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# STATE OF MINNESOTA

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December 30, 2010

Mr. Randy Pozine, Fire Chief  
Isanti Fire District  
401 First Avenue North  
P.O. Box 490  
Isanti, Minnesota 55040

Dear Chief Pozine:

The Office of the State Auditor (OSA) has determined that the Isanti Area Joint Operating Fire District (Fire District) has not had an annual audit as required by Minnesota law and the Joint Powers Agreement creating the Fire District. This letter provides the Fire District with notice that an annual audit is required, information and recommendations regarding the audit requirement, and recommendations based upon other concerns the OSA identified during its review of the audit requirement.

The Fire District was originally created through a Joint Powers Agreement executed on October 24, 2002.<sup>1</sup> A new Joint Powers Agreement (Agreement) was executed on December 28, 2005, that is currently effective. The parties to the Agreement are the City of Isanti and the following six towns: Athens, Bradford, Isanti, Oxford, Spencer Brook and Stanford. Each party to the Agreement agreed to raise sufficient funds to pay for the Fire District.<sup>2</sup> Under the Agreement, the Fire District operates the fire department, owns property, trucks and firefighting equipment, and has the authority to borrow or bond to acquire land or construct buildings.<sup>3</sup>

### **I. Annual Audit Requirement**

The Agreement requires the Fire District to obtain annual audits. The Agreement states: "The Fire District shall authorize and pay for an annual audit prepared to GAAP

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<sup>1</sup> The authority for cities and towns to enter into joint power agreements is found in Minn. Stat. § 471.59.

<sup>2</sup> See 2005 Joint Powers Agreement, arts. III and V.

<sup>3</sup> See, e.g., 2005 Joint Powers Agreement, arts. I (general purpose), II (ownership of equipment), and VIII. B. (acquisition of property).

standards to be prepared by an independent and licensed auditor at the end of each calendar year and distributed to all the Towns and the City.”<sup>4</sup>

Minnesota law also requires a “special district,” such as the Fire District, to obtain an annual audit if the total annual revenue is greater than a certain threshold amount.<sup>5</sup> The Fire District meets the definition of a special district under Minnesota law, and its annual revenues exceeded the statutory threshold in at least 2009 and 2008.<sup>6</sup>

The Fire District Chief informed the OSA that the Fire District did not have an audit because of the cost. Instead of an audit, the Fire District had agreed upon procedures engagements (AUP) performed. An AUP is an agreement between an accounting firm and a client to review specific procedures used by the client. The Fire District’s AUPs did not meet the minimum scope for audits of political subdivisions required by Minnesota law.

In contrast to an AUP, the objective of a financial audit is to provide a reasonable basis for expressing an opinion on the financial statements taken as a whole. An audit requires the auditor to obtain an understanding of internal controls, to assess the control risk, to apply tests of accounting records, and/or to obtain corroborating evidential matter through inspection, observation or confirmation. In addition to a financial audit, Minnesota law requires that all audits of political subdivisions include a legal compliance audit.<sup>7</sup> The legal compliance audit reviews an entity’s compliance with certain Minnesota laws, such as laws on contracting and bidding, conflicts of interest, and cash and investment requirements.<sup>8</sup>

When the OSA identifies an entity that has not had a required audit performed, the OSA notifies the entity of the need for an audit and generally recommends that the entity obtain audits in the future. However, the Isanti City Attorney sent a letter to the Fire District dated April 28, 2010. The letter informed the Fire District of the audit requirement contained in the Agreement and in Minnesota law, and asked the Fire District to have an annual audit performed for the year ended December 31, 2009.

The OSA agrees with the Isanti City Attorney. The OSA recommends that the Fire District have an audit performed for both the year ended December 31, 2009, and the year ending December 31, 2010 (assuming the audit threshold is met for 2010). The auditors hired by the Fire District should be provided with a copy of this letter. Copies of

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<sup>4</sup> See 2005 Joint Powers Agreement, art. III. B.

<sup>5</sup> See Minn. Stat. § 6.756, subd. 2 (a).

<sup>6</sup> The 2009 and 2008 threshold amounts were \$185,000 and \$187,000, respectively. The Fire District’s annual 2009 and 2008 revenues, based upon the Fire District’s trial balances, totaled approximately \$318,000 and \$446,000, respectively. The 2010 threshold will not be known until approximately the end of January 2011.

<sup>7</sup> See Minn. Stat. § 6.65.

<sup>8</sup> The OSA’s Legal Compliance Guide may be found at:  
<http://www.auditor.state.mn.us/default.aspx?page=legalcomplianceguide>.

the completed audit should be provided to the parties to the Agreement and to the OSA.<sup>9</sup> In addition, the OSA recommends that the Fire District comply with Minnesota law and the Agreement in the future.

## **II. Additional Issues**

During the OSA's review of the audit requirement, the OSA identified additional items of concern. The OSA is providing the Fire District with recommendations related to these additional concerns.

### **A. Contracting and Bid Law**

During its review, the OSA found that the Fire District did not comply with Minnesota law regarding the advertisement of bids for the construction of a third fire station.

The Fire District is a joint powers entity consisting of towns and cities. Minnesota law requires that contracts let and purchases made under a joint powers agreement conform to the requirements applicable to contracts and purchases of any one of the parties.<sup>10</sup> The Agreement does not specify whether the Fire District must follow city or town contracting and bid law.

City contracting and bid law requires the notice of bids to be published "once in the official newspaper at least ten days in advance of the last day for the submission of bids."<sup>11</sup> Under town contracting and bid law, the bid notice must be posted in the three most public places in the town ten days in advance or published for two weeks in a newspaper generally circulated in the town.<sup>12</sup>

The OSA obtained a copy of the affidavit of publication for the fire station's construction contracts. The advertisement for bids was published on September 8, 2010. The bids were due on September 14, 2010, with the bids being opened on September 15, 2010. The Fire District failed to comply with either city or town law. The Fire District's attorney informed the OSA that he had intended to comply with town law, but the newspaper published only once a week and changed its deadline due to the Labor Day weekend.

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<sup>9</sup> See 2005 Joint Powers Agreement, art. III. B. (annual audit to be distributed to parties to the Agreement); Minn. Stat. § 6.756, subd. 3 (a special district's financial statements and audits must be presented to the district's governing board and filed with the OSA within 180 days after the end of the district's fiscal year).

<sup>10</sup> See Minn. Stat. § 471.59, subd. 3.

<sup>11</sup> See Minn. Stat. § 412.311, subd. 1. See also Minn. Stat. § 471.345 (uniform municipal contracting law for towns and cities).

<sup>12</sup> See Minn. Stat. § 365.37, subd. 3. See also Minn. Stat. § 471.345 (uniform municipal contracting law for towns and cities).

The OSA recommends that, in the future, the Fire District comply with Minnesota contracting and bid law. The Fire District may want to amend the Agreement to clarify whether the Fire District will follow city or town contracting and bid law.

## **B. Agreed Upon Procedures Engagements**

Minnesota law requires that joint powers entities provide for “[s]trict accountability of all funds and report of all receipts and disbursements.”<sup>13</sup>

The OSA obtained and reviewed the Fire District’s AUPs for 2007 through 2009.<sup>14</sup> The findings identified in the 2009 AUP report included:

- A number of disbursements from the General Fund account were not coded and had no supporting documentation with the check stub.
- A \$20,000 debit was made in the Donations Savings account dated February 2, 2009, per the bank statement. The auditors found a deposit slip dated January 22, 2009 to the General Fund for \$20,000, and noted a transfer from the Donation Savings account. The General Fund bank statement recorded a deposit of \$20,000 on February 2, 2009. The \$20,000 was recorded on the books via a journal entry on December 31, 2008.
- Deposits designated as interest income and donations did not have bank statements (Donations Savings account) to verify amounts.<sup>15</sup>
- Differences existed between confirmed bank balances on certificates of deposit (CD) and the Fire District’s books.<sup>16</sup> The Fire District’s books were lower than the bank confirmed CD balances for year-end.

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<sup>13</sup> See Minn. Stat. § 471.59, subd. 3.

<sup>14</sup> The procedures agreed upon for the three years were as follows: 1) The auditors determined the entire sequence of checks, traced a randomly generated sample of checks to inclusion in the Fire District’s general ledger, vouched the sample disbursements to invoices and/or other documentation for support, and attempted to determine whether the expenditures appeared to be correctly categorized in the general ledger; 2) The auditors confirmed all bank balances for all known accounts as of year-end, and traced all reconciling items (deposits in transit and outstanding checks) to clearing in subsequent bank statements provided; and 3) The auditors traced all bank statement deposits provided to the general ledger, traced copies of the deposit slips to the amounts recorded as deposits on the bank statements in the General Checking account, and traced deposits on the two savings account bank statements to supporting documentation for the account amount deposited.

<sup>15</sup> The 2007 AUP stated there was no documentation to support two donations of \$50 and \$200 into the Donations Savings Account.

<sup>16</sup> The 2008 AUP identified that the auditors were unable to trace the confirmed amount of CD balances because the CDs were not maintained on the Fire District’s books separately. The auditors were unable to determine whether adjustments made on the books for interest income received on the CDs was the correct amount. The auditors further noted that the total 2008 interest income they calculated from the year-end bank statements and the Form 1099-INT’s was \$9,575.35, but the amount of interest income received on the books for 2008 was \$19,993.88. The auditors reported that the December 31, 2007, end-of-year balance differed by \$20,513.50 from the January 1, 2008, beginning-of-year balance due to December 31,

The City of Isanti's (City) auditors selected the Agreement for review during the City's December 31, 2009, year-end audit.<sup>17</sup> The City's auditors identified that the City paid \$123,300.56 to the Fire District in 2009 for fire protection services. They noted that the Fire District used an AUP for the Agreement's audit requirement, that the scope of the AUP was "substantially less" than an audit, and that the AUP "described a number of unresolved findings." The City's auditors stated that the AUP "had a number of findings that identified errors or possibly indicated misappropriation." The City's auditors also reported that the description of the AUP report reflected in the August 27, 2009, Fire District Board's meeting minutes was inconsistent with the final AUP report.

The City's auditors concluded:

[W]e believe the procedures performed were incomplete in assessing the processes and the final condition of the [D]istrict. They also do not provide a user with enough information to determine whether the financial position is accurate. Ultimately the City of Isanti pays for a significant share of the District's costs and should have better financial information regarding the activities of the District.

The City's auditors recommended that the City require the Fire District to submit an annual audit to the City, in compliance with the Agreement and Minnesota law. In addition, they pointed out that, consistent with the Agreement, the City should expect to receive the Fire District's monthly financial statements with a complete reporting of all revenues and expenditures.<sup>18</sup>

The OSA agrees with and supports the recommendations made by the City's auditors. Providing the parties to the Agreement with annual audits and monthly financial statements will help provide strict accountability of all funds and the reporting of all receipts and disbursements, as required of all joint powers entities under Minnesota law.

### **C. Payment of \$52,036 to Isanti Fire Relief Association**

The OSA requested and received copies of relevant Fire District Board meeting minutes to determine whether a \$52,036 payment made on December 17, 2009, by the Fire District to the Isanti Fire Relief Association (Fire Relief) was approved by the Fire District Board.<sup>19</sup> The December 17, 2009, meeting minutes stated that the monthly Treasurer's report was presented and approved, but did not include a separate discussion or approval of the \$52,036 payment. The Treasurer's report was not attached as part of the meeting minutes provided to the OSA.

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2007, payroll and interest income. In the 2007 AUP, the auditors also noted interest income recording errors and reconciliations that did not tie to the bank statements provided.

<sup>17</sup> City of Isanti Management Letter for year ended December 31, 2009, page 16 (April 2, 2010).

<sup>18</sup> See 2005 Joint Powers Agreement, art. III. B.

<sup>19</sup> Fire District check number 3078 was identified in the Fire District's general ledger as "shortfall pay" to the Isanti Fire Relief.

Based upon the OSA's records and other Fire District minutes provided to the OSA, it appears the \$52,036 payment may have been the Fire District's 2010 required municipal contribution to the Fire Relief.<sup>20</sup> However, the amount was paid in 2009. Under Minnesota law, the minimum municipal obligation calculated in 2009 is for the **following** calendar year, and should have been paid in 2010.<sup>21</sup> Because the payment was made in 2009, the payment would generally be considered by the OSA to be a voluntary municipal contribution for 2009.

The Fire Relief reported to the OSA that it received municipal contributions of \$58,636 in 2009, although no municipal contribution was required.<sup>22</sup> A municipal contribution of \$52,036 was required for 2010. The OSA has not yet received the Fire Relief's reporting forms to confirm the amount of municipal contributions the Fire Relief received in 2010.<sup>23</sup> Preliminarily, it appears a municipal contribution of approximately \$53,376 will be required for 2011, although the amount may change once the Fire Relief's reporting information is reviewed by the OSA.

The OSA recommends that the Fire District work with the Fire Relief and the OSA's Pension Director Rose Hennessy Allen to resolve this issue.<sup>24</sup> In the future, required municipal contributions should be paid during the year for which the contribution is required. Ms. Hennessy Allen may be contacted at 651-296-5985, or by email at: [Rose.Hennessy-Allen@state.mn.us](mailto:Rose.Hennessy-Allen@state.mn.us).

The OSA also recommends that the Treasurer's report be included as part of the formal Fire District Board meeting minutes. The OSA's Statement of Position on Meeting Minutes will provide the Fire District with additional guidance on meeting minutes. The Statement is located on the OSA's website at: [http://www.auditor.state.mn.us/other/Statements/meetingMinutes\\_0710\\_statement.pdf](http://www.auditor.state.mn.us/other/Statements/meetingMinutes_0710_statement.pdf).

#### **D. Accounting for Grant Funds**

The OSA obtained and reviewed the Fire District's 2009 general ledger. Based upon that review, it appears the Fire District received \$8,000 in grant funds during 2009. The grants were reported as "other income" rather than grant revenue.<sup>25</sup> In addition, it was not clear from the Fire District's general ledger which expenditures matched to the grant funds.

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<sup>20</sup> See Minn. Stat. § 69.772, subs. 3 and 4. See also Note 5 to Fire Relief's Financial Statements for December 31, 2009 and 2008.

<sup>21</sup> See Minn. Stat. § 69.772, subs. 3 and 4.

<sup>22</sup> See Fire Relief's Financial Statements for December 31, 2009 and 2008.

<sup>23</sup> If required municipal contributions are not received, State Fire Aid may be withheld.

<sup>24</sup> See, e.g., Minn. Stat. § 424A.05, subd. 3a.

<sup>25</sup> Of the total amount, \$3,000 appears to have been from the DNR and \$5,000 from the Minnesota Board of Firefighter Training and Education.

The OSA recommends that the Fire District work with its auditor on the coding of grants in the general ledger. The general ledger should record revenues and expenditures related to each grant. Providing each grant with a different account code in the general ledger would also help the Fire District with grant reporting to the granting agencies.

### **III. Conclusion**

The Office of the State Auditor provided the Fire District with recommendations based upon its review of the Fire District's compliance with audit requirements.

If you have any questions about this letter, please feel free to contact me at 651-282-2388 or via email at [Kathy.Docter@state.mn.us](mailto:Kathy.Docter@state.mn.us), or Nancy Bode at 651-297-5853 or via email at [Nancy.Bode@state.mn.us](mailto:Nancy.Bode@state.mn.us). Questions about the Fire Relief municipal contributions should be directed to Rose Hennessy Allen at 651-296-5985 or via email at [Rose.Hennessy-Allen@state.mn.us](mailto:Rose.Hennessy-Allen@state.mn.us).

Sincerely,

*/s/ Kathy Docter*

Kathy Docter CPA, CFE  
Office of the State Auditor

cc: Fire District Board Members  
Ms. Tina Wallace, Peffer & Wallace, Ltd., Certified Public Accountants  
Mr. Jim Lindberg, Lindberg & McKinnis P.A., Fire District Attorney  
Ms. Kristi Smith, City of Isanti Finance Director  
Mr. Clark Joslin, Isanti City Attorney  
Ms. Rose Hennessy Allen, OSA's Pension Director  
Mr. Tom Pagel, President of the Fire Relief  
Mr. Marc Volk, Treasurer of the Fire Relief