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August 25, 2015

The Honorable Scott Williams
Mayor, City of Cologne
P.O. Box 120
Cologne, Minnesota 55322-0120

Dear Mayor Williams:

The Office of the State Auditor (OSA) received concerns about the City of Cologne (City). The concerns raised questions about the City's payroll practices, handling of petty cash and change funds, and purchasing equipment. As a result of these concerns, we reviewed related City records and interviewed individuals associated with the City. Based on this review, the OSA determined that, in certain instances, the City did not comply with Minnesota law, did not properly segregate duties and did not act consistently with its own policies. This letter will provide the City with guidance in the future.

Background

The statutory City has a five (5) member City Council, a City Administrator, a full-time City Clerk, a part-time Administrative Assistant and a part-time Utility Billing Clerk. The City Council has oversight of the City's expenditures and disbursements.¹ The City Clerk appears to be primarily responsible for processing the City's payroll, including issuing and disbursing payroll checks. The City Clerk also appears to be primarily responsible for the City's imprest funds (petty cash) and change funds.²

Payroll

The OSA received concerns that the City Clerk received unauthorized pay rate increases between May 2013 through April 2014 and additional payroll checks during the same period of time.

In reviewing the City's payroll records from January 1, 2012, through July 25, 2014, the OSA identified a lack of internal controls and payroll practices that were not consistent with the City's policies. Specifically:

¹ The City operates pursuant to state law, including but not limited to Minnesota Statutes, chapters 412, 465, and 471.

² The City Clerk writes checks out to "Petty Cash," endorses them, cashes them, is responsible for documenting and recording the revenue, and deposits the funds into the bank.

- The City Clerk, who processes payroll, received \$36.60 per hour for 80 hours of work in one pay period, twice the approved hourly rate.³ An adjustment to the City Clerk's payroll check was made the following pay period whereby compensation for 80 hours of regular work was withheld.
- Three City employees routinely work overtime. The City's policy states that overtime should be limited "to emergency situations only."⁴
- The City routinely provides monetary compensation for overtime. The City's policy states that "authorized overtime work will usually be compensated for by allowing the employee time off."⁵
- The City pays out unused vacation, floating holiday and/or compensatory time at the end of every year in pay period 26.01. The City's Employee Policy Book does not specify the terms and conditions under which these payouts are to be made, e.g., who is eligible for the payouts, whether there's a threshold for the payout, whether a balance can be carried forward into the next year, etc. The 2012 and 2013 leave payouts were not consistently applied to all employees. We found no documentation from the acting City Administrator nor approval or discussion in the City Council meeting minutes addressing year-end leave payouts.

The OSA determined the City lacked appropriate internal controls regarding its payroll processes and these processes were not consistent with the City's policies.

Imprest (Petty Cash) and Change Fund

The OSA received concerns that the City did not use appropriate oversight when it issued checks to petty cash.

In reviewing the City's bank statements from January 1, 2012, through July 31, 2014, the OSA identified six checks written to "Petty Cash." According to the City's general ledger, three of the checks were used to pay for meals, postage and other miscellaneous expenses.⁶ The majority of the expenditures were not supported with receipts.

³ The 80 hours worked were for pay period 25 in calendar year 2012. For the policies, see City of Cologne Council Resolution 12-20.

⁴ The City's Employee Policy Book states; "Department heads and supervisors will make every effort to limit overtime to emergency situations only." City of Cologne Employee Policy Book Reference Manual dated June 2012.

⁵ See City of Cologne Employee Policy Book Reference Manual dated June 2012. Approved unanimously by motion at the June 11, 2012 City Council meeting.

⁶ Check Numbers 22876, 17940, and 18528.

Based on the City's general ledger, the other three checks were used for change funds for the City sponsored events of Recycling Days, where residents drop off unwanted appliances or other recyclables for a fee, and Open Gym, where residents use certain sports facilities for a fee.⁷ Each check written to petty cash was endorsed by the City Clerk. The City Clerk supplied all of the supporting records for these transactions and deposit receipts were signed by the City Clerk. The City did not provide the OSA with a record of transactions occurring at these City sponsored events (e.g. prenumbered receipts). Subsequent deposits show that \$929 was deposited after the 2013 Recycling Day's event but the documentation was such that the OSA was unable to determine if the original change fund was included in this deposit. The City did not provide documentation, nor did the general ledger report revenue collected at the Open Gym event.

Minnesota law permits cities to establish imprest (petty cash) funds.⁸ It also permits change funds to be established in the same manner as imprest funds. Cash payments can be made from imprest (petty cash) funds to cover approved claims that are "impractical to pay in any other manner." Change funds, on the other hand, should not be used to pay expenses.⁹ Though the change fund law is directed toward counties, it represents best practice for all levels of local government.

The OSA determined that the City's handling of petty cash and change funds did not comply with Minnesota law, duties related to cash handling were not properly segregated and insufficient documentation was maintained by the City for City sponsored events.

Contracting Procedures

The OSA received concerns that the City purchased lights for the baseball field in Fritz Field without using the proper bid procedures.

According to City records, Fritz Field (Field) is a City-owned baseball field used by the community for recreational baseball. The Cologne Hollanders, a baseball team, also uses the Field. On January 23, 2014, the City purchased a design, layout, and lighting system for the Field for \$104,831 without soliciting bids pursuant to Minn. Stat. § 471.345.¹⁰ A September 29, 2014 letter from the Cologne Hollanders Baseball Association (Association) pledged to contribute \$56,000 to the cost of the lights and \$25,000 toward the electrical contract for the installation of the lights, reducing the City's actual cost to less than \$100,000.¹¹

⁷ Check Numbers 23678, 18627, and 18008.

⁸ Minn. Stat. § 412.271, subd. 5.

⁹ See Minn. Stat. § 375.45.

¹⁰ Check number 18319 was issued to pay a \$104,831 invoice from Musco Sports Lighting, LLC.

¹¹ The Association contributed \$25,000 in spring 2014 and \$11,000 in January 2015.

Minn. Stat. § 471.345, subd. 3, requires formal bidding with published public notice and sealed bids when municipalities purchase equipment that costs in excess of \$100,000.¹² The law requires a municipality to undertake an open public process whereby equipment sellers compete through sealed bids to sell the equipment to the City at the lowest price. The bid law requirements apply whether the purchase price is offset, in whole or in part, by outside donations.

The OSA determined that the City did not follow Minnesota bid law requirements.

Conclusion

In reviewing concerns raised about the City's payroll practices, handling of petty cash and change funds, and purchasing equipment, the OSA determined that the City was not compliant with its policies or Minnesota law.

The OSA makes the following recommendations:

- 1) Consider updating the City's Employee Policy Book to clarify how the City administers overtime, compensation time, vacation time, and any other leave payouts.¹³
- 2) Consider having the City Council review payroll expenditures including year-end leave payouts.¹⁴
- 3) Consider segregating payroll duties so that the person responsible for processing payroll is not the same person reviewing and approving the payroll checks after they've been processed.¹⁵
- 4) Consider establishing formal policies and procedures for handling petty cash and change funds to properly safeguard the City's financial resources.¹⁶
- 5) Before making purchases that potentially trigger the bid law requirements of Minn. Stat. § 471.345, consult your City Attorney.¹⁷

¹² Minn. Stat. § 471.345, subd. 3 (requiring public notice pursuant to the law applicable to the city).

See Minn. Stat. § 331A.03, subd. 3 (requiring that notice for cities "be published in a qualified newspaper").

¹³ *See* attached OSA's Avoiding Pitfalls – Pay and Benefits Documentation.

¹⁴ *See* attached OSA's Statement of Position - The Importance of Internal Controls, and OSA's Statement of Position - Employee Timekeeping Procedures for Employees Paid on an Hourly or Daily Basis.

¹⁵ *See* attached OSA's Avoiding Pitfalls – Payroll Entries.

¹⁶ *See* the attached OSA's Statement of Position - Petty Cash (Imprest) Funds.

¹⁷ *See* the attached OSA's Statement of Position - City Bidding and Contract Requirements.

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Thank you in advance for your cooperation. If you have any questions, you may contact me at (651) 297-5853 or by email at jeff.reed@osa.state.mn.us, or Nichole Bjornrud at (651) 282-2750 or by email at Nichole.Bjornrud@osa.state.mn.us.

Sincerely,

/s/ Jeff Reed

Jeff Reed
Office of the State Auditor

cc: The Honorable Jeff McInnis, City Council Member
The Honorable Don Meyer, City Council Member
The Honorable Carol Szaroletta, City Council Member
The Honorable Kyle Evenski, City Council Member
Mr. Jesse Dickson, City Administrator
Ms. Kelly C. Dohm, City Attorney