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FOR RELEASE \_\_\_\_\_ November 24, 2009 \_\_\_\_\_

Auditor of State David A. Vaudt today released a letter to the City of Ottumwa. The letter was issued as a result of reaudit procedures performed at the request of citizens pursuant to Chapter 11.6(4)(c) of the Code of Iowa. The reaudit procedures addressed certain issues identified for the period July 1, 2005 through June 30, 2006, as well as certain issues applicable to the year ended June 30, 2005 and subsequent periods.

Vaudt recommended the City review certain transfers between funds and consult legal counsel and/or TIF legal counsel regarding the propriety of these transfers, including corrective action, if necessary. Vaudt also recommended the City segregate commingled debt proceeds, TIF revenues and related interest earnings. Pursuant to Chapter 403.19(5)(a) of the Code of Iowa, with few exceptions, the City must use TIF revenue for the payment of indebtedness. Excess or undesignated funds, if any, should be used to repay existing debt and/or be decertified on the City's December 2009 TIF debt certification to the Wapello County Auditor.

Other recommendations include establishing separate capital project funds for note proceeds issued for different purposes, making corrective transfers to reimburse the Special Revenue, Employee Benefits Fund for excess amounts transferred and consulting legal counsel regarding corrective action pertaining to the City's solid waste rates established by resolution rather than by ordinance as required by Chapter 384.84 of the Code of Iowa.

A copy of the letter is available for review in the City Finance Director's Office, in the Office of Auditor of State and on the Auditor of State's web site at <http://auditor.iowa.gov/specials/index.html>.

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September 30, 2009

To the Honorable Mayor  
and Members of the City Council:

We received a request to perform a reaudit of the City of Ottumwa (City) under Chapter 11.6(4)(c) of the Code of Iowa. As a result, we performed a review of the fiscal 2006 audit report and workpapers prepared by the City's certified public accounting firm to determine whether the CPA firm may have addressed any or all of the specific issues identified in the request for reaudit during the annual audit of the City. Based on this review and our review of the preliminary information available, we determined a partial reaudit was necessary to further investigate specific issues identified in the request for reaudit. Accordingly, we have applied certain limited tests and procedures to selected accounting records and related information of the City of Ottumwa for the period July 1, 2005 through June 30, 2006. We also inquired and performed procedures for certain items to determine practices applicable to the year ended June 30, 2005 and subsequent periods.

The procedures we performed included reviewing agreements between the City and Bridge View Center, Inc., including related documents. We reviewed City records and documents pertaining to indebtedness, transfers between funds, Bridge View Events Center transactions and tax increment financing. We also reviewed the City's minutes for compliance with Chapter 21 of the Code of Iowa, local option sales tax and hotel-motel tax for compliance with the related voter referendums, the employee benefits levy and the City's solid waste rates and fees.

Based on the performance of the procedures described above, we have the following findings and recommendations for your review and consideration.

Loan and Transfers

The City, Bridge View Center, Inc. and Wapello County entered into a 28E agreement relating to the Bridge View Events Center construction and operation. According to the 28E agreement, "Public money is defined as only City and County money and does not include interest."

The City Council approved a transfer of \$268,000 on March 6, 2007 from the Special Revenue, Tax Increment Fund (Westgate TIF) to the Events Center Fund. The Council minutes stated, in part, "this was investment income of bond issues from the parking ramp, Menard's and Wal-Mart projects, which will need to be spent on another TIF project or future reduction of TIF debt certification." According to the City's Staff Summary Discussion, "During the construction contract awarding process, Bridge View Center, Inc. (BVC, Inc.) verbally agreed to raise an additional \$1,012,000 (\$500,000 plus \$512,000) to help pay for costs in excess of the original project amount (\$20.5 million). Last fall, City staff was informed of a potential \$400,000 deficit in BVC, Inc.'s fund raising activity. The undesignated fund balance in the Westgate TIF was discussed as one of the ways to help pay for construction costs."

The Special Revenue, Tax Increment Fund reported investment income of \$53,698, \$34,483 and \$34,916 for the fiscal years ended June 30, 2006, 2005 and 2004, respectively, for a three year total of \$123,097. We did not determine the amount of investment income for subsequent periods. The City did not document its calculation of the interest income totaling \$268,000 which was transferred to the Events Center Fund.

The City approved a transfer of \$108,000 on April 3, 2007 from the Special Revenue, Tax Increment Fund (Westgate TIF) to the Events Center Fund. The minutes stated, in part, "This resolution would allow the City to reallocate \$108,000 of unspent pre-opening expenses to be used to pay for construction costs of the Bridge View Event Center." The City's minutes did not document or explain "unspent pre-opening expenses."

The City approved a transfer of \$15,000 on April 3, 2007 from the General Fund to the Enterprise, Events Center Operating Fund. The minutes did not document the purpose of the transfer.

On June 12, 2006, the City transferred \$80,000 from the Special Revenue, Tax Increment Fund (Airport TIF) to the Special Revenue, Airport Fund for "maintenance-shop", which does not appear to be an allowable use of TIF revenue.

The Bridge View Events Center is located within the Westgate TIF area. The City Council approved a loan of \$171,000 from the General Fund to the Enterprise, Events Center Operating Fund on July 17, 2007. The Tax Increment Financing (TIF) debt certifications to the County Auditor did not appear to include any debt for the Bridge View Events Center.

Recommendation – Pursuant to Article III, Section 31 of the Constitution of the State of Iowa, public funds may only be spent for the public benefit. Investment income is considered to be "public funds" subject to this Constitutional provision and we do not believe the City can exclude investment income as "public funds" through written agreement or otherwise. Investment income earned on debt proceeds should be used for the payment of principal and interest in accordance with the debt covenants under which the debt was issued or for the same project for which the debt was issued. Investment income from unspent debt proceeds should not be used outside the scope and purpose of the original debt covenants or for other projects unless specifically allowed by the debt covenants.

We were unable to determine the propriety of the transfers totaling \$376,000 from the Special Revenue, Tax Increment Fund (Westgate TIF) to the Events Center Fund without TIF debt certification or the \$80,000 transfer from the Special Revenue, Tax Increment Fund (Airport TIF) to the Special Revenue, Airport Fund. The City should review these transfers, as well as transfers in subsequent periods, including the effect on the current TIF fund balance. The City should consult legal counsel and/or TIF legal counsel regarding the propriety of these transfers, including determination of corrective transfers and/or other corrective action to resolve this.

We were also unable to determine the propriety of the \$15,000 transferred from the General Fund to the Enterprise, Events Center Operating Fund due to the lack of documentation. The City's minutes should include sufficient information and explanation of the purpose and nature of transfers between funds to determine propriety and demonstrate compliance with the intended use of the transferred funds. The City should review this transfer and consult legal counsel regarding the propriety of the transfer, including corrective transfer, if appropriate.

If the City intends to repay the \$171,000 loan from TIF, the debt must be included in the debt certification to the County Auditor.

Response -

March 6, 2007 - \$268,000 Transfer

It was a poor choice of wording referring to using undesignated TIF fund balance for funding. On February 19, 2008, the City Council took action to reallocate \$353,844 of previous bond proceeds (including related investment income). Based on the bonding attorney's recommendation, the City Council allocated \$218,824 to street repairs and \$135,020 to Event Center construction (based on the nature of the original bond issues). Based on that reallocation, City staff transferred \$132,980 (\$268,000 - \$135,020) back into the Westgate TIF from the 2006 bonds issued for Bridge View Center. In a separate, but related note, the City Council allocated an additional \$700,000 for streets out of the 2006 Bond Issue for Bridge View Center at their March 18, 2008 meeting.

April 3, 2007 - \$108,000 Transfer

This is part of the \$2.6 million bond proceeds issued for Bridge View Event Center construction etc. originally deposited in the Westgate TIF Fund. Eventually, all the remaining bond proceeds from this issue were transferred into the appropriate capital projects funds. Our bonding attorney assisted us with the language regarding the \$108,000 reallocation.

April 3, 2007 - \$15,000 Transfer

The Bridge View Event Center Operating (Enterprise) Fund operates at a deficit of approximately \$500,000 annually. The only place to make up this money is through the General Fund, which transfers money as needed to keep the Bridge View Event Center operational. The staff summary refers to the contract with Centerplate, which requires the City to finance operations. Furthermore, the Bridge View Event Center was financed by the City as an urban renewal project. Accordingly, this transfer could be replenished from future TIF captures, if certified.

June 12, 2006 - \$80,000 Airport TIF Transfer

This will be referred to the appropriate legal counsel to determine if the Maintenance Shop is an appropriate use of TIF revenue. If not, City staff will transfer the money back into the Airport TIF until a suitable alternative expenditure is identified to replace the transfer for the Maintenance Shop.

July 17, 2007 - \$171,000 General Fund Loan

These funds were loaned from the General Fund to the Bridge View Event Center Construction Fund to cover final costs of closing out construction contracts. Eventually, Bridge View Center, Inc. (a 501(c)(3) Corporation) raised the necessary funds to repay the City for those construction costs.

Conclusion - Response accepted. In the future, it would be prudent to include additional information and explanation in the Council minutes as disclosure as well as to preserve the background and details preceding Council decisions.

Tax Increment Fund

The Special Revenue, Tax Increment Fund includes commingled debt proceeds, TIF revenues and interest income. According to the City's audit reports, the Special Revenue, Tax Increment Fund balances reserved for capital/construction were as follows:

<b>June 30</b>	<b>Amount</b>
2004	\$ 1,481,715
2005	865,910
2006	1,109,321
2007	775.653
2008	198,217

As previously noted, the City transferred \$376,000 from the Special Revenue, Tax Increment Fund (Westgate TIF) to the Events Center Fund prior to TIF debt certification. Also, as noted, the City has commingled debt proceeds with TIF revenue and interest income. As a result of these and subsequent transfers made by the City, we were unable to determine whether the City had excess balances in its Special Revenue, Tax Increment Fund. Also, as previously noted, the City discussed using "undesignated fund balance in the Westgate TIF ... to help pay for construction costs."

Recommendation – The debt proceeds of each individual issuance should be accounted for separately to demonstrate how the debt proceeds were used and whether the uses were in accordance with the requirements of the debt covenants. As noted above, interest earned on unused debt proceeds should only be used in accordance with the debt covenants.

TIF revenues and related interest income, if any, in previous years should have been segregated and used in accordance with Chapter 403.19(5) of the Code of Iowa (2005), which stated, in part:

"A municipality shall certify to the county auditor on or before December 1 the amount of loans, advances, indebtedness, or bonds which qualify for payment from the special fund referred to in subsection 2, and the filing of the certificate shall make it a duty of the auditor to provide for the division of taxes in each subsequent year until the amount of the loans, advances, indebtedness, or bonds is paid to the special fund. In any year, the county auditor shall, upon receipt of a certified request from a municipality filed on or before December 1, increase the amount to be allocated under subsection 1 in order to reduce the amount to be allocated in the following fiscal year to the special fund, to the extent that the municipality does not request allocation to the special fund of the full portion of taxes which could be collected. Upon receipt of a certificate from a municipality, the auditor shall mail a copy of the certificate to each affection taxing district."

This section of the Code of Iowa has been modified and currently Chapter 403.19(5)(a) of the Code of Iowa (2009) states in part:

"A municipality shall certify to the county auditor on or before December 1 the amount of loans, advances, indebtedness, or bonds which qualify for payment from the special fund referred to in subsection 2, for each urban renewal area in the municipality, and the filing of the certificate shall make it a duty of the

auditor to provide for the division of taxes in each subsequent year without further certification, except as provided in paragraphs "b" and "c", until the amount of the loans, advances, indebtedness, or bonds is paid to the special fund."

Pursuant to this current statutory requirement, with few exceptions, the City must use TIF revenue for the payment of TIF indebtedness. The City may not divert excess or undesignated funds for other purposes, disbursements and/or capital projects. Excess or undesignated funds, if any, should be used to repay existing debt or be decertified on City TIF Form 3 with the City's December 2009 TIF debt certification to the County Auditor as required by Chapter 403.19(5)(b) of the Code of Iowa (2009). This section states, in part:

"If the amount certified in paragraph "a" is reduced by payment from sources other than the division of taxes, by a refunding or refinancing of the obligation which results in lowered principal and interest on the amount of the obligation, or for any other reason, the municipality on or before December 1 of the year the action was taken which resulted in the reduction shall certify the amount of the reduction to the county auditor."

The City should review and reconcile its outstanding TIF indebtedness with the balance of cash on hand in the Special Revenue, Tax Increment Fund when completing the December 2009 TIF debt certification to the County Auditor.

Response – It had been the City's practice to account for all bond proceeds for TIF projects and related expenses in the respective TIF funds. During the past few years, we began the process of disengaging the bonds and projects out of the respective TIF funds. Both TIF funds had small cash balances as of June 30, 2009 that City staff will take into account, thereby reducing the upcoming TIF debt certification accordingly. Currently, the City now maintains separate accounts for projects financed with debt instruments, per the directives of the resolution(s) authorizing the debt.

Conclusion – Response accepted.

#### Note Proceeds

The General Obligation Capital Loan Notes Resolution, Series 2006 for \$2,600,000, states the City is in need of funds to pay costs of improvement and construction of streets together with related work, an essential corporate purpose project, not to exceed \$550,000. Also, the note resolution states the City is in need of funds to pay costs of aiding in the planning, undertaking and carrying out of an urban renewal project under the authority of Chapter 403 of the Code of Iowa, including improving, furnishing and equipping the Bridge View Project with related site improvements, an essential corporate purpose project, not to exceed \$2,150,000. Note proceeds for both purposes were deposited into the Special Revenue, Tax Increment Fund.

Recommendation – One of the purposes of governmental fund accounting is to facilitate the City demonstrating compliance with the use of designated or restricted revenues by segregating the revenues and related expenditures. The note proceeds for the streets, not to exceed \$550,000, and the Bridge View Project, not to exceed \$2,150,000, should be accounted for in separate capital project funds to document the note proceeds were used in accordance with the note resolution and to meet the requirements of Section 1300.106 of the Codification of Governmental Accounting and Financial Reporting Standards.

Response – As mentioned earlier, the \$2.6 million bond proceeds were transferred back out of the Westgate TIF fund to the appropriate capital project funds. The City no longer deposits bond proceeds into TIF funds. Currently, the City now maintains separate accounts for projects financed with debt instruments, per the directives of the resolution(s) authorizing the debt.

Conclusion – Response accepted.

#### Employee Benefit Levy

The City levies and collects taxes and accounts for employee benefits in the Special Revenue, Employee Benefits Fund. During the year ended June 30, 2006, the City made monthly transfers in pre-determined amounts from the Special Revenue, Employee Benefits Fund to the General Fund, Special Revenue, State Road Use Tax, Airport, Library, Cemetery and Retiree Health Insurance Funds to pay for employee benefits from these funds. However, during fiscal 2006, the transfers from the Special Revenue, Employee Benefits Fund exceeded the amounts disbursed for employee benefits from the Special Revenue, State Road Use Tax and Cemetery Funds.

Statutory requirements governing the employee benefits tax levy for fiscal year 2006 are contained in Chapter 384.6(1) of the Code of Iowa (2005), which states, in part:

"A city may establish trust and agency funds (employee benefits fund) for: Accounting for pension and related employee benefit funds as provided by the city finance committee.... .... A city may certify taxes to be levied for a trust and agency fund (employee benefits fund) in the amount necessary to meet its obligations."

Recommendation – The City should reimburse the excess funds by corrective transfer from the General Fund and the Special Revenue, State Road Use Tax and Cemetery Funds to the Special Revenue, Employee Benefits Fund in the amounts noted above. The City should review transfers for subsequent periods to determine whether excess funds were transferred from the Special Revenue, Employee Benefits Fund in subsequent periods and make appropriate corrective transfers, if necessary. In the future, the City should only transfer the actual amounts required to pay employee benefits.

Response – It has been the City's practice to transfer the budgeted amount for employee benefits to the General Fund, etc. In some years, actual expenses exceed budgeted amounts. City staff has prepared a spreadsheet showing the difference the last several years. City staff will record the appropriate transfers back/to the Employee Benefits Fund. The net overall effect is negligible. The timing of that entry will be determined after consulting the auditing firm.

Conclusion – Response acknowledged. In the future, the City should only transfer the actual amounts required to pay employee benefits.

#### Solid Waste Rates

Ottumwa City Code section 31½-19(a) states, in part:

"Solid waste fees are mandatory for all single-family dwellings and other dwellings containing four units or less and the fees are set by resolution, approved by the city council."

Chapter 384.84(6)(a)(1) of the Code of Iowa (2005) states, in part:

"The governing body of a city utility, combined utility system, city enterprise, or combined city enterprise may: By ordinance of the council or by resolution of the trustees published in the same manner as an ordinance, establish, impose, adjust, and provide for the collection of charges for connection to a city utility or combined utility system."

The City's solid waste rates for fiscal year 2006 and subsequent years were approved by resolution of the Council instead of by ordinance.

Recommendation – The City should establish all utility rates by ordinance as required by Chapter 384.84 of the Code of Iowa. The City should consult legal counsel regarding the propriety of City Code section 31½-19(a), including amending the City Code for consistency and compliance with Chapter 384.84 of the Code of Iowa. Also, the City should consult legal counsel regarding the rates charged by the City as established by City resolution rather than ordinance, including corrective action, if any.

Response – The resolution vs. ordinance issue has been referred to the City Attorney for disposition.

Conclusion – Response accepted. The City Attorney has advised a rate ordinance will be prepared for Council consideration.

The procedures we performed were substantially less in scope than an audit of financial statements made in accordance with U.S. generally accepted auditing standards, the objective of which is the expression of an opinion on financial statements. Accordingly, we do not express an opinion. Had we performed additional procedures, or had we performed an audit of the City of Ottumwa, additional matters might have come to our attention that would have been reported to you. A copy of this letter has been provided to the Wapello County Auditor in regard to the tax increment financing issues and related corrective action involving the City's next TIF certification and to facilitate the Wapello County Auditor's TIF reconciliation process. A copy of this letter has also been provided to the City's independent auditors for appropriate review and follow-up in accordance with Government Auditing Standards. Pursuant to Chapter 11.15 of the Code of Iowa, a copy of this letter has been filed with the Wapello County Attorney.

We would like to acknowledge the assistance extended to us by personnel of the City of Ottumwa. 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