

STATE OF MINNESOTA

Office of the State Auditor



Julie Blaha
State Auditor

CITY OF NELSON, MINNESOTA

**REPORT ON PROCEDURES APPLIED TO
FINANCIAL INFORMATION AND COMPLIANCE**

YEAR ENDED DECEMBER 31, 2018

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 100 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 600 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 NELSON, MINNESOTA

Year Ended December 31, 2018



**Report on Procedures Applied to
Financial Information and Compliance**

**Audit Practice Division
Office of the State Auditor
State of Minnesota**

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REPORT ON PROCEDURES APPLIED TO FINANCIAL INFORMATION AND COMPLIANCE FOR THE CITY OF NELSON, MINNESOTA

Council Members
City of Nelson, Minnesota

We have performed the procedures enumerated in the Financial Information section below to assist management of the City of Nelson in evaluating the financial information of the City as of December 31, 2018. The City of Nelson's management is responsible for the financial information of the City. We have also performed the procedures enumerated in the Compliance section below to assist you in evaluating the City of Nelson's compliance with applicable sections of the *Minnesota Legal Compliance Audit Guide for Cities* and other matters during the year ended December 31, 2018. Management is responsible for the City's compliance with those requirements.

Financial Information

Our procedures and findings regarding financial information are as follows:

1. We obtained and read the minutes of the meetings of the Council for the year ended December 31, 2018, to determine if the minutes are adequately prepared and signed by the preparer and also approved and signed by the Council by the subsequent monthly meeting. We identified any Council actions that could impact the other procedures.

We found that staff had prepared the meeting minutes adequately. All of the minutes were approved by the Council at the following meeting. All minutes were signed by the City Clerk and the Mayor.

We recommend the City consider documenting additional details in the minutes of the discussions leading up to each motion.

2. We inquired of the City's management about whether they have assessed whether the City's internal controls are adequate enough to prevent or detect errors or fraud or that internal controls are in place to mitigate the risk. We also inquired as to whether the City has documented the risk assessment.

We found that that the City did not have adequate internal controls to prevent or detect errors or fraud in 2018. The City also had not completed a risk assessment in 2018. Because there were very few effective internal controls in place, adjustments were needed in the general ledger to correct disbursement transactions that had been posted, but for which no payment had been made; bills were being paid late or not at all; and a payment to the City was not recorded or deposited.

We recommend the City implement internal controls that are adequate enough to prevent or detect errors or fraud to help mitigate risk. We also recommend the City document the key internal controls along with the risk assessment and monitoring of the controls.

3. We inquired about the procedures and observed the records used to account for the City's receipts and disbursements.

We found that the City's current receipting and disbursement procedures have changed significantly since the end of 2018. The City became aware that bills were not being paid timely or at all. The City has implemented controls in 2019 to help prevent this from happening going forward. The City is now scanning all of the supporting documentation into its accounting software as well as keeping originals on file for the necessary record retention period. Detail of the disbursements is now being brought to the City Council meetings for review, and the checks are on hand and signed by the Mayor and the City Clerk the day they are approved to ensure that the checks are being printed and sent out timely. The City has also started recording individual receipts in the accounting software as soon as they are received so there is a record at the time of collection. Such procedures are adequate for reporting the receipt and disbursement activities.

4. We inquired of management about the procedures for reconciling bank accounts and determined whether they are being performed in a timely manner. We viewed the monthly bank reconciliations for each month during 2018 to determine whether they had been reviewed and signed-off on by a Council member.

We were informed by the City that in 2018, the City Clerk was attempting to do the bank reconciliations on a timely basis, but the reconciliations were not being done properly, so it was determined that all 2018 reconciliations needed to be re-done in 2019. All bank accounts were properly reconciled for each month of 2018 as of May 28, 2019. The City informed us that the original reconciliations were not being reviewed by any of the City Council members so the errors were not caught in a timely manner.

We recommend that a City Council member review and sign-off on the bank reconciliations to ensure that they are being done in a timely manner and that they are free from errors.

5. We mathematically recomputed a sample of bank reconciliations and traced the bank balances to the bank statements and the book balances to the general ledger.

We found that, after the reconciliations were re-done in 2019, there were no longer any mathematical errors in them.

6. We randomly selected a sample of 16 disbursements to determine that the amount, payee, date, and description recorded in the general ledger agrees to the supporting vendor's invoice, purchase order, contract, and canceled check, as appropriate.

We found that, of the 16 disbursements that were selected for testing, seven of them did not agree to the invoice amount. Of those seven claims, one disbursement had no documentation supporting it. Some reasons for the payment amounts not agreeing to invoice amounts included payment of only current balances rather than total amounts due and payment of rounded amounts instead of actual amounts.

We recommend the City keep records that support any disbursements that are made throughout the year. We also recommend the City pay the claims for the amounts that are requested unless a claim is inaccurate.

7. We inquired as to how receipts are tracked to determine if the receipts journal is complete. We randomly selected a sample of 13 receipts reflected in the receipts journal to cash deposits shown on the bank statement.

We found the City did not have a method for tracking receipts. Receipts were only recorded in the City's records when they were entered into the accounting software as a deposit. All of the receipts that were recorded in the accounting software were able to be traced to the bank statements, but there was not a way to determine that the receipts journal was complete. One payment to the City for a liquor license was not recorded or deposited. The City confirmed with the issuer that the check never cleared the bank. A new check was issued to the City in 2019.

We recommend the City implement a form of tracking receipts to ensure that they have recorded and deposited all of the funds that the City receives.

8. We confirmed all cash accounts on the general ledger as of December 31, 2018, with financial institutions.

We found the City's three checking accounts agree/reconcile in amount to the confirmations.

9. We confirmed with Douglas County the amount of property tax receipts distributed to the City for the year ended December 31, 2018, and compared this to the amounts recorded in the general ledger.

We found property tax receipts confirmed with the County agree to the City's records.

10. We determined whether the City had non-routine journal entries, such as adjustments or reclassifications, posted to the general ledger.

We found that the City did not have any non-routine journal entries in 2018.

11. We determined whether there are sufficient records on hand to document the wages paid to employees. We selected a representative sample of payroll checks to trace and agree the employee's hours worked as recorded in the payroll register to the employee's time sheet and to trace and agree the pay rate to the personnel file or approved wage schedule. We determined whether the payment date was subsequent to the pay period.

We found that the City had very few records to document the wages that were being paid to employees. We tested a sample of ten payroll checks. Three of them did not have any supporting documentation for hours worked. The City also had no documentation of an approved pay rate for any of the employees associated with the payroll checks selected for testing. All of the payments were being made subsequent to the pay period.

We recommend that the City keep sufficient records of hours worked and rates of pay to document the wages paid to employees.

12. We obtained quarterly reports on salary withholdings to determine if they have been filed in a timely manner with the state and federal governments.

We found that salary withholding reports were not being filed appropriately or timely. On April 28, 2019, the City issued a check to the United States Treasury in the amount of \$12,007 for federal withholdings reported on Form 941 Employer's Quarterly Federal Tax Return for the last two quarters of 2014 and all four quarters of 2016, 2017, and 2018. The City has verified with the Internal Revenue Service (IRS) that withholdings for the four quarters of 2015 have not been paid. The City has prepared the quarterly Form 941 Employer's Quarterly Federal Tax Return for 2015, and plans to pay the \$3,198 owed after approval at the next City Council meeting. The City also verified with the IRS that the annual employer's federal unemployment tax has not been paid for 2015, 2016, 2017, and 2018. The City has completed the form 940 Employer's Annual Federal Unemployment (FUTA) Tax Return for these years, which total \$389, and plans to pay this after the next City Council meeting.

In 2018, there were no payments to the Minnesota Department of Revenue for state income taxes posted in the City's general ledger. The accounting system's Summary Report identifying employee W-2 information documents that there were no withholdings for state income taxes. The accounting system's Employee Withholding Report lists all employees as claiming zero allowances. Comparing monthly salaries to the tax tables found in the Minnesota Income Tax Withholding Instruction Booklet and Tax Tables on the Minnesota Department of Revenue's website, we noted four employees in 2018 that had at least some months in which their pay exceeded the threshold for withholding based on them claiming zero deductions. One employee had state unemployment withheld, but it was not paid to the state in 2018.

Minnesota Statutes section 353.01 provides generally that if a public employee's annual salary is stipulated in advance to exceed \$5,100, or is stipulated to be less, but exceeds the stipulated amount in a calendar year, that public employee must participate as a member of the Public Employees Retirement Association. In 2018, the City had one employee that was paid \$7,218. Although we were unable to determine whether the salary was stipulated in advance to exceed \$5,100, it appears PERA contributions may have been required.

We recommend the City file the necessary reports and payments on a quarterly basis as they become due, and that the City contact PERA regarding the employee's PERA eligibility.

13. We inquired about and viewed records to determine if adequate records are kept for land, buildings, and equipment owned by the City.

We found the City has only minimal capital assets and does not maintain capital asset records.

We recommend the City keep a record of all of the capital assets that are owned by the City.

14. We inquired and determined if the City has outstanding debt and, if appropriate, agreed the scheduled payments to disbursements reflected in the monthly bank statement.

We found that the City did not have any outstanding debt.

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Compliance

Our procedures and findings regarding compliance are as follows:

1. We obtained the City's annual reporting forms filed with the Office of the State Auditor and determined whether the filing is current and the amounts reported reflect the amounts recorded in the City's records.

We found that the City was late in providing the Office of the State Auditor with the necessary filings. There were errors in the original financial statement submissions. These errors were brought to the attention of the City, and they are in the process of being corrected.

2. We completed the following checklists of the *Minnesota Legal Compliance Audit Guide for Cities*:

- (a) Depositories of Public Funds and Public Investments

We found no exceptions as a result of applying the checklist procedures.

- (b) Conflicts of Interest

We found no exceptions as a result of applying the checklist procedures.

- (c) Public Indebtedness

We found the City does not have any outstanding debt.

- (d) Contracting – Bid Laws

We found no exceptions as a result of applying the checklist procedures.

- (e) Claims and Disbursements

We found there were a number of instances where the City was not in compliance with Minnesota statutes regarding claims and disbursements. The City did not have supporting documentation for one of 16 claims tested, which is in violation of Minn. Stat. § 412.271. The City was not paying a number of its bills on time and was not paying the required interest on those late payments, which is in violation of Minn. Stat. § 471.425, subs. 2 and 4. The City was not maintaining sufficient documentation to support the wages paid to City employees, which is in violation of Minn. Stat. § 412.271, subd. 2. The City was also not endorsing the claims as prescribed in Minn. Stat. § 412.271 subd. 3.

We recommend the City review the legal compliance checklists, in particular the one for claims and disbursements that are available on the Minnesota Office of the State Auditor website on a regular basis to ensure that it is complying with the statutes that apply to the City.

(f) Local Government Miscellaneous Provisions

We found that the City Council did not by resolution adopt, by a two-thirds majority of its members and express acceptance of the terms, any of the donations that were received in 2018 as required by Minn. Stat. § 465.03.

We recommend the City comply with Minn. Stat. § 465.03 and accept every grant or devise of real or personal property on terms prescribed by the donor made by resolution of the City Council adopted by a two-thirds majority of its members and expressing such terms in full.

3. We inquired of City management whether there are any instances (regardless of materiality) indicating any fraud, illegal acts, or noncompliance, and whether they have been reported to the Office of the State Auditor.

The City found no instances of fraud or illegal acts in 2018.

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We were not engaged to and did not perform an audit, examination, or review, the objective of which would be the expression of an opinion or conclusion, on the financial information and compliance with specified requirements. Accordingly, we do not express such an opinion or conclusion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report has been prepared for the information and use of the City of Nelson and the Office of the State Auditor, but is a matter of public record, and its distribution is not limited.

/s/Julie Blaha

JULIE BLAHA
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

June 18, 2019