

STATE OF MINNESOTA

Office of the State Auditor



**Rebecca Otto
State Auditor**

CITY OF WATSON

PETITION ENGAGEMENT

JANUARY 1, 2003, THROUGH DECEMBER 31, 2009

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:

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Government Information - collects and analyzes financial information for cities, towns, counties, and special districts;

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CITY OF WATSON

January 1, 2003, through December 31, 2009



Petition Engagement

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

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REPORT TO PETITIONERS AND CITY

Petitioners
Members of the City Council
City of Watson
Chippewa County

INTRODUCTION AND BACKGROUND

Two groups of petitioners comprised of eligible voters from the City of Watson 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. The first group of petitioners asked the OSA to examine the books, records, accounts, and affairs of the City for the period January 1, 2006, through October 30, 2009. The second group of petitioners asked the OSA to examine the books, records, accounts, and affairs of the City for the period January 1, 2003, through December 31, 2009.

The City is a public corporation and part of the State of Minnesota's general and uniform system of cities. The City was established in 1900 under the Standard Plan of organization for statutory cities. The governing body consisted of an elected Mayor, elected City Clerk, and three Council members. The City Treasurer was elected but was not a member of the governing council. The City Clerk was responsible for administrative duties. The City, which has a population of just over 200, is not required under Minnesota statutes to have an annual external audit.

On February 23, 2010, the City held a special election, and its residents voted to switch from the Standard Plan to become a Plan A statutory city. In the Plan A form of government, the governing body consists of an elected mayor and four (or six) elected council members.¹ The

¹ See Minn. Stat. § 412.581.

governing body in this form of government can appoint a clerk and treasurer or a combined clerk-treasurer for an indefinite term of office.² The duties of the clerk and treasurer positions remain the same, except the clerk is not a member of the council and cannot vote at council meetings.³

Minnesota Statutes § 6.54 allows the OSA, in the public interest, to confine the scope of the examination to less than that requested by the petitions. Communications with petitioners 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.

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.

1. Petitioners' Concerns - Maintenance Worker Employment Issues

Petitioners observed the maintenance person working an inconsistent schedule throughout the week and questioned the criterion for earning overtime pay or comp time. Primary concerns included the approval of a personnel policy by the City Council addressing topics such as pay dates, employment conditions, accruals of vacation and sick leave, lump-sum payouts of accrued vacation or sick leave, and other termination benefits.

Findings and Responses

A. Maintenance Worker Employment Agreement

The maintenance position was paid hourly with a flexible 40-hour work week before comp time or overtime was earned. The standard work week for the maintenance worker started on Sunday and ended on Saturday. Each pay period is two weeks. The City has no employment contract or Council-approved personnel policy. The Council minutes of October 12, 2001, approved the hiring of the maintenance worker. Those minutes were the only documentation provided of the conditions of employment detailing vacation and sick leave accrual rates. The City did not maintain a personnel file for the maintenance worker.

We recommend that the City maintain a personnel file for any employee. The personnel file should contain terms of employment, the Council's actions taken for hourly pay, pay rate changes, and other changes to the employment agreement.

² *Id.*

³ Minn. Stat. § 412.591.

B. Payroll Processes

The maintenance worker submitted timesheets the Monday after each two-week pay period ended and was paid the following day. The Council approved the timesheets, but there was no signature of the Mayor or the Clerk on the timesheets indicating approval. The Clerk calculated the deductions and net pay and wrote out the payroll check. The Clerk submitted this information to an accounting firm where it was reviewed and recalculated. The payroll deductions were later sent to the appropriate organizations by the accounting firm via a wire transfer out of the City's checking account. The process of the accounting firm making the wire transfer was implemented during 2007 by the Clerk, however, the OSA was not provided with documentation that this process was approved by the City Council.

Minnesota Statutes § 412.271, subd. 2(b), requires that city employee timesheets contain a declaration signed by the "timekeeper, supervisor, or other officers or employee having knowledge of the facts."

We recommend that the employee sign timesheets with a counter signature of someone who is knowledgeable of the employee's activities as required by Minn. Stat. § 412.271, subd. 2(b).

Further, we recommend the City Council approve any process, including the terms and conditions with the bank, that allows the accounting firm to make wire transfers out of the City's checking account for the employee's state and federal withholdings. Any wire transfers made by the accounting firm should be subsequently approved by the City Council. The City Council should establish policies and procedures to ensure the validity of electronic approvals used in any such process.⁴

C. Vacation and Sick Time

We reviewed the Council minutes of the October 12, 2001, meeting, which indicate that the maintenance worker hired was to "receive four hours of sick leave per month and after one year of service [would] receive two weeks of vacation." We noted that the Clerk awarded two weeks of vacation on January 1 of each year rather than at the October anniversary date or having the amount prorated throughout the year. In addition, the maintenance worker used sick and vacation time interchangeably since the Council did not specify authorized or unallowable reasons for sick leave utilization. No lump-sum payouts of either sick or vacation time accrued were made until the maintenance worker resigned in 2010.

⁴ See Minn. Stat. § 471.381, subd. 3.

We recommend the Council establish when leave balances are considered earned, whether on January 1 of each year, on the anniversary date of employment, or prorated over the calendar year. We also recommend the Council approve in advance the appropriate use of leave, any approved payouts of accrued leave, and other termination benefits.

D. Pay Rates, Overtime, and Comp Time

Hourly pay rate changes for the maintenance worker were documented in the Council's minutes. Overtime was paid to the maintenance worker at time and a half for any hours exceeding 80 in a two-week period. However, the October 12, 2001, Council minutes show that the Council approved overtime or comp time to be earned at time and a half for any hours exceeding 40 in a single work week. We noted no material differences. No comp time was accrued or used by the maintenance worker since the January 19, 2004, pay period.

2. **Petitioners' Concern - Free Water and Sewer Services**

The City's maintenance person received free City water and sewer services as a fringe benefit of his employment. Was this legal?

Finding and Response

Fringe Benefits for Maintenance Worker

In the October 12, 2001, minutes, the Council approved free water and sewer as a benefit for the maintenance worker. The Minnesota Attorney General's Office has ruled that a city needs specific statutory authority in order to provide in-kind benefits to its employees.⁵ We are not aware of any specific statutory authority to provide free water and sewer to city employees.

We recommend the City discontinue providing unauthorized in-kind benefits to employees.

3. **Petitioners' Concerns - Pre-Signed Checks and Duties of City Officials**

Checks were signed by the Mayor, Acting Mayor, and/or Treasurer prior to being written by the City Clerk. Is it good business practice to be signing and maintaining blank checks? Who are the authorized signers for the City's checking account? What are the official duties of the Mayor, Acting Mayor, Clerk, Treasurer, and Council members?

⁵ Ops. Att'y Gen. 359b (Oct. 24, 1989) and 161b-12 (Jan. 24, 1989).

Findings and Responses

A. Pre-signed Blank Checks

In our review of the disbursement process, we noted that at monthly meetings, the Clerk presented a list of invoices and supporting information to be approved for payment by the Council. The Council approved the invoices and authorized payment. In addition, the Council inquired of the Clerk how many additional bills must be paid before the next Council meeting. The Council had the Mayor and Treasurer sign a number of checks equivalent to the number of invoices approved, plus additional checks for the claims the Clerk told the Council would be needed to be paid before the next meeting. The checkbook containing the pre-signed and blank checks was then locked in the file cabinet for safekeeping. The following day, the Clerk wrote and signed the checks for the invoices that the Council approved for payment. The remaining pre-signed checks were left in the checkbook.

Minnesota Statutes § 471.425, subd. 2(a), states that, “For municipalities who have governing boards which have regularly scheduled meetings at least once a month, the standard payment period is defined as within 35 days of the date of the receipt” of the invoice from the vendors or, if later, of the completed delivery of goods or services.⁶ Because the Watson City Council has regularly scheduled monthly meetings, invoices received after the Council meeting should be presented at the next scheduled monthly meeting for approval and payment. The approval and payment of these claims would occur within the time allowed by the statutory requirements of Minn. Stat. § 471.425. In addition, Minn. Stat. § 412.271, subd. 4, states,

When payment of a claim based on contract cannot be deferred until the next council meeting without loss to the city through forfeiture of discount privileges or otherwise, it may be made immediately if the itemized claim is endorsed for payment by at least a majority of all the members of the council. The claim shall be acted upon formally at the next council meeting in the same manner as if it had not been paid, and the earlier payment shall not affect the right of the city or any taxpayer to challenge the validity of the claim.

We recommend the City discontinue the practice of pre-signing checks. In addition, we recommend that the City not pay claims until approved by the Council as provided in Minn. Stat. §§ 412.271, subd. 1, 471.425, subd. 2(a), and 471.38. If payment cannot wait until the next Council meeting without a forfeiture of discount privileges, then the procedure set forth in Minn. Stat. § 412.271 should be followed.

⁶See Minn. Stat. § 471.425, subd. 1(b) and subd. 2(a).

B. Duties of City Council and Mayor

The duties of the City Council are defined in Minn. Stat. § 412.191. Details of the City Council duties are also available from the following website: <https://www.revisor.mn.gov/pubs/>. Duties of the Mayor are shown in Chapter 6, section III, of the Handbook for Minnesota Cities. An electronic copy of this Handbook is available to the public from the following website: <https://www.lmc.org>.

C. Duties of the Acting Mayor

The duties of the Acting Mayor are defined in Minn. Stat. § 412.121, which states,

At its first meeting each year the council shall choose an acting mayor from the council members. The acting mayor shall perform the duties of mayor during the disability or absence of the mayor from the city or, in case of vacancy in the office of mayor, until a successor has been appointed and qualifies.

We noted that the Council minutes from January 2007 through January 2010 do not document an acting mayor was selected in the first meeting of any year. On December 16, 2008, the final Council meeting of 2008, an acting mayor was appointed for 2009. We recommend the City Council choose an acting mayor in the time period specified in Minn. Stat. § 412.121.

D. Duties of the City Clerk

The duties of the Clerk are defined in Minn. Stat. § 412.151:

The clerk shall give the required notice of each regular and special election, record the proceedings thereof, notify officials of their election or appointment to office, certify to the county auditor all appointments and the results of all city elections. The clerk shall keep (1) a minute book, noting therein all proceedings of the council; (2) an ordinance book to record at length all ordinances passed by the council; and (3) an account book to enter all money transactions of the city including the dates and amounts of all receipts and the person from whom the money was received and all orders drawn upon the treasurer with their payee and object. . . . The clerk shall act as the clerk and bookkeeper of the city, shall be the custodian of its seal and records, shall sign its official papers, shall post and publish such notices, ordinances and resolutions as may be required and shall perform such other appropriate duties as may be imposed by the council. . . .

Based on our review and the provisions of Minn. Stat § 412.151, we noted the following: The Clerk did not perform the duties as required by Minn. Stat. § 412.151 of keeping an account book to enter all money transactions. The City has contracted with an accounting firm to perform these duties of the Clerk and Treasurer. However, neither the City nor the accounting firm keep a detailed record of the dates and amounts of all receipts and the person from whom the money was received as required by Minn. Stat. §§ 412.141 and 412.151. Despite it being statutorily required, the Clerk did not have in her custody the City's current and/or prior years' monthly receipts journal, disbursements journal, ledgers, and checking account registers.

We recommend the Clerk maintain custody of the monthly and annual records as required by Minn. Stat. § 412.151 and oversee work performed and records created by the accounting firm related to the Clerk's statutory duties.

E. Duties of the City Treasurer

The duties of the Treasurer are defined in Minn. Stat. § 412.141:

The treasurer shall receive and safely keep all moneys belonging to the city, including moneys received in operations of any municipal liquor dispensary maintained by the city, and shall promptly enter in a book provided for the purpose an account of all moneys received and disbursed as treasurer, showing the source and objects thereof with the date of each transaction. The treasurer shall pay out money only upon the written order of the mayor and clerk, or such other officers of independent boards or commissions as are authorized to issue orders in the case of board or commission operations. . . . The treasurer shall deliver to a successor all books, papers and money belonging to the city. The treasurer shall immediately after the close of the calendar year make out and file with the clerk for public inspection a report of balances, receipts and disbursements by funds for the year. . . .

Based on the results of procedures we performed and the provisions of Minn. Stat. §§ 412.141 and 412.271, subd. 3, we noted the following issues:

- (1) The Clerk prepared checks to the vendors after the Council approved the monthly claims. The Mayor and Treasurer signed checks before the Clerk. Under Minn. Stat. §§ 412.141 and 412.271, subd. 3, the City Treasurer should sign last, creating a check on the City depository.

- (2) The Treasurer did not keep monies collected in a secured area. In addition, checks were not restrictively endorsed “For Deposit Only” upon receipt. This was done once a month when the collections were prepared for deposit.
- (3) The Treasurer did not maintain a register for the City’s checking account. Therefore, an ongoing checking account balance per the City’s books was not available for the Council meetings. The balance forward dollar amount the Clerk presented to the Council was the bank’s checking account balance. From this balance, monthly claims to be paid were deducted, to derive at an “ending balance.” This ending balance was an arbitrary number as it did not contain deposits and electronic payments. This ending balance would not be the balance forward amount the Clerk would present to the Council in the subsequent month as it would not be the bank balance for the City’s checking account. Each month, the Clerk obtained a checking account balance from the bank for Council meetings. In addition, neither the Treasurer nor the Clerk maintained a detailed receipts journal that shows the date and from whom the payments and wire transfers were received.
- (4) According to staff with the accounting firm, the Treasurer did not give the accounting firm monthly collections information on a timely basis. Therefore, the accounting firm was not able to generate monthly reports or semi-annual compilation reports for the City on a timely basis.
- (5) The Treasurer performed the following duties relating to the water and sewer computerized records: generated the monthly billings; mailed the billings; received the payments and maintained custody of the monies; posted the payments to the computerized records; made adjustments to the billed amounts; and prepared the deposit and took it to the bank.

For the issues identified above, we recommend the following:

- The City Council ensure that the Clerk and Treasurer perform their respective statutory duties in order to comply with Minn. Stat. §§ 412.141 and 412.151.
- The following process be used for writing checks: (1) The Clerk receives bills and invoices from vendors and prepares checks for signature at the council meeting; and (2) upon approval of a claim, the check is signed by the Mayor, then the Clerk, and finally the Treasurer, who then mails the check to the vendor.
- Collections be kept in a secured area, that deposits be made more frequently than once a month, and that checks be restrictively endorsed “For Deposit Only” upon receipt.

- Deposits, checks written, and wire transfers in and out be recorded in a check register.
- The check register should have an ongoing checking account balance, and this balance should be reconciled with the bank balance soon after the end of each month.
- The City’s checking account register balance rather than the bank balance should be presented to the Council at monthly meetings.
- The Council should request the Clerk to provide the monthly cash balance in each City fund in order to adequately manage the finances of the City.
- The Treasurer should provide timely remittance of the detail of monthly collections and disbursements by the Treasurer to the accounting firm in order for the firm to prepare the accounting records as required by Minn. Stat. §§ 412.141 and 412.151. Punctual remittance is necessary for the firm to generate any monthly, semi-annual, and annual reports for the City Council in a timely manner.
- The duties relating to the water and sewer billing, collections, posting to the computer system, adjustments and credits to the computer system, and deposits should be segregated.
- The Council should monitor the City financial activities to ensure its directives are followed and to monitor compliance with statutory requirements.

4. Petitioners’ Concerns - Treasurer’s Records and Water and Sewer Billings

The Treasurer’s report was presented monthly and contained only limited information. Was there a more inclusive ledger containing the amount of the bills mailed out each month, how much of the monthly billings were received, and how much of the monthly billing remained unpaid? What were the billing rates, and when were they determined?

Findings and Responses

A. Treasurer’s “Books”

The Treasurer did not maintain receipts and disbursements journals (“books”) or a checking account register, therefore, limited information could be provided at the City Council meetings.

We made various requests of the Treasurer for the prior years' accounting records relating to water and sewer billings and collections. We reconciled the 2008 and 2009 billings to the deposits made for Water and Sewer Funds. In 2008, deposits were made in excess of billings by \$2,359.00. In 2009, billings were in excess of deposits by \$275.86. The variance in the annual amounts could be due to the change in accounts receivable between years.

B. Water and Sewer Receipts and Deposits

We reviewed the process for preparing water and sewer receipts and deposits and noted the following:

- (1) Collections for water and sewer were commingled with other collections in a bank bag that was in the custody of the Treasurer. The Treasurer divided the cash and checks received when the monthly deposit slips were prepared. We noted that no documentation was maintained with the collections to specifically identify who remitted the cash and checks.
- (2) In March 2009, the Council approved splitting the Water and Sewer Funds receipts with 25 percent to be deposited into the General Fund for operations. The Treasurer was not following this Council decision at the time of our testing in 2010. The Treasurer had a system for splitting the deposit into the checking and savings accounts that was neither consistent nor calculable. When completing the deposit tickets, the Treasurer inquired of the Clerk what the need was for money in the checking account. If the need for money was higher, the Treasurer would save the larger dollar amount checks for the final deposit ticket. All deposit slips that had all lines filled on them were deposited into the savings account, and the remaining deposit slip that did not have every line filled, which contained the higher dollar checks, was deposited into the checking account. The amount deposited in each of the different accounts was then recorded in the aggregate in a receipt book, and a copy of the receipt was given to the accounting firm. No other detail was maintained by the Treasurer.
- (3) The City had no process in place to reconcile water and sewer collections to monthly billings and deposits.

We recommend pre-numbered receipt books be used and receipts be written for each collection. Receipts should be used in numerical sequence without skipping numbers, and all copies of voided receipts should be attached to the receipt book. The practice of writing lump sum receipts to match deposits should be discontinued.

In addition, we recommend the Council implement a process to ensure monthly water and sewer collections are reconciled with monthly billing, deposits, and any remaining outstanding balance. A detailed listing of unpaid balance by resident should be prepared for the City Council. The Council should monitor deposits to ensure the Council's resolution of depositing twice a month is being complied with. We also recommend the Council ensure that adequate records are maintained, that all collections are recorded as revenues in the correct City fund, and that the Clerk has custody of the City's records.

C. Water and Sewer Rates

The base rates, \$25 for water and \$30 for sewer, were discussed in the November 12, 2008, minutes. Based on our review of the minutes, there was no action taken by the Council to approve these rates. In 2010, the City began using the reading of the new water meter installed at each resident's home. Due to resident questions and concerns regarding incorrect reading of the new water meters and the related charges billed for January 1 to April 30, 2010, the Council approved a new interim flat rate of \$62 for water and sewer until issues relating to the new water meter were resolved. The interim rate was approved and officially posted on the bulletin board of the Community Center; however, the posting did not note a date when the action was taken by the Council. In addition, the Council directed the Treasurer to apply a credit to all accounts for any amount paid over \$62 for the four months ending prior to April 30, 2010.

5. **Petitioners' Concerns - Billing Alterations and Custody of Collections**

Computer-generated water and sewer billings included handwritten changes. What was the cause of the alterations? Where did the City keep receipts from the 18th of the month to the date of deposit? Were cash payments received? How were receipts recorded and subsequently tied to billings, especially cash?

Findings and Responses

A. Handwritten Changes on Computer-Generated Billings

Handwritten changes on billings were changes due to credits given to residents for any amount over \$62 that was paid from January 1 to April 30, 2010. The Council directed the Treasurer to apply a credit to all resident accounts that paid the billed charges in excess of \$62 monthly through April 30, 2010.

B. Collections in Custody of the Treasurer

The Treasurer informed us that only a small number of residents paid their water and sewer bills in cash. On July 21, 2010, we counted the cash and checks the Treasurer had received since the last bank deposit. The total amount the Treasurer had in her custody was \$8,837.58. Of this amount, \$913.54 was cash; the remainder was checks. The amount held in cash is significant because the collections were not held in a secured location. The monies were kept in a bank bag and included water and sewer payments as well as other types of collections. We noted no documentation within the bank bag identifying the remitters' names and dates of collection. With the lack of detail or written receipts for monies collected, it was not possible for us to determine whether all monies received are deposited intact.

We recommend the City Council implement a pre-numbered receipting system for all collections. In addition, we recommend a receipts journal be kept to record each receipt number, the remitter's name, the date of payment, the amount received, and the purpose. The receipts journal should specify the City fund to be credited for the revenue. Furthermore, we recommend the total monthly amount collected according to the receipts journal be reconciled with the deposits for that month. Reasons for any differences should be documented and approved by the Council.

6. **Petitioners' Concern - Passing State-Aid Funds to the Fire Relief Association**

The City did not pass state-aid funds to the Fire Relief Association as required by statute.

Finding and Response

The City did not write detailed receipts for collections and wire transfers received, nor did the City maintain a receipts journal to record the date when payments and wire transfers were received. The Clerk's practice was to use the month-end bank statements to identify wire transfers in from the State of Minnesota and the date these transfers were deposited into the City's checking account.

The State of Minnesota deposits fire state-aid funds by wire transfer into the City's checking account. The deposit is made close to the end of each month or around the first of the following month. Depending on the bank statement cutoff date for the City's checking account, the wire transfers could appear in the current month-end bank statement or in the subsequent month's bank statement. By the time the Clerk received the monthly bank statement, identified state-aid funds transferred to the City, and subsequently presented a claim to the Council for approval, it was more than 30 days since the City received the funds. Minn. Stat. § 69.031, subd. 5, requires the City to transmit state fire aid to the fire relief association treasurer within 30 days after receipt.

We recommend the City modify its current practice to ensure that state aid is paid to the relief association in accordance with Minn. Stat. § 69.031, subd. 5.

7. Petitioners' Concern - Repayment of Small Cities Development Program Loans

The City of Watson received funds through the Department of Employment and Economic Development (DEED) under the Small Cities Development Program. Under this program, if a property is sold within seven years, a payback was required to the City for the remaining portion of the loan not forgiven (loan forgiven at a rate of 1/7 per year for seven years). What happened to monies the City received from the sale of properties prior to the full forgiveness of the loans? Who is responsible for maintaining the records to assure that all funds are being used in compliance with the grant requirements?

Finding and Response

Two homeowners returned Small Cities DEED funds after the program closed. One homeowner returned \$4,310.00, and the other returned \$14,557.86, for a total of \$18,867.86. These funds are kept in a separate bank account. The bank charges a service fee of \$5.00 per month to maintain the account. At June 30, 2010, the balance in the account was \$18,800.66.

The City contracted with the Upper Minnesota Valley Regional Development Commission (UMVRDC) to administer the program. The City contacted UMVRDC for assistance in handling the returned funds now that the program is closed. UMVRDC contacted DEED for direction. DEED informed UMVRDC that, with the closure of the program, the returned funds would not have to be re-loaned to another resident, but could be used for any DEED-approved project. DEED approved use of the returned funds for updating the bathrooms in the Watson Community Center for handicap accessibility. The funds were not spent as of July 21, 2010.

The City does not have physical custody of the original contracts with homeowners. Also, the City does not maintain records of the number of loans outstanding, remaining time until the loan is forgiven, name of the individuals and properties involved, and whether the properties have been sold as required by the grant agreement.

We recommend the City obtain the original contracts and maintain a record for tracking the number of loans outstanding, remaining time until the loans are forgiven, the name of the individuals and properties involved, and follow-up if any of the properties are sold.

8. Petitioners' Concern - Computer Networking

The Clerk may have had her home computer networked with the City's computer.

Finding and Response

At the time of our review, the Clerk's personal computer was not networked to the City's computer. In addition, the City did not have electronic records on the City's computer other than the water and sewer billing system. However, the Clerk informed us that she had determined there was no reason to have antivirus software on the City's computer due to its limited use and let the subscription expire. The City's computer is connected to the City-wide wireless internet connection.

We recommend the City purchase antivirus software and develop processes that contribute to the safekeeping of electronic data.

9. Petitioners' Concern - Compilation Reports

The compilation reports from the accounting firm have not been seen by the City Council and the residents for the past couple of years.

Finding and Response

The City contracted with an accounting firm to perform bookkeeping services for the City and to issue to the City semi-annual and annual compilation reports. According to the accounting firm, the Treasurer did not provide the necessary information to prepare the 2009 semi-annual compilation report; therefore, only an annual compilation report was completed. The accounting firm distributes the report directly to the Clerk and not to the Council.

We recommend the City Council ensure that the Clerk and Treasurer provide the accounting firm the monthly collections and disbursements information on a timely basis. In addition, we recommend the Council direct the accounting firm to issue copies of semi-annual and annual compilation reports directly to City Council members.

10. Petitioners' Concern - Cash Balances by Fund

Residents inquired as to the cash balance in the City account and were not provided with an amount. Petitioners were concerned why a cash balance was not provided upon request. What procedures are used by the Clerk to determine a cash balance? Why did the current month's beginning cash balance on the Clerk's report not tie to the prior month's ending cash balance?

Finding and Response

The Clerk and Treasurer were not maintaining detailed records for receipts, disbursements, or cash balance as required Minn. Stat. §§ 412.151 and 412.141. In addition, according to the accounting firm, the necessary information relating to receipts and disbursements was not provided to the accounting firm on a timely basis so that the firm could generate a monthly cash balance by fund and the corresponding checking and saving accounts balances for Council meetings. What the Clerk provided to the Council was the monthly bank balance of the checking account (not the City's book balance), a list of claims to be paid, and an ending balance. This ending balance would not be the same as the subsequent month's beginning bank checking balance the Clerk provides the City Council.

Since the prior cash balances did not provide accurate information, we compiled information from the accounting firm to create the following:

- (a) Summary of Receipts, Disbursements, and Balances as of December 31, 2009, for all funds:

Fund Name	Balance Jan. 1, 2009*	Receipts*	Disbursements*	Balance Dec. 31, 2009*
General Fund	\$ 415,867.41	\$ 173,494.14	\$ 169,279.51	\$ 420,082.04
Water Fund	(240,340.57)	150,770.45	155,001.82	(244,571.94)
Sewer Fund	56,152.16	118,165.89	84,960.94	89,357.11
Total	<u>\$ 231,679.00</u>	<u>\$ 442,430.48</u>	<u>\$ 409,242.27</u>	<u>\$ 264,867.21</u>

Summary of Cash Deposits in Bank at December 31, 2009⁽¹⁾

Checking Accounts		
Bank Balance	\$ 72,384.39	
Less: Outstanding Checks	(5,693.11)	
Add: Deposit in Transit	32.00	
	<u>66,723.28</u>	
Book Balance		\$ 66,723.28
Savings Account		146,677.53
Certificates of Deposit		<u>51,414.26</u>
Total Cash Deposits in Bank		<u>\$ 264,815.07</u>
Unknown Difference		<u>\$ 52.14</u>

*This information was taken from City's annual compilation reports or audited report, as applicable.

⁽¹⁾This information was taken from the accounting firm's bank reconciliation and the bank statements.

(b) Annual Beginning Cash Balances, Receipts, Disbursements, and End Cash Balances for each City fund from 2005 through 2009:

General Fund:

Year	Beginning Cash Balance*	Receipts*	Disbursements*	Ending Cash Balance*
2005	\$ 423,728.96	\$ 130,702.24	\$ 111,318.24	\$ 443,112.96
2006	443,112.96	287,369.75	292,530.93	437,951.78
2007	437,951.78	364,650.10	361,165.47	441,436.41
2008	441,436.41	145,779.00	171,348.00	415,867.41
2009	415,867.41	173,494.14	169,279.51	420,082.04

Water Fund:

Year	Beginning Cash Balance*	Receipts*	Disbursements*	Ending Cash Balance*
2005	\$ (160,408.28)	\$ 14,697.20	\$ 40,170.46	\$ (185,881.54)
2006	(185,881.54)	15,063.92	37,831.59	(208,649.21)
2007	(208,649.21)	65,225.09	81,463.45	(224,887.57)
2008	(224,887.57)	471,560.00	487,013.00	(240,340.57)
2009	(240,340.57)	150,770.45	155,001.82	(244,571.94)

Sewer Fund:

Year	Beginning Cash Balance*	Receipts*	Disbursements*	Ending Cash Balance*
2005	\$ (40,102.12)	\$ 32,714.80	\$ 18,383.63	\$ (25,770.95)
2006	(25,770.95)	117,229.40	93,481.18	(2,022.73)
2007	(2,022.73)	78,777.06	45,288.17	31,466.16
2008	31,466.16	55,390.00	30,704.00	56,152.16
2009	56,152.16	118,165.89	84,960.94	89,357.11

*This information was taken from City's annual compilation reports or audited report, as applicable.

We recommend the City take appropriate action to resolve the deficit cash balance in its Water Fund.

11. Petitioners' Concern - Changes to Clerk's Salary

How were the increases in the Clerk's salary and billing for mileage handled in 2008 and 2009?

Finding and Response

On October 9, 2008, the Council adopted Resolution No. 1-2008 approving fixed salaries for elected officials, per-meeting rates for the Mayor, City Attorney, out-of-town meeting compensation, and mileage reimbursement rate to be paid from the General Fund. The resolution stated that it was to be effective starting November 2008. Four Council members voted in favor of the resolution; however, the resolution did not have the Mayor's or the Clerk's signature. The fixed salaries, per meeting or month and mileage rates are:

Office of the Mayor (Per Meeting)	\$ 80.00
Office of the Clerk (Per Month)	500.00
Treasurer (Per Month)	100.00
City Councilors (Per Meeting)	60.00
Meeting out of town (Per Meeting)	10.00
Travel expense for City business	0.585 cents per mile

We were unable to determine whether the resolution was ever published.

In addition to the resolution, we were given a page from the minutes for the October 9, 2008, meeting prepared by the City Clerk. Regarding the City Clerk's compensation, these minutes state:

- (2) City Clerk pay will be set at \$500 per month. City Clerk to be paid \$60 a council meeting attended and \$40 a zoning meeting attended...

The amounts payable for attending Council and zoning meetings are not included in Resolution No. 1-2008. These minutes are signed by the Clerk but not the Mayor.

During the prior year, the Council had approved 86 hours of extra pay for the Clerk at the rate of \$10 per hour. Neither Resolution No. 1-2008 nor the meeting minutes for October 9, 2008, provide for extra pay for additional hours.

Minnesota Statutes § 415.11, permits a city council to set the salary of its members and of its chief elected executive officer through an "ordinance." Ordinances must be published, be kept in an ordinance book, and be signed by the Mayor or Clerk.⁷

⁷ Minn. Stat. § 412.191, subd. 4

We recommend that when the City sets salary for Council members,⁸ it does so in ordinance form as required by Minn. Stat. § 415.11 by following the requirements applicable to ordinances, which include having the ordinance signed by the Mayor and Clerk, publishing it and keeping it in the City's ordinance book.

When setting the salaries of other City officials and employees, all aspects of compensation should be addressed including, where applicable, per-meeting payments and overtime eligibility and amounts.

12. Petitioners' Concern - Council Designations

Designations of the City Attorney, Acting Mayor, newspaper, bank, and accountants for 2009 were approved by the City Council in December 2008. Is this within the requirements of Minnesota statutes?

Finding and Response

We noted that the Council approved 2009 appointments of the newspaper and Council members on December 16, 2008. This action was taken prior to when the terms of new Council members began. The City Council must designate a legal newspaper at the first annual meeting of the year.⁹ The acting Mayor must also be chosen at the first meeting each year.¹⁰ Designation of a depository and attorney and accountant appointments need not occur at a particular meeting; but these appointments should be reviewed by the City Council periodically, and the City may find the first meeting of the year convenient for these purposes.

We recommend the City Council comply with statutory requirements for newspapers and acting Mayor appointments.

13. Petitioners' Concern - Check Write-Offs

Several checks were reissued that had not been cashed by payees in prior years. The Clerk researched files and documents to locate necessary information to determine if these checks had been voided or needed to be reissued. Some information could not be located, so the Council voted to write off checks that could not be identified.

⁸ These rules no longer apply to the Clerk because this position is no longer elected.

⁹ Minn. Stat. § 412.831.

¹⁰ Minn. Stat. § 412.121.

Finding and Response

Information relating to four checks that were voided but not reissued was provided to us by the accounting firm. On April 14, 2009, the Council approved the write-off of the four old checks. The total of these checks was \$703.57. Information relating to the checks written off is as follows:

<u>Check Number</u>	<u>Date Issued</u>	<u>Payee</u>	<u>Amount</u>
14004	Unknown	Unknown	\$ 650.00
14067	04/13/1999	Donald Cory	25.57
14909	01/09/2001	Watson Grocery	8.30
16735	11/09/2004	Walmart	19.70
Total			<u>\$ 703.57</u>

According to the staff with the accounting firm, the City did not inform the accounting firm of \$3,795.32 in other checks reissued or written off; therefore, the firm continued to include them as outstanding checks in the City's 2009 bank reconciliations. In addition, the total of the checks written off and related pertinent information were not reported to the Minnesota Department of Commerce as unclaimed property as required by Minn. Stat. §§ 345.41-.43.

We recommend the City communicate to the accounting firm the checks that were voided and reissued and checks that were written off in order for the firm to make proper adjustments to the City's accounting records and checking account balance. In addition, we recommend the City notify the Minnesota Department of Commerce of unclaimed property to comply with Minn. Stat. §§ 345.41-.43.

14. Petitioners' Concern - Insurance Lapse and No Reimbursements Made Toward Medical Deduction

There is concern regarding lapse of the maintenance worker's insurance. Why did this occur? In addition, when the maintenance worker was hired, he was given a \$300 reimbursement per year towards his \$1,000 medical deduction. Why was the annual \$300 medical deduction reimbursement never received?

Finding and Response

The insurance policy was in the name of the maintenance worker, not the City. We were told there were instances where the City did not provide the account number of the policy with the payment. The insurance agent then did not know what the check was for and returned it to the City, causing the lapse in coverage.

Council minutes of October 12, 2001, state that the City would pay for “the first \$300 of the deductible.” In order to receive reimbursement, the maintenance worker would have to submit a claim to the City with supporting information showing that the expenses had occurred and were paid by the maintenance worker. If the maintenance worker did not submit a request for reimbursement and support, the City would not be required to pay the \$300.

15. Petitioners’ Concern - Destruction of Records

A prior Mayor provided the Clerk with file boxes of old City records. The Clerk had not gone through a few years’ worth of these files. The City had a one-time approval for destroying certain files, but the Clerk had not had the time to complete this task.

Finding and Response

It appears from the October 9, 2008, Council meeting minutes, that the City approved a “1 [sic] time Record of Destroying Old City Papers.” However, the October 13, 2008, paperwork filed with the State by the Clerk indicates that the City adopted the General Records Retention Schedule for Cities (GRRSC).

All City records must be retained by the City unless:

- the City adopts a record retention schedule approved by The Records Disposition Panel (RDP), or
- the City receives permission from the RDP to destroy specific records.

Most cities adopt the GRRSC, which has already been approved by the RDP. A PDF copy of the GRRSC can be found on the following website: <http://www.mcfoa.org>.

We recommend that the City clarify the situation by adopting the GRRSC. Once the GRRSC has been adopted, City records should be retained for the time periods specified in the schedule and then destroyed.

16. Petitioners’ Concern - Dedicated Fax Line and Subletting of Community Center

The City is paying more for phone lines than necessary due to citizens interrupting incoming faxes when using the facility. The City installed a separate fax line to resolve the fax interruption issue; however, the City is now paying an additional amount per month for the extra line. The senior citizen group is renting the Community Center for \$125 a month from the City, but the group is collecting \$25 a month because they are subletting it to others.

Finding and Response

On September 11, 2007, the Council approved the installation of a dedicated fax line so incoming faxes would not be interrupted. The decision to approve an additional telephone line is within the Council's statutory authority. The rental agreement with the senior citizen group for the period April 1, 2008, through April 1, 2009, was modified to disallow subletting the Community Center by renters. The Council minutes of April 8, 2008, stated the rental agreement was to be signed by the Clerk and Mayor; however, no motion of the Council was documented in the minutes regarding this issue.

We recommend the Council consider and approve any lease agreements and amendments regarding City facilities. All such decisions should be documented in the minutes.

17. Petitioners' Concern - Elected Officials' Terms and Audit Requirements of a Combined Clerk and Treasurer

On December 31, 2010, five out of six elected officials' terms ended. The City had one Council member with two years left in the member's term. Why was one Council member's term set for two years when all other council members' terms are four years? In the past, an election was held both for the Treasurer and Clerk because their terms were up at the same time. At one time, the prior City Treasurer filled in for the City Clerk position. An audit was never done for the years when the prior City Treasurer held both positions. When you have a separate treasurer and a separate clerk, you have two persons involved with the City money, so audit requirements differ, correct?

Finding and Response

During 2010, the City had six elected officers: the Mayor, the Clerk, three Council members, and the Treasurer. Minnesota Statutes § 412.02, subd. 1, provides descriptions of the elected officials, the term length and an explanation of when the terms end for various types of cities. This statute states that the Clerk and Treasurer in a Standard Plan city without a Clerk-Treasurer should be elected to four-year terms that end in a year when the other is not elected.

An annual audit for cities with a combined clerk/treasurer is required if the city's annual revenue for all governmental and enterprise funds combined is more than \$150,000 (adjusted for inflation), or once every five years if the annual revenue is \$150,000 (adjusted for inflation) or less.¹¹ Cities with a population of more than 2,500 must have their financial statements audited each year.¹² Cities with a population of less than 2,500 and

¹¹ Minn. Stat. §§ 412.02, subd. 3; 412.591.

¹² Minn. Stat. § 471.697.

without a combined clerk/treasurer generally are not required by Minnesota statute to be audited, but may choose to have an audit performed. The OSA noted that the Council took no action to combine the positions of the Clerk and Treasurer because of the vacancy of the Clerk's position.

When the office of City Clerk is vacated in a Standard Plan city, it is the duty of the city council to fill that office by appointment.¹³ Now that the City has adopted Plan A, vacancies in the office of Clerk normally will be filled by Council appointment.

We recommend the City comply with the term requirements for officers as required by Minn. Stat. § 412.02, subd 1, and that any vacancies in the office of Clerk or Treasurer be filled promptly as provided by law.

18. Petitioners' Concern - Meeting Minutes

Residents asked to see Council meeting minutes, and the Clerk would not make them available to the public. Petitioners are concerned that meeting minutes are being changed after approval by the City Council.

Finding and Response

During the course of our work, we reviewed the minutes of the proceedings of the City Council from January 1, 2007, through June 15, 2010. We noted many instances where minutes provided an inadequate history of the meetings, where handwritten changes appear on the typed copy of the minutes, and where the Council failed to preserve order at its meetings.

Various statutes that refer to taking or publishing minutes use the term "proceedings" or "official proceedings." The Minnesota Attorney General has used the definition of "proceedings," found at Minn. Stat. § 331A.01, subd. 6, in analyzing the Clerk's duties to take minutes. The statute states, in part:

"Proceedings" means the substance of all official actions taken by the governing body of a political subdivision at any regular or special meeting, and at minimum includes the subject matter of a motion, the persons making and seconding a motion, the roll call vote on a motion, the character of resolutions or ordinances offered, including a brief description of their subject matter, and whether defeated or adopted.

¹³ Minn. Stat. § 412.02, subd. 2a.

At a minimum, the minutes must include the information required by Minn. Stat. §§ 13D.01 to .07 (Open Meeting Law). Under Minn. Stat. § 13D.01, subd. 4, the individual votes of each member of the governing body on “an action” must be specifically recorded, except votes on “payments of judgments, claims and amounts fixed by statute.” If the minimum requirements are satisfied, how elaborate and extensive the minutes should be is largely a policy matter for determination by the particular body in the exercise of reasonable judgment and discretion. The Attorney General has explained:

there may be circumstances in which it would be advisable for the town board to provide for the minutes to include information over and above what is necessary to satisfy minimum statutory requirements for a record of its official actions.¹⁴

Such circumstances may include meetings where the City Council is acting in a judicial capacity, such as when it reviews requests for variances or special use permits. At such times, the minutes may include the City Council’s reasons for reaching a particular decision. Such minutes could be crucial in defending a court challenge to the decision.

While the following is not an exhaustive list, some specific items that should be included in the minutes to the proceedings of City Council meetings are:

- a. type of meeting (regular, special, adjourned regular, adjourned special, recessed, and emergency);
- b. the type of group that is meeting (whether the meeting is a meeting of the governing body or committee, for example);
- c. date and place meeting was held;
- d. the time the meeting was called to order;
- e. a list of City Council members present and absent;
- f. approval of minutes to previous meeting, with any corrections noted;
- g. appointments of representatives to committees and outside organizations;
- h. authorizations and directions to invest excess funds; information on investment redemptions and maturities;

¹⁴ Op. Atty. Gen. 851 March 5, 1992.

- i. list of all sealed bids received or price quotations obtained;
- j. identity of parties to whom contracts were awarded;
- k. abstentions from voting due to a conflict and the City Council member's name and reason for the abstention;
- l. reasons the City Council determines to award a particular contract to a bidder other than the lowest bidder;
- m. granting of variances or special use permits;
- n. the approval of hourly rates paid for services provided, mileage rates, meal reimbursement amounts, and per diem amounts;
- o. listing of all bills allowed or approved for payment, noting the order-check number, claimant, purpose, and amount;
- p. reports of officers;
- q. transfers of funds; and
- r. the reason the meeting concluded and the time it concluded.

The OSA Statement of Position, *Meeting Minutes*, provides the following additional guidance: "The minutes should not be cluttered with unnecessary detail that could hamper efforts to review or otherwise use the minutes at a later date. In addition, the minutes should never reflect the clerk's opinion on anything said or done."

Minutes should be signed by the Clerk and then signed and dated by a designated member of the governing body to indicate that they are the official meeting minutes.

If a City resident, employee, or official has questions about public access to the Council minutes, we recommend they contact the Information Policy Analysis Division of the Minnesota Department of Administration for assistance. The contact information is as follows: phone number: 651-296-6733 or 800-657-3721; email: info.ipad@state.mn.us; website: <http://www.ipad.state.mn.us>.

OTHER FINDINGS AND RECOMMENDATIONS

A. Violation of Open Meeting Law

On April 8, 2008, the Council held a closed meeting to “discuss the City Clerk’s job responsibilities and wages.” It does not appear that discussion of the Clerk’s job responsibilities and wages is a permissible reason to close an Open Meeting.¹⁵ Allowable reasons to hold a closed meeting include:

- meetings to consider strategies for labor negotiations under PELRA;
- meetings to evaluate the performance of an individual subject to the public body’s authority;
- discussions under attorney-client privilege;
- discussions on the purchase or sale of property; and
- discussions of security briefings.

We recommend the Council ensure that reasons for closing a Council meeting comply with the requirements of the Open Meeting Law.¹⁶ For additional information or training, the City may contact the Information Policy Analysis Division of the Minnesota Department of Administration at <http://www.ipad.state.mn.us>.

B. Mileage Reimbursement Rate in Excess of Internal Revenue Service (IRS) Rate

On October 9, 2008, in Resolution No. 1-2008, the Council approved a mileage reimbursement rate at \$0.585 per mile. The Council did not specifically tie the reimbursement rate to fluctuate with the IRS mileage reimbursement rate. Although the IRS set the standard mileage rate for 2010 at \$0.50 cents per mile for business miles driven, the City continued to reimburse its employee and officials at \$0.585 cents per mile. To the extent employers reimburse employees in excess of the IRS mileage reimbursement rate, that amount will be income to the employee.

We recommend the Council tie the City’s mileage reimbursement rate to fluctuate with the standard mileage rate set by the IRS in order to avoid excess reimbursements that are subject to withholding and payment of employment taxes to its employee and officials. Further, if the City chooses to reimburse its employee and officials over the IRS mileage rate, reimbursements over the approved IRS rates should be included as taxable income on the individual’s W-2 form.

¹⁵ Minn. Stat. §§13D.05, subs. 2, 3; 13D.03; *see also* Chapter 7, Part 11, League of Minnesota Cities Handbook.

¹⁶ Minn. Stat. ch. 13D.

* * *

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 Watson, 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

/s/Greg Hierlinger

REBECCA OTTO
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

February 25, 2011