to how vendors are approved or how they are listed. They are recommending that a full scale review be performed of the current vendor listing, as well as a review of policies and procedures.

4 – Payroll: they are recommending involving a second party to ensure one person doesn't have control over the payroll. He said currently there is no set job descriptions for individual levels. The job descriptions would allow the Town to understand the qualifications needed and also what the compensation range should be. They are recommending the Town hire a third party to perform a compensation study to determine that people are being paid within acceptable terms based on industry averages.

5 – Capital Assets: the listing currently doesn't have all the details it should have. They are recommending it be updated. They are also recommending that an asset review policy/ procedure be put into place. They are recommending that a physical count of assets be conducted at least every two years.

Mr. Bittner said their recommendations came directly from their observations and inquiries at the Town, as well as their overall firm best practices.

Mayor Pro Tem Fletcher asked for comment on the environment we are in today in small municipalities in terms of internal control issues. Mr. Bittner replied that one of reasons they were approached to perform the review was nationwide and in North Carolina there has been an outbreak of fraud in municipalities. The environment is that you should have a look at internal controls as it relates to fraud and opportunity to commit fraud. It doesn't necessarily mean that these controls would prevent all frauds, but it takes away some of the opportunity that would be there. The other aspect is the Government Accounting Standards Board (GASB) is requiring more and more to be reported every year in the financial statements and more and more controls to be in place. It's constantly changing. What was okay eight – nine years ago is not the same today. It's becoming more complex. Mayor Pro Tem Fletcher inquired how much was regarding executive override in cases where they saw fraud in North Carolina. Mr. Bittner responded he hasn't done a ton of research on each fraud case. When his firm performs an external audit, the main risk you have is management override controls. Anything you can do to help mitigate that risk by having policies and procedures in place is beneficial. When they are performing an external audit that is something they consider.

Mayor Holden asked what an additional hired person as a financial officer would be able to do and/ or do better than what is being done now. Mr. Bittner answered there is a listing of all of the individual controls of the Town that having a separate officer will help mitigate. The biggest thing is the problem of segregation of duties. By adding a person you will be able to split the duties amongst other people. The second thing is to help alleviate some of previous issues with significant deficiencies with financial reporting. The third thing besides allowing the town manager to have more availability for more Town functions, the finance officer would be able to prepare financial statements. Yellow book standards currently allows for external auditors to draft the financial statements of their clients. That is a very common practice. There is a large push for that to no longer be allowed, the Town would have to draft their own financial statements or hire an outside firm.

Mayor Holden asked Mr. Bittner to explain so everyone understands what the Town's significant deficiencies are. Mr. Bittner said they didn't perform the Town's audit, but he will speak in terms of when performing an audit since the significant deficiencies and material weaknesses were issued by the Town's external auditors and not RSM. When you are performing an audit under Government Auditing Standards you are required to be cognizant of internal controls and compliance of laws and regulations. Internal

control deficiencies have three categories. A material weakness is a weakness in a control where a material misstatement could be allowed to pass through the control process or has passed through the process. A significant deficiency while not as severe as a material weakness, is still severe enough that it warrants attention and is required to be reported. A deficiency is an error in operation control or a minor issue where a control failed or isn't in place, but there are other mitigating or compensating controls in place. They looked back to the 2011 internal control and compliance reports. The Town from 2013 – 2016 was not required to issue a report under Government Auditing Standards so there is no compliance section reporting and significant deficiencies or material weaknesses in internal control. In 2011, two material weaknesses were issued. One was on insufficient technical expertise to prepare financial statements and the other was related to audit adjustments identified. In 2012, there were three material weaknesses. They were insufficient technical expertise, audit adjustments identified and limited resources related to the year-end close process. 2013 – 2016 did not have a compliance report, the financial report is not required to have findings in them so they do not have record of that. In 2017, there were two significant deficiencies issued. The first one was related to insufficient technical expertise and the second one was audit adjustments identified. Mr. Bittner said the listing of that is available in the back of the room. Commissioner Freer asked if he would expect to see insufficient technical expertise on each one of the reports. He said wouldn't you expect to correct it if you have a material weakness. Mr. Bittner said when there is a material weakness there is a required corrective action plan that needs to be put in place in how the agency would mitigate that risk going forward. Mr. Vick said he didn't obtain one. Mr. Bittner said a corrective action plan is a required part of the report. He believes it is only required to be published if the audit is being performed under a single audit. Typically you can see deficiencies in internal control year after year, especially in smaller communities. Mr. Bittner explained that typically, you see segregation of duties continue because you have to weigh the cost benefit of hiring an additional person. As related to insufficient technical expertise, from their experience you typically will see maybe a material weakness the next year and maybe a significant deficiency or some sort of alleviation. That could be through more training, hiring somebody or hiring a third party to assist in the process. Commissioner Butler inquired if the mitigation plans have to be presented to the governing body if you have a material weakness. Mr. Bittner answered the corrective action plan is required to be in the report. The management responses of a corrective action plan would be required to be presented in the AU-C 260 or formal assessment for team auditor's communication of those charged with governance. He cannot speak to what other firms do.

Commissioner Kwiatkowski said as she looks at the different items that having a separate finance officer would help to mitigate a lot of these look to be putting processes in place, changing procedures and having checklists. These are certain things that bring better management of the overall function. These could be done as an improvement plan that once in place, is in place and doesn't need the continuing financial officer to be there to make sure these things are followed. It can still be done by a combined person. She looks at hiring a financial officer as bringing expertise that is needed long term and a fulltime function, not just a checklist, management function. She asked what specifically, other than doing a CAFR that can still be done by an outside firm, will a financial officer's added technical ability bring that our current system cannot intellectually or capability wise bring. Mr. Bittner said a third party can come in and do that, it is an option. He stated one of biggest problems is segregation of duty and expertise. The finance officer will bring the alleviation of segregation of duties.

Commissioner Kwiatkowski inquired about other towns that have both a finance director and an assistant. Mr. Bittner said having two people depends on the size of the entity and amount of services the town provides. It's based on the capabilities of the finance officer to perform the work and the growth aspects.

Commissioner Kwiatkowski inquired about the period of time spent in observation and the number of interactions spent with the town manager as town manager or as finance officer. It doesn't have much detail to give confidence that there was a significant amount of time covered. Mr. Bittner said Mr. Vick was onsite for a week speaking to different folks, as well as observing the processes. Commissioner Kwiatkowski asked how many meetings were actually held with the town manager to understand and request documents and background information. Mr. Vick said it was ongoing throughout the week. He would take on a cycle per day, work through the process with the finance team and then send it to the town manager for review. Commissioner Kwiatkowski asked how much back and forth there was getting clarifications needed post observation period. Mr. Vick said communications at that point were usually by email. Mr. Bittner said once they left the office, Mr. Vick put together a draft. Mr. Bittner reviewed it, along with one of their internal review specialists. The drafts were sent to Town Manager Hewett for review of the matrix.

Commissioner Kwiatkowski asked if all documents were received by the town manager or town clerk. Mr. Bittner replied that documentation of the observations they had, everything went back to the manager or clerk. Mr. Vick said everything they received came from the town manager, town clerk or the finance team. Commissioner Kwiatkowski stated she didn't see the draft. She inquired if any changes were made to the matrix after the town manager was sent it for his review. Mr. Bittner replied there were limited changes to the drafts, maybe changes to misspellings of words, but there were no change in observations and documentations.

Commissioner Kwiatkowski said everything was in line with what she was expecting until she got to overall job responsibilities and compensation rates. It doesn't appear to be part of the original scope of work. Mr. Bittner said one of the things they look at is everything from hiring to termination, along with payroll action. That came up during that process. They were looking for a policy on how raises are initiated and approved. He said that is part of the overall control environment with the payroll cycle. Commissioner Kwiatkowski stated she was surprised to see the statement that there were no set job descriptions for each position because she recalled that earlier in the year that information was forwarded to the commissioners. Mr. Bittner said they were not provided with the information.

Commissioner Sullivan said when Mr. Bittner was just asked about what a finance officer would bring, it appears to him a large part of it would be oversight. Mr. Bittner agreed that is correct. Commissioner Sullivan said the other part would be the financial reports. Mr. Bittner stated you should have someone with the skills, knowledge and experience of what they are looking at. Commissioner Sullivan asked if it would require a CPA or if you could train someone to do that as long as they are being trained to recognize what they are being asked to do. Mr. Bittner said you could potentially train someone to do that, however you are talking about a significant amount of training to get the skills and knowledge. He said it is possible. They currently have people on staff without an accounting degree that are some of the best auditors they have. They came up through it and have been appropriately trained. A CPA license is not everything. Commissioner Sullivan said as far as the financial oversight, we are forecasting that the current policy of having external auditors do the report is going to be changed and it will be required to be in-house at some point. Mr. Bittner stated they have members of their firm that are heavily involved in these processes and everything they are saying is the next iteration is to change it. Commissioner Sullivan asked if there will be a time period to implement the requirement when that determination is made. Mr. Bittner said yellow book standards would release a proposed draft that would be available for comment. There

will be a timeframe, but he can't speak to the length of that. He said once the yellow book standards are issued they are effective for the next audit period.

Commissioner Sullivan said Mr. Bittner mentioned his firm does this type of internal auditing and risk analysis on large cities, small municipalities, etc. He asked if the deficiencies noted in their report for Holden Beach are common to other similar sized municipalities. Mr. Bittner said segregation of duties is common. There are ways to help segregation of duties issues. Typically they recommend splitting duties out or having another person come in to help alleviate some of the problems. To speak to individual issues, he would need to go back and research individual reports.

Commissioner Sullivan stated he saw a good number of the deficiencies noted had to do with the absence of checklists. He asked if that is common for a municipality. Mr. Bittner explained that a checklist is indicative there is a policy or procedure to follow. Commissioner Sullivan read an example from the report. Mr. Bittner stated if you have people to perform those duties on a regular basis you are probably okay. The risk is if someone was hit by a bus, where the Town would be in that situation. If you don't have the policies and procedures documented on what should be done and somebody wins the lottery, all of your institutional knowledge walks out at one time. It is having the policies and procedures in place for Town continuity. He said that is part of the equation. The other part is people forget things. Having a list of items or procedures helps people. Commissioner Butler said even if you have a checklist you still would need exposure to exactly what is going on. He talked about his previous experience with putting a progressive program in place so that if something would happen, somebody else would be put into an individual position. He said that is critical.

Commissioner Butler said he dealt with regulatory agencies. When he had to submit a plan for a deficiency he would put the plan together. The regulatory agency would check the plan and see what progress was made against the plan. If there was no progress there were penalties. He asked what is in place for municipalities, if there is any follow up by a regulatory group. Mr. Bittner said there is no specific follow-up by any specific regulatory group. The external auditor is required to follow up per auditing standards. Reports in North Carolina are submitted to the Local Government Commission (LGC). The LGC reviews and approves every financial report. If they see consistent issues when it goes to issuances of debt or anything of that nature, they will look at those items. He is not sure what kind of weight they put on those items. As for other regulatory bodies it could have effects on grant funding. The reporting of material weaknesses and significant deficiencies of internal control are designed to be reported to the Board to show where your municipality is deficient. Commissioner Kwiatkowski said she looked for compliance sections in three reports. In all three reports, the corrective action was that management concurs that it is an issue; based on analysis of cost benefit has chosen to engage the external auditor to perform the function. She said in the future, based on her conversation with Mr. Bittner when the yellow book changes you will still have the option to have your year-end report be prepared by an outside firm, but not by the same firm that audits you. The important part is to have the internal expertise to look at what is provided by a third party consultant to determine it is correct. Mr. Bittner agreed. Commissioner Kwiatkowski stated it's not a case that it will be a mandate where you need to do your year-end report internally, but you need to have internal expertise to take something from another firm and confirm it is correct. Mr. Bittner agreed. Commissioner Kwiatkowski asked if the Town has that internal capability. Mr. Bittner responded he can't speak to that because there is a third party hired. Commissioner Kwiatkowski said currently internally we are taking on that this is correct, so do we not have the internal capability to know that a year-end report prepared by the outside is an accurate representation? Mr. Bittner replied that based on the readings of

findings in the audit reports you have to have someone with the skills, knowledge and experience to take ownership. The representation letter that is required to be signed should have that representation that the Town has someone with the skills, knowledge and experience to do that. He said if it didn't he would be very surprised, but he cannot speak to that because he hasn't read the representation letter. Based on the findings, it is saying the Town doesn't have the expertise to do that because they are relying on the auditor to do that. The audit has to stay independent. He cannot speak to what would happen if the Town were to hire a third party, other than the third party could be considered a link of management. They perform this function for multiple clients. It is a possibility to have it hired as a third party. He can't speak to it because the Town hasn't performed that function in the past. Commissioner Kwiatkowski stated many municipalities haven't because it has been allowed to do as we are doing. It will be a change when the separation is demanded. She is of the opinion that you can have someone besides your own internal expert prepare your year-end report, as long as you have a person in place as the finance officer who can validate that it was done correctly. It is the same as using a consultant to do a report in industry. You have a manager to say it was done correctly; they could have done it themselves if it wasn't decided that it was more timewise and appropriate for cost benefit to do outside, rather than inside. Mr. Bittner stated the question would be does the person taking responsibility have the skills, knowledge and expertise to do it themselves.

Mayor Pro Tem Fletcher said the last audit they got suggested that the Town's auditor must prepare the financial statements, additionally any reports provided to the commissioners cannot be relied on because of other adjustments. He said he went back to the only year since 2007 that the auditor listed the adjustments he had to make at the end of the year and they were based on known and likely misstatements during the year. They totaled \$4.8 million. He said if they don't have the skillset, during the year he cannot rely on those statements. He is not comfortable waiting until the end of the year to find out that the Town has issues. Mr. Bittner replied that is his prerogative. He said if you are saying the person does not have the skills, knowledge or experience to do it on a monthly basis you could be receiving misinformation.

Commissioner Sullivan said in relation to the discussion on the insufficient technical expertise, Mr. Bittner's statement is we need someone internal who has the knowledge and the expertise. He asked what this kind of finding would be based upon if they were doing an audit. Mr. Bittner stated if they were performing this it could have multiple aspects, but he will do it through the six areas they reviewed. From a financial reporting prospective this would be the person is not able to prepare financial statements with the appropriate disclosures. Potentially the accounts payable sub ledger was materially different than the actual trial balance or what the internal software says it should be. Fixed assets could be if assets are not being depreciated appropriately because the person responsible for them didn't understand how they were supposed to be depreciating those assets. It's based not necessarily on that there is an error because errors occur, but based on why the error occurred, why the control failed. The way they approach it when they find issues is to bring it to an open question as to why. If it is recorded as it is because the person has a complete misunderstanding, that is the issue. If it is an error and they understand how it is supposed to be done that is different. They didn't review any prior auditors' work papers and that wasn't in the scope of work.

Commissioner Sullivan said in response to the question on governmental review, Mr. Bittner said the reports do get sent to North Carolina and at some point they might come back. Mr. Bittner explained the LGC has the authority to come back and look at anything happening in any government in the state. In his

knowledge they have not come back, but they didn't go into any follow-up the LGC had on any particular findings. Town Manager Hewett said the Town has never been issued the white letter. Mayor Pro Tem Fletcher asked about the team that was sent down a couple of years back to look at controls. Town Manager Hewett explained that a couple of years back as an outreach service that they provided to local governments in general their coach team came by for a visit, not in specific to any issue that was identified to us. Mayor Pro Tem Fletcher said there are two people that cover the state for the follow-up. Commissioner Sullivan agreed that the Town does not want them to come here, but the question was if it rose to the level that would bring them here to do that and the answer is no. Mr. Bittner said to his knowledge the LGC has only taken over one government in the state.

Commissioner Freer said Mr. Bittner was talking about procedures, he highlighted it said informal can be verbal in the approval of vendors. Mr. Bittner said typically the best practice for vendor listing is you have a set policy or procedure for approving vendors and the steps you are going to take to verify there are no conflicts of interest. You then would have a set listing of formalized, approved vendors. He talked about the process involved with the list. Commissioner Freer asked if the 2,700 were approved vendors. Mr. Vick said he thinks the system keeps a rolling list, so it would be considered all vendors that have been paid at some point in the past. Commissioner Freer asked if some incident happened would you expect an organization to do a self-assessment or bring in someone to help them with a procedure. Mr. Bittner said he can't speak to people's preferences. Best practice would be if you have an incident you would have it investigated. Commissioner Kwiatkowski provided an example of a purge in a company she worked for. It is a process that has to be put in place, but it is not something that we need an outside source to do. Commissioner Freer said you need to recognize that is an issue and do that. It's something that hasn't been done. Commissioner Kwiatkowski said if it is something that is agreed should be done, it isn't massively complicated to do.

Town Manager Hewett stated he noted the contract stipulates that after the final is submitted if there aren't any substantive changes after 30 days it is in stone. He finds that the study offers some salient prospective on our processes and has good value in terms of things that need to be worked on. He hopes that the staff's participation with RSM facilitated identifying those in a substantive way. He thinks there are good takeaways and lessons to come out of it. We had three hurricanes in the middle of it and there was some going back and forth. He was under the impression that we would have a final draft to be reviewed by the Audit chair and himself before we went to a published document. He said that didn't occur. Town Manager Hewett stated staff provided comments on development interactions, then the draft for review was provided to staff. He fed comments to Mr. Vick, but there are some specifics in there that are conspicuously absent. One was the piece about debt where there was a recommendation that debt loads were a function of the town manager's recommendation. That was a specific comment that he made that he thought was beyond RSM's sphere of influence and was an overstepping of management's authority in how much debt load the Board and the Town should assume within the realm of authorized debt limits. It was somewhat disappointing that the feedback wasn't included. One of the things that came back that was not in the draft he was provided with, but was in the final proposal was the piece on staff pay increases and the inference that there is no classification pay plan. The inference was that pay raises are handed out willy nilly. That was an addition that was not in the draft that came for his review. It would have been provided to the program officer should that have come up. Town Manager Hewett said there is a Classification and Pay Chart and there are position descriptions. They may be out of date, but there is a structure and review process that is religiously adhered to and is part of the annual evaluation cycle. That's an omission.

Town Manager Hewett said he has some questions of the fiduciary nature regarding the split of the town manager and finance officer. He is assuming this was couched from an unlimited resources prospective because it infers it is an additional person. That implies there are additional resources that would be required over and above what is currently in place. Mr. Bittner said their recommendation is that you have someone in the finance officer position separate from the position he is in. Whether the Town decides to do that by studying other folks to see if they are capable or if they want to create a new position would be the decision of the Town. Town Manager Hewett inquired if there was any consideration about the type of facility accommodations that would be necessitated by the addition of a staff member. Mr. Bittner replied no. Town Manager Hewett asked if it is the recommendation for the finance officer to report to the town manager like in other council manager forms of government. Mr. Bittner said they didn't include that in the recommendation.

Commissioner Sullivan said earlier Mr. Bittner said the only differences between the final and the draft were spelling errors, but Town Manager Hewett brought up data that wasn't included in what he thought was the draft. Mr. Bittner said there were several drafts passed back and forth. He is 99.9% sure everything was included; if not it was an oversight. It was his understanding that the town manager reviewed the final draft. He would have to go back to look. Town Manager Hewett said there were three hurricanes. It could have been on either end, he just wanted to register that it is not right. Commissioner Kwiatkowski asked if there will be a corrective report done since there seems to be a discrepancy between the report saying the Town doesn't have something and the town manager saying we do have it and it would alter what was written as a conclusion. Mr. Bittner said they haven't broached the subject from that prospective. This is the first he is hearing of it. Commissioner Freer said the report was published a month ago. He asked if there were other communications since it was issued. Mr. Bittner said there hasn't been anything since the report has been issued.

Commissioner Freer asked if there is any recommended follow-up. Mr. Bittner said they mentioned third party compensation and third party help with the vendor listing. Other than that they are sticking to the recommendations that were made based on their observations made in this report. They are not prepared to speak on any other recommendations at this point.

Commissioner Butler said when it comes to payroll there seems to be a missing link somewhere, yet we have a final report. The situation is that we have something current and in place. It may have been misunderstood or not presented, but he thinks we should resolve that issue. He asked how we should do that. Mr. Bittner said they would need to modify the report and obtain additional documentation. Commissioner Butler said if we have a process in place we should recognize it.

PUBLIC COMMENTS

Mark Fleischhauer said he is here for two perspectives. He believes he is the only remaining member of the Audit Committee that goes back to the prior Audit Committee and he recalls some of those audits. His other prospective is he has been fortunate enough to sit in the auditor's shoes and Town Manager Hewett's shoes. He thinks as part of the process his experience is it is not really a conclusive thing. Mr. Fleischhauer stated this report isn't meant to be final. It is meant to be the basis for moving forward. One of the critical missing pieces was the corresponding next steps, what we are going to do to remediate. As part of that process clearly the cost benefit issues need to be taken into account. He said he hopes there

isn't any haste to reach a quick conclusion, but recognize this as an initiation process that can hopefully be carried forward constructively and not too hastily.

EXECUTIVE SESSION PURSUANT TO NORTH CAROLINA GENERAL STATUTE 143-318.11(A)(6) TO DISCUSS A PERSONNEL MATTER AND NORTH CAROLINA GENERAL STATUTE 143-318.11(A)(3) TO CONSULT WITH THE TOWN ATTORNEY

Town Clerk Finnell read the reason for Executive Session.

Motion by Commissioner Freer to go into Executive Session at 11:30 a.m.; second by Mayor Pro Tem Fletcher; approved by unanimous vote.

OPEN SESSION

No action was taken.

ADJOURNMENT

Motion to adjourn by Commissioner Butler at 12:51 p.m.; second by Mayor Pro Tem Fletcher; approved by unanimous vote.

J. Alan Holden, Mayor

ATTEST:

Heather Finnell, Town Clerk