STATE OF MINNESOTA
Office of the State Auditor

Rebecca Otto
State Auditor

MANAGEMENT AND COMPLIANCE REPORT
PREPARED AS A RESULT OF THE AUDIT OF

MARTIN COUNTY
FAIRMONT, MINNESOTA

YEAR ENDED DECEMBER 31, 2013

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.

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MARTIN COUNTY
FAIRMONT, MINNESOTA

Year Ended December 31, 2013

Management and Compliance Report

Audit Practice Division
Office of the State Auditor
State of Minnesota

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MARTIN COUNTY
FAIRMONT, MINNESOTA

TABLE OF CONTENTS

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MARTIN COUNTY
FAIRMONT, MINNESOTA

SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED DECEMBER 31, 2013

I. SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: **Unmodified**

Internal control over financial reporting:
- Material weaknesses identified? **Yes**
- Significant deficiencies identified? **No**

Noncompliance material to the financial statements noted? **No**

Federal Awards

Internal control over major programs:
- Material weaknesses identified? **No**
- Significant deficiencies identified? **No**

Type of auditor's report issued on compliance for major programs: **Unmodified**

Any audit findings disclosed that are required to be reported in accordance with Section 510(a) of OMB Circular A-133? **No**

The major programs are:

Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	CFDA #14.228
Formula Grants for Rural Areas	CFDA #20.509

The threshold for distinguishing between Types A and B programs was $300,000.

Martin County qualified as a low-risk auditee? **No**

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

Finding 2012-001

Ditch System Accounting and Reporting

Criteria: Ditch system accounting records on the County's tax system should be maintained in a manner that provides accurate information for tax billing and financial statement reporting.

Condition: During our review of the County ditch systems, we noted errors in the accounting and reporting of ditch system activity. Corrections were made and are reflected in the financial statements.

Context: Although significant improvements have been made in the financial reporting of ditch assessments, during the audit, County personnel identified instances where prepaid assessments collected were not marked as paid in the tax system, and instances where assessments that had not been collected were marked as paid in the tax system.

Effect: Tax system reports used for preparation of the financial statements were inaccurate and required correction. Corrected tax statements had to be prepared and sent to affected parcel owners. Without proper controls, there is the potential that unidentified errors could occur in the future that would result in parcel owners paying assessment amounts that are not appropriate based on the determined benefits for their property.

Cause: Control procedures over accounting for assessments paid are not adequate to identify errors. The County stated that it did not have sufficient checks and balances in place to ensure that the Integrated Financial System (IFS) and the County Tax System were in balance with each other.

Recommendation: We recommend that the County continue to develop accounting procedures necessary to ensure that ditch assessment payments are accurately accounted for in the tax system.

Client's Response:

The County will continue to develop and improve the accounting procedures to ensure that ditch assessment payments are accurately entered into the tax system and will have a check and balance procedure to ensure that ditch assessment payments in IFS and the tax system balance.

ITEM ARISING THIS YEAR

Finding 2013-001

Audit Adjustments

Criteria: 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 of the financial statements on a timely basis. Auditing standards define a material weakness as a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the County's financial statements will not be prevented, or detected and corrected, on a timely basis.

Condition: During our audit, we proposed audit adjustments which were reviewed and approved by the appropriate staff and are reflected in the financial statements. By definition, however, independent external auditors cannot be considered part of the County's internal control.

Context: The inability to detect material misstatements in the financial statements increases the likelihood that the financial statements would not be fairly presented.

Effect: The following audit adjustments were necessary to be recorded for December 31, 2013:

- An adjustment of $611,146 was made in the Road and Bridge Special Revenue Fund for an advance from State Highway allotments. The amount was recorded as a deferred inflow so it should not also have been recorded as a restricted amount. In addition, the amount was misclassified as regular maintenance revenue when it should have been recorded as regular construction revenue.

- The Ditch Special Revenue Fund was adjusted to record an additional contract payable amount of $347,279.

- An adjustment of $288,785 was made in the Ditch Special Revenue Fund to correct a prior year reversing entry for damages applied to prepaid special assessments revenue.

- The Ditch Special Revenue Fund was adjusted to record an additional due from other governments amount of $163,808.

Cause: Procedures are not in place to consider the full extent of all entries needed for financial reporting. The County stated that they did not have adequate procedures in place which allowed for further review of account balances and supporting documentation.

Recommendation: We recommend that the County review internal controls currently in place and design and implement procedures to improve internal controls over financial reporting which will prevent, or detect and correct, misstatements in the financial statements. The updated controls should include review of the balances and supporting documentation by a qualified individual to identify potential misstatements.

Client's Response:

The County will review procedures for internal controls over financial reporting to include a further review of the balances and supporting documentation by a qualified individual to identify potential misstatements.

III. FINDINGS AND QUESTIONED COSTS FOR FEDERAL AWARD PROGRAMS

None.

IV. OTHER FINDINGS AND RECOMMENDATIONS

MINNESOTA LEGAL COMPLIANCE

PREVIOUSLY REPORTED ITEM NOT RESOLVED

Finding 2005-003

Individual Ditch System Deficits

Criteria: Drainage system costs are required by Minn. Stat. § 103E.655 to be paid from the ditch system account for which the costs are being incurred. If money is not available in the drainage system account on which the warrant is drawn, this statute allows for loans to be made from ditch systems with surplus funds or from the General Fund to a ditch system with insufficient cash to pay expenditures. Such loans must be paid back with interest.

Additionally, individual ditch systems should be maintained with a positive fund balance to display solvency. As provided by Minn. Stat. § 103E.735, subd. 1, a fund balance to be used for repairs may be established for any drainage system, not to exceed 20 percent of the assessed benefits of the ditch system or $100,000, whichever is larger.

Condition: The County had individual ditch systems with deficit cash balances and deficit fund balances at December 31, 2013.

Context: At December 31, 2013, 45 ditch systems had negative cash balances totaling $1,949,989, and 11 ditch systems had deficit fund balances totaling $1,526,982.

Effect: The County is not in compliance with Minnesota statutes by having ditch systems with negative cash balances. Ditch systems with negative fund balances indicate that measures have not been taken to ensure that an individual ditch system can meet financial obligations.

Cause: Expenditures have been made for ditch systems with insufficient cash to cover the expenditures. Additionally, special assessments levied for systems have not been sufficient to meet all obligations of the system.

Recommendation: We recommend that the County eliminate the cash deficits by borrowing from eligible funds with surplus cash balances under Minn. Stat. § 103E.655. Individual fund balance deficits should be eliminated by levying assessments pursuant to Minn. Stat. § 103E.735, subd. 1, which permits the accumulation of a surplus cash balance to provide for the repair and maintenance of the ditch systems.

Client's Response:

The County will try to review and improve the levying process to better estimate and levy for future repairs and improvements on individual ditch systems.

ITEM ARISING THIS YEAR

Finding 2013-002

Human Services Fund Deficit Cash Balance and Deficit Fund Balance

Criteria: As stated in Minn. Stat. § 385.04, payment of expenditures may be made only if money is available in the fund for that purpose. Minn. Stat. § 385.32 permits temporary fund transfers but only with the approval of the County Board and County Auditor/Treasurer. Minn. Stat. § 385.31 permits temporary transfer without Board approval but requires the funds be transferred back as soon as they become available. The County Board has oversight responsibilities for the property, funds, and business of the County, and only the County Board is authorized to make a permanent fund transfer under Minn. Stat. § 375.18, subd. 7.

Additionally, County governmental funds should be maintained with a positive fund balance.

Condition: The Human Services Special Revenue Fund had a deficit cash balance and a deficit fund balance at December 31, 2013, of $327,105.

Context: The Human Services Special Revenue Fund is used to account for the tax collections and County share of operating costs for the joint Faribault-Martin Human Services Entity. Monthly payments are made in equal amounts based on the annual Board-approved levy. If during the year, the joint Human Services' cash on hand falls below an established threshold, additional cash may be requested from the County to ensure continued operations. Likewise, if cash on hand exceeds this threshold, cash is returned to the County. In 2011, 2012, and 2013, additional funding requests, net of excess funds returned, totaled $551,337, $807,201, and $498,990, respectively. These additional requests depleted the cash available in the Human Services Special Revenue Fund, resulting in a cash deficit as well as a fund balance deficit.

Effect: The County is not in compliance with Minn. Stat. §§ 385.04, 385.32 and 385.31. By allowing a deficit balance, cash is essentially being used from other funds for purposes that were not budgeted or otherwise approved by the County Board for those funds. Additionally, a negative fund balance indicates that measures have not been taken to ensure that the fund can meet current or future financial obligations.

Cause: In recent years, anticipated revenues for the Human Services Special Revenue Fund have not been sufficient to cover program costs. The County did not levy taxes nor transfer funds to cover all expenditures in the Human Services Special Revenue Fund.

Recommendation: We recommend that the County maintain a positive cash balance in the Humans Services Special Revenue Fund. If costs incurred exceed available cash, the County should approve a temporary or permanent transfer of cash from another fund. The County may want to consider whether improvements need to be made to more accurately budget for the Human Services Special Revenue Fund. The fund balance deficit should be eliminated by maintaining revenues in excess of expenditures.

<u>Client's Response</u>:

We are looking at the programs that are unfunded through Human Services to see if there is a better way of doing business. In the future, the Board is looking at levying higher dollars to make up the cash deficit.

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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*

Independent Auditor's Report

Board of County Commissioners
Martin County

We have audited, 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, the financial statements of governmental activities, each major fund, and the aggregate remaining fund information of Martin County as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the County's basic financial statements, and have issued our report thereon dated July 9, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered Martin County's internal control over financial reporting to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the County's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Schedule of Findings and Questioned Costs, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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 County'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 Questioned Costs as items 2012-001 and 2013-001 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Martin County's financial statements are free from 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 no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Minnesota Legal Compliance

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, promulgated by the State Auditor pursuant to Minn. Stat. § 6.65, contains seven categories of compliance to be tested in connection with the audit of the County's financial statements: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our audit considered all of the listed categories, except that we did not test for compliance with the provisions for tax increment financing because the County has no tax increment financing.

In connection with our audit, nothing came to our attention that caused us to believe that Martin County failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions*, except as described in the Schedule of Findings and Questioned Costs as items 2005-003 and 2013-002. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the County's noncompliance with the above referenced provisions.

Martin County's Response to Findings

Martin County's responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Questioned Costs. The County's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting, compliance, and the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions* and the results of that testing, and not to provide an opinion on the effectiveness of the County's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the County's internal control over financial reporting and compliance. Accordingly, this communication is not suitable for any other purpose.

/s/Rebecca Otto	*/s/Greg Hierlinger*
REBECCA OTTO STATE AUDITOR	GREG HIERLINGER, CPA DEPUTY STATE AUDITOR

July 9, 2014

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REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM AND REPORT ON INTERNAL CONTROL OVER COMPLIANCE

Independent Auditor's Report

Board of County Commissioners
Martin County

Report on Compliance for Each Major Federal Program

We have audited Martin County's compliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the County's major federal programs for the year ended December 31, 2013. Martin County's major federal programs are identified in the Summary of Auditor's Results section of the accompanying Schedule of Findings and Questioned Costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of Martin County's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Martin County's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the County's compliance with those requirements.

Opinion on Each Major Federal Program

In our opinion, Martin County complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended December 31, 2013.

Report on Internal Control Over Compliance

Management of Martin County is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the County's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the County's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit the attention of those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the financial statements of governmental activities, each major fund, and the aggregate remaining fund information of Martin County as of and for the year ended December 31, 2013, and the related notes to the financial statements, which collectively comprise the County's basic financial statements. We have issued our report thereon dated July 9, 2014, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying Schedule of Expenditures of Federal Awards (SEFA) is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the SEFA is fairly stated in all material respects in relation to the basic financial statements as a whole.

Purpose of This Report

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

/s/Rebecca Otto

REBECCA OTTO
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

July 9, 2014

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MARTIN COUNTY
FAIRMONT, MINNESOTA

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2013

Federal Grantor **Pass-Through Agency** **Grant Program Title**	**Federal CFDA Number**	**Expenditures**
U.S. Department of Housing and Urban Development		
Passed Through Minnesota Department of Employment and Economic Development		
Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii	14.228	**$ 332,025**
U.S. Department of Transportation		
Passed Through Minnesota Department of Transportation		
Formula Grants for Rural Areas	20.509	$ 295,667
Job Access and Reverse Commute Program	20.516	52,970
Total U.S. Department of Transportation		**$ 348,637**
U.S. Department of Homeland Security		
Passed Through Minnesota Department of Public Safety		
Hazard Mitigation Grant	97.039	$ 15,610
Emergency Management Performance Grants	97.042	20,177
Passed Through Blue Earth County		
Homeland Security Grant Program	97.067	564
Total U.S. Department of Homeland Security		**$ 36,351**
Total Federal Awards		**$ 717,013**

The notes to the Schedule of Expenditures of Federal Awards are an integral part of this schedule.

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MARTIN COUNTY
FAIRMONT, MINNESOTA

NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED DECEMBER 31, 2013

1. Reporting Entity

The Schedule of Expenditures of Federal Awards presents the activities of federal award programs expended by Martin County. The County's reporting entity is defined in Note 1 to the financial statements.

2. Basis of Presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of Martin County under programs of the federal government for the year ended December 31, 2013. The information in this schedule is presented in accordance with the requirements of Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Because the schedule presents only a selected portion of the operations of Martin County, it is not intended to and does not present the financial position, changes in net position, or cash flows of Martin County.

3. Summary of Significant Accounting Policies

Expenditures reported on the schedule are reported on the modified accrual basis of accounting. Such expenditures are recognized following the cost principles contained in OMB Circular A-87, *Cost Principles for State, Local and Indian Tribal Governments*, wherein certain types of expenditures are not allowable or are limited as to reimbursement. Pass-through grant numbers were not assigned by the pass-through agencies.

4. Subrecipients

During 2013, the County did not pass any federal money to subrecipients.

5. Reconciliation to Schedule of Intergovernmental Revenues

Federal grant revenue per Schedule of Intergovernmental Revenues	$	622,201
Grants received more than 60 days after year-end, deferred in 2013		
Formula Grants for Rural Areas		94,812
Expenditures Per Schedule of Expenditures of Federal Awards	$	717,013