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May 27, 2008

Mr. Duane Burkard, President
Wilmont Fire Relief Association
596 – 5th Avenue
Wilmont, Minnesota 56185

Dear Mr. Burkard:

The Office of the State Auditor (“OSA”) has completed its review of concerns related to a checking account maintained by the Wilmont City Fire Department. The OSA provided assistance to the City of Wilmont (“City”), to its auditors, and to law enforcement during an investigation regarding allegations that \$1,500 in Fire Department funds were deposited into a personal checking account. The investigation regarding the \$1,500 has been closed.

Although the account was listed as a Fire Department account, it appears the use of the account was more consistent with a General Fund of a fire relief association. It is our understanding that the Fire Department checking account was closed in April 2005, and the Wilmont Fire Relief Association (“Relief”) opened a General Fund checking account to be used for deposits from Relief fundraising events and for Relief purchases. Because the Relief now maintains the former Fire Department account, this letter discusses some of our concerns with the way in which the Fire Department account was handled in the past, and provides recommendations to protect Relief funds in the future.

Background

The City Fire Department checking account initially came to the attention of the OSA during a routine review of the City’s 2003 and 2004 audits. The OSA’s involvement changed in 2005 after a request for assistance from the Nobles County Sheriff’s Department (“Sheriff”) was received. The Sheriff was investigating allegations that Fire Department funds had been deposited into a personal account. In late 2007, the Sheriff referred his findings to the Nobles County Attorney. In early 2008, the Nobles County Attorney’s Office declined prosecution, stating that there did not appear to be sufficient evidence to prove beyond a reasonable doubt that a crime had occurred.

During the investigation, it was determined that the Fire Department, a municipal fire department, maintained a separate checking account independent of the City's or the Relief's financial control. The account and related documents were maintained by the Fire Department Treasurer. Bank documents indicate that the Fire Department Treasurer was the sole signatory on the account as of April 13, 2004.

The Fire Department checking account used the City's federal tax identification number. However, when the City first attempted to obtain financial records regarding the Fire Department account, the Fire Department refused to provide the documents to the City. The financial records eventually provided to the City were incomplete.¹ During the investigation, the OSA reviewed documents regarding the Fire Department account, including the account's bank statements, canceled checks, and deposits.

Deposits into the Fire Department account from January 1, 2004, through April 28, 2005, totaled \$4,757.68. Receipts that would have shown the source and purpose of the deposits were not provided to the OSA, and no evidence was received showing that receipts were actually prepared for the funds deposited into the account. The OSA noted that some checks were not deposited in the account in a timely manner.

Disbursements from the Fire Department account for the same time period totaled \$6,134.98. Disbursements from the Fire Department account appeared to be more consistent with a relief association's General Fund than with a city account. For example, Fire Department checks were issued for what appeared to be refreshments for meetings, t-shirts, hats, and fundraising expenses, including postage and liquor. One \$400 check was written to cash, with the check memo field indicating that the disbursement was related to a fundraising dance.

Fire Department checks contained only one signature – that of the Fire Department Treasurer. In many cases, the authorization for disbursements was not adequately documented. For example, the Fire Department meeting minutes frequently contained only a vendor's name, and not the amount of the claim approved. In addition, only one of eighteen disbursements identified by both vendor and amount in the Fire Department meeting minutes matched the check actually issued.

The Fire Department Treasurer admitted to the Sheriff that he deposited Fire Department funds into his personal account. Documentation provided to the OSA by the Fire Department Treasurer showed that, between May 13, 2003, and December 16, 2004, seven separate cash deposits, totaling \$1,500 were made into the Fire Department

¹ The Fire Department account existed prior to January 1, 2004; however, the Fire Department only provided the City with bank records from January 2004 through April 2005. The Clerk-Treasurer was not provided with a check register or itemized receipts supporting payments made from the account.

Treasurer's personal account.² According to a listing provided by the Fire Department Treasurer, the \$1,500 consisted of dance money, donations, a pop fund, and a "thank you."

As evidence that the Fire Department funds had been repaid, the Sheriff was provided with a carbon copy of a check for \$1,500, dated April 20, 2005, that was written by the Fire Department Treasurer, payable to the Fire Department Treasurer. The check was written from a personal account owned by the Fire Department Treasurer other than the personal account into which the \$1,500 cash had been deposited. The Fire Department Treasurer told the Sheriff that a deposit of \$1,806.68 into the Fire Department account on April 28, 2005, consisted of cash he obtained by cashing the \$1,500 personal check, plus \$306.68 in cash that had been maintained in a "red zipper bank bag" purportedly held by the Fire Department to cover any unexpected needs.³

Discussion and Recommendations

We have concerns with the lack of internal control procedures used with the Fire Department account. Because the Relief now maintains the former Fire Department account as its General Fund, we offer the following discussion and recommendations to safeguard these funds in the future.

We have enclosed our Statement of Position on fire department and fire relief association accounts to help the Relief distinguish between City and Relief accounts, and understand the different statutes that apply to each. A municipal volunteer fire department is part of a city. City fire department revenues would include fire call receipts and funds obtained through contracts with other political subdivisions for fire protection services. City fire department expenditures would include equipment, training, insurance, and compensation. The handling of fire department funds must comply with Minnesota laws governing city funds.⁴

In contrast, a fire relief association is an organization that is separate from the city. A fire relief association must have a Special Fund that is a restricted pension fund. A fire relief association may also have a General Fund for fundraising events, donations, gifts to the city for the benefit of the fire department, meeting refreshments, jackets, shirts, and hats.⁵ The handling of Relief funds must comply with Minnesota laws governing fire relief associations and the Relief's Bylaws.

² On two of the seven occasions, the personal account was charged overdraft fees – once within 14 days, and once on the day following the deposit. Based upon these overdraft fees, it appears the funds were not simply "sitting" in the personal account, but may have been converted for personal use.

³ The OSA reviewed the deposit detail for the only two deposits made into the Fire Department account in April 2005. The \$1,500 personal check from the Fire Department Treasurer was not in the deposit detail.

⁴ For example, checks must be approved by the city council and contain the signatures of the appropriate city officials. *See, e.g.,* Minn. Stat. § 412.271, subs. 1 and 3.

⁵ A fire relief association may also have a separate Gambling Fund.

The Relief's Board of Trustees is responsible for establishing and maintaining internal controls for the Relief's funds. One of the most basic and effective controls is to segregate duties.⁶ Proper control procedures are particularly important where cash receipts are involved, such as during ticket sales for fundraising events. Proper internal controls, including the segregation of duties, help protect the Relief funds from loss. They also protect individual Relief officers and members.

Relief funds should never be placed in a personal account. Under the Bylaws, the Relief Treasurer must maintain separate and distinct accounts for the Relief's General and Special Funds.⁷ Under the Bylaws, all Relief funds must be maintained in the Relief's General or Special Funds, in the depositories designated by the Board of Trustees.⁸

According to the Relief's Treasurer, the Relief has issued checks with only one signature.⁹ The Relief's Bylaws require the signatures of the Relief President and the Relief Treasurer on all checks.¹⁰ In addition to being a requirement under the Bylaws, multiple signatures are part of the Relief's internal controls. By requiring two signatures, more than one person is verifying that the Board of Trustees approved the check for payment.¹¹ Allowing checks to be issued without the required signatures defeats this safeguard. We recommend that the Relief have two signatures on all Relief checks, in compliance with the Bylaws. We also recommend that the Relief's banks be made aware that Relief checks should not be negotiated without all of the required signatures.

Individual members of the Board of Trustees do not have the authority to authorize a payment on behalf of the Relief.¹² The decision to expend Relief funds should be based upon a formal vote of the Board of Trustees that is memorialized in the Relief's meeting minutes. Relief checks should be issued only after the claims to which they relate have been approved by the Board of Trustees, in compliance with the Bylaws. We recommend that the Relief's meeting minutes include the vendor to be paid, as well as the amount approved for payment by the Board of Trustees, and that supporting bills/invoices be maintained for all Relief checks.

⁶ Financial duties were not segregated for the Fire Department account. The Relief's Bylaws recognize the need to segregate duties by requiring the Secretary to receive all moneys due the Relief, and to pay the moneys over to the Treasurer for deposit. *See* Bylaws of the Wilmington Fire Department Relief Association (March 10, 1981, as amended August 29, 2007) ("Bylaws"), Article III, sections 3 and 4.

⁷ *See* Bylaws, Article III, section 4.

⁸ *See* Bylaws, Article VI, sections 1, 2, and 4.

⁹ According to the Relief Treasurer, there are two signatories on the Relief accounts. The Fire Department account had only one signatory on the account.

¹⁰ *See* Bylaws, Article VI, section 3 ("No disbursement of funds of this Association shall be made except by check drawn by the Treasurer and countersigned by the President.").

¹¹ *See* Bylaws, Article VI, section 3 (no checks shall be issued until the claim to which it relates has been approved by the Board of Trustees).

¹² *Id.*

If the Relief determines that a petty cash fund should be maintained by the Relief, we recommend that the Relief meeting minutes document the creation and amount of any such fund, as well as any limits placed on the use of the fund.¹³ We recommend that the Board of Trustees should periodically review the petty cash fund to determine whether the fund is still necessary. We also suggest that the Board of Trustees designate a custodian for the petty cash fund, and establish internal control procedures for the petty cash fund.¹⁴ Reconciliations of the petty cash fund should be done by someone other than the fund's custodian, or other person, who approved payments from the fund. If the reimbursement method of disbursing petty cash is used, the amount of cash on hand plus the receipts should equal the amount of the approved petty cash fund.

Cash receipts, such as those received during fundraising events, present special risks that should be addressed in the Relief's internal control procedures. For example, we recommend that all cash collected be deposited in a timely manner. We recommend that pre-numbered receipts be used whenever practicable and be retained to support all deposits. We recommend that two individuals be present when cash is being counted, with both individuals initialing the corresponding deposit tickets.

Finally, relief associations should take steps to prevent individual officers from overriding internal controls. One of the best ways to lessen the risk of management override is to create a culture where a strong internal control environment is held in high esteem and practiced every day. The message must be clear: internal control policies and procedures apply to everyone. In addition, the message should start at the top with the Board of Trustees.

Conclusion

We encourage the Board of Trustees to review existing internal controls, implement any additional controls that may be warranted, and educate the Relief membership about the importance of internal controls. To further assist the Board of Trustees in meeting its responsibilities, we are enclosing our Statements of Position on internal controls and meeting minutes.

¹³ Petty cash funds are not separate checking accounts. Instead, they are cash funds (currency in the form of coins and bills). We address this issue because of the alleged existence in the past of a red cash bag, purportedly used to hold cash to cover unexpected needs.

¹⁴ We also recommend that the Relief's meeting minutes reflect any custodian of the fund. We recommend that original detailed vendor receipts be maintained for all disbursements from the petty cash fund. The Board of Trustee could require that all claims paid from the petty cash fund be presented to the Board of Trustees for approval at the next meeting. If the Board of Trustees fails to approve any of the claims, the custodian of the petty cash fund could be made personally responsible for the claim. School districts, towns, counties, and cities follow these procedures for petty cash (imprest) funds. See Minn. Stat. §§ 123B.11 (school districts), 366.01, subd. 12 (towns), 375.162 (counties), and 412.271, subd. 5 (cities).

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After reviewing this letter and the enclosed Statements of Position, we request that the Relief provide us with a written response, identifying internal control procedures that have been adopted for the handling of Relief funds. If you have any questions about the issues discussed in this letter, please feel free to contact me directly at 651-282-2388.

Sincerely,

/s/Kathleen T. Docter

Kathleen T. Docter, CPA, CFE
Senior Investigative Specialist
Legal/Special Investigations Division

Enclosures

cc: The Honorable Daryl Behrends, City Mayor and Relief Trustee
Mr. Ryan Huisman, Relief Treasurer
Mr. Al Balster, Relief Secretary
Mr. Steve Joens, Fire Chief
Ms. Rita Cowan, City Clerk-Treasurer
Ms. Tisha S. Paplow, City Auditor
Mr. Steven Haugen, Relief Auditor
Ms. Rose Hennessy Allen, Office of the State Auditor Pension Director
Deputy Jay Clarke, Nobles County Sheriff's Department