



Susan Montee, JD, CPA
Missouri State Auditor

City of Salem

January 2010
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Office of the
Missouri State Auditor
Susan Montee, JD, CPA

January 2010

The following findings were included in our audit report on the City of Salem.

The city has transferred substantial amounts from the Electric Fund to the General Fund without adequate justification. From fiscal years 2005 through 2009, operating transfers from the Electric Fund to the General Fund totaled approximately \$4.7 million. City officials indicated the city budgets for and makes transfers as needed to cover General Fund operating shortfalls. The city's electric rates are set to cover the transfers to the General Fund, and the city may have established higher utility rates than necessary in lieu of increasing general revenues or reducing services provided by the city.

In January 2000, the Electric Reserve Fund had a balance of approximately \$1.7 million; however, as of June 30, 2009, the fund balance had decreased to only \$100,681. The city has not adequately documented the calculation of utility rate increases. The Board of Aldermen approved five electric rate increases since 2004, including two increases during fiscal year 2008 and one increase in fiscal year 2009. In August 2005, the city entered into a 45-year agreement to purchase electricity from the electric cooperative and did not consider other electricity suppliers prior to entering into this agreement. The city does not compare or reconcile the kilowatts of electricity billed to customers to the kilowatts of electricity purchased from the electric cooperative.

Bids were not solicited or documented for several purchases between July 2007 and December 2008. Examples include asphalt (\$359,720), culverts (\$20,123), and airline fuel (\$15,919). Bids were solicited by various means for some purchases in excess of \$5,000; however, bids were not advertised as required by city policy. Examples include Highway J power line installation (\$111,373), city sewer relining (\$94,496), water tower repairs (\$10,644), and water and sewer supplies (\$10,127).

The city has not updated the written agreement with Dent County and the County Collector since 2000 for the preparation of the city's property tax books and the collection of city and library property taxes. Neither the city nor the county has entered into a written agreement with the Salem Public Library for the collection of property taxes. The city has accrued an accounts payable balance of \$29,000 to Dent County due to a disagreement on the correct billing amounts for boarding city prisoners at the county jail.

The city provides space at the city's Freedom Activity Center to two entities free of charge: the Telecommunications Community Resource Center run by the University of Missouri and the Cardiovascular Wellness Center run by the Dent County Health Center. The city's lease agreements with these entities are not current and the agreement with the Cardiovascular Wellness Center does not reflect the current arrangements with this entity. The city has not evaluated the cost/benefit of the services provided to city residents by

YELLOW SHEET

these entities and has not attempted to determine how many residents utilize the services provided at the Freedom Activity Center.

The city does not have written vehicle policies or effective monitoring procedures regarding use of its 49 vehicles. Fuel and usage logs are not maintained for each vehicle. The city allows some supervisory employees to commute from their homes in city vehicles on a daily basis and is not reporting the commuting use in city vehicles as compensation to the employees. The city has no documentation to show the vehicle allowance paid to the Mayor is reasonable compared to actual expenses incurred.

The city does not have policies to ensure aviation fuel prices are set at a levy to cover costs incurred by the city airport. The city does not reconcile aviation fuel sold to fuel purchased. The city does not consider the overall cost of airport operations when setting hangar rental rates, and the rates charged by the city are less than rates charged by other small municipal airports in the state.

Actual expenditures exceeded budgeted expenditures for eight city funds for the year ended June 30, 2008. The Electric Fund expenditures exceeded budgeted expenditures by more than \$139,000. An formal annual maintenance plan for city streets has not been prepared or updated since 2004. The open meeting minutes did not always publicly disclose the final disposition of applicable matters discussed in closed session.

The city has not passed an ordinance to establish incentive payments to full-time employees, and these payments totaled approximately \$23,000 and \$22,500 in December 2008 and 2007, respectively. The city provides annual clothing allowances of \$300 each for certain employees not required to wear a uniform or other special clothing, and these clothing allowances were not reported on employees' W-2 forms. Employee timecards are typically prepared by the employee's supervisor and are not signed by the employee. Some city departments do not provide overtime and compensatory time records to the City Clerk's Office.

The city has not prepared a financial analysis of the cost/benefit of splitting the positions of Director of Public Works and City Engineer. In August 2001, the Board of Aldermen separated the Director of Public Works and City Engineer into two separate positions. At that time, the individual holding both positions resigned as Director of Public Works and remained the City Engineer without a decrease in pay, but assumed no additional responsibilities related to the position of City Engineer. In August 2001, the Board temporarily appointed the Mayor as the Director of Public Works and increased his compensation for the new duties assigned to him. The Mayor continues to hold this position.

Other findings in the audit report relate to real estate transactions, accounting/internal controls, city airport, traffic tickets and bonds, and capital assets.

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CITY OF SALEM

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STATE AUDITOR'S REPORT



SUSAN MONTEE, JD, CPA
Missouri State Auditor

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

The State Auditor was petitioned under Section 29.230, RSMo, to audit the City of Salem. The city engaged Verkamp & Malone, LLC, Certified Public Accountants (CPAs), to audit the city's financial statements for the year ended June 30, 2008. To minimize duplication of effort, we reviewed the report and substantiating working papers of the CPA firm. The scope of our audit included, but was not necessarily limited to, the year ended June 30, 2008. The objectives of our audit were to:

1. Obtain an understanding of the petitioners' concerns and perform various procedures to determine their validity and significance.
2. Evaluate the city's internal controls over significant management and financial functions.
3. Evaluate the city's compliance with certain legal provisions.

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. However, providing an opinion on the effectiveness of internal controls was not an objective of our audit and accordingly, we do not express such an opinion.

We 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. 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. Abuse, which refers to behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary given the facts and circumstances, does not necessarily involve noncompliance with legal provisions. Because the determination of abuse is subjective, our audit is not required to provide reasonable assurance of detecting abuse.

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 History, 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.

The accompanying Management Advisory Report presents our findings arising from our audit of the City of Salem.



Susan Montee, JD, CPA
State Auditor

The following auditors participated in the preparation of this report:

Director of Audits:	Alice M. Fast, CPA, CIA, CGFM
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MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

CITY OF SALEM
MANAGEMENT ADVISORY REPORT -
STATE AUDITOR'S FINDINGS

1. Electric Fund and Utility Concerns

The city has transferred substantial amounts from the Electric Fund to the General Fund without adequate justification, and the city's Electric Reserve Fund balance has decreased significantly since 2000. The city has not performed formal reviews of electric, water, and sewer rates and does not perform monthly reconciliations of the total amount of electricity purchased from the power company or gallons of water pumped from the water system to the total amount billed to customers. Additionally, the city entered into a long-term agreement for the purchase of electricity without considering other potential suppliers.

A. The city has historically transferred substantial amounts from its Electric Fund to help finance the operations and activities of the General Fund. In addition, while it appears the city incurs some administration costs in the General Fund related to the operation of the electric system, the city has not attempted to calculate the amount of administrative costs incurred. From fiscal year 2005 through 2009, year-end net operating transfers from the Electric Fund to the General Fund totaled approximately \$4.7 million. The following table presents Electric Fund transfers to the General Fund during this period:

	Year Ended June 30,				
	2009	2008	2007	2006	2005
Amounts Transferred	\$ 675,000	875,000	1,100,000	1,050,000	1,000,000
Percent of Electric Revenues Transferred	13%	19%	25%	25%	26%

City officials indicated the city budgets for and makes the transfers as needed to cover General Fund operating shortfalls. The city's electric rates are set to help cover the transfers to the General Fund, and the city may have established higher utility rates than necessary in lieu of increasing general revenues or reducing services provided by the city.

Utility revenues should be used only to fund the operations of the respective utility services. Rates for the utility services should be set to cover the costs of producing and delivering services (including administrative costs), repaying debt, if applicable, and repairing and replacing infrastructure. Utility services should not generate profits to fund other services provided by the city. If the city wishes

to transfer utility monies to the General Fund for administrative expenses incurred, documentation should be prepared and maintained to determine and support the amount of any administrative costs reimbursed the General Fund related to utility operations. In addition, the city should consult with legal counsel to determine if the funding of the transfers is in compliance with Article X, Section 22, Missouri Constitution (commonly referred to as the Hancock Amendment).

B. In January 2000, the Electric Reserve Fund had a balance of approximately \$1.7 million; however, as of June 30, 2009, the fund balance had decreased to only \$100,681. Factors for the decrease include:

- The city stopped receiving patronage fees (refunds of prior years' profit margins) from its electricity supplier (electric cooperative) in December 2006, which had been received since 1993. The city received more than \$706,000 in patronage fees since 1993, and city officials indicated these amounts were deposited in the Electric Reserve Fund.
- In December 2004, the city stopped receiving checks from the electric cooperative for a 10 percent discount on purchased power. Beginning in 1995, the electric cooperative reimbursed the city 10 percent of the cost of purchased power twice a year. The city received more than \$2.7 million in discounts which were deposited in the Electric Reserve Fund. Beginning in 2005, the discount amount was deducted from the amount billed to the city, and the discount was ceased completely in 2006.
- Until 2009, the city transferred amounts annually from the Electric Reserve Fund to the Electric Fund to cover increases in electric expenses and the transfers to the General Fund. No money was transferred during 2009 because of a lack of money available in the Electric Reserve Fund. The amount transferred during fiscal years 2006 through 2008 ranged from \$100,000 to \$235,000.

While the city currently has no debt related to the electric system and is legally not required to put money into a reserve fund, sound business practices dictate that money be set aside for the repair and replacement of the electric system infrastructure.

C. The city has not adequately documented the calculation of utility rate increases. The Board of Aldermen approved five electric rate increases since 2004, including two increases during fiscal year 2008 and one increase in fiscal year 2009. Electric rates were not adjusted from 1983 until August 2004. These rate increases occurred due to significant increases in the cost of purchased power and in part due to the transfers discussed in Parts A and B above. In addition, the city has not adequately considered the cost of depreciation of the electric

infrastructure when setting the rates, and as a result, the city has not set aside monies in the Electric Reserve Fund as noted in Part B above.

Over 86 percent of the expenses of the Electric Fund in fiscal year 2009 represent power purchases. Total power purchases increased from approximately \$2.4 million in fiscal year 2006 to \$3.9 million in fiscal year 2009. While a portion of this increase is due to an increase in power usage during this period, most of the increase has been due to the price of power purchased, with the cost of power increasing from about \$25 per megawatt hour in 2006 to \$49 per megawatt hour in July 2009.

Additionally, the city increased water and sewer rates in both 2007 and 2009. The city did not maintain adequate documentation to support how the recent electric, water, and sewer rate increases were determined. Documentation for electric rate increases consisted of handwritten calculations on notebook paper with no clear explanation regarding what the figures in the calculation represented, and the city did not maintain any documentation to support water and sewer rate increases.

Section 67.042, RSMo, requires the city to prepare a statement of the costs necessary to maintain the funding of a service supported by a fee. The city should prepare and maintain thorough and detailed documentation and justify any utility rate adjustments.

- D. In August 2005, the city entered into a 45-year agreement to purchase electricity from the electric cooperative. City officials indicated the city did not consider other electricity suppliers prior to entering into this agreement, and indicated the city would receive the lowest rates by remaining with the electric cooperative. While the agreement does outline a pricing arrangement based on the supplier's wholesale costs, price increases of 34.3 percent in 2008 and 10.87 percent in 2009 differed substantially from those anticipated by the city based upon projections received from the supplier at the time of negotiating the agreement. Due to the city's 45-year obligation under the existing agreement, there may be little or no opportunity to seek a new supplier.

While it is difficult to anticipate or predict the long-term cost of purchasing electricity, entering into a long-term commitment without considering other electricity suppliers may not have been in the city's best interest. The city should consult with legal counsel to determine the possibility of terminating or amending the current agreement, and whether the city could obtain a better deal from other electricity suppliers.

- E. The city does not compare or reconcile the kilowatts of electricity billed to customers to the kilowatts of electricity purchased from the electric cooperative. In addition, the city does not reconcile the gallons of water billed to customers to the gallons of water pumped from its water system.

To help detect significant electricity or water loss on a timely basis and to help ensure all utility usage is properly billed, the city should reconcile the kilowatts of electricity billed to the kilowatts of electricity purchased and the gallons of water billed to the gallons of water pumped. Significant differences should be investigated.

WE RECOMMEND the Board of Aldermen:

- A. Discontinue transferring Electric Fund monies to the General Fund to support other general city operations unless such transfers are properly justified, documented, and authorized.
- B. Develop a plan to ensure adequate funds are available for repair and replacement costs of the city's electric system infrastructure.
- C. Ensure thorough and detailed documentation is prepared and maintained to support and justify any utility rate adjustments.
- D. Review the current long-term agreement with the electric cooperative and determine the feasibility of amending or canceling the agreement. In the future, the Board should consider other suppliers prior to entering into electricity purchase agreements.
- E. On a monthly basis, reconcile kilowatts of electricity billed to customers to kilowatts of electricity purchased and gallons of water billed to customers to gallons of water pumped from the water system. Any significant differences should be documented and investigated.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

- A. *The City acknowledges it transfers money from the Electric Fund to General Revenue. Such transfers are justified, documented and authorized. This has been done to keep personal and real estate property taxes at the lowest rate possible for the residents of the City. Also, the City's electric rate is lower than that of the Rural Electric Cooperative serving the area. An evaluation of the administrative and operating costs should be performed to determine what transfers for the same should be made from the Electric Fund and other fund sources to General Revenue to offset such General Revenue expenditures.*

The City acknowledges that a rate study for utilities would be beneficial, though costly, to the City.

The City reviews its expenditures from General Revenue and other funds through the budget development and approval process and will continue to do the same.

- B. *The City accepts this recommendation and has begun budgeting reserve funds for this purpose in the FY 2009 budget and plans to continue the same in the future.*
- C. *The City agrees with this recommendation and will establish a plan for the same for FY 2011 and beyond.*
- D. *The City agrees with this recommendation and is in the process of reviewing the current agreement with the electric cooperative for purposes of amending the same.*
- E. *The City agrees with this recommendation and has implemented a procedure to do the same.*

2.	Purchasing and Bidding Procedures
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Bids were not solicited or advertised for some purchases in accordance with city policy. The city requires documented bids for all purchases in excess of \$1,000 and advertisement for bids in at least one official newspaper publication for purchases in excess of \$5,000.

Bids were not solicited or documented for the following purchases between July 2007 and December 2008:

Asphalt	\$	359,720
Culverts		20,123
Airline fuel		15,919
Timer for ball field		7,960
Street salt		7,320
Christmas decorations		4,641

Bids were solicited by various means for some purchases in excess of \$5,000; however, bids were not advertised as required by city policy. Examples include Highway J power line installation (\$111,373), city sewer relining (\$94,496), water tower repairs (\$10,644), and water and sewer supplies (\$10,127).

Formal bidding procedures for major purchases provide a framework for economical management of city resources and help ensure the city receives fair value by contracting with the lowest and best bidders. Competitive bidding also helps ensure all parties are given equal opportunity to participate in the city's business. The city should ensure compliance with established procedures. In addition, written documentation of bids should be maintained to provide evidence the city complied with its purchasing procedures. Bid documentation should include a list of vendors contacted, a copy of the bid specification, copies of all bids received, justification for awarding the bid, and documentation of discussions with vendors.

WE RECOMMEND the Board of Aldermen ensure compliance with the city's purchasing procedures and retain adequate documentation as evidence of compliance with the policy and to support justification of the bid awards.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written response:

The City agrees with this recommendation and recognizes lapses occurred on occasion in following established procedures and has implemented a practice to prevent such lapses in the future.

3. Real Estate Transactions

The city entered into real estate transactions without obtaining appraisals or fully documenting the reasons for entering into the transactions.

- A. In 2000, the city purchased a 2-acre tract of land from a local college that was adjacent to a 7-acre tract of land the city already owned for the purpose of developing a soccer complex on the entire 9 acres. The city paid \$50,000 for the 2-acre tract, which represented the appraised value. Subsequent to this purchase, the city decided placing the soccer complex at this location was not feasible. The local college approached the city in 2004 about purchasing the entire 9 acres, and the city sold the 9 acres to the college for \$100,000. An appraisal was not obtained for the sale of this land. In addition, the city did not formally document its plans for developing the soccer complex or the reasons for determining the 9-acre tract of land was no longer feasible for the complex.
- B. In 2006, the city purchased approximately 18 acres of land for \$90,000 for the development of the soccer complex at a different location. This land was purchased without obtaining an appraisal and was purchased from an individual related to the Mayor. Board meeting minutes and other documentation indicate the Mayor abstained from all discussions associated with this purchase. Also, the city did not formally document its plans for developing the soccer complex.
- C. In 2004, the city sold an old school building to a local Native American Tribe for \$100. The city also received a proposal from a local religious organization to purchase the building for \$14,000. While some city officials indicated there were doubts the religious organization could obtain financing to make improvements to the building site, the reasons for rejecting the significantly higher offer were not formally documented. City officials indicated the Native American Tribe has made some improvements to the building site, but are currently not using or maintaining the site.

The city should ensure all transactions involving the purchase and/or sale of real property are in the best interest of the city and all decisions are adequately documented. Good business practices require major real estate transactions be formally and independently appraised to ensure fair value is given or received for properties.

WE RECOMMEND the Board of Aldermen ensure independent written appraisals are obtained prior to all real property transactions, and fully document the reasons for all decisions made.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written response:

The City agrees with this recommendation and will implement the same.

4.

Contracts and Leases

Concerns were noted with the city's agreements with Dent County for property tax collection and boarding of prisoners. The city is providing leased space to two entities free of charge but has not adequately documented how these arrangements benefit city residents.

- A. The city has not updated the written agreement with Dent County and the County Collector since 2000 for the preparation of the city's property tax books and the collection of city and library property taxes. The county provides these services for a fee of \$15,000 per year.

In addition, neither the city nor the county has entered into a written agreement with the Salem Public Library for the collection of property taxes. The Salem Public Library is a separate political subdivision governed by a board of trustees. Currently, the library pays the city \$1,000 annually for the city to receive the property taxes from the County Collector and remit the taxes to the library. As a separate political subdivision, it would be appropriate for the library to contract directly with the county for property tax collection services.

Written agreements should be periodically updated to ensure all parties understand and abide by the terms of the agreement. In addition, Section 432.070, RSMo, requires all contracts to be in writing.

- B. The city has accrued an accounts payable balance to Dent County due to a disagreement on the correct billing amounts for boarding city prisoners at the county jail. Dent County has been billing the city \$40 per day per prisoner for boarding city prisoners for several years; however, the city has only been reimbursing the county \$22.50 per day per prisoner, which is equivalent to the state reimbursement rate to counties. In 1995, the city entered into a written

agreement with Dent County and the County Sheriff's Department for boarding city prisoners at a rate of \$14.75 per day per prisoner. In 1997, the city attempted to update this agreement; however, the city indicated the County Sheriff refused to enter into a new agreement with the city. Since that time, the county began charging the city \$40 per day per prisoner, but the city paid the county only \$22.50. The city has accrued an accounts payable balance to the county of approximately \$29,000. On February 1, 2009, the city updated the written agreement with the county and is now paying \$40 per day per prisoner.

To help prevent misunderstandings, written agreements should be updated to reflect the actual terms of the agreement. In addition, the city needs to work with the county to address the accounts payable balance.

- C. The city provides space to two entities free of charge and does not evaluate what benefit is provided to the city for the use of this space. The city owns a building called the Freedom Activity Center that houses three entities: the Telecommunications Community Resource Center (TCRC) run by University of Missouri Outreach and Extension, the Cardiovascular Wellness Center (CWC) run by the Dent County Health Center, and a gymnasium run by the city's Parks and Recreation Department. The city provides the space free of charge to the TCRC and the CWC. The city has written lease agreements with both the TCRC and CWC, but these lease agreements are not current and the agreement with the CWC does not reflect the current arrangements with this entity.

The city provides TCRC free rent and utilities at a value of \$60,000 per year as estimated by the city. In addition, the city also contributes an additional \$10,000 each year for TCRC operations. Beginning in December 2008, the city ceased charging rent to the CWC but has not amended the lease agreement that required the CWC to pay rent of \$467 per month. In addition, the city has never charged the CWC for utilities. City officials indicated the building only has two sets of utility meters, so it would be difficult to determine the utility usage for each entity. City officials indicated the TCRC and CWC provide services to city residents, but the city has not formally documented the value of the services provided.

Costs to cover expenses for this building are paid from the General Fund and have increased from approximately \$24,000 in 2007 to approximately \$27,400 in 2009. The city has not evaluated the cost/benefit of the services provided to city residents and has not attempted to determine how many city residents utilize the services provided at the Freedom Activity Center. To ensure city funds are spent efficiently and effectively, the city should require the TCRC and CWC to report the number of city residents served, and the city should evaluate the cost/benefit of the services provided to city residents. Additionally, updated leases should be obtained to reflect terms of agreements with all parties.

WE RECOMMEND the Board of Aldermen:

- A. Update the written agreement with Dent County for preparation of tax books and the collection of city property taxes. In addition, the Board should consider discontinuing its involvement in the collection and remittance of city library property taxes, or enter into a written agreement with the library if the city continues to receive and remit the library's taxes.
- B. Work with Dent County to resolve the outstanding accounts payable balance for prisoner boarding costs.
- C. Evaluate the number of city residents utilizing the services provided by the TCRC and the CWC at the Freedom Activity Center to ensure city funds are used efficiently and effectively. Additionally, the applicable leases should be updated to reflect the current agreements between the parties.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

- A. *The City agrees with this recommendation and will look at options for future written agreements. The City notes that the 2009 tax bills have already been sent, so any changes would need to apply to future tax years.*
- B. *The City is working on this and it is the City's understanding that there was never an agreement with the County to pay bills for prisoner boarding in excess of that already paid by the City.*
- C. *The City agrees that an evaluation of the city residents using this facility would be beneficial, but recognizes that limits may exist on obtaining this documentation. The City further agrees and will work to update current lease agreements.*

5. Accounting/Internal Controls

The city has not established formal procedures for the issuance and approval of building permits. The city maintains numerous checking accounts, and the City Clerk's accounting duties are not adequately segregated. The city should consider obtaining accounting software that would reduce or eliminate the current duplication of work for recording city revenues.

- A. The city requires by ordinance that building permits be issued for all electrical and sewer improvements and all new building or renovations costing over \$200. The city has not established written policies and procedures related to issuing building permits.

When the City Engineer approves an applicable improvement or a new construction, he normally submits a signed copy of the building permit to the city administration office and the building permit process is considered finalized. Our review of 55 outstanding building permit applications on March 31, 2009, noted 21 related building permits could not be located by the City Engineer. Upon further review, the city was able to locate 18 of these permits. While the city indicated these 18 permits were finalized, the permits were not signed or otherwise documented as approved by the City Engineer. The city has not developed formal policies and procedures to ensure all building permits are accounted for properly and finalized.

To ensure building applications are properly processed and approved, the city should establish written procedures and requirements for handling building permit applications and issuing and approving building permits.

- B. The city maintains 23 checking accounts. Except for separate accounts required by bond covenants, it appears the remaining accounts could be consolidated to help simplify the city's records and reduce the number of accounts that must be monitored and controlled. A large number of bank accounts requires additional record keeping and increases the likelihood that errors will occur in the handling of funds.
- C. There is minimal oversight and inadequate segregation for the City Clerk's duties. The City Clerk's duties include performing bank reconciliations, maintaining payroll records, recording revenue and disbursement information, preparing and distributing checks, and preparing monthly financial reports. Additionally, the City Clerk provides one of the two required signatures on checks. There is minimal evidence the Board provided adequate supervision or review of the work performed by the City Clerk.

To safeguard against possible loss or misuse of funds, internal controls should provide reasonable assurance that all transactions are accounted for properly and assets are adequately safeguarded. Internal controls could be improved by segregating duties to the extent possible. If proper segregation of duties is not possible, timely supervisory or independent review of the work performed by the City Clerk and investigation into unusual items and variances is necessary.

The city's independent auditor reported a similar condition in its report on internal control and compliance for the year ended June 30, 2008.

- D. The city records all city revenues received at City Hall on the utility accounting program. Revenues received by direct deposit or electronic fund transfers are not recorded on the utility accounting program. Additionally, all city revenues are recorded on the city's overall accounting program in the same level of detail, with the exception of utility receipts, which are entered by daily total to the city's overall accounting program. Maintaining two separate accounting systems with

similar information creates duplication of work and increases the chances of recording errors. The city should consider the cost effectiveness of purchasing one program to record all city financial activity, which would decrease the potential for errors and eliminate the time associated with re-entry of information.

WE RECOMMEND the Board of Aldermen:

- A. Establish procedures and requirements for handling and approving building permit applications, issuing building permits, and performing building inspections.
- B. Consider consolidating the city's bank accounts to the extent possible.
- C. Segregate the City Clerk's accounting duties to the extent possible. If proper segregation of duties cannot be achieved, timely supervision or independent reviews of the work performed and investigation into unusual items and variances is necessary.
- D. Evaluate the cost effectiveness of purchasing accounting software that would integrate all financial information and would minimize duplication of work.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

- A. *The City has an Ordinance regarding the requirements that must be met to obtain and issue a building permit. The City acknowledges that additional policies regarding the internal process for approving or disapproving a permit should be implemented and the City is currently taking steps to do the same.*
- B. *The City agrees with the recommendation and will take steps to reduce the number of bank accounts.*
- C. *Upon the recommendation of the City's Independent Auditor, FYE '08, segregation of the City Clerk's duties were implemented with their approval and listed as follows:*

The Mayor reconciles the daily cash summaries from the Utility Office with the bank deposits made by the Administrative Secretary. The City Clerk posts the deposits into the City's General Ledger and at the end of each month reconciles the bank statements to the general ledger. The City Clerk gives the Mayor the Bank Statements and Reconciliations to review and approve. Due to the Utility Clerks receiving and receipting the monies collected and preparing the Daily Cash Summaries, the Administrative Secretary preparing and depositing monies collected, the City Clerk posting deposits and reconciling bank statements, and the Mayor reviewing and approving Daily Cash Summaries to Bank Reconciliations, the City, based on the foregoing, believes sufficient internal controls have been implemented.

The Administrative Secretary receives invoices and reconciles them to the purchase orders and prepares them for payment. The City Clerk prepares the checks for payment of bills and submits reports to the Board of Aldermen for approval to pay bills. The reports consist of the vendor name, what the City is paying for, the amount of each check, and accounts they are charged to for approval for payment. After the Board of Aldermen approves the bills for payment, the City Clerk processes the distribution. Upon the State Auditor's recommendation, the City Clerk will give the purchase orders and invoices, along with the checks, to a Utility Clerk, for review and processing for disbursement.

The City Clerk calculates the weekly timecards and the Utility Clerk inputs the information into the Payroll System. The Utility Clerk prints the paychecks, the weekly payroll reports and other checks for weekly withholdings, such as garnishments and deferred comp payments. The Utility Clerk also reports the taxes thru electronic funds transfer. The City Clerk prepares and submits the quarterly payroll reports, year-end reports and W-2's from the information acquired from the weekly reports. Based on the foregoing, adequate segregation of duties and internal controls have been implemented.

- D. *The City agrees with this recommendation and also realizes that such software would impact the current budget significantly and, therefore, should be considered in future budget years.*

6. Vehicle Usage

The city's policies and procedures related to vehicle usage are in need of improvement. The city owns 49 vehicles assigned to various city departments.

- A. The city does not have written vehicle policies or effective monitoring procedures regarding vehicle use. A vehicle policy would help ensure vehicles are acquired, assigned, utilized, replaced, and maintained in an efficient and effective manner. Additionally, the policy should address and define the purpose and use of city vehicles, usage documentation requirements, and personal use; and identify applicable Internal Revenue Service (IRS) guidelines and reporting regulations.

In addition, fuel and usage logs are not maintained for each vehicle. As a result, fuel usage is not reconciled to fuel purchases. Without adequate fuel and usage logs, the city cannot effectively monitor that vehicles are used only for official business and fuel costs for vehicles are reasonable.

- B. The city allows the Water/Sewer Superintendent, Electric Leadman (who supervises the Electric Department), and Street Department Superintendent to commute from their homes in city vehicles on a daily basis because they are considered on call 24 hours a day. The city is not tracking or reporting the commuting use in city vehicles as compensation to the employees. In addition, because the city does not require vehicle usage logs or have an official policy

prohibiting personal use of city vehicles, the city cannot determine whether these vehicles incur personal (non-city related) use other than commuting.

IRS regulations require employers to withhold payroll taxes and include the value of commuting and other personal automobile use as taxable income. While certain vehicles, such as police cars and other emergency vehicles are exempted from this requirement, there may be tax consequences for the individuals listed above. To ensure compliance with IRS regulations, the city should require applicable employees to maintain records of commuting and other personal use in city vehicles and ensure the proper amount of taxable compensation is reported on applicable W-2 forms.

- C. The city has no documentation to show the vehicle allowance paid to the Mayor is reasonable compared to actual expenses incurred. The city pays a vehicle allowance of \$3,900 annually to the Mayor who uses a personal vehicle to conduct city business. However, a city vehicle is also available to the Mayor and is typically utilized when the Mayor travels outside of Salem on city business. The city reports this allowance as taxable compensation. Using the federal mileage reimbursement rate at January 2009 of 55 cents per mile, the annual allowance paid to the Mayor represents approximately 7,090 miles per year. The city should review the reasonableness of the mileage allowance paid and set the allowance to reasonably reflect actual expenses incurred by the Mayor.

WE RECOMMEND the Board of Aldermen:

- A. Adopt written vehicle policies regarding proper and allowable use of city vehicles, and require detailed fuel and usage logs be maintained for all city vehicles.
- B. Comply with IRS guidelines for reporting taxable benefits related to commuting in city-owned vehicles.
- C. Review the vehicle allowance paid to the Mayor and document the basis for the amount paid.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

A&B. The City agrees with these recommendations and will work to implement the same.

C. The City agrees with this recommendation and is currently documenting the mileage of the Mayor in an effort to evaluate the vehicle allowance paid the Mayor.

Several concerns were noted regarding the city airport.

- A. The city purchases aviation fuel that is sold to patrons using the airport. While the fuel storage tank's data system is used to generate reports of amounts sold, these reports are not reconciled on a periodic basis to the amount of fuel purchased and the inventory in the tank. To ensure fuel is accounted for properly, the sales recorded on the system reports should be reconciled to fuel purchased and the inventory on hand on a periodic basis, and significant differences should be investigated.
- B. The city does not have policies to ensure aviation fuel prices are set at a level to cover costs incurred by the airport. City officials indicated the selling price of the aviation fuel is set based on the cost of the most recently purchased fuel. The city does not consider the cost of the fuel already in the city's tank or other related operating costs when setting the selling price. During the 2 years ended June 30, 2008, fuel sales were approximately \$2,400 less than fuel purchases.

The city should establish policies to ensure the selling price of aviation fuel is set to cover the cost of fuel purchased and other related expenses. Such a policy would help ensure the city does not incur any financial loss on aviation fuel sales.

- C. The city could increase its hangar rental rates based on rates charged by other small municipal airports. The city charges \$240 per year (\$20/month) for hangar rental and this rate was set in 2007. Rates charged by some other small municipal airports in the state ranged from \$50 to \$200 per month. In addition, the city does not consider the overall cost of airport operations when setting hangar rental rates. To ensure the city is maximizing airport revenues and charging a reasonable rate, the city should review its airplane hangar rental rate and set it at an amount that approximates the current going rates and covers applicable airport operating costs.

WE RECOMMEND the Board of Aldermen:

- A. Periodically reconcile aviation fuel sales to fuel purchases and inventory on hand, and investigate any significant differences.
- B. Develop a reasonable method for calculating the selling price of aviation fuel to ensure revenues adequately cover fuel costs and other related expenses.
- C. Review the hangar rental rates in comparison to other similar-sized municipal airports to ensure the rates charged are reasonable and approximate the current going rates.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

- A&B. The City agrees with these recommendations and will implement the same. The City is in the process of updating equipment to give additional technological capabilities to implement these recommendations.*
- C. The City agrees with this recommendation and is in the process of implementing the same.*

8. Budgets, Maintenance Plans, and Minutes

Actual expenditures exceeded budgeted expenditures for several funds. In addition, the city has not updated its street maintenance plan since 2004. Board minutes did not always publicly disclose the final disposition of applicable matters discussed in closed session.

- A. Actual expenditures exceeded budgeted expenditures for eight city funds for the year ended June 30, 2008. For seven of the eight funds, actual expenditures exceeded budgeted expenditures by less than \$6,000 in each fund. However, for the Electric Fund, expenditures exceeded budgeted expenditures by more than \$139,000. While the Board of Aldermen is provided certain financial information at each meeting, the Board is not provided and does not monitor actual expenditures compared to budgeted amounts.

Section 67.040, RSMo, indicates a political subdivision shall not increase the total amount authorized for expenditure from any fund, unless the governing body adopts a resolution documenting the reasons making the increase necessary and approves or adopts a resolution or ordinance to authorize the expenditures.

- B. A formal annual maintenance plan for city streets has not been prepared or updated since 2004, when a maintenance plan for city streets was included in the city's strategic operating plan. A formal maintenance plan should be prepared in conjunction with the annual fiscal budget and include a description of the streets to be worked on, the type of work to be performed, an estimate of the quantity and cost of materials needed, the dates such work could begin, the amount of labor required to perform the work, and other relevant information. The plan should be included in the budget message and approved by the Board. In addition, a public hearing should be held to obtain input from city residents.

A formal maintenance plan would serve as a useful management tool and provide greater input into the overall budgeting process. A plan provides a means to continually and more effectively monitor and evaluate the progress made in the repair and maintenance of streets throughout the year.

- C. The open meeting minutes did not always publicly disclose the final disposition of applicable matters discussed in closed session. For example, two lawsuits against the city were settled; however, the final resolutions were not publicly disclosed. Section 610.021, RSMo, of the Sunshine Law, requires certain matters discussed in closed meetings be made public upon final disposition.

WE RECOMMEND the Board of Aldermen:

- A. Periodically compare year-to-date expenditures with budgeted amounts by fund to monitor the city finances and to ensure actual expenditures do not exceed budgeted amounts. If it is necessary to exceed budgeted expenditures, the Board should prepare budget amendments as required by state law.
- B. Establish a formal annual maintenance plan for city streets.
- C. Ensure minutes publicly disclose the final disposition of applicable matters discussed in closed session.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

- A. *The City has prepared line item budget amendments as needed. The City has implemented a practice of comparing the budget by fund.*
- B. *The City has prepared a plan each year for the maintenance of City streets; however, the City agrees that the plan could be decided upon in a more formal manner.*
- C. *The City agrees with this recommendation and will implement the same.*

9. Payroll and Related Matters

Several concerns were noted regarding payroll and personnel matters.

- A. The city makes incentive payments to full-time employees in December, and these payments totaled approximately \$23,000 and \$22,500 in December 2008 and 2007, respectively. The amount paid to each employee is based on years of service; however, the city has not passed an ordinance to establish these payments. To ensure the incentive plan is in compliance with state and federal laws and all employees are treated equitably, the provisions of the incentive plan should be clearly defined in a city ordinance and reviewed by legal counsel.
- B. The city paid a total of \$1,500 in clothing allowances to certain city employees in fiscal year 2008, and the clothing allowances were not reported on employee W-2 forms. The city provides annual clothing allowances of \$300 each for employees

not required to wear a uniform or other special clothing. Employees are required to submit invoices or receipt slips and are reimbursed for clothing purchases; however, there are no requirements or guidelines for the types of clothing purchases that will be reimbursed.

IRS regulations indicate that clothing allowances can be excluded from wages if they are for clothing that is specifically required as a condition of employment and cannot be adaptable to general use as ordinary clothing. Procedures have not been established to ensure IRS regulations are followed. As a result, the city may be subject to penalties and/or fines for failure to report all taxable benefits.

- C. Employee timecards are typically prepared by the employee's supervisor and are not signed by the employee. Additionally, administrative personnel and superintendent timecards are not reviewed and approved by supervisors or other management-level personnel. To help ensure all timecards accurately reflect hours worked and leave taken, all timecards should be prepared and signed by each employee and reviewed and signed by the employee's supervisor.
- D. Some city departments do not provide overtime and compensatory time records to the City Clerk's office. The city allows employees to be paid for overtime earned or to accrue compensatory leave to be used at a later date. Department supervisors monitor compensatory time earned and taken for each applicable employee and authorize any overtime payments.

Without centralized and complete overtime and compensatory time records, the city has less assurance the records are accurate, all employees are treated equitably, or leave taken does not exceed leave time earned and accumulated. Centralized records aid in determining final pay for employees leaving city employment and in demonstrating compliance with the federal Fair Labor Standards Act of 1938.

- E. The city has not prepared a financial analysis of the cost benefit of splitting the positions of Director of Public Works and City Engineer. In August 2001, the Board of Aldermen separated the Director of Public Works and City Engineer into two separate positions. At that time, the individual holding both positions resigned as Director of Public Works and remained the City Engineer without a decrease in pay, but assumed no additional responsibilities related to the position of City Engineer. In 2002, the City Engineer did assume some additional responsibilities related to building inspections. In August 2001, the Board temporarily appointed the Mayor as the Director of Public Works and increased his compensation for the new duties assigned to him. In April 2002, the Board indicated it had no immediate plans to hire a new Director of Public Works and the Mayor continues to hold this position. On August 20, 2001, the Board approved a revision to the city code that required the mayor to perform the duties of the director of public works if no other employee was appointed to this

position. The city code revision authorized the mayor to receive additional compensation for these additional responsibilities.

While there have been some discussions regarding the need to hire a separate public works director, the city has not prepared a financial analysis of the cost/benefit of splitting the two positions, maintaining a full-time engineer, and allowing the Mayor to hold the position of Director of Public Works. Such an analysis is necessary to ensure city funds are spent efficiently and effectively.

WE RECOMMEND the Board of Aldermen:

- A. Adopt an ordinance that defines the provisions of the employee incentive payment plan and consult with legal counsel regarding the plan.
- B. Evaluate the necessity and benefits of providing clothing allowances for employees who are not required to wear a uniform. Additionally, all clothing allowance reimbursements that do not meet IRS regulations should be reported as other income on the employees' W-2 forms.
- C. Require all employees to prepare and sign timecards and ensure all timecards are reviewed and signed by the employees' supervisor.
- D. Require all department supervisors submit overtime and compensatory time records to the City Clerk to ensure centralized records are maintained for all employees.
- E. Formally evaluate the cost/benefit of assigning the duties of the Director of Public Works to the Mayor and maintaining a full-time City Engineer.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written responses:

- A. *The City acknowledges the recommendation of the auditor. The City believes that the practice of paying an employee the additional sum of \$41.60 per year for each year of seniority is valued and warranted to show a measure of appreciation for its employees. This recommendation will be addressed by the Aldermen through the budget development and approval process in future budget years.*
- B. *The City agrees with this recommendation and the same was implemented beginning FY 2009.*
- C&D. *The City agrees with these recommendations and will implement the same.*
- E. *At this time, the City has a vacancy in the position of Public Works Director. City Code 2-55 provides that when the position of Public Works Director is vacant, the duties of the*

Public Works Director shall be performed by the Mayor with additional compensation being provided for the same. Addressing both the positions of Public Works Director and Engineer and their compensation could result in a significant budgetary impact and, therefore, would need to be considered in future budget development and approval processes.

10.

Traffic Tickets and Bonds

The Police Department does not adequately account for the numerical sequence and ultimate disposition of traffic tickets issued, and does not maintain a log of cash bonds received.

- A. The Police Department maintains a log of ticket books assigned to officers, and individual ticket information is entered into the department's case software; however, records accounting for the numerical sequence and ultimate disposition of tickets issued are not maintained. The department's case software apparently does not have the capability to produce a numerical list of tickets issued.

Without a proper accounting for the numerical sequence and ultimate disposition of traffic tickets, the city cannot be assured all tickets assigned and issued are properly submitted for processing. A log listing each ticket number, the date issued, and the violator's name would ensure all tickets issued are submitted to the Associate Circuit Court for processing, properly voided, or not prosecuted. This log should be reviewed periodically for missing ticket numbers. A record of the ultimate disposition of each ticket should also be maintained to ensure all tickets have been accounted for properly.

- B. The Police Department accepts cash for the payment of bonds and issues pre-numbered receipt slips for these payments; however, bonds are not recorded on a bond log or ledger. To provide assurance that all bond monies are accounted for properly and the disposition of all bonds is properly recorded, all bonds should be recorded on a bond log or ledger, including the numerical sequence of the bond receipt slips and the disposition of all bonds received.

WE RECOMMEND the Board of Aldermen work with the Police Department to ensure:

- A. The numerical sequence and ultimate disposition of all traffic tickets issued are accounted for properly.
- B. All bond receipts and dispositions are recorded on a log or ledger, and the numerical sequence of bond receipt slips is accounted for properly.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written response:

The City agrees with these recommendations and has instituted procedures for doing the same.

11. Capital Assets

The city needs to improve controls over capital assets. While the city's CPA firm maintains a list of capital asset values, which are recorded on the city's financial statements, the city does not maintain any comprehensive records of its capital assets, including land, buildings, infrastructure, equipment, and furniture. In addition, property items are not tagged for specific identification and annual physical inventories of the property are not performed.

Capital asset records are necessary to ensure accountability and for determining proper insurance coverage for city property. To develop appropriate records and procedures for capital assets, the city needs to undertake a comprehensive review of all property owned by the city and establish policies and procedures for capital assets.

WE RECOMMEND the Board of Aldermen maintain property records for capital assets that include all pertinent information for each asset, such as tag number, description, cost, acquisition date, location, and subsequent disposition. These records should be updated for property additions or dispositions as they occur, and annual physical inventories should be performed and compared to the detailed records. In addition, all capital assets should be tagged as property of the city.

AUDITEE'S RESPONSE

The Board of Aldermen provided the following written response:

The City agrees with this recommendation and is working to implement the same.

HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

CITY OF SALEM
HISTORY, ORGANIZATION, AND
STATISTICAL INFORMATION

The City of Salem is located in Dent County. The city was incorporated in 1881 and is currently a fourth-class city. The population of the city in 2000 was 4,854.

The city government consists of a mayor and four-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, Board of Aldermen, and other principal officials during the year ended June 30, 2008, are identified below. The Mayor is paid \$550 per month plus a \$75 per week vehicle allowance and Aldermen are paid \$100 for each Board of Aldermen meeting attended. The compensation of these officials is established by ordinance. Additionally, if the position of Director of Public Works is vacant, the Mayor is required by ordinance to perform the duties of the Director of Public Works and will receive additional compensation of \$2,175 per month. The Mayor performed the duties of Director of Public Works for the entire 12 months of the year ended June 30, 2008.

Elected Officials	Dates of Service During the Year Ended June 30, 2008	Compensation Paid for the Year Ended June 30, 2008
Gary Brown, Mayor	July 2007 – June 2008	\$ 36,600
Bill Riley Jr., Alderman (1)	July 2007 – June 2008	2,800
Jim McDaniels, Alderman	July 2007 – June 2008	2,700
Jim Jackson, Alderman	July 2007 – June 2008	2,800
J. Kenneth Nash, Alderman	April 2008 – June 2008	400
Grover Whitley, Alderman	July 2007 – April 2008	2,200

Other Officials	Dates of Service During the Year Ended June 30, 2008	Compensation Paid for the Year Ended June 30, 2008
Mary D. Happel, City Clerk	July 2007 – June 2008	\$ 44,243
William Huffman, City Engineer	July 2007 – June 2008	67,037
Clifford Jadwin, Police Chief	July 2007 – June 2008	41,799
Sharon Tubbs, Economic Development Director	July 2007 – June 2008	34,177
Benny Bryson, Street Superintendent	July 2007 – June 2008	40,475
Jack Emory, Water/Sewer Superintendent	July 2007 – June 2008	44,493
Gregory Nash, Parks & Recreation Director	July 2007 – June 2008	50,001
Larry Major, Electric Superintendent (2)	July 2007 – June 2008	37,594
Mark Weaver, City Attorney (3)	July 2007 – June 2008	25,121

- (1) Brad Nash was elected Alderman in April 2009.
- (2) Larry Major retired in June 2008 and a new Electric Superintendent has not been hired. Supervisory responsibilities are currently delegated to Gary Cook, Electric Leadman.
- (3) Mark Weaver resigned in September 2008 and Nanci Wisdom was appointed to the position of City Attorney.

In addition to the officials identified above, the city employed 57 full-time employees, 4 part-time employees, and 34 seasonal employees on June 30, 2008.

Assessed valuations and tax rates for 2008 were as follows:

ASSESSED VALUATIONS

Real estate	\$ 35,174,893
Personal property	10,878,142
Total	<u>\$ 46,053,035</u>

TAX RATES PER \$100 ASSESSED VALUATION

	<u>Rate</u>
General	\$ 0.6240
Library	0.2742

TAX RATES PER \$1 OF RETAIL SALES

	<u>Rate</u>
General	\$ 0.010
Capital improvement	0.005