

STATE OF MINNESOTA

Office of the State Auditor



Rebecca Otto
State Auditor

CITY OF CLAREMONT, MINNESOTA

JANUARY 1, 2004, THROUGH NOVEMBER 30, 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.

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CITY OF CLAREMONT, MINNESOTA

January 1, 2004, through November 30, 2007



Petition Engagement

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

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Petitioners
Members of the City Council
City of Claremont
Dodge County

INTRODUCTION AND BACKGROUND

Eligible voters from the City of Claremont petitioned the Office of the State Auditor (OSA) to examine the books, records, accounts, and affairs of the City in accordance with Minn. Stat. § 6.54 for the period January 1, 2004, through November 30, 2007.

The City is a public corporation and part of the State of Minnesota's general and uniform system of cities. The elected City Council is responsible for the care, management, and control of the City. A City Administrator is employed by the Council and is responsible for administrative duties. The City's financial statements are audited annually by an external audit firm.

The OSA has completed its examination into the concerns identified by the petitioners of the City. The objectives of the engagement were to address the concerns of, and to answer the questions raised by, the petitioners. Where applicable and appropriate, we make recommendations to the City in this report.

Minn. Stat. § 6.54 allows the OSA, in the public interest, to confine the scope of the examination to less than that requested by the petition. Communications with the Chief Petitioner assisted us in developing an understanding of the petitioners' areas of interest or concern. We established that some of the issues raised were not within the scope of this review.

1. Petitioners' Concern: The City had no money in October and November 2006 in the General Fund, yet in December the City Administrator came up with \$160,000 to spend wherever they wanted to spend it. Where did the money come from and where did it go?

Finding and Response

We reviewed the City's General Fund general ledger for 2006. The large increases in cash were due to the City receiving its property tax settlement from Dodge County, and receiving its local government aid and market value aid from the State of Minnesota. The City did have cash on hand during the months of October, November, and December as illustrated by the following table.

2006	Beginning Cash Balance	Ending Cash Balance	Notes
January	\$439,607.49	\$428,696.61	
February	\$428,696.61	\$409,102.42	
March	\$409,102.42	\$382,563.99	
April	\$382,563.99	\$362,991.17	
May	\$362,991.17	\$352,827.78	
June	\$352,827.78	\$384,674.04	City received first tax settlement from Dodge County
July	\$384,674.04	\$448,985.26	City received local government aid from the State of Minnesota
August	\$448,985.26	\$403,925.12	
September	\$403,925.12	\$359,760.39	
October	\$359,760.39	\$333,080.71	
November	\$333,080.71	\$325,431.30	
December	\$325,431.30	\$462,087.72	City received second tax settlement from Dodge County and market value aid and local government aid from the State of Minnesota

The City Council on December 12, 2006, designated \$161,149 of the General Fund year-end fund balance for street improvements. This designation is permissible under generally accepted accounting principles for governments. As of January 31, 2008, the City had not spent this cash.

2. Petitioners' Concern: The petitioners claim that in December 2006, there was \$30,000 earmarked for decommissioning the sewer holding pond, and a motion was made to put it in a certificate of deposit (CD) for decommissioning the sewer pond instead of just leaving it in the General Fund. The City levied taxes in the Sewer Fund of \$50,000 for 2007 to use for decommissioning the sewer holding pond. The bid was \$80,000. The City levied taxes in the Sewer Fund of \$50,000 for 2008. How come? They now have \$130,000 to do the pond, which should only have been \$80,000. Where did they spend it or where is it?

Finding and Response

On December 12, 2006, the City Council agreed to put \$30,000 into a CD for the decommissioning of the sewer holding pond, as they had budgeted \$30,000 for this expenditure. CD #84851 was taken out in the amount of \$35,000; \$30,000 was for decommissioning the pond and \$5,000 was for snowplow equipment. We verified the existence of the CD to the December 31, 2007, bank statement, at which time, it was valued at \$36,837.61. No property taxes were levied for decommissioning the holding pond. The City levied property taxes of \$60,000 for the Sewer Fund in 2007 and 2008. The money raised by these two levies was to make the annual principal and interest payments on the City bonds issued in 2005 for \$1,550,000. The money earmarked for the decommissioning of the holding pond is coming from a federal grant received by the City in 2004. According to the federal grant agreement, the City has until November 1, 2008, to complete the decommissioning of the pond. The City has contracted with Di-Mar Construction, Inc., to decommission the pond for \$68,700. The federal grant received in 2004 has been set aside as a General Fund reserve in the City's December 31, 2006, audited financial statements to pay for the decommissioning of the holding pond.

3. Petitioners' Concern: The City Council voted to give an individual \$2,000 to help him start up a truck parking place. The trucks will pay a fee to park. Is it legal to take taxpayers' money for personal upkeep?

Finding and Response

The City has quite a few truck drivers living in it. They were parking their trucks on the City streets, and one of them took some power lines down when driving on a City street. Thereafter, the City entered into a contract with a limited liability company (LLC) under which the LLC agreed to construct a "public truck parking area" on privately-owned property. The contract recites that the City and the LLC agree that, "it is in the public interests of the City of Claremont to have a public truck parking area located on the Property."

Under the contract, the LLC agreed to construct the public truck parking area and maintain it for a minimum of three years. In return, the City agreed to “provide snow removal services to the public truck parking area on the Property and the alley adjacent to the Property at no cost to [the LLC],” and to contribute \$2,000 toward construction of the public truck parking area once it becomes operational. The petitioners question the authority for this arrangement.

The statutes set out authorities regarding city expenditures to control and regulate traffic on the streets and to provide parking. For example, cities have authority to acquire property “needed for improving the municipality’s regulation and control of traffic on its streets.” Minn. Stat. § 459.14. The same statute authorizes cities to “construct, or otherwise provide, equip, maintain and operate automobile parking facilities and [to] expend municipal funds for these purposes.” Minn. Stat. § 459.14. In addition, cities have authority to acquire, improve, and operate automobile parking facilities and tourist camps. Minn. Stat. § 412.221, subd. 14. Although the issue of authority is not without ambiguity because trucks rather than automobiles are involved, it appears that these statutes may serve as authority for the public truck parking area.

4. Petitioners’ Concern: The City voted to give an individual \$500 so he could fix his siding on the side toward town to make it look nice. Is that legal to use my taxes that way (for private person)?

Finding and Response

On July 24, 2007, the City paid \$500 for the use of the side of the building for a mural. Part of the City’s agreement with the building owner is that if the building is sold within 24 months, the owner will have to refund the \$500 to the City.

The City paid for the mural using Economic Development Agency (EDA) funds. The Claremont EDA does not have the authority to expend public funds to put a city mural on a building. However, the City has statutory authority under Minn. Stat. § 469.189, to spend “to advertise the municipality and its resources and advantages.” This authority allows the City to spend money for murals or signs advertising the City.

We recommend that the City reimburse the EDA for the monies taken out of the EDA account to pay for the mural expenses.

5. Petitioners’ Concern: The EDA gave \$10,000 to a business (Toners restaurant) when they already had one EDA loan. They were behind in their bills. Can they do that?

Finding and Response

City of Claremont Economic Development Revolving Loan Funds Guidelines, as amended October 1996, state the loans are limited to one per year for any borrower with a max amount of \$25,000. The first loan was issued on October 27, 2005, for \$10,000; this loan met the EDA guidelines. The second loan was issued more than a year later on November 30, 2006, for \$10,000, keeping the total amount of the two loans below \$25,000. The borrower met the EDA guidelines. According to the EDA guidelines, the City can lend to the same individual twice, as long as the loans are over a year apart and the total amount does not exceed \$25,000. The City of Claremont Economic Development Revolving Loan Funds Guidelines, as amended October 1996, do not require the EDA to consider the financial condition of the business as a component of determining whether the business is qualified for a loan.

Delinquent Loan Payments:

The City is not complying with the requirements of the EDA loan because it is not assessing late charges to the aforementioned borrower. The loan agreement states that the borrower shall pay a late charge of five percent of any monthly installment not received within ten days after the installment is due. On the first loan, the borrower was late with the monthly payments for the following months: April, May, July, August, October, November, and December 2006, and for all 12 months of 2007. On the second loan, the borrower was delinquent on payments for March, April, May, June, July, August, September, October, November, and December 2007. The total late charges due on both of the loans as of December 31, 2007, were \$516.12.

We recommend that the City comply with the requirements of the loan.

6. Petitioners' Concern: Payroll expenditures - the City includes in its employees' paycheck an allowance for the employees to pay for their medical insurance premiums. Are payroll taxes being taken out, and is it being reported on the employee's W-2 form? How is the City handling the medical insurance allowances paid now and in the prior years for payroll tax purposes?

Finding and Response

Three employees of the City receive a bi-weekly allowance to pay for their medical insurance premiums. During 2007 and 2006, the allowance was added to their gross pay, and payroll taxes were withheld. Prior to 2006, employees received a bi-weekly medical allowance, but it was not added to their gross wages. Payroll taxes were not withheld from the allowances, and they were not included in an employee's W-2 form.

We also recommend that the City contact the IRS to discuss how to resolve the nonpayment of income taxes, social security, Medicare, and Federal unemployment taxes (FUTA) in prior years.

7. Petitioners' Concern: Verify the sewer and water bills to see if everyone is being billed and if everyone is being billed the same. For delinquent bills, are arrangements for the water bill payments being made to actually pay the bill, or are they paying less than the minimum?

Finding and Response

During 2005, the water rates were \$6 per 1,000 gallons, and the sewer rates were \$6.30 per 1,000 gallons. The flat fee for each month was \$8 for water and \$10 for sewer. The rates for 2005 were correctly charged. During 2006, the water rates were \$6 per 1,000 gallons, and the sewer rates were \$6.30 per 1,000 gallons. The flat fee for each month was \$8 for water and \$10 for sewer. The rates for 2006 were correctly charged. During 2007, the water rates were \$6.50 per 1,000 gallons, and the sewer rates were \$6.80 per 1,000 gallons. The flat fee for each month was \$8 for water and \$10 for sewer. The rates for 2007 were correctly charged, except for the D.C. United Properties on North Elm Street. When this property was separated into individual users, one unit was not charged the \$10 flat sewer fee since June 2007. It is the City's practice to shut off service for non-payments of water and sewer bills and, if necessary, payments in arrears are added as an assessment to the tax roll of the individual property.

8. Petitioners' Concern: Are the water and sewer receipts going into the right accounts?

Finding and Response

The City's procedures for the water and sewer receipts are as follows: The maintenance worker reads the meters on the last working day of the month with an automatic reader. The reader is brought to the City Clerk who puts the reader into a stand that reads data into the computer software. The Clerk prints a bill register and reviews it for unusual items, prints the bills, and mails them to the customers. Customers mail in their payments, put them in a designated drop box, or come to City Hall to make their payments. The City Clerk marks "Paid" on the bill stubs and endorses the checks right away. Receipts are batched, and a batch control sheet is prepared showing a total of the receipts in the batch. The batch total is recorded in the Water and Sewer Accounting System, and the individual payments get recorded in the customer's account. The total of the individual payments posted to the customers' accounts is compared to the batch total for agreement. Once the information is correct, the Accounting System is backed up, customers' accounts are

updated, and the total receipt information gets transferred to the Water and Sewer Fund General Ledger. The checks are deposited, and the bank deposit slip is stapled to the batch control sheet. For the period tested, water and sewer receipts were going into their proper accounts.

9. Petitioners' Concern: Petty cash account. Check to see if in previous years, the Clerk was taking \$100 every month. (Additional explanation: In 2004 and 2005, petty cash reimbursement may have been for items that should have been billed to other accounts. The City Clerk may have gotten money for payment of highway miscellaneous bill of \$20, but the bill was for \$18, so \$2 change was made, and the full \$20 was recorded as revenue in the highway fund?) Also, noted that past auditors may have had them correct this.

Finding and Response

The past auditors had no comments relating to the petty cash account in their annual report to the City for the years 2004 through 2006.

In 2004 and prior years, the City was receipting monies received for copies, notary, and faxes from individuals into the petty cash account. The City stopped this practice in 2005. We could find no evidence that the City Clerk was collecting \$100 a month for the petty cash account. The average expenditures per month were generally about \$17.50, with a fluctuation for certified letters (see chart that follows). The City Clerk had the invoices on file which documented the petty cash expenditures. The City Clerk had the petty cash account replenished to the \$100 approved amount every four to five months. We noted no change given out from the petty cash account for collections made by the City.

<u>Year</u>	<u>Receipts</u>	<u>Expenditures</u>	<u>Average Expenditure Per Month</u>	<u>Explanation</u>
2004	\$ 21.00	\$ 358.81	\$ 29.90	City had 33 certified letters at \$4.42 each
2005	1.50	242.96	20.25	City had 8 certified letters at \$4.42 each
2006	4.39	215.42	17.95	City had 2 certified letters at \$5.36 each
2007	-	209.84	17.49	City had 1 certified letter at \$4.88

Minn. Stat. § 412.271, subd. 5, authorizes city councils to establish petty cash funds (referred to in the statute as imprest funds) for the payment in cash of any proper claim against the city which is impractical to pay in any other manner. No claim for salary or personal expenses of an officer or employee may be paid from such funds.

Pursuant to the statute, the city council must appoint a custodian for each fund, who shall be responsible for its safekeeping and disbursement according to law. Money for the operation of the fund must be secured by a transfer from the general fund.

The following procedures are mandated by Minn. Stat. § 412.271, subd. 5:

- A claim itemizing all the various demands for which disbursements have been made must be presented to the city council at the next council meeting after the disbursements have been made.
- The city council shall act upon it as in the case of other claims and an order shall be issued to the custodian for the amount allowed.
- The custodian must use the proceeds of the order to replenish the fund.
- If the city council fails to approve the claim in full for any sufficient reason, the custodian shall be personally responsible for the difference.

We recommend that the City Council act to establish and operate the petty cash (imprest) fund in accordance with the requirements of Minn. Stat. § 412.271, subd. 5.

10. Petitioners' Concern: Were the annuity payments handled properly for Council members and also for those who had additional amounts taken out for the annuity?

Finding and Response

The City makes a \$25 contribution for each employee and Council member to a life annuity account held by Pioneer Mutual. Any contributions over \$25 per month to the employees' and members' annuity accounts are taken from the employees' wages and the Council members' per diems. For the years 2005, 2006, and 2007, the correct amount was withheld from the employees' wages and the Council members' per diems. We were unable to verify that this plan was established, maintained or operated prior to May 6, 1971.

We are not aware of any statute that would authorize the City to contribute public funds to life annuity accounts. The City does have authority to provide life insurance coverage to its employees under a group plan. Minn. Stat. § 471.61. Placing funds in a life annuity account is not authorized by this statute.

Minn. Stat. § 356.24 specifically prohibits contributing public funds to any supplemental pension or deferred compensation plan. Exempted from this prohibition are tax sheltered annuities pursuant to IRS Code 403(b) but only for employees of school districts. This exemption does not apply to the City or its employees. Minn. Stat § 356.24, Subd.1(5)(ii). Also exempted are plans established, maintained or operated prior to May 6, 1971. We were unable to verify when this policy went into effect.

Unless the City can determine that this plan was in operation prior to May 6, 1971, we recommend that the City discontinue placing public funds in life annuity accounts for its employees and officers. The City can provide life insurance death benefits to its employees and officers through a group plan. If the City wishes to contribute to a postemployment fund for its employees, it can do so through a deferred compensation program under Minn. Stat. § 352.96. The City's contribution would be limited to \$2,000 annually per employee and the employer contribution must be matched by an equal employee contribution. Minn. Stat. § 356.24, Subd.1(5)(i). Before including City officers in such a plan please consult with the City Attorney regarding their eligibility under state law.

11. Petitioners' Concern: The Hogfest celebration is not funded by the City per the petitioner but by the Chamber of Commerce. Petitioners are concerned that money is being received by the City from charitable gambling organizations for this event, which is not funded by the City. What is this money being spent on and why? Also, they question whether payments are being made on behalf of this celebration for water, sewer, or garbage collection?

Finding and Response

The City received a \$3,000 donation from the Chamber of Commerce for the 2007 Hogfest. The City Council did not accept this donation by resolution. The City paid \$3,012.24 for costs associated with this annual celebration. The petitioners question whether the City has authority to accept donations for and spend money on Hogfest.

Acceptance of Donations:

Cities may accept gifts of real or personal property, including money, and use them in accordance with the terms prescribed by the donor. Under Minnesota law, the gift must be accepted by resolution of the City Council, adopted by a two-thirds majority of its members, expressing the donor's terms in full. *See* Minn. Stat. § 465.03. (Expenditures, of course, must be authorized and serve a public purpose, as explained below.)

We recommend that the City comply with Minn. Stat. § 465.03 by accepting donations by resolution of the City Council adopted by a two-thirds majority of its members.

Festival Expenditures:

A city must have authority to make an expenditure, and the expenditure must be made for a public purpose. *See* Minn. Const., art. X, § 1 ("Taxes . . . shall be levied and collected for public purposes."); *Visina v. Freeman*, 89 N.W.2d 635 (1958) (courts generally construe "public purpose" to mean "such an activity as will serve as a benefit to the community as a body and which, at the same time, is directly related to the functions of

government”); *Tousley v. Leach*, 180 Minn. 293, 230 N.W. 788 (1930) (public funds may be used by public entity if the purpose is a public one for which tax money may be used, there is authority to make the expenditure, and the use is genuine). These requirements apply to money a city receives from sources other than taxation. See Op. Att’y. Gen. 107-A-3 (Jan. 22, 1980), (Authority and public purpose requirements apply to “funds of governmental entities derived not only from taxation but from other sources as well”).

Although authority exists for cities to spend money to commemorate important city historical events and for Memorial Day observances, there is no general authorization for festival expenditures. See Minn. Stat. §§ 471.93; 465.50; see also "Public Purpose Expenditures," League of Minnesota Cities, (publication 215H2.1), March 2006. Therefore, the costs of Hogfest should not be paid by or through the City.

We recommend that the City separate itself from paying for Hogfest.

CONCLUSION

We were not engaged to and did not perform an audit, the objective of which would be the expression of an opinion on specified elements, accounts, or items relating to the petitioners’ concerns as identified in this report. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters may have come to our attention that we would have reported to you.

This report has been prepared for the information of the petitioners of the City of Claremont, the Mayor and City Council, and the management of the City, but is a matter of public record, and its distribution is not limited.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

April 11, 2008