

# STATE OF MINNESOTA

## Office of the State Auditor



**Rebecca Otto**  
**State Auditor**

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**MUNICIPAL LIQUOR STORE FUND**  
**CITY OF BISCAW, MINNESOTA**

**FOR THE YEAR ENDED DECEMBER 31, 2011**

## **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.

The State Auditor serves on the State Executive Council, State Board of Investment, Land Exchange Board, Public Employees Retirement Association Board, Minnesota Housing Finance Agency, and the Rural Finance Authority Board.

Office of the State Auditor  
525 Park Street, Suite 500  
Saint Paul, Minnesota 55103  
(651) 296-2551  
state.auditor@osa.state.mn.us  
www.auditor.state.mn.us

This document can be made available in alternative formats upon request. Call 651-296-2551 [voice] or 1-800-627-3529 [relay service] for assistance; or visit the Office of the State Auditor's web site: [www.auditor.state.mn.us](http://www.auditor.state.mn.us).

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

**For the Year Ended December 31, 2011**



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

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**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

**ELECTED AND APPOINTED OFFICIALS  
2011**

	<u>Position</u>	<u>Term Expires</u>
Ray Urban	Mayor	December 31, 2014
Dennis Schwanke	Council Member	December 31, 2012
Tom Urban	Council Member	December 31, 2012
Jason Mielke	Council Member	December 31, 2014
Rich Pohlmeier	Council Member	December 31, 2014
Paula Brecht	Clerk	Appointed
Marian Knoll	Treasurer	Appointed
Teresa Mahoney	Bookkeeper	Appointed

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REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## INDEPENDENT AUDITOR'S REPORT

Mayor and Members of the City Council  
City of Biscay, Minnesota

We have audited the basic financial statements of the Municipal Liquor Store Fund (Municipal Liquor Store), an enterprise fund of the City of Biscay, Minnesota, as of and for the year ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the City's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the Municipal Liquor Store enterprise fund and are not intended to present fairly the financial position of the City of Biscay, Minnesota, as of December 31, 2011, and the changes in its financial position and the cash flows of its proprietary funds for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Municipal Liquor Store as of December 31, 2011, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements were prepared assuming that the Municipal Liquor Store, an enterprise fund of the City of Biscay, Minnesota, would continue as a going concern. As discussed in Note 4 to the financial statements, the Municipal Liquor Store is in violation of the 2002 Revenue Bond covenant for failure to make payments of principal and interest. In addition, as discussed in Note 8 to the financial statements, the Municipal Liquor Store's expenses have significantly exceeded revenues over the past five years. These conditions have resulted in the discontinuation of operations subsequent to December 31, 2011, and substantial doubt about any further ability to continue as a going concern. Management's plans regarding these matters also are described in Note 8. The financial statements do not include any adjustments that might result from the outcomes of these uncertainties.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 10, 2012, on our consideration of the Municipal Liquor Store's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

September 10, 2012

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

## **BASIC FINANCIAL STATEMENTS**

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**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

**EXHIBIT 1**

**STATEMENT OF NET ASSETS  
DECEMBER 31, 2011**

**Assets**

**Current assets**

Cash and cash equivalents	\$ 3,620
Prepaid items	12,503
Inventories	21,594

**Total current assets** **\$ 37,717**

**Noncurrent assets**

Deferred debt issuance costs	\$ 18,783
Capital assets, net	
Nondepreciable	37,912
Depreciable	596,771

**Total noncurrent assets** **\$ 653,466**

**Total Assets** **\$ 691,183**

**Liabilities**

**Current liabilities**

Accounts payable	\$ 56,060
Salaries payable	6,638
Accrued payroll taxes	17,470
Accrued sales tax	2,952
Accrued interest payable	99,701
Revenue bonds payable - current	75,000

**Total current liabilities** **\$ 257,821**

**Noncurrent liabilities**

Revenue bonds payable - noncurrent	540,000
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**Total Liabilities** **\$ 797,821**

**Net Assets**

Invested in capital assets, net of related debt	\$ 19,683
Unrestricted	(126,321)

**Total Net Assets** **\$ (106,638)**

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCA Y, MINNESOTA**

*EXHIBIT 2*

**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

<b>Operating Revenues</b>	
Sales	\$ 422,730
Cost of goods sold	(206,188)
	<hr/>
<b>Total Operating Revenues</b>	<b>\$ 216,542</b>
<b>Operating Expenses</b>	
Salaries	\$ 127,379
Payroll taxes	9,739
Insurance	28,039
Utilities	40,138
Cable	2,153
Supplies	10,148
Repair and maintenance	7,096
Advertising	5,862
Sponsorship and promotion	600
Depreciation	28,987
Amortization	1,218
Contracted services	2,396
Lease payments	919
Taxes and licenses	893
Entertainment	14,298
Credit card charges	4,935
Unemployment compensation	4,634
Miscellaneous	4,663
	<hr/>
<b>Total Operating Expenses</b>	<b>\$ 294,097</b>
<b>Operating Income (Loss)</b>	<b>\$ (77,555)</b>
<b>Nonoperating Revenues (Expenses)</b>	
Wildlife Habitat - pull tabs	\$ 15,627
ATM fees	1,299
Interest expense	(40,423)
Miscellaneous income	7,010
	<hr/>
<b>Total Nonoperating Revenues (Expenses)</b>	<b>\$ (16,487)</b>
<b>Income (loss) before transfers</b>	<b>\$ (94,042)</b>
<b>Transfers</b>	
Transfers from other funds of the City of Biscay	10,000
	<hr/>
<b>Change in Net Assets</b>	<b>\$ (84,042)</b>
<b>Net Assets - January 1</b>	<b>(22,596)</b>
	<hr/>
<b>Net Assets - December 31</b>	<b>\$ (106,638)</b>
	<hr/> <hr/>

The notes to the financial statements are an integral part of this statement.

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**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAVY, MINNESOTA**

**EXHIBIT 3**

**STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

<b>Cash Flows from Operating Activities</b>	
Receipts from customers and users	\$ 422,730
Payments to suppliers	(307,565)
Payments to employees	(163,671)
Miscellaneous nonoperating revenue	<u>23,936</u>
<b>Net cash provided by (used in) operating activities</b>	<b>\$ (24,570)</b>
<b>Cash Flows from Noncapital Financing Activities</b>	
Transfers from other funds of the City of Biscav	10,000
<b>Cash Flows from Capital and Related Financing Activities</b>	
Payments for acquisition of capital assets	<u>(1,067)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>\$ (15,637)</b>
<b>Cash and Cash Equivalents at January 1</b>	<u><b>19,257</b></u>
<b>Cash and Cash Equivalents at December 31</b>	<u><b>\$ 3,620</b></u>
<b>Reconciliation of operating income (loss) to net cash provided by (used in) operating activities</b>	
<b>Operating income (loss)</b>	<u><b>\$ (77,555)</b></u>
<b>Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities</b>	
Depreciation and amortization expense	\$ 30,205
Miscellaneous nonoperating revenue	23,936
(Increase) decrease in inventories	9,411
(Increase) decrease in prepaid items	13,680
Increase (decrease) in accounts payable	2,618
Increase (decrease) in salaries payable	2,482
Increase (decrease) in accrued payroll taxes	(29,035)
Increase (decrease) in accrued sales tax	<u>(312)</u>
<b>Total adjustments</b>	<u><b>\$ 52,985</b></u>
<b>Net Cash Provided by (Used in) Operating Activities</b>	<u><b>\$ (24,570)</b></u>
<b>Noncash capital and related financing activities</b>	
Interest expense on the bond issue was not paid and increased interest payable.	<u><u><b>\$ 40,423</b></u></u>

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**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

NOTES TO THE FINANCIAL STATEMENTS  
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2011

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1. Summary of Significant Accounting Policies

A. Reporting Entity

The Municipal Liquor Store Fund (Municipal Liquor Store), an enterprise fund of the City of Biscay, Minnesota, is owned and operated by the City. The Municipal Liquor Store is governed by a five-member city council elected from within the City. The city council is composed of a mayor and four council members.

B. Basis of Presentation

The accompanying financial statements were prepared and are presented in accordance with accounting principles generally accepted in the United States of America.

The Municipal Liquor Store's accounts are organized as an enterprise fund. Operations of the Municipal Liquor Store are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues, and expenses. Enterprise funds are used to account for operations that provide a service to the public financed by charges to users of that service and activities where the periodic measurement of net income is deemed appropriate for capital maintenance, management control, accountability, or other purposes.

The accompanying financial statements do not include various other funds of the City of Biscay, Minnesota.

C. Basis of Accounting and Measurement Focus

The Municipal Liquor Store's financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

When both restricted and unrestricted resources are available for use, it is the Municipal Liquor Store's policy to use restricted resources first, then unrestricted resources as they are needed.

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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1. Summary of Significant Accounting Policies (Continued)

D. Assets and Liabilities

1. Assets

Cash and Cash Equivalents

The Municipal Liquor Store's cash consists of cash on hand and checking accounts.

For the purposes of the statement of cash flows, the Municipal Liquor Store considers cash in the bank and all highly liquid investments with a maturity of three months or less when purchased to be cash and cash equivalents. These are reported as current assets.

Prepaid Items

These amounts consist solely of prepaid insurance expense and will be amortized over the terms of the policies.

Inventories

Inventory is valued at the lower of cost or market using the first in, first-out method.

Restricted Assets

The Municipal Liquor Store is required by bond agreements to maintain certain resources on deposit with its fiscal agent for future bond and interest payments and financial assurance requirements. Currently, the Municipal Liquor Store reports no restricted assets.

Capital Assets

Capital assets, both tangible and intangible, which include property, plant, equipment, fixtures and furnishings, and software, are reported in the financial statements. Tangible and intangible capital assets are defined by the Municipal Liquor Store as assets with an initial cost of \$50 or more. Such assets that also meet the capitalization thresholds are recorded at historical cost or estimated

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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1. Summary of Significant Accounting Policies

D. Assets and Liabilities

1. Assets

Capital Assets (Continued)

historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair value at the date of donation. Capital outlays are capitalized in the Municipal Liquor Store's statement of net assets, which uses the full accrual basis of accounting. It is the policy of the Municipal Liquor Store to depreciate tangible and intangible assets using the straight-line method over their estimated useful lives. Useful lives vary from 20 to 50 years for land improvements and buildings, 5 to 15 years for equipment, and 7 to 10 for furniture and fixtures.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

2. Liabilities

Long-Term Obligations

In the financial statements, long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the bonds outstanding method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported separately and amortized over the term of related debt.

E. Equity Classifications

Equity is classified as net assets and displayed in three components:

1. Invested in capital assets, net of related debt - consists of capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings (net of unspent related debt proceeds, if any) attributable to the acquisition, construction, or improvement of those assets.

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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1. Summary of Significant Accounting Policies

E. Equity Classifications (Continued)

2. Restricted net assets - consists of net assets with constraints placed on their use either by: (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
3. Unrestricted net assets - all other assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

F. Operating and Nonoperating Revenues and Expenses

Proprietary funds distinguish operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal ongoing operations. The principal operating revenues of the Municipal Liquor Store are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation of capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

2. Deposits

Reconciliation of the Municipal Liquor Store’s total deposits, cash on hand, and investments to Exhibit 1 follows:

Cash and investments	
Cash in checking account	\$ (2,402)
Cash on hand	1,500
ATM	<u>4,522</u>
Total Cash and Cash Equivalents - Exhibit 1	<u><u>\$ 3,620</u></u>

The Municipal Liquor Store is authorized by Minn. Stat. §§ 118A.02 and 118A.04 to designate a depository for public funds and to invest in certificates of deposit. The Municipal Liquor Store is required by Minn. Stat. § 118A.03 to protect deposits with insurance, surety bond, or collateral. The market value of collateral pledged shall be at least ten percent more than the amount on deposit at the close of the financial institution’s banking day, not covered by insurance or bonds.



**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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2. Deposits (Continued)

Authorized collateral includes treasury bills, notes and bonds; issues of U.S. government agencies; general obligations rated “A” or better and revenue obligations rated “AA” or better; irrevocable standby letters of credit issued by the Federal Home Loan Bank; and certificates of deposit. Minnesota statutes require that securities pledged as collateral be held in safekeeping in a restricted account at the Federal Reserve Bank or in an account at a trust department of a commercial bank or other financial institution not owned or controlled by the financial institution furnishing the collateral.

Custodial Credit Risk for Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the Municipal Liquor Store’s deposits may not be returned to it. As of December 31, 2011, deposits in financial institutions, reported as components of cash and cash equivalents, had a carrying value of (\$2,402). Bank balances were \$4,471, which were entirely covered by federal depository insurance. The Municipal Liquor Store has no policy for custodial credit risk.

3. Capital Assets

Capital asset activity for the Municipal Liquor Store for the year ended December 31, 2011, was as follows:

	Beginning Balance	Acquisitions	Retirements	Ending Balance
Capital assets not depreciated				
Land	\$ 37,912	\$ -	\$ -	\$ 37,912
Capital assets depreciated:				
Buildings	\$ 829,935	\$ -	\$ -	\$ 829,935
Furniture and fixtures	46,914	1,067	-	47,981
Equipment	41,335	-	-	41,335
Total capital assets depreciated	\$ 918,184	\$ 1,067	\$ -	\$ 919,251
Less: accumulated depreciation for				
Buildings	\$ 211,171	\$ 25,820	\$ -	\$ 236,991
Furniture and fixtures	44,344	1,450	-	45,794
Equipment	37,978	1,717	-	39,695
Total accumulated depreciation	\$ 293,493	\$ 28,987	\$ -	\$ 322,480
Total capital assets depreciated, net	\$ 624,691	\$ (27,920)	\$ -	\$ 596,771
Capital Assets, Net	\$ 662,603	\$ (27,920)	\$ -	\$ 634,683

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

4. Long-Term Debt

Long-term debt at December 31, 2011, is comprised of the following:

	Original Amount Issued	Interest Rate Range	Final Maturity Date	Balance December 31, 2011
2002 Revenue Bonds	\$ 690,000	4.40 - 6.25%	12/01/2027	\$ 615,000

The following is a summary of changes in long-term debt for the year ended December 31, 2011:

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year*
2002 Revenue Bonds	\$ 615,000	\$ -	\$ -	\$ 615,000	\$ 75,000

\*Amounts due within one year include principal payments of \$15,000, \$20,000, \$20,000, and \$20,000 for the years 2009, 2010, 2011, and 2012, respectively.

At December 31, 2011, the Municipal Liquor Store was not in compliance with the provisions of the 2002 Revenue Bond covenants. The Municipal Liquor Store failed to maintain reserves in the amount sufficient to cover operation and maintenance costs for an ensuing two-month period. The Municipal Liquor Store did not have sufficient net revenues from operations to set aside a sum equal to 1/6th of the interest due on the bonds on the next interest payment date and 1/12th of the total principal due on the bonds on the next principal payment date. The Municipal Liquor Store did not have sufficient net revenues to maintain a reserve requirement of \$56,162. Funds from the reserve account can be used only to pay principal and interest payments on the bonds; however, the Municipal Liquor Store accessed a portion of these funds to pay operating costs in 2009. In addition, the Municipal Liquor Store failed to maintain operating policies concerning the purchase and sale of merchandise or perform all other acts or things necessary to ensure that the net revenue collected will be sufficient to pay at least 110 percent of the principal and interest of the bonds.

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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4. Long-Term Debt (Continued)

Debt Service Requirements

Debt service requirements at December 31, 2011, were as follows:

<u>Year Ending December 31</u>	<u>Revenue Bonds</u>	
	<u>Principal</u>	<u>Interest</u>
2012	\$ 75,000	\$ 133,189
2013	20,000	32,487
2014	20,000	31,388
2015	25,000	30,287
2016	25,000	28,913
2017 - 2021	150,000	121,388
2022 - 2026	195,000	70,850
2027	105,000	6,563
Total	<u>\$ 615,000</u>	<u>\$ 455,065</u>

5. Transfers

During the year, transfers from other funds of the City of Biscay to the Municipal Liquor Store occurred to provide cash flows for operations. A transfer of \$5,000 from the City Passbook to the Municipal Liquor Store was approved by the City Council in June 2011. In December 2011, an additional transfer of \$5,000 was made to the Municipal Liquor Store from the Park Fund.

6. Risk Management

The Municipal Liquor Store is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors or omissions; injuries to employees; and natural disasters. The Municipal Liquor Store purchases commercial insurance for all risks of loss. There were no significant reductions in insurance coverage from the previous year, except that the Municipal Liquor Store's Liquor Liability Insurance coverage expired on November 14, 2011, and a new policy was not effective until January 26, 2012.

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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7. Pension Plans

A. Plan Description

All full-time and certain part-time employees of the Municipal Liquor Store are covered by defined benefit pension plans administered by the Public Employees Retirement Association of Minnesota (PERA). PERA administers the General Employees Retirement Fund, which is a cost-sharing, multiple-employer retirement plan. The plan is established and administered in accordance with Minn. Stat. chs. 353 and 356.

General Employees Retirement Fund members belong to either the Coordinated Plan or the Basic Plan. Coordinated Plan members are covered by Social Security, and Basic Plan members are not. All new members must participate in the Coordinated Plan, and benefits vest after three years of credited service (five years for those first eligible for membership after June 30, 2010).

PERA provides retirement benefits as well as disability benefits to members and benefits to survivors upon death of eligible members. Benefits are established by state statute. Defined retirement benefits are based on a member's average yearly salary for the five highest-paid consecutive years of allowable service, age, and years of credit at termination of service.

Two methods are used to compute benefits for Coordinated and Basic Plan members. The retiring member receives the higher of a step-rate benefit accrual formula (Method 1) or a level accrual formula (Method 2). Under Method 1, the annuity accrual rate for a Basic Plan member is 2.2 percent of average salary for each of the first ten years of service and 2.7 percent for each year thereafter. For a Coordinated Plan member, the annuity accrual rate is 1.2 percent of average salary for each of the first ten years and 1.7 percent for each successive year. Using Method 2, the annuity accrual rate is 2.7 percent of average salary for Basic Plan members and 1.7 percent for Coordinated Plan members for each year of service.

For General Employees Retirement Fund members whose annuity is calculated using Method 1, a full annuity is available when age plus years of service equal 90. Normal retirement age is 65 or 66 (depending on date hired). A reduced retirement annuity is also available to eligible members seeking early retirement.

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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7. Pension Plans

A. Plan Description (Continued)

The benefit provisions stated in the previous paragraphs of this section are current provisions and apply to active plan participants. Vested, terminated employees who are entitled to benefits but are not yet receiving them are bound by the provisions in effect at the time they last terminated public service.

PERA issues a publicly available financial report that includes financial statements and required supplementary information for the General Employees Retirement Fund. That report may be obtained on the internet at [www.mnpera.org](http://www.mnpera.org); by writing to PERA at 60 Empire Drive, Suite 200, Saint Paul, Minnesota 55103-2088; or by calling 651-296-7460 or 1-800-652-9026.

B. Funding Policy

Pension benefits are funded from member and employer contributions and income from the investment of fund assets. Rates for employer and employee contributions are set by Minn. Stat. ch. 353. These statutes are established and amended by the State Legislature. The Municipal Liquor Store makes annual contributions to the pension plans equal to the amount required by state statutes. General Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 6.25 percent, respectively, of their annual covered salary.

The Municipal Liquor Store is required to contribute the following percentages of annual covered payroll in 2011:

General Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	7.25

The Municipal Liquor Store's contributions for the years ending December 31, 2011, 2010, and 2009, for the General Employees Retirement Fund were:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
General Employees Retirement Fund	\$ 25,256	\$ 7,394	\$ 1,545

These contributions are equal to the contractually required contribution rates for each year as set by state statute, with the exception of 2009.

**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

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8. Summary of Significant Contingencies and Subsequent Event

Subsequent Closing of Municipal Liquor Store

There is substantial doubt about the Municipal Liquor Store's ability to continue as a going concern. The Municipal Liquor Store is delinquent on its principal and interest payments for the 2002 Revenue Bonds. The last principal payment was on December 1, 2008, and the last interest payment was on June 1, 2009. Also, the Municipal Liquor Store has had significant operating losses for years ending December 31, 2011, 2010, 2009, 2008, and 2007, of \$77,555, \$85,255, \$125,224, \$133,461, and \$70,119, respectively. If the Municipal Liquor Store cannot restructure debt and increase revenues, it is possible that operations could be discontinued and the City of Biscay would be forced to liquidate assets to cover existing debt. The Municipal Liquor Store was closed on May 25, 2012. During July 2012, the City of Biscay City Council formally approved the process to begin procedures to sell the Municipal Liquor Store.



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**MUNICIPAL LIQUOR STORE FUND  
CITY OF BISCAY, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS  
FOR THE YEAR ENDED DECEMBER 31, 2011**

**I. FINDINGS RELATED TO FINANCIAL STATEMENTS AUDITED IN  
ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

A. COMPLIANCE

11-1 Failure to Meet Debt Obligations and Covenants

**Criteria:** Bond principal and interest payments should be made in a timely manner in accordance with the repayment schedule set forth in the bond covenant. Any additional requirements for reserves and operations are also required to be met.

**Condition:** The Municipal Liquor Store has not made principal payments on the 2002 Revenue Bonds since 2008. Interest payments have not been made since June 2009. In addition, the Municipal Liquor Store is not in compliance with the provisions of the 2002 Revenue Bond covenants requiring reserves in the amount sufficient to cover operation and maintenance costs for an ensuing two-month period. The Municipal Liquor Store did not have sufficient net revenues from operations to set aside a sum equal to 1/6th of the interest due on the bonds on the next interest payment date and 1/12th of the total principal due on the bonds on the next principal payment date. The Municipal Liquor Store did not have sufficient net revenues to maintain a reserve requirement of \$56,162. Funds from the reserve account were to be used only to pay principal and interest payments on the bonds; however, the Municipal Liquor Store accessed these funds to pay operating costs in 2009. The Municipal Liquor Store also failed to maintain operating policies concerning the purchase and sale of merchandise or perform all other acts or things necessary to ensure that the net revenue collected would be sufficient to pay at least 110 percent of the principal and interest of the bonds.

**Context:** Bond covenants are designed to protect the interests of both the bond issuer and bond holders. Failure to meet debt obligations raises concern over financial stability.

**Effect:** The Municipal Liquor Store's inability to make debt payments and meet other requirements of bond covenants has resulted in the Store discontinuing operations.

**Cause:** The Municipal Liquor Store has not generated enough revenue to make principal or interest payments, maintain reserve requirements, or continue operations.

**Recommendation:** We recommend the Municipal Liquor Store take steps necessary to satisfy creditors.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

B. INTERNAL CONTROL

11-2 Segregation of Duties

**Criteria:** A good system of internal control provides for an adequate segregation of duties so that no one individual handles a transaction from its inception to completion.

**Condition:** A single employee is responsible for the reconciliation of cash registers, preparation of deposits, and deposit of funds to the bank.

**Context:** Due to the limited number of Municipal Liquor Store staff, segregation of the accounting functions necessary to ensure adequate internal accounting control is not possible. This is not unusual in operations the size of the Municipal Liquor Store; however, the Municipal Liquor Store's management should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an accounting point of view.

**Effect:** Inadequate segregation of duties could adversely affect the Municipal Liquor Store's ability to detect misstatements in amounts that would be material in relation to the financial statements in a timely period by employees in the normal course of performing their assigned functions.

**Cause:** The Municipal Liquor Store does not have the economic resources needed to hire additional qualified staff in order to segregate duties.

**Recommendation:** We recommend that the Municipal Liquor Store's management be aware of the lack of segregation of duties of the accounting functions and, where possible, implement oversight procedures to ensure that the internal control policies and procedures are implemented by staff to the extent possible.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-3

Preparation of Financial Statements

**Criteria:** The Municipal Liquor Store is required to prepare financial statements in accordance with generally accepted accounting principles (GAAP). The preparation of the financial statements is the responsibility of the Municipal Liquor Store's management and the City of Biscay. Financial statement preparation in accordance with GAAP requires internal control over both (1) recording, processing, and summarizing accounting data (that is, maintaining internal books and records); and (2) preparing and reporting appropriate financial statements, including the related notes to the financial statements.

**Condition:** As is the case with many small and medium-sized entities, the Municipal Liquor Store has relied on its independent external auditors to assist in the preparation of the basic financial statements, including notes to the financial statements, as part of its external financial reporting process.

**Context:** The Municipal Liquor Store's ability to prepare financial statements in accordance with GAAP is based, at least in part, on its reliance on its external auditors, who cannot by definition be considered part of the government's internal control.

**Effect:** As a result of this condition, the entity lacks internal control over the preparation of financial statements in accordance with GAAP.

**Cause:** This condition was caused by the Municipal Liquor Store's decision that it is more cost effective to have its auditors prepare its annual basic financial statements than to incur the time and expense of obtaining the necessary training and expertise required to prepare the financial statements internally.

**Recommendation:** We recommend the Municipal Liquor Store obtain the training and expertise to internally prepare its annual financial statements in accordance with GAAP. If the Municipal Liquor Store still intends to have external audit staff assist in preparation then, at a minimum, it must have an individual identified and trained with the expertise to sufficiently review, understand, and approve the Municipal Liquor Store's financial statements, including notes. As an alternative, the Municipal Liquor Store could have an outside consultant assist in preparing its basic financial statements.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-4

Formal Policies and Procedures

**Criteria:** Proper internal control in a government entity is set forth by formally adopted policies and procedures. Written policies and procedures should exist to ensure the Municipal Liquor Store's practices are followed as intended by management.

**Condition:** The Municipal Liquor Store does not have formally adopted policies and procedures documenting accounting controls.

**Context:** Failure to adopt formal policies and procedures increases the risk of fraud and/or theft.

**Effect:** As a result of this condition, practices may not be followed as intended by management, and there is an increased risk of fraud.

**Cause:** Development of formal policies and procedures for the Municipal Liquor Store has not been a priority.

**Recommendation:** We recommend operating policies and procedures for the Municipal Liquor Store, as well as defined internal control measures, be developed and formally adopted by the City of Biscay City Council.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-5

Annual Adopted Budget

**Criteria:** A budget is a key element of internal control. Budget modifications should be made throughout the year to maintain the value of the budget as a monitoring tool.

**Condition:** The City Council and/or management of the Municipal Liquor Store has not developed and adopted a formal budget policy for management's administration of the Municipal Liquor Store budget. A formal budget has not been approved for operations.

**Context:** Failure to create a budget results in a lack of guidelines for planned expenses.

**Effect:** Failure to budget increases the likelihood of overspending.

**Cause:** Budgeting as a monitoring tool for the Municipal Liquor Store had not been identified as a priority.

**Recommendation:** We recommend an annual budget be adopted by the City for the Municipal Liquor Store in order to plan expenses and revenues and to assist in analyzing profitability of the Municipal Liquor Store.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-6

Bank Reconciliations

**Criteria:** Performing complete and timely bank reconciliations for all accounts is a control designed to detect errors and irregularities in a timely manner.

**Condition:** The Municipal Liquor Store has two checking accounts - one for the ATM located on-site and another used for operational purposes. The Municipal Liquor Store does not reconcile the ATM account. We also noted three months where the operating account had not been reconciled.

**Context:** Bank reconciliations are a tool to help ensure cash records are complete and accurate.

**Effect:** Failure to monitor cash activity monthly increases the risk that fraud or errors will go undetected and that financial reporting will not be accurate.

**Cause:** The Municipal Liquor Store does not have enough qualified staff to perform two bank reconciliations monthly.

**Recommendation:** We recommend all bank accounts be reconciled monthly. Any differences should be immediately investigated and resolved. Someone independent of the bank reconciliation process should review bank reconciliations and document the ongoing monitoring process.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-7

Cash Payments

**Criteria:** All vendor payments made by the Municipal Liquor Store should be by check in order to document, control, and monitor payments made.

**Condition:** The Municipal Liquor Store paid some vendors with cash from the register rather than by check.

**Context:** During 2011, as noted in the accounting system, \$15,316 of cash from the register was paid out to vendors.

**Effect:** Paying vendors with cash from the register increases the risk of theft and misappropriation of assets as well as financial reporting errors.

**Cause:** The Municipal Liquor Store faced serious financial instability. Some vendors preferred payments in cash. Staff considered this method of payment acceptable.

**Recommendation:** We recommend all vendor payments be made by check and that cash payments desist.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-8

Disbursement Support and Authorization

**Criteria:** All payments made by the Municipal Liquor Store should be supported by invoices. Expense documentation is a fundamental requirement of a sound accounting system. It is the primary evidence used to support and explain the nature of the Municipal Liquor Store's cash outlays and expenses recorded in the general ledger. Prior to payment, a knowledgeable individual should verify all goods/services listed on the invoice were received and should sign the invoice to indicate approval for payment.

**Condition:** During our testing, we noted some disbursements not supported by invoices. Additionally, we noted a lack of signature indicating the invoice was approved to be paid.

**Context:** For 10 of 25 disbursements tested, supporting documentation could not be located. For these and an additional 5 of the 25 disbursements tested, there was no signature documented authorizing the invoice for payment.

**Effect:** Failures to require proper support and approval of invoices for payment increases the risk of fraudulent activity. It can also result in the overpayment of vendors, affecting financial statement presentation.

**Cause:** Staff was not aware of the importance of these controls.

**Recommendation:** We recommend all disbursements be supported by appropriate and adequate documentation, and that this documentation be maintained. We also recommend that each disbursement be authorized by a manager or someone in a position of knowledge and with the authority to do so.

Client's Response:

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11-9

Journal Entries

**Criteria:** All journal entries should be supported by appropriate documentation. Journal entries should be reviewed and approved by someone other than the individual who prepared or processed the journal entry.

**Condition:** For two of two journal entries tested, we noted that support was not maintained and there was no documentation of review to verify accuracy and purpose.

**Context:** Journal entries allow staff the ability to make changes to the financial system. Support and review are important checks over this powerful function.

**Effect:** Without proper support and review of journal entries, errors in journal entries may affect financial reporting, and improper journal entries may result from fraud.

**Cause:** Staff size and awareness of proper internal controls is limited.

**Recommendation:** We recommend the Municipal Liquor Store maintain support for journal entries made and a knowledgeable individual with proper authority review journal entry activity.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-10

Cash Receipts Documentation

**Criteria:** Deposit slips supporting bank deposits should be created and copies should be maintained by the Municipal Liquor Store for all deposits made.

**Condition:** For 1 of 25 receipts/deposits tested, there was no deposit slip supporting the bank deposit.

**Context:** The Municipal Liquor Store prepares deposits daily.

**Effect:** Failure to maintain documentation for deposits made can lead to errors in recordkeeping and make fraudulent activity more difficult to detect.

**Cause:** Staff size and awareness of proper internal controls is limited.

**Recommendation:** We recommend the Municipal Liquor Store maintain documentation for all deposits made. By requiring deposits to be initiated by one individual and processed by another, the Municipal Liquor Store can implement controls to ensure all proper documentation exists to support a deposit.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-11

Verification of Payroll Hours

**Criteria:** A good system of internal control requires payroll duties to be segregated so that an individual cannot determine his or her own hours worked, approve such hours, and issue his or her own payroll check.

**Condition:** We noted during our testing and inquiry of payroll procedures that one employee receives pay without review or approval of payroll hours by another person. This employee also issues the payroll checks.



**Context:** When proper segregation of duties is limited, review and oversight are critical in detecting errors or irregularities on a timely basis.

**Effect:** The Municipal Liquor Store is exposed to risk of fraudulent activity and unapproved payroll expenses.

**Cause:** Staff size is not large enough to ensure that one individual processes the payroll and another issues the paycheck.

**Recommendation:** We recommend someone independent of the payroll processing function review and monitor payroll input/processing before payroll disbursements are made.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

## II. OTHER FINDINGS AND RECOMMENDATIONS

### A. MINNESOTA LEGAL COMPLIANCE

#### 11-12 City Council Approval of Claims

**Criteria:** According to Minn. Stat. § 412.271, no disbursement of city funds, including municipal liquor store funds, shall be made except through a formal City Council process, including approval by the Council.

**Condition:** During 2011, there were instances where payments were made to vendors prior to, and without, Council approval.

**Context:** The City of Biscay cannot delegate authority to pay claims to the Municipal Liquor Store as the City does not prepare annual audited financial statements. Minn. Stat. § 412.271, subd. 8.

**Effect:** Noncompliance with Minn. Stat. § 412.271.

**Cause:** The Municipal Liquor Store and the City of Biscay were not aware of the requirements.

**Recommendation:** We recommend Municipal Liquor Store claims be approved by the City Council prior to payment pursuant to Minn. Stat. § 412.271.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-13

Late Vendor Payments

**Criteria:** As required by Minn. Stat. § 471.425, subd. 2, municipalities are to pay each vendor obligation according to the terms of the contract or within the standard payment period. Standard payment period is defined as within 35 days of the date of receipt.

**Condition:** We noted during testing that 8 of 25 payments to vendors were not made within 35 days of receipt of invoice as required by Minn. Stat. § 471.425, subd. 2.

**Context:** Claims should be paid in a timely manner.

**Effect:** Noncompliance with Minn. Stat. § 471.425, subd. 2.

**Cause:** The Municipal Liquor Store had insufficient funds.

**Recommendation:** We recommend vendor obligations be paid within 35 days of receipt of invoices to comply with Minn. Stat. § 471.425, subd. 2.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-14

Declaration for Payment

**Criteria:** As required by Minn. Stat. § 471.38, demands against a local government should be signed with a declaration to the effect that such account, claim, or demand is just and correct and that no part of it has been paid.

**Condition:** We noted no such declarations for the Municipal Liquor Store.

**Context:** Sufficient form of such declaration is often printed on the reverse side of checks above the space for endorsement.

**Effect:** Noncompliance with Minn. Stat. § 471.38.

**Cause:** The Municipal Liquor Store had not yet obtained new checks with the appropriate declaration printed on the back.

**Recommendation:** We recommend declarations in sufficient form be made for all claims paid.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-15

Signed and Approved Timecards

**Criteria:** As required by Minn. Stat. § 412.271, subd. 2(b), a supervisor, officer, or the employee is to sign timecards stating hours worked are correct, and when payroll is paid, employees should sign a declaration (which may be a part of the payroll process) to the effect that the employee has received the wages and done the work for which wages have been paid.

**Condition:** Employees are not required to sign their own timecards to certify hours prior to turning them in for payroll processing. Manager approval of timecards has not occurred since June 2011, when new management took place.

**Context:** When an employee's signature is on a timecard, it serves to certify the hours worked. We noted that 13 of 25 timecards tested did not contain approval by appropriate personnel.

**Effect:** Noncompliance with Minn. Stat. § 412.271, subd. 2(b).

**Cause:** There was a lack of appropriate personnel and policy to ensure compliance.

**Recommendation:** We recommend employees sign their timecards prior to handing them in at the end of the pay period. We also recommend all timecards be signed and approved by a manager.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

B. MANAGEMENT PRACTICES

11-16 Interest Paid to Vendors

**Criteria:** As required by Minn. Stat. § 471.425, subd. 4, payment of interest is required on bills not paid within 35 days. It is the entity's responsibility to calculate and pay such finance charges.

**Condition:** During 2011, the Municipal Liquor Store made late payments to vendors. Interest was charged on many of these payments.

**Context:** In 2011, \$1,766 was paid to vendors for interest charges. Interest payments under these circumstances are viewed as a poor use of funds and unsatisfactory management practice.

**Effect:** The Municipal Liquor Store incurred \$1,766 in unnecessary expenses.

**Cause:** The Municipal Liquor Store had insufficient funds available to pay bills in a timely manner.

**Recommendation:** We recommend payments to vendors be made within 35 days of the receipt of the invoice to avoid interest charges.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

11-17 Insurance Premiums Payments and Insurance Coverage

**Criteria:** Insurance premiums should be paid timely when due to prevent a lapse in insurance coverage and exposure to risk. When new insurance policies are obtained through a different agency, the Municipal Liquor Store should ensure that coverage periods are structured so no lapse in coverage occurs.

**Condition:** The premiums for Property Insurance and Municipal Liability coverage beginning November 14, 2011, were not paid before the coverage period began. At the end of the fiscal year, these premiums were still not paid. In addition, subsequent to year-end, the Municipal Liquor Store engaged the Indemnity Insurance Corporation of DC, RRG, to insure the Municipal Liquor Store for Liquor Liability with a coverage period beginning on January 26, 2012. However, the previous Liquor Liability with the League of Minnesota Cities Insurance Trust expired on November 14, 2011. This resulted in a lapse in insurance coverage.

**Context:** The Municipal Liquor Store paid Property Insurance and Municipal Liability coverage premiums in March 2012. The lapse in Liquor Liability coverage exposed the Municipal Liquor Store to risk.

**Effect:** Failure to pay insurance premiums timely may affect coverage and may result in the Municipal Liquor Store being susceptible to potentially material loss of assets. Lapses in coverage expose the Municipal Liquor Store to potentially material claims.

**Cause:** The Municipal Liquor Store did not pay the Property Insurance and Municipal Liability coverage premiums timely due to a lack of funds. The Liquor Liability coverage was allowed to lapse during the transition period from one insurance company to another.

**Recommendation:** We recommend the Municipal Liquor Store pay insurance premiums in a timely manner to reduce the risk of exposure to potentially material loss of assets. We also recommend the Municipal Liquor Store take steps to ensure insurance coverage does not lapse during transition periods.

Client's Response:

*The Liquor Store is closed, and the City of Biscay does not plan on re-opening it. The Liquor Store is up for sale and is being listed with a realtor. There are no management employees working for the liquor store at this time.*

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REBECCA OTTO  
STATE AUDITOR

# STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500  
525 PARK STREET  
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)  
(651) 296-4755 (Fax)  
state.auditor@state.mn.us (E-mail)  
1-800-627-3529 (Relay Service)

## **REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Mayor and Members of the City Council  
City of Biscay, Minnesota

We have audited the basic financial statements of the Municipal Liquor Store Fund, an enterprise fund of the City of Biscay, Minnesota, as of and for the year ended December 31, 2011, and have issued our report thereon dated September 10, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

### Internal Control Over Financial Reporting

Management of the Municipal Liquor Store is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Municipal Liquor Store's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Municipal Liquor Store's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Municipal Liquor Store's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and, therefore, there can be no assurance that all deficiencies, significant deficiencies, or material

weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the Municipal Liquor Store's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 11-2, 11-3, 11-6, and 11-7 to be material weaknesses.

A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiencies described in the accompanying Schedule of Findings and Recommendations as items 11-4, 11-5, and 11-8 through 11-11 to be significant deficiencies.

#### Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Municipal Liquor Store's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance or other matter that is required to be reported under *Government Auditing Standards*, and which is described in the accompanying Schedule of Findings and Recommendations as item 11-1.

#### Minnesota Legal Compliance

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65. Accordingly, the audit included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.



The *Minnesota Legal Compliance Audit Guide for Political Subdivisions* contains six categories of compliance to be tested for the Municipal Liquor Store: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, and miscellaneous provisions. Our study included all of the listed categories, except that we did not test for contracting and bidding since the Municipal Liquor Store did not enter into any contracts in 2011.

The results of our tests indicate that for the items tested, the Municipal Liquor Store complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 11-12 through 11-15.

Also included in the Schedule of Findings and Recommendations are management practices comments. We believe these recommendations to be of benefit to the Municipal Liquor Store, and they are reported for that purpose.

The Municipal Liquor Store's written responses to the financial reporting compliance, internal control, legal compliance, and management practices findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit the Municipal Liquor Store's responses and, accordingly, we express no opinion on them.

This report is intended solely for the information and use of the Mayor and Members of the Biscay City Council, management, and others within the Municipal Liquor Store's management and is not intended to be, and should not be, used by anyone other than those specified parties.

*/s/Rebecca Otto*

REBECCA OTTO  
STATE AUDITOR

*/s/Greg Hierlinger*

GREG HIERLINGER, CPA  
DEPUTY STATE AUDITOR

September 10, 2012