



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

David A. Vaudt, CPA  
Auditor of State

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**NEWS RELEASE**

FOR RELEASE April 26, 2010

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 \$6,673,953 for the year ended June 30, 2009. The receipts included \$233,045 in property tax, \$168,307 from tax increment financing, \$297,778 from charges for service, \$2,858,026 from operating grants, contributions and restricted interest, \$282,589 from local option sales tax, \$4,180 from unrestricted interest on investments, \$2,804,508 from bond proceeds and other general receipts of \$25,520.

Disbursements for the year totaled \$5,889,841, and included \$2,902,392 for capital projects, \$2,346,171 for public safety and \$150,540 for general government. Also, disbursements for business type activities totaled \$120,406.

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/index.html>.

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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, 2009**

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**City of Palo**

**Officials**

<u>Name</u>	<u>Title</u>	<u>Term Expires</u>
Terry Sanders	Mayor	(Resigned)
Jeff Bearegard (Appointed)	Mayor	Nov 2009
Jeff Bearegard	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/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, 2009, 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.

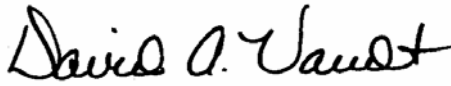
As described in Note 1, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles. Also, as permitted by the Code of Iowa, the accounting records of the City have not been audited for all prior years. Accordingly, we were unable to satisfy ourselves as to the distribution by fund of the total fund balance at July 1, 2008.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to verify the distribution by fund of the total fund balance at July 1, 2008, as discussed in the preceding paragraph, 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, 2009, 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 March 5, 2010 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. Other supplementary information included in Schedules 1 through 4, 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, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to verify the distribution by fund of the total fund balance at July 1, 2008, as discussed in the third paragraph, 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

March 5, 2010



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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, 2009. We encourage readers to consider this information in conjunction with the City's financial statements, which follow.

Because the City is not required to be audited annually, much of the information is not easily comparable to prior years. Comparative data has been provided if available.

### **2009 FINANCIAL HIGHLIGHTS**

- The cash basis net assets of the City's government activities increased approximately \$659,500, primarily due to the City receiving a disaster recovery grant for which there were no disbursements in fiscal year 2009.
- The cash basis net assets of the City's business type activities increased approximately \$124,600, primarily due to increased sewer rates.

### **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 Road Use Tax, Employee Benefits, Local Option Sales Tax and Tax Increment Financing, and 3) the Capital Projects 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.

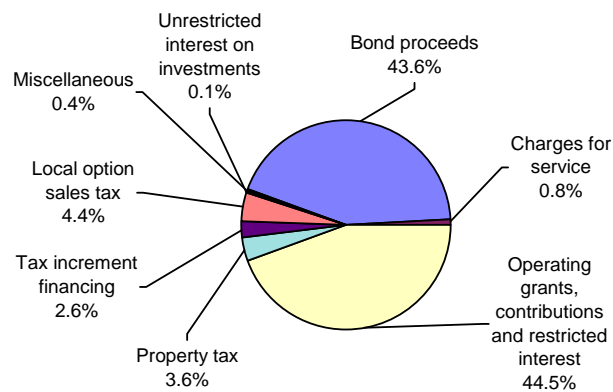
The required financial statement for proprietary funds is a statement of cash receipts, disbursements and changes in cash balances.

## GOVERNMENT-WIDE FINANCIAL ANALYSIS

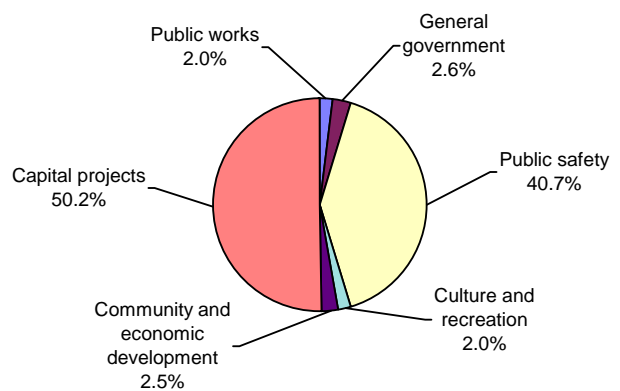
Net assets may serve over time as a useful indicator of financial position. The City's cash balance for governmental activities increased from \$1,006,027 at June 30, 2008 to \$1,665,526 at June 30, 2009. The analysis that follows focuses on the changes in cash basis net assets of governmental activities.

Changes in Cash Basis Net Assets of Governmental Activities	
	Year ended June 30, 2009
Receipts:	
Program receipts:	
Charges for service	\$ 52,759
Operating grants, contributions and restricted interest	2,858,026
General receipts:	
Property tax	233,045
Tax increment financing	168,307
Local option sales tax	282,589
Unrestricted interest on investments	4,180
Bond proceeds	2,804,508
Miscellaneous	25,520
Total receipts	<u>6,428,934</u>
Disbursements:	
Public safety	2,346,171
Public works	113,498
Culture and recreation	114,554
Community and economic development	142,280
General government	150,540
Capital projects	2,902,392
Total disbursements	<u>5,769,435</u>
Change in cash basis net assets	659,499
Cash basis net assets beginning of year	<u>1,006,027</u>
Cash basis net assets end of year	<u>\$ 1,665,526</u>

**Receipts by Source**



**Disbursements by Function**



<u>Changes in Cash Basis Net Assets of Business Type Activities</u>	
	<u>Year ended June 30, 2009</u>
Receipts:	
Program receipts:	
Charges for service:	
Sewer	<u>\$ 245,019</u>
Disbursements:	
Water	1,190
Sewer	<u>119,216</u>
Total disbursements	<u>120,406</u>
Change in cash basis net assets	124,613
Cash basis net assets beginning of year	<u>136,224</u>
Cash basis net assets end of year	<u>\$ 260,837</u>

Total business type activities cash basis net assets increased from \$136,224 at June 30, 2008 to \$260,837 at June 30, 2009. The increase is primarily due to increased sewer rates.

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

As the City of Palo completed the year, its governmental funds reported a combined fund balance of \$1,665,526, an increase of \$659,499 over last year's total of \$1,006,027. 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 increased \$269,064 over the prior year to a year-end balance of \$235,270. This was partially due to receiving \$2,272,867 in federal disaster aid.
- The Special Revenue, Local Option Sales Tax Fund cash balance decreased \$59,344 to \$596,593 during the fiscal year. This change was attributable to transfers to the General Fund for projects utilizing local option sales tax funds.
- The Special Revenue, Tax Increment Financing Fund cash balance increased \$19,892 to \$419,952 during the fiscal year. This change was attributable to additional receipts from the County, which outpaced disbursements.
- The Special Revenue, Community Disaster Grant Fund includes the proceeds from a new grant for the City. There were no disbursements in fiscal year 2009.
- The Capital Projects Fund cash balance decreased \$97,884 to \$(132,011) during the fiscal year, primarily due to timing differences between receipts of State Revolving Funds and sewer project costs.

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

- The Enterprise, Sewer Fund cash balance increased \$125,803 to \$262,027, primarily due to increased sewer rates.

## BUDGETARY HIGHLIGHTS

Over the course of the year, the City amended its budget once. The amendment was approved on June 8, 2009 and resulted in an increase in receipts and disbursements related to federal disaster funds. Also, disbursements increased in the capital projects function to account for the sewer improvement project.

The City's receipts were \$2,321,590 less than budgeted. This was primarily due to the City receiving \$2,804,508 in bond revenues which were budgeted as receipts but reported as other financing sources.

With the budget amendment, total disbursements were \$1,807,965 less than the amended budget. This was primarily due to budgeting FEMA disbursements which were not disbursed.

During the year ended June 30, 2009, disbursements did not exceed the amounts budgeted.

## DEBT ADMINISTRATION

At June 30, 2009, the City had \$3,928,871 in bonds outstanding, compared to \$1,124,363 last year, as shown below.

	Outstanding Debt at Year-End	
	June 30,	
	2009	2008
General obligation bonds	\$ 928,871	12,000
Sewer revenue bonds	3,000,000	1,112,363
Total	\$ 3,928,871	1,124,363

Debt increased as a result of the City drawing down more debt from the state revolving fund in fiscal year 2009 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 \$928,871 is significantly below its constitutional debt limit of \$2,572,873.

## 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 2010 budget, tax rates and fees charged for various City activities.

These indicators were taken into account when adopting the budget for fiscal year 2010. Amounts available for appropriation in the operating budget are \$11,011,076, an increase of 43% from the final fiscal year 2009 budget. 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 \$233,657 by the close of fiscal year 2010.

## 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 Stacy Dix, 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, 2009

	Disbursements	Program Receipts	
		Charges for Service	Operating Grants, Contributions and Restricted Interest
<b>Functions/Programs:</b>			
Governmental activities:			
Public safety	\$ 2,346,171	6,640	2,279,099
Public works	113,498	45,416	74,589
Culture and recreation	114,554	200	504,338
Community and economic development	142,280	-	-
General government	150,540	503	-
Capital projects	2,902,392	-	-
Total governmental activities	5,769,435	52,759	2,858,026
Business type activities:			
Water	1,190	-	-
Sewer	119,216	245,019	-
Total business type activities	120,406	245,019	-
Total	\$ 5,889,841	297,778	2,858,026

**General Receipts:**

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

**Cash Basis Net Assets**

Restricted:
Local option sales tax
Urban renewal purposes
Community disaster grant
Other purposes
Unrestricted

**Total cash basis net assets**

See notes to financial statements.



Net (Disbursements) Receipts and Changes in Cash Basis Net Assets		
Governmental Activities	Business Type Activities	Total
(60,432)	-	(60,432)
6,507	-	6,507
389,984	-	389,984
(142,280)	-	(142,280)
(150,037)	-	(150,037)
(2,902,392)	-	(2,902,392)
(2,858,650)	-	(2,858,650)
-	(1,190)	(1,190)
-	125,803	125,803
-	124,613	124,613
(2,858,650)	124,613	(2,734,037)
233,045	-	233,045
168,307	-	168,307
282,589	-	282,589
4,180	-	4,180
2,804,508	-	2,804,508
25,520	-	25,520
3,518,149	-	3,518,149
659,499	124,613	784,112
1,006,027	136,224	1,142,251
\$ 1,665,526	260,837	1,926,363
\$ 596,593	-	596,593
419,952	-	419,952
504,128	-	504,128
41,594	-	41,594
103,259	260,837	364,096
\$ 1,665,526	260,837	1,926,363

City of Palo

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

As of and for the year ended June 30, 2009

	Special Revenue		
	General	Local Option Sales Tax	Tax Increment Financing
Receipts:			
Property tax	\$ 184,167	-	-
Tax increment financing	-	-	168,307
Local option sales tax	-	282,589	-
Licenses and permits	5,743	-	-
Use of money and property	9,194	-	260
Intergovernmental	2,272,867	-	-
Charges for service	45,616	-	-
Miscellaneous	20,061	-	-
Total receipts	2,537,648	282,589	168,567
Disbursements:			
Operating:			
Public safety	2,340,574	-	-
Public works	35,938	-	-
Culture and recreation	30,876	65,000	8,000
Community and economic development	1,605	-	140,675
General government	136,524	-	-
Capital projects	-	-	-
Total disbursements	2,545,517	65,000	148,675
Excess (deficiency) of receipts over (under) disbursements	(7,869)	217,589	19,892
Other financing sources (uses):			
Bond proceeds	-	-	-
Operating transfers in	276,933	-	-
Operating transfers out	-	(276,933)	-
Total other financing sources (uses)	276,933	(276,933)	-
Net change in cash balances	269,064	(59,344)	19,892
Cash balances beginning of year	(33,794)	655,937	400,060
Cash balances end of year	\$ 235,270	596,593	419,952
<b>Cash Basis Fund Balances</b>			
Unreserved:			
General fund	\$ 235,270	-	-
Special revenue funds	-	596,593	419,952
Capital projects fund	-	-	-
Total cash basis fund balances	\$ 235,270	596,593	419,952

See notes to financial statements.

Community Disaster Grant	Capital Projects	Nonmajor	Total
-	-	48,878	233,045
-	-	-	168,307
-	-	-	282,589
-	-	-	5,743
-	-	242	9,696
504,128	-	75,562	2,852,557
-	-	425	46,041
-	-	6,387	26,448
504,128	-	131,494	3,624,426
-	-	5,597	2,346,171
-	-	77,560	113,498
-	-	10,678	114,554
-	-	-	142,280
-	-	14,016	150,540
-	2,902,392	-	2,902,392
-	2,902,392	107,851	5,769,435
504,128	(2,902,392)	23,643	(2,145,009)
-	2,804,508	-	2,804,508
-	-	-	276,933
-	-	-	(276,933)
-	2,804,508	-	2,804,508
504,128	(97,884)	23,643	659,499
-	(34,127)	17,951	1,006,027
504,128	(132,011)	41,594	1,665,526
-	-	-	235,270
504,128	-	41,594	1,562,267
-	(132,011)	-	(132,011)
504,128	(132,011)	41,594	1,665,526

**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, 2009

	Enterprise		Total
	Sewer	Nonmajor Water	
Operating receipts:			
Charges for service	\$ 245,019	-	245,019
Operating disbursements:			
Business type activities	119,216	1,190	120,406
Excess (deficiency) of operating receipts over (under) operating disbursements	125,803	(1,190)	124,613
Cash balances beginning of year	136,224	-	136,224
Cash balances end of year	\$ 262,027	(1,190)	260,837
<b>Cash Basis Fund Balances</b>			
Unreserved	\$ 262,027	(1,190)	260,837

See notes to financial statements.

City of Palo

Notes to Financial Statements

June 30, 2009

**(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, 2009 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**

As of June 30, 2009, the City has received \$928,871 of the general obligation bonds dated December 13, 2007 authorized for issuance in the total amount of \$1,200,060. Therefore, a repayment schedule has not been prepared. Annual debt service requirements to maturity for sewer revenue bonds are as follows:

Year Ending June 30,	Principal	Interest	Total
2010	\$ 10,000	96,700	106,700
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
2015-2019	429,000	452,303	881,303
2020-2024	498,000	378,235	876,235
2025-2029	577,000	292,305	869,305
2030-2034	670,000	192,725	862,725
2035-2039	776,000	77,122	853,122
Total	\$ 3,000,000	1,876,140	4,876,140

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 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.

The City has pledged future sewer customer receipts, net of specified operating disbursements, to repay \$3,000,000 of sewer revenue bonds issued in December 2007 with interest at 3% per annum. The agreement also requires the City to annually pay a .25% servicing fee on the outstanding principal balance. Proceeds from the bonds provided financing for the construction of improvements to the sewer treatment plant. 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 \$4,876,140. For the current year, principal and interest paid and total customer net receipts were \$60,238 and \$125,803, respectively.

Annual principal and interest payments on the above sewer revenue bonds required 48% of net receipts.

The resolution providing for the issuance of the revenue 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 sinking account for the Sewer Fund as required by the bond resolutions.

Also, the City was not in compliance with the bond requirement to have the books audited annually by an independent auditor.

**(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 4.10% of their annual covered salary and the City is required to contribute 6.35% 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 year ended June 30, 2009 was \$12,976, equal to the required contribution for the year.

**(5) 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, 2009, primarily relating to the General Fund, is \$3,700.

This liability have been computed based on rates of pay in effect at June 30, 2009.

**(6) Interfund Transfers**

The detail of interfund transfers for the year ended June 30, 2009 is as follows:

Transfer to	Transfer from	Amount
General	Special Revenue: Local Option Sales Tax	<u>\$ 276,933</u>

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

**(7) 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 577 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, 2009 were \$21,407.

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 \$100,000 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, 2009, 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.

**(8) Deficit Balances**

The Capital Projects Fund and the Enterprise, Water Fund had deficit balances of \$132,011 and \$1,190, respectively, at June 30, 2009. The deficit balance in the Capital Projects Fund was a result of project costs incurred prior to the availability of funds. Deficits will be eliminated through transfers from other funds. The City will make a transfer from the General Fund to eliminate the Enterprise, Water Fund deficit.

**(9) Construction Progress**

In 2006, the City entered into a contract totaling \$4,145,616. As of June 30, 2009, the City made payments totaling \$3,710,301. The balance remaining on the contract at June 30, 2009, totaled \$435,315. The project is being funded through a bond issuance.

**(10) Development Agreement**

The City entered into a development agreement on November 1, 1999 to assist an urban renewal project.

The City agreed to rebate 65.29% of the incremental tax paid by the developer in exchange for installation of certain improvements, including streets, sanitary sewer lines and wastewater treatment facilities, made by the developer. The remaining 34.71% of the funds are retained by the City to provide assistance to low to moderate income families in the City. The portion of the incremental tax received by the City from the developer under Chapter 403.19 of the Code of Iowa will be rebated for a period of ten years, beginning December 1, 2002. The total to be paid to the developer by the City under this agreement is not to exceed \$255,000 plus accrued interest on the unpaid principal at a rate equal to the rate being paid by the developer for private financing.

In February 2009, the City and the developer, through mediation, agreed to discontinue the development agreement. The City paid \$120,000 to Farmers Savings Bank, \$20,000 to the developer to satisfy the mediation and \$675 for legal fees.

**(11) Related Party**

The City had business transactions between the City and City officials totaling \$68,299 during the year ended June 30, 2009.

**(12) Subsequent Event**

On February 15, 2010, the City was awarded a CDBG grant totaling \$6,645,781 for a water distribution system.

**(13) Litigation**

The City is involved in a potential lawsuit as of June 30, 2009. The probability of loss, if any, is indeterminable.

**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, 2009

	Governmental Funds Actual	Proprietary Funds Actual	Total
<b>Receipts:</b>			
Property tax	\$ 233,045	-	233,045
Tax increment financing	168,307	-	168,307
Local option sales tax	282,589	-	282,589
Licenses and permits	5,743	-	5,743
Use of money and property	9,696	-	9,696
Intergovernmental	2,852,557	-	2,852,557
Charges for service	46,041	245,019	291,060
Miscellaneous	26,448	-	26,448
Total receipts	<u>3,624,426</u>	<u>245,019</u>	<u>3,869,445</u>
<b>Disbursements:</b>			
Public safety	2,346,171	-	2,346,171
Public works	113,498	-	113,498
Culture and recreation	114,554	-	114,554
Community and economic development	142,280	-	142,280
General government	150,540	-	150,540
Capital projects	2,902,392	-	2,902,392
Business type activities	-	120,406	120,406
Total disbursements	<u>5,769,435</u>	<u>120,406</u>	<u>5,889,841</u>
Excess (deficiency) of receipts over (under) disbursements	(2,145,009)	124,613	(2,020,396)
Other financing sources (uses), net	<u>2,804,508</u>	-	<u>2,804,508</u>
Excess (deficiency) of receipts and other financing sources over (under) disbursements and other financing uses	659,499	124,613	784,112
Balances beginning of year	<u>1,006,027</u>	<u>136,224</u>	<u>1,142,251</u>
Balances end of year	<u>\$ 1,665,526</u>	<u>260,837</u>	<u>1,926,363</u>

See accompanying independent auditor's report.

Budgeted Amounts		Final to
Original	Final	Total
		Variance
229,255	233,406	(361)
233,800	168,448	(141)
216,331	272,050	10,539
15,650	6,700	(957)
14,900	8,560	1,136
1,580,400	5,202,621	(2,350,064)
343,200	273,050	18,010
34,900	26,200	248
<u>2,668,436</u>	<u>6,191,035</u>	<u>(2,321,590)</u>
129,610	3,277,772	931,601
139,850	141,700	28,202
140,575	122,600	8,046
142,335	143,225	945
133,759	162,209	11,669
1,500,000	3,709,000	806,608
369,012	141,300	20,894
<u>2,555,141</u>	<u>7,697,806</u>	<u>1,807,965</u>
113,295	(1,506,771)	(513,625)
-	-	2,804,508
113,295	(1,506,771)	2,290,883
567,925	567,925	574,326
<u>681,220</u>	<u>(938,846)</u>	<u>2,865,209</u>

City of Palo

Notes to Required Supplementary Information – Budgetary Reporting

June 30, 2009

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 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 increased budgeted disbursements by \$5,142,665. The budget amendment is reflected in the final budgeted amounts.

During the year ended June 30, 2009, 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, 2009

	Special Revenue			
	Employee Benefits	Road Use Tax	Palo Volunteer Fire Department	Total
Receipts:				
Property tax	\$ 48,878	-	-	48,878
Use of money and property	-	-	242	242
Intergovernmental	-	74,590	972	75,562
Charges for service	-	-	425	425
Miscellaneous	-	-	6,387	6,387
Total receipts	48,878	74,590	8,026	131,494
Disbursements:				
Operating:				
Public safety	985	-	4,612	5,597
Public works	11,967	65,593	-	77,560
Culture and recreation	10,678	-	-	10,678
General government	14,016	-	-	14,016
Total disbursements	37,646	65,593	4,612	107,851
Excess of receipts over disbursements	11,232	8,997	3,414	23,643
Cash balances beginning of year	(9,271)	15,955	11,267	17,951
Cash balances end of year	\$ 1,961	24,952	14,681	41,594
<b>Cash Basis Fund Balances</b>				
Unreserved:				
Special revenue funds	\$ 2,169	24,952	14,681	41,802

See accompanying independent auditor's report.

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City of Palo  
Schedule of Indebtedness  
Year ended June 30, 2009

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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
12,000	916,871	-	928,871	3,360
1,112,363	1,887,637	-	3,000,000	60,238

**Schedule 3**

City of Palo  
Bond Maturities  
June 30, 2009

Year Ending June 30,	Sewer Revenue Bonds	
	Sewer Improvements	
	Issued Dec 13, 2007	
	Interest	
	Rates	Amount
2010	3.00%	\$ 10,000
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>\$ 3,000,000</u>

See accompanying independent auditor's report.

City of Palo  
 Schedule of Expenditures of Federal Awards  
 Year ended June 30, 2009

Grantor/Program	CFDA Number	Agency or Pass-through Number	Program Expenditures
Indirect:			
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	<u>\$ 2,219,772</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 on 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.

**City of Palo**





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

David A. Vaudt, CPA  
Auditor of State

State Capitol Building  
Des Moines, Iowa 50319-0004

Telephone (515) 281-5834 Facsimile (515) 242-6134

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, 2009, which collectively comprise the City's basic financial statements listed in the table of contents, and have issued our report thereon dated March 5, 2010. Our report on the financial statements, which were prepared in conformity with an other comprehensive basis of accounting, expressed qualified opinions since we were unable to satisfy ourselves as to the distribution by fund of the total fund balance at July 1, 2008. Except as noted in the Independent Auditor's Report, 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 our 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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies, including deficiencies we consider to be material weaknesses.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City of Palo's ability to initiate, authorize, record, process or report financial data reliably in accordance with an other comprehensive basis of accounting such that there is more than a remote likelihood a misstatement of the City of Palo's financial statements that is more than inconsequential will not be prevented or detected by the City of Palo's internal control. We consider the deficiencies in internal control described in Part II of the accompanying Schedule of Findings and Questioned Costs to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by the City of Palo's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we believe items II-A-09 and II-B-09 are material weaknesses.

#### Compliance and Other Matters

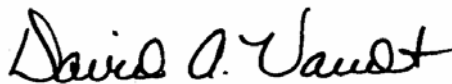
As part of obtaining reasonable assurance about whether the City of Palo's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material 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 that 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, 2009 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.

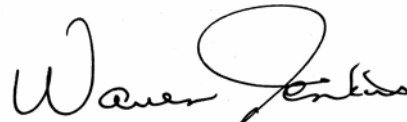
The City of Palo's responses to findings identified in our audit are described in the accompanying Schedule of Findings and Questioned Costs. While we have expressed our conclusions on the City's responses, we did not audit the City of Palo's responses and, accordingly, we express no opinion on them.

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. This report 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

March 5, 2010

**Independent Auditor's Report on Compliance with Requirements  
Applicable to Each Major Program and on Internal Control over Compliance  
in Accordance with OMB Circular A-133**

**City of Palo**



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Independent Auditor's Report on Compliance with Requirements  
Applicable to 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 compliance of the City of Palo, Iowa, 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 its major federal program for the year ended June 30, 2009. The City of Palo's major federal program is 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 its major federal program 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 its major federal program for the year ended June 30, 2009.

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, 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.

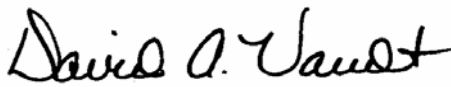
Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in the City's internal control that might be significant deficiencies or material weaknesses as defined below. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a significant deficiency and a material weakness.

A control deficiency in the City's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect non-compliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the City's ability to administer a federal program such that there is more than a remote likelihood non-compliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the City's internal control. We consider the deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items III-A-09 and II-B-09 to be significant deficiencies.

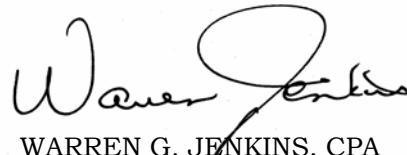
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood material non-compliance with a type of compliance requirement of a federal program will not be prevented or detected by the City's internal control. We consider the significant deficiencies in internal control over compliance described in the accompanying Schedule of Findings and Questioned Costs as items III-A-09 and II-B-09 to be material weaknesses.

The City of Palo's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Questioned Costs. While we have expressed our conclusion on the City's response, we did not audit the City of Palo's response and, accordingly, we express no opinion on it.

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

March 5, 2010

City of Palo  
Schedule of Findings and Questioned Costs  
Year ended June 30, 2009

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

- (a) Qualified 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, because we were unable to satisfy ourselves as to the distribution by fund of the total fund balance at July 1, 2008.
- (b) Significant deficiencies in internal control over financial reporting were disclosed by the audit of the financial statements, including material weaknesses.
- (c) The audit did not disclose any non-compliance which is material to the financial statements.
- (d) Significant deficiencies in internal control over the major program were disclosed by the audit of the financial statements, which are considered to be material weaknesses.
- (e) An unqualified opinion was issued on compliance with requirements applicable to the major program.
- (f) The audit disclosed 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 program was CFDA Number 97.036 – Disaster Grants Public Assistance (Presidentially Declared Disasters).
- (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, 2009

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

**SIGNIFICANT DEFICIENCIES:**

II-A-09 Segregation of Duties – One important element in designing internal control that safeguards assets and reasonably ensures the reliability of the accounting records is the concept of segregation of duties. When duties are properly segregated, the activities of one employee act as a check on those of another. One person has control over each of the following areas:

- (1) Cash – reconciling bank accounts, initiating cash receipt and disbursement transactions and handling and recording cash.
- (2) Receipts – collecting, depositing, journalizing and posting.
- (3) Utility receipts – billing, collection, depositing, posting and reconciling.
- (4) Disbursements – purchasing, check signing, recording and reconciling.
- (5) Payroll – preparing and distributing.
- (6) Bank reconciliations – reconciling book balances to bank balances.

In addition, an initial listing of mail receipts is not prepared by the mail opener.

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. Evidence of review of reconciliations should be indicated by initials of the independent reviewer and the date of the review.

Responses

City – The City will segregate duties to the extent possible with existing personnel and City Council members. The City and the Palo Volunteer Fire Department will work toward improving segregation of duties.

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, 2009

II-B-09 Reconciliation of Utility Billings, Collections and Delinquencies – Utility billings, collections and delinquencies were not reconciled throughout the year.

Recommendation – Procedures should be established to reconcile utility billings, collections and delinquencies each month and delinquent lists should be prepared monthly. The City Council should review the reconciliations and monitor delinquencies.

Response – Reconciliation procedures have been established and will be performed. A delinquent list is provided to the City Council monthly.

Conclusion – Response accepted.

II-C-09 Charge Accounts – The City has charge accounts for use by various employees while on City business. The City has adopted a formal policy to regulate the use of charge accounts and to establish procedures for the proper accounting of charge account charges. However, the policy has not consistently been followed.

Recommendation – The City should ensure the written charge account policy is followed.

Response – The City will review the policy to ensure it is current and will follow it.

Conclusion – Response accepted.

II-D-09 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) Restricting the installation of copyrighted software not licensed to the City.
- (4) Logging off unattended computers.
- (5) Back ups should be stored off-site
- (6) No disaster recovery plan has been developed and implemented.

Recommendation – The City should develop written policies addressing the above items in order to improve the City's control over computer based systems.

Response – The City will adopt written policies and procedures. Employees now receive a reminder to change passwords every 60 days.

Conclusion – Response accepted.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

II-E-09 Award of Contract – The City Council solicited bids for the removal of debris from flooding of the City. The City awarded the contract for debris removal to the third lowest bidder.

The bids were based on an estimate of 17,500 tons of debris and driving 14 miles. Based on the bids and the estimated tons, the lowest bid would have totaled \$376,775, the second lowest bid \$671,825 and the third lowest bid \$1,195,250.

The City did not appropriately document why the third lowest bid was chosen. The City has paid the third lowest bidder \$345,706 for the removal of 5,062 tons of debris and \$34,284 for site restoration, for a total of \$379,990.

Recommendation – Although not specifically required by the Code of Iowa, the City has a fiduciary responsibility to accept the lowest responsive, responsible bidder or document the reasons why a higher bid is chosen.

Response – The City of Palo acknowledges and takes seriously its responsibility to serve the best interests of its citizens. The City acknowledges the award to the third lowest bidder for contract services was potentially more costly but, in the end, believed it was appropriate, given the predicament and circumstances facing the City at the time.

First, this award was made approximately seven weeks after a devastating flood left nearly the entire City under water and only after consultation with and verbal approval from both federal and state emergency management authorities on the scene, which included the observation the fees in this contract were lower than what was awarded in nearby Cedar Rapids. Palo, as a small town, had not routinely administered a contract for services of this proportion and had never experienced a disaster of this magnitude. With these factors in mind, the City relied on the advice and consent provided by these emergency management authorities.

Second, a part of the City's decision was related to the fact the third lowest bidder was local. At the time this decision was made, the City was very concerned about the future of the City and felt strongly this award would be a small but significant step in keeping the contract funds within the community and would also demonstrate to the community at large the City was committed to the rebuilding effort, monumental as it was.

Third, the third lowest bidder had previously done work for and in the City, was reputable in terms of the quality of its work and its billing practices, and had voluntarily contributed significant resources to the recovery efforts during and immediately after the flood. At the same time, the City was not familiar with the reputation or the work of the second-lowest bidder. The City, already facing performance issues with other contractors at the time, placed a priority on making the bid award to a contractor who was willing and able to do the work timely and would provide the services in accordance with the contract without needing special supervision or seeking reimbursement above and beyond the terms of the original contract.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

In the end, the City is confident and comfortable it selected the most responsible and responsive bidder under the circumstances. Following the award of this contract, a significant amount of discussion was held among City officials, including in public meetings, regarding the processes and decision-making for awarding such contracts, which resulted in the City adopting a policy related to contract awards, which included more objective criteria, in December 2008.

Conclusion – Response acknowledged. However, the City should document the reasons why a higher bidder was chosen when the contract is awarded.

**INSTANCES OF NON-COMPLIANCE:**

No matters were noted.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

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

**INSTANCES OF NON-COMPLIANCE:**

No matters were noted.

**SIGNIFICANT DEFICIENCIES:**

**CFDA Number 97.036: Disaster Grants – Public Assistance (Presidentially Declared Disasters)**

**Pass-through Agency Number: FEMA-1763-DRIA**

**Federal Award Year: 2009**

**U.S. Department of Homeland Security**

**Passed through the Iowa Department of Public Defense**

- III-A-09 Segregation of Duties over Federal Receipts – The City did not properly segregate collection, deposit and record-keeping for receipts, including those related to federal programs. See item II-A-09.
  
- III-B-09 Award of Contract – Although the FEMA Project Worksheet Report indicated the lowest bid was selected, the City actually selected the third lowest bid. The City did not properly document the reason why the higher bid was chosen when the contract was awarded. See item II-E-09.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

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

IV-A-09 Certified Budget – Disbursements during the year ended June 30, 2009 did not exceed the amounts budgeted.

IV-B-09 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-09 Travel Expense – No disbursements of City money for travel expenses of spouses of City officials or employees were noted.

IV-D-09 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	\$ 68,299

In accordance with Chapter 362.5(11) of the Code of Iowa, the transaction with the Flood Recovery Coordinator may represent a conflict of interest since the total transactions were greater than \$2,500 during the fiscal year. 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 City has consulted legal counsel.

Conclusion – Response acknowledged. However, the City should obtain a written opinion from its legal counsel.

IV-E-09 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-09 Council Minutes – No transactions were found that we believe should have been approved in the Council minutes but were not.

IV-G-09 Deposits and Investments – A resolution naming official depositories has not been adopted by the City Council as required by Chapter 12C.2 of the Code of Iowa.

Recommendation – The City should adopt a depository resolution which establishes maximum amounts for each bank as required by Chapter 12C.2 of the Code of Iowa.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

Response – This will be done.

Conclusion – Response accepted.

- IV-H-09 Tax Increment Financing (TIF) – Although the City did not have any TIF debt outstanding at June 30, 2009, the City had cash on hand of \$419,952 at June 30, 2009 in the Special Revenue, Tax Increment Financing Fund, including \$278,830 for low to moderate income projects. Therefore, the City has \$141,122 more cash on hand than is needed for low to moderate income projects. In December 2009, the City certified additional debt of \$3,928,870.

The City does not currently have policies to provide guidance for low to moderate income projects.

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

Response – The City has had discussions with our financial consultant for the proper use of the low to moderate income tax increment financing cash.

Conclusion – Response acknowledged. The City should establish written policies and procedures for the use of low to moderate projects.

- IV-I-09 Local Option Sales Tax – The Special Revenue, Local Option Sales Tax Fund has accumulated a balance of \$569,593.

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

Response – Since June 30, 2009, some funds have been disbursed. The City also has other projects that will utilize funds from this fund.

Conclusion – Response accepted.

- IV-J-09 Financial Condition – The Capital Projects Fund and the Enterprise, Water Fund had deficit balances of \$132,011 and \$1,190, respectively, at June 30, 2009.

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

Response – The deficit balance in the Capital Projects Fund is likely due to a timing difference between SRF funds and sewer project bills. The City will make a transfer from the General Fund to eliminate the Enterprise, Water Fund deficit.

Conclusion – Response accepted.

- IV-K-09 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.

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

- The City has not complied with the provision which states the City will cause the books to be audited annually by an independent auditor.

Recommendation – Monthly transfers should be made to the sewer revenue bond sinking account as required by the sewer revenue bond resolutions.

Also, the City should review the bond provisions and comply with the audit requirement.

Response – Monthly transfers will be made to the sinking fund, rates will be reviewed and adjusted accordingly. The City will consider the audit requirement.

Conclusion – Response acknowledged. Unless waived by the lender, the City should comply with the audit requirement.

- IV-L-09 Bond and Interest Payments – General obligation bond interest payments were paid from the Capital Projects Fund. Chapter 384.4 of the Code of Iowa states, in part “Moneys pledged or available to service general obligation bonds, and received from sources other than property tax, must be deposited in the debt service fund.” The City has not established a Debt Service Fund.

Also, the sewer revenue bond interest payments were paid from the Capital Projects Fund. The sewer revenue bond resolution requires the payments be made from an Enterprise, Sewer Revenue Sinking Account, which the City has not established.

Recommendation – The City should establish a Debt Service Fund and make payments on the general obligation bonds from this fund as required by the Code of Iowa.

The City should establish an Enterprise, Sewer Revenue Sinking Account and make payments on the revenue bonds from this account as required by the bond resolution.

Response – A Debt Service Fund has currently been established and future payments will be made through this fund. Revenue bond payments will be made from the Sinking Account as required.

Conclusion – Response accepted.

- IV-M-09 Records of Accounts – The Palo Volunteer Fire Department maintained its financial accounting records separate from the Clerk’s records. The transactions and the resulting balances were not reported to the Council each month and the transactions were not recorded in the 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.

Recommendation – The Palo Volunteer Fire Department’s financial transactions and balances should be included in the Clerk’s monthly financial reports. Internal

City of Palo

Schedule of Findings and Questioned Costs

Year ended June 30, 2009

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 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 City and Fire department will establish procedures to provide information to City Clerk.

Conclusion – Response accepted.

IV-N-09 Ball Park Fence – Tax increment financing (TIF) disbursements included \$8,000 for fence at a ball park which the City did not certify as TIF indebtedness to the County Auditor.

Recommendation – The City should establish procedures to ensure disbursements from the Special Revenue, Tax Increment Financing Fund are only for TIF debt approved by the Council and included on the TIF debt certification to the County Auditor as required by Chapter 403 of the Code of Iowa.

Response – In the future, the City will ensure disbursements from the Special Revenue, Tax Increment Financing Fund are in accordance with the Code of Iowa.

Conclusion – Response accepted.



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City of Palo

Staff

This audit was performed by:

K. David Voy, CPA, Manager  
Shawn R. Elsbury, Senior Auditor  
Kristin M. Ockenfels, 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