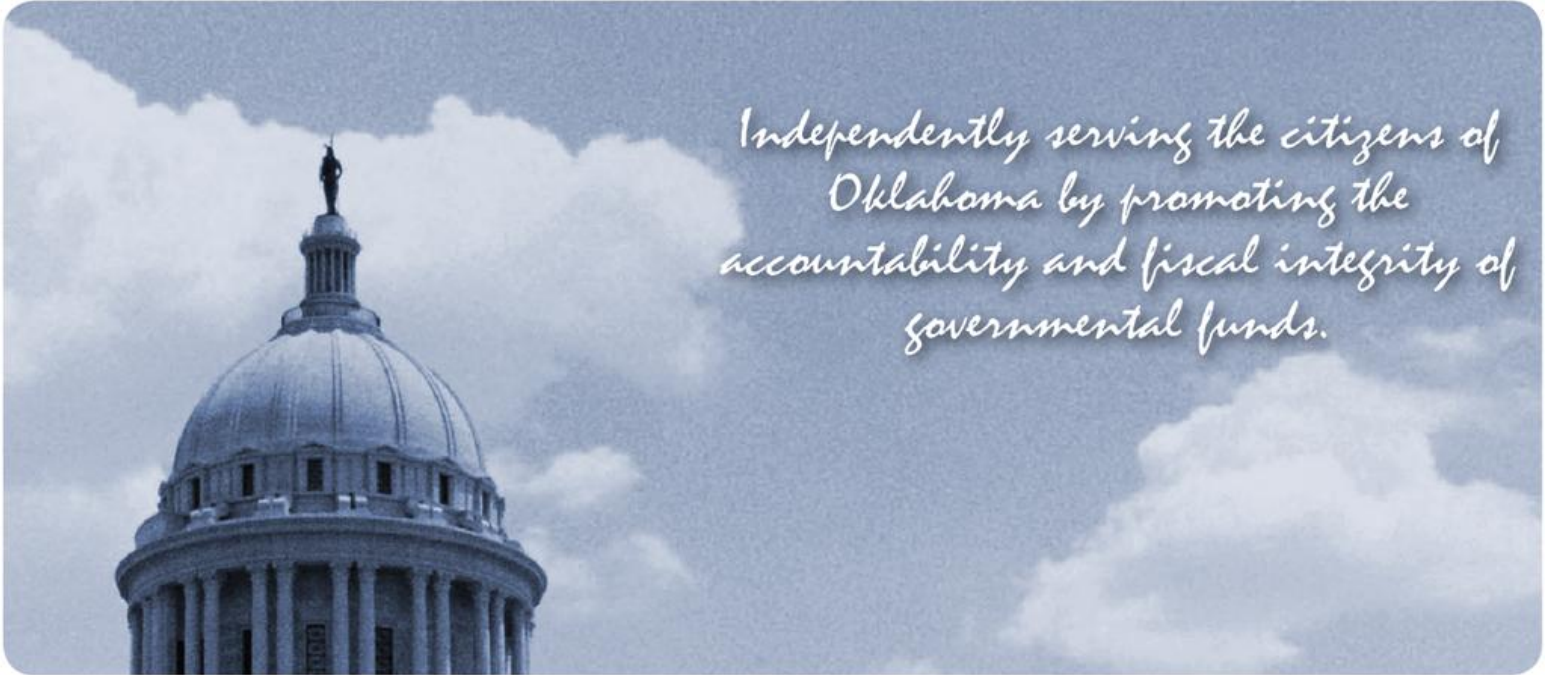


INVESTIGATIVE AUDIT

# TOWN OF CHELSEA

January 19, 2017



Oklahoma State  
Auditor & Inspector  
Gary A. Jones, CPA, CFE

**TOWN OF CHELSEA**  
**ROGERS COUNTY, OKLAHOMA**  
**INVESTIGATIVE AUDIT REPORT**  
**JANUARY 19, 2017**

---

This publication, issued by the Oklahoma State Auditor and Inspector's Office as authorized by **74 O.S. § 212(H)**, has not been printed but is available on our agency's website ([www.sai.ok.gov](http://www.sai.ok.gov)) and in the Oklahoma Department of Libraries Publications Clearinghouse Digital Prairie Collection, (<http://digitalprairie.ok.gov/cdm/search/collection/audits/>) pursuant to **65 O.S. § 3-114**.



## Report Highlights

### WHY WE CONDUCTED THIS AUDIT

The Honorable Matthew J. Ballard, District Attorney for the 12<sup>th</sup> District of Oklahoma, requested the assistance of the Oklahoma State Auditor and Inspector in conducting an audit of the Town of Chelsea. Per District Attorney Ballard's request, allegations existed that public funds had been improperly managed by the Town of Chelsea, the Chelsea Economic Development Authority, and/or the Chelsea Improvement Trust.

### WHAT WE FOUND

- The net proceeds of the sale of the electric distribution system have not been held intact as required by both the voter proposition and the trust indenture of the Chelsea Improvement Trust. (Pg. 2)
- Expenditures and/or withdrawals have been made against the principal of the net proceeds, without voter approval, when the account value of the proceeds fell below \$2.2M. (Pg. 3)
- The Town did not maintain copies of the investment documents, statements and policies. (Pg. 4)
- The Town's Independent Audit Reports for the Town of Chelsea have previously reported the investment of the Chelsea Improvement Trust in violation of Oklahoma Statutes, local ordinances and voter propositions for at least the prior four years with no corrective action taken by management. (Pg. 5)
- For the audit period July 1, 2014 through October 31, 2015, the Town purchased insurance totaling \$11,321.87 through an insurance agency owned by George Fraley, the town treasurer, in violation of 11 O.S. § 8-113. (Pg. 5)
- Written documentation for insurance quotes, as required by Town policy, could not be provided. (Pg. 7)
- Three *Authority* projects totaling \$38,600 were not bid in accordance with statute. (Pg. 8)
- There was no documentation indicating a \$4,000 contract between the *Town* and Haggard Excavation was bid as required by town policy. (Pg.10 )



# Oklahoma State Auditor & Inspector

2300 N. Lincoln Blvd. • State Capitol, Room 100 • Oklahoma City, OK 73105 • Phone: 405.521.3495 • Fax: 405.521.3426

January 19, 2017

The Honorable Matthew J. Ballard  
District Attorney, District 12  
200 S. Lynn Riggs Blvd.  
Claremore, Oklahoma 74017

District Attorney Ballard:

Pursuant to your request and in accordance with the requirements of **74 O.S. § 212(H)**, we performed an investigative audit of the Town of Chelsea and the related Chelsea Economic Development Authority and the Chelsea Improvement Trust. Transmitted herewith is our investigative report for the period July 1, 2014 through October 31, 2015.

The objectives of our investigation primarily included, but were not limited to, the areas noted in your request. The results of the investigation, related to these objectives, are presented in the accompanying report.

Because the procedures of an investigative audit do not constitute an audit conducted in accordance with generally accepted auditing standards, we do not express an opinion on the account balances or financial statements of the Town of Chelsea for the period July 1, 2014 through October 31, 2015.

The goal of the State Auditor and Inspector is to promote accountability and fiscal integrity in state and local government. Maintaining our independence as we provide this service to the taxpayers of Oklahoma is of utmost importance. We also wish to take this opportunity to express our appreciation for the assistance and cooperation extended to our office during the course of our engagement.

This report is addressed to, and is for the information and use of, the District Attorney as provided by statute. This report is also a public document pursuant to the Oklahoma Open Records Act, in accordance with **51 O.S. §§ 24A.1, et seq.**

Sincerely,

GARY A. JONES, CPA, CFE  
OKLAHOMA STATE AUDITOR & INSPECTOR

**TABLE OF CONTENTS**

	<b>Page</b>
Town Officials.....	ii
Introduction .....	1

**OBJECTIVES**

1. Review the Town’s management of invested funds from the sale of the Town’s electric distribution system .....	2
2. Review the Town’s acquisition of insurance from the town treasurer.....	5
3. Determine if a conflict of interest exists between the Town and a financial institution partially owned by the town treasurer .....	7
4. Review contracts between the Town, and a company owned by a friend of the town administrator, for compliance with proper bidding procedures. ....	8

**TOWN OFFICIALS**  
(As of October 31, 2015)

Mike Provence..... Mayor  
Frank Johnson..... Vice-Mayor  
Sheila McNutt..... Trustee  
Charlie Welch..... Trustee  
Bill Woodruff ..... Trustee  
George Fraley ..... Town Treasurer  
Wanda Pelletier ..... Town Clerk  
Kenny Weast ..... Town Administrator

**TOWN OFFICIALS**  
(As of January 1, 2017)

Mike Provence..... Mayor  
Frank Johnson..... Vice-Mayor  
Charlie Welch..... Trustee  
Bobby Wilson..... Trustee  
Bill Woodruff ..... Trustee  
George Fraley ..... Town Treasurer  
Wanda Pelletier ..... Town Clerk  
Kenny Weast ..... Town Administrator

## INTRODUCTION

---

The Town of Chelsea (Town) is organized under the statutory town board of trustees form of government, as outlined in **11 O.S. §§ 12-101, et seq.**

**11 O.S. § 12-101 states:**

The form of government provided by Sections 12-101 through 12-114 of this title shall be known as the statutory town board of trustees' form of government. Towns governed under the statutory town board of trustees form shall have all the powers, functions, rights, privileges, franchises and immunities granted, or which may be granted, to towns. Such powers shall be exercised as provided by law applicable to towns under the town board of trustees form, or if the manner is not thus prescribed, then in such manner as the board of trustees may prescribe.

The Chelsea Economic Development Authority (the Authority) is a public trust established under **60 O.S. §§ 176 et seq.** The Authority operates a utility service providing water, sewer, and garbage to the residents of the Town and was established for the use and benefit of the Town. The Town Board of Trustees serves ex-officio as the Board of Trustees for the Authority.

The Chelsea Improvement Trust (the Trust) is also a public trust established under **60 O.S. §§ 176 et seq.** The Trust was established in part to "provide funds for the furtherance and accomplishment of any authorized and proper public function or purpose of the Town of Chelsea". The proceeds of the sale of the Town's electric distribution system were transferred to the Trust to be invested and for the income from the proceeds to be utilized for the operating expenses of the Town. The Town Board of Trustees serves ex-officio as the Board of Trustees for the Trust.

In accordance with a request by the District Attorney, the Office of the State Auditor and Inspector has conducted an investigative audit primarily related to the objectives listed in the accompanying *Table of Contents*.

The results of our inquiry are included in the following report and were prepared for the District Attorney, along with officials with oversight responsibilities.

<b>OBJECTIVE</b>	<b>Review the Town's management of invested funds from the sale of the Town's electric distribution system.</b>
------------------	---

**Background**

On April 25, 1989, an election was held in which voters approved three propositions relating to the sale of the Town's electrical system. *Proposition 1* called for selling the Town's electrical distribution system to the Public Service Company of Oklahoma. *Proposition 2* called for granting to the Public Service Company of Oklahoma a 25-year franchise, and *Proposition 3* related to the management of the proceeds of the sale.

The basis of our investigation pertained to *Proposition 3* which states:

PROPOSITION NO. 3

SHALL THE NET PROCEEDS OF THE SALE OF THE ENTIRE ELECTRIC DISTRIBUTION SYSTEM OF THE TOWN OF CHELSEA BE HELD IN TACT AND NOT EXPENDED UNLESS SUCH EXPENDITURE BE APPROVED AT AN ELECTION CALLED AND HELD IN THE TOWN FOR THAT PURPOSE; AND THAT THE INCOME FROM THE INVESTMENT OF SUCH PROCEEDS SHALL BE UTILIZED SOLELY FOR THE OPERATING EXPENSES OF THE TOWN OF CHELSEA?

Documentation obtained indicated that the Town received \$2.2M in net proceeds from the sale of the electric distribution system. On September 13, 2004, the Chelsea Improvement Trust (Trust) was created in part to manage the investment of the proceeds from the sale.

Our objectives, based on the concern presented to us, were:

1. Determine if the Town had, as required by Proposition 3, held the net proceeds intact; and
2. Determine if the Town expended funds from the proceeds when the balance fell below the initial \$2.2M, without the required voter approval.

**Finding**

**The net proceeds of the sale of the electric distribution system have not been held intact as required by both the voter proposition and the trust indenture of the Chelsea Improvement Trust.**

The language in Proposition 3 called for the net proceeds of the public sale to be held intact and not be expended unless the expenditure was approved at an election called and held by the Town for that purpose.



Additionally, *Section 6.II.(b)* of the Chelsea Improvement Trust Indenture mandates that the principal amount of the net proceeds be kept intact and not expended without the approval of the citizens of the Town of Chelsea. The Indenture states in part:

6.II. Proceeds. Notwithstanding any provision in this Indenture to the contrary, as regards that part of the Trust principal consisting of the proceeds of the 1988 sale to Public Services Company of Oklahoma of the Beneficiary's electric distribution system (hereinafter the "Proceeds"), the power of the Trustees shall be limited as follows:

(b) the principal amount of the Proceeds shall be kept intact and not be expended without the approval of the citizens of the Town of Chelsea at an election called and held for such purpose; and

In January 2008, the account value of the net proceeds at the beginning of the month was \$2.35M, during that month withdrawals totaled \$7,000. Along with changes in the market, at the end of the year, the account value had dropped to \$2.15M and remained below \$2.2M for all periods continuing through June 30, 2008<sup>1</sup>.

We resumed our review of account records for our audit period of July 1, 2014 through October 31, 2015. During this time period, the account value remained below \$2.2M, fluctuating from a high of \$1.77M to a low of \$1.53M.

For the net proceeds to be held "intact" they would need to be maintained at \$2.2M. At September 30, 2016, the net proceeds of the sale of the electric distribution system were invested in non-qualified annuities with an account value of \$1,557,463.99.

**Finding**

**Expenditures and/or withdrawals have been made against the principal of the net proceeds, without voter approval, when the account value of the proceeds fell below \$2.2M.**

Proposition 3 and the Chelsea Improvement Trust Indenture both prohibit the Town from expending the net proceeds of the Trust account unless such expenditures are approved by the citizens of the Town of Chelsea at an election called for that purpose.

Beginning in 2008 and in most months since that time, the account value of the net proceeds investment has been below \$2.2M; however, the Town continues to withdraw \$84,000 per year from the investment.

---

<sup>1</sup> We reviewed historical records to determine when the first instance of the account dropping below \$2.2M had occurred.

According to Town officials, they consider the Town in compliance with *Proposition 3* since the proceeds are invested in an investment that includes a “death-benefit guarantee”.

The trust indenture requires the funds be invested in an investment that will “guaranty the principal amount” or in an investment with a “principal guaranty feature”.

(a) the principal amount of such Proceeds shall be invested in investments authorized by applicable statutes for the Beneficiary that guaranty the principal amount and/or in one or more variable annuities with a principal guaranty feature;

At this time the net proceeds are invested in a non-qualified annuity that is only guaranteed through a “death-benefit guarantee”. The death-benefit is based on the life of the town administrator and the town treasurer. The principal of the net proceeds are not guaranteed until death.

An analysis of the complex details and legality of the Town’s investment of the net proceeds in a non-qualified annuity is beyond the scope of this investigation. However, in summary, based on our review of the invested net proceeds it does appear that:

- The net proceeds of \$2.2M are below the defined principal amount of \$2.2M in violation of the voter proposition and the trust indenture.
- Even though the net proceeds are below the established \$2.2M, the Town continues to make withdrawals of \$84,000 annually without a vote of the people in violation of the voter proposition and the trust indenture.
- The net proceeds are only guaranteed through a “death-benefit guarantee”, the principal is not guaranteed until death or until annuitization.

**Finding**

**The Town did not maintain copies of the investment documents, statements and policies.**

**Title 51 O.S. § 24A.4 states:**

In addition to other records which are kept or maintained, every public body and public official has a specific duty to keep and maintain complete records of the receipt and expenditure of any public funds reflecting all financial and business transactions

relating thereto, except that such records may be disposed of as provided by law.

We recommend the Town maintain records supporting the investment of the net proceeds including all related contracts, policies, withdrawals and transactions.

**Finding**

**The Town’s Independent Audit Reports for the Town of Chelsea have previously reported the investment of the Chelsea Improvement Trust in violation of Oklahoma Statutes, local ordinances and voter propositions for at least the prior four years with no corrective action taken by management.**

The Independent audit reports of the Town of Chelsea were reviewed for the fiscal years ending 2011 through 2014. The FY2014 version of the reported investment finding stated:

*Condition:* The Town currently reports an investment of \$1,750,516.63 in the Chelsea Improvement Trust. This investment appears to be in violation of Oklahoma Statutes, local ordinances and voter propositions. The investment, according to local ordinance, was to remain intact at approximately \$2.2 million.

The lack of compliance with required investment procedures have been brought to management’s attention for at least four years with no corrective action taken.

**OBJECTIVE      Review the Town’s acquisition of insurance from the town treasurer.**

**Background**

It was alleged that the Town purchased insurance from the independently owned insurance agency of the town treasurer George Fraley without utilizing competitive bids.

Additionally, it was reported the Town received a bid for insurance from the Oklahoma Municipal Assurance Group (OMAG), an interlocal cooperation agency that provides insurance for cities and towns, their bid was allegedly the lowest, but the Town continued to maintain insurance coverage through Fraley’s agency.

**Finding**

**For the audit period July 1, 2014 through October 31, 2015, the Town purchased insurance totaling \$11,321.87 through an insurance agency owned by George Fraley, the town treasurer, in violation of 11 O.S. § 8-113.**

We confirmed George Fraley, the town treasurer, owns Fraley Insurance Agency, Inc. During the period July 1, 2014 through October 31, 2015, the Town contracted with the Fraley Insurance Agency to insure the police station, the fire station, the dog shelter and a warehouse. The remaining insurance coverage for workers' compensation, general liability, automobile and equipment were provided by OMAG.

For the period, July 2014 through October 2015, premium payments to Liberty Mutual Insurance<sup>2</sup> from the Town and the Authority totaled \$11,321.87 and \$19,301.52, respectively. Payments from the Town to OMAG totaled \$77,958.40.

We found nothing that would preclude a town official from contracting with the *Authority*. However, statutes do prohibit municipal officers from selling or contracting with the *municipality*.

Title 11 O.S. § 8-113(A)(B)(F) provides in part:

- A. Except as otherwise provided by this section, **no municipal officer** or employee, or any business in which the officer, employee, or spouse of the officer or employee has a proprietary interest, shall engage in:
  - 2. **Contracting with the municipality**; [Emphasis added]
- B. The provisions of this section shall not apply to any officer or employee of any municipality of this state with a population of not more than five thousand (5,000) according to the latest Federal Decennial Census, who has a proprietary interest in a business *which is the only business of that type* within five (5) miles of the corporate limits of the municipality... [Emphasis added]
- F. For the purposes of this section, "proprietary interest" means ownership of more than twenty-five (25%) of the business or of the stock therein or any percentage which constitutes a controlling interest but shall not include any interest held by a blind trust.

**Title 11 O.S. § 8-113** appears to exempt municipalities from compliance with this law if the population of the town is 5,000 or less, and if the business is the *only business of that type* within five miles of the corporate town limits. This exemption would not appear to apply to Fraley since there is more than one insurance agency in the Town of Chelsea.

---

<sup>2</sup> The Fraley Insurance Agency, Inc. is an independent Liberty Mutual Insurance Agent.

**Finding**                      **Written documentation for insurance quotes, as required by Town policy, could not be provided.**

Town policy does not specifically define bidding requirements for insurance, but does provide procedures for purchases as noted here:

**PURCHASES IN EXCESS OF \$500.00 BUT NOT MORE THAN \$10,000.00**

Purchases in excess of \$500.00 but not more than \$10,000.00 require the written approval of the purchasing officer and Town Administrator or in the absence of the Town Administrator the Town Clerk or Trustee authorizing written bids from sources for the requirement.

Written bids can be requested from a sufficient number of businesses so as to give reasonable opportunities for businesses to compete for the contract, as well as to all known prospective bidders who have made known, in writing, to the town their interest in bidding within the twelve months immediately preceding the date of requesting bids. Documentation of these efforts shall be maintained.

Per policy, written bids should be maintained for purchases between \$500 and \$10,000. Purchases as defined in town policy include contracts for services.

According to the town clerk, insurance quotes were obtained approximately every two years in order to obtain the best price and benefit for the Town. However, documentation of these quotes did not appear to be written and could not be found in Town records.

**Finding**                      **The allegation that a sealed bid from OMAG was the lowest bid for insurance, but was not accepted, could not be substantiated.**

Per the clerk, sealed bids have never been received for insurance. Since sealed bids were not obtained in the acquisition of insurance, the allegation of not accepting the lowest bidder through a sealed bid process could not be substantiated.

**OBJECTIVE**                      **Determine if a conflict of interest exists between the Town and a financial institution partially owned by the town treasurer.**

**Background**                      It was alleged the Town conducting business with the Bank of Commerce in Chelsea, which is partially owned by the town treasurer George Fraley, was a conflict of interest.

**Finding**                      **A statutory conflict of interest does not exist between the Town and the Bank of Commerce.**

There are two banks in Chelsea. Based on an interview with the town treasurer and a review of bank statements, the Bank of Commerce is the

depository bank for the Town and Lakeside State Bank is the depository for the Authority.

As previously noted, statutes preclude municipal officers from selling or contracting with the municipality. Prohibited conduct as described in **11 O.S. § 8-113** provides in relevant part:

...no municipal officer or employee, or any business in which the officer, employee, or spouse of the officer or employee has a *proprietary interest*, shall engage in:

...Contracting with the municipality;

Proprietary interest is specifically defined in **11 O.S. § 8-113(H)**:

...For the purposes of this section, “*proprietary interest*” means ownership of more than twenty-five (25%) of the business or of the stock therein or any percentage which constitutes a controlling interest but shall not include any interest held by a blind trust.

It was confirmed that town treasurer George Fraley owns a 5% interest in the Bank of Commerce. Because the percentage owned by Fraley is less than the percentage defined by statute as a proprietary interest (25%), it appears no statutory conflict of interest exist between the Town and the Bank of Commerce.

**OBJECTIVE**

**Review contracts between the Town, and a company owned by a friend of the town administrator, for compliance with proper bidding procedures.**

**Background**

It was alleged that Haggard Excavation had been awarded most of the Town’s construction and excavation work without bids, because the owner of the company was a personal friend of the town administrator.

Between July 1, 2014 and October 31, 2015, the Town and the Authority paid Haggard Excavation a combined total of \$63,410, \$4,000 was paid by the Town and \$59,410 was paid by the Authority.

**Finding**

**Three Authority projects totaling \$38,600 were not bid in accordance with statute.**

The Public Competitive Bidding Act (the Act) as set forth in **61 O.S. §§ 101-138 et seq.** defines bidding requirements for public construction and public improvement contracts.

Under **Section 102** of the Act, “Public Agency” is defined as:

5. “Public agency” means the State of Oklahoma, and any county, city, town, school district or other political subdivision of the state, *any public trust*, any public entity specifically created by the statutes of the State of Oklahoma or as a result of statutory authorization therefor, and any department, agency, board, bureau, commission, committee or authority of any of the foregoing public entities; [Emphasis Added]

The Authority is a **public trust** established under **60 O.S. §§ 176 et seq.** and as such would be required to bid projects in compliance with the Public Competitive Bidding Act.

Under **Section 103(B)** of the Act, bid requirements for public improvements for \$50,000 or less are defined as follows:

B. Except as provided in subsection D of this section, other construction contracts for the purpose of making any public improvements or constructing any public building or making repairs to the same for **Fifty Thousand Dollars (\$50,000.00) or less shall be let and awarded to the lowest bidder by receipt of written bids or awarded on the basis of competitive quotes to the lowest responsible contractor.** Work may be commenced in accordance with the purchasing policies of the public agency. [Emphasis Added]

C. Except as provided in subsection D of this section, other construction **contracts for less than Five thousand Dollars (\$5,000.00)** may be negotiated with a qualified contractor. Work may be commenced in accordance with the purchasing policies of the public agency. [Emphasis Added]

As noted in the table below, six projects totaling \$59,410 were made with Haggard Excavation Two projects were under the \$5,000 threshold and as per statute would have only required “negotiation with a qualified contractor”.

One project, paid through Check 5097 on November 11, 2014, in the amount of \$15,100, was awarded the low bid by the Authority Board in an open meeting on October 17, 2014.

The remaining three transactions<sup>3</sup> totaling \$38,600 were not “awarded to the lowest bidder by receipt of written bids or awarded on the basis of

---

<sup>3</sup> Check 3145 for \$10,600; Check 5532 for \$18,000; and Check 5587 for \$10,000

competitive quotes to the lowest responsible contractor” as required by statute.

Date	Check	Amount	Description
7/11/2014	3145	\$10,600*	Waterline extension-Industrial Park
8/12/2014	4891	\$1,510	Brush hog lake and spray lake
11/11/2014	5097	\$15,100	Waterline extension-Secondine
3/11/2015	5334	\$4,200	Trakhoe rental/Kelton & repairs
6/10/2015	5532	\$18,000*	Phase 1 - sewer line extension
7/15/2015	5587	\$10,000*	Phase 2 - sewer line extension
	Total	\$59,410	*Not bid - \$38,600

**Finding**

**There was no documentation indicating a \$4,000 contract between the Town and Haggard Excavation was bid as required by town policy.**

Although, there was no statutory requirement for the Town to bid a \$4,000 contract for cemetery clean-up, the Town’s purchasing policy requires written bids for purchases in excess of \$500 but not more than \$10,000.

Town policy states:

Written bids can be requested from a sufficient number of businesses so as to give reasonable opportunities for businesses to compete for the contract, as well as to all known prospective bidders who have made known, in writing, to the town their interest in bidding within the twelve months immediately preceding the date of requesting bids. Documentation of these efforts shall be maintained.

The purchasing officer may also request written bids from sources by telephone and/or internet as long as an identical, adequate specific description of the requirement is given to each source and a date and time by which the Town of Chelsea must receive the bid.

The written bids shall be attached to the purchase requisition and the pertinent information summarized on the purchase requisition.

On August 11, 2014, the Town issued Check 2801 in the amount of \$4,000 to Haggard Excavation. The supporting documentation indicated the payment was for work performed on the cemetery and paid for with Town funds.

The town clerk confirmed that there was no documentation that bids had been solicited for this project as required by the Town’s purchasing policy.

**Finding**

**Nothing precluded the Town or the Authority from utilizing a vendor or contractor because the town administrator was friends with the owner.**



A secondary concern expressed was that the town administrator and the owner of Haggard Excavation were friends, inserting preferential treatment in the purchasing process. During an interview, Town Administrator Weast acknowledged that he did consider himself friends with the owner of the excavation company.

There are no known provisions in state statutes or town code that would preclude the Town or the Authority from using vendors or contractors based on their non-familial relationships.

The authority for purchasing and the approval of transactions ultimately rests with the respective boards and not the town administrator. All payments to Haggard Excavation were approved by the respective boards.

**DISCLAIMER**

---

In this report there may be references to state statutes and legal authorities which appear to be potentially relevant to the issues reviewed by this Office. The State Auditor and Inspector has no jurisdiction, authority, purpose, or intent by the issuance of this report to determine the guilt, innocence, culpability, or liability, if any, of any person or entity for any act, omission, or transaction reviewed. Such determinations are within the exclusive jurisdiction of regulatory, law enforcement, and judicial authorities designated by law.



**OFFICE OF THE STATE AUDITOR & INSPECTOR**  
2300 N. LINCOLN BOULEVARD, ROOM 100  
OKLAHOMA CITY, OK 73105-4896

[WWW.SAI.OK.GOV](http://WWW.SAI.OK.GOV)