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FOR RELEASE _____ June 11, 2010

Auditor of State David A. Vaudt today released a reaudit report on the City of Waverly, Iowa for the period July 1, 2007 through June 30, 2008. The reaudit also covered certain items to determine practices applicable to the years ended June 30, 2007, 2009 and the year ending June 30, 2010. The reaudit was performed at the request of citizens pursuant to Chapter 11.6(4)(a)(3) of the Code of Iowa.

The reaudit report addressed concerns regarding uses of surplus municipal utility funds, transfers from Waverly Light and Power and potential conflicts of interest.

The City's responses to the recommendations are included in the reaudit report. A copy of the reaudit report was filed with the Bremer County Attorney for his review and determination of further action, if any.

A copy of the reaudit 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/specials/index.html>.

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CITY OF WAVERLY
AUDITOR OF STATE'S REPORT ON REAUDIT
FOR THE PERIOD
JULY 1, 2007 THROUGH JUNE 30, 2008

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City of Waverly

Officials

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
June 30, 2008		
Ivan Ackerman	Mayor	Jan 2010
Fred Ribich	Mayor Pro Tem	Jan 2010
Eugene Lieb	Council Member	Jan 2010
Cyndi Ecker	Council Member	Jan 2010
Duane Liddle	Council Member	Jan 2010
Jim Vowels	Council Member	Jan 2012
Gary Boorom	Council Member	Jan 2012
Gary Grace	Council Member	Jan 2012

City Officials

Richard J. Crayne	Administrator/Clerk	Indefinite
Jack Bachhuber	Director of Finance	Indefinite
JoEllen Raap	City Clerk	Indefinite
Gerald B. Carney	Attorney	Indefinite

City of Waverly Reaudit



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Auditor of State's Report on Reaudit

To the Honorable Mayor
and Members of the City Council:

We received a request to perform a reaudit of the City of Waverly (City) under Chapter 11.6(4)(a)(3) of the Code of Iowa. As a result, we performed a review of the fiscal 2008 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 tests and procedures to selected accounting records and related information of the City of Waverly for the period July 1, 2007 through June 30, 2008. We also inquired and performed procedures for certain items applicable to the years ended June 30, 2007 and 2009 and the year ending June 30, 2010.

The procedures we performed are summarized as follows:

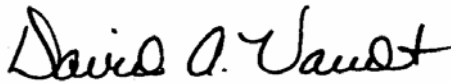
1. We obtained and reviewed certain City documents pertaining to lots leased and sold in the South Industrial Park.
2. We obtained and reviewed the City Council minutes and 28E agreement pertaining to transactions between the City and Wartburg College, including City contributions to Wartburg College pursuant to the agreement.
3. We obtained and reviewed the City Council minutes and agreements pertaining to transactions between the City and Waverly Light and Power, including transfers from Waverly Light and Power to the City.
4. We obtained and reviewed the City's TIF debt certification documents as of December 1, 2006, 2007 and 2008.
5. We obtained and reviewed the Bremer County Auditor's reconciliation forms for each TIF district for the City of Waverly.
6. We reviewed and tested selected transfers, including transfers from the City's Tax Increment Financing Fund, for propriety and proper City Council approval.
7. We reviewed the City Council minutes and other related documents pertaining to transactions between the City and Wartburg College to determine whether a potential conflict of interest exists between certain Council Members who are employees of Wartburg College.
8. We inquired whether the City had established a Wellness Center Account for revenues from memberships, fees, dues and other activities and reviewed account transactions for proper recording, documentation and remittance to Wartburg College.

9. We obtained and reviewed the City's Local Option Sales and Services Tax (LOSST) referendum and hotel/motel tax referendum and tested related expenditures to determine compliance with the referendums.

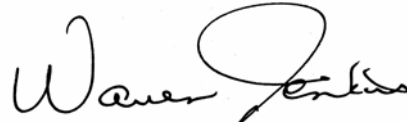
Based on the performance of the procedures described above, we identified instances of non-compliance and have developed various recommendations for the City. Our recommendations and the instances of non-compliance are described in the Detailed Findings of this report. Unless reported in the Detailed Findings, items of non-compliance were not noted during the performance of the specific procedures listed above.

The procedures described above are 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 Waverly, additional matters might have come to our attention that would have been reported to you. A copy of this reaudit report has been filed with the Bremer County Attorney.

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

November 17, 2009

Detailed Findings

City of Waverly

Detailed Findings

July 1, 2007 through June 30, 2008

- (A) Use of Surplus Municipal Utility Funds – The governing body of Waverly Light and Power (WLP) approved transfers to the City for various purposes. **Exhibit 1** is a summary of the transfers from WLP to the City during the year ended June 30, 2008. Similar transfers have been approved in prior and subsequent periods.

Chapter 384.89 of the Code of Iowa states:

“The governing body of a city utility, combined utility system, city enterprise, or combined city enterprise which has on hand surplus funds, after making all deposits into all funds required by the terms, covenants, conditions, and provisions of outstanding revenue bonds, pledge orders, and other obligations which are payable from the revenues of the city utility, combined utility system, city enterprise, or combined city enterprise and after complying with all of the requirements, terms, covenants, conditions and provisions of the proceedings and resolutions pursuant to which revenue bonds, pledge orders, and other obligations are issued, may transfer such surplus funds to any other fund of the city in accordance with any rules promulgated by the city finance committee created in section 384.13 if the transfer is also approved by the city council, provided that no transfer may be made if it conflicts with any of the requirements, terms, covenants, conditions or provisions of any resolution authorizing the issuance of revenue bonds, pledge orders, or other obligations which are payable from the revenues of the city utility, combined utility system, city enterprise, or combined city enterprise which are then outstanding.”

The City Finance Committee Administrative Rules, IAC Section 545–2.5(5) state:

“City utility fund and city enterprise fund. Any governing body of a city utility, combined utility system, city enterprise, or combined city enterprise which has a surplus in its fund may transfer such surpluses to any other city fund, except the emergency fund, by resolution of the appropriate governing body. For the purposes of this subrule, a surplus may exist only after all required transfers have been made to any restricted accounts in accordance with the terms and provisions of any revenue bonds or loan agreement related to the utility or enterprise fund.

A surplus shall be defined as the cash balance in the operating account or the unrestricted retained earnings calculated in accordance with GAAP (generally accepted accounting principles) in excess of:

1. The amount of the expenses or disbursements for operating and maintaining the utility or enterprise for the preceding three months, and,
2. The amount necessary to make all required transfers to restricted accounts for the succeeding three months.

These rules are intended to implement Iowa Code chapters 384 and 388.”

An opinion of the Iowa Attorney General dated November 10, 1986 concludes, in part,

“A municipal utility board may spend utility revenues to coordinate economic development promotional efforts if it properly determines that this is a utility operating expense. The determination whether an expenditure is a proper utility operating expense is to be made by the utility board. A utility board may not spend utility revenues for city purposes not related to operation of the utility but may transfer surplus revenues to other city funds as provided in Iowa Code section 384.89. City boards, other than the city council, do not have home rule authority to act outside their statutory field of operation.”

This opinion also addresses Constitutional public purpose criteria and states, in part, “Article III, Section 31 of the Iowa Constitution generally prohibits the appropriation of public money or property for private purposes. This office recently opined that the goal of economic development is a public purpose. Whether a specific expenditure of public moneys for economic development serves a public purpose must be determined in light of the specific circumstances.”

Chapter 15A of the Code of Iowa was enacted subsequent to these 1986 opinions of the Iowa Attorney General. Chapter 15A.1 of the Code of Iowa states, “Economic development is a public purpose for which the state, a city, or a county may provide grants, loans, guarantees, tax incentives, and other financial assistance to or for the benefit of private persons.”

Various court cases have held the fees and charges for the services provided by local governments may not exceed the cost of providing the services. The following quote from the Iowa Supreme Court decision in *Home Builders Assn’ of Greater Des Moines v. West Des Moines*, 644 N.W.2d 339, 347–48 (Iowa 2002) provides some clarification of the distinctions between taxes and fees:

“Having examined the sources and scope of the City’s taxing authority, we now examine its authority to charge fees under its police power. Before municipalities had home rule authority, this court had interpreted the regulatory authority granted by statute to cities to include the power to charge a fee to meet the expenses of the city in exercising its regulatory authority. *Felt v. City of Des Moines*, 247 Iowa 1269, 1273, 78 N.W.2d 857, 859 (1956) (holding that fee charged to cover city’s expenses in exercising its statutory authority was “a proper incident to the authority granted under the statute”); see *City of Pella v. Fowler*, 215 Iowa 90, 98, 244 N.W. 734, 738 (1932); *Solberg v. Davenport*, 211 Iowa 612, 617, 232 N.W. 477, 480 (1930). The same principle applies with respect to a city’s home rule authority: a city may charge a fee to cover its administrative expenses in exercising its police power. Thus, the reasonable cost of inspecting, licensing, supervising, or otherwise regulating an activity may be imposed on those engaging in the activity in the form of a license fee, permit fee, or franchise fee. See *City of Hawarden*, 590 N.W.2d 504, 506–07 (Iowa 1999). In addition to regulatory fees, a municipality may charge a citizen when it provides a service to that citizen. See *Newman*, 232 N.W.2d 568, 573 (Iowa 1975).

The rather narrow range of fees permitted by our cases is consistent with our long-standing definition of a tax. As noted above, a tax is “a charge to pay the cost of government *without regard to special benefits conferred.*” *In re Shurtz’s Will*, 242 Iowa 448, 454, 46 N.W.2d 559, 562 (1951) (emphasis added). Consistent with this definition, the regulatory and service fees permitted under Iowa law are based on a special benefit conferred on the person paying the fee. In the regulatory context, fees enable the government to administer a particular activity or occupation to the peculiar benefit of those engaged in that activity or occupation. Therefore, fees designed to cover the administrative expense of regulating a particular activity, occupation, or transaction are not taxes.

Similarly, when one pays for a service such as admission to the municipal swimming pool, one has received a special benefit—admission to the pool—and so the admission fee is not a tax.”

An Attorney General’s opinion dated April 26, 1993 concluded:

“Construction and maintenance of a toll road by a county for the purpose of raising revenue would amount to the imposition of a tax. There is no statutory authority, either express or implied, to impose such a tax, and therefore, such a tax may not be levied.” 1994 Iowa Op. Att’y Gen. (#93–4–7).

Another Attorney General’s opinion dated May 4, 1979 concluded:

“The county board of supervisors may issue a permit to and collect a permit fee from quarry operations pursuant to the County Home Rule Amendment, as long as the permit fee is reasonable and related to the expense of administration. However, if the purpose or the effect of the fee is to raise revenue beyond the administrative costs of permit system itself, the fee would be a tax and be in contravention of the County Home Rule Act.” 1980 Iowa Op. Att’y Gen. 154 (#79–5–6).

According to **Exhibit 1**, WLP transferred a total of \$951,399 to the City during the City’s fiscal year ended June 30, 2008. These transfers of surplus exclude an additional \$494,157 from WLP to the City for services provided, sales tax and other reimbursements, and represent approximately 8% of WLP’s calendar year 2007 annual operating revenues. The transfers include \$120,000 for the City’s annual funding obligation to the Wartburg–Waverly Wellness Center for construction and operation. According to City Resolution 06–95, dated December 5, 2006, WLP agreed to make 15 annual payments to the City of \$120,000, a total of \$1,800,000, beginning in fiscal year 2008 with final payment to the City in fiscal year 2022. According to the same resolution, the City will then make 15 annual payments of \$120,000 to Wartburg College, a total of \$1,800,000, beginning in fiscal year 2008 with final payment to Wartburg College in fiscal year 2022.

The transfers from WLP also included \$150,000 deposited in the City’s Capital Improvement Fund and \$75,000 deposited in the City’s Recreational Capital Improvement Fund, which will be used, in part, for the Wartburg–Waverly Wellness Center. The original purpose of the \$150,000 transfer, initially approved in January 1992, was to pay principal and/or interest on the City’s Civic Center Series 1991 lease revenue bonds. These bonds were redeemed in fiscal year 2007. The original purpose of the \$75,000 transfer, initially approved in April 1998, was to address quality of life issues in the community and assist in economic development. Transfers from WLP also included \$25,000 per year for the Waverly Health Center’s “Healing Capital Campaign.”

According to the WLP audit report for calendar year 2007, the “utility (WLP) has complied with all provisions of the 1998, 2002, and 2005 Bond Covenants. All required payments to the sinking, reserve and improvement funds were made.”

While WLP has statutory authority to transfer any surplus to the City, these transfers have been pursuant to resolutions providing for multiple-year and long-term funding commitments to the City rather than annual determinations of surplus pursuant to the aforementioned provisions of Chapter 384.89 of the Code of Iowa and City Finance Committee administrative rules. It is unclear how “surplus” as defined in City Finance Committee administrative rules can be determined and/or obligated for multiple years and/or on a long-term basis. Accordingly, we question the propriety of the transfers of surplus from WLP to the City, including the annual transfers of \$150,000, \$75,000 and/or \$25,000 from WLP to the City pursuant to resolutions and/or agreements resulting in multiple-year and long-term funding commitments.

We also question the propriety of the transfer of \$150,000 to pay principal and/or interest on the City's Civic Center Series 1991 lease revenue bonds, which were redeemed in fiscal 2007, for the reasons noted in the preceding paragraph and because the use now varies from the original purpose/authorization.

Recommendation – The transfers from WLP provide significant funding for the City's long-term commitments to fund various private purposes and/or other purposes which would not likely meet the criteria of proper utility operating expenses pursuant to the opinion of the Iowa Attorney General noted above. We are unable to determine the propriety of the determination of "surplus" for future periods and WLP's guarantee of the transfer of surplus in future periods. In essence, WLP and the City have obligated future revenues which could result in the necessity to raise rates (fees) to meet the obligation. As such, we question whether any additional fees charged and collected to fund the transfer of surplus represents a tax since the revenue generated is not intended to be and will not be used for utility operations.

The City and WLP should consult legal counsel regarding the propriety of these transfers and related compliance with Chapter 384.89 of the Code of Iowa and City Finance Committee administrative rules. The City and WLP should consider the reasonableness of the transfers and related fees and charges for service in view of the aforementioned court cases and opinions of the Iowa Attorney General since WLP does not have home rule authority.

Response – The City of Waverly has contacted legal counsel regarding transfers from Waverly Light and Power for economic development projects (such as the Wellness Center) and for other City uses. Please see the attachment, **Exhibit 3**, dated December 7, 2009, from Lance A. Coppock from Ahlers & Cooney, P.C.

The transfers have been approved by the utility for multiyear economic development projects. The utility also assesses the surplus fund availability on an annual basis and adopts a resolution each year approving transfers.

Please note that the Vision Iowa Board has mandated the use of municipal utility transfers in providing local funds to match Community Attraction and Tourism Grants to the City of Waverly. Vision Iowa has reviewed and accepted multi-year commitments of local utility transfers to match CAT Grants that support community and economic projects throughout the State.

Conclusion – Response acknowledged. As noted in **Exhibit 3**, "... economic development is a public purpose and that utility revenues may be used for economic development if the expenditures can meet either a 'surplus funds' analysis or a 'utility operating expense' analysis. Thus there are two mechanisms which may be utilized if a city and its city utility wish to use funds from the utility for economic development purposes."

Our findings are reported after careful review and consideration of the facts, documents and explanations before us. Based on City Finance Committee rules, transfers of surplus, if any, must be determined annually and only after actual revenues, expenditures, balances and outstanding debt are known. Any determination of surplus before actual and final transactions are known is speculative and subject to change since actual results could vary significantly. As a result, we remain concerned with multiple-year and long-term funding commitments of surplus. We did not determine or reach definitive conclusions as to whether the City and its City utility met the "surplus funds" analysis.

The 1986 opinion of the Iowa Attorney General and subsequent provisions of Chapter 15A of the Code of Iowa include various criteria to consider in determining, documenting and addressing the Constitutional public purpose criteria. The City and/or WLP have not documented these transfers meet the "utility operating expense" analysis.

We continue to question the propriety of the transfer of \$150,000 to pay principal and/or interest on the City's Civic Center Series 1991 lease revenue bonds for the reasons noted in our initial findings.

Transfers from WLP to the City totaled nearly \$1.446 million in fiscal year 2008, in addition to prior and subsequent year transfers. We believe the significant commitments made by the City and WLP result in commitments of surplus for which WLP could be obligated to raise rates (fees), which we are reporting in accordance with Chapter 11 of the Code of Iowa.

We are, therefore, referring these issues to the Bremer County Attorney for review and determination of further action, if any.

- (B) Transfers from Waverly Light and Power – Chapter 437A.8(2) of the Code of Iowa states, in part:

“Each taxpayer subject to a municipal transfer replacement tax, on or before March 31 following a tax year, shall file with the chief financial officer of each city located within an electric or natural gas competitive service area served by a municipal utility as of January 1, 1999, a return including, but not limited to, the following information:

- a. The total taxable kilowatt-hours of electricity delivered by the taxpayer within each electric competitive service area described in section 437A.4, subsection 4, during the tax year and the total taxable therms of natural gas delivered by the taxpayer within each natural gas competitive service area described in section 437A.5, subsection 4, during the tax year.
- b. For a municipal utility taxpayer, the total transfers made by the taxpayer under section 384.89 within each competitive service area during the preceding calendar year, allocated between electric-related transfers and natural gas-related transfers and total credits described in section 437A.4, subsection 5, and section 437A.5, subsection 5.”

The WLP Board of Trustees approves an annual transfer based on kilowatt (KWh) sales. An additional payment is also made from WLP to the City for operating costs for City traffic signals and streetlights. The City began this process with a rate of 3.4 mills per billed KWh sales in January 7, 1992 with the ordinance establishing the City Utility Board of Trustees. This rate increased to 5.177 mills beginning January 1, 1999, 6.159 mills beginning January 1, 2003 and 6.135 mills beginning January 1, 2007. Per discussion in City Council minutes, the increase in the amount of the transfers is based on the Utility's increase in 'net worth'. Per the Mayor, all the City expects is a 'fair return on the City's investment'.

Pursuant to Chapter 437A of the Code of Iowa and according to the “Municipal Transfer Replacement Tax Return” form completed by WLP dated February 24, 2009, WLP calculated the amount of municipal electric transfer tax based on kilowatt hours delivered at a municipal electric transfer tax rate of .00562418. On this same form, WLP reported a transfer of \$764,952 to the City pursuant to section 384.89 of the Code of Iowa during calendar year 2008.

According to WLP's independent audit report as of December 31, 2007 and 2006, the transfer to the City's General Fund was \$761,328 and \$731,220, respectively. The City's independent audit report for the year ended June 30, 2008 did not separately report or otherwise disclose the transfers/contributions from WLP to the City.

However, as previously noted, according to **Exhibit 1**, WLP transferred a total of \$951,399 to the City during the City's fiscal year ended June 30, 2008. These transfers do not include \$494,157 paid to the City by WLP for services provided, sales tax and other reimbursements, during the City's fiscal year ended June 30, 2008. We are unable to determine the propriety of the amount reported on the "Municipal Transfer Replacement Tax Return" form or the reason for the significant variance in the actual amount transferred compared to the amount disclosed.

Recommendation – In the interest of fair and objective disclosure (transparency) and to ensure complete and accurate reporting, the City and WLP should review this with the independent auditors to ensure amounts reported in the "Municipal Transfer Replacement Tax Return" form and audit reports are consistent.

Response – The City of Waverly and Waverly Light and Power will review the "Municipal Transfer Replacement Tax Return" form to ensure amounts reported in said form are complete and accurate. We will each review said form with our independent auditors to ensure that the amounts reported in the "Municipal Transfer Replacement Tax Return" form are consistent in the audit reports of each city unit. Please note that the utility is audited on a calendar year and the City on July 1 – June 30 fiscal year.

Conclusion – Response accepted.

- (C) Potential Conflicts of Interest – Gary Grace and Fred Ribich are members of the City Council and are also employed by Wartburg College. Gary Grace is the Vice President for Administration and Fred Ribich is Director of Institutional Research and Professor of Psychology at Wartburg College.

In addition to the transfers of surplus from WLP to the City as a conduit for payments to Wartburg College, the City has also committed other funding support to Wartburg College for the Wartburg–Waverly Wellness Center, including tax increment financing revenues beginning in fiscal year 2010.

Chapter 403.16 of the Code of Iowa, "Personal interest prohibited," pertains to urban renewal and states, in part:

"No public official or employee of a municipality, or board or commission thereof, and no commissioner or employee of an urban renewal agency, which has been vested by a municipality with urban renewal project powers under section 403.14, shall voluntarily acquire any personal interest, as hereinafter defined, whether direct or indirect, in any urban renewal project, or in any property included or planned to be included in any urban renewal project of such municipality, or in any contract or proposed contract in connection with such urban renewal project. Where such acquisition is not voluntary, the interest acquired shall be immediately disclosed in writing to the local governing body, and such disclosure shall be entered upon the minutes of the governing body. If any such official, commissioner or employee presently owns or controls, or has owned or controlled within the preceding two years, any interest, as hereinafter defined, whether direct or indirect, in any property which the official, commissioner or employee knows is included or planned to be included in an urban renewal project, the official, commissioner or employee shall immediately disclose this fact in writing to the local governing body, and such disclosure shall be entered upon the minutes of the governing body; and any such official, commissioner or employee shall not participate in any action by the municipality, or board or commission thereof, or urban renewal agency affecting such property, as the terms of such proscription are hereinafter defined."

City Council minutes were reviewed for the period October 24, 2005 through November 5, 2007 to determine significant actions related to the Wartburg-Waverly Wellness Center (WWWC), as well as actions related to the City's Amended Urban Renewal Plan for Economic Development which includes the WWWC. In addition, various presentations were made at City Council meetings by Council Member Grace pertaining to the Wartburg-Waverly Wellness Center.

Exhibit 2 details the action taken, if any, and the votes of Council Members Grace and Ribich pertaining to resolutions proposing/adopting the amendment of the Waverly Urban Renewal Plan and setting a public hearing date, amending the Waverly Municipal Code related to the division of taxes in an urban renewal area, approving a Wellness Center Funding Agreement between the City and WLP and approval of a resolution transferring funds to the Wartburg-Waverly Endowment Fund. As shown in **Exhibit 2**, when present at meetings, Council Members Grace and Ribich voted "yes" on all actions noted except Council Member Grace abstained from voting on Resolution Number 05-147, Approving a Wellness Center Development and Use Agreement between the City of Waverly and Wartburg College, on November 28, 2005. None of the votes were decisive in the passage of the action.

Opinion number 83-8-6 of the Iowa Attorney General dated August 29, 1983 states, in part:

"A prohibition against a 'direct or indirect interest' is contained in a number of other statutory provisions... included in court decisions and in a number of opinions by this (Iowa Attorney General) office. In one significant case, the Iowa Supreme Court in *Wilson v. Iowa City*, 165 N.W.2d 813 (Iowa 1969), reviewed the prohibition in 403.16 against a public official acquiring a direct or indirect interest in an urban renewal project. The Court voided certain city council actions on the ground that some council members faced a conflict of interest under this statute because of their financial interest in urban renewal property. In addition, the Court invalidated other council action because of the personal, as opposed to financial, conflict of interest on the part of a mayor, who was also employed in a 'position of influence' by the University of Iowa. The University owned urban renewal property and was 'vitally interested' in the city's urban renewal project. Finding that section 403.16 should be read as incorporating common law conflict of interest principles, the court stated as follows:

These rules, whether common law or statutory, are based on moral principles and public policy. They demand complete loyalty to the public and seek to avoid subjecting a public servant to the difficult, and often insoluble, task of deciding between public duty and private advantage. It is not necessary that this advantage (to the public servant) be a financial one. Neither is it required that there be showing that the official sought or gained such a result. It is the potential for conflict of interest which law desires to avoid (emphasis in original).

The Wilson Court thus makes clear a conflict of interest may arise from a situation where a public official could potentially benefit from a personal relationship as well as a financial one. Further, Wilson emphasizes the potential for conflict, as opposed to an actual conflict, creates a serious conflict of interest problem."

Recommendation – Conflicts of interest may only be determined definitively in a court of law. However, since Council Member Grace and Council Member Ribich are employed by Wartburg College, the appearance of and potential conflict of interest exists. The City should consult legal counsel to determine the proper course of action.

Response – The City of Waverly contacted legal counsel regarding the potential conflict of interest outlined by the Auditor of State’s office. Please refer to the attachment, **Exhibit 3**, accompanying this response from Lance Coppock of the Ahlers & Cooney, P.C. law firm. An excerpt from the attorney’s response states the following: “These statutes reflect the legislative determination that minor conflict of interest, having the possible appearance of impropriety, should not determine the benefits of economic development and other governing body actions which accrue to the public generally, relate to all or a major portion of property in an urban renewal project or which promote clearly public purposes. While a court could find that the actions that are in question here had the appearance of impropriety, we do not believe that under the existing framework which exists, the matters rise to the level of any sort of fatal conflict of interest which should be criticized. The votes were not decisive. As discussed earlier, the overriding economic development benefits of this project to the community have been widely recognized by the City and State. While it may have been better practice for these two individuals to recuse themselves from the vote with respect to the Wartburg matter, we do not believe that they were required to do so, or that their failure to do so violates the law or rises to the level which should be criticized in an audit.”

The City Attorney had been asked the question by City Council if there was a legal conflict of interest involving Council Members Grace and Ribich prior to the City Council voting on issues involving “The W” project. The City Attorney had responded there was not a legal conflict of interest. Council Member Grace, before reviewing the project and proposal with Council, stated he would be abstaining when the vote on the agreement would be taken, which he did. Both of the council members either abstained at certain times on this issue or were absent. Neither Council Members Grace’s or Ribich’s votes were decisive on any of “The W” matters.

Bottom line, elected officials in Waverly are conscious of potential conflicts of interest in not just the decisions made with “The W” project but in all matters before the Council. Waverly officials will continue to make every effort to not violate conflict of interest provisions and continue their ethical conduct of City matters.

Conclusion – Response acknowledged. We concur with City legal counsel’s conclusion “While it may have been a better practice for these two individuals to recuse themselves from the vote with respect to the Wartburg matter, we do not believe that they were required to do so, or that their failure to do so violates the law...” as noted in his letter to the City dated December 7, 2009, **Exhibit 3**. However, we offer the following additional clarification for your review and consideration.

In his letter to the City dated December 7, 2009, City legal counsel addressed the evolution of Chapter 403.16 of the Code of Iowa. The excerpt from Chapter 403.16 of the Code of Iowa included in our initial finding as basis for our recommendation was taken from the current (2009) version of the Code of Iowa.

Conflicts of interest are addressed in statute in terms of both direct and indirect and may result both in fact and/or appearance. We do not find any statutory references or criteria for determining or distinguishing “minor” or “fatal” conflicts of interest. However, as we previously noted, “conflicts of interest may only be determined definitively in a court of law.” Also, as previously noted, “...since Council Member Grace and Council Member Ribich are employed by Wartburg College, the appearance of and potential conflict of interest exists.”

As noted in **Exhibit 2**, Council Members Grace and Ribich voted affirmatively on most issues pertaining to the Wartburg-Waverly Wellness Center. As previously noted in our initial finding and again by City legal counsel, the votes of Council Members Grace and Ribich were not decisive. While compelling, we do not believe this, in and of itself, would eliminate the appearance of potential conflict of interest. In the future, we recommend elected officials abstain from voting in an effort to avoid the appearance of potential conflict of interest.

- (D) Wartburg-Waverly Wellness Center Fund Accounts – In accordance with the Wellness Center Development and Use Agreement between Wartburg College and the City, revenues from the sale of all memberships shall be deposited in a separate and distinct interest bearing account of the City and all amounts, including any interest earnings, shall be transferred not less often than monthly to the College.

Based on our review, receipts generated by the Wellness Center are deposited into two bank accounts in the name of the City and the Wartburg-Waverly Wellness Center. One account is for automatic payments (credit card deductions for memberships). The other account is for cash deposits. Bank account information is mailed directly to the Wartburg-Waverly Wellness Center. Account activity is reported by Wartburg College only and is not maintained by the City.

Recommendation – In accordance with the Wellness Center Development and Use Agreement, these accounts should be accounted for and reported as City accounts. The City should ensure account activity is periodically monitored, reconciled and reported in accordance with Chapter 384.20 of the Code of Iowa, which 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, by any city officer, employee, or other person, and which show the receipt, use and disposition of all city property.”

Response – The City will report the activity of the Wartburg-Waverly Wellness Center Account. This will be reported in the City's monthly fund status report and its monthly Clerk and Investment Reports. This process was started in the December 2009 financial reports to City Council.

Conclusion – Response accepted.

- (E) Wellness Center – Conservative Revenue Estimate – City Revenue Guarantees – The Wellness Center Development and Use Agreement between Wartburg College and the City dated November 28, 2005 states, in part:

“Section 4. City Financial Support. In consideration of the agreement of the College to construct the Project and in order to provide support for the Project, the City agrees to make eight (8) annual payments to the College of \$150,000 each (the “Annual Payments”) beginning in the fiscal year of the College ending May 31, 2008 and continuing in each fiscal year of the College thereafter through the fiscal year ending May 31, 2015. Each Annual Payment shall be paid no later than May 31 of the fiscal year in which the payment is due.

Section 5. City Revenue Contingent Obligation. In order to induce the College to offer the Recreation Programs at the Project, the City agrees that it will annually pay to the College (the “Revenue Payments” and, together with the Annual Payments, the “City Payments”) the difference between the actual total revenues of the Project and the projected total estimated revenues shown on Exhibit C attached hereto for each fiscal year of the College beginning with the fiscal year ending May 31, 2009 and continuing each fiscal year of the College thereafter through the fiscal year ending May 31, 2016; provided, however, that the total Revenue Payment in any fiscal year from the City shall not exceed \$600,000.”

The agreement or other provisions between the City and Wartburg College do not require periodic reporting or accountability by Wartburg College regarding the actual revenue collected.

Wellness Center revenues per Wartburg College for the year ended May 31, 2009 totaled \$642,013, which is \$1,259,184, or 66%, less than the conservative revenue estimate amount of \$1,901,197. As a result, the City paid Wartburg College \$600,000 on July 15, 2009. Details of the total actual revenue amount were not provided to the City. Due to the lack of reporting from Wartburg College to the City, we were unable to compare the City's contribution to the actual revenues generated by the Wellness Center.

Recommendation – The City should request verification of actual revenues by Wartburg College to provide periodic reporting and accountability.

Response – The City of Waverly will request Wartburg College to verify actual revenues that support the monthly revenue report now provided to the City of Waverly.

Conclusion – Response accepted.

- (F) Hotel/Motel Tax – Chapter 423A.7(3) of the Code of Iowa provides moneys received by the City from the local transient (hotel/motel) guest tax fund shall be credited to the General Fund of the City. The City deposits these funds directly into a Special Revenue Fund of the City and transfers 50% of the total tax deposited to the City's General Fund at year-end.

Recommendation – The City should deposit all hotel/motel guest tax revenue in the General Fund when received as required by Chapter 423A.7(3) of the Code of Iowa. The City may then spend directly from the General Fund or transfer to other City funds, if appropriate and permitted by Chapter 423A.7 of the Code of Iowa.

Response – Upon the recommendation of the Field Auditor and prior to receiving the reaudit written report from the Auditor of State, the City of Waverly began depositing Hotel/Motel Tax moneys into the General Fund and then disbursing a portion of said moneys from the General Fund.

Conclusion – Response accepted.

City of Waverly Reaudit

Exhibits

City of Waverly Reaudit

Amounts Received from Waverly Light and Power
as Transfers of Surplus

July 1, 2007 through June 30, 2008

	July 2007	August	September	October	November
Approved Purpose of Transfer:					
Payment in lieu of taxes	\$ 14,853	14,853	14,853	14,853	14,853
Increase in payment in lieu of taxes	19,500	19,500	19,500	19,500	19,500
Capital Improvement Fund	10,341	10,341	10,341	10,341	10,341
Debt service for Civic Center*	12,500	12,500	12,500	12,500	12,500
Recreational Capital Improvement Fund**	6,250	6,250	6,250	6,250	6,250
Wartburg-Waverly Wellness Center	-	-	-	-	-
Waverly Health Center	25,000	-	-	-	-
Economic Fund	3,485	3,485	3,485	3,485	3,485
Monthly Totals	\$ 91,929	66,929	66,929	66,929	66,929

* The transfer amount originally approved for debt service for the Civic Center is deposited directly to the Capital Improvement Fund.

** The transfer amount originally approved for quality of life/economic development (Recreational Capital Improvement Fund) was transferred to the Wartburg-Waverly Wellness Center Guarantee Reserve Fund.

December	January	February	March	April	May	June 2008	Total
14,853	14,968	14,968	14,968	14,968	14,968	14,968	178,926
19,500	19,500	19,500	19,500	19,500	19,500	19,500	234,000
10,341	10,528	10,528	10,528	10,528	10,528	10,528	125,214
12,500	12,500	12,500	12,500	12,500	12,500	12,500	150,000
6,250	6,250	6,250	6,250	6,250	6,250	6,250	75,000
-	120,000	-	-	-	-	-	120,000
-	-	-	-	-	-	-	25,000
3,485	3,485	3,966	3,725	3,725	3,725	3,725	43,259
66,929	187,231	67,712	67,471	67,471	67,471	67,471	951,399

City of Waverly Reaudit

Council Member Votes

October 24, 2005 through November 5, 2007

Date	Significant Action		
		Gary Grace	Fred Ribich
10/24/05	Presentation on Proposed Wartburg-Waverly Wellness Center (WWWC).	Present	Present
11/07/05	RES# 05-140 Proposing the Amendment to the Waverly Urban Renewal Plan and Setting Public Hearing Date.	YES	Absent
11/21/05	Public Hearing on the proposed Amendment to Waverly's Urban Renewal Plan for Economic Development. Passed. Res# 05-144	YES	Absent
	First reading of Ordinance 853, Amending Chapter 97 of the Waverly Municipal Code of the City of Waverly, Iowa (Amending Urban Renewal Plan for Economic Development).	YES	Absent
	Public Forum Held regarding the WWWC	Present	Absent
11/28/05	Res# 05-147, Approving a Wellness Center Development and Use Agreement between the City of Waverly and Wartburg College	Abstain	Absent
09/11/06	Res# 06-70, Public Hearing on proposed Amendment to Waverly's Urban Renewal Plan for Economic Development. Res# 06-70, determining an area of the City to be an economic development area; adopting the Amended Waverly Urban Renewal Plan for Economic Development	YES	YES
09/11/06	First Reading of ordinance 866, An Ordinance Amending Chapter 97 of the Waverly Municipal Code of the City of Waverly.	YES	YES
10/02/06	Third and final reading of ordinance 866, An Ordinance Amending Chapter 97 of the Waverly Municipal Code of the City of Waverly.	YES	YES
12/04/06	Res# 06-94, approving a Community Attraction and Tourism Program (CAT) Grant Agreement for the Waverly-Wartburg Wellness Center.	YES	YES
12/04/06	Res# 06-95, approving a Wellness Center Funding Agreement Between the City of Waverly and the Waverly Municipal Electric Utility (Waverly Light and Power)	YES	YES
10/01/07	Res# 07-93 - Establishing Bank Accounts for WWWC	YES	YES
11/05/07	Res# 07-101- transferring funds to the Wartburg-Waverly Endowment Fund in the amount of \$141,200 from Jerome Aleff and Sandra Rada Aleff.	YES	YES

Votes by Council Member						
Cyndi Ecker	Mel Kramer	Connie Rasmussen	Tammy McKenzie	Gary Boorum	Duane Liddle	Eugene Lieb
Present	Present	Present	Present	Present		
YES	YES	YES	YES	YES		
YES	YES	YES	YES	YES		
YES	YES	YES	YES	YES		
Present	Present	Present	Present	Present		
YES	YES	YES	YES	YES		
YES		YES		YES	Absent	YES
YES		YES		YES	Absent	YES
YES		YES		YES	YES	YES
YES		YES		YES	YES	YES
YES		YES		YES	YES	YES
YES		YES		YES	YES	YES
YES		YES		YES	YES	YES

City of Waverly Reaudit

Ahlers & Cooney, P.C. Letter to City – December 7, 2009

July 1, 2007 through June 30, 2008

AHLERS & COONEY, P.C.

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December 7, 2009

Richard J. Crayne, City Administrator
Civic Center
200 - 1st Street NE
P.O. Box 616
Waverly, IA 50677-2604

Dear Mr. Crayne:

You have asked us to review the preliminary findings of the State Auditor, which have been provided to you on a confidential basis, in connection with the re-audit of certain of the City's financial statements. You have also asked that we comment upon a portion of the detailed findings of the State Auditor. We have reviewed the information which you provided, and report to you as follows:

The Auditor raises concern with respect to several points related to the transfer of funds to the City from the municipal utilities, Waverly Light and Power. Concerns are also raised with respect to the City's use of these funds in connection with the Wartburg Waverly Wellness Center Project. Additional questions are raised with respect to the expenditure of funds from Waverly Light and Power to retire City debt originally incurred on the City's Civic Center financing. In summary, the Audit Report argues that providing for multiple-year and long-term funding commitments to the City, rather than annual determinations of surplus, is questionable; the use of such money for debt retirement and commitments to the Wellness Center are private purposes that would not likely meet the criteria for proper utility operating expenses; and that Waverly Light and Power and the City have obligated future revenues which could result in the necessity to raise Waverly Light and Power utility rates to meet these future obligations.

While the Auditor's Report has made reference to the appropriate statutory provisions and opinions of the Attorney General addressing the appropriate guidelines for the transfer of utility funds to other funds of the City and the expenditure of those funds, the conclusions drawn with respect to the transactions in question are incorrect. The Auditor has assumed that Waverly Light and Power and the City Council have not

City of Waverly Reaudit

Ahlers & Cooney, P.C. Letter to City – December 7, 2009

July 1, 2007 through June 30, 2008

December 7, 2009

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Auditor has assumed that Waverly Light and Power and the City Council have not followed the appropriate procedures for transfer and expenditure of funds. We do not believe the record reflects any inappropriate action by either governing body.

The Iowa cases and statutes make clear that a municipal utility may be operated at a profit. *See, e.g., City of Corning v. Iowa-Nebraska Light & Power Co.* 282 N.W. 791, 800 (Iowa 1938). In authorizing municipalities to own and operate utilities, the Legislature not only empowered the governing body to fix rates, but also provided its decisions should control in case of conflict with any other law. *State ex rel. Turner v. City of Altoona*, 274 N.W.2d 366 (1979). The auditor cites *Homebuilders Association of Greater Des Moines v. West Des Moines*, 644 N.W.2d 339 (2002), and some related opinions of the Attorney General. Those authorities do not apply here. Those authorities discuss the distinctions between taxes and service fees and when one can be legally substituted for another. Those authorities have nothing to do with city utility rates and charges, or when and how it is appropriate to transfer or spend utility revenue. The statutes and administrative rules make clear that it is appropriate to make transfers of surplus from utility funds to other funds of the City, under established procedures. The cases and statutes have recognized that economic development is a public purpose for which public funds may be spent. The Iowa Attorney General has rendered an opinion with respect to the appropriate use of utility revenues for economic development purposes. This opinion was rendered in 1986 and dealt with a proposed commitment by certain utilities to pay dues and fund (on a multi-year basis) certain economic development activities. The opinion generally holds that economic development is a public purpose and that utility revenues may be used for economic development if the expenditures can meet either a "surplus funds" analysis or a "utility operating expense" analysis. Thus there are two mechanisms which may be utilized if a city and its city utility wish to use funds from the utility for economic development purposes.

First, under the surplus funds analysis, the Utility Board must, in fact, determine it has on hand surplus revenues generated by the Utility. In other words, monies generated and available by operation of the system, but not needed to pay operating expenses, debt service or required reserves. This finding of "surplus" specifically entails that the Board be able to find that the monies are, indeed, available surplus and that rates and charges are, in effect, sufficient to maintain the requirements of the outstanding bond resolutions, and that its currently generated revenue is sufficient to pay all operating expenses together with debt coverage. With permission of the city council these funds can be transferred to any city fund, except the emergency fund, and expended by the city council for any municipal purpose.

The other permitted route to an expenditure of utility monies for economic development is to make a finding that the particular economic development expenditures

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Ahlers & Cooney, P.C. Letter to City – December 7, 2009

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are an appropriate operating expense of the Utility. A utility board can use utility revenues to pay those expenses which it properly determines are utility operating expenses. The opinion does not recite what types of economic development expenses are appropriate "utility expenses", only that they can be. Accordingly, based in part on this opinion of the Attorney General, many utilities have made findings that it is appropriate to spend utility revenues on various economic development projects because the expenditures will enhance the utility by improving its rate base, increasing its load or otherwise generally benefitting the customers of the utility with respect to utility operations.

The Auditor's office jumps to the conclusion that Waverly Light and Power and the City have not followed the statutes or the Attorney General's opinion. We do not believe the record reflects that result. While the Wellness Center Funding Agreement mentioned in the Audit Report is not a model of clarity, it cannot be assumed, and the actions of the Utility Board of Trustees and the City Council do not reflect, that money will be paid under that Agreement unless there is a surplus in the utility fund available for transfer on an annual basis. As you know, the Vision Iowa Fund demanded that there be an agreement from the City to pay a local share in connection with Vision Iowa payments on the Wellness Center. We have found it to be common that Vision Iowa suggest or insist that those funds come from the municipal electric utility of a city. It must be assumed that an agency of the state would not expect a city to make payments on a basis which would be violative of state statute or opinions of the Attorney General. There is no indication that annual determinations have not been made by Waverly Light and Power and, in fact, it appears that such annual determinations for transfer of monies to the City have been made. As the Attorney General's opinion, discussed by the Auditor and above, makes clear it is for the governing body of the utility to determine whether or not it does, indeed, have a surplus or whether or not an expenditure it expects to make for economic development purposes, either directly to an economic development purpose or to the city, is an appropriate operating expense. Either expenditure would be appropriate. In short, we see no basis on this record for the Auditor to question the propriety of the approach taken by Waverly Light and Power and the City as respects either the determination of annual surplus, which may be transferred to meet the Wellness Center Funding Agreement, or the decision by the City to use the money for the retirement of debt once the money is properly transferred as surplus.

If the Auditor's real concern is that the records of the City and Waverly Light and Power with respect to these annual transfers could be more clearly reflected in the resolutions and other actions, it would be appropriate for the City to make an effort in that regard. However, it does appear that the determinations are being made on an annual basis, and it seems wholly inappropriate for the State Auditor to jump to the conclusion that the situation is otherwise. Neither the Wartburg College Wellness Center payments

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Ahlers & Cooney, P.C. Letter to City – December 7, 2009

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nor the retirement of City debt from surplus revenues are private purposes, as is suggested in the Auditor's notes. The Wellness Center is clearly on the record as an economic development effort and the College, the City Council, the Board of Trustees of Waverly Light and Power and the Vision Iowa Board have all determined that it is a viable and valuable economic development effort for the community. There is no evidence that the findings of Waverly Light and Power that the money is surplus and available for transfer each year were inappropriate or invalid. Transfers of surplus from utility funds to other funds of the City is a common practice. If in any future year there is not a finding of either surplus or proper operating expense, the payment could not be made. If failure to make a payment that year could be construed to violate the Wellness Center Agreement, that is not a concern for the Auditor.

Another major component of the Audit Report relates to concerns of the Auditor that votes by two members of the Council, with respect to Wartburg College matters, have the appearance of impropriety and were inappropriate. Urban renewal and economic development projects in a community often stir up concern about the appearance of conflicts of interest because quite often, members of the business community serve on the boards and councils of the community. The appearance of impropriety is to be avoided as reflected in some of the authority cited by the Auditor. However, we believe the Auditor's analysis is incomplete and fails to recognize some things that the Legislature has given thought to and addressed by statute. The Auditor's Report refers to *Wilson v. Iowa City* 165 N.W. 2d 813 (Iowa 1969) and Section 403.16 of the *Code*, with respect to conflicts of interest relating to personal interest in economic development projects. What needs to be noted is that the Section 403.16 of the *Code* cited in *Wilson* is not the present section of the *Code*. *Wilson* was decided March 11, 1969. On April 16, 1969, the Legislature adopted a complete revision of *Iowa Code* Section 403.16 (chapter 238, section 4, 63 GA 1969) which includes the following in what is now subsection 7:

The limitations of this section shall be construed to permit action by a public official, commissioner, or employee where any benefits of such action accrue to the public generally, such action affects all or a substantial portion of the properties included or planned to be included in such a project, or such action promotes the public purposes of such project, and shall be construed to limit only that action by a public official, commissioner, or employee which directly or specifically affects property in which such official, commissioner, or employee has an interest or in which an employer of such official, commissioner, or employee has an interest . . . but no ordinance or resolution of a municipality or

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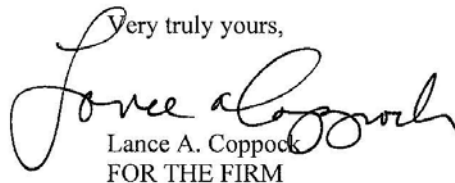
December 7, 2009
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agency shall be invalid by reason of a vote or votes in violation of the standards of this section as now amended unless the vote or votes were decisive in the passage of such ordinance or resolution.

The statute is consistent with the general statute regarding conflicts of interest by members of a city council which also invalidates actions only if the conflicted vote was decisive. See Section 362.6 *Iowa Code*.

These statutes reflect the legislative determination that minor conflicts of interest, having the possible appearance of impropriety, should not undermine the benefits of economic development and other governing body actions which accrue to the public generally, relate to all or a major portion of property in an urban renewal project or which promote clearly public purposes. While a court could find that the actions that are in question here had the appearance of impropriety, we do not believe that under the existing statutory framework which exists, the matters rise to the level of any sort of fatal conflict of interest which should be criticized. The votes were not decisive. As discussed earlier, the overriding economic development benefits of this project to the community have been widely recognized by the City and the State. While it may have been a better practice for these two individuals to recuse themselves from the vote with respect to the Wartburg matter, we do not believe that they were required to do so, or that their failure to do so violates the law or rises to the level which should be criticized in an audit.

I believe we have addressed the major issues which remain of concern in this preliminary Audit Report, and I understand that some of the other matters which appear in the preliminary draft have now been resolved. If you wish to discuss this subject further, or if more detail is required, please do not hesitate to contact us.

Very truly yours,

Lance A. Coppock
FOR THE FIRM

LAC/mmc

MMCGINLE/639538.1 /MSWord11316.000

City of Waverly

Staff

This reaudit was performed by:

Susan D. Battani, CPA, Director
Suzanne R. Dahlstrom, CPA, Manager
Billie Jo Heth, Senior Auditor II

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

Andrew E. Nielsen, CPA
Deputy Auditor of State