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State Auditor

Suite 500
525 Park Street
Saint Paul, MN 55103

May 13, 2021

The Honorable Greg Hagy
Mayor, City of Cohasset
305 Northwest 1st Avenue
Cohasset, Minnesota 55721

TRANSMITTED VIA ELECTRONIC MAIL

Dear Mayor Hagy:

The Office of the State Auditor (OSA) received concerns about the City of Cohasset (City). Specifically, concerns were raised about the City's cash handling procedures and use of petty cash. In response to these concerns, the OSA contacted the City and requested and examined certain City documents including bank statements, check images, and certain itemized claims for the period July 1, 2020, through October 31, 2020. The City also provided some City cash records to the OSA going back to 2002. The OSA discussed the City's cash handling procedures with City staff. Based on this review, the OSA found that;

- 1) The City Council did not establish its petty cash as an imprest cash fund or follow the requirements for the establishment and use of such funds.
- 2) The City used petty cash funds to make purchases not authorized by Minnesota Law.
- 3) The City has not established proper internal controls over certain cash handling procedures. For example, the City commingled petty cash and cash used to make change for cash transactions (change funds) in one cash drawer that was accessed by several City employees on a daily basis.

This letter contains the OSA's findings and internal control recommendations to help the City comply with Minnesota law.

Background

The City is a statutory City with a population of 2,624. According to its website, the City "provides essential services, such as municipal sewer, water, natural gas, and fire protection." The City's 2019 audited Financial Statements report Charges for Services totaling \$2,232,245. According to the notes to the City's 2019 audited Financial Statements, the City had \$765 in "Petty cash" on December 31, 2019.¹

Minnesota Law

Minnesota Statutes specify the methods a city may use to pay claims. Minnesota Statutes, section 412.271, subd. 1, states "[n]o disbursement of city funds, including funds of any municipal liquor dispensary operated by the city, shall be made except by an order drawn by the mayor and clerk upon the treasurer." Minnesota law thus requires city checks to be signed by the mayor, the city clerk, and

¹ See Financial Statements, December 31, 2019, City of Cohasset, Minnesota. This amount appears to report both the City's petty cash and change funds.

the treasurer.² As a general rule, a check must not be issued until the claim to which the check relates has “been audited and allowed by the council.”³

A city, however, is also authorized to pay claims by electronic funds transfer or by credit card if statutory procedures are followed.⁴

Finally, Minnesota Statutes, section 412.271, subd. 5, specifically authorizes petty cash expenditures, but only through the use of an imprest cash fund. Because these funds consist of cash, extra security precautions are statutorily required to safeguard them.

The statute requires that each imprest cash fund must be established by the city council, and a “custodian” of the fund must be appointed.⁵ Meeting minutes should document the creation, custodian, and amount of any imprest fund. The city council should periodically review these funds to determine whether they are still necessary.

An imprest cash fund may be used for the payment of a proper claim if “it is impractical” to pay the claim in any other manner.⁶ The statute prohibits using an imprest cash fund “for salaries or personal expenses of an officer or employee.”

A claim itemizing all disbursements from an imprest cash fund must be presented to the city council at its next meeting. If the city council approves the claim, the fund’s custodian should be given payment to replenish the fund. If the city council fails to approve the claim in full, the fund’s custodian is personally responsible for the difference.⁷

Expenditure of public funds requires that there be both authority and a public purpose.⁸ Authority may be specifically stated in a statute or implied as necessary to do something that is expressly authorized.⁹ A public purpose has been defined by the Minnesota Supreme Court as “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.”¹⁰

OSA Review

City Receipt of Cash

According to the City, the City accepts cash payments for utility bills and zoning fees. The cash received for these payments is placed in a cash box located at the City’s main office. To support this process, the City has placed additional cash in this cash box to make change for cash payments made to the City. On

² See Minn. Stat. § 412.271, subd. 1.

³ *Id.*

⁴ See Minn. Stat. §§ 471.381 and 471.382.

⁵ See Minn. Stat. § 412.271, subd. 5.

⁶ *Id.*

⁷ *Id.*

⁸ See, e.g., Op. Att’y Gen. (Dec. 4, 1934); 63a-2 (May 6, 1965); 59a-22 (Nov.23, 1966).

⁹ See, e.g., *Mangold Midwest Co. v. Village of Richfield*, 143 N.W.2d 813, 820 (1966).

¹⁰ See *Visina v. Freeman*, 89 N.W.2d 635 (1958).

December 31, 2019, this change fund in the cash box totaled \$265.¹¹ The City also noted that it issues receipts for all cash payments it receives, that the lock box is locked after hours, and that the office is under video surveillance. The OSA requested financial documents from the City including bank statements from July 1, 2020, through December 31, 2020. The OSA scanned images of City deposit slips included in these statements and noted that it appears the City deposited cash amounts between \$1,200 and \$4,300 each month during this period.

City Petty Cash

The City informed the OSA that it uses a petty cash fund that totals \$500 to make certain City purchases throughout the year.¹² The OSA requested and the City provided certain City documents related to the petty cash fund including a handwritten ledger of petty cash activity from September 11, 2019, through October 23, 2020. The City reported that the City uses petty cash for both advances and reimbursements.

Cash Expenditures – Concerns

The OSA requested but the City could not provide documentation establishing that its petty cash funds were established as imprest cash funds as required by Minn. Stat. § 412.271, subd. 5.

City petty cash records from September of 2019 through August of 2020 show that the City used petty cash to pay for certain items that do not appear authorized under Minnesota Law including; reimbursement for employee use of a personal gift card (\$44.95), and an employee reimbursement for a “going away” event (\$51.30).

Finally, the OSA also discovered a City check written to “cash” that was not included in the City’s petty cash records. This check totaled \$2,300 and was issued on July 28, 2020. The OSA requested the itemized claim for this check and was provided a “Request for City Council Action” in which it appears the City Council approved “awards for the first half of 2020 for no lost time Worker’s Comp. claim (LTWCC).” The itemized claim included a list of City employees with hand written notes. It appears the City disbursed cash to its employees. The OSA is not aware of any authority for a city to disburse cash in this manner.

Cash Expenditures - Recommendations

Based on the information provided to the OSA by the City, the OSA recommends that City make the following changes to its cash handling procedures:

- 1) If it wishes to authorize petty cash expenditures, the City Council must establish imprest cash funds under Minn. Stat. § 412.271, subd. 5.

¹¹ City records going back to 2002 show that the balance of the change fund has varied over time and was as much as \$568.

¹² City records going back to 2002 show that the balance of this petty cash fund has varied over time and was as much as \$809.

- 2) The City Council must appoint a “custodian” for each fund.¹³
- 3) Periodically, the City Council should review these funds to determine whether they are still necessary.
- 4) The City should stop the practice of paying cash to employees.
- 5) The City should insure that petty cash is only used for purchases permitted by law.

For more information I have enclosed a copy of the OSA’s Statement of Position on Petty Cash (Imprest) Funds.

Cash Handling Internal Controls - Concerns

Based on the information provided by the City, the OSA identified the following concerns regarding lax internal controls in the City’s cash handling procedures:

- 1) The City’s petty cash is held in the same lock box as the change fund,
- 2) The lock box remains unlocked during the business day,
- 3) Six different City employees can access the lock box during the business day,
- 4) The City employee responsible for reconciling the cash box accesses the lock box during the business day, and
- 5) The City’s electronic records are not reviewed for adjusting entries or voids.

Cash Handling Internal Controls - Recommendations

It appears the City could benefit from a review and update of its cash handling controls. To assist in this process, the OSA suggests the following:

- 1) The City should separate its petty cash and change funds.
- 2) The City should keep any lock boxes locked during the business day when not in use.
- 3) The City should implement more stringent access controls for its petty cash and change funds. Whenever possible, one employee should be responsible for a cash box or drawer. This procedure makes it clear which employee is responsible for the cash in each cash box or drawer. When two or more employees place cash into the same cash box or drawer, this simple internal control is corrupted.
- 4) The City’s cash boxes or drawers should be reconciled at the end of every day by someone who has not accessed the cash box or drawer that day so that no one individual is responsible for recording and reconciling the same transaction.
- 5) Voids and adjusting entries should be reviewed on at least a quarterly basis. Voids and adjusting entries can be used to cover up cash or cash register theft schemes. All voids and adjusting entries should be reviewed by someone other than the person recording the entry.

* * *

We remain available to provide you with additional assistance in this matter, should you need it.

¹³ The designated imprest fund custodian is personally responsible for the cash entrusted to the fund. See Minn. Stat. § 412.271, subd. 5.

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You can contact me at (651) 296-4717 or Mark.Kerr@osa.state.mn.us or Nichole Bjornrud, CPA, CFE, at (651) 282-2750 or Nichole.Bjornrud@osa.state.mn.us.

Sincerely,
/s/ Mark F. Kerr
Mark F. Kerr, JD, CFE
Special Investigations Director
Office of the State Auditor
(651)296-4717

Enc.

cc: The Honorable Tim Carlson, City Council Member
The Honorable Phillip Hermel, City Council Member
The Honorable Jason Tabaka, City Council Member
The Honorable Terry Bartz, City Council Member
Mr. Max Peters, Director of City Operations / Finance Director