

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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

**MARTIN COUNTY**  
**FAIRMONT, MINNESOTA**

YEAR ENDED DECEMBER 31, 2007

## **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, 2007**



**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 OF FINDINGS AND RECOMMENDATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2007**

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEMS NOT RESOLVED

05-1 Agency Funds

The County Auditor/Treasurer's Office does not reconcile agency funds to ascertain their balances are identifiable. Our review of the agency funds disclosed the following:

- The Refunding Fund started the year with a negative cash balance of \$85,576, which increased to a negative cash balance of \$87,752 as of December 31, 2007. The County made additional refunds to taxpayers during 2007. A negative tax settlement should be prepared to reconcile and eliminate the negative cash balance. The Refunding Fund is combined with the Taxes and Penalties Fund for reporting.
- The Taxes and Penalties Fund has an unidentified balance of \$132,091 at December 31, 2007. This may be partially related to the negative balance in the Refunding Fund.
- The State Agency Fund started the year with a negative cash balance of \$81,817, which increased to a negative cash balance of \$152,963. The County distributed more County Recorder fees to the General Fund than it collected. An adjustment to correct the overpayment of fees was made to the financial statements.

Agency funds are used to account for funds held in an agent capacity for others. All assets reported in an agency fund are offset by a liability to the party on whose behalf they are held.

We recommend that the County identify and reconcile the balances in all the agency funds and make the corrections necessary to eliminate negative cash balances.

Client's Response:

*The refunding fund and taxes and penalties fund has been adjusted to eliminate negative cash balances. The state agency fund is continually being looked at and will be settled out.*

05-2 Sheriff's Department Checking Accounts

While reviewing the Sheriff's Department checking accounts, we noted the following concerns:

- The checking account for the collections of Writs of Executions, Huber, and other miscellaneous funds had a balance of \$41,959 as of December 31, 2007.
- The checking account for the collections of civil process and paper services had a balance of \$17,475 as of December 31, 2007.

Collections in these two accounts should be reported and remitted to the County on a timely basis.

We recommend that the County implement procedures in the Sheriff's Department to report and remit all collections in a timely manner.

Client's Response:

*The Sheriff's Department will report and remit the collections of these accounts in a timelier manner to the Auditor/Treasurer's office.*

06-1 Audit Adjustments

A control deficiency 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 misstatements of the financial statements on a timely basis. One control deficiency that typically is considered significant is identification by the auditor of a material misstatement in the financial statements not initially identified by the County's internal controls. During our audit, we proposed the following adjustments that resulted in significant changes to the County's financial statements.

- An adjustment was made to record an interfund accrual for a receipt recorded in error on April 26, 2004. The error was recorded as a receivable in the Human Services Special Revenue Fund and a liability in the Building Special Revenue Fund in 2005. The money was never transferred. Without transferring the money, the error of \$56,485 was never corrected.

- To adjust for 2006 and 2007 overpayment of Recorder's fees from Fund 82 to the General Fund for \$174,400.
- To record \$584,108 in capital assets disposals that were not removed from the County's capital asset records (\$230,678 for prior year disposals and \$353,430 for current year disposals).
- To restrict net assets of \$1,925,366 for highway allotments on the government-wide financial statements.
- To record the Board-approved budget amount of \$400,000 in the Ditch Special Revenue Fund that was not recorded in the County's Integrated Financial System.
- To record the unspent portion of a Clean Water Partnership Grant--\$99,600.
- To record \$269,402 in town road allotment revenues and expenditures in the Road and Bridge Special Revenue Fund.
- To record \$378,520 in additional special assessments deferred revenue in the County Ditch Special Revenue Fund.
- To record \$868,411 in adjustments from 2004 to 2006 for interfund tax credits and aids that have yet to be transferred between various funds.

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

We recommend that the County modify internal controls over financial reporting to detect misstatements in the financial statements.

Client's Response:

*The County will make the adjustments and review the internal controls on the financial reporting in the statements.*

## 06-2 Budgeting

The County does not have a formal written budget policy. In general, local governments should have an adopted budget policy that includes elements such as:

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

After the County Board has adopted a budget, it should be entered into the Integrated Financial System (IFS) to be used as a monitoring tool. Someone who is independent of the budgeting process should enter the budget. At Martin County, the budget is entered into the IFS by the County Auditor/Treasurer, who is not independent of the budgeting process.

The ability to modify the budget for new circumstances makes the budget more valuable; budgetary differences are not distorted by the new circumstances. Budget modifications should be made throughout the year to maintain the value of the budget as an internal control tool. In Martin County, budget modifications are not always made for significant changes in expected activity.

We recommend the County Board adopt a budget policy to include the elements recommended above, that budget amounts be entered into the IFS by a person independent of the budgeting process, and that the County budget be modified as necessary for significant changes in expected activity.

### Client's Response:

*The County has a draft budget policy and will review it and adopt the policy at a board meeting. The change of personnel that enter the amounts was done this past year and the County will modify the budget as changes are made.*

#### 06-4 Capital Assets

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 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 assets policy. A capital assets policy should be adopted which defines the County's accounting policies over capital assets, such as capitalization thresholds, useful lives, and depreciation methods.

The County also does not have policies and procedures in place to identify capital asset additions and deletions for entry in the capital assets system. County staff generally identifies 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 assets 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 assets listings to the records maintained by the Auditor/Treasurer.

#### Client's Response:

*The County will continue to improve the process in having the departments report the additions and deletions of assets. The County will also establish a policy on capital assets.*

PREVIOUSLY REPORTED ITEM RESOLVED

**Investment Policy (06-3)**

The County did not have a formal written investment policy.

**Resolution**

The County has a written investment policy to be adopted by the Board.

**II. OTHER FINDINGS AND RECOMMENDATIONS**

A. MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEMS 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 180 individual systems, 39 ditch systems had deficit cash balances totaling \$232,311 at December 31, 2007. 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, 18 ditch systems had negative fund balances totaling \$204,508, on a full accrual basis, as of December 31, 2007. Minn. Stat. § 103E.735, subd. 1, provides 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.

We recommend Martin County eliminate the individual ditch system cash balance deficits by borrowing from an eligible fund with a surplus cash balance and the County 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:

*As in the past the County will continue to look at the assessment process and attempt to keep the ditch systems in a positive balance.*

Publication of Vendors

For 2005, Martin County did not publish a summary of disbursements over \$5,000 by vendor. For 2006, the County did publish a summary of disbursements over \$5,000 by vendor; however, it did not list individual vendors paid with credit cards. Minn. Stat. § 375.17, subd. 2, specifies the conditions for publication of payments to vendors. Minn. Stat. § 471.38 specifies the conditions for payment of claims, specifically that claims presented for payment must be in writing and itemized. Bills received from a credit card company lack sufficient detail to comply with these statutory requirements.

We recommend Martin County comply with Minnesota statutes regarding the proper publication of information regarding payments to vendors.

Client's Response:

*The County did publish a summary of disbursements last year and will continue to do so. The County will include the names of vendors that are over the limit that the credit cards are used for the purchases and not the name of the credit card company.*

PREVIOUSLY REPORTED ITEM RESOLVED**Net Proceeds for Forfeited Land Sale (06-5)**

The County had not apportioned the net proceeds received from past forfeited land sales.

**Resolution**

The County has begun apportioning tax-forfeited land sale proceeds.

**B. OTHER ITEM FOR CONSIDERATION**Other Postemployment Benefits (OPEB)

The Governmental Accounting Standards Board (GASB) issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which governs employer accounting and financial reporting for OPEB. This standard, similar to what GASB Statement 27 did for government employee pension benefits and plans, provides the accounting and reporting standards for the various other postemployment benefits many local governments offer to their employees. OPEB can include many different benefits offered to retirees such as health, dental, life, and long-term care insurance coverage.

If retirees are included in an insurance plan and pay a rate similar to that paid for younger active employees, this implicit subsidy is considered OPEB. In fact, local governments may be required to continue medical insurance coverage pursuant to Minn. Stat. § 471.61, subd. 2b. This benefit is common when accumulated sick leave is used to pay for retiree medical insurance. Under GASB Statement 45, accounting for OPEB is now similar to the accounting used by governments for pension plans.

In 2008, the legislature enacted a new law, Minn. Stat. § 471.6175, intended to help local governments address their OPEB liability in at least three important ways:

- it allows counties to create both revocable and irrevocable OPEB trusts;
- it authorizes the use of a different list of permissible investments for both revocable and irrevocable OPEB trusts; and
- it also permits counties to invest OPEB trust assets with the State Board of Investment, bank trust departments, and certain insurance companies.

Some of the issues that the County Board will need to address in order to comply with the statement are:

- determine if employees are provided OPEB;
- if OPEB are being provided, the County Board will have to determine whether it will advance fund the benefits or pay for them on a pay-as-you-go basis;
- if OPEB are being provided, and the County Board determines that the establishment of a trust is desirable in order to fund the OPEB, the County Board will have to comply with the new legislation enacted authorizing the creation of an OPEB trust and establishing an applicable investment standard;
- if an OPEB trust will be established, the County Board will have to decide whether to establish a revocable or an irrevocable trust, and report that trust appropriately in the financial statements; and
- in order to determine annual costs and liabilities to be recognized, the County Board will have to decide whether to hire an actuary.

GASB Statement 45 would be applicable to Martin County for the year ended December 31, 2008.



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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, 2007, which collectively comprise the County's basic financial statements and have issued our report thereon dated March 31, 2009. 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 of this section and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the County's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the County's financial statements that is more than inconsequential will not be prevented or detected by the County's internal control. We considered the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 05-1, 05-2, 06-1, 06-2, and 06-4 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by Martin County's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 05-1 and 06-1 to be material weaknesses.

### 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 six categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. 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 Recommendations as items 05-3 and 05-4.

Also included in the Schedule of Findings and Recommendations is an other item for consideration. We believe this information to be of benefit to Martin County and report it for that purpose.

Martin County's written responses to the significant deficiencies, material weaknesses, and legal compliance findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit the County's responses and, accordingly, we express no opinion on them.

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

*/s/Rebecca Otto*

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*/s/Greg Hierlinger*

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DEPUTY STATE AUDITOR

March 31, 2009