

**CITY OF KINSTON  
KINSTON, NORTH CAROLINA**

**COMPLIANCE LETTERS**

**FOR THE YEAR ENDED JUNE 30, 2009**

# **CITY OF KINSTON, NORTH CAROLINA**

## **Compliance Letters For the Year Ended June 30, 2009**

### **Table of Contents**

	<u>Page</u>
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
Report On Compliance With Requirements Applicable to Each Major Federal Program and Internal Control Over Compliance In Accordance With OMB Circular A-133 and the State Single Audit Implementation Act	3-4
Report On Compliance With Requirements Applicable to 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	5-6
Schedule of Findings, Responses, and Questioned Costs	7-9
Summary Schedule of Prior Audit Findings	10
Schedule of Expenditures of Federal and State Awards	11-12

# 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 accompanying 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, 2009, which collectively comprises the City of Kinston's basic financial statements, and have issued our report thereon dated October 9, 2009. 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 the City of Kinston's internal control over financial reporting as a basis for designing 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's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

Our consideration of 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 internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 City'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 City's financial statements that is more than inconsequential will not be prevented or detected by the City's internal control. We consider the deficiency described in the accompanying Schedule of Findings, Responses, and Questioned Costs as item 2009-01 to be a significant deficiency in internal control over financial reporting.

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 City'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, of the significant deficiencies described above, we consider 2009-01 to be a material weakness.

### **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 and other matters with certain provisions of laws, regulations, contracts and grants, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance and other matters 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 an instance of non-compliance that is required to be reported under *Government Auditing Standards* which is described in the accompanying Schedule of Findings, Responses, and Questioned Costs as item 2009-02.

The City's responses to the findings identified in our audit are described in the accompanying Schedule of Findings, Responses, and Questioned Costs. We did not audit the City's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the City Council, management, others within the organization, and 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.  
October 9, 2009

# MARTIN ♦ STARNES & ASSOCIATES, CPAs, P.A.

---

*"A Professional Association of Certified Public Accountants and Management Consultants"*

## **Report On Compliance With Requirements Applicable To Each Major Federal Program And 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 the 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, 2009. 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 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 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 on the City of Kinston's compliance with those requirements.

In our opinion, the City of Kinston, North Carolina 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, 2009.

## **Internal Control Over Compliance**

The management of the City of Kinston is responsible for establishing and maintaining effective internal control over compliance with 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 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 the City's internal control over compliance.

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

## **Schedules 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, as of and for the year ended June 30, 2009, and have issued our report thereon dated October 9, 2009. Our audit was performed 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 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 audit committee, management, others within the organization, members of City Council, and 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.  
October 9, 2009

# MARTIN ♦ STARNES & ASSOCIATES, CPAs, P.A.

---

*"A Professional Association of Certified Public Accountants and Management Consultants"*

## **Report On Compliance With Requirements Applicable To 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**

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, 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, 2009. 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, 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 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, North Carolina, 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, 2009.

### **Internal Control Over Compliance**

The management of the City of Kinston is responsible for establishing and maintaining effective internal control over compliance with 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 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 the City's internal control over compliance.

A control deficiency in the City'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 non-compliance 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 City's ability to administer a State program such that there is more than a remote likelihood that non-compliance with a type of compliance requirement of a State program that is more than inconsequential will not be prevented or detected by the City'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 non-compliance with a type of compliance requirement of a State program will not be prevented or detected by the City's internal control.

Our consideration of the internal control over compliance was for the limited purpose described in the preceding paragraph of this section and would not necessarily identify all deficiencies in the City's 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.

#### **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 as of and for the year ended June 30, 2009, and have issued our report thereon dated October 9, 2009. Our audit was performed 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 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 audit committee, management, others within the organization, members of City Council, and 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.  
October 9, 2009

## **CITY OF KINSTON, NORTH CAROLINA**

### **SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009**

#### **1. Summary of Auditors' Results**

- A. An unqualified opinion was issued on the financial statements of the City of Kinston, North Carolina.
- B. Our audit of the basic financial statements disclosed a significant deficiency and material weakness in internal controls (2009-01).
- C. Our audit of the basic financial statements disclosed an instance of non-compliance with laws, regulations, and the provisions of contracts and grant agreements that are material to the basic financial statements (2009-02).
- D. Our audit of compliance with the types of compliance requirements applicable to the City's major programs disclosed no significant deficiencies or material weakness in internal controls over major programs.
- E. An unqualified opinion was issued on the City of Kinston, North Carolina's compliance with the types of compliance requirements applicable to its major federal programs.
- F. An unqualified opinion was issued on the City of Kinston, North Carolina's compliance with the types of compliance requirements applicable to its major State programs.
- G. Our audit disclosed no audit findings which related to federal and State awards.
- H. Major federal programs for the City of Kinston, North Carolina, for the fiscal year ended June 30, 2009 are:

<b><u>Program Name</u></b>	<b><u>CFDA#</u></b>
----------------------------	---------------------

Family Emergency Management Agency Public Assistance Grant	97.036
--	--------

- I. Major State programs for the City of Kinston, North Carolina for the fiscal year ended June 30, 2009 are:

Powell Bill

Family Emergency Management Agency Public Assistance Grant Clean Water Management Trust Fund Water Reuse

N.C. Department of Health and Human Services-Caswell Center Project N.C. Rural Development Center Grant

- J. The threshold for determining Type A programs for the City of Kinston, North Carolina is \$300,000.
- K. The City of Kinston, North Carolina, did not qualify as a low risk auditee under Section .530 of Circular No. A-133.

## CITY OF KINSTON, NORTH CAROLINA

### **SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009**

#### **2. Findings Related to the Audit of the Basic Financial Statements**

##### **2009-01 Material Prior Period Adjustments**

**Criteria:** Management should have a system in place to reduce the likelihood of errors in financial reporting.

**Condition:** In the current year, beginning assets for the governmental activities, Electric, Water and Wastewater Funds were restated due to lack of internal policies regarding tracking construction in progress.

**Effect:** For the statements affected, the prior year amounts were misstated.

**Cause:** Inadequate policy regarding tracking construction in progress.

**Recommendation:** Implementation of a City policy, requiring management to review project expenses and reconcile construction in progress on a monthly basis. Proper review of the audited financial statements should be implemented to prevent prior period adjustments in the future.

**Contact Person:** Keith Fiaschetti, Finance Director

**Management's Response:** Management concurs and has implemented an internal policy.

##### **2009-02 Noncompliance with Bond Covenants**

**Criteria:** Management should have a system in place to reduce the likelihood of errors in financial reporting and to ensure compliance with applicable laws, regulations, contracts, and grant agreements.

**Condition:** Pursuant to bond and related agreements, the City has certain covenants that provide for rates to be set at levels annually to maintain certain debt service coverage ratios. In addition, rates must be set at levels to provide for the payment of current expenses and to provide deposits to meet certain trust fund requirements associated with the bond agreements. The City is not in compliance with the debt covenants above.

**Effect:** Per the bond trust agreement, within 30 days of the receipt of the audit report, management must hire a Consultant to make its recommendation, if any, as to a revision in rates, current expenses, or the method of operation of the combined enterprise system funds in order to satisfy the requirements of the bond agreement. Copies of such request and of the recommendation of the Consultant, if any, must be filed by the City with the Trustee and the Local Government Commission. If the City fails to comply with the recommendations of the Consultant or with its own recommended action legal proceedings can be taken, forcing the City to revise rates or its nature of operations to ensure compliance.

## CITY OF KINSTON, NORTH CAROLINA

### **SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2009**

**Cause:** Inadequate monitoring of revenues, expenditures and future debt service requirements to ensure compliance, in light of changes in operations in the current year.

**Recommendation:** Within 30 days of the receipt of the audit report, management must hire a Consultant to make recommendations, if any, as to a revision in rates, current expenses, or the method of operation of the combined enterprise system funds in order to satisfy the requirements of the bond agreement. Copies of such request and of the recommendation of the Consultant, if any, must be filed by the City with the Trustee and the Local Government Commission. Management should project, at least quarterly, where it stands with regards to covenant compliance.

**Contact Person:** Keith Fiaschetti, Finance Director

**Management's Response:** The reason the City is out of compliance is two fold:

1. A one-time payment in the water fund of \$900 thousand representing incentives to a large manufacturer building a production facility at the Global TransPark (GTP) in Kinston.
2. New minimum payments (effective 9/1/2008) to the Neuse Regional Water and Sewer Authority reflecting purchase of surface water per State mandated regulations requiring the City (along with many other Eastern North Carolina communities) that depend on aquifers' to start turning to surface water in an effort to preserve the water supply in the underground reservoir.

With regard to No. 2 above, prior to fiscal year ended June 30, 2009 we established a water rate stabilization capital reserve fund. According to GAAP, this revenue was recognized in prior years and the expenditures in fiscal year ended 2009. This threw off our covenant ratio this year (fiscal year 2009) as the revenue was received in prior years and the expenditure was incurred in the current year.

As per the bond trust agreement within 30 days of the receipt of the audit report, we will hire a Consultant to make recommendation, if any, as to a revision in rates, current expenses, or the method of operation of the combined enterprise system fund in order to satisfy the requirements of the bond agreement. Copies of such request and of the recommendation of the Consultant, if any, shall be filed by the City with the Trustee and the LGC.

#### **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 AUDIT FINDINGS  
FOR THE YEAR ENDED JUNE 30, 2009**

No prior year findings.

## CITY OF KINSTON

### SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	State Pass-Through Grantor's Number	Federal Direct and Pass-Through Expenditures	State Expenditures
<b>Federal Grants:</b>				
U.S. Department of Transportation				
Passed through the North Carolina Department of Transportation:				
Highway Safety Cluster - Occupant Protection	20.602		\$ 10,324	\$ -
U.S. Department of Housing and Urban Development				
Pass through: N.C. Department of Commerce				
Individual Development Account	14.228		19,525	-
U.S. Department of Justice				
Direct Programs:				
Ballistic Vest Grant	16.592		9,890	-
<b>Total U.S. Department of Justice</b>			<u>9,890</u>	<u>-</u>
U.S. Department of Homeland Security				
Federal Emergency Management Agency				
Pass Through: N.C. Department of Crime				
Control and Public Safety				
Public Assistance Grants	97.036		2,770,047	923,343
<b>Total U.S. Department of Homeland Security</b>			<u>2,770,047</u>	<u>923,343</u>
<b>State Grants (all direct):</b>				
N.C. Department of Transportation				
Non-State System Street Aid				
Allocation (Powell Bill)	DOT-4		-	702,690
N.C. Department of Environment and				
Natural Resources				
Clean Water Management Trust Fund Water Reuse			-	663,900
Clean Water Management Trust Fund - College Street Sewer Rehabilitation			-	90,900
Flood Buy-Out Project			-	135,811
Rural Development Center Grant			-	-
Rural Development Center Grant-E Vernon Ave. Sewer Rehab			-	226,554
Rural Development Center Grant-Smithfield			-	3,778
Rural Development Center Grant-Spirit AeroSystems Utilities			-	<u>194,477</u>
<b>Total N.C. Department of Environment and Natural Resources</b>			<u>-</u>	<u>1,315,420</u>
N.C. Department of Commerce				
Division of Community Assistance:				
Kinston Enterprise Center Incubator Project			-	11,642
Division of Commerce Finance Center:				
Industrial Development Fund-Lenox China Generator Project			-	40,210
<b>Total NC Department of Commerce</b>			<u>-</u>	<u>51,852</u>

## CITY OF KINSTON

### SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS FOR THE FISCAL YEAR ENDED JUNE 30, 2009

Grantor/Pass-Through Grantor/Program Title	Federal CFDA Number	State Pass-Through Grantor's Number	Federal Direct and Pass-Through Expenditures	State Expenditures
N.C. Department of Health and Human Services Caswell Center Project				1,338,672
N.C. Department of Crime Control and Public Safety Governor's Crime Commission				
Gang Awareness, Training and Education			-	21,835
Gang Awareness, Training and Education Expansion			-	82,008
			-	103,843
<b>Total federal expenditures</b>			<b>\$ 2,809,786</b>	
<b>Total State expenditures</b>				<b>\$ 4,435,820</b>

#### Notes to the Schedule of Expenditures of Federal and State Awards

##### 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 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.