

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

CITY OF ELYSIAN, MINNESOTA

YEARS ENDED DECEMBER 31, 2005 AND 2006

Description of the Office of the State Auditor

The mission of the Office of the State Auditor is to oversee local government finances for Minnesota taxpayers by helping to ensure financial integrity and accountability in local governmental financial activities.

Through financial, compliance, and special audits, the State Auditor oversees and ensures that local government funds are used for the purposes intended by law and that local governments hold themselves to the highest standards of financial accountability.

The State Auditor performs approximately 160 financial and compliance audits per year and has oversight responsibilities for over 3,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits of local governments;

Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

Legal/Special Investigations - provides legal analysis and counsel to the Office and responds to outside inquiries about Minnesota local government law; as well as investigates allegations of misfeasance, malfeasance, and nonfeasance in local government;

Pension - monitors investment, financial, and actuarial reporting for approximately 730 public pension funds; and

Tax Increment Financing - promotes compliance and accountability in local governments' use of tax increment financing through financial and compliance audits.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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CITY OF ELYSIAN, MINNESOTA

Years Ended December 31, 2005 and 2006



Petition Engagement

**Audit Practice Division
Office of the State Auditor
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PETITION ENGAGEMENT

Petitioners
Mayor and City Council
City of Elysian

INTRODUCTION

Eligible voters of the City of Elysian (City) petitioned the Office of the State Auditor (OSA) to examine the books, accounts, and affairs of the City and Economic Development Authority (EDA) in accordance with Minn. Stat. § 6.54 for the period January 1, 2000, through December 31, 2006. The statute allows the OSA, in the public interest, to confine the scope of the audit to less than that requested by the petition. Through discussion and agreement with petitioner representatives, the scope of our review concentrated on years 2005 and 2006, unless more information was needed in some areas, and was limited to addressing the issues discussed below.

City Hall Purchase

Petitioners were concerned about some of the procedures involved in the purchase of the City Hall building. The primary concerns included whether a reasonable price was paid for the purchase of the Pizza Palace building, whether an appraisal was obtained for the property, whether the Fire Hall was used as collateral for the purchase, who holds title to the building, the total costs for the improvements to the building, and how the City was paying the EDA for the purchase of the building. We reviewed the 2005 and 2006 City Council and EDA minutes; bond documents; the December 31, 2006, Elysian Bank statement and lease assignment from Municipal Financial; the City's lease-purchase agreement with the EDA; and the 2006 general ledger and journal entries.

The EDA borrowed \$315,000 from Municipal Financial to purchase the City Hall building, formerly the Pizza Palace, at an interest rate of six percent, dated February 8, 2006. A lease-purchase agreement was established between the EDA as lessor and the City as lessee. The

EDA and the City signed the lease-purchase agreement dated January 30, 2006. The City had estimated that the cost to build a new building would be \$300,000 based on a cost of \$100/square foot for 3,000 square feet. Proceeds were used as detailed below.

(i) Payments for Pizza Palace	\$ 237,786.00
(ii) Excess loan proceeds for remodeling City Hall	60,183.50
(iii) Fees paid to lease purchase company	15,000.00
(iv) Legal and recording fees	<u>2,030.50</u>
Total Use of Proceeds	<u>\$ 315,000.00</u>

1. The EDA did not obtain an appraisal of the property purchased for the City Hall.
2. The Fire Hall was not used as collateral to secure the lease purchase of the City Hall.
3. The City Hall and Fire Hall were refinanced with \$500,000 G.O. Capital Improvement Plan Refunding Bonds, Series 2006B, at an interest rate of 4.028 percent, dated December 1, 2006. The bonds were issued by the City. Proceeds were used as detailed below.

(i) Refund outstanding portion of Fire Hall capital lease	\$ 149,601.58
(ii) Refund outstanding portion of City Hall lease-purchase agreement plus accrued interest	331,222.50
(iii) Issuance costs of new refunding bonds	18,917.13
(iv) Excess amount to Debt Service Fund	<u>258.79</u>
Total Use of Proceeds	<u>\$ 500,000.00</u>

The full faith and credit of the City was pledged to the payment of the bonds, and the City has obligated itself to levy additional ad valorem taxes in the event of any deficiency in the debt services account established for this bond issue. The bond payments required to be paid by the Fire Hall remained at the same amounts and terms as prior to the refinancing of the bonds.

4. On January 30, 2006, the City entered into a lease-purchase agreement with the EDA as a method of financing the purchase of the City Hall. Minn. Stat. § 465.71 permits government entities to enter into lease-purchase agreements, but requires the following:

The city, county, town, or school district must have the right to terminate a lease-purchase agreement at the end of any fiscal year during its term.

The lease-purchase agreement signed by the City does not contain an opt-out provision as required by this statute.

Minn. Stat. § 465.71 authorizes cities to enter into lease-purchase agreements and exempts those agreements from the election requirements of Minn. Stat. § 475.58. The City's lease-purchase agreement was not authorized by Minn. Stat. § 465.71. The lease constituted an "obligation" of the City under Minn. Stat. § 475.51, subd. 3. As such it could not be entered into until a majority of electors in the City approved the lease-purchase. Since the City did not obtain this voters' approval, the lease-purchase agreement could not be entered into by the City. Minn. Stat. § 475.58, subd. 1.

5. The lease-purchase agreement was replaced by the refunding bonds issued by the City in December 2006. Both the terms of the replaced lease-purchase agreement and the refunding bond called for the EDA to turn over the title of the City Hall to the City. The lease-purchase required transfer of title when the lease was paid off (which occurred when the refunding bonds were issued in December 2006), and the refunding bonds resolution adopted by the EDA on December 15, 2006, indicated that the EDA would have no interest or title in the City Hall once the bond proceeds are deposited in the Payment Account. These events occurred in 2006; yet, the EDA has not transferred title to the City Hall to the City.
6. Review of the documents provided indicated that total costs for improvements to the City Hall building, including furniture and equipment, approximated \$66,900. These costs were substantially financed with the excess loan proceeds of the original \$315,000 lease purchase.
7. The EDA purchased the Pizza Palace, but the EDA minutes did not indicate approval of the purchase.
8. We noted that all Council members were in attendance at the "emergency" meeting of December 7, 2005, when the Council approved the purchase of the Pizza Palace property.
9. The estimated market value of the Pizza Palace was confirmed with the LeSueur County Auditor for payable 2006 at \$120,200. It should be noted that the last time that LeSueur County had updated the estimated market value on this property was for payable 2004.

Because of the large discrepancy between the purchase price and estimated market value (nearly 100%), an appraisal of the property before the purchase of the Pizza Palace would have been appropriate.

We encountered some difficulties in following the transactions that occurred in the process of purchasing the City Hall. We were unable to obtain detailed documentation of discussions and specific reasons behind City and EDA decisions. Approvals made by the City Council and the EDA were not always clear.

We recommend that the City expand on discussions relating to major issues of the City and its EDA in its preparation of meeting minutes. The League of Minnesota Cities provides guidance in this area through its Publication 140B.1, Meetings of City Councils, located in Part IV., section C., “Other items that should be in the minutes;” which states that the City should include specific reasons behind the Council’s conclusions. Examples would include such things as the economical, social, political, or safety factors that were considered when the Council made a particular decision. Further, we recommend that when the city is purchasing property for an amount significantly higher than its estimated market value, that it obtain an independent appraisal of the property’s value.

We also recommend that the City not enter into unauthorized lease-purchase agreements and not incur debt unless authorized to do so by state law, and that the City obtain title to the City Hall from the EDA.

Cash Payments in Lieu of Health Insurance

Petitioners were concerned about the monthly cash payments full-time City employees were receiving in lieu of health insurance. The City does not provide employees with health care coverage. The City makes monthly cash payments to full-time employees in lieu of health care coverage. This practice began a number of years ago with full-time employees being paid \$50 per month. Our examination focused on January 1, 2000, through December 31, 2006. The monthly payments have ranged from \$250 per month in 2000 to \$500 per month in 2006. The petitioners questioned whether these payments were subject to income tax withholding (and payment of social security, Medicare, federal unemployment (FUTA) Taxes, and Public Employee Retirement Association (PERA) contributions) and whether they were being reported as income.

We reviewed the City’s 2005 and 2006 payroll records and Personnel Guidelines Manual and noted the following.

1. No amounts were withheld from these cash payments for tax purposes.
2. These cash payments were not being reported as income.
3. No documentation was required from the employees to verify that these cash payments were used to purchase health insurance, which is one of the three rules of an accountable plan as defined by the Internal Revenue Service (IRS).
4. The City did not include these cash payments in its calculation of PERA-required contributions.

Discussions with personnel at the IRS indicated that the City's cash payments to employees in lieu of health insurance appears to fit best under IRS Publication 15B - Employer's Tax Guide to Fringe Benefits (Circular E). Accident and health benefits would be tax exempt if payments are made to an accountable accident or health plan for payments or reimbursements of medical expenses or payments for specific injuries or illnesses.

Circular E - Employer's Tax Guide to Fringe Benefits explains what is required of an accountable accident and health plan:

A reimbursement or allowance arrangement is a system by which the employer pays the advances, reimbursements, and charges for employees' substantiated business expenses. How you report a reimbursement or allowance amount depends on whether you have an accountable or a nonaccountable plan. . . . These rules apply to all ordinary and necessary employee business expenses that would otherwise qualify for a deduction by the employee.

Accountable plan. To be an accountable plan, your reimbursement or allowance arrangement must require employees to meet all three of the following rules.

1. They must have paid or incurred deductible expenses while performing services as your employees.
2. They must adequately account to you for these expenses within a reasonable period of time.
3. They must return any amounts in excess of expenses within a reasonable period of time.

Amounts paid under an accountable plan are not wages and are not subject to income tax withholding and payment of social security, Medicare, and federal unemployment (FUTA) taxes.

If the expenses covered by this arrangement are not substantiated (or amounts in excess of expenses are not returned within a reasonable period of time), the amount paid under the arrangement in excess of the substantiated expenses is treated as paid under a nonaccountable plan. This amount is subject to income tax withholding and payment of social security, Medicare, and FUTA taxes. . . .

Discussion with personnel at PERA indicated that these cash payments would not be considered salary that would require PERA amounts to be withheld from payments to employees and, more than likely, would not require the City to make PERA contributions.

We recommend that if the City continues to make cash payments to full-time employees in lieu of health insurance coverage, income taxes should be withheld and social security, Medicare, and FUTA taxes should be paid.

As an alternative, the City could adopt an accountable plan that requires employees to provide documentation that supports the health care related expenses paid by the employees receiving cash payments.

We also recommend that the City contact the IRS to discuss how to resolve the nonpayment of income taxes, social security, Medicare, and FUTA taxes in prior years.

Payroll

Petitioners were concerned with the policies and general internal control procedures over payroll processing. The petitioners' concerns included the approval of time worked by employees, the issuance of W-2s for employees of the City's EDA, the City Council's approval of employees' pay rates, and the City Council's proper approval of Council member salaries. We reviewed all 2005 and 2006 time sheets of the City's four full-time employees, salary processing and approval procedures, and the 2005 and 2006 Council minutes. The following items were noted in this review.

1. Timesheets were not signed by employees.
2. Timesheets were not signed by supervisors.
3. Section V, page 5, of the City's Personnel Guidelines Manual states that, "All employees will be compensated according to the wages and salaries established annually by the City Council, provided that the Council may change or modify any wages or salaries of any employee at any time for budget reasons." The City Council determined the employees' annual pay increases during its budgeting workshops, which were ultimately approved by the adoption of the budget. The salary increases were noted on budget worksheets. The approval of salary increases and the process of including salary increases in the budgeting process were not noted in the Council minutes. The exercise of the authority to set salaries and approve contracts should be separate from the budget process, and the council's action, in this regard, should not be concealed in budget worksheets.
4. Approval of 2005 and 2006 Council salaries was noted in the Council minutes.

The OSA has developed "Statement of Position: Employee Timekeeping Procedures" (#2007-1004) to assist local governments with payroll-related issues. Among the items recommended in the Statement of Position is a positive reporting system where employees affirmatively attest to the hours or days they have actually worked, dual attestation of the hours or days worked (both by the employee and supervisor or other appropriate person), and affirmation of carry-forward amounts of vacation and sick leave accrued.

We recommend the City establish and document payroll policies and procedures to ensure that timekeeping and payroll methods are accurate and reliable. Included should be controls to ensure that all payroll contracts, time records, and amounts paid are properly documented and authorized. We also recommend that the annual salary increases be voted on by the City Council in a motion or motions separate from approval of the City budget, and that the salary increases be documented in the Council minutes.

Overtime

Petitioners had concerns with overtime worked by City employees. The primary concerns were whether the City had a policy defining overtime pay and the approval of overtime, and whether overtime was accurately calculated.

We reviewed all 2005 and 2006 time sheets of the City's four full-time employees. Time sheets were reviewed for advance approval of overtime, accurate calculation of overtime, and recording of compensated absences.

1. Section V, page 5, of the City's Personnel Guidelines Manual states that overtime to be worked must first be approved by the Clerk/Administrator. In the case of overtime to be worked by the Clerk/Administrator, approval must first be given by the Mayor or the City Council as a whole.

The only indication of overtime approval appears in the total payroll for the month, which is presented to the Council showing totals paid for regular hours, total overtime paid, total gross wages, and explanations for overtime per employee. We noted no documentation of approval of overtime by the Clerk/Administrator, Mayor, or the City Council as a whole.

2. Overtime hours were accurately calculated. Section V, page 5, of the City's Personnel Guidelines Manual states that overtime will be paid for all approved time worked over 40 hours per week at the rate of 1.5 times the employee's regular hourly rate. The work week shall be defined as Sunday through Saturday.

Vacation and sick hours taken each pay period appeared on employee time sheets and on payroll registers. Sick and vacation hours were not included in the total of 40 hours per week calculation.

- Section V, page 5, of the City’s Personnel Guidelines Manual states that in order to maintain basic services under unusual circumstances, emergencies, and peak workloads; employees may be required to work overtime. In our review, we noted that overtime (OT) hours were worked and paid in each of the 26 pay periods of both 2005 and 2006.

	City Clerk/ Administrator	Supervisor/ Superintendent of Public Works and Utilities	Public Works Assistant Superintendent
2005 Pay periods with OT pay	22 of 26	25 of 26	15 of 26
2006 Pay periods with OT pay	23 of 26	25 of 26	22 of 26

Because it does not appear overtime is being used only for unusual circumstances, emergencies, or peak workloads, the City’s practices seem to conflict with the City’s Personnel Guidelines Manual.

We recommend that the City review its policy regarding the payment of overtime. The overtime being paid appears to be for employees’ regular duties. In a City of this size, it may not be cost effective to consider hiring additional personnel in place of paying overtime wages. The City may consider the use of flex-time hours or salaried positions in place of paying hourly wages for overtime. If the City prefers to continue to pay overtime at current levels, it may consider revising Section V of the City’s Personnel Guidelines Manual to reflect that preference.

Workers’ Compensation

Petitioners were concerned that employees on workers’ compensation were receiving reimbursement for travel to doctor’s appointments. We reviewed the City’s 2005 and 2006 general ledgers for reimbursements related to medical appointments. We also reviewed the City’s procedures and controls relating to workers’ compensation insurance. We noted the following upon this review.

- The City had reimbursed an employee for medical travel expenses totaling \$20.54 in 2005 and \$728.03 in 2006. Of the 2006 reimbursement, \$242.53 was later reimbursed to the City by the workers’ compensation provider.
- Reimbursement for medical travel expenses is a workers’ compensation benefit provided for in state law. The injured employee must submit proper documentation of the expense and the city needs to ensure benefit payments are not being duplicated.
- All medical travel expenses reimbursed to the employee were based on detailed supporting documentation.
- The City appears to have few controls in place with regard to collecting workers’ compensation reimbursements that are paid directly to the employee by the insurance provider.

5. The City's workers' compensation policy does not give detailed information about disbursement and receipt procedures related to workers' compensation claims.

We recommend that the City submit timely requests for reimbursement to the insurance provider for all expenses paid by the City that are to be covered by insurance. We also recommend that the City establish procedures to ensure that all workers' compensation payments made directly by the provider to the employee are collected from the employee. Finally, we recommend that the City Council approve a more detailed workers' compensation policy detailing the City's practice of paying for the hours and expenses covered by workers' compensation, which are later reimbursed by the insurance company. Since the City is in the process of updating its current personnel policy, we would recommend that the City include this information in its approved policy.

EDA Loan Procedures

Petitioners were concerned that some EDA loan applications may not have been completed prior to receipt of loan proceeds. We reviewed the 2005 and 2006 EDA minutes; all nine new loans for 2005 and 2006; loan amortization schedules; the December 31, 2006, Loans Receivable Report; the EDA's list of items needed to make application for EDA funds; and individual loan folders. Based on this review, we noted the following information.

1. The EDA provides a list to potential applicants. This list includes:
 - application,
 - itemized list of project costs,
 - copy of contractor invoices for which funds will be used,
 - statement from bank on viability of project,
 - copy of paid invoices to EDA Executive Director for costs incurred from project when project is finalized,
 - return information to EDA Director by date specified, and
 - matter will be reviewed and discussed at the next regular meeting of the EDA.
2. Our review of the Loans Receivable Report listed one loan from 2005 that we could not find approval for in our review of the EDA minutes.
3. Upon review of individual loan folders, we found that only three of the nine loans reviewed had signed promissory notes.

4. Our comparison of loan dates in the EDA minutes and loans dates listed on the Loans Receivable Report indicated that one loan was approved one day after the date of the loan. All other loans reviewed received approval prior to the loan date.
5. Our review of individual loan folders indicated that only two of the nine loans reviewed had any kind of documentation of project costs.
6. We found no loan applications in the loan folders.

The EDA has been in the process of updating its loan policy and obtaining promissory notes on loans that had previously been approved. We recommend the EDA complete this process and document its policies and procedures regarding EDA loans. The policies and procedures should be prepared by appropriate levels of management, approved by the EDA Board to emphasize its importance and authority, describe the procedures to be performed, indicate which employees are to perform the procedures, and explain the design and purpose of control-related procedures to increase employee understanding and support for controls. Although other methods might suffice, this documentation should be included in the EDA's policies and procedures manual. This manual should document the accounting policies and procedures which make up the EDA's internal control system.

We also recommend the EDA obtain loan applications for all EDA loans. These applications should be kept on file along with project costs and/or business plans, loan amortization schedules, promissory notes, loan agreements, and records of payment.

EDA Meetings Per Diem Payments

Petitioners were concerned that the City Clerk/Administrator was receiving per diems as well as regular pay while attending EDA meetings. Petitioners wanted to know if the EDA was issuing a separate W-2 to the City Clerk/Administrator for duties as the EDA Executive Director.

We reviewed EDA minutes for 2005 and 2006 noting the beginning and ending times for the meetings. These meeting times were compared to corresponding times listed on the City Clerk/Administrator's time sheets. We also reviewed 2005 and 2006 W-2 forms. The following was noted.

1. Review of the 26 meetings held in the two year period indicated that per diem pay and salaried pay overlapped on five of the EDA meetings attended, for a total of 131 minutes. Our review and discussion with the City Clerk/Administrator indicated that she was aware that salaried time cannot be charged for meeting time that is paid with per diems. It appears that the overlapping time was not deliberate but a consequence of weak internal controls over payroll (see previous Payroll concern).

2. The City issued one W-2 form per year for the City Clerk/Administrator that included amounts paid for the City and the EDA. The amounts on the W-2 forms were traced to the respective year-to-date Payroll Registers.
3. The EDA does not have a written policy regarding the payment of per diems for EDA meetings.

We recommend that the EDA establish and approve a written policy regarding how the Clerk/Administrator is to be paid for attendance at EDA meetings. The policy should include:

- the documentation requirements for meeting attendance, such as detail on time sheets to indicate meeting beginning and ending times, and
- time sheet review and approval procedures.

The EDA could also consider paying administrative employees an hourly wage for meeting attendance instead of per diem payments.

City Clerk/Administrator Building Permit

Petitioners were concerned that the City Clerk/Administrator did not obtain a building permit for remodeling work done on her home. We reviewed the building permit, inspection notices, remodeling schematic and specifications list, estimated market value from the LeSueur County Auditor, receipt for payment of the building permit fee, receipt of payment into the City’s general ledger, and deposit of the receipt. We also discussed the process and procedures of obtaining a building permit with the Building Inspector. The following dates of transactions were noted.

Date obscure	Blank building permit signed by City Clerk/Administrator and contractor
March 28, 2007	Site inspection notice signed by Building Inspector
April 6, 2007	Building permit issued and signed by Building Inspector
April 9, 2007	Building permit fee received from the City Clerk/Administrator
April 27, 2007	Receipt deposited at the bank
April 30, 2007	Receipt recorded to the City’s general ledger
June 14, 2007	Framing and mechanical inspection notice signed by Building Inspector

Based on the evidence we obtained, a building permit was obtained and paid for by the City Clerk/Administrator. Normal procedures were followed for this type of project. Discussion with the Building Inspector indicated that the project has yet to be finalized.

Budget

Petitioners were concerned with budget overruns. We reviewed the City’s 2005 and 2006 budgeting process and year-end financial statements. The following items were noted.

1. Detailed budget to actual amounts of revenue and expenditures are presented to the City Council prior to each monthly meeting.
2. Budget workshops usually take place after the July bills have been paid.
3. The preliminary budget is approved in September.
4. The final budget is approved and adopted in December.
5. Expenditures were in excess of the approved budget for both 2005 and 2006.

	<u>Expenditures</u>		<u>Budget</u>		<u>Excess</u>
2005	\$ 616,305	\$	529,140	\$	87,165
2006	906,464		588,584		317,880

6. The City generally does not amend the original budget.
7. The City Council has not adopted a budget policy.

The purpose of any budget is to serve as a policy document that sets goals and tracks performance. This policy helps City Council members and other decision-makers make choices about allocating resources among competing needs. Decision-makers must find budgeting techniques that work best for the City. A budget system should outline priorities, conduct program evaluations, allow for management implementation and reporting, and provide sound financial resource management. A budget policy should include guidance for:

- which funds require budgets,
- the legal level of control,
- when budgets can be modified and when budget modifications require Council approval,
- the budgetary basis on which the budget is adopted, and
- procedures for monitoring the budget.

After the City Council has adopted a budget, it should be entered into the City's automated financial system to be used as a monitoring tool. Someone who is independent of the budgeting process should enter the budget information into this system.

The City Council should approve budget amendments as required by the City budget policy. The ability to modify the budget during the year for new circumstances makes the budget more valuable because budgetary differences are not distorted by the new circumstances. Approved budget amendments should be entered into the automated system.

City Council members should review budget to actual reports on a monthly basis. This review process should be documented in the Council minutes or by signing off on the reports.

We recommend the City Council adopt a budget policy to include the elements recommended above. Additional information regarding budgeting may be found at the League of Minnesota Cities' website: www.lmnc.org/handbook/chapter21.

Internal Controls

Petitioners were concerned with general internal controls. We reviewed the City's control procedures by inquiry, observation, review of the City's Independent Auditor's Reports for years ended December 31, 2005, and December 31, 2006, and as part of our review procedures of other concerns.

1. The City's auditors have included comments on internal controls and segregation of duties in the City's audits.
2. We found no documentation of review processes for payments made by the City.
3. We found no consistent documentation of support for payment of expense reimbursements.
4. We found that the City does not have written accounting policies and procedures.

The City does not have a current and comprehensive accounting policies and procedures manual. All governments should document their accounting policies and procedures. Although other methods might suffice, this documentation is traditionally in the form of an accounting policies and procedures manual. This manual should document the accounting policies and procedures which make up the City's internal control system.

An accounting policies and procedures manual will enhance employees' understanding of their roles and functions in the internal control system, establish responsibilities, provide guidance for employees, improve efficiency and consistency of transaction processing, and improve compliance with established policies. It can also help to prevent deterioration of key elements in the City's internal control system and can help to avoid circumvention of City policies.

We recommend the City establish an accounting policies and procedures manual. The accounting policies and procedures manual should be prepared by appropriate levels of management and be approved by the City Council to emphasize its importance and authority. The documentation should describe procedures as they are intended to be performed, indicate which employees are to perform the procedures, and explain the design and purpose of control-related procedures to increase employee understanding and support for controls.

Petty Cash (Imprest Fund)

Petitioners were concerned about the excess number of transactions processed through the petty cash fund. We obtained and reviewed all petty cash reconciliations and supporting payment slips for January 2005 through November 2007. We also reviewed the relevant statute, Minn. Stat. § 412.271, subd. 5 (imprest funds), which sets forth procedures that must be followed in the operation of a petty cash (imprest) fund. We noted the following upon our review.

1. Review of petty cash payment slips indicated that the petty cash fund is used predominately for postage and miscellaneous office supplies. The use of petty cash for these items is typical.
2. The average monthly expenditure of petty cash funds over the 35-month period reviewed was \$31.52 per month.
3. Over the 35-month period we reviewed, only 25 reconciliations had been prepared. Six of those reconciliations were performed in 2005. We noted that reconciliations were performed more regularly in 2006 and 2007.
4. Upon review of petty cash reconciliations, we noted that on 19 of the 25 reconciliations prepared, there was an amount included in the reconciliation labeled as "Pat Owes." Discussion with the City Clerk/Administrator indicated that whenever she takes money from petty cash to make necessary purchases, she puts a note in the petty cash to show how much was withdrawn. It appears that the City Clerk/Administrator is not timely in bringing back the related payment slips and change.
5. We noted that petty cash funds were not kept in a secure location and that there was no indication that reconciliations were being reviewed and approved by an employee other than the Office Assistant, who prepares the reconciliations.

Minn. Stat. § 412.271, subd. 5, authorizes city councils to establish petty cash funds (referred to in the statute as imprest funds) for the payment in cash of any proper claim against the city which is impractical to pay in any other manner. No claim for salary or personal expenses of an officer or employee may be paid from such funds.

Pursuant to the statute, the city council must appoint a custodian for each fund, who shall be responsible for its safekeeping and disbursement according to law. Money for the operation of the fund must be secured by a transfer from the general fund.

The following procedures are mandated by Minn. Stat. § 412.271, subd. 5:

- A claim itemizing all the various demands for which disbursements have been made must be presented to the city council at the next council meeting after the disbursements have been made.
- The city council shall act upon it as in the case of other claims and an order shall be issued to the custodian for the amount allowed.
- The custodian must use the proceeds of the order to replenish the fund.
- If the city council fails to approve the claim in full for any sufficient reason, the custodian shall be personally responsible for the difference.

We recommend that the City Council act to establish and operate the petty cash (imprest) fund in accordance with the requirements of Minn. Stat. § 412.271, subd. 5.

In addition, in the interest of making petty cash funds less susceptible to theft and non-public use, we also recommend that procedures for use of petty cash be modified. Procedures should include the following:

- minimize the time that petty cash funds and related purchase receipts are vacated from the petty cash drawer,
- ensure that petty cash is kept secure,
- separate the responsibilities for petty cash reconciliations from the review/approval process, and
- incorporate the approved petty cash policy into the City's policy and procedures manual.

Bank Transfers

Petitioners were concerned with an excessive number of bank transfers being made between the various City bank accounts.

We obtained all year-end 2006 bank statements to review the number of transfers occurring. We also discussed transfer procedures and purposes with City employees. The following observations were noted.

1. It appears that the large number of bank transfers made by the City was due to its use of multiple specific-purpose savings accounts. Based on discussion with City personnel, the City had approximately 20 savings accounts open during the periods covered by our examination. Each savings account was used for a specific type of activity such as debt service, specific fund activity, infrastructure, cable TV royalties, fire equipment, etc. Use of the multiple savings accounts allowed the City to readily track the cash balances for the related programs without utilizing the accounting system. Because all receipts were first receipted into the City's checking account, and all disbursements were made from that checking account, any receipt or disbursement made relating to the savings accounts resulted in a transfer to or from a savings account. In November 2007, the savings accounts were consolidated into four accounts. This consolidation should reduce the number of transfers required during the year, decrease the time and energy spent on reconciling accounts, and possibly earn more interest for the City.
2. Upon review of the year-end 2006 bank statements, we noted that the City had 22 savings accounts open. Sixty-four transfers were made between those accounts and the City's checking account during the month of December. Both the savings and checking accounts were held at the same depository, so all activity was intra-bank activity. All transfers were reconciled between statements.

Fire Relief Association Pension Fund

Petitioners were concerned about the timely filing of Fire Relief Reports with the State of Minnesota and payment of the City's contribution to the Fire Relief Association pension fund.

We confirmed with the Pension Division of the Office of the State Auditor (OSA) the status of the City's Fire Relief Reports. We traced the contribution payment from the City to the Fire Relief Association. We also confirmed with the Fire Relief Association Treasurer the receipt of payment from the City.

1. The Elysian Fire Relief Association has submitted all required reporting information to the OSA Pension Division for the 2006 reporting year. Reporting information for the 2007 reporting year is due by June 30, 2008.
2. The City of Elysian paid its contribution to the Fire Relief Association on November 9, 2007, and is current with its obligations.

Allocation of Costs to the Fire Department

Petitioners expressed concern about the practice of allocating a portion of the City's annual financial audit cost to the Fire Department.

We discussed the allocation process with City employees and reviewed the 2006 general ledger. In 2006, approximately three percent (\$450 of the total audit cost of \$16,420) was allocated to the Fire Department. The Fire Department is accounted for on the City's automated accounting system, and transactions are entered to the system by City employees. The Fire Department is included in the City's audited financial report. The Fire Department fund is included in the City's budget.

Based on the administrative services provided by the City and the audit costs incurred relating to the Fire Department, an allocation such as this seems reasonable.

Water and Sewer Bills

Petitioners were concerned that not all residents were paying their water and sewer bills. They were also concerned that not all residents were receiving water and sewer bills. Since there were no specific bills in question, we focused our attention on the overall procedures and internal controls in place. We reviewed the City's procedures relating to delinquent utility accounts and the internal controls surrounding the utility accounting system. We discussed procedures with City personnel.

1. We noted that the City Utility Clerk/Office Assistant annually reviews all utility accounts for accounts that are more than three months delinquent. Residents with such accounts are given written notice that if the balance of their account is not paid within a month, it will be placed on their next year's taxes payable. Upon review of this process for 2006, we noted that of the 16 residents with delinquent accounts, four had paid the outstanding balance within a month, nine had the balance added to their taxes, and the remaining three were left uncollected and not added to taxes payable. The City Clerk/Administrator was able to provide reasonable explanations for the three bills that were not added to the residents' taxes.
2. We noted that the utilities accounting system program is interfaced with the City's general ledger system. This interface reduces the possibility of items in the utilities program being marked as paid when they have not actually been paid.
3. We noted that during the monthly billing process, the City Utility Clerk/Office Assistant reviews all utility accounts for any unusual balances (including zero balances). Corrections and adjustments are made prior to the mailing of utility bills.
4. We noted that the utilities program allows the City to adjust utility bills. All adjustments made in 2006 appeared reasonable. However, there was no indication that adjustments were reviewed by an employee other than the person making the adjustment.

We recommend that when adjustments are made to the utility receivable accounts, they be reviewed by an employee other than the person preparing the adjustments. The reviewer should indicate approval of the adjustments on the adjustment summary.

Water and Sewer Hook-Up Fees

Petitioners were concerned that water and sewer hook-up fees were not charged consistently.

We reviewed all building permits for 2005 and 2006, scanning for new construction projects that may not have been charged water and sewer hook-up fees. Upon our initial investigation, we noted that two new construction projects had not been charged water and sewer hook-up fees. After further investigation, we noted that the water and sewer hook-up fees had been paid prior to the purchase of the building permits. In one case, the water and sewer hook-up fees were included in a special assessment charged by the City for a new development area. In the other case, the hook-up fees were paid in 2003 when a property owner first began work on a new development area. We also noted that the water and sewer hook-up fees reviewed had been fairly charged.

CONCLUSION

We were not engaged to and did not perform an audit, the objective of which would be the expression of an opinion on specified elements, accounts, or items relating to the petitioners' concerns identified in this report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that we would have reported to you.

This report has been prepared for the information of the petitioners of the City of Elysian, the Mayor and City Council, and the management of the City, but is a matter of public record, and its distribution is not limited.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

February 26, 2008

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR