STATE OF MINNESOTA

Office of the State Auditor

Patricia Anderson
State Auditor

TOWN OF MAY
WASHINGTON COUNTY, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2004

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

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 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for 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 over 700 public pension funds; and

Tax Increment Financing, Investment and Finance - 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 Employee's Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

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TOWN OF MAY
WASHINGTON COUNTY, MINNESOTA

For the Year Ended December 31, 2004

Audit Practice Division
Office of the State Auditor
State of Minnesota

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TOWN OF MAY
WASHINGTON COUNTY, MINNESOTA

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2004

I. INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

04-1 Segregation of Duties

Due to the limited number of office personnel within the Town of May, segregation of accounting functions necessary to ensure adequate internal accounting control is not possible. This is not unusual in operations the size of the Town; however, the Town's Board members should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an accounting control point of view.

Currently, bills are approved by the Board, and checks issued for payment require dual signatures. We recommend that the Board continue to monitor and oversee these procedures and constantly be aware of the lack of segregation of accounting functions.

II. LEGAL COMPLIANCE

ITEM ARISING THIS YEAR

04-2 Annual Budgets

In accordance with Minn. Stat. §§ 365.10 and 365.431, the Town's electors vote to authorize the amount of money to be raised for a given year through tax levies for Town purposes. This vote is to occur at the Town's annual meeting in March. The Town's Board may not spend more than the amount approved for the levy at the annual meeting without approval from a majority of the electors, in accordance with Minn. Stat. § 365.43, subd. 1.

In 2004, the Town disbursed more money than permitted by the budget authorized by electors at the annual meeting.

The Town was not in strict compliance with the statutes, but the Office of the State Auditor believes that the statute needs revision. There is a bill in consideration by the 2005 Legislature to revise Minn. Stat. § 365.43, subd. 1, to limit a town's spending to total revenue received, including amounts carried forward from the prior year and non-levy amounts.

<u>Client's Response</u>:

In its attempt to place controls on local government levies and spending, May Township believes state government demonstrates a continued and worrisome lack of understanding of how local governance works.

In the 2004 levy proposal presented to the citizens at the annual meeting in March of 2003, the Town Board, because of prudent spending and in an effort to keep taxes low for the citizens of the Town of May, proposed using $70,000 in excess existing funds to reduce the levy. The citizens approved this levy knowing we would spend funds that we had on hand. The Town was unaware of these statutes until being notified by the Office of the State Auditor in April 2005. This means that in 2005 and 2006 the Town will again be in non-compliance since these levies, approved by the citizens at the annual meetings, include the use of existing funds.

It would not be unusual for Townships, from time-to-time, to spend down what it considers excess reserve funds. This phenomenon will occur as Town boards shift their thinking about what constitutes prudent fund balances ... "is our rainy day fund too big?"

Beyond this, May Township sees other legitimate levy and spending decisions that seem to be at odds with state laws and regulations. For example:

<u>Towns cannot spend more than the citizens approve in a levy, and – Towns cannot spend more money than they receive in a year</u>.

Emergency spending and capital expenditures can be at odds with these goals. In the case of unforeseen damage or loss to Township buildings, equipment or infrastructure due to acts of God, some of which may be underinsured or uninsurable, the Town will be faced with emergency expenditures over and above anything that the citizens approved in the budget. An example would be damage due to flooding which could cause road and culvert washouts.

The more obvious example that violates the state's goals is in the replacement of equipment, such as a grader or truck, that becomes un-repairable or not worthy of repair, but was ***not*** *scheduled for replacement in any specific year. For example, Towns will levy new dollars each year for a capital equipment replacement fund, but in austere times no specific plan for equipment replacement is set for any given year. Like a family on a tight budget, we make do each year and keep "the old buggy" running.*

Invariably an older truck reaches its last legs due to the latest needed costly repair, and the Town Board may decide to replace it right then and there, even though the Board presented no such replacement plan to the citizens earlier at the annual meeting, and thus, no such expenditure was approved for this year. Yet there is ample money to replace the truck in the capital equipment replacement fund. Once the expenditure is made, the Town would continue to levy for the replacement fund at about the same dollar amount per year as it did before, or perhaps slightly higher.

To require that a Town must schedule equipment replacements for the year in the budget it proposes for the annual meeting will force premature spending on new equipment and eventual, higher taxes on its citizens.

Finally, there are non-levy expenditures that may occur every year: TIF funded projects; park spending from park fees collected from developers; development site monitoring and even repair, funded by development fees and building permit fees.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND MINNESOTA LEGAL COMPLIANCE

Board of Supervisors
Town of May, Minnesota

We have audited the financial statements of the Town of May as of and for the year ended December 31, 2004, and have issued our report thereon dated February 23, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America.

Internal Control Over Financial Reporting

The management of the Town of May is responsible for establishing and maintaining internal control. In fulfilling this responsibility, management must make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition,
- transactions are executed in accordance with management's authorization, and
- transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit, we considered the Town of May's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Town's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is described in the accompanying Schedule of Findings and Recommendations as item 04-1.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition indicated above is not a material weakness.

Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Local Government*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The *Minnesota Legal Compliance Audit Guide for Local Government* contains five categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study included all of the listed categories except public indebtedness, because the Town of May had no debt. The results of our tests indicate that, for the items tested, the Town complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as item 04-2.

This report is intended solely for the information and use of the Town Board of Supervisors and management and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Pat Anderson	*/s/Greg Hierlinger*
PATRICIA ANDERSON STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

End of Fieldwork: February 23, 2005