

STATE OF MINNESOTA

Office of the State Auditor



Patricia Anderson
State Auditor

SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA

FOR THE YEAR ENDED DECEMBER 31, 2003

Description of the Office of the State Auditor

The Office of the State Auditor serves as a watchdog for Minnesota taxpayers by helping to ensure financial integrity, accountability, and cost-effectiveness in local governments throughout the state.

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 250 financial and compliance audits per year and has oversight responsibilities for over 4,300 local units of government throughout the state. The office currently maintains five divisions:

Audit Practice - conducts financial and legal compliance audits for 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 Oversight - monitors investment, financial, and actuarial reporting for over 700 public pension funds;

Tax Increment Financing (TIF) - promotes compliance and accountability in local governments' use of TIF through financial and compliance audits;

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

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**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

For the Year Ended December 31, 2003



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

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**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

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**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

ORGANIZATION
2003

<u>Board of Managers</u>	<u>Term Expires</u>
Glenn Mitchell, President	December 2004
Joe Lang, Vice President*	September 2006
Ron Scegura, Treasurer	December 2004
Bill Bredeck	December 2003
Bob St. Marie	December 2004
<u>Executive Secretary</u>	
Jim Wynnemer	Resigned October 2003

*Appointed to Board of Managers in October 2003.

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PATRICIA ANDERSON
STATE AUDITOR

INDEPENDENT AUDITOR'S REPORT

Board of Managers
South Two River Watershed District

We have audited the general purpose financial statements of the South Two River Watershed District as of and for the year ended December 31, 2003. These general purpose financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these general purpose financial statements based on our audit.

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

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the South Two River Watershed District as of December 31, 2003, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1.H. to the financial statements, the District changed its basis of accounting from the cash basis to the modified accrual basis.

/s/Pat Anderson

PATRICIA ADERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: December 2, 2004

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GENERAL PURPOSE FINANCIAL STATEMENTS

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**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

EXHIBIT 1

**COMBINED BALANCE SHEET
GENERAL FUND AND ACCOUNT GROUP
DECEMBER 31, 2003**

	Governmental Fund Type General	Account Group General Fixed Assets	Totals (Memorandum Only)
<u>Assets</u>			
Cash and investments	\$ 92,359	\$ -	\$ 92,359
Prepaid rent	285	-	285
Due from other governments	8,709	-	8,709
Fixed assets	-	14,257	14,257
	\$ 101,353	\$ 14,257	\$ 115,610
<u>Equity</u>			
Investment in general fixed assets	\$ -	\$ 14,257	\$ 14,257
Fund balance Unreserved Undesignated	101,353	-	101,353
	\$ 101,353	\$ 14,257	\$ 115,610

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

EXHIBIT 2

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2003**

Revenues	
Taxes	\$ 80,360
Intergovernmental	
State of Minnesota	
Market value credit	13,483
Investment income	715
Miscellaneous	23
	<hr/>
Total Revenues	\$ 94,581
Expenditures	
Current	
Conservation of natural resources	73,143
	<hr/>
Excess of Revenues Over (Under) Expenditures	\$ 21,438
Fund Balance - January 1, as restated (Note 1.H.)	<hr/> 79,915
Fund Balance - December 31	\$ 101,353
	<hr/> <hr/>

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

EXHIBIT 3

**STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL
GENERAL FUND
FOR THE YEAR ENDED DECEMBER 31, 2003**

	<u>Budget</u>	<u>Actual</u>	<u>Variance Favorable (Unfavorable)</u>
Revenues			
Taxes	\$ 81,517	\$ 80,360	\$ (1,157)
Intergovernmental			
State of Minnesota			
Market value credit	13,483	13,483	-
Investment income	-	715	715
Miscellaneous	-	23	23
	<u> </u>	<u> </u>	<u> </u>
Total Revenues	\$ 95,000	\$ 94,581	\$ (419)
Expenditures			
Current			
Conservation of natural resources			
Payroll			
Executive Director	\$ 22,000	\$ 15,759	\$ 6,241
Managers	4,600	3,495	1,105
Advisors	1,800	1,537	263
Payroll taxes and employer's share of PERA	3,400	2,756	644
Engineering	2,000	4,039	(2,039)
Consulting and legal	1,000	1,569	(569)
Subscriptions	300	49	251
Dues	1,200	1,165	35
Office rent	3,300	3,300	-
Meals, mileage, and lodging	3,500	3,428	72
Postage	400	467	(67)
Employee internet	-	554	(554)
Office telephone, internet, and website	1,200	1,203	(3)
Publishing notices	200	410	(210)
Workshop and seminar tuition	2,000	665	1,335
Annual audit	1,200	1,105	95
Fidelity bonds	161	161	-
Insurance	1,000	451	549
Office equipment, computers, and software	7,000	1,264	5,736
Office supplies	1,000	262	738
Additional water testing	300	-	300
General project fund	37,669	29,420	8,249
Miscellaneous	-	84	(84)
	<u> </u>	<u> </u>	<u> </u>
Total Expenditures	\$ 95,230	\$ 73,143	\$ 22,087
Excess of Revenues Over (Under)			
Expenditures	\$ (230)	\$ 21,438	\$ 21,668
Fund Balance - January 1, as restated			
(Note 1.H.)	<u>79,915</u>	<u>79,915</u>	<u>-</u>
Fund Balance - December 31	<u><u>\$ 79,685</u></u>	<u><u>\$ 101,353</u></u>	<u><u>\$ 21,668</u></u>

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**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 2003

1. Summary of Significant Accounting Policies

The financial reporting policies of the South Two River Watershed District conform to generally accepted accounting principles.

A. Financial Reporting Entity

The South Two River Watershed District was organized in 1986 under the provisions of Minn. Stat. ch. 103D; additional powers and duties are contained in Minn. Stat. chs. 103E and 103B.

The purpose of the District is to provide water management within its geographic boundaries. The watershed is 93 square miles in size and includes those lands within the drainage area, or watershed, of South Two River. The River's drainage involves portions of the communities of Albany, Albany Township, Krain, Holdingford, Holdingford Township, and Avon Township. The headwaters of the River are in the Upper Mississippi River Basin. In addition to existing water problems, the District recognizes the need to prevent flooding and improve water quality.

The District is governed by a Board of Managers composed of five members, who are appointed by the Stearns and Morrison County Boards of Commissioners for three-year terms.

As required by generally accepted accounting principles, consideration has been given to other organizations that should be included in the District's financial statements for which the nature and significance of their relationship with the District are such that exclusion would cause the District's financial statements to be misleading or incomplete. There are no organizations that should be presented with the District.

B. Basis of Presentation - Fund Accounting

The accounts of the District are organized on the basis of a General Fund and a General Fixed Assets Account Group, each of which is considered a separate accounting entity. The operations of the General Fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues, and expenditures. The General Fund and the General Fixed Assets Account Group are described below.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

1. Summary of Significant Accounting Policies

B. Basis of Presentation - Fund Accounting (Continued)

Governmental Fund

The General Fund is the general operating fund of the District and is used to account for all financial resources.

Account Group

The General Fixed Assets Account Group is used to account for the District's fixed assets, which consist of equipment.

C. Basis of Accounting

The District's financial statements are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when they become susceptible to accrual, that is, both measurable and available. The District considers all revenues to be available if collected within 60 days after the end of the current period. Expenditures are recognized when the corresponding liabilities are incurred.

D. Budgets

The District Board of Managers adopts estimated revenue and expenditure budgets for the General Fund. The budgets may be amended or modified at any time by the Board. Comparisons of estimated revenues and expenditures to actual are presented in the financial statements for the General Fund. The General Fund budget was adopted on a basis consistent with generally accepted accounting principles.

E. Assets, Liabilities, and Equity Accounts

Cash and Investments

Cash and investments are stated at fair value and consist of amounts in demand deposits, savings, and certificates of deposit.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

1. Summary of Significant Accounting Policies

E. Assets, Liabilities, and Equity Accounts (Continued)

General Fixed Assets

General fixed assets are valued at historical or estimated historical cost and are recorded as expenditures at the time of their purchase. No depreciation is calculated on general fixed assets.

Equity

Investment in general fixed assets represents the District's equity in general fixed assets.

Unreserved, undesignated fund balance indicates the portion of fund equity available for expenditure in future periods.

F. Revenues and Expenditures

1. Revenues

In accordance with Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, revenues for nonexchange transactions are recognized based on the principal characteristics of the revenue. Exchange transactions are recognized as revenue when the exchange occurs. The modified accrual basis of accounting is used by the General Fund. Under this basis, revenue is not recognized in the financial statements unless it is available to finance current expenditures.

Property Taxes

An ad valorem property tax may be levied against all properties in the District with levy limits prescribed by state statute. Property tax levies must be approved by the District Board and certified to the Stearns County Auditor/Treasurer and the Morrison County Auditor in September of each year for collection in the following year. Taxes are payable to the County in two installments by May 15 and October 15.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

1. Summary of Significant Accounting Policies

F. Revenues and Expenditures

1. Revenues (Continued)

Intergovernmental

Government-mandated nonexchange transactions occur when a government at one level provides resources to a government at another level and requires that government to use them for a specific purpose. The provider government establishes purpose restrictions and also may establish time requirements. State grants mandating the District perform particular programs are government-mandated nonexchange transactions. Revenues are recognized when eligibility and time requirements are met, usually when the corresponding expenditure is incurred.

Voluntary nonexchange transactions result from legislative or contractual agreements, such as grants, entitlements, appropriations, and donations. The provider may establish purpose restrictions or eligibility requirements. Revenues are recognized in the year which they apply according to the statute or contract. Gifts and contributions from individuals are also considered voluntary nonexchange transactions and are generally recognized when received.

Exchange Transactions

Other revenues, such as charges for services and investment income, are recognized as revenue when earned.

2. Expenditures

Expenditure recognition is limited to amounts represented by current liabilities.

G. Total Columns on Combined Statements

The total column on the combined balance sheet is captioned “Memorandum Only” to indicate that it is presented only to facilitate analysis. Data in this column do not present financial position or results of operations in conformity with generally accepted accounting principles.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

H. Change in Basis of Accounting

During 2003, the District changed its basis of accounting from the cash basis to the modified accrual basis. The effect of the change on the General Fund's fund balance is as follows.

Fund Balance - January 1, as previously reported (cash basis)	\$	68,098
Net change to modified accrual basis of accounting		<u>11,817</u>
Fund Balance - January 1, as restated (modified accrual basis)	\$	<u>79,915</u>

2. Detailed Notes on the General Fund and Account Group

A. Deposits and Investments

Minn. Stat. §§ 118A.02 and 118A.04 authorize the District to deposit its cash and to invest in certificates of deposit in financial institutions designated by the District. Minnesota statutes require that all of the District's deposits be covered by insurance, surety bond, or collateral.

At December 31, 2003, the District's bank deposits were \$92,910. The carrying value of these deposits on the District's records was \$92,359.

The entire bank balance of \$92,910 at December 31, 2003, was covered by insurance.

B. Changes in General Fixed Assets

The following is a summary of changes in the General Fixed Assets Account Group for the year ended December 31, 2003.

	Balance January 1, 2003	Deletions	Balance December 31, 2003
Equipment	<u>\$ 21,467</u>	<u>\$ 7,210</u>	<u>\$ 14,257</u>

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

2. Detailed Notes on the General Fund and Account Group (Continued)

C. Operating Lease

The District had an operating lease for office space beginning January 1, 2003, and terminating on December 31, 2003. The District made lease payments totaling \$3,300 on this lease for the year ended December 31, 2003. Beginning January 1, 2004, and terminating on December 31, 2004, the monthly lease payment for office space is \$285. The future minimum lease payments under the operating lease, to be paid in 2004, is \$3,420.

3. Pension Plans

A. Plan Description

The part-time employee of the South Two River Watershed District is covered by defined benefit plans administered by the Public Employees Retirement Association of Minnesota (PERA). The PERA administers the Public 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.

Public 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.

The 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 and vest after three years of credited service. The defined retirement benefits are based on a member's highest average salary for any five successive 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.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

3. Pension Plans

A. Plan Description (Continued)

For Public Employees Retirement Fund members hired prior to July 1, 1989, 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 for Basic and Coordinated Plan members hired prior to July 1, 1989. Normal retirement age is the age for unreduced Social Security benefits capped at 66 for Coordinated Plan members hired on or after July 1, 1989. A reduced retirement annuity is also available to eligible members seeking early retirement.

There are different types of annuities available to members upon retirement. A single-life annuity is a lifetime annuity that ceases upon the death of the retiree--no survivor benefit is payable. Also available are various types of joint and survivor annuity options that will be payable over joint lives. Members may also leave their contributions in the fund upon termination of public service in order to qualify for a deferred annuity at retirement age. Refunds of contributions are available at any time to members who leave public service, but before retirement benefits begin.

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.

The PERA issues a publicly available financial report that includes financial statements and required supplementary information for the Public Employees Retirement Fund. That report may be obtained on the web at 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. Minn. Stat. ch. 353 sets the rates for employer and employee contributions. These statutes are established and amended by the State Legislature. The District makes annual contributions to the pension plans equal to the amount required by state statutes. Public Employees Retirement Fund Basic Plan members and Coordinated Plan members are required to contribute 9.10 and 5.10 percent, respectively, of their annual covered salary.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

3. Pension Plans

B. Funding Policy (Continued)

The District is required to contribute the following percentages of annual covered payroll:

Public Employees Retirement Fund	
Basic Plan members	11.78%
Coordinated Plan members	5.53

The District's contributions for the years ending December 31, 2003, 2002, and 2001, were \$897, \$1,144, and \$898, respectively, equal to the contractually required contributions for each year as set by state statute.

4. Risk Management

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is self-insured, in part, for losses related to destruction of assets. The District carries commercial insurance for all other forms of risk. There were no significant reductions in insurance from the previous year or settlements in excess of insurance for any of the past three years.

**SOUTH TWO RIVER WATERSHED DISTRICT
STEARNS COUNTY, MINNESOTA**

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2003**

I. INTERNAL CONTROL

03-1 Segregation of the Accounting Functions

Due to the South Two River Watershed District having only one office employee, segregation of the accounting functions necessary to ensure adequate internal control is not possible. This is not unusual in operations the size of the South Two River Watershed District; however, the Board of Managers 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.

We recommend that District management be aware of the risks associated with limited segregation of duties and monitor and provide oversight for the District's financial and accounting activities on an ongoing basis.

Client's Response:

At the present time, one of the managers picks up the mail, opens it, and reviews it. This is a check and balance we have in place now. This is something we should consider adding to our policies as a standard method of checks and balances for now and the future of the District.

03-2 Disbursements

A review of disbursements revealed the following:

- Vendor invoices and related checks were reviewed and approved by the Board of Managers at the regular monthly meetings. However, we found no physical evidence of this approval on the face of the invoices.
- The June 2003 Board meeting did not take place because not enough members were present for a quorum. Eleven checks dated June 12, 2003, totaling \$5,633 were disbursed; however, the minutes for the next meeting do not document that these June disbursements were approved.
- When invoices were paid, they were not always cancelled by marking the check number and payment date.

- The District made a payment to an individual on September 23, 2003, in the amount of \$2,261.86, with no supporting documentation. The reference on the check stub for this payment indicated it was for the “cost share for grass waterway.”

We recommend the following:

- A detailed list of claims, including the identity of the claimant and the amount claimed for payment, should be prepared prior to the Board meeting.
- Documentation supporting the claims should be available for review by members of the Board.
- Board members present at the meeting should review the list of claims and place their initials on it. This list should be kept as an attachment to the minutes.
- If unusual circumstances prevent regularly scheduled disbursement approval by the Board, the approval should occur at a special meeting or the next scheduled meeting.
- All vendor invoices should be adequately cancelled to prevent submission of the same invoice for duplicate payment. A “PAID” stamp could be used to record the check number and payment date.
- All disbursements should be adequately documented.

Client’s Response:

The claims are prepared prior to the meetings now and reviewed by managers at the meetings before the claims are approved.

- *We will bring the recommendation to sign each invoice by each manager to the board and possibly add it to our policies. Each claim can be listed as a line item on the minutes with the check number.*
- *In the case where the meeting couldn’t take place and the claims were paid anyway, the recommendation to schedule a special meeting to cover these claims is so noted.*
- *An invoice paid stamp can be purchased to stamp on invoices with the check number and date paid to avoid any invoice from being paid twice.*

03-3 Bank Reconciliations

From the information provided, it appears the District did not maintain a formal reconciliation of the cash balance on the monthly bank statements to the book balance for the year ended December 31, 2003. There was evidence that someone was tracking which checks cleared the bank, but we could find no evidence that formal bank

reconciliations were completed. Bank reconciliations are essential in maintaining an accurate cash position of the District.

We recommend that bank reconciliations be completed, documented, and reviewed by the Managers on a monthly basis.

Client's Response:

We will recommend to the board that the employee have a simple reconciliation form listing each check and document when they clear the bank and to have it at each meeting for the managers at the meeting to sign off that they reviewed it.

II. COMPLIANCE

03-4 Publication of Budget Hearing

According to the August 22, 2002, Board of Managers' meeting minutes, the public hearing on the proposed budget for 2003 was scheduled for September 19, 2002. However, the District was unable to provide us with documentation showing that it published a notice of the budget hearing along with a summary of the proposed 2003 budget.

According to the affidavit of publication, and inquiry of staff employed by the District's official newspaper, the District published notice of the proposed administrative and general fund levy for 2004, one time, on September 9, 2003. The published notice failed to mention that there would be a public hearing on the proposed levies.

Minn. Stat. § 103D.911, subd. 1, requires the District Managers to hold a public hearing on the proposed budget before adopting the budget. Furthermore, the statute requires the District Managers to publish a notice of the hearing with a summary of the proposed budget in one or more newspapers of general circulation in each county comprising the watershed district. The notice and summary should be published once each week for two successive weeks before the hearing, and the last publication should be at least two days before the hearing.

We recommend the District Managers publish the required notice of a budget hearing, along with a summary of the proposed budget, for two successive weeks before the hearing as required by Minn. Stat. § 103D.911, subd. 1.

Client's Response:

In 2004, the proposed budget and date and time on the meeting was published, and it will be our goal to make sure this is done correctly in the future.

03-5 Adoption of Budget and Certification of Tax Levy

According to the September 19, 2002, Board of Managers' meeting minutes, the 2003 District budget and tax levy was set at \$95,000. The September 18, 2003, Board of Managers' meeting minutes set the 2004 District budget and tax levy at \$75,000.

Minn. Stat. § 103D.911, subd. 2, states that, on or before September 15 of each year, the managers shall adopt a budget for the next year and decide on the total amount necessary to be raised from ad valorem taxes to meet the watershed district's budget. In addition, Minn. Stat. § 103D.915, subd. 1, requires the secretary of the watershed district to certify to the auditor of each county within the watershed district, the county's share of the tax after the adoption of the District's budget. The certification to the county auditor should occur no later than September 15.

Since the Board of Managers did not approve the 2003 and 2004 budgets and levies until September 19, 2002, and September 18, 2003, respectively, it was not possible for the District to comply with the September 15 deadlines set forth in Minn. Stat. §§ 103D.911, subd. 2, and 103D.915, subd. 1.

We recommend the Board of Managers, each year in the future, adopt the next year's budget and tax levy early enough to comply with the September 15 deadlines set forth in Minn. Stat. §§ 103D.911, subd. 2, and 103D.915, subd. 1. The District bylaws indicate that, in order to ensure compliance with the September 15 deadline, study and comment of the proposed budget should occur at the July meeting with adoption at the public budget hearing meeting in August.

Client's Response:

There is now a new board of managers in place and, in 2004, they had the budget meeting done in August and the levy sent in before the deadline. It will be our goal to continue to have it done on time.

03-6 Appointing of Advisory Committee

Minn. Stat. § 103D.331 requires the managers to annually appoint an advisory committee to advise and assist them on all matters affecting the interests of the watershed district and to make recommendations on all contemplated projects and improvements in the watershed district. According to the meeting minutes, the Board of Managers never officially appointed an advisory committee for 2003. The minutes did note individuals that were periodically appointed as advisors by the managers. The minutes also identify four or more advisors usually in attendance at Board of Managers' meetings.

The District paid a total of \$2,653 in 2003 to seven individuals identified as District advisors. The payments were for hourly wages for attending Board of Managers' meetings and reimbursements for meals, mileage, and a portion of Internet costs at the

advisors' personal residences. We were provided with no documentation, nor did we find indication in the Board minutes, that these advisors performed the duties described by statute. We also did not find evidence that additional Internet expense was incurred in the performance of their duties.

The November 2003 minutes state that advisors will no longer get paid for attending meetings or other expenses until policies and bylaws are adopted to ensure compliance with statutory requirements for advisors' appointments and duties. Amended bylaws were adopted in February 2004. The minutes from May 2004 document appointment of an advisory committee.

We recommend the District managers ensure ongoing compliance with Minn. Stat. § 103D.331. The advisory committee should continue to be appointed annually, perform the duties required, report to the Board, and be reimbursed only for actual and necessary expenses incurred in the performance of duties in the amounts as provided for state employees. The statute does not authorize an hourly wage or per diem to be paid to advisors for attending meetings or otherwise. Because these amounts paid to the individuals identified as advisors in 2003 are not authorized by statute, we recommend the Managers consider seeking reimbursement to the District.

Client's Response:

In 2004 we did appoint an Advisory Committee, and they did have a meeting in August. We need to continue doing this yearly. We will recommend to the board to send letters out to the past advisors to seek reimbursement to the District for the money they received that was not authorized by statute.

03-7 District Officers

Minn. Stat. § 103D.315, subd. 3, states the managers must elect different managers as president, secretary, and treasurer. Until his resignation in October 2003, the Board of Managers had annually elected the Executive Director to the office of secretary. As an employee and not a manager, the Executive Director was not eligible to hold the office of secretary.

Since then, the January 2004 minutes and amended bylaws adopted in February 2004 both now identify a combined treasurer/secretary position elected from the managers.

We recommend the District comply with Minn. Stat. § 103D.315, subd. 3, in the election of its officers. District bylaws should also be consistent with state law.

Client's Response:

We will recommend to the board to correct our bylaws and have the four officers as required.

03-8 District Credit Card

During the year ended December 31, 2003, the District made nine disbursements totaling \$3,056 to Capital One for charges on a credit card issued to the District. Included in this amount was \$33 in penalties and late fees. Certain governmental entities have been given specific statutory authority to allow employees to use a credit card issued to the government; watershed districts have not been given this authority.

We recommend the District immediately discontinue use of and close the credit card account.

Client's Response:

The account was closed late in 2003. We no longer have a District credit card.

03-9 Record Retention Schedule

The Board of Managers has not prepared and adopted a record retention schedule for the Watershed District.

Minn. Stat. § 138.17, subd. 7, states that it is the duty of the governing body of each municipality and other subdivision of government to establish and maintain an active, continuing program for the economical and efficient management of its records. When requested by the commissioner of administration, public officials should assist in the preparation of an inclusive inventory of records in their custody, to which a schedule should be attached, approved by the head of the governmental unit or agency having custody of the records and the commissioner, establishing a time period for the retention or disposal of each series of records. When the schedule is unanimously approved by the records disposition panel, the head of the governmental unit or agency having custody of the records may dispose of the type of records listed in the schedule at a time and in a manner prescribed in the schedule for particular records which were created after the approval. A list of records disposed of pursuant to this subdivision should be maintained by the governmental unit or agency. In the absence of an applicable records retention schedule, records can be disposed of only by gaining authority from the records dispositions panel through an approved Application for Authority to Dispose of Records.

Records should be disposed of only in compliance with a properly approved records retention schedule or Application for Authority to Dispose of Records. We recommend the District Managers adopt a record retention schedule for the District in accordance with Minn. Stat. § 138.17, subd. 7.

Client's Response:

With the help of the Auditor's Office, we hope to get a sample of the correct Retention Schedule needed here and recommend to the board to adopting it.

III. MANAGEMENT PRACTICES

03-10 Employment Terms

In October 2003, the Board of Managers accepted the resignation of the District's Executive Director. The Executive Director was paid wages at \$20 per hour, totaling \$16,540 for 2003 hours worked. In addition to this, the Executive Director was paid \$106.60 per month, or a total of \$1,066 in 2003, for vacation and sick pay. Time sheets submitted for payment each month typically consisted of a typed page listing the hours worked each day, sometimes accompanied by a brief description of the work performed. These time sheets were not signed by the Executive Director or approved by a District Manager. We were unable to verify the authorized terms and conditions of employment for this employee.

The District subsequently hired a replacement employee with the title Administrative Secretary. Based on the job description and employment terms discussed in the minutes, it appears that this employee performs duties similar to those of the former Executive Director. The approved hourly rate was \$10 per hour for eight hours of work each week in addition to attending regular monthly Board Meetings. No mention was made of payment for vacation or sick leave.

We recommend that the terms and conditions of employment for District employees be documented in writing and authorized by the Board of Managers. This was substantially accomplished for the current employee in the minutes. Documentation of the employment terms should be periodically updated and available as needed or changed. We also recommend that time sheets completed by employees be signed by the employee and approved by a District Manager.

Client's Response:

In the past, we had an employee with the title of District's Executive Director. This employee had a lot of training in what a watershed district should be doing. After his resignation, the board decided to hire an Administrative Secretary at a rate about the same as what the county pays for secretary-type duties as spelled out in the job description. It was felt that, due to the size of the District, an Executive Director may not be needed and, to date, it has been working out okay. We recommend to the board to update employee terms and conditions periodically. Also, that it be our policy that the employee timesheet has a place for the employee to sign and the President, or in his absence the Vice President, to sign each month before, or the night of, the monthly meeting.

03-11 Mileage Reimbursement Documentation

The District bylaws state, "Authorized use of personal vehicles for District business shall be paid on a per mile rate set by the Managers at the last regular meeting of each year."

During the year ended December 31, 2003, the District reimbursed a total of \$2,021 in mileage to individuals.

Supporting documentation for a mileage reimbursement claim would typically indicate the number of miles to be reimbursed, but did not always document the purpose of the travel as it related to District business, the departure and arrival locations, and how the mileage was calculated (for example, odometer reading or Internet maps). The District does not have a policy or bylaw provision requiring this documentation. Such information is necessary to assist in verifying the authorized business purpose of mileage reimbursement.

The District should develop a travel policy or bylaw provision that addresses the documentation requirements to support the business purpose for mileage reimbursement.

Client's Response:

We will recommend to the board to find a more detailed expense form or come up with one to suit our needs more closely following the Auditor's recommendations.

03-12 Meals and Lodging

The District bylaws allow payment or reimbursement for actual costs of tuition, registration, and meal costs incurred while engaged in activities serving the legitimate needs of the District. Proof of payment is required for reimbursement of meals and lodging. The managers shall set the maximum allowances for reimbursement at the last regular meeting of each year.

We noted the following:

- Included in the January 16, 2003, payment to Capital One was a \$62 charge incurred on December 6, 2002, related to lodging expense of a District Manager's spouse. On November 19, 2003, a District check was written to this Manager for per diems and reimbursement for personal expenses incurred for District business. At that time, the \$62 was deducted from the amount owed by the District to the Manager. Although the District was eventually reimbursed, the District, in effect, advanced the Manager \$62 for a period exceeding 11 months.
- For 2003, the District made payments totaling \$1,260 for expense reimbursements of meals and lodging. The inadequate documentation submitted for these expense reimbursements included District credit card charge statements, personal credit card receipts lacking details of the transaction, or a notation on the reimbursement request forms. These documents support only that an individual incurred a charge. Adequate supporting documentation would include original meal and lodging receipts from the

vendors itemizing the specific charges, including the date, amount, and item. There should be an identifiable relationship between these expenses and a legitimate business purpose.

- The Board of Managers' meeting minutes for December 19, 2002, and December 18, 2003, which were the last regular meetings for those years, do not identify that the District Managers set the maximum allowances for meals or other reimbursements for the next year. District Managers and advisors were reimbursed a total of \$166 in 2003 for meals incurred while on District business.

We recommend the District:

- make disbursements only for legitimate needs of the District. Any costs incurred for spouses should be immediately reimbursed.
- reimburse individuals for expenses only when they have supported that the costs were incurred while on legitimate District business. Original, itemized receipts should be attached to the reimbursement request form.
- set the maximum allowances for meals or other reimbursements for the next calendar year at its last regular meeting of each year.

Client's Response:

The findings and recommendations will be reviewed with the managers. We will recommend that the Auditor's recommendations be followed and adopted by the board.

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PATRICIA ANDERSON
STATE AUDITOR

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND MINNESOTA LEGAL COMPLIANCE

Board of Managers
South Two River Watershed District

We have audited the general purpose financial statements of South Two River Watershed District as of and for the year ended December 31, 2003, and have issued our report thereon dated December 2, 2004. We conducted our audit in accordance with auditing standards generally accepted in the United States of America.

Internal Control Over Financial Reporting

The management of South Two River Watershed District is responsible for establishing and maintaining internal control. In fulfilling this responsibility, management must make estimates and judgments to assess the expected benefits and related costs of internal control policies and procedures. The objectives of internal control are to provide management with reasonable, but not absolute, assurance that:

- assets are safeguarded against loss from unauthorized use or disposition,
- transactions are executed in accordance with management's authorization, and
- transactions are recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the controls to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the effectiveness of the design and operation of policies and procedures may deteriorate.

In planning and performing our audit, we considered South Two River Watershed District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on

the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the District's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying Schedule of Findings and Recommendations as items 03-1 through 03-3.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions listed above, we consider item 03-2 to be a material weakness.

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 Local Government*, 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 Local Government* contains five categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, and claims and disbursements. Our study included all of the listed categories. In addition, we tested for compliance with certain other laws applicable to watershed districts.

The results of our tests indicate that, for the items tested, South Two River Watershed District complied with the material terms and conditions of applicable legal provisions except as described in the Schedule of Findings and Recommendations as items 03-4 through 03-9.

This report is intended solely for the information and use of the Board of Managers and management and is not intended to be, and should not be, used by anyone other than those specified parties.

/s/Pat Anderson

PATRICIA ANDERSON
STATE AUDITOR

/s/Greg Hierlinger

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

End of Fieldwork: December 2, 2004