

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 Lexington, North Carolina

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Lexington, North Carolina, as of and for the year ended June 30, 2011, which collectively comprise the City of Lexington's basic financial statements, and have issued our report thereon dated October 11, 2011. Our report includes a reference to other auditors. 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. Other auditors audited the financial statements of the City of Lexington ABC Board, as described in our report on the City of Lexington's financial statements. The financial statements of the City of Lexington ABC Board and the Tourism Authority were not audited in accordance with *Government Auditing Standards*.

Internal Control Over Financial Reporting

Management of the City of Lexington is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the City of Lexington's internal control over financial reporting as a basis for designing our auditing procedures 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 Lexington'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 the internal control over financial reporting was for limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

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 entity'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 and Questioned Costs as Finding 2011-01 to be a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Lexington's financial statements are free of 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The City of Lexington's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. We did not audit the City's response and, accordingly, we express no opinion on it.

This report is intended for the information and use of management, members of the Lexington City Council, 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 11, 2011

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

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Report On Compliance With Requirements That Could Have A Direct And Material Effect On 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 Lexington, North Carolina

Compliance

We have audited the compliance of the City of Lexington, North Carolina, with the types of compliance requirements described in applicable sections of OMB Circular A-133 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 its major State program for the year ended June 30, 2011. The City of Lexington's major State program is identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to the major State program is the responsibility of the City of Lexington's management. Our responsibility is to express an opinion on the City of Lexington'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 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 Lexington'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 Lexington's compliance with those requirements.

In our opinion, the City of Lexington complied, in all material respects, with the requirements referred to above that are applicable to the major State program for the year ended June 30, 2011.

Internal Control Over Compliance

The management of the City of Lexington 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 Lexington'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, 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 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 a 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.

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 deficiencies, 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.

This report is intended solely for the information and use of management, members of the Lexington City Council, others within the organization, 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.

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Report On Compliance With Requirements That Could Have A Direct And Material Effect On 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 Lexington, North Carolina

Compliance

We have audited the compliance of the City of Lexington, 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 could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011. The City of Lexington's major federal programs are identified in the summary of auditors' results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to the major federal program is the responsibility of the City of Lexington's management. Our responsibility is to express an opinion on the City of Lexington'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 Lexington'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 Lexington's compliance with those requirements.

In our opinion, the City of Lexington 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, 2011.

Internal Control Over Compliance

The management of the City of Lexington 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 Lexington'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, 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 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, such that there is a 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.

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 the City's internal control over compliance that might be deficiencies, 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.

This report is intended solely for the information and use of management, members of the Lexington City Council, others within the organization, 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 11, 2011

CITY OF LEXINGTON, NORTH CAROLINA

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011**

1. Summary of Auditors' Results

Financial Statements

Type of auditors' report issued:	Unqualified		
Internal control over financial reporting:			
• Material weaknesses identified?	<u> X </u>	Yes	<u> </u> No
• Significant deficiencies identified?	<u> </u>	Yes	<u> X </u> No
Non-compliance material to financial statements noted?	<u> </u>	Yes	<u> X </u> No

Federal Awards

Internal control over major federal programs:			
• Material weaknesses identified?	<u> </u>	Yes	<u> X </u> No
• Significant deficiencies identified?	<u> </u>	Yes	<u> X </u> No
Type of auditors' 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

Identification of major federal programs:

<u>Program Name</u>	<u>CFDA#</u>
Neighborhood Stabilization Program	14.228
Highway Planning and Construction Program	20.205-1

Dollar threshold used to distinguish between Type A and Type B Programs:	\$300,000
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Auditee qualified as low-risk auditee?	<u> </u>	Yes	<u> X </u>	No
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CITY OF LEXINGTON, NORTH CAROLINA

**SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011**

State Awards

Internal control over major State programs:

• Material weaknesses identified? _____ Yes X No

• Significant deficiencies identified? _____ Yes X No

Type of auditors' report issued on compliance for major State programs: Unqualified

Any 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:

Powell Bill

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

Finding 2011-01

Criteria: City Management should have a system in place to include a periodic review of component units and fund presentation to ensure proper financial reporting.

Condition: Audit and accounting standards require that errors in prior periods, which are detected in a subsequent year, be reported as prior period adjustments, resulting in a restatement of net assets and/or fund balance. An error was not detected prior to the report issuance by the City's system of internal controls. However, the City did detect the error in the subsequent year. The error detected related to the reporting of Uptown Lexington, Inc. as a component unit. In previous years, all financial activity of Uptown Lexington, Inc. was incorrectly reported in the special revenue fund of the City; whereas, only activity related to the special uptown district tax levy should have been reported within the Special Revenue Fund.

Context: City Management inquired about the classification of Uptown Lexington, while performing a review of 2010 Form 990-EZ for the 501(c)(3) entity. While responding to the inquiry, the above condition was noted.

Recommendation: As part of the internal control structure, City Management should incorporate a review of the fund structure and component unit classifications each year to ensure that component units are properly classified.

CITY OF LEXINGTON, NORTH CAROLINA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2011

Cause: Lack of review of component unit and special revenue fund segregated reporting requirements.

Effect: Fund balance of governmental funds and net assets of governmental activities were overstated at June 30, 2010 by \$88,607.

Name of Contact Person: Terra Greene, Finance Director

Management's Response/Corrective Action: As changes occurred in the structure and operations of Uptown Lexington, Inc., City Management inadvertently overlooked the corresponding need to change the presentation in the financial statements. The entity has varied operations; some of which are properly classified as a special revenue fund and some of which should be defined as operations of a component unit. Management discovered this issue in a review of Uptown Lexington financial reporting during FY2010-11. Management has properly shown the special tax levy and financial operations related to Uptown Lexington, Inc. in the FY2010-11 Comprehensive Annual Financial Report. In addition to strengthen internal control practices, Management has formalized a process of detailed review in regards to the requirements of component unit reporting to prevent future occurrence.

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

The audit did not detect any findings or questioned costs as it relates to federal and State awards.

CITY OF LEXINGTON, NORTH CAROLINA

**SCHEDULE OF PRIOR YEAR FINDINGS
FOR THE YEAR ENDED JUNE 30, 2011**

There were no prior year findings.

City of Lexington, North Carolina
Schedule of Expenditures of Federal and State Awards
For the Year Ended June 30, 2011

Federal Grantor/Passed Through Grantor/Program Title	Federal CFDA Number	Federal (Direct and Passed Through) Expenditures	State Expenditures
Federal Grants			
U.S. Department of Homeland Security Assistance to Firefighters	97.044	\$ 67,644	\$ -
U.S. Department of Housing and Urban Development N.C. Department of Commerce - Community Investment and Assistance Neighborhood Stabilization Program	14.228	659,299	-
N.C. Department of Commerce - Commerce Finance Center CDBG Economic Development - Moran Foods Water	14.228	276,967	-
U.S. Department of Energy N.C. Department of Commerce - Energy Division ARRA - Energy Efficiency Community Block Grant Program	81.128	76,771	-
State Energy Program - Energy Efficiency in Governmental Buildings	81.041	17,032	-
U.S. Department of Justice Justice Assistance Grant (JAG) - 2009 Local Solicitation	16.738	9,675	-
Justice Assistance Grant (JAG) - 2010 Local Solicitation	16.738	8,537	-
ARRA - Justice Assistance Grant (JAG)	16.804	50,309	-
ARRA - Community Oriented Policing Services (COPS) - Hiring Recovery	16.710	46,564	-
Community Oriented Policing Services (COPS) - Secure Our Schools	16.710	9,506	-
N.C. Dept. Crime Control & Public Safety - Division of Governor's Crime Commission ARRA - Community Oriented Policing Services (COPS) - Equipment	16.803	218	-
U.S. Department of Transportation N.C. Department of Transportation Governor's Highway Safety Program - Traffic Safety Initiative	20.609	11,238	-
Governor's Highway Safety Program - State and Community Highway Safety	20.600	30,825	-
N.C. Department of Transportation - Highway Planning and Construction Program Congestion Mitigation and Air Quality Program (C-5117)	20.205-1	230,530	-
Congestion Mitigation and Air Quality Program (C-5118)	20.205-1	133,339	33,335
State Grants			
N.C. Dept. Crime Control & Public Safety - Division of Governor's Crime Commission Project Safe Neighborhood Program	N/A	-	10,249
N.C. Department of Transportation Powell Bill	N/A	-	612,196
Total Federal Grants		<u>\$ 1,628,454</u>	
Total State Grants			<u>\$ 655,780</u>

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

1. Basis of Presentation

The accompanying schedule of expenditures of federal and state awards includes the federal and state grant activity of City of Lexington 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.

