

McGladrey & Pullen

Certified Public Accountants

City of Kinston, North Carolina

Compliance Report

Year Ended June 30, 2005

Contents

Compliance Reports

Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	1 - 2
Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Federal Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 and the State Single Audit Implementation Act	3 - 4
Independent Auditor's Report on Compliance With Requirements Applicable to Each Major State Program and on Internal Control Over Compliance in Accordance With Applicable Sections of OMB Circular A-133 and the State Single Audit Implementation Act	5 - 6
Schedule of findings and questioned costs	7 - 9
Corrective action plan	10
Summary schedule of prior audit findings	11
Schedule of expenditures of federal and state awards	12 - 13

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Certified Public Accountants

**Independent Auditor's 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 City of Kinston, North Carolina, as of and for the year ended June 30, 2005, which collectively comprise City of Kinston's basic financial statements, and have issued our report thereon dated September 8, 2005. 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

In planning and performing our audit, we considered City of Kinston'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 an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involved matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect City of Kinston's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs as item 05-1.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe that the reportable condition referred to above is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether 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, 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 and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Mayor, members of the City Council, management, federal and State awarding agencies, pass-through entities and the North Carolina Department of the State Treasurer and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Morehead City, North Carolina
September 8, 2005

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report on Compliance With Requirements Applicable to Each Major Federal Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 and the State Single Audit Implementation Act

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

Compliance

We have audited the compliance of City of Kinston, 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 its major federal program for the year ended June 30, 2005. City of Kinston's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to its major federal program is the responsibility of City of Kinston's management. Our responsibility is to express an opinion on 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; 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 noncompliance 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 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 on City of Kinston's compliance with those requirements.

In our opinion, City of Kinston complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended June 30, 2005.

Internal Control Over Compliance

The management of 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 City of Kinston'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 and to test and report on internal control over compliance in accordance with OMB Circular A-133 and the State Single Audit Implementation Act.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

Schedule of Expenditures of Federal and State Awards

We have audited the basic financial statements of City of Kinston, North Carolina as of and for the year ended June 30, 2005, and have issued our report thereon dated September 8, 2005. Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule of expenditures of federal and State awards is presented for the 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 basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Mayor, members of the City Council, management, federal awarding agencies, pass-through entities and the North Carolina Department of the State Treasurer and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Morehead City, North Carolina
September 8, 2005

McGladrey & Pullen

Certified Public Accountants

Independent Auditor's Report on Compliance With Requirements Applicable to Each Major State Program and on Internal Control Over Compliance in Accordance With Applicable Sections of OMB Circular A-133 and the State Single Audit Implementation Act

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

Compliance

We have audited the compliance of City of Kinston, 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, 2005. City of Kinston's major State programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major State programs is the responsibility of City of Kinston's management. Our responsibility is to express an opinion on 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; 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 noncompliance 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 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 on City of Kinston's compliance with those requirements.

In our opinion, City of Kinston 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, 2005.

Internal Control Over Compliance

The management of 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 City of Kinston'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 and to test and report on internal control over compliance in accordance with applicable sections of OMB Circular A-133 and the State Single Audit Implementation Act.

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major State program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Mayor, members of the City Council, management, State awarding agencies, pass-through entities and the North Carolina Department of the State Treasurer and is not intended to be and should not be used by anyone other than these specified parties.

McGladrey & Pullen, LLP

Morehead City, North Carolina
September 8, 2005

City of Kinston, North Carolina

**Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 2005**

Section 1. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unqualified

Internal control over financial reporting:

• Material weakness(es) identified? _____ yes no

• Reportable condition(s) identified that are not considered to be material weaknesses? yes _____ no

Noncompliance material to financial statements noted? _____ yes no

Federal Awards

Internal control over major federal programs:

• Material weakness(es) identified? _____ yes no

• Reportable condition(s) identified that are not considered to be material weaknesses? yes none reported

Type of auditor's 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 Circular A-133? _____

yes no

(Continued)

City of Kinston, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2005

Identification of major federal program:

CFDA #	Program Name
97.036	Federal Emergency Management Agency Public Assistance Grant

Dollar threshold used to distinguish between Type A and
Type B Programs

\$300,000

Auditee qualified as low-risk auditee? yes no

State Awards

Internal control over major State programs:

- Material weakness(es) identified? yes X no
- Reportable condition(s) identified that are not
considered to be material weaknesses? yes X none reported

Type of auditor's 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 X no

Identification of major State programs:

NC Object #	Program Name
N/A	Nonstate System Street Aid Allocation (Powell Bill)
N/A	Federal Emergency Management Agency Public Assistance Grant

(Continued)

City of Kinston, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2005

Section 2. Financial Statement Findings

Finding: 05 - 1 Segregation of Duties - MIS

A. Internal Controls

Condition: Due to the limited number of employees in the City's electronic data processing department, there is a lack of segregation of duties. Specifically, persons with programming capabilities have access to the system's data files (database), which contain all of the City's transactions.

Recommendation: When a lack of segregation of employee duties is present, management must implement supervisory and review controls to mitigate the control problem.

Section 3. Federal Award Findings and Questioned Costs

None

Section 4. State Award Findings and Questioned Costs

None

City of Kinston, North Carolina

**Corrective Action Plan
For the Fiscal Year Ended June 30, 2005**

Section 2. Financial Statement Findings

Finding 04-1 Segregation of Duties - MIS

Contact Name: Catherine Gwynn

Corrective Action: Due to the limited number of staff available, a complete segregation of duties is not practical. However, certain procedures have been implemented to increase segregation including increased management awareness of the issue and authorization of the additional hiring of an employee.

Effective Date: September 8, 2005

Section 3. Federal Award Findings and Questioned Costs

No corrective action plan is required in the current year.

Section 4. State Award Findings and Questioned Costs

No corrective action plan is required in the current year

City of Kinston, North Carolina

**Summary Schedule of Prior Audit Findings
For the Fiscal Year Ended June 30, 2005**

Prior year finding 04-1:

See Finding 05 - 1 under the current year schedule of findings and questioned costs.

City of Kinston, North Carolina

**Schedule of Expenditures of Federal and State Awards
For the Fiscal Year Ended June 30, 2005**

Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	State Pass-Through Grantor's Number	Expenditures		
			Federal Direct and Pass-Through	State	Local
Federal Grants:					
Environmental Protection Agency					
Direct Program:					
Special Purpose Grant	66.606		\$ 86,192	\$ -	\$ -
US Department of Housing and Urban Development					
Pass through: NC Department of Commerce					
Single Family Rehabilitation	14.228		148,547	-	73,313
CDBG -Program Income	14.228		3,197	-	113,854
Total US Department of Housing and Urban Development			151,744	-	187,167
US Department of Justice					
Direct Programs:					
Local Law Enforcement Block					
Grant - 2004	16.592		11,348	-	934
2004 GCC Computers on Patrol	16.579		5,780	-	-
Pass through: Lenoir County School System					
School Resource Officer	16.710		69,917	-	-
Total US Department of Justice			87,045	-	934
US Department of Transportation					
Pass through: NC Department of Transportation					
Governor's Highway Safety Program -2005	20.600		-		20,000
Governor's Highway Safety Program - 2004	20.600		4,798	-	1,600
Total US Department of Transportation			4,798	-	21,600
US Department of Homeland Security					
Pass through: NC Department of Crime Control and Public Safety					
Public Assistance Grants	97.036		9,432,361	3,144,121	-
Hazard Mitigation Grant Program	97.039		144,866	48,288	-
Total US Department of Homeland Security			9,577,227	3,192,409	-

(Continued)

City of Kinston, North Carolina

Schedule of Expenditures of Federal and State Awards (Continued)
For the Fiscal Year Ended June 30, 2005

Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	State Pass-Through Grantor's Number	Expenditures		
			Federal Direct and Pass-Through	State	Local
State Grants (all direct):					
NC Department of Transportation Nonstate System Street Aid Allocation (Powell Bill)		N/A	\$ -	\$ 607,347	\$ -
NC Department of Environment and Natural Resources Clean Water Management Trust Fund			-	704,310	-
Land and Water Conservation Fund			-	19,000	-
Rural Development Center Grant			-	55,030	-
Salvage Yard Buyout			-	828,998	-
NC Clean Water Revolving Loan and Grant Fund			-	765,000	-
Total NC Department of Environment and Natural Resources			-	2,372,338	-
NC Department of Commerce Division of Community Assistance Smithfield Grant	98-R-0005			32,462	-
State Acquisition and Relocation			-	264	-
Total NC Department of Commerce			-	32,726	-
NC Department of Crime Control and Public Safety Redevelopment Center Victims Advocate Grant			-	7,500	-
Total federal expenditures			<u>\$ 9,907,006</u>		
Total State expenditures				<u>\$ 6,212,320</u>	
Total local expenditures					<u>\$ 209,701</u>

Note 1. Basis of Presentation

The accompanying schedule of expenditures of federal and State awards includes the federal and State grant activity of 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*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

