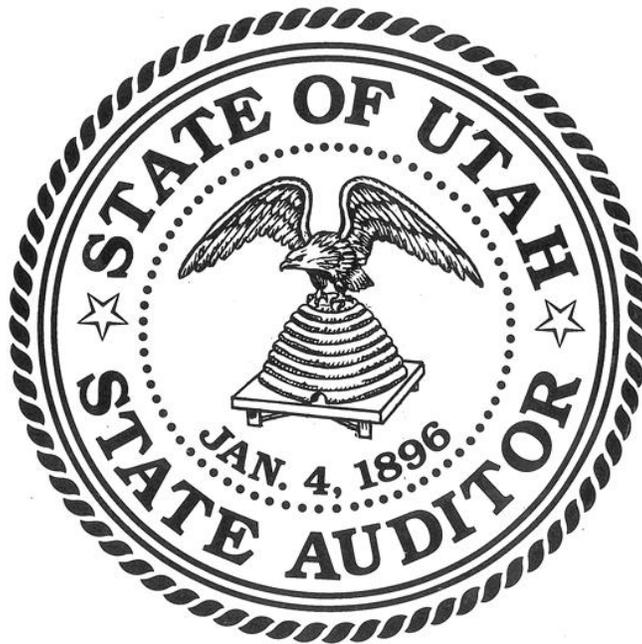


UTAH LEAGUE OF CITIES AND TOWNS

Findings and Recommendations
For the Period May 2012 to September 2016

Report No. ULCT-17-SP



OFFICE OF THE STATE AUDITOR

AUDIT LEADERSHIP:

John Dougall, State Auditor

Van Christensen, CPA, CFE, Audit Director

Jeremy Walker, CPA, Local Government Manager



OFFICE OF THE
STATE AUDITOR

REPORT NO. ULCT-17-SP

January 19, 2017

Utah League of Cities and Towns
Board of Directors
50 South 600 East, #150
Salt Lake City, UT 84102

Dear Board Members:

We have performed the procedures described below to certain aspects of the Utah League of Cities and Towns' (ULCT's) internal control and compliance for the period May 2012 to September 2016, unless otherwise stated. The purpose of these procedures is to assist ULCT in evaluating its internal control and investigate allegations of improper disbursements to certain employees, misuse of credit cards, and other potential misuse of public funds. We performed the following procedures:

1. We reviewed credit card transactions for proper approval and reasonableness.
2. We reviewed check disbursements to employees, related to payroll and benefits.
3. We reviewed compliance with financial reporting requirements.
4. We reviewed ULCT's compliance with the Open and Public Meetings Act.
5. We reviewed ULCT's bylaws and policies and evaluated for compliance.

Our procedures were more limited than would be necessary to express an audit opinion on compliance or on the effectiveness of ULCT's internal control or any part thereof. Accordingly, we do not express such opinions. Alternatively, we have identified the procedures we performed and the findings resulting from those procedures. Had we performed additional procedures or had we made an audit of the effectiveness of ULCT's internal control, other matters might have come to our attention that would have been reported to you.

Our findings resulting from the above procedures are included in the attached findings and recommendations section of this report.

By its nature, this report focuses on exceptions, weaknesses, and problems. This focus should not be understood to mean there are not also various strengths and accomplishments. We appreciate the courtesy and assistance extended to us by the personnel of ULCT during the course of the engagement, and we look forward to a continuing professional relationship. If you have questions, please contact Jeremy Walker, Local Government Manager, at 801-538-1040 or jeremywalker@utah.gov

Office of the State Auditor

Office of the State Auditor

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BACKGROUND

The Utah League of Cities and Towns (ULCT) is an “interlocal entity” formed under *Utah Code* 11-13, Interlocal Cooperation Act. *Utah Code* 11-13-102 states that the purpose of the Interlocal Cooperation Act is “...to permit local governmental units to make the most efficient use of their powers by enabling them to cooperate with other localities on a basis of mutual advantage and ... to provide the benefit of economy of scale.”

According to ULCT’s website, ULCT “represents municipal government interests ... at the state and federal levels and provides information, training and technical assistance to local officials on municipal issues...” and includes 246 incorporated municipalities in the State of Utah. According to the ULCT Constitution, Article IV, Directors and Officers, The League is governed “by a Board of Directors, consisting of four officers and 12 directors.”

FINDINGS AND RECOMMENDATIONS

When questionable or inappropriate behavior occurs, accountability is often focused on the potential perpetrator. However, when a governing body fails to provide appropriate oversight by clearly establishing authority, responsibility, and accountability through words, policies, and actions, the risk of inappropriate activity increases. As such, we have focused part of this report on the lack of adequate oversight by the ULCT Board of Directors (Board). Governing bodies should exercise oversight, allow suspicious activity to be reported without fear of reprisal, promptly and thoroughly evaluate reports of suspicious activity, aggressively seek out possible fraudulent conduct, and enforce accountability by demonstrating zero tolerance for improper activity.

1. FORMER CFO EMBEZZLED ULCT FUNDS BY CHARGING PERSONAL EXPENSES TO A ULCT CREDIT CARD

Prior to this audit, the former Director of Administrative Services (CFO) reimbursed ULCT \$4,996 for personal purchases made with a ULCT credit card for the period July 2015 through June 2016. Subsequently, the former CFO resigned in August of 2016.

We reviewed credit card charges for the former CFO from May 2012 through September 2016 and found \$26,652 of charges that appear to be for personal purposes. These charges are similar to the ones the former CFO previously determined were personal purchases. The Director provided us with information regarding likely personal charges relative to what was reasonable for the CFO position.

Examples of personal charges for the former CFO include:

- \$1,402 of iTunes purchases
- \$351 at Soma Intimates for women’s apparel
- \$482 of spa charges
- \$8,437 of dining charges

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- \$574 at the Utah State Liquor Store
- \$142 in charges to Devils Daughter Bar on New Year's Eve 2014
- \$3,459 worth of ULCT American Express (AMEX) points used for personal airline travel
- 219,800 of ULCT AMEX points (valued at approximately \$1,465) used to book personal travel on last day of employment

Additionally, the former CFO's ULCT credit card contained charges for \$57,261 that are questionable due to lack of receipts or documented business purposes. Examples of questionable charges for the former CFO include:

- \$29,981 in dining charges
- \$1,428 at various floral shops
- \$482 to SLC Corp for parking tickets

Utah Code 76-8-402, Misusing public money, states that,

Every public officer ... charged ... with the receipt, safekeeping, transfer, disbursement, or use of public money commits an offense if the officer or other charged person: (a) appropriates the money or any portion of it to his own use or benefit or to the use or benefit of another without authority of law;

Recommendations:

We recommend the former CFO repay all unreimbursed personal and improper charges made on ULCT credit cards.

We also recommend the Board refer the misuse of public funds to law enforcement for possible criminal investigation.

2. DIRECTOR FAILED TO TAKE ADEQUATE CORRECTIVE ACTION FOR FORMER CFO'S CONTINUOUS POOR PERFORMANCE

The former CFO had a four to five year history of very poor performance in the areas bulleted below. The Director knew about various significant performance failings of the former CFO but failed to take adequate corrective action within an appropriate timeframe, as follows:

- Repeated failure to timely submit reports to the Office of the State Auditor (OSA).
 - The former CFO was responsible for submitting the required financial reports to the OSA. The Director and former CFO were repeatedly notified by the OSA about ULCT's failure to comply with financial reporting requirements. While ULCT would occasionally come into compliance, it would consistently return to delinquent status.

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- Failure to ensure the completion of the FY 2015 audit in a timely manner.
 - The FY 2015 annual financial statement audit was several months late due to the former CFO's inability to produce basic reports and documents. These issues were documented in the external auditor's reports to management.
- Failure to maintain adequate supporting documentation for ULCT payments.
 - We reviewed credit card charges from May 2012 to September 2016 for the AMEX credit cards assigned to the Director and found that \$722,032 in charges, or 85%, did not have adequate documentation. A key duty of the former CFO is to ensure that adequate documentation exists prior to payment.
 - The former CFO initiated payments to herself and other employees from the Flexible Spending Arrangement (FSA) without adequate documentation, in some cases without any documentation. (see Finding No.10)
 - The Director was aware of weaknesses in ULCT's receipt submission and retention practices.
- Repeated late payment of bills by the former CFO, incurring additional costs.
 - \$7,159 in penalties were incurred for 79 late credit card payments.
 - \$4,921 in penalties were incurred for 3 late payroll tax payments.
 - \$19,172 in penalties were incurred for 8 late pension payments to Utah Retirement Systems (URS).
- Untimely submission and inadequate reviews of credit card statements for inappropriate purchases.
 - The Director was aware that the former CFO was chronically delinquent submitting credit card statements for review, often spanning months of delay. The Director would perform a cursory review of those statements, failing to identify improper purchases.

When an individual is unable to perform their duties or is unwilling to correct extremely poor performance, an organization should terminate that employment arrangement. The Director's delay effectively placed the interests of the former CFO above those of the ULCT and its members.

Recommendations:

We recommend the Director take corrective action whenever a staff member exhibits significant inappropriate behavior or inadequate job performance.

We recommend ULCT implement a process to ensure that required payments are remitted in a timely manner.

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3. VARIOUS PERSONAL EXPENSES WERE IMPROPERLY CHARGED TO THE DIRECTOR'S ULCT CREDIT CARD

From May 2012 to September 2016, the Director reimbursed ULCT in aggregate \$45,857 for personal travel related charges on a ULCT credit card.

We asked the Director how he tracked personal expenditures and whether those expenditures were reviewed by anyone else. The Director explained that at the end of his son's college basketball season he would go through his credit card statements and identify personal charges. He could then reimburse ULCT for those personal charges.

This method of reimbursement resulted in loans from ULCT to the Director for up to six months. The Board was unaware of this type of activity prior to July 2016. The Board was unaware of the magnitude and duration of this type of activity prior to October 2016.

We reviewed credit card charges for the Director from May 2012 through September 2016 and found approximately \$57,000 of charges for personal purposes. These charges are similar to those he previously determined to be for personal purposes.

The Director failed to fully reimburse ULCT for these personal loans likely due to poor recordkeeping or insufficient review.

Utah Code 76-8-402 Misusing public money states that,

Every public officer ... charged ... with the receipt, safekeeping, transfer, disbursement, or use of public money commits an offense if the officer or other charged person: (a) appropriates the money or any portion of it to his own use or benefit or to the use or benefit of another without authority of law; (b) loans or transfers the money or any portion of it without authority of law.

The Director should not have used a ULCT credit card to provide a personal loan. Only the Board has the authority to provide a loan to the Director. Personal charges should never be made on a ULCT credit card. In the rare occasion of an error, personal charges on a ULCT credit card should be paid back promptly and fully.

We also question approximately \$130,000 of additional charges made on the Director's ULCT credit card due to the absence of a receipt or clearly documented business purpose. The Director admits to sharing his credit card with ULCT personnel, and various ULCT personnel also admit to using the Director's credit card. The Director should not have shared his credit card with other individuals, even personnel of ULCT, particularly without sufficient controls to prevent and detect improper use.

Recommendations:

We recommend the Director repay all unreimbursed personal and improper charges made on ULCT credit cards.

We recommend the Board consider additional corrective action regarding this matter.

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We recommend ULCT personnel avoid sharing credit cards.

4. BOARD FAILED TO PROVIDE ADEQUATE OVERSIGHT

Prior to 2016, the Board, consisting of various Board members at various points in time, failed to perform basic governing body functions, which include directing and overseeing management. Historically, the Board operated as a ceremonial board, rubberstamping the Director's recommendations, rather than as a governing board responsible for operational oversight. The Board was overly deferential to the Director.

The Board members are all elected municipal mayors or council members who should understand the role of a governing body. The Board's failure to provide appropriate oversight appears to be caused by a lack of understanding by Board members of their role and a lack of understanding of ULCT's structure as an interlocal government agency.

The Board must directly monitor the financial activity and internal controls performed directly by the Director. Although the Board Treasurer was assigned to review and approve various expenditures, those reviews were inadequate. For example, personal expenses were not questioned and appropriate business documentation was missing.

Recommendations:

We recommend the Board function as a governing board by:

- **Taking ownership in the organization;**
- **Instituting effective financial oversight;**
- **Reviewing internal controls regularly for adequacy and effectiveness; and Designating a Board member who will adequately review all of the Director's expenditures to ensure they are reasonable, appropriate, properly documented, and in compliance with policy.**

5. BOARD FAILED TO OPERATE ULCT AS A GOVERNMENT ENTITY

Under State Law, local government entities are required to conduct the people's business in an open and transparent manner. As an interlocal entity, ULCT is a government entity. The Board failed to comply in the following areas:

- Failed to publish notices as required by the Open and Public Meetings Act (OPMA).
 - This is particularly concerning given the financial statement auditors wrote a finding for noncompliance with OPMA.
- Failed to adequately perform financial reporting, as follows:
 - Did not report to the Utah Public Finance Website.
 - Did not file Money Management Council Deposit and Investment reports.
 - Did not submit financial reports to the OSA in a timely manner (see Finding No. 2).

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- Failed to hold a public hearing prior to adopting its budgets as required in the Fiscal Procedures for Interlocal Entities.

Recommendation:

We recommend the Board comply with all applicable laws and reporting requirements.

6. BOARD FAILED TO ENSURE COMPLIANCE WITH ITS POLICIES

We obtained ULCT policies and procedures, which were last amended June 30, 2008. These policies appear to have been formally adopted by the Board; however, based upon our review of financial records and interviews with personnel, these policies do not appear to have been followed. In fact, many personnel were unaware that these policies even existed.

Utah Code 11-13-402(3) dictates that “A governing board shall manage and direct the business and affairs of the interlocal entity; and... adopt and enforce rules and regulations for the orderly operation of the interlocal entity or for carrying out the interlocal entity’s purposes.”

Recommendations:

We recommend the Board:

- **Review ULCT policies on an annual basis.**
- **Revise policies as needed.**
- **Ensure that policies are understood and enforced.**

7. ULCT FAILED TO CLOSE CREDIT CARD ACCOUNTS UPON EMPLOYEE TERMINATION

We identified five open credit card accounts for individuals who were no longer employed by ULCT. Some of these individuals had not been employed by ULCT for up to six years. A credit card account should be closed immediately upon an employee’s termination to minimize the risk that the card could be used to make improper purchases, whether by the former employee or by another employee within ULCT.

Recommendation:

We recommend ULCT close credit card accounts as employees terminate employment.

8. INCREASED RISK BY USING CREDIT CARDS VERSUS PURCHASE CARDS

The use of credit cards can be an efficient method of making purchases, especially small dollar purchases or “micro-purchases.” However, credit cards by their nature have a high risk of improper use because few controls exist over the creation of credit card accounts. Purchase

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cards, or p-cards, can effectively mitigate some of these risks, as the organization has more control in establishing p-card accounts. For example, organizations can mandate transaction limits unique to each p-card and, depending upon the p-card service provider, can limit purchases to certain merchant categories. Because p-cards are linked to an organization's bank, only authorized employees may create p-card accounts.

In addition, p-card transaction details are electronically transmitted to the purchasing entity, allowing an organization to review the purchases more timely. Transmitted information typically includes the amount, the vendor's name and address, and the date of the transaction. In some instances, p-card service providers may be able to transmit descriptions and quantities of items purchased; however, such line-item detail is only available from a few merchants. Since p-card accounts are more difficult to create and allow establishment of unique restrictions, ULCT could minimize potential inappropriate purchases by using p-cards rather than credit cards. Sound controls, such as those recommended above, are still critical for ensuring proper use of any "micro-purchase" cards, be they credit cards or p-cards.

Recommendations:

We recommend ULCT consider replacing its credit cards with p-cards.

We recommend ULCT limit distribution of p-cards to those employees who have a compelling business interest.

9. ULCT MAY HAVE FAILED TO REPORT CERTAIN MEALS AS TAXABLE INCOME

We reviewed credit card purchases for all employees from May 2012 through September 2016. We found numerous meal charges which could be subject to taxation given the frequency, amount, and lack of documentation supporting the business purpose. For example, of the 405 dining charges on the former CFO's AMEX card, only 20, or 5% were supported with adequate documentation to determine if the meals were taxable.

IRS guidance found in 26CFR §1.274-5 describes what documentation is necessary to justify the business purpose of expenditures. It explains that evidence such as a receipt establishing the essential character of the expenditure plus an explanation of the business purpose generally is sufficient to support the business purpose.

IRS publication 15-B states that, "You can exclude any occasional meal you provide to an employee if it has so little value (taking into account how frequently you provide the meals to your employees) that accounting for it would be unreasonable or administratively impracticable."

ULCT does not have any mechanism to ensure its compliance with requirements for reporting taxable meals. As a result of this weakness, taxable meals may have gone unreported. Failure to report taxable income, may result in penalties and interest from the IRS.

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Recommendation:

We recommend the Board, when required by the IRS, ensure that meals provided to employees are reported as taxable income.

10. FORMER CFO MAY HAVE MISMANAGED THE FLEXIBLE SPENDING ACCOUNT (FSA) PROGRAM

We reviewed checks issued from the FSA program to employees from June 2011 through July 2016. We found that near the end of fiscal years 2011 through 2016, the former CFO issued checks totaling \$2,525 to herself for the remaining balance in her FSA account without proper documentation.

According to IRS Publication 969, an FSA allows employees to be reimbursed for medical expenses through a voluntary salary reduction agreement to reduce the employee's taxable income by the amount of the predetermined reduction. However, contributed amounts that are not spent by the end of the plan year are forfeited. Also, an FSA participant must provide the FSA with a written statement from an independent third party stating that a medical expense has occurred and the amount of the expense.

It appears that the former CFO took advantage of her position to receive reimbursements from the FSA without fulfilling the legal requirements, thus, potentially reducing her taxable income illegally. Failure to report taxable income may result in penalties and interest from the IRS.

Recommendations:

We recommend ULCT develop and implement a process to ensure that fringe benefit programs are administered in accordance with laws and policies.

We recommend the Board consult with legal counsel regarding appropriate disposition of this matter.

11. PERSONNEL FAILED TO ADEQUATELY DISCLOSE POTENTIAL CONFLICTS OF INTEREST

Several ULCT employees received compensation from organizations other than ULCT. We obtained documents dated May 2014 where two members of the full-time staff and two contract employees made written disclosures of entities for which they were registered lobbyists. Additionally, various current and former ULCT personnel report making verbal disclosures regarding conflicts of interest to the Director. The Director acknowledges having received various verbal disclosures. However, we found no records of any disclosures of conflicts of interest by the Director and the former CFO.

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The Director received payments of \$79,483, over a ten year period, from an organization which he claims is “private.” The Director stated that a portion was for compensation while some was for reimbursement. As such, his understanding should have caused him to make a written disclosure pursuant to *Utah Code 67-16-6(1)*.

Except as provided in Subsection (5), it is an offense for a public officer or public employee to receive or agree to receive compensation for assisting any person or business entity in any transaction involving an agency [or political subdivision] unless the public officer or public employee files a sworn, written statement containing the information required by Subsection (2) with:

- (a) the head of the officer or employee's own agency;*
- (b) the agency head of the agency with which the transaction is being conducted; and*
- (c) the state attorney general.*

Utah Code 10-3-1305 also contains a similar provision requiring municipal officers to disclose conflicts of interest.

State law requires any employee or officer of ULCT to provide written disclosure if they receive compensation from any organization doing business with ULCT. The 2014 disclosures by the four employees noted above appear to be appropriate for that year; however, *all* employees and officers of ULCT must make disclosures required by law or policy.

Recommendation:

We recommend ULCT implement a process to ensure that potential or actual conflicts of interest by employees and board members are disclosed in writing on an annual basis.

12. MANAGEMENT USED ULCT CREDIT CARD REWARDS FOR PERSONAL USE; ULCT PAID UNNECESSARY CREDIT CARD FEES

ULCT has AMEX credit cards assigned to the Director and former CFO. ULCT paid fees to AMEX for the Director to generate rewards in a frequent flyer program. ULCT also paid fees to participate in AMEX’s rewards points program on the former CFO’s card.

While ULCT paid the fees for these rewards programs, the Director and former CFO used the rewards for personal use. It does not appear that the Director or former CFO received authorization to use the reward for personal use, nor were the value of the purchases tracked or reported as compensation.

We question why ULCT would pay any credit card fees. In addition, rewards generated on ULCT cards are ULCT property and should be treated as such.

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Recommendations:

We recommend ULCT seek reimbursement for improperly used credit card rewards.

We recommend the Board adopt policies that clarify acceptable use of ULCT credit cards.

We recommend ULCT avoid paying credit card fees whenever possible.

Appendix A

**RESPONSE FROM
UTAH LEAGUE OF CITIES AND TOWNS**



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OFFICERS

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MAYOR, KAYSVILLE

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SINCE 1907

MEMBER
NATIONAL LEAGUE OF CITIES

January 18, 2017

Office of the Utah State Auditor
East Office Building, Suite E310
Utah State Capitol Complex
Salt Lake City, Utah 84114

Dear Auditor Dougall,

On behalf of the Board of Directors of the Utah League of Cities and Towns, we express our sincerest appreciation to the Utah State Auditor's Office for the quick and thorough way your office responded to our request for an in-depth investigation of alleged misuse of public funds within the ULCT.

The ULCT Board is unanimous in its desire to maintain the integrity of the League. The ULCT Board has already acted on many of the items identified in this report, including a comprehensive restructuring of ULCT policies. The ULCT Board is steadfast in its commitment to put measures in place to ensure to our membership and the public that these types of unfortunate events never take place again.

As you are aware, the former CFO resigned from the Utah League of Cities and Towns effective August 31, 2016. The Executive Director and Board Treasurer have also resigned from the ULCT effective January 18, 2017.

Below, please find our response to each of the State Auditor's Findings and Recommendations to the Utah League of Cities and Towns.

1. The Board concurs the former CFO's use of public funds is egregious. The board will pursue all avenues available to recover funds that were expended by the former CFO for improper charges. The board will also refer the misuse of public funds to law enforcement.
2. There is no excuse for the lax manners in which these items were handled by the former CFO and Executive Director. The Board concurs that personal accountability is critical for the success of any entity, especially one charged with the responsibility of managing public funds.

Because of a previous internal review, the board had already taken steps to address these types of management shortfalls including the adoption of policies and procedures will ensure a well-defined structure of checks and balances and personal accountability.

The former CFO and Executive Director have since resigned from the ULCT. We believe the current CFO and Interim Director possess the business and management acumen to avoid reoccurrence of any of these events.

3. The Board concurs that governmental credit cards should never be used for personal purposes. The ULCT has already moved to a "reimbursement only" program and has eliminated all but one League credit card.

The Board does not believe that the Executive Director had any criminal intent to defraud the Utah League of Cities and Towns.



That said, the Board concurs that the Executive Director exercised poor oversight of financial operations and likely delegated essential fiscal responsibilities that should have remained in his purview. The Executive Director resigned on January 18, 2017. The Board will pursue repayment of any remaining unreimbursed personal and improper charges made on ULCT credit cards.

4. The current ULCT Board fully recognizes its role and the need to operate as a governing body. The Board recommits to its responsibility to function as a governing body and not act in a purely ceremonial role. The Board Treasurer resigned from the ULCT Board effective January 18, 2017.

5. The ULCT conducted its business in the open, including providing public notice of meetings to its members and to the public. The failure to publish notices as required by the Open and Public Meetings Act is an unfortunate oversight. We believe we have remedied the problem by naming the records manager as the responsible employee for posting such notices.

6. The Board adopted a comprehensive update of its policies and procedures on December 9, 2016. We believe these amendments, along with a restructuring of management and reiteration of board responsibilities, will appropriately address these concerns and commit to revisiting these policies on an annual basis.

7. Amended policies are now in place that will ensure that credit cards are closed any time an employee leaves the ULCT.

8. The ULCT has already eliminated the use of employee credit cards except for one credit card to be used by one individual. All other employees now operate on a business expense reimbursement basis. The Board will also investigate implementing use of a P-card for the employee who has access to a card.

9. The Board concurs with this assessment and will ensure that meals provided to employees are for business purposes. Should an unintentional exception take place, the CFO will ensure those meals are reported as taxable income.

10. The ULCT commits to developing and implementing a process to ensure that fringe benefit programs are administered in accordance with laws and policies and will consult with legal counsel on the appropriate way to address this manner. In addition, the ULCT is no longer operating an FSA program.

11. The Board adopted amended policies on December 9, 2016 which we believe adequately addresses this issue. The Board will ensure that potential or actual conflicts of interest of staff or board members are annually disclosed in writing.

12. The ULCT has cancelled all credit cards with any rewards or mileage component. Regardless, the Board will amend the current policies to address credit card rewards.

Please contact me for any additional information. You can reach me at mayor.hiatt@kaysvillecity.com.

Sincerely,



Steve Hiatt
President, on behalf of the Utah League of Cities and Towns Board of Directors
Mayor, Kaysville City