

City of Kinston, North Carolina

Compliance Report
Year Ended June 30, 2007

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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, 2007, which collectively comprise City of Kinston's basic financial statements, and have issued our report thereon dated October 31, 2007. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements but not to for the purpose of expressing an opinion on the effectiveness of City of Kinston's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of City of Kinston's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified a certain deficiency in internal control over financial reporting that we consider to be a significant deficiency.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential, will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying schedule of findings and questioned costs to be a significant deficiency in internal control over financial reporting. The significant deficiency is described in the accompanying schedule of findings and questioned costs as item 07-1.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

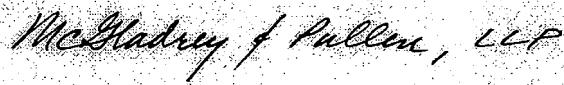
Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe that the significant deficiency described 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 or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain other matters that we reported to management of City of Kinston in a separate letter dated October 31, 2007.

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.

A handwritten signature in black ink that reads "McGladrey & Pullen, LLP". The signature is cursive and appears to be a professional business name.

Morehead City, North Carolina
October 31, 2007

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, 2007. 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, 2007.

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, 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 City of Kinston's internal control over compliance.

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential, will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program that is more than inconsequential, will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be 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. However, we noted certain other matters that we reported to management of City of Kinston in a separate letter dated October 31, 2007.

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, 2007, and have issued our report thereon dated October 31, 2007. 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.



Morehead City, North Carolina
October 31, 2007

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, 2007. 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, 2007.

Internal Control Over Compliance

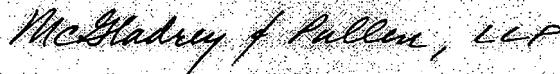
The management of City of Kinston is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to State programs. In planning and performing our audit, we considered City of Kinston's internal control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

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a State program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a State program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a State program that is more than inconsequential, will not be prevented or detected by the entity's internal control.

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Morehead City, North Carolina
October 31, 2007

City of Kinston, North Carolina

**Schedule of Findings and Questioned Costs
For the Fiscal Year Ended June 30, 2007**

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 _____ X _____ no

• Significant deficiency(ies) identified that are not considered to be material weaknesses? _____ X _____ yes _____ no

Noncompliance material to financial statements noted? _____ yes _____ X _____ no

Federal Awards

Internal control over major federal programs:

• Material weakness(es) identified? _____ yes _____ X _____ no

• Significant deficiency(ies) identified that are not considered to be material weaknesses? _____ yes _____ X _____ 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 _____ X _____ no

(Continued)

City of Kinston, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2007

Identification of major federal programs:

CFDA #	Program Name
97.036	Federal Emergency Management Agency Public Assistance Grant
66.458	Clean Water State Revolving Loan Fund
10.766	Community Facilities Grant and Loan Program

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
- Significant deficiency(ies) 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	Clean Water Management Trust Fund --Flood Buy-out Project
N/A	Federal Emergency Management Agency Public Assistance Grant
N/A	Clean Water State Revolving Loan Fund

(Continued)

City of Kinston, North Carolina

Schedule of Findings and Questioned Costs (Continued)
For the Fiscal Year Ended June 30, 2007

Section 2. Financial Statement Findings

Finding: 07 - 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 should 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, 2007

Finding 07-1 Segregation of Duties - MIS

Contact Name: Scott Stevens

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 improve segregation of duties including increased management awareness of the issue and authorization of the additional hiring of an employee.

Effective Date: September 15, 2006

No corrective action plan is required in the current year for federal and State awards.

City of Kinston, North Carolina

**Summary Schedule of Prior Audit Findings
For the Fiscal Year Ended June 30, 2007**

Prior year finding 06-1:

See Finding 07 - 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, 2007**

Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grantor's Number	State Expenditures		
			Federal	Pass-Through	Federal
Federal Grants:					
Environmental Protection Agency					
Direct Program:					
Special Purpose Grant	66.606		\$ 206,625	\$ -	\$ -
Pass through: NC Department of Environment and Natural Resources - Division of Water Quality					
Clean Water State Revolving Loan Fund	66.458		5,260,395	1,315,049	-
Total Environmental Protection Agency			5,467,020	1,315,049	-
US Department of Housing and Urban Development					
Pass through: NC Department of Commerce					
CDBG - Program income	14.228		8,041	-	834
Oaks Apartments Project	14.228		2,233	-	(2,233)
Total US Department of Housing and Urban Development			10,274	-	(1,399)
US Department of Justice					
Direct Programs:					
Ballistic Vest Grant	16.592		8,264	-	-
Justice Assistance Grant	16.738		24,649	-	-
Pass through: Lenoir County School System					
School Resource Officer	16.710		73,290	-	-
Total US Department of Justice			106,203	-	-
US Department of Agriculture					
Direct Program					
Community Facilities Grants and Loans	10.766		1,218,926	-	14,000
US Department of Homeland Security					
Federal Emergency Management Agency					
Pass through: NC Department of Crime Control and Public Safety					
Viper Grant	97.004		101,200	-	-
Public Assistance Grants	97.036		2,661,754	887,251	-
Total US Department of Homeland Security			2,762,954	887,251	-

(Continued)

City of Kinston, North Carolina

Schedule of Expenditures of Federal and State Awards (Continued)
For the Fiscal Year Ended June 30, 2007

Grantor/Pass-Through Grantor/Program Title	CFDA Number	Grantor's Number	State Expenditures		
			Federal	Pass-Through	Federal
State Grants (all direct):					
NC Department of Transportation Nonstate System Street Aid Allocation (Powell Bill)	N/A		\$	-	\$ 615,442
NC Department of Environment and Natural Resources Clean Water Management Trust Fund Water Reuse				-	19,178 20,777
Flood Buy-Out Project				-	375,261
Rural Development Center Grant				-	200,000
Rural Development Center Grant - Briery Run				-	253,122
Rural Development Center Grant - Smithfield				-	9,510 9,957
Division of Parks and Recreation Part F Grant				-	14,637 93,793
Total NC Department of Environment and Natural Resources				-	871,708 124,527
NC Department of Commerce Division of Community Assistance Kinston Enterprise Center Incubator Project				-	53,003
NC Department of Health and Human Services Caswell Center Project				-	29,738 39,504
NC Department of Crime Control and Public Safety Governor's Crime Commission Gang Awareness, Training and Education				-	30,505 17,757
Total federal expenditures			\$	9,565,377	
Total State expenditures					\$ 3,802,696
Total local expenditures					\$ 194,389

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.

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