



CITY OF LEXINGTON
NORTH CAROLINA
FINANCE DEPARTMENT

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To the Honorable Mayor, members of the City Council and the Citizens of the City of Lexington, North Carolina:

I am pleased to present the Comprehensive Annual Financial Report (CAFR) of the City of Lexington, North Carolina for the fiscal year ended June 30, 2011. I am extremely proud that this report has been prepared virtually in its entirety by the City's Finance Department. The financial statements and supplemental schedules contained herein have been audited by the independent, certified public accounting firm of Martin Starnes and Associates; and that firm's unqualified opinion is included in the Financial Section of this report. Responsibility for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures, rests with management. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner that presents fairly the financial position and results of operations of the various funds and component units of the City of Lexington, North Carolina. All disclosures necessary to enable the reader to gain the maximum understanding of the City of Lexington's financial activities have been included.

Description of the City

The City of Lexington, North Carolina, was settled in the industrial region of North Carolina known as the "Piedmont Triad Area" in 1775. Lexington incorporated in 1828 under North Carolina General Statutes and became the county seat of Davidson County in 1847. Lexington land area is 18 square miles with a population of 19,001. The City has a Council-Manager form of government and is governed by an eight-member City Council consisting of two members elected at large and six elected by ward. The Council operates under the guidance of a popularly-elected Mayor. Council members are elected on a nonpartisan basis for staggered four-year terms; and the Mayor is elected on a nonpartisan basis for a two-year term. The Mayor may vote only in case of a tie among members of the City Council. The City Council is responsible for establishing policy, passing ordinances, adopting the budget, appointing committees and the City's legal counsel, as well as hiring the City's chief administrative officer, the City Manager. The City Manager is responsible for carrying out the policies and ordinances of the governing board, for overseeing the day-to-day operations of the City, and for the appointment of the Department Heads who direct city staff to deliver the services and to meet the goals of the organization.

The "Statement of Purpose of the City of Lexington City Council" is a document in which the Council identifies its mission, vision for the future, values, roles of the Council and strategic goals. The Council wants to maintain as high a service level to its citizens as possible but is

consistent with maintaining the City in sound financial condition. The strategic goals of the Council will be accomplished by the City's management through long-term planning, prudent use of debt, and use of citizens' committees to review and recommend operating standards in managing the City's resources.

The City provides a full range of services including police and fire protection, sanitation waste collection services, the construction and maintenance of streets and infrastructure, recreational activities, cemetery services and cultural events. In addition, the City of Lexington owns and operates four utility services: a water treatment and distribution system, a sewer treatment and collection system, an electric distribution system and a natural gas distribution system. These enterprise funds serve portions of Davidson County in addition to serving City residents. The City also owns and operates a golf course.

The City extends financial support to certain boards, agencies and commissions to assist their efforts in serving the citizens. Support efforts are largely centered on partnership efforts for essential economic development and neighborhood revitalization. Among these are the Davidson County Economic Development Commission, Davidson County Airport Authority, Lexington Appearance and Historic Preservation Commissions, Edward C. Smith Civic Center, Lexington Housing Community Development Corporation, and Uptown Lexington, Incorporated.

Economic Conditions and Outlook

Internationally known artist Bob Timberlake, a Lexington native and resident, has a beautifully constructed gallery and welcome center just off Interstate 85 within the City limits. With Bob Timberlake well established on the east side of the gateway entrance to the City of Lexington, Richard Childress anchors the west gateway entrance with a 65-acre winery complex, at the intersection of US Highways 64 and 52. Effective August 11, 2003, the property was voluntarily annexed into the corporate limits and the Childress Vineyards complex opened on October 14, 2004. Within the tract, 33 acres of the land are designated for cultivating grapes. With an investment of approximately \$9.4 million now ranking as the seventh largest taxpayer, the 35,000 square foot winery is inspired by the Italian Renaissance architecture of rural Tuscany. The winery includes a banquet hall that can accommodate 500, a bistro, a wine tasting room and gift shop.

Two phases of The Shoppes at Vineyards Crossing, retail pedestrian specialty shops modeled in the same Tuscan architecture with a view of the vineyards, were constructed and opened in the spring and summer of 2006. With only one tenant, The Shoppes were recently acquired by Richard Childress in July 2010 in an effort to increase tenant occupancy with plans to add a restaurant. In addition, construction broke ground in May 2007 to develop a Holiday Inn Express Hotel and Suites at the Vineyards, a complementary mid to upper scale hotel with 88 rooms, an indoor pool, business center, fitness facility, lobby furniture from the Bob Timberlake collection and a suite named for Richard Childress. The hotel was completed and opened in October 2008. The retail center has added a \$3 million dollar investment thus far; while the hotel has added another \$5.6 million dollar investment. With the Childress Vineyards tourism draw continuing to expand, the potential outlook is positive for future growth in tourism dollars.

The Uptown Lexington, Incorporated project began in 1993 when local property owners elected to tax themselves an additional \$.20 per \$100 assessed valuation to generate funding for the revitalization of the uptown business district. Investments of typically \$1 million or more a year have resulted, with the total of public and private investment reaching approximately \$27 million to

date. The Uptown organization has won numerous awards over the years and earned a reputation as one of the top redevelopment programs in the state. The "Pigs in the City" campaigns, in which sponsors decorated fiberglass figures in colorful and witty themes for placement on the uptown sidewalks for the last several years, has garnered the City of Lexington national publicity. Uptown complimented the promotion of Lexington style barbecue and the annual Barbecue Festival this past spring with a BBQ Capital Cook-off event. Sanctioned by the Kansas City Barbeque Society (KCBS), the 2011 event brought 54 competitive teams and over 75 judges from across the United States. The inaugural event was highly successful and the 2nd Annual BBQ Capital Cook-off is slated again April 27-28, 2012.

All of the aforementioned efforts in combination with the 28th annual Barbecue Festival in 2011, which brings in over 100,000 people to Lexington and recognized as one of the Top Ten Food Festivals in the U.S. by Travel and Leisure Magazine and as one of the Top Twenty Events for the month of October by the Southeast Tourism Society and featured in People Magazine in October 2009, are helping to create a tourism platform for economic impact.

The City of Lexington's economy has been experiencing a downturn since late 2000 further impacted by the recent 'great recession', with a higher unemployment rate, seasonally adjusted, in the Thomasville-Lexington micropolitan statistical area of 11.5% compared to the state unemployment rate of 9.9% at the end of the fiscal year. The unemployment rate has been affected by the adverse market conditions in the furniture and manufacturing industries, but most recently by the national 'great recession'. Several local businesses have experienced reduced production and sales, closings, and layoffs in this past decade; the most significant of which have affected the furniture industry and the loss of the Duracell battery plant. Lexington Home Brands (LHB) has had the largest negative impact by closing three plants since December of 2000.

In July 2008, a closing was announced by the City's third largest taxpayer at the time, Stanley Furniture Company, resulting in the elimination of 350 jobs. Stanley Furniture's closing left Linwood Furniture, which employs approximately 135 people, as the City's largest remaining active furniture manufacturer until the addition of United Furniture as discussed below. Linwood Furniture began occupying LHB's shuttered Plant #2 in 2006 with the help of a five-year economic development incentive grant from both the city and county. Terms of the agreement required the company to add a \$4.1 million investment and 250 full-time jobs within three years. Linwood upheld the terms of the agreement in order to receive the first grant incentive payment in fiscal year 2007-08, but failed to meet the obligations in subsequent fiscal years.

Diversification of the employment base and job creation is critical to the future of Lexington. Major industries have historically included tissue products, battery manufacturing, furniture manufacturing, textiles, printing and banking. Kimberly Clark Corporation, a global consumer products company, continues to be the City's largest taxpayer, with 5.32% of the City's assessed valuation. Jeld-Wen and Wal-Mart round out the top three at 1.41% and 1.07%, respectively, of the assessed valuation. (Please refer to Table 12 for the Schedule of Principal Property Taxpayers in the Statistical Section for a complete list.)

In an effort to attract new industry, the City continues to support the Davidson County Economic Development Commission (EDC) and demonstrate a willingness to offer economic development incentive grants. Due to the EDC's efforts in both 2007 and 2010, the Thomasville-Lexington micropolitan area received top ranking nationally by Site Selection magazine in economic development success out of 576 micropolitan areas in the United States.

A major contributor to that ranking in 2007 evolved when the City offered an incentive grant to Arneg LLC, a privately held international company that manufactures refrigeration cases for retail and commercial outlets. The company is the third largest case manufacturer in the world with 16 manufacturing plants and 8 regional sales offices in 20 nations. In exchange for the five-year \$545,000 grant from the City, the company must invest \$20 million in the facility and create and employ 181 new full-time positions at an average annual wage in excess of 110% of Davidson County's average wage; conditions which they have failed to meet thus far. Construction of the Lexington plant, only the second production facility in the United States, was complete in July 2008. A key to the EDC ranking in 2010 was United Furniture Industries locating in Lexington in the spring of 2010, with an expected gain of \$3 million capital investment in the facility and equipment and 150 new manufacturing jobs for the community over a three year period in order to qualify for the economic development grant. United Furniture Industries, a Mississippi-based manufacturer of moderate priced residential furniture, has exceeded the jobs figure by adding more than 200 jobs at the plant, a former Stanley Furniture warehouse facility.

The EDC maintains a data bank to provide information to industrial prospects and expanding industries such as Vitacost and Moran Foods (dba Save-A-Lot, Ltd.), of which a great deal revolve around the Lexington Business Center Industrial Park (LBC).

In March 1995, the City of Lexington, Davidson County and Energy United formed a project partnership to enhance economic development through building an industrial park. The goals established then for building the LBC were to build \$100 million in tax base in ten years, provide higher paying jobs, provide diversity in manufacturing and employment, and to the extent practical slow the migration of workers to other counties. During fiscal year 1997-1998, the LBC was granted Foreign Trade Zone designation along with five other sites in the "Piedmont Triad Area." Since the partnership agreement, the LBC has been fully served with water, sewer, natural gas, and electric utilities as well as road infrastructure. Three shell buildings were built and sold in Phase I of the development totaling to approximately \$30 million increased tax base. A local company Chesapeake Printing, a national firm Diebold, and an internet based wholesale nutritional supplement supplier, Vitacost, are the current tenants. In May 2010, Vitacost announced a \$6.7 million expansion to more than double the size of their facility with the commitment to add 228 jobs over three years, a significant increase from the 181 full-time permanent employees and 100 temporary workers in the manufacturing, distribution and customer service call center. With this expansion, Vitacost now ranks fifth as a top ten taxpayer with approximately \$13.5 million assessed value or .91% of total city assessed valuation. (Please refer to Table 12 for the Schedule of Principal Property Taxpayers in the Statistical Section for a complete list.)

In November 1999, Phase II began when Energy United entered a contract to purchase an additional 20.382 acres to construct a fourth 100,000 square foot shell building. This facility was sold in August 2005 to Border Concepts, a manufacturer and supplier to the landscape and garden industry. The shell building along with the acreage results in a \$3 million investment. The company had outgrown its existing facility in Lexington with no more room to expand; therefore, the additional building offered the space to handle its 11 product lines with some manufacturing, warehouse, and distribution operations performed in both facilities.

Additional activity at the Lexington Business Center has transpired over the past few years. Upon relocating from High Point, NC, Roehrig Engineering, a motor sports suspension development company, opened its 12,000 square foot \$1 million facility on a 2.8 acre parcel of land at the entrance of the industrial park in October 2005. Secondly, the City solidified plans to expand

the business park by exercising a purchase option for 69.769 acres of additional land. The land purchase was made in December 2004 but has just recently developed into a twelve-year economic development land lease agreement negotiation between the City and Davidson County, and successfully resulting in luring Save-a-Lot to break ground in the business center in October 2010 with the promise of a \$20 million investment and 42 jobs over three years. Save-A-Lot is an independent but wholly owned subsidiary of SuperValu Inc., a Fortune 100 company. Based in St. Louis, it is the nation's fifth largest grocery store chain overall with 1,200 food stores operated either corporately or by licensed retailers in 39 states, one of which is operated locally in Lexington.

Finally as part of the Arneg economic development initiative, the City and Davidson County shared in the purchase of a 21.426 acre tract of land situated between the Arneg plant site and the Lexington Business Center to be available for future economic development opportunities. The City's share of that cost was paid in January 2008 in the amount of \$269,388.

With the revitalization of the uptown area, the potential tourism boosts, the strategic use of economic development incentive grants and the increased occupancy and expansions in the industrial park, it is anticipated that Lexington's economic base will be sustained somewhat despite the drastic losses in local manufacturing or further economic deterioration.

Major Initiatives

For the Year. The "Statement of Purpose of the Lexington City Council" continues to provide the focus for the City's efforts. The strategic goals include the following: open communication with citizens, customers and employees; improve financial strength and integrity of City government; shift from government solving problems to community solving problems through citizen involvement and partnerships; City utilities and other enterprises to be operated in a businesslike manner; improve quality of life; and promote a strong, diversified economy. In working toward these goals among others, the following projects and initiatives have been undertaken.

Community officials have purchased and are working diligently to evaluate redevelopment opportunities to prevent a vacated 18-acre uptown complex from becoming a negative blight on the community. The City took a significant step in attempting to control its own economic future by purchasing the Lexington Furniture Industries, Inc. Plant #1 property for \$1,000,000 with payments spread out over three fiscal years, the final \$200,000 of which was made in fiscal year 2008-09. Plant #1, which has been closed since 2003, contains 18 acres of land and over one million square feet of building space and is located adjacent to the heart of uptown Lexington and the newly renovated depot district. The City faced real threats of declining appearance and tax base due to the expected acquisition of the property by absentee ownership if the City decided against the purchase. This acquisition has financial impacts on current and future City budgets as the huge tasks of redeveloping the property and seeking brownfield grant opportunities are addressed. However, it is considered a financial risk worth taking and grant funding for redevelopment plans are moving forward as discussed in the "For the Future" section below.

In June 2009, City Council accepted the funding award for the Neighborhood Stabilization Program grant administered by the NC Department of Commerce, Division of Community Assistance. The program is financed with \$2.1 million federal stimulus funds authorized under the Housing and Economic Recovery Act of 2008, supplemented by \$157,600 in local leveraging dollars to be funded equally over four fiscal years. Under this program, the City is acquiring foreclosed or abandoned homes and rehabilitating, reselling or redeveloping these homes in order to stabilize local

neighborhoods and stem the decline of house values of neighboring homes throughout Lexington. To comply with the federal stimulus timeline requirements, the City must obligate all funds by July 18, 2010, expend all funds by August 9, 2012 and submit all closeout documents by January 9, 2013.

The City leveraged extraordinary receipts of controlled substance federal forfeiture funds to build a state of the art police training facility including multiple classrooms and a firearms maintenance room, with a firing range already on site. Construction of this 9,000 square foot training facility, with a final project cost of approximately \$1.7 million, is now complete. The facility replaced a 1968 dilapidated house that had been adapted into a training room in 1970, which was demolished before construction began. This newly constructed training facility will meet the needs of the Lexington Police Department for years to come and is made available for use by other law enforcement agencies.

A comprehensive technological plan was developed in fiscal year 2003-04 to identify the priorities for the best use of economic and personnel resources to progress the City towards technological efficiencies, improved customer service capabilities, and a thrust forward in e-commerce. The first phase of this city-wide technology plan began in fiscal year 2004-05 with a multi-year implementation plan for a city-wide Geographic Information System with a cost slightly in excess of \$1.6 million. This computerized mapping technological improvement is a capital project that is now fully implemented and offers the ability to enhance service levels in the following areas: expedient responses to requests for economic development information, easily identifies zoning and political districts, allows for an interface with the City's Customer Information System for utility accounts, improves service deliveries in the utilities, and enhances public safety in terms of investigations, emergency response and notification.

The second major technological initiative has been underway for the past several years. Automated meter reading (AMR) encompasses installing an encoder receiver transmitter (ERT) device on utility meters, which enables the meter readers to drive by and record consumption readings from an electronic unit. This technology prevents personnel from having to exit the vehicle and physically read and enter the data manually in hand held units. With the City billing over 22,000 utility accounts monthly and continuing to expand electric and natural gas service territory outside the corporate limits to more distant geographical areas, AMR has become a component of reducing the need for meter reader personnel. The City embarked on an eight-year funding and implementation plan beginning in fiscal year 2006-07 with an estimated total cost to the three utilities of over \$3 million. Over half of the utility service areas are currently being read by AMR meters.

Additional information regarding this fiscal year's major initiatives along with the financial implications can be found in the Management's Discussion and Analysis (MD&A) beginning on page 3. The MD&A immediately follows the independent auditor's report and provides a narrative introduction, overview, and analysis of the basic financial statements. The MD&A complements this letter of transmittal and should be read in conjunction with it.

For the Future. The City Manager's performance goals include the strategic goal of "shift from government solving problems to community solving problems by stimulating more citizen involvement, empowering boards, commission, and staff to do more and developing partnerships." One of the ways this goal is obtained is through the update of the Lexington Challenge Strategic Plan throughout fiscal years' 1999-2000 and 2000-2001. The original Plan developed between 1988 and 1991 has proven to be the most successful citizen-led, long-range planning effort in the history

of the City – with over 100 citizens involved; 22 recommendations were made, of which 19 were accomplished. The 2000 Challenge Committee, comprised of 27 members, began its work April 26, 1999. The committee completed an update of recommendations and the City Council adopted the Lexington Challenge 2000 Plan. Challenge 2000 is the City's blueprint to improve education, economic development, quality of life and transportation. The City began incorporating these goals over the last decade by focusing on Lexington City Schools' performance and community and economic development strategic planning. The Plan remains as the blueprint guide for initiatives in the future; that is, until a new plan is revealed in 2012. A new Strategic Planning Committee was appointed in late 2010 to reevaluate the future direction and goals for the organization and the results from this citizen led committee are expected in 2012.

Grant funding in the amount of \$700,000 for a TIGER II (*Transportation Investment Generating Economic Recovery*) award was accepted October 10, 2011 from the U.S. Department of Transportation, administered by the Federal Railroad Administration. The funds will be used to prepare construction and operational plans for a passenger rail station, platform, and street cross sections, namely the Lexington Multi-Modal Transportation Station Area Plan. This work is described as Phase I of the overall redevelopment plan for the Depot District. Funding is currently being sought for Phase II, which will be the master redevelopment plan for the remainder of the redevelopment area including the LFI Plant #1 property.

After a multi-year comprehensive annexation feasibility study process, City Council passed ordinances on July 21, 2008 to annex four areas along its municipal borders to be effective June 30, 2009. This annexation could have resulted in adding an estimated 1,506 acres coincident with Lexington's planning areas for future growth. This annexation would also have complemented the existing population by an estimated 1,953 and increased Lexington's tax base by an estimated \$186 million in assessed value. However in September 2008, the City was served with a legal challenge filed by annexation opponents in the Davidson County Superior Court alleging the City did not follow proper procedures and that selected annexation report information was incorrect. An isolated part of the allegations resulted in one of the annexation areas, the Winston Road area, being rescinded from annexation consideration on November 24, 2008. Removing the Winston Road area reduced the acreage of the revised annexation areas to 1,282 acres, decreased the estimated population to 1,561 and decreased the anticipated additional tax base to an estimated \$160 million in assessed value deriving from the areas. However, the Davidson County Superior Court ruled in favor of the City for the other three annexation areas. An appeal was then filed by the opponents in the North Carolina Court of Appeals but the three judge Court held unanimously for the City. The opponents subsequently requested the North Carolina Supreme Court hear the lawsuit but that request was denied in October 2011.

Having successfully cleared the legal hurdle to annex three areas, the City now awaits the outcome of a petition process conducted by the Davidson County Board of Elections. On June 18, 2011, House Bill 56 and Senate Bill 37 were ratified into law. Both of these bills were created by the North Carolina Legislature with the intent to give the property owners in the proposed annexation areas the ability to sign a petition against being annexed. The decision in terms of future growth to the City's corporate limits will be determined by the outcome of the petition process December 5, 2011. Pending that outcome, the increased assessed valuation and corresponding service level provisions could be recognized in fiscal year 2011-2012.

Census 2010 population figures became available this spring, registering the City with a revised population of 18,931. The Census 2010 number is a 5% drop or 1,022 decrease in population from the

last official census in 2000. However, the 18,931 population is a 2,489 or 12% decrease from the 2009 Certified Population figure that the State updates annually. The State Certified Population figure is an estimate the State prepares and uses for annual revenue distribution purposes and has been updated as of June 30, 2011 to reflect Lexington's population at 19,001. The City receives several State collected local revenues that are partially based on State per capita distribution models; those being the local option sales tax, beer and wine tax, and the Powell Bill gasoline tax which supports 32% of the City's street maintenance budget. Despite Lexington's recorded loss of population, various other local governments in Davidson County and the County itself experienced population growth with the Census 2010 figures, which may result in further detriment to Lexington's weighted share of the revenues. Thus, the fiscal year 2011-12 budget reflects a minimum loss of \$445,000 in sales tax, beer and wine tax and Powell Bill gasoline tax revenues to support government services funded in the General Fund.

Another primary work program that began in the spring of 2010 and has continued is construction of three key facilities. Major financial planning was utilized to find the most effective means to finance a Natural Gas and Public Works utilities operations center, to relocate Fire Station #2, and replace dilapidated sheds that house the vehicles and equipment of the Street and Sanitation departments. First, the new operations center opened in the spring of 2011 to accommodate the growing space needs of the Natural Gas department due to their expansion efforts, relocated Public Works staff from the inadequate 1946 existing structure which was in need of expensive repairs, and results in potential efficiencies that could be gained by the utilities sharing office space and equipment. Second, relocation of Fire Station #2 to leased property at the Davidson County Airport will enhance public safety response within the corporate limits and construction is expected to be complete in the fall of 2011. Finally, the replacement of the dilapidated equipment sheds for the Street and Sanitation departments are now complete and remove an eyesore for the community. The City issued a \$4.2 million Build America Bond installment financing in April 2010 to fund these initiatives; while simultaneously serving as a local stimulus plan of sorts for the infrastructure needs.

Comprehensive long range financial planning is essential to maintain the sound fiscal integrity of the City's financial position in an ever changing environment with issues on the horizon such as: continued loss of revenues due to local manufacturing plant closings and recession impacts, escalating capital infrastructure needs, and the impact of the Census 2010 results on local revenues and future economic development opportunities. These impacts will affect the City's fiscal condition and the City's five-year Financial Planning Model will be used to help discover future weaknesses. The information provided will be used to help the City forge strategies for the future to maintain the goal of a strong financial condition. Therefore, the City is committed to updating the Financial Planning Model every year in concert with the City Council retreat and annual budget development. The biennial business plans for the utilities were completely evaluated and updated in fiscal year 2010-11. The plans identified and recommended ways to effectively deal with areas of uncertainty, higher levels of competition, and increased risks due to adverse changes in the local economy. Current factors necessitate that these plans be monitored and adjusted every two years to aid in long range scenario financial planning for the utilities. The City uses these plans along with the Financial Planning Model to adjust to various pressures in each of the utilities in future years.

In summary, the City will be focused on programs to meet the mission of the City which leverages City and grant resources and increases operational effectiveness, while maintaining basic City services. That being said, the City has adopted a "reserve the right to play" strategy that necessitates cautious spending and efficiency maneuvers until economic conditions improve.

Financial Information

In government, much more than in business, the budget is an integral part of a unit's accounting system and daily operations. The City, in accordance with North Carolina General Statutes, operates under an appropriation act which provides extensive budgetary controls. The appropriation act applies to all City funds, including governmental and proprietary funds. The object of these controls is to ensure compliance with legal provisions embodied in the annual appropriated budget approved by the City Council. Multi-year project budgets are prepared for the Community Development Grants, Public Safety Grants and Economic Stimulus Grants Special Revenue Funds, General Capital Improvement Projects Fund, and the Enterprise and Internal Service Construction in Progress Funds. The level of budgetary control (i.e., an appropriated amount) is at the departmental level within each fund. The government also maintains an encumbrance accounting system as one method of maintaining budgetary control. Encumbrance amounts lapse at year-end but are re-appropriated as part of the following year's budget; therefore, these amounts are reported in the financial statements as reservations of fund balances.

In accordance with State law, the City's budget is prepared on the modified accrual basis; and its accounting records are also maintained on that basis. Under modified accrual accounting, revenues are recorded when they are both measurable and available. Expenditures are recorded when a fund liability is incurred, except for unmatured principal and interest on long-term debt and certain compensated absences, claims and judgments. Governmental fund types are reported on the modified accrual basis in the fund financial statements. The Proprietary Funds are reported on the full accrual basis in the financial statements, under which revenues are recorded when earned and expenditures are recorded when incurred.

The City of Lexington, North Carolina is required by State law (North Carolina General Statute 159-34) to have an annual independent financial audit. A compliance audit on federal and state financial assistance programs is also required under the federal Single Audit Act of 1984 and the State Single Audit Implementation Act of 1987, and the related U.S. Office of Management and Budget's Circular A-133. The City's auditors, Martin Starnes and Associates, were selected through a formal request for proposals process. Generally accepted auditing standards and the standards set forth in the General Accounting Office's Government Auditing Standards were used by the auditors in conducting the engagement. The auditors' report on the basic financial statements, fund statements, and schedules are included in the Financial Section of this report. The auditors' reports required as part of a single audit are found in the Compliance Section of this report.

Management is responsible for the accounting system and for establishing and maintaining an internal control structure. The internal control structure is designed to provide a reasonable, but not absolute, assurance regarding: (1) the safeguarding of assets against loss from unauthorized use or disposition; (2) the reliability of financial records for preparing financial statements in conformity with generally accepted accounting principles and maintaining accountability for assets; and (3) compliance with applicable laws and regulations related to federal and state financial assistance programs. The concept of reasonable assurance recognizes that: (1) the cost of a control should not exceed the benefits likely to be derived; and (2) the evaluation of cost and benefits requires estimates and judgments by management.

All internal control evaluations occur within the above framework. We believe that the City's internal accounting controls adequately protect assets and provide reasonable assurance of the proper recording of financial transactions. As part of the City's single audit, the independent auditor

performed a review of the City's internal control structure. This review was not an audit and no opinion was issued on the City's internal control structure; however, the procedures performed by the independent auditor did not indicate any material internal control weaknesses or reportable conditions.

Additional financial information can be found in the Management's Discussion and Analysis beginning on page 3. As illustrated by the statements and schedules included in the Financial Section of this report, the City continues to meet its responsibility for sound financial management. All amounts presented in the Management's Discussion and Analysis, Financial Section and in the remainder of this letter are expressed in whole dollars.

Other Information

Awards. The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the City of Lexington for its comprehensive annual financial report for the fiscal year ended June 30, 2010. This marked the nineteenth consecutive year that the City has received this prestigious award. In order to be awarded a Certificate of Achievement, the government must publish an easily readable and efficiently organized comprehensive annual financial report. This report satisfied both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

Acknowledgments. The preparation of this comprehensive annual financial report is accomplished through the collective efforts and dedicated service of the entire staff of the Finance Department. I wish to express my appreciation to all members of the department for their team effort, dedication and hard work in preparing this report. In particular, I would like to mention and credit Kathy Whitman, Susan Floyd, Wendy Everhart, Sarah Reece, TJ Jackson and Christina Smith for their extraordinary efforts and contributions in conjunction with this year's report.

I would like to express my appreciation and give credit to the Mayor, City Council and City Manager for their support and interest in providing the resources necessary to accomplish this project. In addition, I am grateful for their support in planning and conducting the operations of the City of Lexington in a responsible and progressive manner.

Respectfully submitted,



Terra Greene
Director of Finance

Certificate of Achievement for Excellence in Financial Reporting

Presented to

City of Lexington
North Carolina

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2010

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A stylized, handwritten signature in black ink.

President

A handwritten signature in black ink, appearing to read "Jeffrey R. Emer".

Executive Director

City of Lexington, North Carolina Organizational Chart

