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September 18, 2003

The Honorable John Stone, Mayor
and Glenwood City Commissioners
Mr. David Iverson, City Administrator
137 East Minnesota Avenue
Glenwood, Minnesota 56334-9254

Dear Mayor Stone, City Commissioners and City Administrator:

The State Auditor's Office has conducted an examination of the financial records of the Lakeside Ballroom. As a result of our examination, we identified a number of weaknesses in the internal controls and management practices at the Lakeside Ballroom.¹ The purpose of this letter is to report our findings, to make recommendations that will address the weaknesses identified, and to assist the City of Glenwood (City) in protecting its assets in the future.²

Timely Daily Deposits

It is our understanding that deposits of Lakeside Ballroom receipts were to have been made on a daily basis. However, we have found deposits from the Lakeside Ballroom that were late or never made.

At the time of the Lakeside Ballroom fire on June 7, 2003, deposits of daily sales dating back to April 2003 were outstanding. Specifically, the City's deposit documentation shows that, at the time of the fire, deposits had been made from daily sales at the Lakeside Ballroom for only seventeen days in April 2003, five days in May 2003, and zero days in June 2003. The seventeen April 2003 deposits were not made until May and June 2003; four of the five May 2003 deposits were made on May 29, 2003; and the fifth May 2003 deposit was made on June 5, 2003. A review of the City's deposit documentation shows that three deposits for March 2003 daily sales were made on March 5, 2003, and one deposit for March 2003 daily sales was made on March 13, 2003, but

¹ We provided the Pope County Sheriff's Office and the Pope County Attorney's Office with additional findings from our review. Enclosed with this letter is a copy of the public version of our report.

² We understand that the City plans to rebuild the Lakeside Ballroom. In addition to protecting Lakeside Ballroom assets in the future, we hope that these recommendations will be considered for other City operations where appropriate. Because our review was limited to the records of the Lakeside Ballroom, other conditions may exist in other areas that we would not have identified during our review.

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the remaining deposits for March 2003 daily sales were not made until March 24, March 31 or April 2, 2003. A review of the City's deposit documentation shows that deposits for daily sales at the Lakeside Ballroom from February 1 – 6, 2003 were not deposited until March 2003, more than one month late.³

Timely deposits prevent unnecessary handling of funds, decrease the risk of potential misappropriation or loss of funds, and increase investment earnings. We recommend that deposits be made on a daily basis. In addition, we recommend that the City's Finance Officer review the timeliness of deposits on a regular basis, and that the City take appropriate action if the deposits are found to be untimely.

Handling of Funds for Special Events

Sales of beer, liquor, food (miscellaneous), wine, cigarettes and pop were rung into the cash registers used at the Lakeside Ballroom. However, the Lakeside Ballroom also received payments for such things as the rental of the Lakeside Ballroom, and kegs of beer or bottles of wine or champagne purchased for special events. Those payments were not rung into the cash registers.⁴ In addition, we were informed that the City did not have set rental rates for the Lakeside Ballroom until January 2003.

Checks for rentals of the Lakeside Ballroom that had not been deposited in the City's account were found at the Lakeside Ballroom fire scene.⁵ Some of the checks date back to August 2002. In addition, based upon our review of deposits into the City's account, we found rental checks that were not timely deposited.⁶ As a result, customers had checks written to the City that remained outstanding for months, the City was deprived of interest, and some of the checks may no longer be valid.⁷ In addition, we understand that

³ In addition to these late deposits, we observed additional deposits in 2002 and 2003 that were more than two weeks late.

⁴ Similarly, receipts from games operated at the Lakeside Ballroom were not rung into the register. The City was informed by the games vendor that two checks from the vendor were outstanding at the time of the fire (one from April 2003 and one from May 2003). The vendor has reissued a check for the amount reflected in the two outstanding checks (\$330.05). The State Auditor's Office obtained a list of checks issued by the vendor to the City for the time period January 7, 2002 through May 12, 2003. It appears that all other checks from the vendor during those dates were deposited in the City's account. We recommend that, in the future, such vendor checks be sent directly to the City.

⁵ A summary listing of the undeposited checks found at the Lakeside Ballroom fire scene is provided in the enclosed report. In addition to checks for special events, it appears that some of the checks found at the fire scene should have been included in deposits from register sales.

⁶ For example, checks for rental deposits dated December 12, 2002, and February 27, 2003, were not deposited until June 5, 2003.

⁷ A bank is not obligated to honor a check that is presented more than six months after the date of the check. *See* Minn. Stat. 336.4-404 (2002).

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the City had difficulty determining the amounts that properly needed to be refunded following the Lakeside Ballroom fire.⁸

We recommend that:

- All receipts, including those for rental of the Lakeside Ballroom, be rung into a cash register at the time the receipts are received; alternatively, receipts for items not rung into the register could be maintained in a numbered receipt book, with a copy of the receipt provided to the customer/vendor and to the City as deposit documentation;⁹
- The City maintain a record separate from the record maintained by the Lakeside Ballroom of all deposits received for rental of the Lakeside Ballroom;
- The City establish a calendar of Lakeside Ballroom events based upon the rental deposits received, and monitor that the full amount for the rental of the Lakeside Ballroom, as established by the Commission, has been deposited in the City's account; and
- Any refunds of deposits for the rental of the Lakeside Ballroom should be made by the City, not by the Lakeside Ballroom.

Use of Second Cash Register

The Lakeside Ballroom primarily used one register, but on occasion used a second register. Every summary tape run on the registers to zero-out the day's sales (Z1 Report) has a unique and sequential number. From our review of register tapes and deposit documentation, it appears that certain sales from the second register were never deposited in the City's account, and the City was provided with no explanation for the lack of the deposits.

To reduce the risk of potential misappropriation or loss of funds, we recommend that the City require the summary tapes that zero-out a day's sales (Z1 Report) to be submitted to the City with the deposit documentation.¹⁰ The City should then routinely review the sequential numbers found on the summary tapes to monitor that all register sales have been reported to the City and deposited in the City's account.

⁸ We reviewed deposits made into the City's account from August 2002 through June 2003. Based upon that review, we are compiling a list of deposits received by the City for events scheduled to be held at the Lakeside Ballroom after the June 7, 2003 fire.

⁹ The City would then be responsible to review that all receipted funds are deposited by comparing the sequential numbers found on the receipts.

¹⁰ The City had been accepting X1 Reports. However, the X1 Report may be run on a register at anytime and may not reflect all sales made prior to re-setting the register at zero for the next day's sales.

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Cashing Personal Checks

We were informed that the City had an unwritten policy allowing checks to be written for up to \$20.00 over the purchase amount. We found that the Lakeside Ballroom was cashing personal checks for Lakeside Ballroom employees and customers, and that many of the checks were for more than \$20.00 over the purchase amount. During our review of deposits made into the City's account, we found checks written to "cash", checks where the payee was left blank, and third-party checks.¹¹

These practices cause the City to be susceptible for losses incurred from checks returned due to insufficient funds, increasing the related costs of collection. Checks made out to "cash" or with no payee increase the risk of potential misappropriation. These practices also increase the cash balance that must be maintained at the Lakeside Ballroom, precluding the City from earning interest on the additional funds.

We recommend that the City discontinue the practice of cashing personal or third-party checks for Lakeside Ballroom employees and customers. All checks accepted by the Lakeside Ballroom should be made payable to the Lakeside Ballroom. The City may wish to explore the installation of an automated teller machine (ATM) at the Lakeside Ballroom if customers need access to cash.

Cash Returned During Deposits

We noted instances in which cash was given back during deposits of Lakeside Ballroom receipts into the City's account. Returning cash during a deposit increases the risk of loss of funds through misappropriation. We recommend that each deposit be made intact, and that the City's bank be directed not to return cash during a deposit.¹²

Voiding Receipts

While reviewing cash register tapes and deposit documentation for the Lakeside Ballroom, we noted weaknesses in the procedures used to document voids and over-rings.

¹¹ For example, during our review of City deposits, we found one check made out to "Cash" for \$120.00. In addition, on one occasion a daily sales deposit for \$474.24 included five personal checks from Lakeside Ballroom employees totaling \$210.00. Specifically, employee #1 submitted two checks totaling \$50.00, employee #2 issued one check for \$40.00, and employee #3 submitted two checks totaling \$120.00. Among the third-party checks that appear to have been cashed at the Lakeside Ballroom were City checks made out to bands playing at the Lakeside Ballroom. We noted third-party checks from both companies and individuals.

¹² The need for cash back will be reduced if personal and third-party checks are no longer cashed at the Lakeside Ballroom. For example, cashing a \$600.00 City check for a band playing at the Lakeside Ballroom increases the likelihood that cash will need to be returned during a deposit.

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When receipts are voided or over-rings occur, the employee responsible does not appear to consistently be documenting the incident by signing, explaining, and retaining the voided receipt or over-rung transaction. In addition, the Lakeside Ballroom manager does not appear to be consistently signing off and retaining the voided transactions or over-rings to document that they have been reviewed and an explanation of the differences has been provided. Documentation regarding voided transactions or over-rings reduces the risk of loss of funds through misappropriation.

We recommend that all voided and over-rung transactions be initialed and explained by the employee responsible for the transaction, reviewed by a supervisor for appropriateness, and retained as documentation for the differences between cash register sales tapes and daily cash balances.

Use of Cash vs. Check Function on the Cash Registers

The cash registers used at the Lakeside Ballroom had the capacity to identify whether receipts were collected as cash or checks. However, we found that the cash vs. check function on the cash register was not used. As a result, the summary tape did not identify whether the receipts collected were in the form of cash or checks.

To monitor whether cash has been taken from a register and replaced with a check that was not rung into the register, we recommend that the City use the cash vs. check function on the cash registers. The City would then be able to compare the cash and check amounts deposited in the City's account with the cash and check amounts reflected on the cash register tapes, and to investigate and document any differences.

Check Endorsements

The Lakeside Ballroom had a stamp used to endorse checks received by the Lakeside Ballroom. The stamp read: "FOR DEPOSIT ONLY GLENWOOD STATE BANK LAKESIDE BALLROOM" with the City's account number. However, we found checks made out to the Lakeside Ballroom that had not been endorsed with the stamp when received. In addition, it appears that prior to March 2003, Lakeside Ballroom employees were not required to initial checks that they received from customers as payment for purchases at the Lakeside Ballroom.

We recommend that upon receipt, all checks be endorsed with the stamp so the check is endorsed for deposit only. Checks that contain an endorsement "for deposit only" with the name of the account and account number are less likely to be cashed if lost or stolen. We also recommend that employees initial all checks upon receipt. Having checks initialed by employees provides a mechanism to review whether employees are handling

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checks in accordance with City policies and procedures. Employee initials on checks may also provide additional evidence should checks received in one register be placed in another register.

Change Fund

The City was unable to provide the OSA with documentation regarding the amount of money that the Lakeside Ballroom maintained as a reserve balance or change fund. To be able to determine if all City funds are accounted for, we recommend that the City determine the amount needed for a reserve balance or change fund, and document the amount provided for that purpose. Approval of the funds should be made by the City Commission and documented in the Commission minutes.

Entertainment Claims

The City issued checks to bands scheduled to play at the Lakeside Ballroom. We understand that it was the City's practice to issue the checks before the performance date without receiving a purchase order request from Lakeside Ballroom staff or an invoice from the band.¹³ As a result, the City maintains no documentation supporting these entertainment claims. The lack of documentation increases the risk of loss of funds through misappropriation. We recommend that the City require the submission of a vendor invoice before issuing a check to a band performing at a City facility.¹⁴

Lack of Timesheets

The City did not have timesheets from the Lakeside Ballroom manager for 2002 and 2003. Without timesheets, the City is less able to monitor employees and the time spent on the performance of their duties. We recommend that all employees provide the City with timesheets signed by the employee and a supervisor.¹⁵

Non-Sufficient Fund Collections

Approximately \$340.00 in checks that had been returned to the Lakeside Ballroom for non-sufficient funds ("nsf") or closed accounts were found at the Lakeside Ballroom fire scene. Although we found deposits in 2001 where collections were made for nsf checks, we found no such deposits after August 1, 2001. Lack of collection on nsf checks

¹³ We were informed that the City does enter into a contract with a band hired to perform at the City's Waterama event.

¹⁴ See generally Minn. Stat. § 412.271, subd. 2 (2002). See also Minn. Stat. § 471.38, subd. 1 (2002). Alternatively, the City could enter a contract with each band.

¹⁵ See generally Minn. Stat. § 412.271, subd. 2 (2002). See also Minn. Stat. § 471.38, subd. 2 (2002).

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deprives the City of a source of funds. We recommend that the City take steps to collect on NSF checks in a timely manner.

Future Audits

We recommend that future City audits include a detailed review of City operations where cash receipts are prevalent. Those audits should include an on-site review of internal control procedures. If the City decides to lease the management of the Lakeside Ballroom, the City may wish to retain authority to review internal controls associated with the operation of the Lakeside Ballroom.

Internal Control Policies and Procedures

The City does not have written policies and procedures for its accounting functions, including the following: the handling of cash receipts, the need for daily deposits, the cashing of personal checks, and the establishment of change funds. The lack of written policies and procedures increases the risk that errors, omissions, and irregularities may occur and go undetected. We recommend that the City establish written policies and procedures for its accounting functions.

Segregation of Duties

Until January 2003, the Lakeside Ballroom manager was responsible for setting the rate to be charged for rental of the Lakeside Ballroom. In addition, the Lakeside Ballroom manager was responsible for collecting the deposit and final payment for the rental of the Lakeside Ballroom. The Lakeside Ballroom manager was also responsible for preparing and delivering all Lakeside Ballroom deposits to the bank.

Good business practices require that certain incompatible accounting functions or duties be segregated in a manner that would allow errors or irregularities to be detected timely. Segregation of duties is an arrangement of responsibilities so that the work of one employee is checked by another. Ideally, no single individual should be able to: authorize a transaction, record the transaction and maintain related financial records, or have custody of assets.

We recommend that the City Commission review these responsibilities and assign duties so that there is adequate separation. If it is not possible to adequately separate these duties due to limited staff, we recommend that the City Commission constantly be aware of the lack of segregation of duties and implement oversight procedures to ensure that the internal control policies and procedures are being implemented.

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Conclusion

The City Commission is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments are required to assess the expected benefits and related costs of internal control policies and procedures. The objective of internal controls is to provide the City Commission with reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition;
- Transactions are executed in accordance with the City Commission's authorization; and
- Transactions are recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles.

We remain available to provide you with any additional assistance you may need. We request that you notify us in writing of any changes implemented as a result of this examination. If you have any questions about the matters contained in this letter, please feel free to call Ms. Nancy Bode at 651-297-5853, or Deputy State Auditor Greg Hierlinger at 651-296-7003.

/s/ Patricia Awada

Patricia Awada
State Auditor

Enclosure

cc: Mr. Bruce Obenland
City Attorney

Mr. Belvin Doebbert
Pope County Attorney

