



DIXON HUGHES PLLC

Certified Public Accountants and Advisors

October 31, 2007

To the Honorable Mayor
And Members of the Town Council
Town of Chapel Hill
Chapel Hill, North Carolina

In planning and performing our audit of the financial statements of the Town of Chapel Hill, North Carolina for the year ended June 30, 2007, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control.

Our audit of the financial statements, which was made in accordance with auditing standards generally accepted in the United States of America, including the study and evaluation of the Town's system of internal accounting control for the year ended June 30, 2007, would not necessarily disclose all weaknesses in the system because it was based on selective tests of accounting records and related data. However, during our audit we became aware of other matters of which the Board should be made aware of. The attached memorandum summarizes our comments and suggestions regarding those matters. This letter does not affect our report dated October 31, 2007 on the financial statements of the Town of Chapel Hill, North Carolina.

We appreciate the opportunity to present these comments for your consideration. We are prepared to discuss them at your convenience and to provide such assistance in their implementation as you may desire. This report is intended solely for the information and use of the Members of the Town Council and management, and is not intended to be and should not be used by anyone other than these specified parties.



Certified Public Accountants

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**TOWN OF CHAPEL HILL
MANAGEMENT LETTER MEMORANDUM
October 31, 2007**

Excess of Transfers over Appropriations

For the year ended June 30, 2007 the Town had a significant transfer in excess of appropriations for a transfer from the Transit Fund to the Transit Grant Fund. The transfer exceeded appropriations by \$1,052,124. The transfer was necessitated to cover outstanding amounts due from other governments for federal and state reimbursements, chiefly for the construction of the new Town Operations Center and for the purchase of buses and technology. As the amounts were not received within 90 days of the fiscal year-end, the revenues in the receiving fund were deferred under the Town's modified accrual accounting guidelines. We recommend that management more closely review grant status to ensure compliance in future years.

Risk Assessment Standards Implementation

The Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) has issued eight new Statements on Auditing Standards collectively referred to as the Risk Assessment Standards. The Risk Assessment Standards, SAS Number 104 through SAS Number 111, are effective for financial statement audit periods beginning after December 15, 2006.

These Statements establish standards and provide guidance concerning the auditor's assessment of the risks of material misstatement (whether caused by error or fraud) in a financial statement audits of non-SEC entities, and the design and performance of audit procedures whose nature, timing, and extent are responsive to the assessed risks. Additionally, the Statements establish standards and provide guidance on planning and supervision, the nature of audit evidence, and the evaluation of whether the audit evidence obtained affords a reasonable basis for an opinion regarding the financial statements under audit.

The primary objective of these standards is to enhance the auditors' application of the audit risk model in practice by specifying, among other things:

- A more in-depth understanding of the entity and its environment, including its internal control, to identify the risks of material misstatement in the financial statements and the procedures the entity is performing to mitigate them.
- A more rigorous assessment of the risks of where and how financial statements could be materially misstated based on that understanding.
- An improved linkage between the auditors' assessed risks and the nature, timing, and extent of the audit procedures performed in response to those risks.

We anticipate that most audits will result in an overall increase in the effort and time by both the audited entity and the audit team. Accordingly, as preparation for your next audit, we will continue to communicate expected changes in the audit process and ways in which you and your staff can assist in making the audit process as efficient as possible.



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October 31, 2007

To the Honorable Mayor
And Members of the Town Council
Town of Chapel Hill
Chapel Hill, North Carolina

We have audited the financial statements of the Town of Chapel Hill for the year ended June 30, 2007, and have issued our report thereon dated October 31, 2007. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U. S. Generally Accepted Auditing Standards, OMB Circular A-133, and the State Single Audit Act

As stated in our engagement letter dated May 30, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance about whether the financial statements are free of material misstatement and are presented in accordance with U.S. generally accepted accounting principals. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the Town of Chapel Hill's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal and major state programs 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, and the State Single Audit Implementation Act.

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Praxity
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INDEPENDENT FIRMS

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Our Responsibility under U. S. Generally Accepted Auditing Standards, OMB Circular A-133 and the State Single Audit Implementation Act (Continued)

As part of obtaining reasonable assurance about whether the Town of Chapel Hill's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. Also, in accordance with OMB Circular A-133 and the State Single Audit Implementation Act, we examined, on a test basis, evidence about the Town of Chapel Hill's compliance with the types of compliance requirements described in the *U. S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* and the State Single Audit Implementation Act applicable to each of its major federal and major state programs for the purpose of expressing an opinion on the Town of Chapel Hill's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the Town of Chapel Hill's compliance with those requirements.

Significant Accounting Policies

Management has the responsibility for selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the Town of Chapel Hill are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2007. We noted no transactions entered into by the Town of Chapel Hill during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. No significant accounting estimates were made.

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Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the Town of Chapel Hill's financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments proposed, whether recorded or unrecorded by the Town of Chapel Hill, either individually or in the aggregate, indicate matters that could have a significant effect on the Town of Chapel Hill's financial reporting process.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Town of Chapel Hill's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

This information is intended solely for the use of the Mayor, Members of the Town Council, and management of the Town of Chapel Hill and is not intended to be and should not be used by anyone other than these specified parties.

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