

**CITY OF KINSTON
NORTH CAROLINA**

COMPLIANCE LETTERS

FOR THE YEAR ENDED JUNE 30, 2012

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CITY OF KINSTON, NORTH CAROLINA

Compliance Letters For the Year Ended June 30, 2012

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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
Members of the City Council
City of Kinston, North Carolina

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kinston, North Carolina, as of and for the year ended June 30, 2012, which collectively comprise the City of Kinston's basic financial statements, and have issued our report thereon dated September 24, 2012. 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.

Internal Control Over Financial Reporting

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

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Kinston's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, 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 instances of non-compliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings, Responses, and Questioned Costs as item 2012-01.

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

This report is intended for the information and use of management, others within the organization, members of the City 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 24, 2012

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

Independent Auditors' Report

To the Honorable Mayor and
Members of the City Council
City of Kinston, North Carolina

Compliance

We have audited the compliance of the City of Kinston with the types of compliance requirements described in applicable sections of 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, 2012. The City of Kinston'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 the City of Kinston's management. Our responsibility is to express an opinion on the City of Kinston'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 applicable sections of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as described in the *Audit Manual for Governmental Auditors in North Carolina*, 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 the City of Kinston'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 of the City of Kinston's compliance with those requirements.

In our opinion, the City of Kinston 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, 2012.

Internal Control Over Compliance

Management of the City of Kinston 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 City of Kinston's 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 applicable sections of 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 City of Kinston's internal control over compliance.

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 a 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.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal and State Awards

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kinston, North Carolina, as of and for the year ended June 30, 2012, which collectively comprise the City of Kinston's basic financial statements, and have issued our report thereon dated September 24, 2012, which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the City of Kinston's basic 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 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 additional 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 Expenditures 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 for the information and use of management, others within the organization, members of the City 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 24, 2012

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Report On Compliance With Requirements That Could Have a Direct And Material Effect On 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

Independent Auditors' Report

To the Honorable Mayor and
Members of the City Council
City of Kinston, North Carolina

Compliance

We have audited the compliance of the City of Kinston with the types of compliance requirements described in applicable sections of 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 State programs for the year ended June 30, 2012. The City of Kinston'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 the City of Kinston's management. Our responsibility is to express an opinion on the City of Kinston'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 applicable sections of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as described in the *Audit Manual for Governmental Auditors in North Carolina*, 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 State program occurred. An audit includes examining, on a test basis, evidence about the City of Kinston'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 of the City of Kinston's compliance with those requirements.

In our opinion, the City of Kinston complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major State programs for the year ended June 30, 2012.

Internal Control Over Compliance

Management of the City of Kinston is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to State programs. In planning and performing our audit, we considered the City of Kinston's internal control over compliance with the 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 and to test and report on internal control over compliance in accordance with applicable sections of 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 City of Kinston's internal control over compliance.

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 State 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 a reasonable possibility that material non-compliance with a type of compliance requirement of a State program will not be prevented, or detected and corrected, on a timely basis.

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Schedule of Expenditures of Federal and State Awards

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This report is intended for the information and use of management, others within the organization, members of the City 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 24, 2012

CITY OF KINSTON, NORTH CAROLINA

**SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012**

1. Summary of Auditors' Results

Financial Statements:

| | |
|---|-------------|
| Type of auditors' report issued | Unqualified |
| Internal control over financial reporting: | |
| • Material weakness(es) identified | No |
| • Significant deficiency identified that are not considered to be material weaknesses | No |
| Non-compliance material to financial statements noted | Yes |

Federal Awards:

| | |
|--|-------------|
| Internal control over major federal programs: | |
| • Material weakness(es) identified | No |
| • Significant deficiency identified that are 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 Section 510(a) of Circular A -133 | No |
| Identification of major federal programs: | |

| <u>Program Name</u> | <u>CFDA #</u> |
|--|---------------|
| USDA Rural Development Community Facilities Loans and Grants - ARRA | 10.766 |
| Recovery Act Energy Efficiency and Conservation Block Grant - ARRA | 81.128 |
| Federal Emergency Management - Public Assistance Grants | 97.036 |
| Dollar threshold used to distinguish between Type A and Type B Programs | \$300,000 |
| Auditee qualified as low-risk auditee? | No |

CITY OF KINSTON, NORTH CAROLINA

**SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2012**

State Awards:

Internal control over major State programs:

- Material weakness(es) identified No
- Significant deficiency identified that are 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 No

Identification of major State programs:

Program Name

Powell Bill
Federal Emergency Management - Public Assistance Grants
NC Department of Commerce - Industrial Development Fund-Dopaco, Inc. Generator Project

CITY OF KINSTON, NORTH CAROLINA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2012

2. Findings Related to the Audit of the Financial Statements

Finding 2012-01 Deficit Fund Equity

Criteria: North Carolina General Statutes preclude units from having funds that operate in a deficit.

Condition: In the current year, there were violations of the General Statutes regarding deficit fund equity in various Nonmajor Governmental Funds, the Warehouse Internal Service Fund, and the Fleet Maintenance Internal Service Fund.

Context: During our audit procedures, we noted violations General Statutes noted above.

Effect: The City was in violation of North Carolina General Statutes.

Cause: The City adopted a balance budget; however, revenues were insufficient to cover the cost of operations.

Recommendation: The City should reevaluate the cost of providing services and adjust charges to insure that revenues cover all related cost.

Contact Person: Catherine Gwynn, Finance Director

Views of Responsible Officials and Planned Corrective Actions: The City will re-evaluate the charges for services and the cost of providing services for the Warehouse Inventory Fund and the Fleet Maintenance Fund to ensure that operations are breaking even.

This will involve periodic review on a quarterly basis to assess whether this goal is being met and if not being met we will address Council with proposed corrective measures which may involve additional appropriations from participating funds or cutting expenditures within funds.

As to the deficit balances in the Warehouse Inventory Fund and Fleet Maintenance Fund, the City Council recently approved the consolidation of the deficit balance into one fund, the Fleet Maintenance Fund. This consolidated deficit occurring from fiscal year 2005 through 2011 will be repaid over a 5 year period based on a ratio of spending over a 7 year historical average. A one-half year payment will be paid in fiscal year 2013, a full year payment for fiscal year 2014 through 2017, and a one-half year final payment in fiscal year 2018.

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

None

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

None

CITY OF KINSTON, NORTH CAROLINA
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2012

Finding 2011-01 - Repeated as 2012-01

CITY OF KINSTON, NORTH CAROLINA

**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

| <u>Grantor/Pass-Through Grantor/Program Title</u> | <u>Federal CFDA Number</u> | <u>State Pass-Through Grantor's Number</u> | <u>Federal Direct and Pass-Through Expenditures</u> | <u>State Expenditures</u> |
|--|------------------------------------|--|---|-------------------------------|
| Federal Grants: | | | | |
| U.S. Department of Homeland Security | | | | |
| Federal Emergency Management - Public Assistance Public Assistance Grants | 97.036 | | \$ 908,125 | \$ 302,709 |
| U.S. Department of Housing and Urban Development | | | | |
| Passed-Through the NC Department of Commerce Community Development Block Grant - Abby Gardens | 14.228 | | 192,717 | - |
| U.S. Department of Energy | | | | |
| Recovery Act Energy Efficiency and Conservation Block Grant - ARRA | 81.128 | | 499,081 | - |
| US Department of Justice | | | | |
| 2010 Ballistic Vest Grant | 16.607 | | 13,122 | - |
| 2010 Justice Assistance Grant | 16.738 | | 774 | - |
| 2011 Justice Assistance Grant | 16.738 | | 46,592 | - |
| Community Oriented Policing Services - ARRA | 16.710 | | <u>81,648</u> | <u>-</u> |
| Total US Department of Justice | | | <u>142,136</u> | <u>-</u> |
| USDA Rural Development | | | | |
| Community Facilities Loans and Grants - ARRA | 10.766 | | <u>1,890,083</u> | <u>-</u> |
| Total USDA Rural Development | | | <u>1,890,083</u> | <u>-</u> |
| State Grants: | | | | |
| NC Department of Transportation | | | | |
| Non-State System Street Aid Allocation (Powell Bill) | | DOT-4 | - | 614,365 |
| Martin Luther King Jr. Blvd. Enhancement Golden LEAF Grant | | | - | 89,004 |
| Spirit AeroSystems Rail Spur Project | | | <u>-</u> | <u>43,404</u> |
| Total NC Department of Transportation | | | <u>-</u> | <u>746,773</u> |
| NC Department of Environment and Natural Resources | | | | |
| Clean Water Management Trust Fund - College Street Sewer Rehabilitation | | | - | 824,272 |
| Clean Water Management Trust Fund - Flood Buy-Out II Project | | | - | 24,120 |
| Clean Water Management Trust Fund - Battlefield Parkway/Soccer Complex | | | - | 73,923 |
| Rural Development Center Grant - Sanderson Farms Utilities | | | - | 5,730 |
| Rural Development Center Grant - Pollock Street Sewer Project | | | - | 288,335 |
| Rural Development Center Grant - Neuse Outfall Sewer Evaluation | | | - | 44,750 |
| Rural Development Center Grant - Smithfield Plant Expansion Project | | | <u>-</u> | <u>52,800</u> |
| Total NC Department of Environment and Natural Resources | | | <u>-</u> | <u>1,313,930</u> |
| NC Department of Commerce | | | | |
| Division of Commerce Finance Center: | | | | |
| Energy Efficiency Improvements Grant | | | - | 58,434 |
| Industrial Development Fund - Dopaco, Inc. Generator Project | | | - | 856,601 |
| Office of Community Investment: | | | | |
| Talent Enhancement and Capacity Grant | | | <u>-</u> | <u>20,315</u> |
| Total NC Department of Commerce | | | <u>-</u> | <u>935,350</u> |

CITY OF KINSTON, NORTH CAROLINA

**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2012**

| <u>Grantor/Pass-Through Grantor/Program Title</u> | <u>Federal CFDA Number</u> | <u>State Pass-Through Grantor's Number</u> | <u>Federal Direct and Pass-Through Expenditures</u> | <u>State Expenditures</u> |
|---|------------------------------------|--|---|-------------------------------|
| NC Department of Crime Control and Public Safety | | | | |
| Governor's Crime Commission | | | - | 1,495 |
| Total NC Department of Crime Control and Public Safety | | | - | 1,495 |
| Total Federal expenditures | | | <u>\$ 3,632,142</u> | |
| Total State expenditures | | | | <u>\$ 3,300,257</u> |

Note 1. Basis of Presentation

The accompanying Schedule of Expenditures of Federal and State Awards includes the federal and State grant activity of the City of Kinston, North Carolina, 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, and Non-Profit Organizations*, and the State Single Audit Implementation Act. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of the basic financial statements.

Note 2. Loans Outstanding

The City of Kinston had the following loan balances outstanding at June 30, 2012. These loan balances outstanding are also included in the federal expenditures presented in the schedule.

| <u>USDA Rural Development:</u> | <u>CFDA Number</u> | <u>Amount Outstanding</u> |
|---|------------------------|-------------------------------|
| Community Facilities Loans and Grants -ARRA | 10.766 | \$ 4,859,041 |