



AUDIT WRAP UP & Presentation

to

City of Durham, North Carolina

October 22, 2012

Cherry, Bekaert & Holland, L.L.P.

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The Firm of Choice.

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October 22, 2012

Audit Services Oversight Committee
City of Durham, North Carolina
Durham, North Carolina

Dear Members of the Committee:

Professional standards require us to communicate with you regarding matters related to the financial statement audit that are, in our professional judgment, significant and relevant to your responsibilities in overseeing the financial reporting process. The following documents various matters with respect to the wrap-up phase of the audit of the annual financial statements of the City of Durham, North Carolina (herein called the "City") for the year ended June 30, 2012.

The following communication was prepared as part of our audit, has consequential limitations, and is intended solely for the information and use of those charged with governance and, if appropriate, management of the City and is not intended and should not be used by anyone other than those specified parties.

Sincerely,

A handwritten signature in black ink that reads "Cherry, Bekaert & Holland, L.L.P." in a cursive style.

Cherry, Bekaert & Holland, L.L.P.

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Contact.

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Cherry, Bekaert & Holland, L.L.P.



1

Status of Our Audit

AUDIT OF FINANCIAL STATEMENTS

- We have completed our audit of the financial statements of the City for the year ended June 30, 2012.
- Our audit was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. This audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
- We are responsible for forming and expressing an opinion about whether the financial statements that have been prepared by management with the oversight of those charged with governance are presented fairly, in all material respects, in conformity with generally accepted accounting principles. **We have issued an unqualified opinion on the financial statements.**
- The objective of our audit was to obtain reasonable - not absolute - assurance about whether the financial statements are free from material misstatements. The scope of the work performed was substantially the same as that described to you in our pre-engagement communications.
- All records and information requested by Cherry, Bekaert & Holland (CB&H) were freely available for our inspection.

- Management and other personnel provided full cooperation.

INTERNAL CONTROL OVER FINANCIAL REPORTING

- In planning and performing our audit of the financial statements of the City for the year ended June 30, 2012 in accordance with auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, we considered the City's internal control over financial reporting (internal control) as a basis for designing our 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. Accordingly, we do not express an opinion on the effectiveness of the City's internal control.
- Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses.

1

Status of Our Audit (continued)

COMPLIANCE

- Our audit of compliance was conducted in accordance with OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations and the State Single Audit Implementation Act.
- We planned and performed the audit to obtain reasonable assurance about whether noncompliance with compliance requirements of laws, regulations, contracts, and federal and State grants which could have a direct and material effect on the determination of the financial statement amounts.
- In our opinion, the City complied, in all material aspects, with the compliance requirements referred to above.
- Our consideration of internal control was for the limited purpose described above and was not designed to identify all deficiencies in internal control 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 a material weakness.

INTERNAL CONTROL OVER COMPLIANCE

- In planning and performing our audit, we considered the City's internal control over compliance with requirements that could have a direct and material effect on a major federal or State program to determine the auditing procedures for the purpose of expressing an opinion on compliance and to test and report on internal control over compliance in accordance with 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.

2 Results of Our Audit

We have reviewed the accounting practices, which include policies, estimates and financial statement disclosures, management has identified to be the most critical and concur with management's assessment. These include:

Primary Areas of Focus	Procedures Performed
Compliance with new GAAP (FASB) regulations	Discussed with management and evaluated new accounting and reporting requirements to determine the extent these pronouncements affect the City.
Cash and Investments	Cash and investment reconciliations were inspected for accuracy and agreed to original bank or brokerage statements. Investments were independently valued to determine that assigned market values were reasonable.
Accounts Receivable and Revenue	Analytically reviewed recorded revenues and confirmed directly with revenue sources amounts received in the current year.
Capital Assets and Related Expenditures	Property and Equipment records were inspected for reasonableness. Significant additions were agreed to supporting records.
Accounts Payable and Expenses	Search for unrecorded liabilities was performed to determine that all liabilities were reported at year end.
Payroll and Related Liabilities	Analytical procedures were performed to determine that payroll related liabilities were properly accrued and that the fluctuation in payroll expense was consistent with the City's hiring activity.
Debt and Debt Service Expenditures	Ending debt balances were confirmed with 3rd party. All material issuances in the current year were agreed to supporting agreements.
Single Audit	Performed test of compliance with grant agreements and certain laws and regulations.
Litigation	Discussed actual and threatened litigation with and reviewed accounting detail and noted instances of recording of legal fees and obtained representations with respect to the effect of litigation on the financial statements.
Management's Judgments and Accounting Estimates	Accounting estimates are an integral part of the financial statements and are based on management's current judgments. We believe that the items representing significant judgmental areas that impact the City's financial reporting were Collectability of Receivables, Depreciation Expense, Landfill Post Closure Costs, Self-Insurance Liability, Post Employment Healthcare Benefit Plan Liability and Law Enforcement Separation Allowance Liability.

3 Required Communications Internal Control Over Financial Reporting

CB&H is required to communicate, in writing, to those charged with governance all material weaknesses and significant deficiencies that have been identified in the City's internal controls over financial reporting. The definitions of material weakness, significant deficiencies and control deficiencies follow:

Category	Definition
Material Weakness	A deficiency, or 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.
Significant Deficiency	A deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.
Deficiency in Internal Control	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.

In conjunction with our audit of the financial statements, we did not identify any material weaknesses.

Required Communications

Matters Required to be Reported to Those Charged with Governance

Various professional guidance requires independent auditors to communicate with those charged with governance certain matters in relation to an audit. Following is a summary of those required items along with specific discussion points as they pertain to the City:

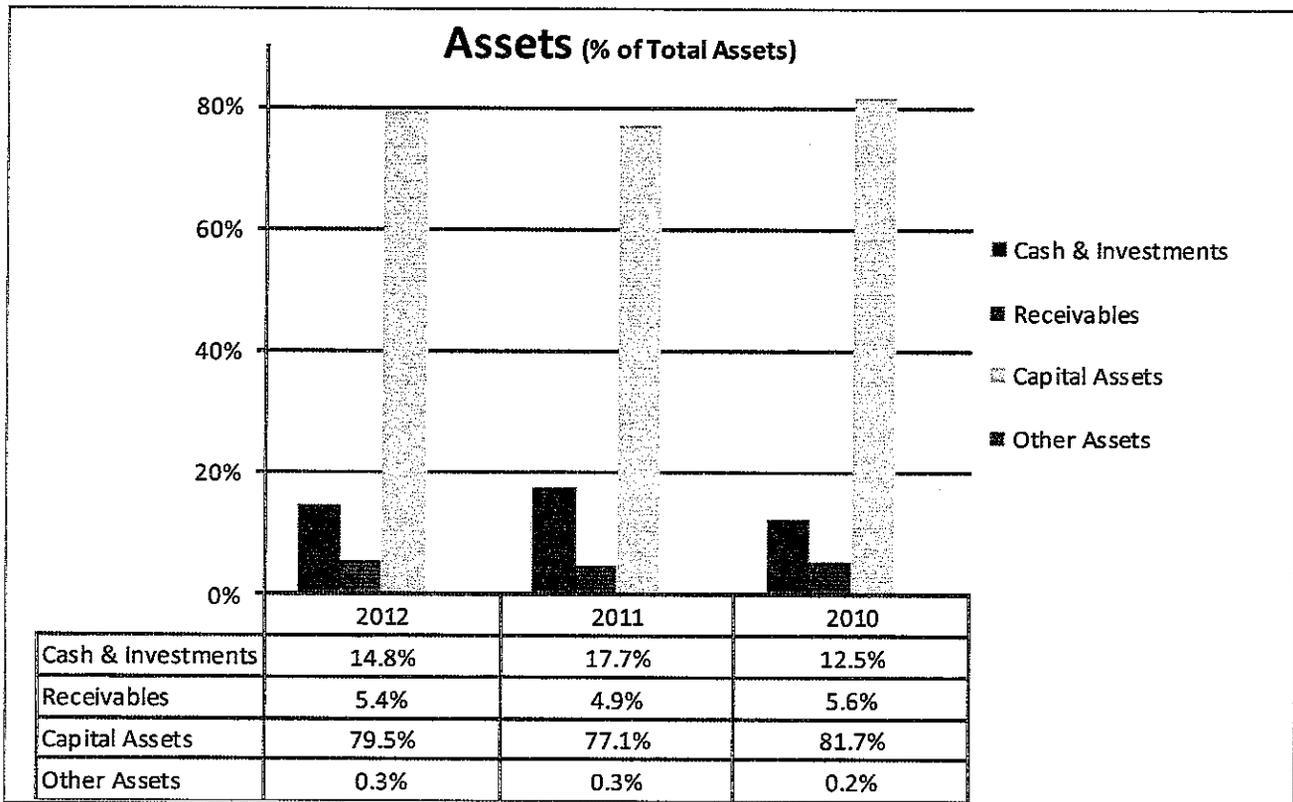
Requirement	Discussion Points
<p>Auditor's judgment about the quality of the City's accounting policies, estimates and financial statement disclosures</p>	<p>In accordance with applicable auditing standards, a discussion was held regarding the quality of financial reporting, which included the City's significant accounting practices, estimates and financial statement disclosures.</p>
<p>Critical accounting policies and practices</p>	<p>Please refer to Primary Areas of Focus in section two.</p>
<p>Adoption of a change in accounting principle</p>	<p>There were no situations involving the adoption of or a change in accounting principles where the application of alternative generally accepted accounting principles, including alternative methods of applying an accounting principle, would have a material effect on the City's financial statements.</p>
<p>Material, corrected misstatements brought to the attention of management by the auditor</p>	<p>There were no material misstatements detected as a result of our audit procedures required to be corrected by management.</p>
<p>Uncorrected misstatements, other than those the auditor believes to be trivial</p>	<p>There were no uncorrected misstatements detected as a result of our audit procedures.</p>
<p>Disagreements with management</p>	<p>There were no disagreements with management on financial accounting and/or reporting matters and auditing procedures that, if not satisfactorily resolved, would cause a modification of our auditors' report.</p>

Required Communications

Requirement	Discussion Points
<p>Consultations with other accountants</p>	<p>We are not aware of any consultations about accounting or auditing matters between management and other independent public accountants. Nor are we aware of opinions obtained by management from other independent public accountants on the application of generally accepted accounting principles.</p>
<p>Significant issues discussed with management</p>	<p>Please refer to the Results of Our Audit in section two.</p>
<p>Significant difficulties encountered during the audit</p>	<p>There were no significant difficulties encountered during the audit.</p>
<p>Representations requested from management</p>	<p>Please refer to the management representation letter, which was signed by management, included as Exhibit A.</p>
<p>Other issues arising from the audit the auditor considers significant and relevant to those charged with governance</p>	<p>There was no other issues arising from the audit that we consider significant and relevant to those charged with governance.</p>
<p>Material alternative accounting treatments discussed with management</p>	<p>There was no discussion with management concerning alternative accounting treatments.</p>

4 Accounting Measurements & Metrics

ASSETS



Statement of Net Assets

The major changes were as follows:

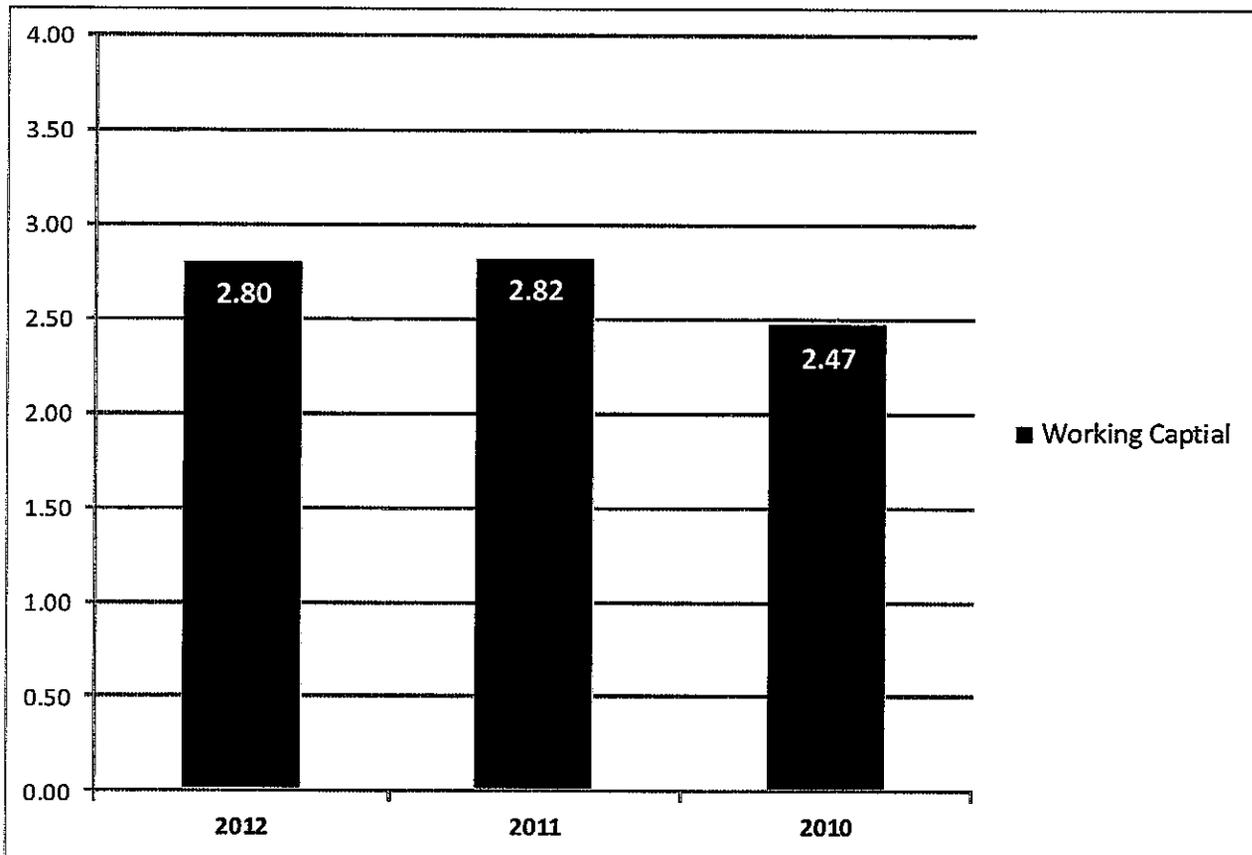
- Total Cash and Restricted Cash decreased by approximately \$44 million. Total capital assets increased by approximately \$37 million. These two variances are correlated; decreases as it is used to finance capital projects.

Accounting Measurements & Metrics

WORKING CAPITAL

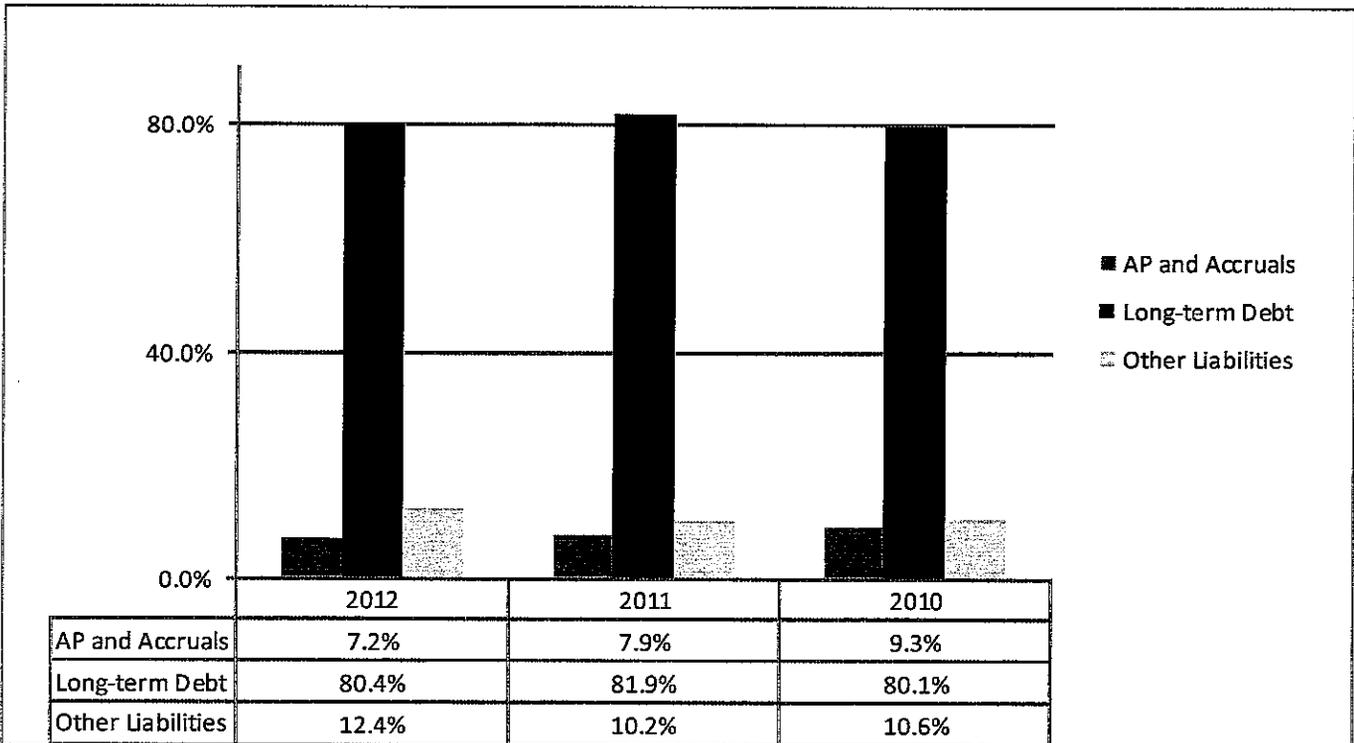
$$\frac{\text{Current Assets}}{\text{Current Liabilities}}$$

- Measures the financial health of the City.
- A ratio > 1 represents an entity that is able to meet its short term obligations and satisfy both maturing short-term debt and upcoming operational expenses.



Accounting Measurements & Metrics

LIABILITIES



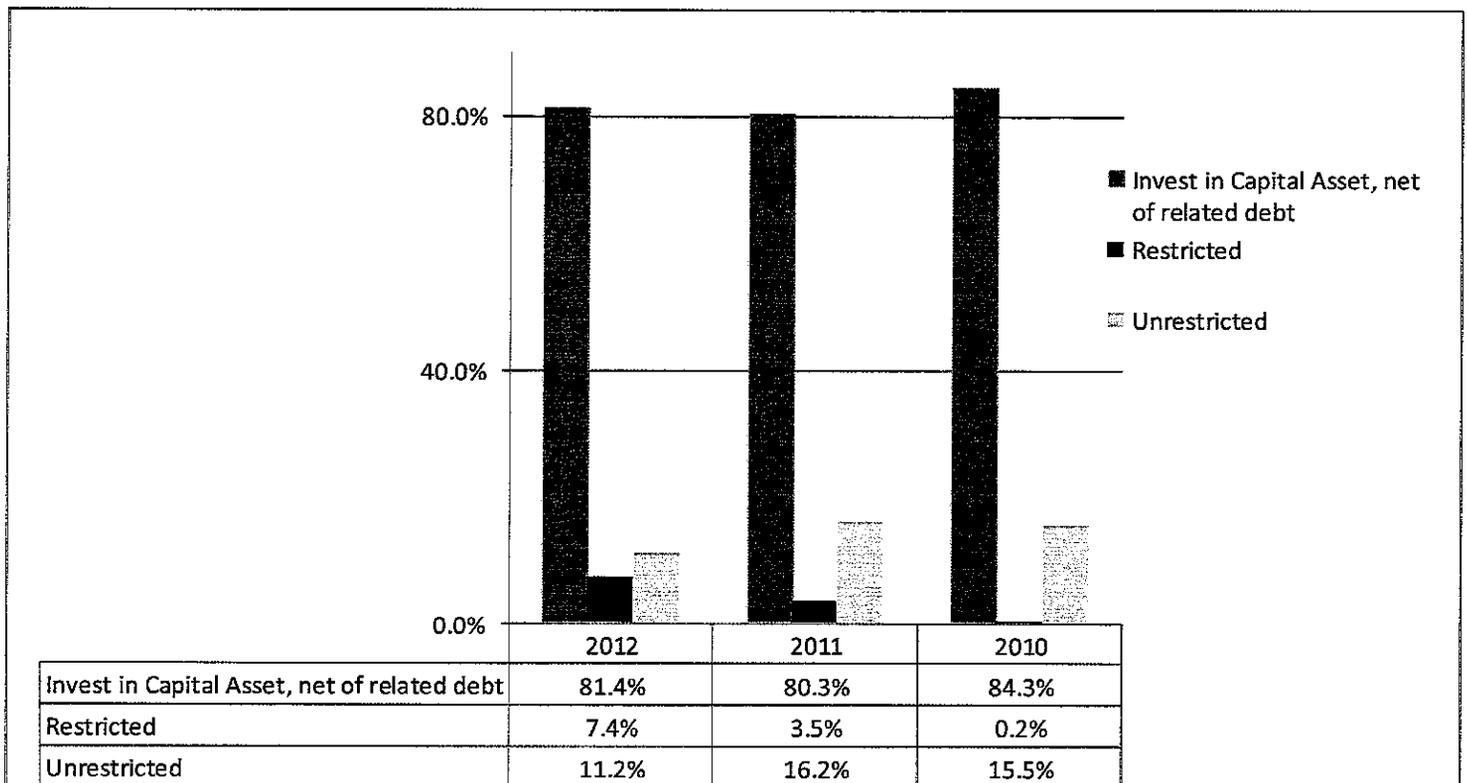
Statement of Net Assets

The major changes were as follows:

- There were minimal new financings during the year. Over all long term liabilities decreased due to the normal pay down and maturities of long term debt.

Accounting Measurements & Metrics

NET ASSETS



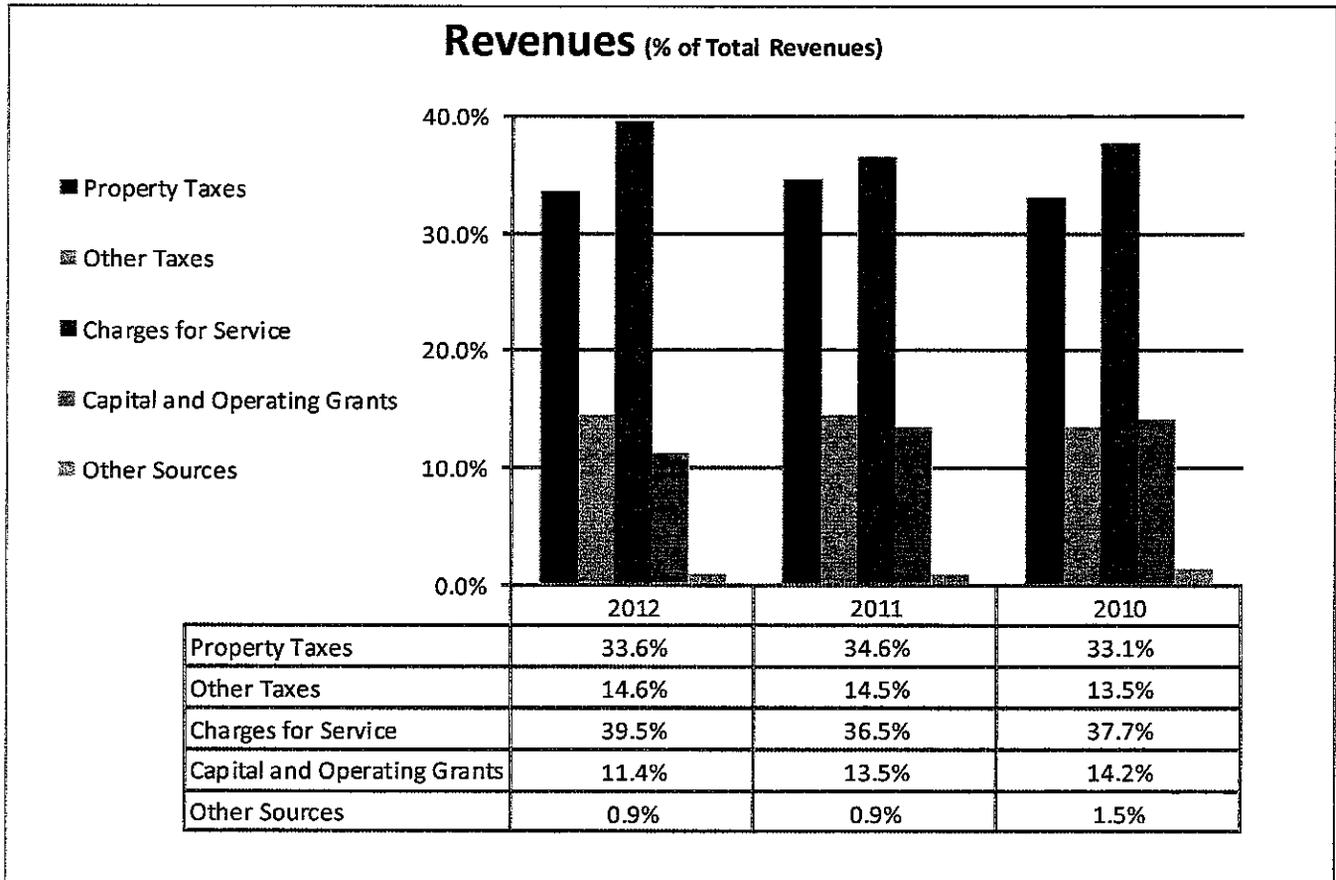
Statement of Net Assets

The major changes were as follows:

- Investment in capital assets, net of related debt, increased during the year. This increase was function of capital assets increasing due to on going capital projects and debt decreasing due to normal pay downs and maturities.

Accounting Measurements & Metrics

REVENUES



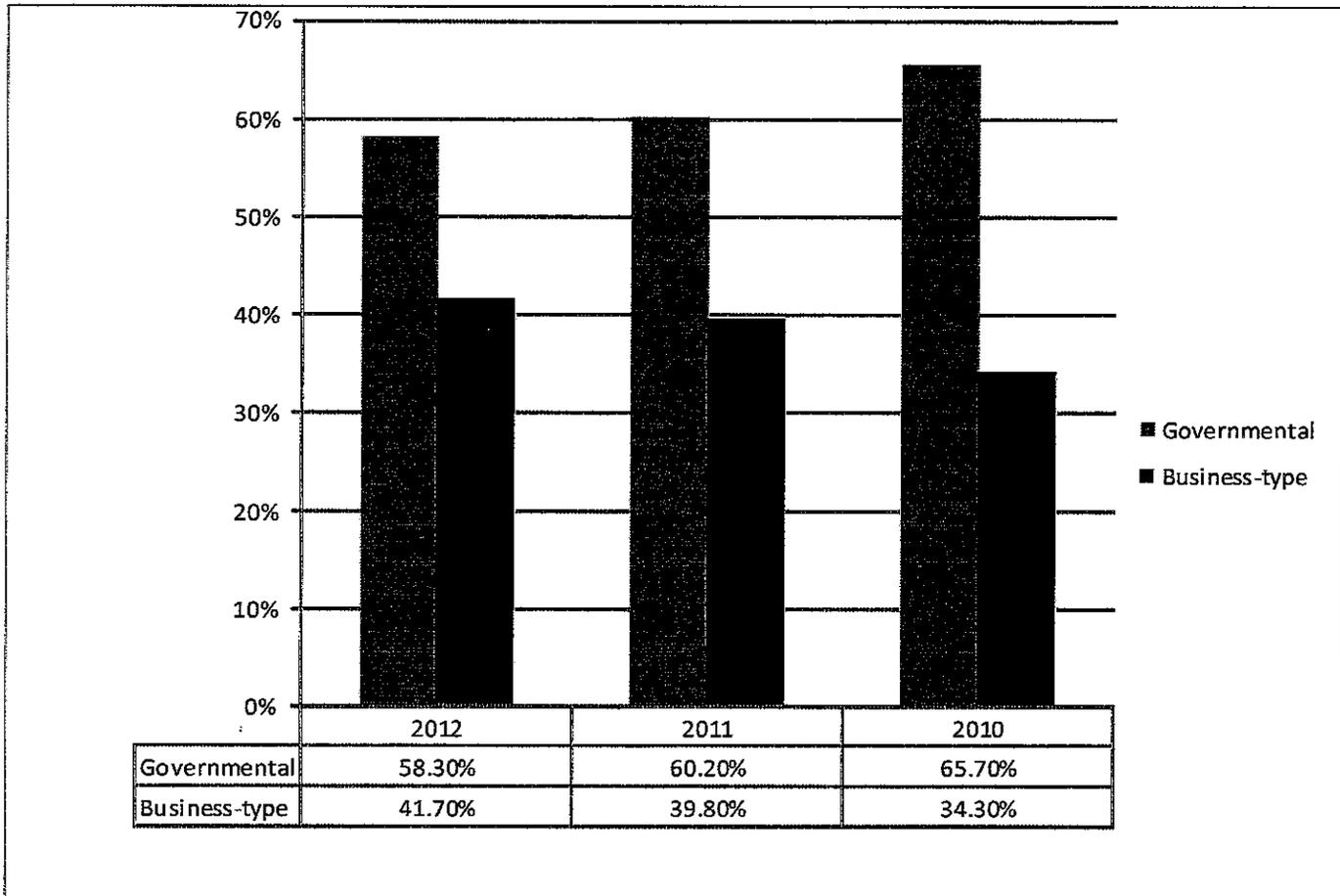
Statement of Activities

The major changes were as follows:

- Most revenue sources remained consistent with the prior year with the exception of Charges for Service. There were two main causes for the \$18 million increase in charges for service. 1) Streets and highways increased as a result of more donated streets than were donated in the prior year. 2) Water and Sewer charges increased as a result of increased rates and increased number of customers.

Accounting Measurements & Metrics

EXPENSES



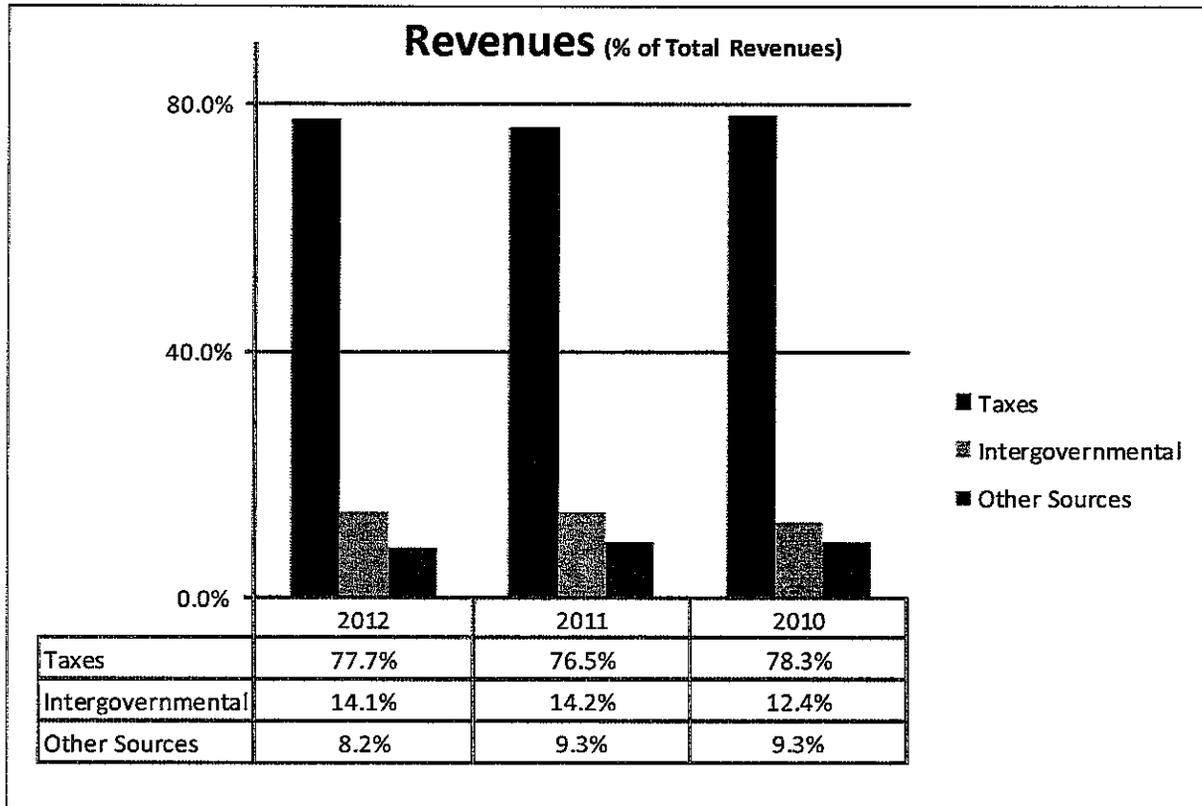
Statement of Activities

The major changes were as follows:

- Governmental expenses remained relatively consistent with the prior year while business-type increased. The largest increase was in water and sewer. The increase is reasonable given the increase in the number of customers served.

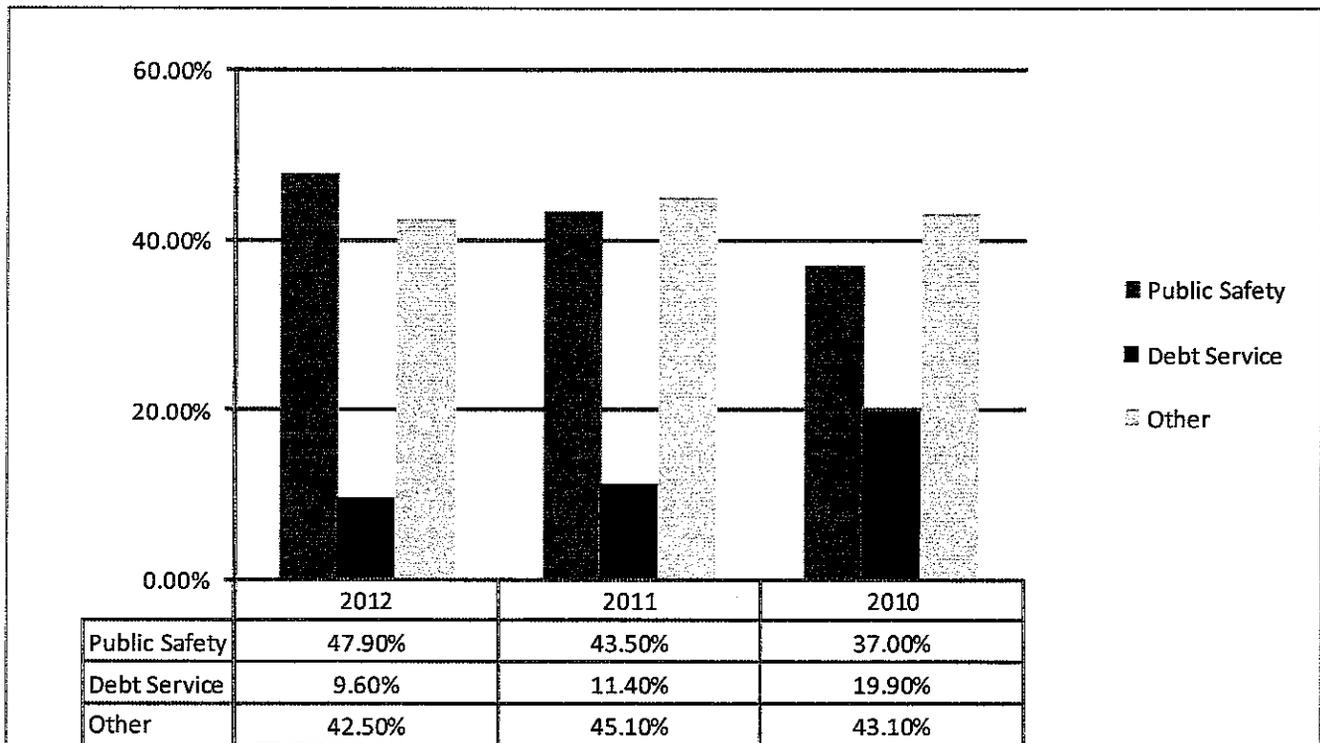
Accounting Measurements & Metrics

GENERAL FUND REVENUES



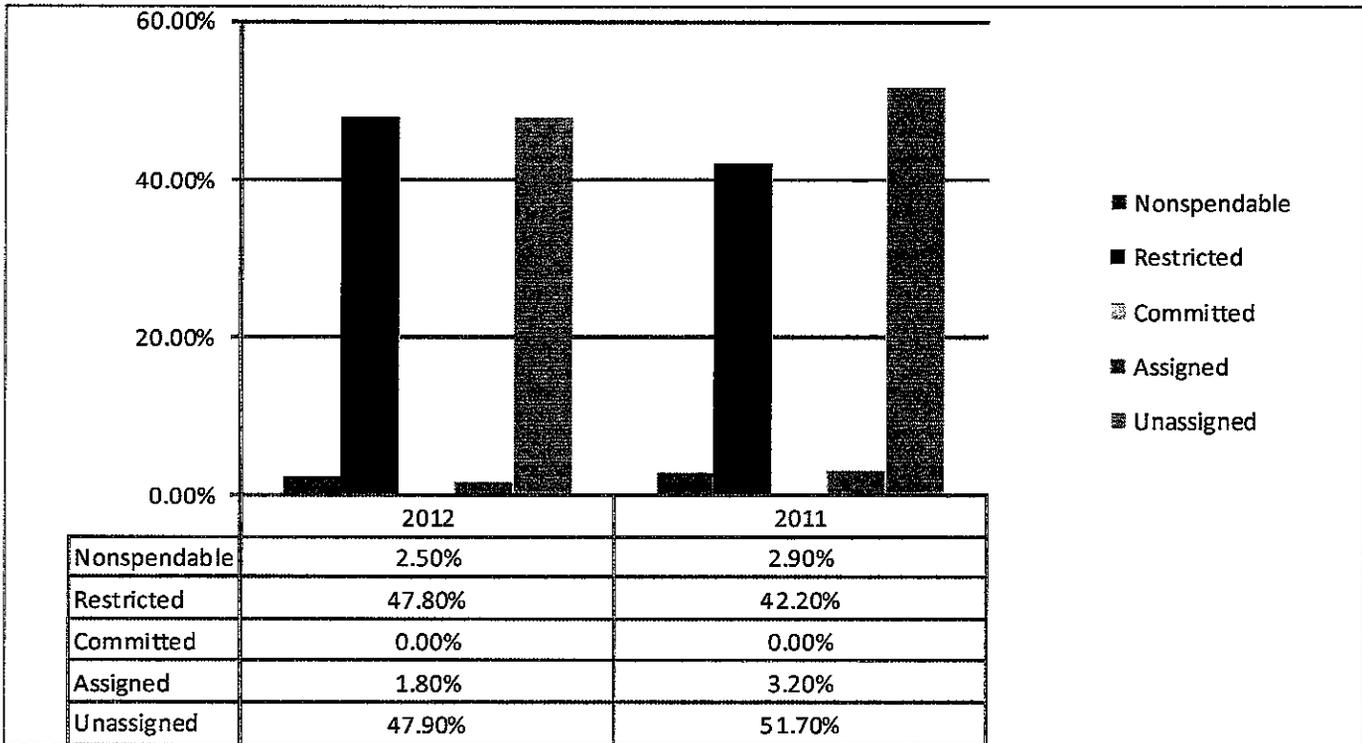
Accounting Measurements & Metrics

GENERAL FUND EXPENDITURES



Accounting Measurements & Metrics

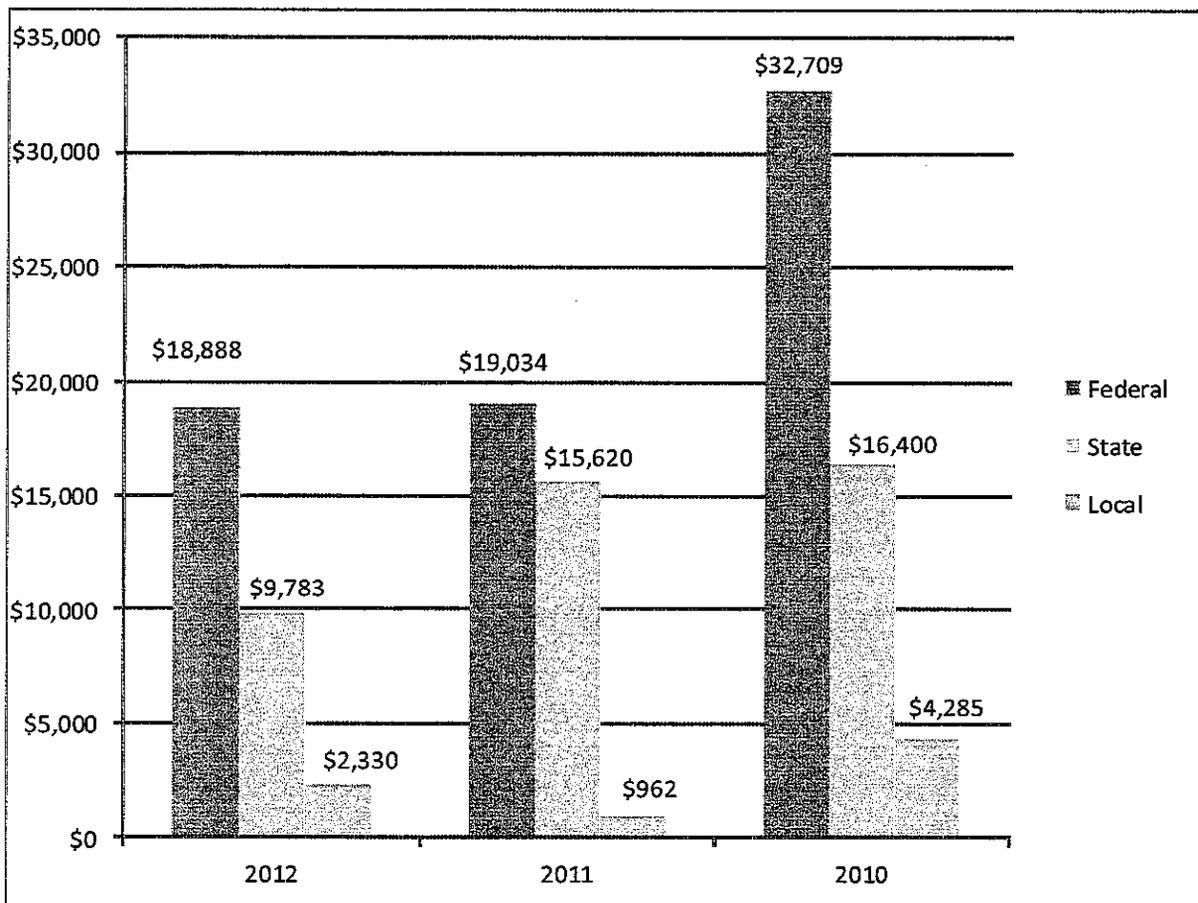
GENERAL FUND - FUND BALANCE



Accounting Measurements & Metrics

SCHEDULES OF EXPENDITURES OF FEDERAL AWARDS

In thousands (000)



5 **Exhibit A** Management Representation Letter

DURHAM



CITY OF DURHAM

City Manager's Office

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1869
CITY OF MEDICINE

October 9, 2012

Cherry, Bekaert & Holland, L.L.P.
2626 Glenwood Avenue, Suite 200
Raleigh, North Carolina 27608

We are providing this letter in connection with your audit of the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Durham, North Carolina, (the "City"), as of and for the year ended June 30, 2012, for the purpose of expressing opinions as to whether the financial statements present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City, as of June 30, 2012, and the respective changes in financial position and cash flows, where applicable, thereof and the respective budgetary comparison for the General Fund for the year then ended in conformity with U.S. generally accepted accounting principles. We confirm that we are responsible for the fair presentation of the previously mentioned financial statements in conformity with accounting principles generally accepted in the United States of America. We are also responsible for adopting sound accounting policies, establishing and maintaining effective internal control over financial reporting, and preventing and detecting fraud.

We confirm, to the best of our knowledge and belief, as of October 9, 2012, the following representations made to you during your audit.

- 1) The financial statements referred to above are fairly presented in conformity with U.S. generally accepted accounting principles and include all properly classified funds and other financial information of the primary government and all component units required by generally accepted accounting principles to be included in the financial reporting entity.
- 2) We have made available to you all—
 - a) Financial records and related data and all audit or relevant monitoring reports, if any, received from funding sources.
 - b) Minutes of the meetings of City Council, and committees or summaries of actions of recent meetings for which minutes have not yet been prepared.
- 3) There have been no communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices, except for the Federal Transit Administration Financial Management Oversight Review final report received October 9, 2012 and the Federal Transit Administration FY 2012 procurement System review received October 15, 2012.
- 4) There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements or the schedule of expenditures of federal and State awards.
- 5) We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.
- 6) We have no knowledge of any fraud or suspected fraud affecting the City involving:
 - a) Management,

- b) Employees who have significant roles in internal control, or
 - c) Others where the fraud could have a material effect on the financial statements.
- 7) We have no knowledge of any allegations of fraud or suspected fraud affecting the City received in communications from employees, former employees, analysts, regulators, or others.
 - 8) We have identified to you any previous financial audits, attestation engagements, or other studies related to the objectives and whether related recommendations have been implemented.
 - 9) The City has no plans or intentions that may materially affect the carrying value or classification of assets, liabilities, or equity.
 - 10) The following, if any, have been properly recorded or disclosed in the financial statements:
 - a) Related party transactions, including revenues, expenditures/expenses, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
 - b) Guarantees, whether written or oral, under which the City is contingently liable.
 - c) All accounting estimates that could be material to the financial statements, including the key factors and significant assumptions underlying those estimates and measurements. We believe the estimates and measurements are reasonable in the circumstances, consistently applied, and adequately disclosed.
 - 11) We are responsible for compliance with the laws, regulations, and provisions of contracts and grant agreements applicable to us, including tax or debt limits and debt contracts; and we have identified and disclosed to you all laws, regulations and provisions of contracts and grant agreements that we believe have a direct and material effect on the determination of financial statement amounts or other financial data significant to the audit objectives, including legal and contractual provisions for reporting specific activities in separate funds.
 - 12) There are no—
 - a) Violations or possible violations of budget ordinances, laws and regulations (including those pertaining to adopting, approving, and amending budgets), provisions of contracts and grant agreements, tax or debt limits, and any related debt covenants whose effects should be considered for disclosure in the financial statements, or as a basis for recording a loss contingency, or for reporting on noncompliance.
 - b) Unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with generally accepted accounting principles.
 - c) Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by generally accepted accounting principles.
 - d) Committed or assigned equity that was not properly authorized and approved.
 - 13) The City has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged as collateral, except as disclosed in the financial statements.
 - 14) The City has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
 - 15) We have followed all applicable laws and regulations in adopting, approving, and amending budgets.

- 16) The financial statements include all component units as well as joint ventures with an equity interest, and properly disclose all other joint ventures and other related organizations.
- 17) The financial statements properly classify all funds and activities.
- 18) All funds that meet the quantitative criteria in GASB Statement Nos. 34 and 37 for presentation as major are identified and presented as such and all other funds that are presented as major are particularly important to financial statement users.
- 19) Net asset components (invested in capital assets, net of related debt; restricted; and unrestricted) and fund balance classifications (non-spendable, restricted, committed, assigned, and unassigned) are properly designated and, if applicable, approved.
- 20) All special revenue funds have a specific revenue source as the foundation for the fund that is restricted or committed to expenditure for specified purposes other than debt service or capital projects.
- 21) Provisions for uncollectible receivables have been properly identified and recorded.
- 22) Expenses have been appropriately classified in or allocated to functions and programs in the statement of activities, and allocations have been made on a reasonable basis.
- 23) Revenues are appropriately classified in the statement of activities within program revenues, general revenues, contributions to term or permanent endowments, or contributions to permanent fund principal.
- 24) Interfund, internal, and intra-entity activity and balances have been appropriately classified and reported.
- 25) Deposits and investment securities are properly classified as to risk, and investments are properly valued.
- 26) Capital assets, including infrastructure assets, are properly capitalized, reported, and, if applicable, depreciated.
- 27) We believe that the actuarial assumptions and methods used to measure pension and OPEB liabilities and costs for financial accounting purposes are appropriate in the circumstances.
- 28) We acknowledge our responsibility for the required supplementary information (RSI). The RSI is measured and presented within prescribed guidelines and the methods of measurement and presentation have not changed from those used in the prior period. We have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the RSI.
- 29) With respect to the introductory section, financial section – governmental funds, enterprise funds, and internal service funds, accompanying financial schedules, and the statistical section, as listed in the table of contents of the financial statements (“supplementary information”), we acknowledge our responsibility for presenting the supplementary information in accordance with accounting principles generally accepted in the United States of America, and we believe the supplementary information, including its form and content, is fairly presented in accordance with accounting principles generally accepted in the United States of America. The methods of measurement and presentation of the supplementary information have not changed from those used in the prior period, and we have disclosed to you any significant assumptions or interpretations underlying the measurement and presentation of the supplementary information.
- 30) Joint ventures, jointly governed organizations, and other related organizations have been properly disclosed in the financial statements.

- 31) Arrangements with financial institutions involving repurchase, reverse repurchase, or securities lending agreements, compensating balances, or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements, have been properly recorded or disclosed in the financial statements.
- 32) Receivables recorded in the financial statements represent valid claims against debtors for transactions arising on or before the statement of net assets or balance sheet date and have been appropriately reduced to their estimated net realizable values.
- 33) Capital assets have been evaluated for impairment as a result of significant and unexpected decline in service utility. Impairment loss and insurance recoveries have been properly recorded
- 34) We believe that all material expenditures that have been deferred to future periods will be recoverable
- 35) Provisions, when material, have been made to reduce excess or obsolete inventories to their estimated net realizable value.
- 36) With respect to federal and State award programs:
 - (a) We are responsible for understanding and complying with and have complied with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and the State Single Audit Implementation Act including requirements relating to preparation of the schedule of expenditures of federal and State awards (SEFSA).
 - (b) We have prepared the SEFSA in accordance with OMB Circular A-133 and the State Single Audit Implementation Act, and have identified and disclosed in the schedule expenditures made during the audit period for all awards provided by federal and State agencies in the form of grants, federal and State cost-reimbursement contracts, loans, loan guarantees, property (including donated surplus property), cooperative agreements, interest subsidies, insurance, food commodities, direct appropriations, and other assistance.
 - (c) We acknowledge our responsibility for presenting the SEFSA in accordance with the requirements of OMB Circular A-133 §310.b, and we believe the SEFSA, including its form and content, is fairly presented in accordance with the Circular. The methods of measurement and presentation of the SEFSA have not changed from those used in the prior period and we have disclosed to you any significant assumptions and interpretations underlying the measurement and presentation of the SEFSA.
 - (d) We have identified and disclosed to you all of our government programs and related activities subject to OMB Circular A-133 and the State Single Audit Implementation Act.
 - (e) We are responsible for understanding and complying with, and have complied with, the requirements of laws, regulations, and the provisions of contracts and grant agreements related to each of our federal and State programs and have identified and disclosed to you the requirements of laws, regulations, and the provisions of contracts and grant agreements that are considered to have a direct and material effect on each major program.
 - (f) We are responsible for establishing and maintaining, and have established and maintained, effective internal control over compliance requirements applicable to federal and State programs that provides reasonable assurance that we are managing our federal and State awards in compliance with laws, regulations, and the provisions of contracts and grant agreements that could have a material effect on our federal and State programs. We believe the internal control system is adequate and is functioning as intended.

- (g) No changes have been made in internal control over compliance or other factors that might significantly affect internal control, including any corrective action we have taken regarding significant deficiencies in internal control over compliance (including material weaknesses in internal control over compliance), have occurred subsequent to the date as of which compliance was audited.
- (h) We have made available to you all contracts and grant agreements (including amendments, if any) and any other correspondence with federal or State agencies or pass-through entities relevant to federal or State programs and related activities.
- (i) We have received no requests from a federal or State agency to audit one or more specific programs as a major program.
- (j) We have complied with the direct and material compliance requirements (except for noncompliance disclosed to you), including when applicable, those set forth in the *OMB Circular A-133 Compliance Supplement* and the *Audit Manual for Governmental Auditors in North Carolina*, relating to federal and State awards and have identified and disclosed to you all amounts questioned and all known noncompliance with the requirements of federal and State awards.
- (k) Amounts claimed or used for matching were determined in accordance with relevant guidelines in *OMB Circular A-87, Cost Principles for State, Local, and Tribal Governments*, and *OMB's Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments*.
- (l) We have disclosed to you our interpretation of compliance requirements that may have varying interpretations.
- (m) We have made available to you all documentation related to compliance with the direct material compliance requirements, including information related to federal and State program financial reports and claims for advances and reimbursements.
- (n) We have disclosed to you the nature of any subsequent events that provide additional evidence about conditions that existed at the end of the reporting period affecting noncompliance during the reporting period.
- (o) There are no such known instances of noncompliance with direct and material compliance requirements that occurred subsequent to the period covered by the auditor's report except for the Federal Transit Administration Financial Management Oversight Review final report received October 9, 2012 and the Federal Transit Administration FY 2012 procurement System review received October 15, 2012.
- (p) Federal and State program financial reports and claims for advances and reimbursements are supported by the books and records from which the financial statements have been prepared.
- (q) We have charged costs to federal and State awards in accordance with applicable cost principles.
- (r) The copies of federal and State program financial reports provided you are true copies of the reports submitted, or electronically transmitted, to the respective federal and State agency or pass-through entity, as applicable.
- (s) We have monitored subrecipients to determine that they have expended pass-through assistance in accordance with applicable laws and regulations and have met the requirements of *OMB Circular A-133* and the *State Single Audit Implementation Act*.
- (t) We have taken appropriate action, including issuing management decisions, on a timely basis after receipt of sub-recipients' auditors' reports that identified noncompliance with laws, regulations, or the provisions of contracts or grant

agreements and have ensured that subrecipients have taken the appropriate and timely corrective action on findings.

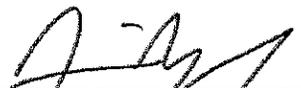
- (u) We have considered the results of subrecipient audits and have made any necessary adjustments to our books and records.
 - (v) We are responsible for and have accurately prepared the summary schedule of prior audit findings to include all findings required to be included by OMB Circular A-133 and the State Single Audit Implementation Act and we have provided you with all information on the status of the follow-up on prior audit findings by federal and State awarding agencies and pass-through entities, including all management decisions.
 - (w) We are responsible for and have accurately prepared the auditee section of the Data Collection Form as required by OMB Circular A-133.
 - (x) We are responsible for preparing and implementing a corrective action plan for each audit finding.
 - (y) We have disclosed to you all contracts or other agreements with service organizations, and we have disclosed to you all communications from the service organizations relating to noncompliance at the service organizations.
 - (z) We have correctly identified all expended American Recovery and Reinvestment Act grant expenditures on the SEFSA and the Data Collection Form.
- 37) We have evaluated and classified any subsequent events as recognized or nonrecognized through the date of this letter. No events, including instances of noncompliance, have occurred subsequent to the balance sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements or in the schedule of findings and questioned costs.

Very truly yours,

CITY OF DURHAM



Thomas J. Bonfield, City Manager



David Boyd, Finance Director