

**CITY OF KINSTON
NORTH CAROLINA**

COMPLIANCE LETTERS

FOR YEAR ENDED JUNE 30, 2013

CITY OF KINSTON, NORTH CAROLINA

COMPLIANCE LETTERS FOR THE YEAR ENDED JUNE 30, 2013

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

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

Report On Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit of Financial Statements Performed In Accordance With *Government Auditing Standards*

Independent Auditor's Report

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

We have audited, in accordance with the 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, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Kinston, North Carolina, as of and for the year ended June 30, 2013, not presented here, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated December 16, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the City of Kinston's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City of Kinston's internal control. Accordingly, we do not express an opinion on the effectiveness of the City of Kinston's internal control.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings, Responses, and Questioned Costs, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings, Responses, and Questioned Costs as item 2013-002 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 from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of non-compliance or other matter that is required to be reported under *Government Auditing Standards* and is described in the accompanying Schedule of Findings, Responses, and Questioned Costs as item 2013-001.

City of Kinston's Responses to Findings

The City of Kinston's responses to the findings identified in our audit are described in the accompanying schedule of Findings, Responses, and Questioned Costs. The City's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the City's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Martin Starnes & Associates, CPAs, P.A.

Martin Starnes & Associates, CPAs, P.A.

Hickory, NC

December 16, 2013

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Report On Compliance For Each Major Federal Program; Report On Internal Control Over Compliance; Report On The Schedule Of Expenditures Of Federal And State Awards As Required By OMB Circular A-133; And The State Single Audit Implementation Act

Independent Auditor's Report

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

Report On Compliance for Each Major Federal Program

We have audited the City of Kinston, North Carolina's, compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* and the *Audit Manual for Governmental Auditors in North Carolina*, issued by the Local Government Commission, that could have a direct and material effect on each of the City of Kinston's major Federal programs for the year ended June 30, 2013. The City of Kinston's major Federal programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings, Responses, and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its Federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City of Kinston's major Federal programs based on our audit of the types of compliance requirements referred to above. 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*, as described in the *Audit Manual for Governmental Auditors in North Carolina*, and the State Single Audit Implementation Act. Those standards, OMB Circular A-133, and the State Single Audit Implementation Act require that we plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the City of Kinston's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the City of Kinston's compliance.

Opinion On Each Major Federal Program

In our opinion, the City of Kinston complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major Federal programs for the year ended June 30, 2013.

Report On Internal Control Over Compliance

Management of the City of Kinston is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City of Kinston's internal control over compliance with the requirements that could have a direct and material effect on a major Federal program in order to determine our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major Federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of Kinston's internal control over compliance.

A *deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, non-compliance with a type of compliance requirement of a Federal program on a timely basis. A *material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material non-compliance with a type of compliance requirement of a Federal program will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a Federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report On Schedule of Expenditures of Federal and State Awards Required by OMB Circular A-133 and the State Single Audit Implementation Act

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, 2013, and the related notes to the financial statements, which collectively comprise the City of Kinston's basic financial statements, and have issued our report thereon dated December 16, 2013, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions 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 U.S. Office of Management and Budget

Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State Single Audit Implementation Act, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal and State Awards is fairly stated, in all material respects, in relation to the financial statements as a whole.

Martin Starnes & Associates, CPAs, P.A.

Martin Starnes & Associates, CPAs, P.A.

Hickory, NC

December 16, 2013

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Report On Compliance For Each Major State Program; Report On Internal Control Over Compliance; Report On The Schedule Of Expenditures Of Federal And State Awards As Required By OMB Circular A-133 And The State Single Audit Implementation Act

Independent Auditor's Report

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

Report On Compliance for Each Major State Program

We have audited the City of Kinston, North Carolina, compliance with the types of compliance requirements described in the *Audit Manual for Governmental Auditors in North Carolina*, issued by the Local Government Commission, that could have a direct and material effect on each of the City of Kinston's major State programs for the year ended June 30, 2013. the City of Kinston's major State programs are identified in the summary of auditor's results section of the accompanying Schedule of Findings, Responses and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its State programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the City of Kinston's major State programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and applicable sections of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, as described in the *Audit Manual for Governmental Auditors in North Carolina*, and the State Single Audit Implementation Act. Those standards, OMB Circular A-133, and the State Single Audit Implementation Act, require that we plan and perform the audit to obtain reasonable assurance about whether non-compliance with the types of compliance requirements referred to above that could have a direct and material effect on a major State program occurred. An audit includes examining, on a test basis, evidence about the City of Kinston's compliance with those requirements and performing such other procedures, as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major State program. However, our audit does not provide a legal determination of the City of Kinston's compliance.

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Opinion On Each Major State Program

In our opinion, the City of Kinston complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major State programs for the year ended June 30, 2013.

Report On Internal Control Over Compliance

Management of the City of Kinston is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the City of Kinston's internal control over compliance with the requirements that could have a direct and material effect on a major State program in order to determine our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on compliance for each major State program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the City of Kinston's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, non-compliance with a type of compliance requirement of a State program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is reasonable possibility that material non-compliance with a type of compliance requirement of a State program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a State program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal and State Awards Required by OMB Circular A-133 and the State Single Audit Implementation Act

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, 2013, and the related notes to the financial statements, which collectively comprise the City of Kinston's basic financial statements, and have issued our report thereon dated December 16, 2013, which contained unmodified opinions on those financial statements. Our audit was performed for the purpose of forming opinions 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 the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State Single

Audit Implementation Act, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain other procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal and State Awards is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Martin Starnes & Associates, CPAs, P.A.

Martin Starnes & Associates, CPAs, P.A.
Hickory, NC
December 16, 2013

CITY OF KINSTON, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2013

1. Summary of Auditor's Results

Financial Statements

Type of auditor's report issued	Unmodified
Internal control over financial reporting:	
• Material weakness identified?	Yes
• Significant deficiency(ies) identified not Considered to be material weakness(es)?	None reported
Non-compliance material to financial statements noted?	Yes

Federal Awards

Internal control over major federal programs:	
• Material weakness identified?	No
• Significant deficiency(ies) identified not Considered to be material weaknesses?	None reported
Type of auditor's report issued on compliance for major Federal programs	Unmodified
Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133?	No

Identification of major federal programs:

<u>Program Name</u>	<u>CFDA#</u>
USDA Rural Development Community Facilities Loans and Grants - ARRA	10.766
Dollar threshold used to distinguish between Type A and Type B Programs	<u>\$300,000</u>
Auditee qualified as low-risk auditee?	No

CITY OF KINSTON, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2013

1. Summary of Auditor's Results (continued):

State Awards

Internal control over major State programs:

• Material weakness identified?	No
• Significant deficiency(ies) identified not Considered to be material weaknesses	None reported

Type of auditor's report issued on compliance for major
State programs

Unmodified

Any audit findings disclosed that are required to be
reported in accordance with the State Single Audit
Implementation Act?

No

Identification of major State programs:

Program Name

Powell Bill

NC Department of Commerce – Industrial Development Fund –
West Pharmaceuticals Generator Project

CITY OF KINSTON, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2013

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

Finding 2013-001 Deficit Fund Equity

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

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

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

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

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

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

Contact Person: Catherine Gwynn, Finance Director

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

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

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

CITY OF KINSTON, NORTH CAROLINA

SCHEDULE OF FINDINGS, RESPONSES, AND QUESTIONED COSTS FOR THE YEAR ENDED JUNE 30, 2013

2. Findings Related to the Audit of the Basic Financial Statements (continued)

Finding 2013-002 Lack of Segregation of Duties

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

Condition: Due to the limited number of personnel in the City's finance office, there are inherent limitations to segregation of duties among City personnel.

Context: Presently, a single individual maintains the general ledger and has full access to make adjustments in the general ledger system.

Effect: Adjustments could be made without oversight.

Cause: There are a limited number of personnel for certain functions.

Recommendation: Access to the books and records of the City should be separated from access to the assets of the City as much as possible. Non-financial staff should review an adjustment report on a monthly basis to detect unauthorized adjustments to general ledger.

Name of Contact Person: Catherine Gwynn, Finance Director

Views of Responsible Officials and Planned Corrective Actions: Management agrees and is aware of the weakness, but due to cost benefit analysis, hiring personnel does not appear to be feasible at this time. Management has made compensating changes through duty reassignments, review and software controls.

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

None reported

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

None reported

CITY OF KINSTON, NORTH CAROLINA

**SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2013**

Finding 2012-01 – Repeated as 2013-001

CITY OF KINSTON, NORTH CAROLINA

**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

<u>Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>State Pass-Through Grantor's Number</u>	<u>Federal Direct and Pass-Through Expenditures</u>	<u>State Expenditures</u>
Federal Grants:				
U.S. Department of Homeland Security				
Federal Emergency Management - Public Assistance				
Public Assistance Grants	97.036		\$ 129,321	\$ -
U.S. Department of Housing and Urban Development				
Passed-through the NC Department of Commerce				
Community Development Block Grant -Abby Gardens	14.228		\$ 21,339	\$ -
US Department of Justice				
Federal Ballistic Vest Program	16.607		15,078	\$ -
Passed-through the NC Department of Justice				
2010 Ballistic Vest Grant	16.607		1,269	\$ -
2012 Justice Assistance Grant	16.738		34,857	\$ -
2009 Community Oriented Policing Services Hiring Grant - ARRA	16.710		88,887	\$ -
Total US Department of Justice			140,091	\$ -
USDA Rural Development				
Community Facilities Loans and Grants - ARRA - Fire Station 2	10.766		1,438,570	\$ -
Community Facilities Loans and Grants - ARRA - Fire Station 3	10.766		1,188,628	\$ -
Total USDA Rural Development			2,627,198	\$ -
National Council on the Arts				
NEA Grants	45.024		82,501	\$ -
State Grants:				
NC Department of Transportation				
Non-state System Street Aid Allocation (Powell Bill)		DOT-4		713,961
Martin Luther King Jr. Blvd Enhancement Golden LEAF grant			-	121,911
Spirit AeroSystems Rail Spur Project			-	58,655
Total NC Department of Transportation			-	894,527
NC Department of Environment and Natural Resources				
Clean Water Management Trust Fund -College Street Sewer Rehabilitation			-	79,998
Clean Water Management Trust Fund -Battlefield Parkway/Soccer Complex			-	13,390
Clean Water Management Trust Fund -Flood Buy-Out II Project			-	16,007
Rural Development Center Grant-Pollock Street Sewer Project			-	18,817
Rural Development Center Grant-Smithfield Plant Expansion Project			-	241,931
Total NC Department of Environment and Natural Resources			-	260,748
NC Railroad Company				
Train Depot Capital Project Fund			-	15,407
NC Department of Commerce				
Division of Commerce Finance Center:				
Industrial Development Fund-West Pharmaceutical Generator Project			-	962,500
Office of Community Investment:				
Talent Enhancement and Capacity Grant			-	117
Total NC Department of Commerce			-	962,617

CITY OF KINSTON, NORTH CAROLINA

**SCHEDULE OF EXPENDITURES OF FEDERAL AND STATE AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2013**

<u>Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>State Pass-Through Grantor's Number</u>	<u>Federal Direct and Pass-Through Expenditures</u>	<u>State Expenditures</u>
NC Department of Crime Control and Public Safety Governor's Crime Commission				1,906
Total Federal expenditures			<u>\$ 3,000,450</u>	
Total State expenditures				<u>\$ 2,135,205</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* and the State Single Audit Implementation Act. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in, the preparation of, the basic financial statements.

Note 2. Loans Outstanding

City of Kinston had the following loan balances outstanding at June 30, 2013. These loan balances outstanding are also included in the Federal expenditures presented in the schedule.

<u>USDA Rural Development:</u>	<u>CFDA Number</u>	<u>Amount Outstanding</u>
Community Facilities Loans and Grants - ARRA - Fire Station 2	10.766	\$ 1,438,570
Community Facilities Loans and Grants - ARRA - Fire Station 3	10.766	1,188,628