STATE OF MINNESOTA
Office of the State Auditor

Rebecca Otto
State Auditor

MANAGEMENT AND COMPLIANCE REPORT
PREPARED AS A RESULT OF THE AUDIT OF

MARTIN COUNTY
FAIRMONT, MINNESOTA

YEAR ENDED DECEMBER 31, 2009

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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MARTIN COUNTY
FAIRMONT, MINNESOTA

Year Ended December 31, 2009

Management and Compliance Report

Audit Practice Division
Office of the State Auditor
State of Minnesota

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MARTIN COUNTY
FAIRMONT, MINNESOTA

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MARTIN COUNTY
FAIRMONT, MINNESOTA

Schedule 1

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2009

I. SUMMARY OF AUDITOR'S RESULTS

A. Our report expresses unqualified opinions on the basic financial statements of Martin County.

B. Deficiencies in internal control were disclosed by the audit of financial statements of Martin County and are reported in the "Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*." One of the significant deficiencies is a material weakness.

C. No instances of noncompliance material to the financial statements of Martin County were disclosed during the audit.

D. No matters involving internal control over compliance relating to the audit of the major federal award program were reported in the "Report on Compliance with Requirements Applicable to Each Major Program and Internal Control Over Compliance in Accordance with OMB Circular A-133."

E. The Auditor's Report on Compliance for the major federal award program for Martin County expresses an unqualified opinion.

F. No findings were disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133.

G. The major program is:

Highway Planning and Construction	CFDA #20.205

H. The threshold for distinguishing between Type A and B programs was $300,000.

I. Martin County was not determined to be a low-risk auditee.

II. FINDINGS RELATED TO FINANCIAL STATEMENTS AUDITED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

06-1 Audit Adjustments

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements of the financial statements on a timely basis. Statement on Auditing Standards No. 115 defines a material weakness as a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis.

During our audit, we proposed audit adjustments that were reviewed and approved by the appropriate staff and are reflected in the financial statements. By definition, however, independent external auditors cannot be considered part of the government's internal control.

The inability to detect material misstatements in the financial statements increases the likelihood that the financial statements would not be fairly presented.

We recommend that the County review internal controls currently in place and then design and implement procedures to improve internal controls over financial reporting which will detect misstatements in the financial statements. The updated controls should include review of the balances and supporting documentation by a qualified individual to identify potential misstatements.

Client's Response:

The County will explore new procedures and policies to improve internal controls over financial reporting.

06-4 <u>Capital Assets</u>

For financial reporting and asset management purposes, the County is required to keep records of its capital assets, including infrastructure. The County has made improvements in capital asset record keeping through the implementation of the Integrated Financial System (IFS) Capital Asset Program. The program is maintained by the Auditor/Treasurer's Office. The program assists in tracking capital assets and calculating depreciation. However, further improvements need to be made to ensure that every County department's capital asset activity has been included in the system.

Capital asset policies utilized by the County in maintaining the capital asset system have not been formally approved. The County Board has not adopted a capital asset policy. The County has adopted policies regarding infrastructure and procedures for capitalization thresholds, useful lives, and depreciation; however, the County does not have policies and procedures in place to identify capital asset additions and deletions for entry in the capital asset system. County staff generally identify capital asset additions by reviewing capital expenditure accounts at year-end and determining which assets to capitalize. There is no system in place to identify asset disposals. Also, a physical inventory of capital assets has never been done.

We recommend the County Board establish a capital asset policy to define the County's accounting policies over capital assets. The Board should also establish policies and procedures to identify capital asset additions and deletions. Department heads should report capital asset additions and deletions at least annually. Also, we recommend a physical inventory of capital assets be performed periodically. This physical inventory can be rotated so that a portion of the capital assets is inventoried each year. Each asset should be counted at least once every five years. Some critical capital assets may need more frequent accounting. We also recommend that departments reconcile their capital asset listings to the records maintained by the Auditor/Treasurer.

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

We have a policy in place but need to improve and define it more; we will need to create a schedule for taking a physical inventory of the capital assets. We will have the new policy for board approval by the end of the year.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

05-3 Individual Ditch System Deficits

It is a continuing practice for Martin County to have individual ditch systems with cash and fund balance deficits. Of the 176 individual systems, 35 ditch systems had deficit cash balances totaling $375,616 at December 31, 2009. In cases where a ditch account has insufficient funds to pay project costs, Minn. Stat. § 103E.655, subd. 2, allows loans to be made from ditch systems with surplus funds or from the General Fund to a ditch system with insufficient cash to pay expenditures. This statute also specifies such loans must be repaid with interest. Allowing a ditch system to maintain a deficit cash balance, in effect, constitutes an interest-free loan from the other ditch systems in violation of Minnesota law.

In addition, 15 ditch systems had negative fund balances totaling $265,138, on a full accrual basis, as of December 31, 2009. Minn. Stat. § 103E.735, subd. 1, (2009) provided that a fund balance to be used for repairs may be established for any drainage system, not to exceed 20 percent of the assessed benefits of the ditch system or $40,000, whichever is larger. In 2010, the monetary cap was increased to $100,000. *See* 2010 Minn. Laws, ch. 298, § 7.

We recommend Martin County eliminate the individual ditch system cash balance deficits by borrowing from an eligible fund with a surplus cash balance or levy assessments pursuant to Minn. Stat. § 103E.735, subd. 1, to accumulate a cash balance sufficient to provide for the repair and maintenance costs of ditch systems.

Client's Response:

Redetermination of several ditches has caused some of the findings; the total bills have not been received by the time the levy has been established. In the future, the County will look at those items when doing the levy for the ditch systems.

ITEM ARISING THIS YEAR

09-1 Mutual Fund Investment

The County owned $534,577 worth of shares in General Government Securities Money Market Class B (General Government), a Dreyfus mutual fund. The County's investment in mutual funds is restricted by Minn. Stat. § 118A.05, subd. 4, to those at least rated in the top two highest categories by a nationally recognized rating agency. General Government has no rating at all and is not a permissible investment for the County.

We recommend that the County develop a plan to bring its investment portfolio into compliance with state law.

Client's Response:

The County will develop a plan to bring its investments into compliance with State law. The County will work with the broker to have the money invested in the proper fund which has the correct rating.

PREVIOUSLY REPORTED ITEM RESOLVED

Publication of Vendors (05-4)

The County did not comply with Minnesota statutes regarding the proper publication of information regarding payments to vendors.

Resolution

During the current audit, the County complied with Minnesota statutes regarding the publication of payments to vendors.

B. OTHER ITEM FOR CONSIDERATION

GASB Statement 54

The Governmental Accounting Standards Board (GASB) recently issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. The intention of this standard is to enhance the usefulness of information included in the financial report about fund balance through clearer fund balance classifications that can be more consistently applied, as well as to clarify existing governmental fund type definitions.

Fund Balance Reporting

Statement 54 establishes new fund balance classifications based on constraints imposed on how resources can be spent. The existing components of fund balance reserved, unreserved, designated, and undesignated are being replaced by nonspendable, restricted, committed, assigned, and unassigned as defined below:

- *Nonspendable* - amounts that cannot be spent because they are either not in spendable form (for example, inventory or prepaid items) or legally or contractually required to be maintained intact (such as the corpus of a permanent fund).

- *Restricted* - amounts that can be spent only for specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

- *Committed* - amounts that can be used only for specific purposes determined by a formal action of a government's highest level of decision-making authority.

- *Assigned* - amounts a government intends to use for a specific purpose that do not meet the criteria to be classified as restricted or committed.

- *Unassigned* - spendable amounts not contained in the other classifications.

Governmental Fund Type Definitions

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified in Statement 54. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

The requirements of GASB Statement 54 are effective for the County for the year ending December 31, 2011.

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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

Board of County Commissioners
Martin County

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Martin County as of and for the year ended December 31, 2009, which collectively comprise the County's basic financial statements, and have issued our report thereon dated August 26, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Martin County's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified a deficiency in internal control over financial reporting that we consider to be a material weakness and another deficiency that we consider to be a significant deficiency.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the County's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 06-1 to be a material weakness.

A significant deficiency is a deficiency or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs as item 06-4 to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Martin County's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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 seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our study included all of the listed categories.

The results of our tests indicate that, for the items tested, Martin County complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Questioned Costs as items 05-3 and 09-1.

Also included in the Schedule of Findings and Questioned Costs is an other item for consideration. We believe this information to be of benefit to the County, and it is reported for that purpose.

Martin County's written responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Questioned Costs. We did not audit the County's responses and, accordingly, we express no opinion on them.

The Office of the State Auditor is conducting a separate review of certain County expenditures and will issue its report at a later date.

This report is intended solely for the information and use of the Board of County Commissioners, management, others within Martin County, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

August 26, 2010

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Board of County Commissioners
Martin County

Compliance

We have audited the compliance of Martin County with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that are applicable to its major federal program for the year ended December 31, 2009. Martin County's major federal program is identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to its major federal program is the responsibility of the County's management. Our responsibility is to express an opinion on the County's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Martin County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the County's compliance with those requirements.

In our opinion, Martin County complied, in all material respects, with the requirements referred to above that are applicable to its major federal program for the year ended December 31, 2009.

Internal Control Over Compliance

Management of Martin County is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the County's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of the internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Martin County as of and for the year ended December 31, 2009, which collectively comprise the County's basic financial statements, and have issued our report thereon dated August 26, 2010. Our audit was performed for the purpose of forming opinions on Martin County's financial statements that collectively comprise the County's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of the Board of County Commissioners, management and others within the County, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Rebecca Otto	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

August 26, 2010

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MARTIN COUNTY
FAIRMONT, MINNESOTA

Schedule 2

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2009

Federal Grantor Pass-Through Agency Grant Program Title	Federal CFDA Number		Expenditures
U.S. Department of Justice			
Passed Through Minnesota Department of Public Safety			
Crime Victim Assistance	16.575	**$**	**72,500**
U.S. Department of Transportation			
Passed Through Minnesota Department of Transportation			
Highway Planning and Construction	20.205	$	1,000,000
Formula Grants for Other Than Urbanized Areas Cluster			
Formula Grants for Other Than Urbanized Areas	20.509		164,169
Formula Grants for Other Than Urbanized Areas - ARRA	20.509		65,025
Total U.S. Department of Transportation		**$**	**1,229,194**
U.S. Department of Homeland Security			
Passed Through Minnesota Department of Natural Resources			
Boating Safety Financial Assistance	97.012	$	13,053
Passed Through Minnesota Department of Public Safety			
Emergency Management Performance Grants	97.042		16,342
Total U.S. Department of Homeland Security		**$**	**29,395**
Total Federal Awards		**$**	**1,331,089**

The notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

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MARTIN COUNTY
FAIRMONT, MINNESOTA

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2009

1. Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activities of federal award programs expended by Martin County. The County's reporting entity is defined in Note 1 to the financial statements.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Martin County under programs of the federal government for the year ended December 31, 2009. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Martin County, it is not intended to and does not present the financial position, changes in net assets, or cash flows of Martin County.

3. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through grant numbers were not assigned by the pass-through agencies.

4. Subrecipients

During 2009, the County did not pass any federal money to subrecipients.

5. American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009 (ARRA) requires recipients to clearly distinguish ARRA funds from non-ARRA funding. In the schedule, ARRA funds are denoted by the addition of ARRA to the program name.