STATE OF MINNESOTA

Office of the State Auditor

Rebecca Otto
State Auditor

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

LINCOLN COUNTY
IVANHOE, MINNESOTA

YEAR ENDED DECEMBER 31, 2010

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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LINCOLN COUNTY
IVANHOE, MINNESOTA

Year Ended December 31, 2010

Management and Compliance Report

Audit Practice Division
Office of the State Auditor
State of Minnesota

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LINCOLN COUNTY
IVANHOE, MINNESOTA

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LINCOLN COUNTY
IVANHOE, MINNESOTA

SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 2010

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

INTERNAL CONTROL

PREVIOUSLY REPORTED ITEM NOT RESOLVED

98-1 Departmental Internal Accounting Controls

One basic objective of internal control is to provide for segregation of incompatible duties. In other words, responsibilities should be separated among employees so that a single employee is not able to authorize a transaction, record the transaction in accounts, and be responsible for custody of the asset resulting from the transaction.

Due to the limited number of personnel within some County offices, segregation of accounting duties necessary to ensure adequate internal accounting control is not always possible. This is not unusual in operations the size of Lincoln County; however, the County's management 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 internal control point of view.

Some of the County's departments that collect fees have segregation of duties weaknesses. These departments generally have one staff person who is responsible for billing, collecting, depositing, and recording receipts as well as reconciling bank accounts.

We recommend the County Board segregate accounting duties as much as possible. When it is not feasible to segregate certain duties, Lincoln County management should be aware of the lack of segregation of the accounting functions and, if possible, implement oversight procedures to ensure that the internal control policies and procedures are being followed by staff.

Client's Response:

Lincoln County is aware of the lack of segregation of the accounting functions. We continually strive to implement feasible internal controls with our limited staff.

PREVIOUSLY REPORTED ITEMS RESOLVED

Audit Adjustments (06-4)

During our audit, we proposed material adjustments that resulted in significant changes to the County's financial statements.

Resolution

The County has continued to implement procedures over financial reporting to detect misstatements in the financial statements. No material audit adjustments were proposed for the 2010 audit.

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Employee Password Security (09-1)

An employee in the County Auditor's Office maintained a listing of other employees' passwords and user names that provided access to the County's information system.

Resolution

Each employee is responsible for maintaining his or her unique username and password for entry to the financial system.

Property Tax Amount Levied in 2009 for County Use (09-2)

For 2009, $77,300 more was levied for property taxes than the amount approved by the County Board on December 18, 2008. The Board approved $4,182,367; however, $4,259,667 was levied on owners' property.

Resolution

The amount levied on owners' property for 2010 matched the Board-approved tax levy for the period.

Monitoring Internal Controls (09-3)

Our audit procedures detected areas and responsibilities that were performed by County staff with little or no monitoring by management or other staff members. Some areas with minimal or no monitoring included entering budget information into the accounting system, processing payroll and transmitting payment information to the bank, reviewing receipts issued, and reviewing identified receivables.

Resolution

We noted improvement in the areas of processing payroll and transmitting information to the bank, reviewing receipts issued, and reviewing identified receivables. We expect the County continue to make improvements over entering budget information in the accounting system.

II. OTHER FINDINGS AND RECOMMENDATIONS

A. MINNESOTA LEGAL COMPLIANCE

ITEMS ARISING THIS YEAR

10-1 Publishing Board Minutes and Claims Paid

According to Minn. Stat. § 375.12, County Board minutes are to be published within 30 days of the meeting and the publication is to include an individualized, itemized list of County Board-approved payments over $2,000. A statement showing the total number of claims that do not exceed the threshold amount and their dollar amounts must be stated. The County can publish summaries conforming to the requirements of Minn. Stat. § 331A.01, subd. 10. This section does not change the requirement that payments be published monthly as discussed in Minn. Stat. § 375.12. Also, this section requires that the full data be available at a specified County location or by standard or electronic mail.

The County Board minutes are not always published within 30 days. Published minutes contain only a summary of payments by fund.

We recommend the County Board comply with the above-noted statutes and publish the County Board minutes with vendor payments.

Client's Response:

The newspapers in Lincoln County are published once per week. The County publishes summaries of the Board minutes. Due to deadlines of the local newspapers, it can take up to two weeks from the time the legal is sent to the newspaper until it is actually published. We will begin to publish an itemized list of County Board-approved payments over $2,000.

10-2 Safekeeping of Investments

At December 31, 2010, Wells Fargo Advisors held security investments totaling $2,592,882 on behalf of Lincoln County. According to Minn. Stat. § 118A.06, brokers can hold public investments to the extent they have insurance to protect their clients through Securities Investors Protection Corporation (SIPC) coverage or excess SIPC coverage.

We recommend that all County securities be held only by brokers that meet the criteria of Minn. Stat. § 118A.06. For brokers such as Wells Fargo Advisors, the County must verify the brokers have SIPC coverage or excess SIPC coverage sufficient to protect all County securities in their possession in order to be in compliance with Minn. Stat. § 118A.06.

Client's Response:

The County will comply with Minn. Stat. § 118A.06 and verify that brokers have SIPC coverage and excess SIPC coverage sufficient to protect all County securities.

B. OTHER ITEM FOR CONSIDERATION

GASB Statement 54

The Governmental Accounting Standards Board's (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions,* is effective for Lincoln County for the year ending December 31, 2011. The standard's objectives are to enhance the usefulness of fund balance information included in the financial report through clearer fund balance classifications that can be consistently applied and to clarify existing governmental fund type definitions.

Fund Balance Reporting

Statement 54 establishes new fund balance classifications based on constraints imposed on how resources can be spent. The existing components of fund balance are reserved, unreserved-designated, and unreserved-undesignated. Statement 54 replaces these components with nonspendable, restricted, committed, assigned, and unassigned as defined below:

- *Nonspendable* - amounts that cannot be spent because they are either not in spendable form (for example, inventory or prepaid items) or legally or contractually required to be maintained intact (such as the corpus of a permanent fund).

- *Restricted* - amounts that can be spent only for specific purposes stipulated by constitution, external resource providers, or through enabling legislation.

- *Committed* - amounts that can be used only for specific purposes determined by a formal action of a government's highest level of decision-making authority.

- *Assigned* - amounts a government intends to use for a specific purpose that do not meet the criteria to be classified as restricted or committed.

- *Unassigned* - spendable amounts not contained in the other classifications.

The County should begin the process for implementing the new fund balance classifications. A key step in successfully implementing the new fund balance requirements is to plan ahead. The County can start with the following steps:

- review the requirements of GASB Statement 54;

- review current fund balances and compare to the new classifications;

- reclassify January 1, 2011, fund balance using the new classifications;

- review/update/prepare a comprehensive fund balance policy;

- prepare appropriate Board resolutions to commit fund balance; and

- if the County Board intends to delegate authority to assign fund balance, prepare the resolutions delegating that authority.

Governmental Fund Type Definitions

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified in the new standard. The new definition for a special revenue fund could have significant impact on the County's current fund classifications.

GASB Statement 54 provides a new and clearer description of when it is appropriate to account for an activity using a special revenue fund. Special revenue funds are used to report specific revenue sources restricted or committed to specified purposes other than debt service and capital projects, where the restricted or committed revenue sources comprise a substantial portion of the fund's resources, and are expected to continue to do so in the future. The standard does not define substantial portion; however, most recommendations are generally that the restricted or committed revenues should comprise at least 35 to 50 percent of total fund revenues. Under this definition, it is possible that some current special revenue funds will no longer meet the requirements for special revenue fund treatment. The County's management should review the County's special revenue funds to ensure these funds continue to warrant treatment as special revenue funds.

The County's management should perform the following steps prior to December 31, 2011:

- prepare a list of the County's special revenue funds;
- determine the sources of revenues for each of those funds;
- identify whether any of those revenues are restricted or committed;
- determine if these restricted or committed revenues represent a substantial portion of the fund's revenues and are expected to continue to be a substantial source of revenues;
    - if yes, the fund may continue to be classified as a special revenue fund;
    - if not, determine whether the County will combine that fund with the general fund or with a similar purpose special revenue fund that meets the new definition;
- code revenues in the general ledger by source constraints--restricted, committed, assigned, or unassigned; and
- determine if there needs to be a restatement of beginning fund balances.

Additional implementation steps could include: informing any component units that they also will need to meet the requirements; deciding on how fund balance will be presented in the financials, such as detailed vs. aggregate methods; and developing the potential note disclosures. Additional guidance on GASB Statement 54 can be found on the Office of the State Auditor's website at: http://www.auditor.state.mn.us/other/Statements/fundbalances_postGASB54_1012_statement.pdf.

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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*

Board of County Commissioners
Lincoln County

We have audited the financial statements of the governmental activities, the discretely presented component unit, each major fund, and the aggregate remaining fund information of Lincoln County as of and for the year ended December 31, 2010, which collectively comprise the County's basic financial statements, and have issued our report thereon dated June 27, 2011. We conducted our audit 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Lincoln County's internal control over financial reporting as a basis for designing our auditing procedures 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.

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.

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 deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses as defined above. However, we identified a deficiency in internal control over financial reporting, described in the Schedule of Findings and Recommendations as item 98-1, that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Lincoln County's financial statements are free of 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

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 Political Subdivisions*, 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 Political Subdivisions* contains seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing. Our study included all of the listed categories, except that we did not test for compliance in tax increment financing because the County does not have any tax increment financing districts of its own.

The results of our tests indicate that, for the items tested, Lincoln County complied with the material terms and conditions of applicable legal provisions, except as described in the Schedule of Findings and Recommendations as items 10-1 through 10-3.

Also included in the Schedule of Findings and Recommendations is an other item for consideration. We believe this information to be of benefit to the County, and it is reported for that purpose.

Lincoln County's written responses to the internal control and legal compliance findings identified in our audit have been included in the Schedule of Findings and Recommendations. We did not audit the County's responses and, accordingly, we express no opinion on them.

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

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

June 27, 2011