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Missouri State Auditor

City of Gallatin



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Nicole R. Galloway, CPA
Missouri State Auditor

CITIZENS SUMMARY

Findings in the audit of the City of Gallatin

Utility System Controls and Procedures	<p>The city does not maintain a separate fund for the financial activity of the combined water and sewer systems, as required by bond covenants and state law. Currently, electric, water, and sewer transactions are accounted for in the Utility Fund. The city has historically violated bond covenants for its combined water and sewer system bonds by transferring surplus water and sewer revenues to the General Fund. From 2011 through 2014, approximately \$252,000 of water and sewer revenues were transferred to the General Fund. The board has no documentation of any discussions held or a basis for determining the amount to be transferred from the electric department to the General Fund, and from 2011 through 2014, approximately \$607,000 was transferred from the electric department to the General Fund. The city also allocated approximately 75 percent of the wages for the city administrator, city clerk, and deputy city clerk, totaling approximately \$85,000, to the Utility Fund (25 percent to each department - water, sewer, and electric) with no supporting documentation indicating how these amounts were determined. The city increased sewer rates in December 2012 and electric rates in September 2013 without preparing a statement of costs as required by law or maintaining documentation of how the rate increase was calculated. Additionally, some adjustments posted to customer utility accounts are not approved by the city administrator, in violation of city policy. The city does not track or restrict the balance of customer utility deposits in its financial records. Penalties are not properly assessed on delinquent sewer accounts.</p>
Accounting Controls and Procedures	<p>The city is not properly tracking and recording some restricted funds. The board has not adequately segregated duties or performed adequate reviews of the work performed by the city clerk or the deputy city clerk. The city has not established procedures to routinely follow up on outstanding checks.</p>
Disbursements	<p>The city does not have a formal bidding policy and bids were not solicited for several significant goods and services purchased in 2014. The board did not document its evaluation and selection of engineering services and professional services are obtained without the benefit of a competitive selection process. The city does not have adequate procedures to account for fuel used by the public works and police departments.</p>
Payroll	<p>Procedures have not been established to ensure IRS regulations are followed regarding uniform allowances and the police chief's additional compensation received for teaching the DARE program. As a result, the city may be subject to penalties and/or fines for failure to report all taxable benefits.</p>
Missouri Public Energy Pool Disclosures	<p>The city does not include any disclosure about its relationship with the Missouri Joint Municipal Electric Utility Commission and the Missouri Public Energy Pool or detail about the city's ownership interest in power generating facilities under construction or potential ownership costs in the city's financial statements. Such disclosures are necessary to comply with accounting standards for state and local governments and to fully disclose the financial arrangements, as well as potential, significant future debt, to citizens.</p>

Lease Agreements and Policies	The former city administrator entered into a lease agreement with his father on behalf of the city. The lease agreement allowed the city to use salt bins owned by the former city administrator's father to store city salt used for street maintenance, but the board did not approve the lease agreement. In addition, the city has not adopted formal policies for a gun purchase program for police officers.
Budgets and Financial Reporting	Budget amendments are not prepared prior to incurring related expenditures and the budgets do not include beginning or ending cash balances. The city did not submit an annual financial report for 2014 to the State Auditor's Office.
Electronic Data Security	The city has not established adequate password controls to reduce the risk of unauthorized access to computer systems and electronic data. Passwords are not required to be changed on a periodic basis to help ensure they remain known only to the assigned user and to reduce the risk of a compromised password. In addition, security controls are not in place to lock a computer after a specified number of incorrect logon attempts.

In the areas audited, the overall performance of this entity was **Fair***

*The rating(s) cover only audited areas and do not reflect an opinion on the overall operation of the entity. Within that context, the rating scale indicates the following:

- Excellent:** The audit results indicate this entity is very well managed. The report contains no findings. In addition, if applicable, prior recommendations have been implemented.
- Good:** The audit results indicate this entity is well managed. The report contains few findings, and the entity has indicated most or all recommendations have already been, or will be, implemented. In addition, if applicable, many of the prior recommendations have been implemented.
- Fair:** The audit results indicate this entity needs to improve operations in several areas. The report contains several findings, or one or more findings that require management's immediate attention, and/or the entity has indicated several recommendations will not be implemented. In addition, if applicable, several prior recommendations have not been implemented.
- Poor:** The audit results indicate this entity needs to significantly improve operations. The report contains numerous findings that require management's immediate attention, and/or the entity has indicated most recommendations will not be implemented. In addition, if applicable, most prior recommendations have not been implemented.

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NICOLE R. GALLOWAY, CPA
Missouri State Auditor

To the Honorable Mayor
and
Members of the Board of Aldermen
City of Gallatin, Missouri

The State Auditor was petitioned under Section 29.230, RSMo, to audit the City of Gallatin. We have audited certain operations of the city in fulfillment of our duties. The city engaged R. Scott Stephens, Certified Public Accountant (CPA), to audit the city's financial statements for the year ended December 31, 2014. To minimize duplication of effort, we reviewed the report of the CPA firm for the year ending December 31, 2013, since the audit for the year ending December 31, 2014, had not been completed. The scope of our audit included, but was not necessarily limited to, the year ended December 31, 2014. The objectives of our audit were to:

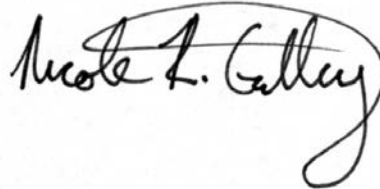
1. Evaluate the city's internal controls over significant management and financial functions.
2. Evaluate the city's compliance with certain legal provisions.
3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing minutes of meetings, written policies and procedures, financial records, and other pertinent documents; interviewing various personnel of the city, as well as certain external parties; and testing selected transactions. We obtained an understanding of internal controls that are significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contract or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying Organization and Statistical Information is presented for informational purposes. This information was obtained from the city's management and was not subjected to the procedures applied in our audit of the city.

For the areas audited, we identified (1) deficiencies in internal controls, (2) noncompliance with legal provisions, and (3) the need for improvement in management practices and procedures. The accompanying Management Advisory Report presents our findings arising from our audit of the City of Gallatin.

A handwritten signature in black ink, reading "Nicole R. Galloway". The signature is written in a cursive style with a large, looping "G" at the end.

Nicole R. Galloway, CPA
State Auditor

The following auditors participated in the preparation of this report:

Deputy State Auditor:	John Luetkemeyer, CPA
Director of Audits:	Regina Pruitt, CPA
Audit Manager:	Todd M. Schuler, CPA
In-Charge Auditor:	Wayne Kauffman, MBA
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City of Gallatin

Management Advisory Report

State Auditor's Findings

1. Utility System Controls and Procedures

There are significant weaknesses in city operations related to utility services. The city provides electric, water, and sewer services and tracks the related financial activity in the Utility Fund. According to city records, the city collected \$2,144,418, \$418,935, and \$405,805 in electric, water, and sewer receipts, respectively during the year ended December 31, 2014.

The city has historically transferred substantial amounts of money from its Utility Fund operations to help finance the operations and activities of the General Fund. The city is currently taking approximately 8 percent of each utility's gross revenue monthly and transferring the amount to the General Fund. The activity of each department is tracked separately, but all 3 are combined and presented as the Utility Fund in the financial statements of the city. Our review of the Utility Fund and related transfers identified various concerns.

1.1 Utility operations

The city does not maintain a separate fund for the financial activity of the combined water and sewer systems, as required by bond covenants and state law. Currently, electric, water, and sewer transactions are accounted for in the Utility Fund. The city tracks receipts and disbursements by activity; however, accumulated balances of the respective utility operations are not accounted for separately and the monies are commingled in the same bank account. The unaudited balance of the Utility Fund at December 31, 2014, was approximately \$645,000, but the city does not know which portion of the balance belongs to the electric utility or the combined water and sewer system.

Section 250.150.1, RSMo, states that revenues from the operations for its combined water and sewer systems shall be segregated from all other revenues or funds of the city. In addition, the bond covenants of the 2014 and 2004 combined water and sewer revenue bonds require a separate fund for water and sewer activity.

1.2 Water/Sewer transfers

The city has historically violated bond covenants for its combined water and sewer system bonds by transferring surplus water and sewer revenues to the General Fund. From 2011 through 2014, approximately \$252,000 of water and sewer revenues were transferred to the General Fund. City officials based the transfers on taking 8 percent of the gross revenues of the combined system and have been using this rate for many years, even prior to 2011, according to city personnel. The bond covenants related to the 2004 and 2014 combined water and sewer system bonds do not authorize system revenues to be used in this manner.

Article VI, Section 602 (e) of the 2004 bond agreement and Article VI, Section 602 (f) of the 2014 bond agreement prohibit the transfer of any surplus revenue for any purpose other than a system related expense. Failure to follow the bond covenants could result in the bondholders taking action to call the bonds.



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1.3 Electric transfers

The Board of Alderman (Board) has no documentation of any discussions held or a basis for determining the amount to be transferred from the electric department to the General Fund. From 2011 through 2014, approximately \$607,000 was transferred to the General Fund, which was based on 8 percent of gross revenues of the system. The city has made these transfers for many years, even prior to 2011, at the same percent. The transfers from the Utility Fund (water/sewer and electric) are significant and account for approximately 33 percent of the General Fund revenues during 2014, with the majority of the monies coming from the electric department.

The transfer rate for the electric department has been 8 percent for many years, as established by the Board, but there is no evidence or documentation of any discussions held on how this percentage was determined. Because these transfers, along with the administrative transfers discussed in section 1.4, represent a significant revenue source for the General Fund, it is important for the Board to periodically re-evaluate their impact, not only on the General Fund budget, but also on electric rates. City officials provided us with information, which they indicate was compiled by the Missouri Municipal League, documenting the transfer rate to the General Fund by other cities to support the transfer rate in Gallatin. We reviewed the transfer rates established by 103 cities with a population less than 6,000 residents (including Gallatin). For those cities, the average electric transfer rate was 5.09 percent of gross electric revenues and 94 of the 103 cities (or 91 percent) have established a transfer rate less than Gallatin.

To ensure these electric transfers are reasonable, it is important the city evaluate the value of the government services the transfers are offsetting during the annual budget process and document its process for determining the percentage to be charged.

1.4 Disbursement allocations

Some disbursements allocated to the General Fund and the various departments within the Utility Fund may not be reasonable and are not adequately supported. In addition to the transfers from the Utility Fund to the General Fund discussed in sections 1.2 and 1.3, the city also allocates approximately 75 percent of the wages for the City Administrator, City Clerk, and Deputy City Clerk, totaling approximately \$85,000, to the Utility Fund (25 percent to each department - water, sewer, and electric). The city did not have any supporting documentation indicating how these amounts were determined. In addition, no supporting documentation exists for the allocation of some other personnel costs and general expenses to various funds and departments of the city as described below:

- The Public Works Director's entire salary of \$49,582 was charged to the combined water and sewer department although he is also the director for the electric and street departments.



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- The city's entire \$4,905 postage expense was charged to the electric department, although all utilities are billed on the same statement. In addition, some of this postage was used for general activities such as building permits, business license renewals, and liquor license renewals.
- Cell phone charges for the City Administrator and Mayor of \$2,406 were charged entirely to the electric department.
- The annual audit cost of \$6,424 was allocated evenly between the General Fund and the Utility Fund (electric department only) although the audit covered all city funds and departments.

The proper allocation of expenses is necessary for the city to accurately determine the results of operations of specific activities, thus enabling the city to establish the level of taxation and/or user charges necessary to meet all operating costs. To ensure funds are used for intended purposes, the allocation of expenditures to city funds should be based on specific criteria, such as the number of hours worked by each employee, and documentation of allocations should be retained.

1.5 Sewer and electric rates

The city increased sewer rates in December 2012 and electric rates in September 2013 without preparing a statement of costs as required by law or maintaining documentation of how the rate increase was calculated. The Board maintained documentation of the various increases in revenue that could be expected by increasing the utility rates, but the reason for increasing the rates was not documented. Without a current cost study to support the rates charged for sewer and electric services, it is unclear whether the rates assessed for these services are set at an appropriate level.

Section 67.042, RSMo, provides that fees may be increased if supported by a statement of costs that shows the increase is necessary to cover costs of providing the service. To ensure utility rates are set to cover the cost of providing the related services, the city should perform and document a detailed cost study of its sewer and electric costs, including depreciation, and establish rates to cover the total cost of operations without generating excessive profits.

1.6 Utility adjustments

Controls over adjustments posted to customer utility accounts need improvement. Adjustments are sometimes needed to change a customer account balance, including adjusting usage for inaccurate meter readings when bills are processed or reducing a balance due to water leaks. Prior to August 2014, neither type of adjustment was required to be approved. The city adopted a policy in August 2014 requiring adjustments for water leaks to be approved by the City Administrator, but no procedures are in place to compare adjustments posted to the computer system to the manual approval forms to ensure all water leak adjustments are properly approved and only approved adjustments are made to customer accounts. Inaccurate meter



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reading adjustments still do not require approval. In addition, reports of adjustments posted to the system are not reviewed and approved.

To ensure adjustments to utility accounts are valid and approved, adjustment transactions should be approved before they are made in the computer system and the posted adjustments should later be compared to the list of approved adjustments.

1.7 Utility deposits

The city does not track or restrict the balance of customer utility deposits in its financial records. The city maintains a list of customer deposits held, which totaled \$134,161 as of December 29, 2014, but these monies are not maintained separately. According to city officials, customer utility deposits are held, along with other monies, in the city's primary checking account, but the actual amount of deposits held is not reported in the accounting records, and thus, cannot be compared to the listing. The balance of the Utility Fund in the city's primary checking account at December 31, 2014, was \$167,668, with a significant portion of this amount apparently being customer utility deposits.

Maintaining an accounting of utility deposits within the accounting records and comparing it to the list of customer deposits provides the city assurance the Utility Fund account balance is sufficient to cover customer deposit liabilities and other obligations, and ensure customer deposit monies are not used for utility operations.

1.8 Sewer delinquencies

Penalties are not properly assessed on delinquent sewer accounts. Ordinance 700.260(D) requires a 5 percent penalty to be added to delinquent accounts. The city does not assess this penalty.

Because ordinances passed by the Board to govern the city and its residents have the force and effect of law, it is important the ordinances are followed.

Recommendations

The Board of Aldermen:

- 1.1 Establish a separate fund to account for the electric utility financial activity or maintain records in a manner to separately account for the receipts, disbursements, and accumulated balances for the electric utility and the combined water and sewer system. Additionally, the city should establish the proper balance of the separate funds and maintain separate balances in the future.
- 1.2 Discontinue making transfers from the combined water and sewer revenues to the General Fund.
- 1.3 Determine the value of government services being offset by the electric transfers, evaluate the effects of the transfers and their



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impact on the General Fund, and retain documentation of how the transfer rate is determined.

- 1.4 Ensure costs allocated to the Utility Fund departments are reasonable, supported by adequate documentation, and the documentation is retained.
- 1.5 Ensure a statement of costs is prepared to support any utility rate increases, and document formal reviews of water, sewer, and electric rates periodically to ensure revenues are sufficient to cover all costs of providing these services.
- 1.6 Ensure all adjustments are properly approved and compared to actual changes posted to the computer system.
- 1.7 Properly account for the utility deposits and reconcile the utility deposits to available funds in the Utility Fund to ensure the city can meet its financial liability.
- 1.8 Assess a late penalty on delinquent sewer bills in accordance with city ordinance.

Auditee's Response

- 1.1 *The city agrees within six months to establish separate funds and divide the utility fund into two funds - electric and a combined water/sewer fund. The existing Utility fund reserves will be divided according to the percentage calculated by comparing the revenues of each utility to the total and then dividing the existing Utility Fund balance accordingly.*
- 1.2 *The city during the audit became aware of the specific bond requirements. Previously the city was relying on Section 250.150.2, RSMo, which permits interfund transfers. Due to the bond requirements, the city agrees that going forward it will not transfer surplus funds to the General Fund of the city in violation of any bond covenant. The city would note that it has always timely paid all bond payments and otherwise complied with the bond requirements and does not expect any adverse actions due to this inadvertent error.*
- 1.3 *The city agrees there is no formal documentation retained on discussion for the funds transferred from the electric department to the General Fund but the city annually in considering the budget does discuss all expenditures, income, and transfers as a part of the budget process. The city agrees to do a better job documenting such discussions.*



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The city believes the 8 percent transfer amount from the electric department is appropriate based on upon the city's investment in the electric system, the costs that the city incurs in providing city services to the electric system, the use of city streets and other facilities by the electric system, and to replace funds the city would otherwise be receiving as a franchise fee and property taxes if the electric system was investor owned. The city would also note that the 8 percent amount is lower than transfer amounts that have been approved by the Missouri Supreme Court and in line with transfers to the General Fund made by other cities in the area. The city does agree that it is a good management practice as suggested to periodically review the transfer amount to ensure that it is fair to both the electric system users and the General Fund and will institute such suggestion in future budget years.

- 1.4 *The city believes that the disbursements for reimbursements to the General Fund are generally reasonable. Due to the city's size and staffing level, the city deems it appropriate to allocate the staff costs among the funds (General and Utility) for the positions as is the city's current practice. The work load for each employee is ever changing and dynamic. The city feels in the long run that the allocations are fair and that additional costs to study and track time spent on each task would not be productive and would be a waste of resources as the data would vary from day to day, week to week, and year to year.*

The city would point out that the Administrator, in addition to the overall management of General Fund activities, also serves in the capacity of Utility General Manager and as such the city believes the amount allocated for his services to these funds to be reasonable. When comparing the costs allocated to the utilities for the salaries in Gallatin to the salaries for utility managers in other cities in the state the salary allocation by the city is below average. So the sum being paid to the City Administrator from the Utility Fund to act as its Utility General Manager represents a savings to the utility customers.

The city agrees that it needs to do a better job of allocation of the Public Works Director's salary among the utility departments for which he provides services.

The city agrees with the recommendation on allocation of postage costs and will institute the recommendation in the 2016 budget.

The city agrees with the recommendation to improve the allocation of cell phone costs among the department funds and is in the



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process of reducing cell phone usage and remaining usage will be allocated to among the funds in the 2016 budget.

The city agrees with the recommendation and the cost of any audits will be allocated among the department funds in relation to percent of such funds to the overall budget in next budget year.

- 1.5 The city Board of Aldermen do discuss the basis for the increases in utility rates but agrees that it needs to do a better job of documenting the basis for such increases. In the future the city will adopt the audit recommendation that all increases be accompanied by a statement of costs.*
- 1.6 The city agrees with the recommendation and has already implemented the required procedure and documentation by monthly reporting and reconciliation by the City Administrator on a monthly basis.*
- 1.7 The city does track customer utility deposits and maintains records of such deposits. The city agrees to implement the audit recommendation on segregation of the customer deposits and the necessary account will be established by 2016 budget year.*
- 1.8 The city agrees that sewer penalties need to be fully and fairly enforced. The city accepts the audit recommendation and will institute a policy to make penalty assessments in the next budget cycle.*

2. Accounting Controls and Procedures

2.1 Restricted monies

Accounting controls and procedures need improvement. The city receives monies for utility payments, taxes, merchant licenses, and other miscellaneous receipts. During the year ended December 31, 2014, the city collected approximately \$3.7 million.

The city is not properly tracking and recording some restricted monies. For the year ended December 31, 2014, the city received \$67,347 in state motor-vehicle related monies. Although these monies are restricted for specific purposes, they were deposited into the General Fund and the related disbursements and balance were not tracked separately. As a result, the city cannot determine at a point in time what portion of the General Fund represents restricted street improvement monies or demonstrate disbursements of these funds were allowable or appropriate.

Article IV, Sections 30(a) and 30(b), of the Missouri Constitution require motor vehicle-related receipts apportioned by the state of Missouri be disbursed for street related purposes only. Separate accounting of restricted monies is necessary to ensure compliance with the Missouri Constitution.



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2.2 Segregation of duties

The Board has not adequately segregated duties or performed adequate reviews of the work performed by the City Clerk or the Deputy City Clerk. The Deputy City Clerk is primarily responsible for receipting and depositing monies and making adjustments to customers' account balances. The City Clerk is responsible for receipting and depositing monies in the Deputy City Clerk's absence, purchasing, preparing checks, and reconciling the bank accounts. A detailed review of accounting records is not performed by an independent person.

Proper segregation of duties helps ensure all transactions are accounted for properly and assets are adequately safeguarded. If segregation of duties is not possible, a timely supervisory review by the Board should be performed and documented.

2.3 Outstanding checks

The city has not established procedures to routinely follow up on outstanding checks. As of December 31, 2014, the city had 28 checks, totaling \$1,287, that had been outstanding more than a year. Two checks have been outstanding since June 2006.

Proper follow-up procedures are necessary to prevent the accumulation of old outstanding checks and ensure monies are appropriately disbursed to the payee or as otherwise allowed by state law. Old outstanding checks should be voided and reissued to those payees who can be readily located, and amounts remaining unclaimed should be disposed of in accordance with state law.

Recommendations

The Board of Aldermen:

- 2.1 Determine the amount of restricted monies in the General Fund and establish a separate accounting of the restricted monies.
- 2.2 Segregate the duties of the City Clerk and Deputy City Clerk. At a minimum, there should be a documented supervisory review of city records and reconciliations.
- 2.3 Establish procedures to routinely follow up on and reissue old outstanding checks and dispose of unclaimed monies in accordance with state law.

Auditee's Response

- 2.1 *The city agrees with the recommendation and all transportation related funds will be deposited into the established account for the city transportation sales tax and capital improvement sales tax to allow for clear and easy assessment of available restricted funds and to be able to track expenditures per state law requirements.*



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2.2 *The city agrees with the recommendation and will segregate duties as is practical and where not practical it will use second party verification of all transactions. The accounting system also allows for certain verification of activities. The city acknowledges the need and is continually looking for ways to improve protection for both the public and the city employees.*

2.3 *The city agrees with the recommendation and will start utilizing the state system to dispose of unclaimed monies.*

3. Disbursements

Controls and procedures over city disbursements need improvement.

3.1 Procurement procedures

The city does not have a formal bidding policy and bids were not solicited for several significant goods and services purchased during the year ended December 31, 2014.

Item or Service	Cost
Street repairs	\$110,294
Oiler truck	43,750
Water tower and well maintenance	30,977
Water treatment supplies	6,413

The Public Works Director indicated the water tower and well maintenance purchase was from a sole source vendor; however, the Board had not documented this information.

Formal bidding procedures for major purchases or services provide a framework for economic management of city resources and help ensure the city receives fair value by contracting with the lowest or best bidders. Competitive bidding also helps ensure all parties are given an equal opportunity to participate in city business.

3.2 Professional and engineering services

The Board did not document its evaluation and selection of engineering services and professional services are obtained without the benefit of a competitive selection process.

- The city did not document its evaluation and selection of engineering services for the new water plant. Payments to the firm totaled \$190,000 during the year ended December 31, 2014. A city official indicated the city uses this firm because of past performance and a good working relationship.
- The city has not solicited proposals for auditing services. According to city personnel, the same firm has provided auditing services for the city for at least 20 years. The city paid \$6,424 for auditing services during the year ended December 31, 2014.



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- The city has not solicited proposals for legal counsel services. According to city personnel, the same law firm has provided legal services for the city for at least 20 years. The city paid \$2,790 to this firm for legal services during the year ended December 31, 2014.
- The city did not solicit proposals for the sewer plant operator. The city contracted with a vendor to operate the sewer plant during 2015 for \$88,200.
- The city has not solicited proposals for banking services in recent years and maintains its accounts at a local bank where a current Board member is the bank's Chief Financial Officer. As a result, this gives the appearance of a conflict of interest even though the checking account was established with the bank prior to April 2006 when the bank's Chief Financial Officer became a Board member.

Soliciting proposals for professional services is a good business practice, helps provide a range of possible choices, and allows the city to make better-informed decisions to ensure necessary services are obtained from the best qualified provider after taking expertise, experience, and cost into consideration. In addition, Sections 8.289 and 8.291, RSMo, provide requirements for obtaining, evaluating, and negotiating engineering services. Also, to reduce the appearance of a conflict of interest, proposals should be solicited for services provided by a Board member's employer.

3.3 Fuel purchases

The city lacks adequate procedures to account for fuel used by the public works and police departments. The city purchases gasoline using fuel cards at a local business and uses a bulk fuel tank for diesel fuel that is refilled as needed. According to city records, the city spent approximately \$23,500 on gasoline and \$9,700 on diesel fuel during the year ended December 31, 2014.

Employees do not submit receipts for fuel purchases to the City Clerk and thus, a comparison of the monthly fuel statement to individual fuel tickets cannot be performed. In addition, the fuel statement is not compared to the fuel logs maintained by the Public Works Department or law enforcement employees' daily activity logs.

The city also does not properly monitor bulk fuel use or reconcile fuel billings to fuel use records. The city uses a bulk tank to store diesel fuel, but prior to July 2014, the city was not maintaining a log to document the number of gallons pumped. Employees now record on a log each time fuel is pumped from the tank; however, the log is not used to reconcile to fuel purchased.

Chapter 6 of the city's personnel manual requires employees to bring a copy of the receipt immediately to the City Clerk when a charge on a credit card



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is made. In addition, requiring employees submit fuel tickets and reconciling them to items on the monthly vendor billing, as well as fuel and activity logs, will help provide assurance that all fuel billed was actually charged to and used by city employees. Procedures for maintaining and reviewing fuel usage logs and reconciling log information to fuel purchased and related records are necessary to ensure vehicles and equipment are properly utilized, prevent paying vendors for improper amounts, and decrease the risk of loss, theft, or misuse of fuel occurring without detection.

Recommendations

The Board of Aldermen:

- 3.1 Establish formal bidding policies and procedures, including documentation requirements regarding the bids or quotes received and the justification for bids selected.
- 3.2 Solicit proposals for professional services and comply with state law when procuring engineering services and document the evaluation and selection process for those services.
- 3.3 Require employees submit fuel tickets to the City Clerk and have applicable staff, reconcile them with fuel billings and investigate any discrepancies.

Auditee's Response

- 3.1 *The city agrees with the recommendation and has established a formal bidding procedure, and will maintain records of subsequent procedures.*
- 3.2 *The city agrees with the recommendation and starting immediately will follow state requirements for acquiring professional engineering services.*
- 3.3 *The city agrees with the recommendation and has already implemented a new system of fuel cards and all purchases are balanced against receipts and vehicle logs. The bulk fuel log will also be balanced against fuel purchased with normal expected usage being tracked for vehicles that do not have an odometer.*

4. Payroll

Procedures have not been established to ensure Internal Revenue Service (IRS) regulations are followed regarding uniform allowances and the Police Chief's additional compensation received for teaching the Drug Abuse Resistance Education (DARE) program. As a result, the city may be subject to penalties and/or fines for failure to report all taxable benefits.

The city paid 11 full-time employees, including the City Administrator and administrative staff, uniform allowances totaling \$3,300 (\$300 to each employee) in 2014. The City Administrator and administrative staff



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received the allowance even though they are not required to wear uniforms. Employees were not required to submit invoices or itemized expense reports to support the allowances, nor were the allowances reported on their W-2 forms. In addition, the \$1,200 paid to the Police Chief for teaching the DARE program was not processed through the payroll system so payroll taxes were not withheld.

IRS regulations require employee business expenses not accounted for to the employer be considered gross income and payroll taxes be withheld from the undocumented payments. Uniform allowances are intended to offset the cost of maintaining a uniform and should be restricted to employees who wear uniforms. In addition, all employee compensation should be reported on the employee's W-2 form and payroll taxes should be withheld and remitted, if necessary, as required by the IRS.

Recommendation

The Board of Aldermen require employees to submit itemized reports of uniform clothing purchases or report the allowance payments as other income on W-2 forms. The Board of Aldermen should ensure all employee compensation is properly taxed and reported to the IRS.

Auditee's Response

The city agrees with the recommendation and any new uniform allowance will only be allowed for job specific requirements such as highly reflective gear for street and utility personnel and fire resistant gear for electric utility workers.

5. Missouri Public Energy Pool Disclosures

The Board needs to evaluate its relationship with the Missouri Joint Municipal Electric Utility Commission (MJMEUC), including the Missouri Public Energy Pool (MoPEP), a power pool managed by the MJMEUC, to determine proper disclosures about the relationship in the city's financial statements.

Currently, the city does not include any disclosure about MJMEUC and MoPEP or detail about the city's ownership interest in power generating facilities under construction and/or to be constructed and the potential ownership costs in the city's financial statements. However, based on the requirements of the Governmental Accounting Standards Board (GASB) for state and local governments, the relationship between the city and the MJMEUC/MoPEP may be a joint venture. Additionally, joint venture participants must disclose specific information including information regarding ongoing financial interest and/or financial responsibility and information to evaluate whether the joint venture is accumulating significant financial resources or causing financial burden on the participating government in the future. Such disclosures are necessary to comply with GASB financial reporting requirements and to fully disclose the financial arrangements, as well as potential, significant future debt, to citizens.



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The city contracts with the MJMEUC for the purchase of electrical power and energy. The city, along with other Missouri municipalities, is also a member of the MoPEP. In order to provide the MoPEP members a diversified portfolio of reliable energy resources on a long-term basis due to growing load requirements of the members and to replace power and energy currently purchased under short-term contracts, the MoPEP members directed the MJMEUC to participate in the development and construction of new generating facilities.

The obligations of the MoPEP members include maintaining adequate customer rates and maintenance of power facilities and contracts in order to meet the members' commitments to the pool. If a member city, such as Gallatin, decides to leave the pool, it must give a 5-year notice. At the end of the 5-year period, the city would be responsible for a pro-rata share of the ongoing capital and operation costs of each pool project based on its share of energy. According to MJMEUC documents, Gallatin's pro-rata share was 0.7 percent and the city's obligation for the project bonds issued would be approximately \$3.5 million as of December 2014. The city may also be obligated for any power purchase contracts.

Recommendation

The Board of Aldermen consult with its independent auditor to evaluate the relationship with MJMEUC/MoPEP and determine the proper and necessary disclosures for the financial statements.

Auditee's Response

The city will consult with its independent auditors on the relationship with MJMEUC/MoPEP. It is the city's understanding that it is not a joint venture relationship. The following DISCLOSURE LANGUAGE FOR MEMBER'S AUDITED FINANCIAL STATEMENT was obtained from MJMEUC/MoPEP:

LONG TERM CONTRACTS:

The City of Gallatin (the City) is a member of the Missouri Joint Municipal Electric Utility Commission (MJMEUC). MJMEUC manages a power pool known as Missouri Public Energy Pool #1 ("MoPEP"). The City is a member of MoPEP. All MoPEP members (including the City) have an agreement (the "MoPEP Agreement") with MJMEUC for the purchase of electric capacity and energy from MJMEUC. The MoPEP Agreement requires MJMEUC to supply the full energy requirements of the City and includes a procedure for the City to dedicate its capacity to MoPEP.

MoPEP operations are governed by a committee ("Pool Committee") consisting of one representative from each MoPEP member and is currently comprised of 35 members. The Pool Committee is charged with setting rates for all services provided by MJMEUC to MoPEP members. These rates include recovery of all of MJMEUC's costs (the "Direct Costs") incurred in



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connection with acquiring, providing, arranging, or financing the provision of full requirements service to MoPEP members. Such rates are based upon an annual budget and include, but are not limited to, all payments MJMEUC is required to make, or reserves or coverage MJMEUC is required to maintain, pursuant to any bond indenture, financing lease or loan agreement or other financial contract in order to procure, deliver, or finance resources intended to provide full requirements service, without regard to whether any particular resource is available to or used by any particular MoPEP member. Direct Costs also include amounts required to fund MoPEP capital and/or operating reserves as may be established from time to time by the Pool Committee.

The rates are established so as to charge each MoPEP member (including the City) its proportionate share of all costs associated with MJMEUC's performance under the MoPEP Agreement. Charges based on such rates are assessed and billed monthly. Rates are required to be established at least annually and adjusted to recognize variances between budgeted and actual costs at least every six months.

To meet the power and energy requirements of the City and the other MoPEP members, MJMEUC presently obtains power and energy from the following resources: (i) power purchased under long-term firm energy contracts, unit-contingent energy contracts and interruptible contracts; (ii) MJMEUC owned generation; (iii) member capacity; and (iv) spot market purchases. The City purchases its full energy requirements from MJMEUC pursuant to the MoPEP Agreement, but does not have any ownership interest in MJMEUC's resources.

In the event a MoPEP member would cancel the MoPEP Agreement, the member would remain responsible for its allocated share of MJMEUC's Direct Costs associated with all resource obligations entered into by MJMEUC for MoPEP prior to the notice of cancellation. MJMEUC would utilize or sell the member's allocated share of output in exchange for providing the member a credit or offset equal to the fair market value of the output up to the amount of the member's obligation. As a result, the member would have a financial obligation after cancellation in the event that the fair market value of the output is less than the member's allocated share of MJMEUC's Direct Costs with respect to the resource obligations at the time of cancellation. Since the amount of the cancelling member's obligation would depend on MJMEUC's Direct Costs after cancellation and the fair market value of the output at such times in the future, the amount of the obligation is not reasonably determinable. Currently, the City of Gallatin has no plans or intentions to begin cancellation proceedings.



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6. Lease Agreements and Policies

A lease agreement and several contracts were entered into by the former City Administrator without Board approval and policies have not been established for the gun purchase program.

On August 26, 2013, the former City Administrator entered into a lease agreement with his father on behalf of the city. The lease agreement allowed the city to use salt bins owned by the former City Administrator's father to store city salt used for street maintenance for 9 months starting August 26, 2013, and ending May 26, 2014. In return, the city agreed to set 3 poles and assist with framing a building extension. The Public Works Director estimated 20 hours of city labor and several city vehicles were used to set the poles and frame the extension. The Board did not approve this lease agreement. The September 9, 2013, Board meeting minutes indicate a discussion was held on this lease agreement but no action to approve the agreement was taken. This meeting occurred 2 weeks after the lease agreement took effect. Although the lease agreement expired in May 2014, the city continues to use the salt bins.

In addition, the city has not adopted formal policies for a gun purchase program for police officers. The former City Administrator entered into contracts with police officers that were not approved by the Board, allowing police officers to reimburse the city through payroll deductions for the cost of firearms purchased by the city. The contracts indicated the repayments had to be made within 12 months, but city officials indicated no other restrictions or limitations for the program exist, such as what type of guns, or how many, can be purchased. After the 12 month interest free repayment plan is complete, the ownership of the firearm transfers from the city to the individual police officer. One Board member we spoke to regarding this program indicated he was unaware of its existence.

To adequately monitor lease agreements and contracts entered into by the city, they should not be signed on behalf of the city without the documented authorization and approval of the Board. Written policies regarding the gun purchase program, including any restrictions or limitations on the types of guns and how many can be purchased, would help ensure the program is operating for the purposes the Board intended.

Recommendation

The Board of Aldermen ensure lease agreements and contracts are not entered into prior to documented Board approval. In addition, written policies for the gun purchase program should be developed.

Auditee's Response

The city agrees with the recommendation and all future leases and agreements will be approved by Board of Aldermen, and the gun purchase program will be revised as suggested for the 2016 budget year.



7. Budgets and Financial Reporting

7.1 Budget amendments

Budget amendments are not prepared prior to incurring related expenditures and the budgets do not include beginning or ending fund balances, as required by state law.

Budget amendments are not prepared before the original budgeted expenditure total is overspent. The Board waits until the last meeting of the year to amend the budget to increase the expenditure budget to the actual expenditure amount, resulting in funds being overspent in total without proper authorization. For example, the original budgeted expenditures amount for the General Fund for the year ended December 31, 2014, was \$596,822. During the last regular Board meeting of the year, on December 19, 2014, the Board amended the General Fund budget through a resolution that stated the "annual budget for fiscal year 2014 be amended to reflect actual expenditures for the year ending December 31, 2014, and that the amended amounts are hereby authorized for expenditure." This effectively increased the budgeted expenditures to \$681,790, resulting in the General Fund being overspent by \$84,968 before the amended budget was approved by the Board.

Section 67.080, RSMo, provides that no expenditure of public monies shall be made unless it is authorized in the budget. The Board should formally amend the budget before the related expenditures are incurred.

7.2 Fund balances

Budget documents do not include the actual beginning and estimated ending cash for any funds. As a result, the Board is not using all available information to assist in effectively managing the city and the public is not provided a complete overview of city finances.

Section 67.010, RSMo, requires the budget present a complete financial plan for the ensuing budget year and outlines the various information to be included in the budget. A complete and well planned budget, in addition to meeting statutory requirements, can serve as a useful management tool by establishing specific financial expectations for each area of city operations. It also assists in setting utility rates and informing the public about city operations and current finances.

7.3 Financial reporting

The city did not submit an annual financial report to the State Auditor's Office as required by law for the year ended December 31, 2014. Section 105.145, RSMo, requires each political subdivision to file annual reports of its financial transactions with the State Auditor's Office.

Recommendations

The Board of Aldermen:

- 7.1 Prepare and approve budget amendments prior to incurring the related expenditures.



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- 7.2 Ensure annual budgets contain all information required by state law.
- 7.3 Submit annual financial reports to the State Auditor's Office as required by state law.

Auditee's Response

- 7.1 *The city agrees with the recommendation and will follow Section 67.080, RSMo. Amendments to the budget, if needed, will be made throughout the budget year.*
- 7.2 *The city agrees with the recommendation and will follow the requirements of Section 67.010, RSMo.*
- 7.3 *The city agrees with the recommendation and will follow the requirements of Section 105.145, RSMo.*

8. Electronic Data Security

The city has not established adequate password controls to reduce the risk of unauthorized access to computer systems and electronic data. Passwords are not required to be changed on a periodic basis to help ensure they remain known only to the assigned user and to reduce the risk of a compromised password. In addition, security controls are not in place to lock a computer after a specified number of incorrect logon attempts.

Passwords are required to authenticate access to computers. Passwords should be changed periodically to reduce the risk of unauthorized access to and use of systems and data. Logon attempt controls lock the capability to access a system after a specified number of consecutive invalid logon attempts and are necessary to prevent unauthorized individuals from continually attempting to logon to a system by guessing passwords. Without effective security controls, there is an increased risk of unauthorized access to systems and the unauthorized use, modification, or destruction of data.

Recommendation

The Board of Aldermen should require a unique password for each employee that is periodically changed to prevent unauthorized access to city computer systems and electronic data. The Board of Aldermen should also require each city computer to have security controls in place to lock the computer after a specified number of incorrect logon attempts.

Auditee's Response

The city agrees with the recommendations and is in the process of investigating a two factor authentication system to increase the security of its system and in the meantime will change passwords on a monthly basis.

City of Gallatin

Organization and Statistical Information

The City of Gallatin is located in Daviess County. The city was incorporated in 1856 and is currently a fourth-class city. The city employed 11 full-time employees and 8 part-time employees on December 31, 2014.

City operations include law enforcement services, utilities (water, sewer, electric, and trash), street maintenance, swimming pool, park, and planning and zoning.

Mayor and Board of Aldermen

The city government consists of a mayor and a 4-member board of aldermen. The members are elected for 2-year terms. The mayor is elected for a 2-year term, presides over the board of aldermen, and votes only in the case of a tie. The Mayor and Board of Aldermen, at December 31, 2014, are identified below. The Mayor is paid \$300 per month and the Board of Aldermen members are paid \$200 per month. The compensation of these officials is established by ordinance.

Barbara Ballew, Mayor
John Whitfield, Alderman and Board President, East Ward
Carol Walker, Alderwoman, East Ward
Steve Evans, Alderman, West Ward
Dan Lockridge, Alderman, West Ward

Financial Activity

A summary of the city's financial activity for the year ended December 31, 2014, follows:

City of Gallatin
Schedule of Receipts, Disbursements, and Changes in Cash Balances
Year Ended December 31, 2014

	General Fund	Park Fund	Swimming Pool Fund	Gallatin Industrial Development Authority Fund	Band Fund	Cemetery Fund	Utility Fund	Total
RECEIPTS								
Property taxes	\$ 92,359	32,711	0	0	3,206	0	0	128,276
Sales taxes	237,640	0	0	0	0	0	0	237,640
Motor fuel and vehicle taxes	67,347	0	0	0	0	0	0	67,347
Institutional tax	773	274	0	0	27	0	0	1,074
Cable franchise	293	0	0	0	0	0	0	293
Utilities	0	0	0	0	0	0	2,924,121	2,924,121
Bond proceeds	0	0	0	0	0	0	192,934	192,934
Penalties	0	0	0	0	0	0	27,800	27,800
Reconnect fees	0	0	0	0	0	0	3,350	3,350
4th of July event	0	3,893	0	0	0	0	0	3,893
Programs	0	8,275	0	0	0	0	0	8,275
Concessions	0	350	4,753	0	0	0	0	5,103
Pool passes	0	0	2,390	0	0	0	0	2,390
Donations	0	0	4,687	0	0	1,906	0	6,593
Gate deposits	0	0	6,516	0	0	0	0	6,516
Licenses and permits	3,296	0	0	0	0	0	0	3,296
Fines	2,692	0	0	0	0	0	0	2,692
Interest	1,830	22	0	1	0	740	837	3,430
Rent	450	2,205	675	0	0	0	0	3,330
Miscellaneous	24,775	1,201	0	0	0	0	13,050	39,026
Transfers in	215,105	0	33,325	0	0	8,288	0	256,718
Total Receipts	646,560	48,931	52,346	1	3,233	10,934	3,162,092	3,924,097
DISBURSEMENTS								
Payroll	276,759	8,942	22,955	0	0	0	380,389	689,045
Supplies	117,468	407	7,454	0	0	0	90,179	215,508
Electricity purchase	0	0	0	0	0	0	1,558,405	1,558,405
Debt service	9,570	0	0	0	0	0	326,727	336,297
New water plant	0	0	0	0	0	0	194,999	194,999
Contracts	0	0	0	0	0	0	7,350	7,350
Festivals -								
4th of July event	0	4,462	0	0	0	0	0	4,462
Chautauqua	0	0	0	0	2,000	0	0	2,000
Programs	0	7,210	0	0	0	0	0	7,210
Concessions	0	0	3,235	0	0	0	0	3,235
Insurance	7,000	1,908	0	0	0	0	21,000	29,908
Capital improvements	158,191	11,336	0	0	0	0	14,958	184,485
Utilities	5,714	0	394	0	0	0	18,899	25,007
Maintenance	8,441	6,249	13,074	0	0	0	182,675	210,439
Vehicles	16,872	0	0	0	0	0	41,579	58,451
Legal fees	3,065	0	0	0	0	0	1,000	4,065
Postage	0	0	0	0	0	0	4,905	4,905
Audit	3,212	0	0	0	0	0	3,212	6,424
Membership fees	0	0	0	0	0	0	5,561	5,561
Dues and subscriptions	3,705	0	0	0	0	0	5,406	9,111
Easement	0	0	0	0	0	0	2,500	2,500
Mowing	0	0	0	0	0	10,500	0	10,500
Transfers out	41,613	0	0	0	0	0	215,105	256,718
Miscellaneous	30,180	39	5,234	40	0	434	7,875	43,802
Total Disbursements	681,790	40,553	52,346	40	2,000	10,934	3,082,724	3,870,387
RECEIPTS OVER (UNDER) DISBURSEMENTS	(35,230)	8,378	0	(39)	1,233	0	79,368	53,710
CASH, JANUARY 1, 2014	478,046	54,341	9,513	4,815	13,222	15,596	565,972	1,141,505
CASH, DECEMBER 31, 2014	\$ 442,816	62,719	9,513	4,776	14,455	15,596	645,340	1,195,215