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To the Members of the General Assembly:

The Memo summarizes the reasons behind the Auditor's proposed legislation and administrative changes regarding periodic examination of cities. The Auditor has proposed these changes to more effectively implement the provisions of Iowa Code § 11.6.

Chapter 11.6(1)(a) of the Code of Iowa requires cities "having a population of less than two thousand and budgeted gross expenditures of less than one million dollars in a fiscal year shall be subject to periodic examination by the auditor of state according to procedures established by the auditor of state...". This section also states, in part, "A city meeting the requirements for a periodic examination shall be subject to an examination under this section at least once during an eight-year period at a time determined by the auditor of state."

Fees to perform the periodic examinations are set by Administrative Rule in accordance with Chapter 11.6(11)(a) of the Code of Iowa which states "The auditor of state shall adopt rules in accordance with Chapter 17A to establish and collect a periodic examination fee from cities that are not required to have an audit or required fiscal year examination conducted pursuant to section 1 during a fiscal year. Such fees are due by March 31 each year. The auditor of state shall base fees on a sliding scale, based on the city's budgeted gross expenditures, to produce total revenue of not more than three hundred seventy-five thousand dollars for each fiscal year."

Periodic fees are set by Administrative Rule, Chapter 81-21.2(11). The previous fee schedule using four strata based on budgeted expenditures of the original certified budget is as follows:

Budget Expenditures In Thousands of Dollars	\$
Under 50	100
At least 50 but less than 300	475
At least 300 but less than 600	900
600 or more	1,200

The above fee schedule was created based on an estimate that periodic examinations would cost approximately \$3,000 each, on average. However, based on the first five years of actual information now available, periodic examinations are averaging more than expected (roughly \$4000 per examination).

More examination procedures are needed than were anticipated. This is primarily due to the significant issues identified in a number of the smaller cities which have never been subject to oversight. In order to perform our due diligence in ensuring the purposes of the program, to provide oversight over smaller cities in Iowa and help reduce the opportunity for fraud, we were returning to cities, typically within two years of their initial periodic examination, to follow up on the status of the findings and determine whether or not the cities are implementing the recommendations reported in their initial periodic examination. This is a much more aggressive

schedule than the “at least once during an eight year period” that was anticipated at the time the original legislation was passed. To date, these follow up visits have been performed on approximately 58% of the cities who have had a periodic examination.

However, due to the costs involved, follow-ups have been discontinued due to rising costs. In FY2019, even after discontinuing follow-ups, AOS expended over \$535K on periodic examinations. Revenue for the program remains capped at \$375K.

Further complicating matters, following the 2020 census, it is anticipated that approximately 100 cities will fall below the 2000 person threshold, moving those cities into the periodic universe.

In order to meet these challenges in FY2022, the Auditor proposes increasing the cap to \$600K and has changed the fee schedule to allocate costs more equitably. The auditor adopted an administrative rule change to alter the fee schedule. The new fee schedule is as follows:

Budget Expenditures	
<u>In Thousands of Dollars</u>	FEE \$
Under 100	200
At least 100 but less than 250	550
At least 250 but less than 500	800
At least 500 but less than 750	1200
Over 750	\$1500

The above fee schedule has reduced fees for approximately 200 cities, while increasing fees for about 400. The new fee schedule will increase periodic fee revenue by approximately \$20,000 in the short term, but is designed to help AOS absorb the anticipated addition of 100 cities to the periodic universe following the 2020 census. AOS has proposed legislation that will increase the periodic fee cap from \$375K to \$600K.