



**OFFICE OF AUDITOR OF STATE**  
**STATE OF IOWA**

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Auditor of State

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**NEWS RELEASE**

FOR RELEASE \_\_\_\_\_

July 5, 2011

Contact: Andy Nielsen  
515/281-5834

Auditor of State David A. Vaudt today released an audit report on the City of Palo, Iowa.

The City's receipts totaled \$3,277,090 for the year ended June 30, 2010, a 51% decrease from the prior year. The receipts included \$291,070 in property tax, \$4,073 from tax increment financing, \$432,219 from charges for service, \$2,077,895 from operating grants, contributions and restricted interest, \$182,737 from local option sales tax, \$2,655 from unrestricted interest on investments, \$266,129 from bond proceeds and other general receipts of \$20,312. The significant decrease in receipts was primarily due to bond proceeds received in the prior year.

Disbursements for the year totaled \$4,443,181, a 25% decrease from the prior year, and included \$3,010,290 for public safety, \$298,787 for capital projects and \$291,799 for public works. Also, disbursements for business type activities totaled \$294,969. The significant decrease in disbursements was primarily due to capital projects in the prior year.

A copy of the audit report is available for review in the City Clerk's Office, in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/reports/1021-0549-B00F.pdf>.

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**CITY OF PALO**

**INDEPENDENT AUDITOR'S REPORTS  
BASIC FINANCIAL STATEMENTS  
AND SUPPLEMENTARY INFORMATION  
SCHEDULE OF FINDINGS AND QUESTIONED COSTS**

**JUNE 30, 2010**

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**City of Palo**

**Officials**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
<b>(Before January 2010)</b>		
Terry Sanders	Mayor	(Resigned)
Jeff Beauregard (Appointed)	Mayor	Nov 2009
Jeff Beauregard	Council Member	(Resigned)
Trent Miller (Appointed)	Council Member	Nov 2009
Julie Klawiter	Council Member	(Resigned)
John Harris (Appointed)	Council Member	Nov 2009
Jeannie Blumer	Council Member	Jan 2010
Al Mengler	Council Member	Jan 2010
Paula Gunter	Council Member	Jan 2012
Stacy Dix	City Administrator/City Clerk	Indefinite
Scott Peterson	Attorney	Indefinite
<b>(After January 2010)</b>		
John Harris	Mayor	Jan 2014
Paula Gunter	Council Member	Jan 2012
Tom Sanders	Council Member	Jan 2012
Jeff Beauregard	Council Member	Jan 2014
Trent Miller	Council Member	Jan 2014
Scott Spider Packingham	Council Member	Jan 2014
Stacy Dix	City Administrator/City Clerk	Indefinite
Scott Peterson	Attorney	Indefinite

**City of Palo**



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Independent Auditor's Report

To the Honorable Mayor and  
Members of the City Council:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Palo, Iowa, as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements listed in the table of contents. These financial statements are the responsibility of the City of Palo's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinions.

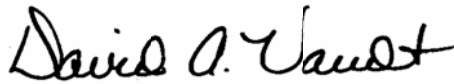
As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis financial position of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Palo as of June 30, 2010, and the respective changes in cash basis financial position for the year then ended in conformity with the basis of accounting described in Note 1.

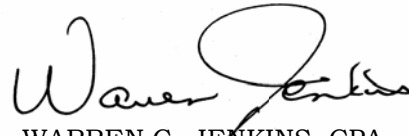
In accordance with Government Auditing Standards, we have also issued our report dated June 23, 2011 on our consideration of the City of Palo's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages 7 through 11 and 28 through 30 are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the City of Palo's basic financial statements. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the year ended June 30, 2009 (which are not presented herein) and expressed unqualified opinions on those financial statements which were prepared in conformity with an other comprehensive basis of accounting. Other supplementary information included in Schedules 1 through 5, including the Schedule of Expenditures of Federal Awards required by U.S. Office of Management and Budget (OMB) Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

June 23, 2011



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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

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The City of Palo provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the fiscal year ended June 30, 2010. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

### **2010 FINANCIAL HIGHLIGHTS**

- The cash basis net assets of the City's government activities decreased approximately \$1,151,000, primarily due to disbursements of disaster recovery grant proceeds received in fiscal year 2009.
- The cash basis net assets of the City's business type activities decreased approximately \$15,000.

### **USING THIS ANNUAL REPORT**

The annual report consists of a series of financial statements and other information, as follows:

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the City's financial activities.

The Government-wide Financial Statement consists of a Statement of Activities and Net Assets. This statement provides information about the activities of the City as a whole and presents an overall view of the City's finances.

The Fund Financial Statements tell how governmental services were financed in the short term as well as what remains for future spending. Fund financial statements report the City's operations in more detail than the government-wide statement by providing information about the most significant funds.

Notes to Financial Statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

Required Supplementary Information further explains and supports the financial statements with a comparison of the City's budget for the year.

Other Supplementary Information provides detailed information about the nonmajor governmental funds and the City's indebtedness. In addition, the Schedule of Expenditures of Federal Awards provides details of various federal programs benefiting the City.

## **BASIS OF ACCOUNTING**

The City maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles. Therefore, when reviewing the financial information and discussion within this annual report, readers should keep in mind the limitations resulting from the use of the cash basis of accounting.

## **REPORTING THE CITY'S FINANCIAL ACTIVITIES**

### *Government-wide Financial Statement*

One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Activities and Net Assets reports information which helps answer this question.

The Statement of Activities and Net Assets presents the City's net assets. Over time, increases or decreases in the City's net assets may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.

The Statement of Activities and Net Assets is divided into two kinds of activities:

- Governmental Activities include public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service and capital projects. Property tax and state and federal grants finance most of these activities.
- Business Type Activities include the waterworks and the sanitary sewer system. These activities are financed primarily by user charges.

### *Fund Financial Statements*

The City has two kinds of funds:

1) Governmental funds account for most of the City's basic services. These focus on how money flows into and out of those funds and the balances at year-end that are available for spending. The governmental funds include: 1) the General Fund, 2) the Special Revenue Funds, such as Local Option Sales Tax, Tax Increment Financing and Community Disaster Grant, 3) the Capital Projects Fund and 4) the Debt Service Fund. The governmental fund financial statements provide a detailed, short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs.

The required financial statement for governmental funds is a statement of cash receipts, disbursements and changes in cash balances.

2) Proprietary funds account for the City's Enterprise Funds. Enterprise Funds are used to report business type activities. The City maintains two Enterprise Funds to provide separate information for the Water and Sewer Funds. The Sewer Fund is considered to be a major fund of the City.

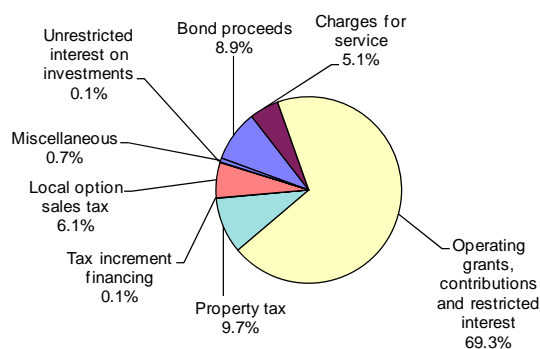
The required financial statement for proprietary funds is a statement of cash receipts, disbursements and changes in cash balances.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

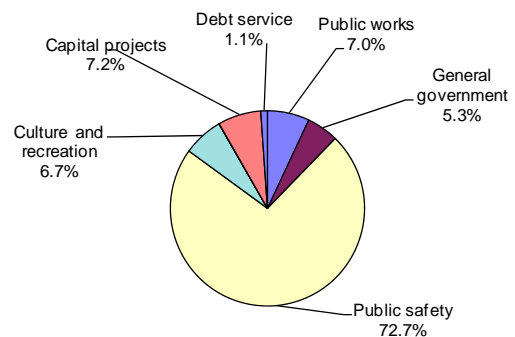
Net assets may serve over time as a useful indicator of financial position. The City's cash balance for governmental activities decreased from \$1,665,526 at June 30, 2009 to \$514,063 at June 30, 2010, primarily due to a decrease in bond proceeds. The analysis that follows focuses on the changes in cash basis net assets of governmental activities.

Changes in Cash Basis Net Assets of Governmental Activities		
	Year ended June 30,	
	2010	2009
Receipts:		
Program receipts:		
Charges for service	\$ 151,878	52,759
Operating grants, contributions and restricted interest	2,077,895	2,858,026
General receipts:		
Property tax	291,070	233,045
Tax increment financing	4,073	168,307
Local option sales tax	182,737	282,589
Unrestricted interest on investments	2,655	4,180
Bond proceeds	266,129	2,804,508
Miscellaneous	20,312	25,520
Total receipts	2,996,749	6,428,934
Disbursements:		
Public safety	3,010,290	2,346,171
Public works	291,799	113,498
Culture and recreation	279,849	114,554
Community and economic development	1,498	142,280
General government	219,320	150,540
Debt service	46,669	-
Capital projects	298,787	2,902,392
Total disbursements	4,148,212	5,769,435
Change in cash basis net assets	(1,151,463)	659,499
Cash basis net assets beginning of year	1,665,526	1,006,027
Cash basis net assets end of year	\$ 514,063	1,665,526

**Receipts by Source**



**Disbursements by Function**



Changes in Cash Basis Net Assets of Business Type Activities		
	Year ended June 30,	
	2010	2009
Receipts:		
Program receipts:		
Charges for service:		
Sewer	\$ 280,341	245,019
Disbursements:		
Water	4,676	1,190
Sewer	290,293	119,216
Total disbursements	294,969	120,406
Change in cash basis net assets	(14,628)	124,613
Cash basis net assets beginning of year	260,837	136,224
Cash basis net assets end of year	\$ 246,209	260,837

Total business type activities cash basis net assets decreased from \$260,837 at June 30, 2009 to \$246,209 at June 30, 2010.

#### **INDIVIDUAL MAJOR GOVERNMENTAL FUND ANALYSIS**

As the City of Palo completed the year, its governmental funds reported a combined fund balance of \$514,063, a decrease of \$1,151,463 from last year's total of \$1,665,526. The following are the major reasons for the changes in fund balances of the major funds from the prior year.

- The General Fund cash balance decreased \$422,596 from the prior year to a year-end deficit balance of \$187,326. This was primarily due to an overall decrease in grant receipts in fiscal year 2010 and an increase in disbursements due to the construction of a splash pad.
- The Special Revenue, Local Option Sales Tax Fund cash balance increased \$92,183 to \$688,776 during the fiscal year. This change was attributable to a decrease in operating transfers out which exceeded a decrease in local option sales tax (LOST) receipts.
- The Special Revenue, Tax Increment Financing Fund cash balance decreased \$230,937 to \$189,015 during the fiscal year. This change was attributable to additional disbursements, which outpaced receipts from the County.
- The Special Revenue, Community Disaster Grant Fund includes the proceeds from a grant received in the prior year which the City disbursed this year.
- The Capital Projects Fund cash balance decreased \$31,907 to a deficit balance of \$163,918 during the fiscal year, primarily due to sewer project costs exceeding bond proceeds.

#### **INDIVIDUAL MAJOR BUSINESS TYPE FUND ANALYSIS**

- The Enterprise, Sewer Fund cash balance decreased \$9,952 to \$252,075.

## BUDGETARY HIGHLIGHTS

Over the course of the year, the City amended its budget once. The amendment was approved on June 28, 2010 and resulted in an overall decrease in disbursements related to federal disaster funds.

The City's receipts were \$7,780,451 less than budgeted. This was primarily due to the City budgeting FEMA receipts for projects not yet completed.

With the budget amendment, total disbursements were \$1,477,150 less than the amended budget. This was primarily due to budgeting FEMA disbursements which were not disbursed.

## DEBT ADMINISTRATION

At June 30, 2010, the City had \$4,175,000 in bonds outstanding, compared to \$3,928,871 last year, as shown below.

	Outstanding Debt at Year-End	
	June 30,	
	2010	2009
General obligation bonds	\$ 1,185,000	928,871
Sewer revenue bonds	2,990,000	3,000,000
Total	\$ 4,175,000	3,928,871

Debt increased as a result of the City drawing down more debt from the state revolving fund in fiscal year 2010 for the sewer improvement project.

The Constitution of the State of Iowa limits the amount of general obligation debt cities can issue to 5% of the assessed value of all taxable property within the City's corporate limits. The City's outstanding general obligation debt of \$1,185,000 is significantly below its constitutional debt limit of \$2,855,688.

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The City of Palo's elected and appointed officials and citizens considered many factors when setting the fiscal year 2011 budget, tax rates and fees charged for various City activities.

These indicators were taken into account when adopting the budget for fiscal year 2011. Amounts available for appropriation in the operating budget are \$10,305,416, an increase of 132% over the actual year 2010 disbursements. The increase is primarily due to the continued cleanup of the flood.

If these estimates are realized, the City's budgeted cash balance is expected to decrease approximately \$569,000 by the close of fiscal year 2011.

## CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Michelle Nejd1, City Clerk, 4533 Shellsburg Road, Palo, Iowa 52324.

**City of Palo**

## **Basic Financial Statements**

City of Palo

Statement of Activities and Net Assets – Cash Basis

As of and for the year ended June 30, 2010

	Disbursements	Program Receipts	
		Charges for Service	Operating Grants, Contributions and Restricted Interest
<b>Functions/Programs:</b>			
Governmental activities:			
Public safety	\$ 3,010,290	23,933	1,858,484
Public works	291,799	126,693	85,259
Culture and recreation	279,849	600	118,484
Community and economic development	1,498	-	-
General government	219,320	652	15,668
Debt service	46,669	-	-
Capital projects	298,787	-	-
Total governmental activities	4,148,212	151,878	2,077,895
Business type activities:			
Sewer	290,293	280,341	-
Water	4,676	-	-
Total business type activities	294,969	280,341	-
Total	\$ 4,443,181	432,219	2,077,895
<b>General Receipts:</b>			
Property and other city tax levied for:			
General purposes			
Tax increment financing			
Local option sales tax			
Unrestricted interest on investments			
Bond proceeds			
Miscellaneous			
Total general receipts			
Change in cash basis net assets			
Cash basis net assets beginning of year			
Cash basis net assets end of year			
<b>Cash Basis Net Assets</b>			
Restricted:			
Local option sales tax			
Urban renewal purposes			
Community disaster grant			
Other purposes			
Unrestricted			
<b>Total cash basis net assets</b>			

See notes to financial statements.



Net (Disbursements) Receipts and Changes in Cash Basis Net Assets		
Governmental Activities	Business Type Activities	Total
(1,127,873)	-	(1,127,873)
(79,847)	-	(79,847)
(160,765)	-	(160,765)
(1,498)	-	(1,498)
(203,000)	-	(203,000)
(46,669)	-	(46,669)
(298,787)	-	(298,787)
(1,918,439)	-	(1,918,439)
-	(9,952)	(9,952)
-	(4,676)	(4,676)
-	(14,628)	(14,628)
(1,918,439)	(14,628)	(1,933,067)
291,070	-	291,070
4,073	-	4,073
182,737	-	182,737
2,655	-	2,655
266,129	-	266,129
20,312	-	20,312
766,976	-	766,976
(1,151,463)	(14,628)	(1,166,091)
1,665,526	260,837	1,926,363
\$ 514,063	246,209	760,272
\$ 688,776	-	688,776
189,015	-	189,015
2,404	-	2,404
34,589	-	34,589
(400,721)	246,209	(154,512)
\$ 514,063	246,209	760,272

City of Palo

Statement of Cash Receipts, Disbursements  
and Changes in Cash Balances  
Governmental Funds

As of and for the year ended June 30, 2010

	Special Revenue		
	General	Local Option Sales Tax	Tax Increment Financing
<b>Receipts:</b>			
Property tax	\$ 249,816	-	-
Tax increment financing	-	-	4,073
Local option sales tax	-	182,737	-
Licenses and permits	4,703	-	-
Use of money and property	7,784	-	120
Intergovernmental	1,932,382	-	-
Charges for service	49,694	-	-
Miscellaneous	124,381	-	-
<b>Total receipts</b>	<b>2,368,760</b>	<b>182,737</b>	<b>4,193</b>
<b>Disbursements:</b>			
<b>Operating:</b>			
Public safety	2,388,458	-	90,157
Public works	46,306	47,870	54,815
Culture and recreation	169,104	11,522	90,158
Community and economic development	1,475	-	-
General government	200,006	6,162	-
Debt service	-	-	-
Capital projects	-	-	-
<b>Total disbursements</b>	<b>2,805,349</b>	<b>65,554</b>	<b>235,130</b>
<b>Excess (deficiency) of receipts over (under) disbursements</b>	<b>(436,589)</b>	<b>117,183</b>	<b>(230,937)</b>
<b>Other financing sources (uses):</b>			
Sale of property	13,993	-	-
Bond proceeds	-	-	-
Operating transfers in	-	-	-
Operating transfers out	-	(25,000)	-
<b>Total other financing sources (uses)</b>	<b>13,993</b>	<b>(25,000)</b>	<b>-</b>
<b>Net change in cash balances</b>	<b>(422,596)</b>	<b>92,183</b>	<b>(230,937)</b>
Cash balances beginning of year	235,270	596,593	419,952
Cash balances end of year	\$ (187,326)	688,776	189,015
<b>Cash Basis Fund Balances</b>			
<b>Unreserved:</b>			
General fund	\$ (187,326)	-	-
Special revenue funds	-	688,776	189,015
Capital projects fund	-	-	-
Debt service fund	-	-	-
<b>Total cash basis fund balances</b>	<b>\$ (187,326)</b>	<b>688,776</b>	<b>189,015</b>

See notes to financial statements.

Community Disaster Grant	Capital Projects	Nonmajor	Total
-	-	50,910	300,726
-	-	-	4,073
-	-	-	182,737
-	-	-	4,703
-	-	-	7,904
2,402	-	90,775	2,025,559
-	-	9,945	59,639
-	751	6,154	131,286
2,402	751	157,784	2,716,627
504,126	-	27,549	3,010,290
-	-	142,808	291,799
-	-	9,065	279,849
-	-	23	1,498
-	-	13,152	219,320
-	-	46,669	46,669
-	298,787	-	298,787
504,126	298,787	239,266	4,148,212
(501,724)	(298,036)	(81,482)	(1,431,585)
-	-	-	13,993
-	266,129	-	266,129
-	-	25,000	25,000
-	-	-	(25,000)
-	266,129	25,000	280,122
(501,724)	(31,907)	(56,482)	(1,151,463)
504,128	(132,011)	41,594	1,665,526
2,404	(163,918)	(14,888)	514,063
-	-	-	(187,326)
2,404	-	31,781	911,976
-	(163,918)	-	(163,918)
-	-	(46,669)	(46,669)
2,404	(163,918)	(14,888)	514,063

**City of Palo**

City of Palo

Statement of Cash Receipts, Disbursements  
and Changes in Cash Balances  
Proprietary Funds

As of and for the year ended June 30, 2010

	Enterprise		Total
	Sewer	Nonmajor Water	
Operating receipts:			
Charges for service	\$ 280,341	-	280,341
Operating disbursements:			
Business type activities	190,337	4,676	195,013
Excess (deficiency) of operating receipts over (under) operating disbursements	90,004	(4,676)	85,328
Non-operating disbursements			
Debt service	(99,956)	-	(99,956)
Deficiency of receipts under disbursements	(9,952)	(4,676)	(14,628)
Cash balances beginning of year	262,027	(1,190)	260,837
Cash balances end of year	\$ 252,075	(5,866)	246,209
<b>Cash Basis Fund Balances</b>			
Unreserved	\$ 252,075	(5,866)	246,209

See notes to financial statements.

City of Palo

Notes to Financial Statements

June 30, 2010

**(1) Summary of Significant Accounting Policies**

The City of Palo is a political subdivision of the State of Iowa located in Linn County. It was first incorporated in 1954 and operates under the Home Rule provisions of the Constitution of Iowa. The City operates under the Mayor-Council form of government with the Mayor and Council Members elected on a non-partisan basis. The City provides numerous services to citizens, including public safety, public works, health and social services, culture and recreation, community and economic development and general government services. The City also provides sewer utilities for its citizens.

A. Reporting Entity

For financial reporting purposes, the City of Palo has included all funds, organizations, agencies, boards, commissions and authorities. The City has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the City are such that exclusion would cause the City's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body and (1) the ability of the City to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the City. The City has no component units which meet the Governmental Accounting Standards Board criteria.

Jointly Governed Organizations

The City participates in several jointly governed organizations that provide goods or services to the citizenry of the City but do not meet the criteria of a joint venture since there is no ongoing financial interest or responsibility by the participating governments. City officials are members of the following boards and commissions: Linn County Assessor's Conference Board, Linn County Emergency Management Commission and Linn County Joint E911 Service Board.

B. Basis of Presentation

Government-wide Financial Statement - The Statement of Activities and Net Assets reports information on all of the nonfiduciary activities of the City. For the most part, the effect of interfund activity has been removed from this statement. Governmental activities, which are supported by tax and intergovernmental revenues, are reported separately from business type activities, which rely to a significant extent on fees and charges for service.

The Statement of Activities and Net Assets presents the City's nonfiduciary net assets. Net assets are reported in two categories:

*Restricted net assets* result when constraints placed on net asset use are either externally imposed or imposed by law through constitutional provisions or enabling legislation.

*Unrestricted net assets* consist of net assets not meeting the definition of the preceding category. Unrestricted net assets often have constraints on resources imposed by management which can be removed or modified.

The Statement of Activities and Net Assets demonstrates the degree to which the direct disbursements of a given function are offset by program receipts. Direct disbursements are those clearly identifiable with a specific function. Program receipts include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services or privileges provided by a given function and 2) grants, contributions and interest on investments restricted to meeting the operational or capital requirements of a particular function. Property tax and other items not properly included among program receipts are reported instead as general receipts.

Fund Financial Statements – Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements. All remaining governmental funds are aggregated and reported as nonmajor governmental funds.

The City reports the following major governmental funds:

The General Fund is the general operating fund of the City. All general tax receipts and other receipts not allocated by law or contractual agreement to some other fund are accounted for in this fund. From the fund are paid the general operating disbursements, the fixed charges and the capital improvement costs not paid from other funds.

Special Revenue:

The Local Option Sales Tax Fund is used to account for the collection and use of the local option sales tax.

The Tax Increment Financing Fund is used to account for tax increment financing collections and the repayment of tax increment financing indebtedness.

The Community Disaster Grant Fund is used to account for receipts and disbursements for recovering from the flood of June 2008.

The Capital Projects Fund is used to account for receipts and disbursements related to capital projects in progress in the City.

The City reports the following major proprietary fund:

The Sewer Fund accounts for the operation and maintenance of the City's wastewater treatment and sanitary sewer system.

C. Measurement Focus and Basis of Accounting

The City maintains its financial records on the basis of cash receipts and disbursements and the financial statements of the City are prepared on that basis. The cash basis of accounting does not give effect to accounts receivable, accounts payable and accrued items. Accordingly, the financial statements do not present financial position and results of operations of the funds in accordance with U.S. generally accepted accounting principles.

Under the terms of grant agreements, the City funds certain programs by a combination of specific cost-reimbursement grants, categorical block grants and general receipts. Thus, when program disbursements are paid, there are both restricted and unrestricted cash basis net assets available to finance the program. It is the City's policy to first apply cost-reimbursement grant resources to such programs, followed by categorical block grants and then by general receipts.

Proprietary funds distinguish operating receipts and disbursements from non-operating items. Operating receipts and disbursements generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. All receipts and disbursements not meeting this definition are reported as non-operating receipts and disbursements.

D. Budgets and Budgetary Accounting

The budgetary comparison and related disclosures are reported as Required Supplementary Information.

**(2) Cash and Pooled Investments**

The City's deposits in banks at June 30, 2010 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against the depositories to insure there will be no loss of public funds.

The City is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the City Council; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The City had no investments meeting the disclosure requirements of Governmental Accounting Standards Board Statement No. 3, as amended by Statement No. 40.



**(3) Bonds Payable**

General Obligation Bonds

As of June 30, 2010, the City has received \$1,195,000 of the general obligation bonds dated December 13, 2007 authorized for issuance in the total amount of \$1,200,000. Therefore, a repayment schedule has not been prepared.

Revenue Bonds

On December 13, 2007, the City entered into a state revolving fund loan and disbursement agreement with the Iowa Finance Authority and Wells Fargo Bank Iowa, N.A. (Trustee) for the issuance of \$3,000,000 of sewer revenue bonds with interest at 3% per annum. The agreement also requires the City to annually pay a .25% servicing fee on the outstanding principal balance. The bonds were issued pursuant to the provisions of Sections 384.24A and 384.83 of the Code of Iowa for the purpose of paying the cost of constructing improvements and extensions to the City sewer system.

Annual debt service requirements to maturity for the sewer revenue bonds are as follows:

Year Ending June 30,	Principal	Interest	Total
2011	\$ 10,000	97,175	107,175
2012	10,000	96,850	106,850
2013	10,000	96,525	106,525
2014	10,000	96,200	106,200
2015	81,000	95,875	176,875
2016-2020	442,000	438,360	880,360
2021-2025	513,000	362,050	875,050
2026-2030	594,000	273,552	867,552
2031-2035	690,000	170,950	860,950
2036-2039	630,000	51,903	681,903
Total	\$ 2,990,000	1,779,440	4,769,440

The City has pledged future sewer customer receipts, net of specified operating disbursements, to repay the bonds. The bonds are payable solely from sewer customer net receipts and are payable through 2039. The total principal and interest remaining to be paid on the bonds is \$4,769,440. For the current year, principal and interest paid and total customer net receipts were \$99,956 and \$90,004, respectively.

Annual principal and interest payments on the bonds required 111% of net receipts for the year ended June 30, 2010.

The resolution providing for the issuance of the bonds includes the following provisions:

- (a) The bonds will only be redeemed from the future earnings of the enterprise activity and the bond holders hold a lien on the future earnings of the funds.
- (b) Sufficient monthly transfers shall be made to a sewer revenue bond sinking account within the Enterprise Funds for the purpose of making the bond principal and interest payments when due.

- (c) Sewer user rates shall be established at a level which produces and maintains net revenues at a level not less than 110% of the amount of principal and interest on the bonds falling due in the same year.
- (d) The City shall keep proper books and cause the books to be audited annually by an independent auditor.

The City has not transferred the required amounts to the sewer revenue bond sinking account as required by the bond resolution.

Also, the City was not in compliance with the bond requirement to establish user rates at a level which produces and maintains net receipts at a level not less than 110% of the amount of principal and interest on the bonds falling due in the same year.

**(4) Pension and Retirement Benefits**

The City contributes to the Iowa Public Employees Retirement System (IPERS), which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits which are established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa 50306-9117.

Most regular plan members are required to contribute 4.30% of their annual covered salary and the City is required to contribute 6.65% of covered salary. Certain employees in special risk occupations and the City contribute an actuarially determined contribution rate. Contribution requirements are established by state statute. The City's contribution to IPERS for the years ended June 30, 2010 and 2009 were \$19,182 and \$12,976, respectively, equal to the required contributions for each year.

**(5) Other Postemployment Benefits (OPEB)**

Plan Description - The City operates a single-employer retiree benefit plan which provides medical/prescription drug benefits for employees and retirees and their spouses. There are 4 active and no retired members in the plan. Retired participants must be age 55 or older at retirement.

The medical/prescription drug benefits are provided through a fully-insured plan with Wellmark. Retirees under age 65 would pay the same premium for the medical/prescription drug benefits as active employees.

Funding Policy - The contribution requirements of plan members are established and may be amended by the City. The City currently finances the retiree benefit plan on a pay-as-you-go basis. The most recent active member monthly premiums for the City and plan members are \$345 for single coverage and \$926 for family coverage. The same monthly premiums apply to retirees. For the year ended June 30, 2010, the City contributed \$9,349 and plan members eligible for benefits did not contribute to the plan.

**(6) Compensated Absences**

City employees accumulate a limited amount of earned but unused vacation leave for subsequent use or for payment upon termination, retirement or death. These accumulations are not recognized as disbursements by the City until used or paid. The City's approximate liability for earned vacation payable to employees at June 30, 2010, primarily relating to the General Fund, is \$7,800.

This liability have been computed based on rates of pay in effect at June 30, 2010.

**(7) Interfund Transfers**

The detail of interfund transfers for the year ended June 30, 2010 is as follows:

<u>Transfer to</u>	<u>Transfer from</u>	<u>Amount</u>
Special Revenue: Road Use Tax	Special Revenue: Local Option Sales Tax	\$ 25,000

Transfers generally move resources from the fund statutorily required to collect the resources to the fund statutorily required to disburse the resources.

**(8) Risk Management**

The City is a member of the Iowa Communities Assurance Pool, as allowed by Chapter 670.7 of the Code of Iowa. The Iowa Communities Assurance Pool (Pool) is a local government risk-sharing pool whose 634 members include various governmental entities throughout the State of Iowa. The Pool was formed in August 1986 for the purpose of managing and funding third-party liability claims against its members. The Pool provides coverage and protection in the following categories: general liability, automobile liability, automobile physical damage, public officials liability, police professional liability, property, inland marine, and boiler/machinery. There have been no reductions in insurance coverage from prior years.

Each member's annual casualty contributions to the Pool fund current operations and provided capital. Annual operating contributions are those amounts necessary to fund, on a cash basis, the Pool's general and administrative expenses, claims, claims expenses and reinsurance expenses due and payable in the current year, plus all or any portion of any deficiency in capital. Capital contributions are made during the first six years of membership and are maintained to equal 200 percent of the total current members' basis rates or to comply with the requirements of any applicable regulatory authority having jurisdiction over the Pool.

The Pool also provides property coverage. Members who elect coverage make annual operating contributions which are necessary to fund, on a cash basis, the Pool's general and administrative expenses and reinsurance premiums, all of which are due and payable in the current year, plus all or any portion of any deficiency in capital. Any year-end operating surplus is transferred to capital. Deficiencies in operations are offset by transfers from capital and, if insufficient, by the subsequent year's member contributions.

The City's property and casualty contributions to the risk pool are recorded as disbursements from its operating funds at the time of payment to the risk pool. The City's contributions to the Pool for the year ended June 30, 2010 were \$27,294.

The Pool uses reinsurance and excess risk-sharing agreements to reduce its exposure to large losses. The Pool retains general, automobile, police professional, and public officials' liability risks up to \$350,000 per claim. Claims exceeding \$350,000 are reinsured in an amount not to exceed \$2,650,000 per claim and \$10,000,000 in aggregate per year. For members requiring specific coverage from \$3,000,000 to \$10,000,000, such excess coverage is also reinsured. Property and automobile physical damage risks are retained by the Pool up to \$150,000 each occurrence, each location, with excess coverage reinsured by The Travelers Insurance Company.

The Pool's intergovernmental contract with its members provides in the event a casualty claim or series of claims exceeds the amount of risk-sharing protection provided by the member's risk-sharing certificate, or in the event a series of casualty claims exhaust total members' equity plus any reinsurance and any excess risk-sharing recoveries, then payment of such claims shall be the obligation of the respective individual member. As of June 30, 2010, settled claims have not exceeded the risk pool or reinsurance coverage since the Pool's inception.

Members agree to continue membership in the Pool for a period of not less than one full year. After such period, a member who has given 60 days' prior written notice may withdraw from the Pool. Upon withdrawal, payments for all casualty claims and claims expenses become the sole responsibility of the withdrawing member, regardless of whether a claim was incurred or reported prior to the member's withdrawal. Members withdrawing within the first six years of a membership may receive a partial refund of their casualty capital contributions. If a member withdraws after the sixth year, the member is refunded 100 percent of its casualty capital contributions. However the refund is reduced by an amount equal to the annual casualty operating contribution which the withdrawing member would have made for the one-year period following withdrawal.

The City also carries commercial insurance purchased from other insurers for coverage associated with workers compensation in the amount of \$1,000,000. The City assumes liability for any deductibles, and claims in excess of coverage limitations. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

**(9) Deficit Balances**

The General, Special Revenue, Road Use Tax, Debt Service, Capital Projects and Enterprise, Water Funds had deficit balances of \$187,326, \$2,808, \$46,669, \$163,918 and \$5,866, respectively, at June 30, 2010. The City is in the process of working on many projects relating to the flood of 2008. After the City has closed out these projects, the deficits should be eliminated.

**(10) Construction Progress**

The City entered into contracts totaling \$2,234,815. As of June 30, 2010, the City made payments totaling \$2,056,501. The balance remaining on the contracts at June 30, 2010, totaling \$178,314, will be paid as work on the projects progresses.

**(11) Related Party**

The City had business transactions between the City and City officials totaling \$69,717 during the year ended June 30, 2010.

**(12) Litigation**

The City is involved in a potential lawsuit as of June 30, 2010. The probability of loss, if any, is indeterminable.

**(13) Subsequent Event**

On February 21, 2011, the City authorized the issuance of a general obligation loan agreement anticipation project note for \$1,000,000 for the purpose of paying the cost of remediation, restoration, repair, cleanup, replacement and improvement of property, buildings, equipment and public facilities.

**Required Supplementary Information**

City of Palo

Budgetary Comparison Schedule  
of Receipts, Disbursements, and Changes in Balances –  
Budget and Actual (Cash Basis) – All Governmental Funds and Proprietary Funds

Required Supplementary Information

Year ended June 30, 2010

	Governmental Funds Actual	Proprietary Funds Actual	Total
Receipts:			
Property tax	\$ 300,726	-	300,726
Tax increment financing	4,073	-	4,073
Local option sales tax	182,737	-	182,737
Licenses and permits	4,703	-	4,703
Use of money and property	7,904	-	7,904
Intergovernmental	2,025,559	-	2,025,559
Charges for service	59,639	280,341	339,980
Miscellaneous	131,286	-	131,286
Total receipts	<u>2,716,627</u>	<u>280,341</u>	<u>2,996,968</u>
Disbursements:			
Public safety	3,010,290	-	3,010,290
Public works	291,799	-	291,799
Culture and recreation	279,849	-	279,849
Community and economic development	1,498	-	1,498
General government	219,320	-	219,320
Debt service	46,669	-	46,669
Capital projects	298,787	-	298,787
Business type activities	-	294,969	294,969
Total disbursements	<u>4,148,212</u>	<u>294,969</u>	<u>4,443,181</u>
Excess (deficiency) of receipts over (under) disbursements	(1,431,585)	(14,628)	(1,446,213)
Other financing sources (uses), net	280,122	-	280,122
Excess (deficiency) of receipts and other financing sources over (under) disbursements and other financing uses	(1,151,463)	(14,628)	(1,166,091)
Balances beginning of year	1,665,526	260,837	1,926,363
Balances end of year	<u>\$ 514,063</u>	<u>246,209</u>	<u>760,272</u>

See accompanying independent auditor's report.

Budgeted Amounts		Final to
Original	Final	Total Variance
331,992	331,992	(31,266)
-	-	4,073
86,292	86,292	96,445
3,150	3,150	1,553
10,525	10,525	(2,621)
10,043,015	10,043,015	(8,017,456)
274,245	274,245	65,735
28,200	28,200	103,086
10,777,419	10,777,419	(7,780,451)
9,629,017	4,284,738	1,274,448
236,650	299,600	7,801
341,586	301,225	21,376
-	1,550	52
167,248	309,293	89,973
-	47,000	331
515,700	370,500	71,713
120,875	306,425	11,456
11,011,076	5,920,331	1,477,150
(233,657)	4,857,088	(6,303,301)
-	(25,000)	305,122
(233,657)	4,832,088	(5,998,179)
1,075,137	1,075,137	851,226
841,480	5,907,225	(5,146,953)

City of Palo

Notes to Required Supplementary Information – Budgetary Reporting

June 30, 2010

The budgetary comparison is presented as Required Supplementary Information in accordance with Governmental Accounting Standards Board Statement No. 41 for governments with significant budgetary perspective differences resulting from not being able to present budgetary comparisons for the General Fund and each major Special Revenue Fund.

In accordance with the Code of Iowa, the City Council annually adopts a budget on the cash basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon nine major classes of disbursements known as functions, not by fund. These nine functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government, debt service, capital projects and business type activities. Function disbursements required to be budgeted include disbursements for the General Fund, the Special Revenue Funds, the Capital Projects Fund, the Debt Service Fund and the Enterprise Funds. Although the budget document presents function disbursements by fund, the legal level of control is at the aggregated function level, not by fund. During the year, one budget amendment decreased budgeted disbursements by \$5,090,745. The budget amendment is reflected in the final budgeted amounts.

During the year ended June 30, 2010, disbursements did not exceed the amounts budgeted.



**Other Supplementary Information**

**City of Palo**

## City of Palo

Schedule of Cash Receipts, Disbursements  
and Changes in Cash Balances  
Nonmajor Governmental Funds

As of and for the year ended June 30, 2010

	Special Revenue				Total
	Employee Benefits	Road Use Tax	Palo Volunteer Fire Department	Debt Service	
Receipts:					
Property tax	\$ 50,910	-	-	-	50,910
Intergovernmental	-	78,832	11,943	-	90,775
Charges for service	-	-	9,945	-	9,945
Miscellaneous	-	-	6,154	-	6,154
Total receipts	50,910	78,832	28,042	-	157,784
Disbursements:					
Operating:					
Public safety	-	-	27,549	-	27,549
Public works	11,216	131,592	-	-	142,808
Culture and recreation	9,065	-	-	-	9,065
Community and economic development	23	-	-	-	23
General government	13,152	-	-	-	13,152
Debt service	-	-	-	46,669	46,669
Total disbursements	33,456	131,592	27,549	46,669	239,266
Excess (deficiency) of receipts over (under) disbursements	17,454	(52,760)	493	(46,669)	(81,482)
Other financing sources:					
Operating transfers in	-	25,000	-	-	25,000
Net change in cash balances	17,454	(27,760)	493	(46,669)	(56,482)
Cash balances beginning of year	1,961	24,952	14,681	-	41,594
Cash balances end of year	\$ 19,415	(2,808)	15,174	(46,669)	(14,888)
<b>Cash Basis Fund Balances</b>					
Unreserved:					
Special revenue funds	\$ 19,415	(2,808)	15,174	-	31,781
Debt service fund	-	-	-	(46,669)	(46,669)
Total cash basis fund balances	\$ 19,415	(2,808)	15,174	(46,669)	(14,888)

See accompanying independent auditor's report.

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City of Palo  
Schedule of Indebtedness  
Year ended June 30, 2010

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Obligation	Date of Issue	Interest Rates	Amount Originally Issued
General obligation bonds: Sewer improvements	Dec 13, 2007	3.00%	\$ 1,200,000
Sewer revenue bonds: Sewer improvements	Dec 13, 2007 *	3.00%	\$ 3,000,000

\* - The agreement also requires the City to annually pay a .25% servicing fee on the outstanding principal balance.

See accompanying independent auditor's report.

Balance Beginning of Year	Issued During Year	Redeemed During Year	Balance End of Year	Interest and Servicing Fees Paid
928,871	266,129	10,000	1,185,000	33,669
3,000,000	-	10,000	2,990,000	89,956

**Schedule 3**

City of Palo  
Bond Maturities  
June 30, 2010

Year Ending June 30,	Sewer Revenue Bonds	
	Sewer Improvements	
	Issued Dec 13, 2007	
	Interest	
	Rates	Amount
2011	3.00%	\$ 10,000
2012	3.00	10,000
2013	3.00	10,000
2014	3.00	10,000
2015	3.00	81,000
2016	3.00	83,000
2017	3.00	86,000
2018	3.00	88,000
2019	3.00	91,000
2020	3.00	94,000
2021	3.00	97,000
2022	3.00	99,000
2023	3.00	102,000
2024	3.00	106,000
2025	3.00	109,000
2026	3.00	112,000
2027	3.00	115,000
2028	3.00	119,000
2029	3.00	122,000
2030	3.00	126,000
2031	3.00	130,000
2032	3.00	134,000
2033	3.00	138,000
2034	3.00	142,000
2035	3.00	146,000
2036	3.00	151,000
2037	3.00	155,000
2038	3.00	160,000
2039	3.00	164,000
Total		<u>\$ 2,990,000</u>

See accompanying independent auditor's report.

## City of Palo

Schedule of Receipts By Source and Disbursements By Function -  
All Governmental Funds

For the Last Two Years

	2010	2009
Receipts:		
Property tax	\$ 300,726	233,045
Tax increment financing	4,073	168,307
Other city tax	182,737	282,589
Licenses and permits	4,703	5,743
Use of money and property	7,904	9,696
Intergovernmental	2,025,559	2,852,557
Charges for service	59,639	46,041
Miscellaneous	131,286	26,448
	<u>\$ 2,716,627</u>	<u>3,624,426</u>
Total		
Disbursements:		
Operating:		
Public safety	\$ 3,010,290	2,346,171
Public works	291,799	113,498
Culture and recreation	279,849	114,554
Community and economic development	1,498	142,280
General government	219,320	150,540
Debt service	46,669	-
Capital projects	298,787	2,902,392
	<u>\$ 4,148,212</u>	<u>5,769,435</u>
Total		

See accompanying independent auditor's report.

**Schedule 5**

## City of Palo

## Schedule of Expenditures of Federal Awards

Year ended June 30, 2010

Grantor/Program	CFDA Number	Agency or Pass-through Number	Program Expenditures
Indirect:			
U.S. Department of Housing and Urban Development:			
Iowa Department of Economic Development:			
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	14.228	08-DRMH-05	\$ 113,973
U.S. Department of Homeland Security:			
Iowa Department of Public Defense:			
Iowa Homeland Security and Emergency Management Division:			
Disaster Grants - Public Assistance (Presidentially Declared Disasters)	97.036	FEMA-1763-DR-IA	1,476,172
Hazard Mitigation Grant	97.039	DR-1763-57-01	631,284
Total			<u>\$ 2,221,429</u>

**Basis of Presentation** – The Schedule of Expenditures of Federal Awards includes the federal grant activity of the City of Palo and is presented in conformity with an other comprehensive 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. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

See accompanying independent auditor's report.





**OFFICE OF AUDITOR OF STATE**  
**STATE OF IOWA**

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Independent Auditor's 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:

We have audited the accompanying financial statements of the governmental activities, the business type activities, each major fund and the aggregate remaining fund information of the City of Palo, Iowa, as of and for the year ended June 30, 2010, which collectively comprise the City's basic financial statements listed in the table of contents, and have issued our report thereon dated June 23, 2011. Our report expressed unqualified opinions on the financial statements which were prepared in conformity with an other comprehensive basis of accounting. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City of Palo'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 Palo's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City of Palo's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the 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 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 deficiency in internal control over financial reporting we consider to be a material weakness and other deficiencies we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of the 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 a material misstatement of the City of Palo's financial statements will not be prevented or detected and corrected on a timely basis. We consider the deficiency described in Part II of the accompanying Schedule of Findings and Questioned Costs as item II-A-10 to be a material weakness.

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control which is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in Part II of the accompanying Schedule of Findings and Questioned Costs as items II-B-10 and II-C-10 to be significant deficiencies.

## Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City of Palo'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 non-compliance or other matters that are required to be reported under Government Auditing Standards. However, we noted certain immaterial instances of non-compliance or other matters which are described in Part IV of the accompanying Schedule of Findings and Questioned Costs.

Comments involving statutory and other legal matters about the City's operations for the year ended June 30, 2010 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the City. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.


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

This report, a public record by law, is intended solely for the information and use of the officials, employees and citizens of the City of Palo and other parties to whom the City of Palo may report, including federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of the City of Palo during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

June 23, 2011

**Independent Auditor's Report on Compliance  
with Requirements That Could Have a Direct and Material Effect  
on Each Major Program and on Internal Control over Compliance in Accordance  
with OMB Circular A-133**

**City of Palo**



**OFFICE OF AUDITOR OF STATE**  
**STATE OF IOWA**

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Independent Auditor's Report on Compliance  
with Requirements That Could Have a Direct and Material Effect  
on Each Major Program and on Internal Control over Compliance in Accordance  
with OMB Circular A-133

To the Honorable Mayor and  
Members of the City Council:

Compliance

We have audited the City of Palo, Iowa's compliance with the types of compliance requirements described in U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that are applicable to each of its major federal programs for the year ended June 30, 2010. The City of Palo's major federal programs are identified in Part I of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts and grant agreements applicable to each of its major federal programs is the responsibility of the City of Palo's management. Our responsibility is to express an opinion on the City of Palo's compliance based on our audit.

We conducted our audit of compliance in accordance with U.S. generally accepted auditing standards, 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. Those standards and OMB Circular A-133 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 Palo's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the City of Palo's compliance with those requirements.

In our opinion, the City of Palo 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, 2010.

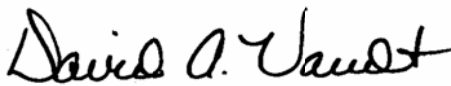
Internal Control Over Compliance

The management of the City of Palo is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grant agreements applicable to federal programs. In planning and performing our audit, we considered the City of Palo'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 of Palo's internal control over compliance.

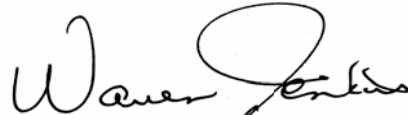
A deficiency in the internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance such that there is a reasonable possibility material noncompliance 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 internal control over compliance that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance we consider to be material weaknesses, as defined above.

This report, a public record by law, is intended solely for the information and use of the officials, employees and citizens of the City of Palo and other parties to whom the City of Palo may report, including federal awarding agencies and pass-through entities. This report is not intended to be and should not be used by anyone other than these specified parties.



DAVID A. VAUDT, CPA  
Auditor of State



WARREN G. JENKINS, CPA  
Chief Deputy Auditor of State

June 23, 2011

City of Palo  
Schedule of Findings and Questioned Costs  
Year ended June 30, 2010

**Part I: Summary of the Independent Auditor's Results:**

- (a) Unqualified opinions were issued on the financial statements which were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles.
- (b) Significant deficiencies and a material weakness in internal control over financial reporting were disclosed by the audit of the financial statements.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.
- (d) No material weaknesses in internal control over the major programs were noted.
- (e) An unqualified opinion was issued on compliance with requirements applicable to the major programs.
- (f) The audit disclosed no audit findings which are required to be reported in accordance with Office of Management and Budget Circular A-133, Section .510(a).
- (g) The major programs were CFDA Number 97.036 – Disaster Grants Public Assistance (Presidentially Declared Disasters) and 97.039 – Hazard Mitigation Grant.
- (h) The dollar threshold used to distinguish between Type A and Type B programs was \$300,000.
- (i) The City of Palo did not qualify as a low-risk auditee.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

**Part II: Findings Related to the Financial Statements:**

**INTERNAL CONTROL DEFICIENCIES:**

II-A-10 Segregation of Duties – One important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible. When duties are properly segregated, the activities of one employee act as a check on those of another. Generally, one person has control over each of the following areas:

- (1) Receipts – opening and listing mail receipts.
- (2) Bank reconciliations – no review by an independent person.

For the Palo Volunteer Fire Department, one individual has control over each of the following areas:

- (1) Receipts – collecting, depositing, posting and reconciling.
- (2) Disbursements – preparing, recording and reconciling.
- (3) Bank reconciliations – reconciling book balances to bank balances.

Recommendation – We realize segregation of duties is difficult with a limited number of office employees. However, the City and the Palo Volunteer Fire Department should review their control procedures to obtain the maximum internal control possible under the circumstances utilizing currently available personnel, including elected officials. Evidence of review of reconciliations should be indicated by initials of the independent reviewer and the date of the review.

Responses:

City –

- (1) City Clerk completes daily mail log. Procedure has been in place since December 15, 2010.
- (2) City Clerk reconciles bank statements. City Administrator reviews and approves the bank reconciliation checklists and bank statements. Mayor and Council Members review the Treasurer's Report monthly. Council Members have authorized the Treasurer's Report since May 1, 2010.

Palo Volunteer Fire Department – Will examine procedures and segregate as much as possible.

Conclusions – Responses accepted.



City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

II-B-10 Computer Controls – The City does not have written policies and procedures for:

- (1) requiring password changes or to maintain password privacy.
- (2) requiring computer passwords to be changed every 60 to 90 days.
- (3) logging off unattended computers.
- (4) backups being stored off-site.
- (5) anti-virus software.

Also, a disaster recovery plan has not been developed and implemented.

Recommendation – The City should develop written policies addressing the above items to improve the City’s control over its computer systems.

Response – The City Personnel Policy and Procedure Manual is currently being updated. The updates will address the above computer controls. The adoption of this will be on the June 27<sup>th</sup>, 2011 Council Agenda.

Conclusion – Response accepted.

II-C-10 Vacation and Sick Leave Balances – The City is not following the provisions of the City’s personnel policy regarding the maximum allowable carryover of vacation hours. During the year ended June 30, 2010, an employee had a vacation balance in excess of the maximum carryover at the employee’s anniversary date.

Recommendation – The City should limit the carryover of employee vacation hours as prescribed by City policy.

Response – Due to the urgency of the numerous emergency projects and ongoing projects the City has been occupied with since the flood of 2008, vacation time accrued has exceeded the maximum. The Mayor has signed an approval to carryover vacation time and employees are currently utilizing their earned vacation time. Changes to the current policy have been addressed in the updated City Personnel Policy and Procedure Manual.

Conclusion – Response accepted.

**INSTANCES OF NON-COMPLIANCE:**

No matters were noted.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

**Part III: Findings and Questioned Costs For Federal Awards:**

**INSTANCES OF NON-COMPLIANCE:**

No matters were noted.

**INTERNAL CONTROL DEFICIENCIES:**

No material weaknesses in internal control over the major programs were noted.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

**Part IV: Other Findings Related to Required Statutory Reporting:**

- IV-A-10 Certified Budget - Disbursements during the year ended June 30, 2010 did not exceed the amounts budgeted.
- IV-B-10 Questionable Disbursements - No disbursements we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 were noted.
- IV-C-10 Travel Expense - No disbursements of City money for travel expenses of spouses of City officials or employees were noted.
- IV-D-10 Business Transactions - Business transactions between the City and City officials or employees are detailed as follows:

Name, Title, and Business Connection	Transaction Description	Amount
Tom Watson, Flood Recovery Coordinator, Owner of Watson Services	Construction, flood clean-up	\$ 69,717

In accordance with Chapter 362.5(11) of the Code of Iowa, the transactions with the Flood Recovery Coordinator may represent a conflict of interest since the total transactions were greater than \$2,500 during the fiscal year. Of the \$69,717 paid, \$58,405 was based on quotes and the difference of \$11,312 was not. All transactions were approved for payment by the City Council.

Recommendation - The City should consult legal counsel to determine the disposition of this matter.

Response - The previous year's audit recommendation was to consult legal counsel. The City did comply with that recommendation. The City Attorney drafted a Conflict of Interest Waiver on July 1<sup>st</sup>, 2009. This year's recommendation is to obtain a written legal opinion from legal counsel. A written legal opinion was requested on June 17<sup>th</sup>, 2011, from our City Attorney, Scott Peterson.

Conclusion - Response accepted.

- IV-E-10 Bond Coverage - Surety bond coverage of City officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to ensure the coverage is adequate for current operations.
- IV-F-10 Council Minutes - No transactions were found that we believe should have been approved in the Council minutes but were not.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

- IV-G-10 Tax Increment Financing (TIF) – The City does not currently have policies to provide guidance for low to moderate income projects.

Also, the City's tax increment financing (TIF) certification includes the sewer revenue bond principal debt of \$3,000,000. However, the sewer bond resolution requires the bonds to be payable solely and only out of the future net revenues of the sewer utility of the City.

In addition, the City purchased land for \$90,158 from the Special Revenue, Tax Increment Financing Fund which was not included on the City's TIF Indebtedness Certification.

Recommendation – The City should establish policies and procedures for low to moderate income projects.

Also, the City should complete Form 3 of the TIF Indebtedness Certification to the County Auditor to reduce the TIF indebtedness outstanding for the \$3,000,000 of sewer revenue bonds.

In addition, the City should complete Form 1 of the TIF Indebtedness Certification to the County Auditor to add the land purchase to the TIF Indebtedness.

Response – The City is planning on utilizing TIF funds for street improvements on Clinton Street in front of the Palo Senior Housing Apartments. We will work with our financial consultants for further projects related to low to moderate income.

The City will complete Form 3 of the TIF Indebtedness Certification to the County Auditor to reduce the TIF indebtedness outstanding by the amount of sewer revenue bonds of \$3,000,000.

In addition, the City will complete Form 1 of the TIF Indebtedness Certification to the County Auditor to add the land purchase to the TIF Indebtedness.

Conclusion – Response accepted.

- IV-H-10 Local Option Sales Tax – The Special Revenue, Local Option Sales Tax Fund has accumulated a balance of \$688,776.

Recommendation – The City should develop a plan to utilize the local option sales tax funds in accordance with the provisions of the ballot.

Response – The City is in the process of working on many projects relating to the City flood and after the City has received its grant funding the City plans to use the Special Revenue, Local Option Sales Tax Fund to pay for any amounts not funded by the grants, in accordance with the local option sales tax ballot.

Conclusion – Response accepted.

- IV-I-10 Financial Condition – The General, Special Revenue, Road Use Tax, Debt Service, Capital Projects and Enterprise, Water Funds had deficit balances of \$187,326, \$2,808, \$46,669, \$163,918 and \$5,866, respectively, at June 30, 2010.

Recommendation – The City should investigate alternatives to eliminate these deficits to return these funds to a sound financial position.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Response – The City is in the process of working on many projects relating to the flood of 2008. After the City has closed out these projects, the deficits should be eliminated. Currently the deficits are an accurate representation of how funds are being allocated and removing the deficits by transferring funds from another source would misrepresent the applicable funding sources.

Conclusion – Response accepted.

IV-J-10 Revenue Bonds – The following instances of non-compliance with the requirements of the sewer revenue bond resolution were noted:

- Monthly transfers were not made to the sewer revenue bond sinking account as required by the sewer revenue bond resolution.
- The provisions of the sewer revenue bonds require sewer user rates be established at a level which produces and maintains net revenues at a level not less than 110% of the amount of principal and interest on the bonds falling due in the same year. During the year ended June 30, 2010, the City was not in compliance with the net revenue requirement for the sewer revenue bonds as required by the bond resolution.

Recommendation – Monthly transfers should be made to the sewer revenue bond sinking account as required by the sewer revenue bond resolution. The City should ensure sewer user rates are established at a level which produces net revenues of 110% of the annual principal and interest payments on the bonds.

Response – The City had been informed these transfers could be done annually, in lieu of the monthly transactions. The City will now do these transfers monthly. The City raised rates July 14, 2008. The City did not initiate another rate increase in the anticipation of installing City water and will be adjusting the sewer rates to reflect usages as a ratio of water usage, rather than the current flat rate. The City will ensure sewer user rates are established at a level which produces net revenues of 110% of the annual principal and interest payments on the bonds.

Conclusion – Response accepted.

IV-K-10 Records of Accounts – The Palo Volunteer Fire Department maintained its financial accounting records separate from the City Clerk’s records. The transactions and the resulting balances were not reported to the City Council each month and the transactions were not recorded in the City Clerk’s records. Chapter 384.20 of the Code of Iowa states, in part, “A city shall keep accounts which show an accurate and detailed statement of all public funds collected, received or expended for any city purpose.”

Accounting records did not facilitate the classification of receipts or disbursements by source and object. This matter was resolved for audit purposes.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2010

Recommendation – The Palo Volunteer Fire Department’s financial transactions and balances should be included in the City Clerk’s monthly financial reports. Internal control could be strengthened and operating efficiency could be increased by integrating the accounting receipts and disbursements with the City’s accounting records in the City Clerk’s office.

If the Palo Volunteer Fire Department’s receipts and disbursements are not integrated with the City’s accounting records, the Palo Volunteer Fire Department should segregate accounting duties to the extent possible and cancel all invoices or other appropriate documentation in a manner to help prevent possible duplicate payments. Accounting records should facilitate the classification of receipts and disbursements by source and object, respectively.

Response – The financials are now incorporated in the City Council minutes effective May 9, 2011. The Palo Volunteer Fire Department will work towards improving segregation of duties. The City will incorporate the information in the City’s Annual Financial Report and City Budget.

Conclusion – Response accepted.

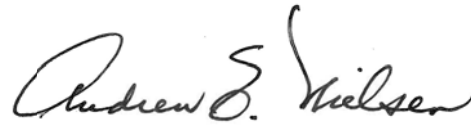
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City of Palo

Staff

This audit was performed by:

K. David Voy, CPA, Manager  
Kristin M. Ockenfels, Staff Auditor  
James H. Pitcher, Assistant Auditor  
Ryan A. Yeager, CPA, Assistant Auditor

A handwritten signature in black ink that reads "Andrew E. Nielsen". The signature is written in a cursive style with a large initial "A" and "N".

Andrew E. Nielsen, CPA  
Deputy Auditor of State