

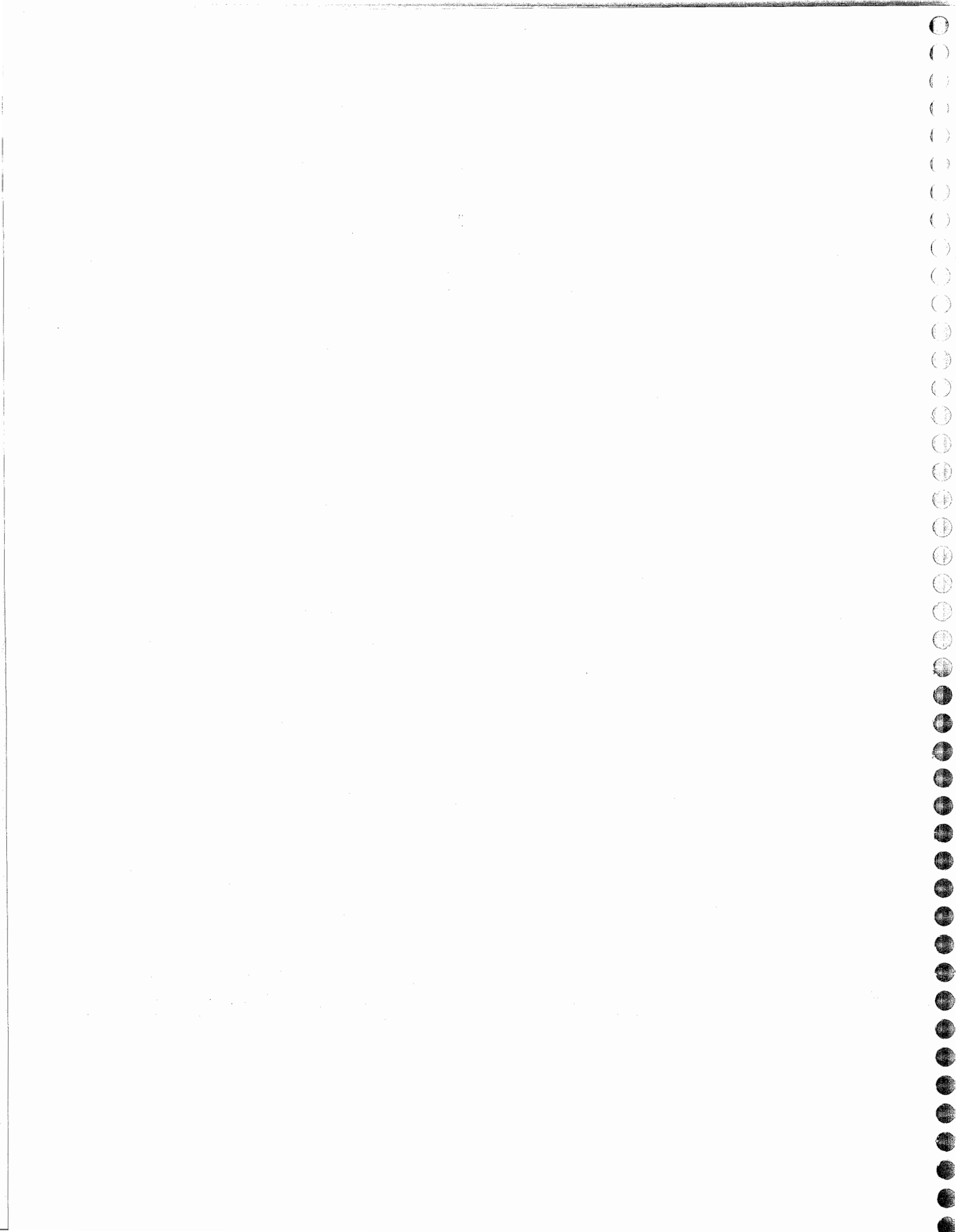
McGladrey & Pullen

Certified Public Accountants

City of Kinston, North Carolina

Compliance Report

Year Ended June 30, 2004



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Compliance Reports

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McGladrey & Pullen

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, 2004, which collectively comprise City of Kinston's basic financial statements, and have issued our report thereon dated September 17, 2004. 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 assurance 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 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 or management in the financial statements. The reportable condition is described in the accompanying schedule of findings and questioned costs as item 04-1.

A material weakness is a 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 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 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 17, 2004

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 each of its major federal programs for the year ended June 30, 2004. City of Kinston's major federal 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 federal 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; 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 each of its major federal programs for the year ended June 30, 2004.

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 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, 2004, and have issued our report thereon dated September 17, 2004. 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 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 17, 2004

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, 2004. 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, 2004.

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 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 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 17, 2004

City of Kinston, North Carolina

**Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 2004**

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? | <u> </u> | yes | <u> X </u> | no |
| • Reportable condition(s) identified that are not considered to be material weaknesses? | <u> X </u> | yes | <u> </u> | no |

Noncompliance material to financial statements noted?

<u> </u>	yes	<u> X </u>	no
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Federal Awards

Internal control over major federal programs:

- | | | | | |
|---|-------------------|-----|------------------|---------------|
| • Material weakness(es) identified? | <u> </u> | yes | <u> X </u> | no |
| • Reportable condition(s) identified that are not considered to be material weaknesses? | <u> </u> | yes | <u> X </u> | 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?

<u> </u>	yes	<u> X </u>	no
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(Continued)

City of Kinston, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2004

Identification of major federal program:

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

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

\$300,000

Auditee qualified as low-risk auditee? X 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	Salvage Yard Buyout Program
N/A	Clean Water Management Trust Fund

(Continued)

City of Kinston, North Carolina

**Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2004**

Section 2. Financial Statement Findings

Finding: 04 - 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 Year Ended June 30, 2004**

Section 2. Financial Statement Findings

Finding 03-1 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 17, 2004

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 Year Ended June 30, 2004**

Prior year finding 03-1:

See Finding 04 - 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 Year Ended June 30, 2004**

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		\$ 918,950	\$ -	\$ -
US Department of Housing and Urban Development					
Pass through: NC Department of Commerce					
Single Family Rehabilitation	14.228		-	-	4,310
Oaks Apartments Project	14.228		9,375	-	(7,887)
Total US Department of Housing and Urban Development			9,375	-	(3,577)
US Department of Justice					
Direct Programs:					
Local Law Enforcement Block					
Grant - 2003	16.592	03-LBVX-2316	31,757	-	934
2003 GCC Computers on Patrol	16.579		47,952	-	15,984
Pass through: Lenoir County School System					
School Resource Officer	16.594		70,582	-	-
Total US Department of Justice			150,291	-	16,918
US Department of Transportation					
Pass through: NC Department of Transportation					
Enhancement Project	20.205		8,306	-	-
Governor's Highway Safety Program - 2004	20.600		31,210	-	10,403
Total US Department of Transportation			39,516	-	10,403
US Department of Homeland Security					
Pass through: NC Department of Crime Control and Public Safety					
Public Assistance Grants	97.036		606,185	202,062	-
Assistance to Fire Fighters	97.044		34,625	11,541	4,354
Hazard Mitigation Grant Program	97.039		1,068,928	356,309	-
Total US Department of Homeland Security			1,709,738	569,912	4,354

City of Kinston, North Carolina

Schedule of Expenditures of Federal and State Awards (Continued)
For the Year Ended June 30, 2004

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	\$ -	\$ 548,326	\$ -
NC Department of Environment and Natural Resources					
Clean Water Management Trust Fund			-	1,533,991	1,937
Rural Development Center Grant			-	2,957	-
Clean Water Management Trust Fund			-	-	-
Salvage Yard Buyout			-	306,502	(7,381)
NC Clean Water State Revolving Loan Fund			-	404,966	-
Total NC Department of Environment and Natural Resources			-	2,248,416	(5,444)
NC Department of Commerce					
Division of Community Assistance					
State Acquisition and Relocation		98-R-0005	-	-	-
NC Department of Crime Control and Public Safety					
Redevelopment Center					
Crisis Housing Assistance Funds			-	52,237	(52,237)
Victims Advocate Grant			-	116,500	-
State Tenant Relocation Assistance		98-R-0005	-	279,474	(278,624)
Total NC Department of Commerce			-	448,211	(330,861)
Total federal expenditures			<u>\$ 2,827,870</u>		
Total State expenditures				<u>\$ 3,814,865</u>	
Total local expenditures					<u>\$ (308,207)</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.





