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July 22, 2016

The Honorable Sandra Froemming
Mayor, City of Parkers Prairie
102 North Otter Avenue
Parkers Prairie, MN 56361-4996

Dear Mayor Froemming:

The Office of the State Auditor (OSA) received concerns about the City of Parkers Prairie (City). Specifically, the concerns relate to the City's operation and oversight of its municipal liquor store, including its on-sale, off-sale, and event center operations (Liquor Store). In response to these concerns, the OSA interviewed various individuals and requested and reviewed various documents from the City related to Liquor Store sales for the period of October 1, 2015, to February 16, 2016 (Review). During the Review, additional issues were identified that also are discussed in this letter.

Based on the OSA's Review, the City appears to be lacking a number of basic internal controls and management practices recommended for effective oversight of a municipal liquor store.

This letter describes the findings from the OSA Review and provides the City with recommendations to improve its processes and controls related to operating the Liquor Store. Additionally, attached are three OSA Statements of Position: *Internal Controls for Municipal Liquor Stores*, *The Importance of Internal Controls*, and *Petty Cash (Imprest) Funds*. The statements provide additional information on how the City can safeguard against the financial risks related to municipal liquor store operations.

Background

The Liquor Store has reported net losses in 2012 (\$27,657), 2013 (\$18,585), and 2014 (\$9,889). Minnesota law requires a city whose liquor store has experienced a net loss in at least two of the years during the past three-year period to hold a public hearing on the question of whether the city should continue to operate a municipal liquor store.¹ The City held a public hearing on December 21, 2015, to consider the continued operation of the Liquor Store. Meeting minutes of the hearing state that the City Council unanimously approved a motion authorizing the continued operation of the Liquor Store and "to give more decision-making flexibility to the manager."

¹ Minn. Stat. § 340A.602.

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During the OSA's Review, the City reported that the Liquor Store staff consists of a manager who oversees the store operations (Liquor Store Manager), a separate manager overseeing the event center operations, and ten additional employees.

Sales Oversight

Daily Deposits of Liquor Store Receipts

The OSA found that the Liquor Store Manager position description states an expectation that the Liquor Store Manager will make daily bank deposits of the money received from its sales.² After review of the City's bank statements, it does not appear that daily deposits are being made.

Timely deposits decrease the risk of potential misappropriation or loss of funds and increase investment earnings. The OSA recommends that the City require compliance with its expectation of daily bank deposits of Liquor Store sales proceeds.

The OSA also recommends that the Liquor Store complete a deposit slip with each deposit clearly identifying the funds that came from the on-sale, the off-sale, and the event center operations. Each deposit slip should be verified by at least two individuals to ensure that all cash and checks collected are properly accounted for. In addition, the OSA recommends that the City review the timeliness of deposits on a regular basis and take appropriate action if they are found to be untimely.

Reconciliations of Sales

After the Review, it appears to the OSA that basic daily reconciliations of the Liquor Store sales and monthly reconciliations of the bank deposits tied to those sales are not taking place. Daily reconciliations of the sales (as recorded in the Z-outs) to the cash on hand is a control used to reduce the risk of misappropriation or loss of funds and for timely identification of discrepancies requiring further investigation. Similarly, monthly reconciliations of the Liquor Store deposits, as recorded in the City's bank statements, to source documents, including bank-generated deposit receipts and daily Z-outs, also help avoid loss of funds and allow for timely investigation of any discrepancies found. Maintaining records that demonstrate the reconciliations is equally important in order to allow for appropriate financial reviews.

The OSA recommends that the City: (1) require the performance of daily reconciliations of Z-outs to collections at the Liquor Store; (2) maintain the documents demonstrating the reconciliations; and (3) routinely review the sequential numbers found on the summary tapes to verify that all register sales have been reported. Any discrepancies found in the daily reconciliations and gaps found in the sequence of the summary tape numbers should be investigated further.

² See "Essential Functions" section of Liquor Store Manager position description dated December 16, 2013.

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The OSA further recommends that the Clerk/Treasurer or Deputy Clerk/Treasurer perform monthly bank reconciliations to verify that all money received by the Liquor Store is being deposited. Each Liquor Store deposit should be reconciled to source documents.

For additional guidance on this issue, please refer to the enclosed copy of the OSA's *Statement of Position on Internal Controls for Municipal Liquor Stores*.

Timely and Accurate Record Keeping

The OSA found that the City does not appear to be maintaining appropriate records of Liquor Store sales or records of transactions related to the Liquor Store Automatic Teller Machines (ATMs). City personnel reported a previous practice in which the Deputy Clerk/Treasurer received records of sales from the Liquor Store and recorded them in the City's general ledger and in an independent log. That practice did not appear to be in place during the Review.

The OSA understands that, in the past, the City would issue a City check for cash to fund the Liquor Store ATMs. The Liquor Store then would print and provide to the Clerk/Treasurer or Deputy Clerk/Treasurer all receipts from the ATMs. The OSA found that this practice appears to have been discontinued, and there do not appear to be records kept of the source or amounts of the funds used to "fill" the ATMs.

Municipal liquor stores are cash businesses that present financial risks that other city functions may not. Under Minnesota law, a city treasurer is obligated to account for all money received and disbursed.³ Such accounting requires proper recordkeeping practices.

The OSA recommends that the City maintain records of all Liquor Store sales in a manner compliant with Minnesota law. Additionally, the City should resume its practice of properly issuing City checks to fund the Liquor Store ATMs. It also should keep records of the ATM transactions.

Access Control

Segregation of Duties

It appears to the OSA that one employee, the Liquor Store Manager, has sole responsibility for maintaining the Liquor Store's sales records (Z-outs), has access to the Liquor Store's cash collections, and has the ability to void transactions in the Liquor Store's registers. Enabling a single official or employee to authorize a transaction, record the transaction, and obtain custody of the item resulting from the transaction creates the potential for the individual to commit an irregularity and cover it up.

³ See Minn. Stat. § 412.141.

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The OSA recommends that the City segregate these duties and arrange for a separate City employee to review all Liquor Store sales and deposits and all voids made to the Liquor Store registers. For additional guidance on this issue, please refer to the enclosed copy of the OSA's *Statement of Position on Internal Controls for Municipal Liquor Stores*.

Access Controls to Safeguard Liquor Store Assets

It was reported to the OSA that the City Council recently learned that multiple keys to the Liquor Store had been distributed to Liquor Store employees and non-employees, including vendors. The City reported that it intended to collect the keys that had been distributed to vendors.

Limiting access to Liquor Store facilities is an important control that helps ensure security of the premises and protection of inventory. The OSA recommends that the City determine which Liquor Store employee positions require keys to perform their official job duties, develop a policy that reflects that determination, and require compliance with the policy. Distribution of keys to individuals who are not Liquor Store employees or officials should be discontinued.

Access Controls to Safeguard the Liquor Store's Data

The City reported to the OSA that it recently discovered an unauthorized server on the Liquor Store computer, which would allow remote access to the Liquor Store computer through another computer. The City Council had not authorized or approved remote access to the Liquor Store computer.

Weak control over access to a computer system increases the risk that unauthorized individuals may enter the system or that unauthorized and even harmful programs may be installed on it. Limiting administrative rights to the computer to one employee or official (ideally not involved in operations) helps ensure that only approved programs and services are installed on the computer. Having employee-specific usernames and passwords also helps protect the computer system from unauthorized or improper access and use.

The OSA recommends that the City determine which employee or official should have administrative rights based on that employee or official's function and official responsibilities. The City should then ensure that administrative rights are granted only to that position. The OSA also recommends that any individual who is granted access to the Liquor Store's computer receive his or her own unique username and password, which should not be shared and which should be changed from time-to-time.

Handling of Cash Funds

Petty Cash and Change Funds

During the OSA Review, the City indicated that the Liquor Store maintains a number of cash funds. Cash funds are particularly vulnerable to theft, fraud, misappropriation, and loss, and require extra security precautions and safeguards.

The OSA did not receive any policies, procedures, or other records from the City that showed any internal controls or oversight of these funds.

Under Minnesota law, petty cash funds can be established to pay claims that are impractical to pay in any other way, but the City Council must establish the amount of such funds and appoint a “custodian” who is responsible for the cash entrusted to the fund.⁴

The OSA recommends that the City follow this law to establish its petty cash funds and appoint a custodian for each fund. Meeting minutes should document the creation and amount of each fund. Periodically, the City Council should review these funds to determine whether they are still necessary.

The OSA also recommends that the City Council determine the amount required for each change fund and similarly document in the meeting minutes the authorization and the amount of each fund. The City Council should also appoint a custodian responsible for each change fund.

When disbursements are made from petty cash funds, the law requires that a claim itemizing the disbursements be presented to the City Council at its next meeting after the disbursements are made. If the City Council approves the claim, a City check should be issued to replenish the fund. If the City Council does not approve the claim in full, the fund’s custodian is personally responsible for the difference. When replenishing petty cash funds, the total of the original receipts maintained by the custodian should match the amount of the replenishing check.

The OSA recommends that the City Council comply with the law regarding review and approval of disbursements made from the petty cash funds.

It is equally important that all cash held in petty cash or change funds be accounted for and supported with documentation, such as daily Z-outs, change fund records, and receipts. The City did not provide the OSA with records demonstrating that it is performing reconciliations to verify that the monies placed in the cash funds are being accounted for.

⁴ Minn. Stat. § 412.271, subd. 5.

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The OSA recommends that reconciliations of the Liquor Store's cash funds be done regularly and by someone other than the person approving disbursements or exchanges from these funds. Any differences between the amount of cash on hand and the approved amount of the change or petty cash funds should be investigated in a timely manner. The City should maintain a record of these reconciliations.

Finally, the OSA recommends strong controls to protect petty cash and change funds, specifically that they be kept in a locked safe with limited access.

For additional guidance on this issue, please refer to the enclosed copy of the OSA's *Statement of Position on Petty Cash (Imprest) Funds*.

Employee Charge Log

The OSA was provided and reviewed a handwritten notebook entitled "Employee Charge Log" (Log). City officials reported that the Log had been used since December 2015 by the Liquor Store Manager to list items she purchased and consumed at the Liquor Store. Specifically, the Log notes "credits" (i.e., amounts the Liquor Store Manager reportedly put into the cash register at various points in time, not attached to any particular purchase) and lists of items "purchased" against the credit amounts. The Log does not include the price of the item or the date of "purchase." Additionally, the Log includes what appear to be discount rates applied to the "purchases," even though the Liquor Store Employee Handbook states that there are no discounts to employees.⁵ The City could not confirm that the transactions noted in the Log were ever recorded in the Liquor Store's register.

The OSA recommends that the City immediately discontinue use of the Log and require that all Liquor Store purchases, regardless of the purchaser, be recorded in the Liquor Store register at the time of purchase. Failure to do so jeopardizes the ability to track inventory, guard against theft or loss, and identify situations requiring further investigation. The OSA also recommends that the City enforce its policy prohibiting employee discounts at the Liquor Store.

The Payment of Expenses Directly Out of Cash

The OSA understands that certain Liquor Store expenses, such as for Halloween costume prizes, have been paid directly out of cash at the Liquor Store. The City could not confirm that these expenses were recorded in the City's general ledger.

⁵ See Parkers Prairie Municipal Liquor Store Policy Employee Handbook, p.3.

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Minnesota law generally requires “disbursement of city funds, including funds of any municipal liquor dispensary operated by the city,” to be made “by an order drawn by the mayor and clerk upon the treasurer.”⁶ The Liquor Store Manager position description requires review of bills for accuracy and submission to the City office for payment.⁷

The OSA recommends that the City comply with Minnesota law by issuing City checks for Liquor Store disbursements. For additional guidance, please refer to the enclosed copy of the OSA’s *Statement of Position on Internal Controls for Municipal Liquor Stores*.

Conclusion

The OSA reviewed concerns about the Liquor Store. The OSA found several issues indicating a lack of internal controls. The City Council is responsible for establishing and maintaining effective internal controls and for the sound operation of the Liquor Store.

This letter provides recommendations to bring the City into compliance with Minnesota law. By August 15, 2016, please provide the OSA with the steps the City has taken to address the identified issues. For further information and assistance in addressing the issues identified in this letter, the City Attorney, the League of Minnesota Cities, the Minnesota Municipal Beverage Association, and your auditors may be good resources.

If you have any questions, please feel free to contact me at (651) 297-5853, or by email at Jeff.Reed@osa.state.mn.us.

Sincerely,

/s/ Jeff Reed

Jeff Reed, Attorney
Office of the State Auditor

cc: The Honorable Brian D. Koehn, City Council
The Honorable Greg Larson, City Council
The Honorable Kelly Mesker, City Council
The Honorable Tom Myers, City Council
Mr. Tomas Jacobson, City’s Attorney
Ms. Beth Wussow, City Clerk
Abdo, Eick, & Meyers, LLP

Enclosures

⁶ See Minn. Stat. § 412.271, subd. 1.

⁷ See Liquor Store Manager position description dated December 16, 2013.