



MINNESOTA OFFICE OF THE STATE AUDITOR

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

YEAR ENDED DECEMBER 31, 1996

**JUDITH H. DUTCHER
STATE AUDITOR**

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

FINANCIAL STATEMENTS

YEAR ENDED DECEMBER 31, 1996

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

TABLE OF CONTENTS

	<u>Reference</u>	<u>Page</u>
<u>Financial Section</u>		
Independent Auditor's Report		1
Financial Statements		
Statement of Financial Position	Exhibit 1	3
Statement of Activities	Exhibit 2	4
Statement of Revenues and Functional Expenses	Exhibit 3	6
Statement of Cash Flows	Exhibit 4	10
Notes to the Financial Statements		11
<u>Management and Compliance Section</u>		
Schedule of Findings and Recommendations	Schedule 1	
Introduction		18
Detailed Findings and Recommendations		21
Summary of Questioned Costs		67
Client's Response		69
Other Required Reports		
Compliance Reports		
Financial Statements		72
Specific Requirements Applicable to Major and Nonmajor Federal Financial Assistance Programs and Transactions		73
General Requirements Applicable to Federal Financial Assistance Programs		75
Reports on the Internal Control Structure		
Audit of Financial Statements		77
Single Audit		80
Report on Supplemental Schedule of Federal Financial Assistance		84
Supplemental Schedule of Federal Financial Assistance	Schedule 2	85

Financial Section



JUDITH H. DUTCHER
STATE AUDITOR

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INDEPENDENT AUDITOR'S REPORT

**Neighborhood Council
People of Phillips, Inc.**

We were engaged to audit the accompanying statement of financial position of People of Phillips, Inc., as of December 31, 1996, and the related statements of activities, revenues and functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the People of Phillips' management.

Sufficient accounting records were not available to support compensatory time use or vacation accrual of \$11,621 at December 31, 1996. People of Phillips, Inc., did not have supporting documentation for accounts receivable of \$27,345 at December 31, 1996. Accounting records did not support payments to vendors and their related classification of functional expenses for the year ended December 31, 1996. Neither did the records support program revenues. The records of People of Phillips, Inc., did not permit the application of other auditing procedures to these conditions.

The accounting records did not segregate expenses associated with fund raising activities. Therefore, the functional expenses of People of Phillips, Inc., as presented in the financial statements, are not in accordance with generally accepted accounting principles.

Since People of Phillips, Inc., did not provide sufficient records to support compensatory time use and vacation accrual, certain accounts receivable, vendor payments, and the classification of functional expenses; we were not able to apply other auditing procedures to these amounts; and we were unable to determine expenses associated with fund raising through the accounting records, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

Page 1

In accordance with *Government Auditing Standards*, we have also issued a report dated December 19, 1997, on our consideration of People of Phillips' internal control structure and a report dated December 19, 1997, on its compliance with laws and regulations.



JUDITH H. DUTCHER
STATE AUDITOR



GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997

FINANCIAL STATEMENTS

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

EXHIBIT 1

**STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 1996**

	Unrestricted	Temporarily Restricted	Total
<u>Assets</u>			
Current assets			
Cash	\$ (135,759)	\$ 236,131	\$ 100,372
Accounts receivable	94,747	-	94,747
Grants receivable - Neighborhood Revitalization Program (NRP)	138,257	-	138,257
Grants receivable	121,771	125,000	246,771
Leases receivable	10,012	-	10,012
Prepaid expenses	4,818	-	4,818
Total current assets	\$ 233,846	\$ 361,131	\$ 594,977
Property and equipment			
Net of depreciation	12,020	396,209	408,229
Total Assets	\$ 245,866	\$ 757,340	\$ 1,003,206
<u>Liabilities and Net Assets</u>			
Current liabilities			
Accounts payable	\$ 161,049	\$ -	\$ 161,049
Contracts payable	119,337	-	119,337
Payroll taxes	83,219	-	83,219
Accrued payroll	24,672	-	24,672
Leases payable	5,214	-	5,214
Deferred leases receivable	5,500	-	5,500
Total current liabilities	\$ 398,991	\$ -	\$ 398,991
Long-term liabilities			
Capital leases payable	\$ 15,095	\$ -	\$ 15,095
Accrued vacation	11,621	-	11,621
NRP loans payable	120,000	-	120,000
Total long-term liabilities	\$ 146,716	\$ -	\$ 146,716
Total Liabilities	\$ 545,707	\$ -	\$ 545,707
Net Assets	(299,841)	757,340	457,499
Total Liabilities and Net Assets	\$ 245,866	\$ 757,340	\$ 1,003,206

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

EXHIBIT 2

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 1996**

	Unrestricted	Temporarily Restricted	Total
Public Support and Other Revenue			
Public support			
Government grants			
City of Minneapolis	\$ 445,552	\$ -	\$ 445,552
Minneapolis Community Development Agency (MCDA)	19,372	-	19,372
Neighborhood Revitalization Program (NRP)	232,172	-	232,172
State of Minnesota	7,683	-	7,683
Other	2,000	-	2,000
Foundation grants	173,600	50,000	223,600
Corporation grants	18,697	-	18,697
Other contributions	12,301	-	12,301
Satisfaction of time and purpose restrictions	96,516	(96,516)	-
	\$ 1,007,893	\$ (46,516)	\$ 961,377
Other revenue			
Fee and event income	\$ 100,593	\$ -	\$ 100,593
Miscellaneous	29,230	-	29,230
	\$ 129,823	\$ -	\$ 129,823
	\$ 1,137,716	\$ (46,516)	\$ 1,091,200
Expenses			
Program services			
MCDA	\$ 32,740	\$ -	\$ 32,740
Economic development	1,256	-	1,256
Foundations	85,035	-	85,035
NRP implementation			
Administration	135,742	-	135,742
Native American	20,418	-	20,418
District organizers	101,815	-	101,815
Community economic development	59,305	-	59,305
Youth programs	167,113	-	167,113
Housing	286,807	-	286,807
EC/EZ	170,892	-	170,892
NRP general	36,001	-	36,001
NRP/Mobile safety center	54,578	-	54,578
Youth enterprise center	20,065	-	20,065
NRP/theatre	48,183	-	48,183
NRP/Phillips community office center	21,600	-	21,600
NRP/HRCP	45,374	-	45,374
NRP/Arts and culture	3,574	-	3,574
	\$ 1,290,498	\$ -	\$ 1,290,498
Support services			
Management and general	125,704	-	125,704
	\$ 1,416,202	\$ -	\$ 1,416,202

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

**EXHIBIT 2
(Continued)**

**STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED DECEMBER 31, 1996**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Total</u>
Increase (Decrease) in net assets	\$ (278,486)	\$ (46,516)	\$ (325,002)
Net Assets - January 1	\$ 15,928	\$ 803,856	\$ 819,784
Prior period adjustment (Note 2)	(37,283)	-	(37,283)
Net Assets - January 1, as restated	\$ (21,355)	\$ 803,856	\$ 782,501
Net Assets - December 31	\$ (299,841)	\$ 757,340	\$ 457,499

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

**STATEMENT OF REVENUES AND FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 1996**

	MCDA	Economic Development	Foundations	Management and General
<u>Revenues</u>				
Government grants				
City of Minneapolis	\$ -	\$ -	\$ -	\$ -
Minneapolis Community Development Agency (MCDA)	19,372	-	-	-
Neighborhood Revitalization Program (NRP)	-	-	-	-
State of Minnesota	-	-	-	-
Other	-	-	-	2,000
Foundation grants	-	-	20,000	147,600
Corporation grants	-	-	-	13,062
Other contributions	-	-	-	2,369
Fee and event income	-	-	-	6,404
Miscellaneous	-	-	-	2,668
Total Revenues	\$ 19,372	\$ -	\$ 20,000	\$ 174,103
<u>Expenses</u>				
Salaries	\$ 24,044	\$ 1,154	\$ 21,061	\$ 18,988
Payroll taxes	1,957	102	4,149	5,239
Workers' compensation	-	-	-	-
Employee benefits	830	-	292	2,430
Professional fees	40	-	34,115	1,009
Advertising fees	455	-	890	568
Building rent	-	-	-	544
Building repairs	-	-	-	-
Copying/printing	102	-	195	225
Depreciation	2,036	-	2,036	2,036
Equipment purchases	978	-	-	10,902
Insurance	887	-	198	-
Meetings/childcare	467	-	3,957	526
Local travel	-	-	9	-
Miscellaneous	-	-	3	2,392
Office expense	142	-	16	4,017
Program expense	35	-	5,830	75,000
Office supplies	166	-	-	681
Postage	310	-	13	-
Repairs/maintenance	118	-	-	445
Telephone	175	-	-	641
Project/community	-	-	12,272	-
Administrative support	-	-	-	-
Loss on trade-in of fixed assets	-	-	-	61
Total Expenses	\$ 32,742	\$ 1,256	\$ 85,036	\$ 125,704
Net Surplus (Deficit)	\$ (13,370)	\$ (1,256)	\$ (65,036)	\$ 48,399

EXHIBIT 3

NRP Implementation					
Administration	Native American	District Organizers	Community Economic Development	Youth Programs	Housing
\$ -	\$ -	\$ -	\$ -	\$ 375	\$ 251,818
-	-	-	-	-	-
76,137	21,112	3,366	917	-	77,532
-	-	-	-	-	7,683
-	-	-	-	-	-
-	-	-	-	56,000	-
-	-	-	-	5,285	-
-	-	-	-	3,944	5,988
-	-	-	-	51,089	42,810
-	-	-	-	16,449	10,113
\$ 76,137	\$ 21,112	\$ 3,366	\$ 917	\$ 133,142	\$ 395,944
\$ 69,236	\$ 2,378	\$ 72,957	\$ 40,361	\$ 87,400	\$ 109,195
5,936	242	6,664	3,475	7,432	9,051
286	57	286	115	-	5,137
7,762	793	6,900	4,314	4,227	13,797
20,251	5,860	-	-	7,544	31,937
2,724	1,292	428	2,242	3,646	2,976
-	-	943	1,681	490	33,906
179	-	-	-	-	4,597
1,604	1,099	972	1,249	630	1,613
2,036	-	-	-	2,036	1,351
5,393	2,480	4,894	424	8,058	2,893
3,448	748	1,767	1,485	4,257	3,084
4,533	286	717	496	4,791	2,180
15	-	-	15	1,364	45
-	-	-	-	5,316	3,092
851	180	444	258	1,637	1,753
231	-	144	8	13,843	46,398
2,768	842	896	741	1,407	2,186
2,255	1,295	1,931	857	846	1,807
2,558	911	542	135	2,291	4,730
3,445	1,954	1,331	1,449	5,339	4,242
229	-	-	-	4,559	838
-	-	-	-	-	-
-	-	-	-	-	-
\$ 135,740	\$ 20,417	\$ 101,816	\$ 59,305	\$ 167,113	\$ 286,808
\$ (59,603)	\$ 695	\$ (98,450)	\$ (58,388)	\$ (33,971)	\$ 109,136

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

**STATEMENT OF REVENUES AND FUNCTIONAL EXPENSES
FOR THE YEAR ENDED DECEMBER 31, 1996**

	<u>EC/EZ</u>	<u>NRP General</u>	<u>NRP Mobile Safety Center</u>
<u>Revenues</u>			
Government grants			
City of Minneapolis	\$ 155,437	\$ -	\$ 21,879
Minneapolis Community Development Agency (MCDA)	-	-	-
Neighborhood Revitalization Program (NRP)	-	-	9,739
State of Minnesota	-	-	-
Other	-	-	-
Foundation grants	-	-	-
Corporation grants	-	-	350
Other contributions	-	-	-
Fee and event income	-	-	250
Miscellaneous	-	-	-
	<hr/>	<hr/>	<hr/>
Total Revenues	\$ 155,437	\$ -	\$ 32,218
<u>Expenses</u>			
Salaries	\$ 95,427	\$ 17,706	\$ 21,589
Payroll taxes	8,588	1,447	1,916
Workers' compensation	1,752	-	-
Employee benefits	3,458	971	2,914
Professional fees	31,256	1,500	9,096
Advertising fees	309	-	200
Building rent	3,804	9,600	9,600
Building repairs	-	-	-
Copying/printing	-	-	-
Depreciation	-	2,036	-
Equipment purchases	2,056	379	761
Insurance	8,970	536	2,006
Meetings/childcare	200	-	330
Local travel	1,852	-	235
Miscellaneous	528	-	-
Office expense	1,019	-	-
Program expense	4,564	-	1,788
Office supplies	1,539	46	25
Postage	890	-	42
Repairs/maintenance	472	484	-
Telephone	3,692	881	-
Project/community	516	75	4,077
Administrative support	-	340	-
Loss on trade-in of fixed assets	-	-	-
	<hr/>	<hr/>	<hr/>
Total Expenses	\$ 170,892	\$ 36,001	\$ 54,579
Net Surplus (Deficit)	\$ (15,455)	\$ (36,001)	\$ (22,361)

EXHIBIT 3
(Continued)

Youth Enterprise Center	NRP/Theatre	NRP/Phillips Community Office Center	NRP/HRCP	NRP Arts and Culture	Total
\$ 15,028	\$ -	\$ -	\$ 1,015	\$ -	\$ 445,552
-	-	-	-	-	19,372
20,015	11,868	6,901	3,044	1,541	232,172
-	-	-	-	-	7,683
-	-	-	-	-	2,000
-	-	-	-	-	223,600
-	-	-	-	-	18,697
-	-	-	-	-	12,301
-	40	-	-	-	100,593
-	-	-	-	-	29,230
\$ 35,043	\$ 11,908	\$ 6,901	\$ 4,059	\$ 1,541	\$ 1,091,200
\$ -	\$ 23,196	\$ -	\$ 38,916	\$ 1,912	\$ 645,520
-	2,099	-	3,558	150	62,005
-	172	-	-	-	7,805
-	3,878	-	2,444	-	55,010
2,620	10,118	-	-	634	155,980
250	4,454	-	156	175	20,765
9,921	-	21,600	-	69	92,158
-	-	-	-	3	4,779
-	-	-	-	6	7,695
-	-	-	-	-	13,567
1,572	472	-	188	352	41,802
3,378	2,918	-	-	17	33,699
20	41	-	-	52	18,596
-	-	-	-	-	3,535
-	-	-	111	-	11,442
30	-	-	-	-	10,347
-	-	-	-	-	147,841
38	183	-	-	29	11,547
-	2	-	-	94	10,342
2,236	649	-	-	12	15,583
-	-	-	-	68	23,217
-	-	-	-	-	22,566
-	-	-	-	-	340
-	-	-	-	-	61
\$ 20,065	\$ 48,182	\$ 21,600	\$ 45,373	\$ 3,573	\$ 1,416,202
\$ 14,978	\$ (36,274)	\$ (14,699)	\$ (41,314)	\$ (2,032)	\$ (325,002)

The notes to the financial statements are an integral part of this financial statement.

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

EXHIBIT 4

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 1996**

Cash flows from Operating Activities		
Increase (Decrease) in net assets	\$	<u>(325,002)</u>
Adjustments to reconcile changes in net assets to net cash provided by (used in) operating activities		
Depreciation	\$	13,567
Loss on disposal of fixed assets		61
(Increase) decrease in accounts receivable		(94,747)
(Increase) decrease in grants receivable		518,023
(Increase) decrease in leases receivable		(10,012)
(Increase) decrease in prepaid expenses		(2,831)
Increase (decrease) in bank overdraft		(71,899)
Increase (decrease) in notes payable		(2,288)
Increase (decrease) in accounts payable		106,424
Increase (decrease) in contracts payable		119,337
Increase (decrease) in payroll taxes payable		82,917
Increase (decrease) in accrued vacation		3,230
Increase (decrease) in accrued payroll payable		18,145
Increase (decrease) in deferred revenue		<u>5,500</u>
Total adjustments	\$	<u>685,427</u>
Net cash provided by (used in) operating activities	\$	<u>360,425</u>
Cash Flows from Investing Activities		
Purchase of property and equipment	\$	<u>(313,231)</u>
Cash Flows from Financing Activities		
Reduction in long-term liabilities - capital leases	\$	(4,082)
Addition of loan payable		<u>55,923</u>
Net cash provided by (used in) financing activities	\$	<u>51,841</u>
Net Increase (Decrease) in Cash and Cash Equivalents	\$	<u>99,035</u>
Cash and Cash Equivalents - January 1		<u>1,337</u>
Cash and Cash Equivalents - December 31	\$	<u><u>100,372</u></u>
Supplemental data for noncash investing and financing activities		
Gifts of equipment	\$	3,800
Fixed asset acquired by capital lease		19,039
Supplemental disclosure of cash flows		
Cash paid during the year for interest	\$	2,221

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

NOTES TO THE FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED DECEMBER 31, 1996

1. Summary of Significant Accounting Policies

A. Organization

People of Phillips, Inc. (POP) was organized to develop a sense of community in the Phillips Neighborhood of Minneapolis; to encourage widespread citizen participation in all decision-making processes affecting the community; to provide mechanisms for the residents to be well informed; and to facilitate improvement of the physical, social, and cultural environment of the neighborhood. POP is educational and advisory in nature.

B. Basis of Presentation

The provisions of Statement of Financial Accounting Standards (SFAS) No. 116, *Accounting for Contributions Received and Contributions Made*, and SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*, have been applied to the amounts presented in these financial statements. Under these provisions, net assets and revenues, gains, and losses are classified based on donor-imposed restrictions. Accordingly, net assets of POP and changes therein are classified and reported as follows:

Unrestricted - Those resources over which POP has discretionary control.

Temporarily Restricted - Those resources subject to donor-imposed restrictions which will be satisfied by actions of POP or passage of time.

Permanently Restricted - Those resources subject to a donor-imposed restriction that they be maintained permanently by POP. The donors of these resources permitted POP to use all or part of the income earned, including capital appreciation or related investments, for unrestricted or temporarily restricted purposes.

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

C. Expense Allocation

There has been no functional allocation of fund raising expenses. POP does not have a cost allocation plan for indirect expenses.

D. Income Taxes

POP is a not-for-profit organization that is exempt from income taxes under § 501(c)(3) of the Internal Revenue Code and comparable state statutes.

E. Cash and Cash Equivalents

Cash and cash equivalents include deposits in three checking and two savings accounts at three different financial institutions. At times, such deposits may be in excess of FDIC insurance coverage. At year-end, there was insufficient cash on hand to satisfy donor-imposed time or purpose restrictions.

F. Property and Equipment

All purchased property and equipment is valued at cost. Donated fixed assets are valued at their fair market value at the date of contribution. Depreciation is computed using the straight-line method over estimated useful lives of five to 40 years for equipment and buildings.

G. Grants and Contracts

POP's funding includes several cost-reimbursement grants, primarily from the Minneapolis Neighborhood Revitalization Program (NRP). Government grants and contracts recognize revenue as earned when eligible expenses, as defined in each grant or contract, are made. Funds advanced and received on the above grants but not yet earned are shown as restricted cash. Expenses under government grants are subject to review by the granting authority. To the extent, if any, that such a review reduces expenses allowed under these grants, POP will record such disallowance at the time the final assessment is made.

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

1. Summary of Significant Accounting Policies (Continued)

H. Contributions

The following types of contributions are recorded as revenue at their fair value when they are received unconditionally: cash, promises to give, certain contributed services, gifts of long-lived assets, and other assets. Conditional contributions are recognized as revenue when the conditions on which they depend have been substantially met.

I. Donated Services

No amounts have been reflected in the financial statements for donated services. POP did not track donated services; however, many individuals volunteer their time and perform a variety of tasks that assist POP with specific programs and committee assignments.

2. Prior Period Adjustment

A re-examination of the December 31, 1995, balance for payroll taxes payable showed that the liability was understated by \$37,283. As such, the January 1, 1996, net asset balance has been decreased for the amount of the understatement.

3. Property and Equipment

Property and equipment at December 31, 1996, was as follows:

Land	\$ 7,000
Buildings and improvements	347,457
Office furniture and equipment	<u>74,607</u>
Total	\$ 429,064
Less: accumulated depreciation	<u>(20,835)</u>
Total Property and Equipment	<u><u>\$ 408,229</u></u>

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

3. Property and Equipment (Continued)

The EZ/EC grant contract provides that title to the Youth Enterprise Center property, which is included in land and buildings above, reverts to the City of Minneapolis upon termination of the grant contract. The City, subject to federal grant requirements, may authorize other actions to be taken with program assets.

4. Temporarily Restricted Net Assets

Temporarily restricted net assets as of December 31, 1996, are for the following purposes:

Wendall Phillips Community Federal Credit Union	\$ 15,735
John Heinz Community Development Grant	75,000
Comprehensive Community Policing Strategy	20,000
Bush Foundation	50,000
Youth Enterprise Center	
EZ/EC	232,182
NRP	120,000
NRP	179,423
MHFA Building Capacity	10,000
McKnight Foundation	50,000
Minneapolis Community Development Agency (MCDA) - CDBG Grant	<u>5,000</u>
Total Temporarily Restricted Net Assets	<u><u>\$ 757,340</u></u>

5. Operating Leases

POP leases certain equipment under various noncancelable operating lease commitments with original terms ranging from three to five years. Rental expense related to these leases was \$10,931 for 1996. Future minimum rental payments are as follows:

1997	\$ 10,855
1998	9,887
1999	1,368
2000	<u>192</u>
Total Minimum Lease Payments	<u><u>\$ 22,302</u></u>

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

6. Building Rent

POP leases office space from Phillips Community Office Center, Inc., a related organization. POP has two leases that are month-to-month for \$2,400 per month and \$3,200 per month for the same space at 1014 East Franklin Avenue. In addition, POP leases a "Lead Safety House" with a one-year lease term ending on January 31, 1997. Rental payments are \$2,250 per quarter, due in advance. POP leases two other "Lead Safety Houses" from the MCDA for \$1 per year. POP made rental payments of \$73,950 for 1996.

7. Long-Term Debt

The following is a summary of the long-term debt transactions for the year ended December 31, 1996.

	Loans	Leases
Payable - January 1	\$ -	\$ 5,353
Additions	120,000	19,039
Deductions	-	(4,083)
Payable - December 31	\$ 120,000	\$ 20,309

Loans Payable

POP entered into a loan and mortgage agreement with the MCDA for \$120,000 for the rehabilitation of the Youth Enterprise Center. The loan will be forgiven on the 15th anniversary of the loan agreement if POP has complied with certain requirements as defined by the loan agreement. The balance at December 31, 1996, is \$120,000 and will remain at that level until forgiveness or repayment conditions are met or activated and payments are made.

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

7. Long-Term Debt (Continued)

Capital Leases

POP leased certain copier and phone equipment under capital lease obligations. The leases have been capitalized and included in property and equipment in the amount of \$31,093. Accumulated depreciation on the equipment at December 31, 1996, is \$5,520. The following is a schedule of future minimum lease payments at December 31, 1996:

<u>Year Ended</u> <u>December 31</u>	
1997	\$ 8,008
1998	6,979
1999	5,538
2000	5,538
2001	<u>923</u>
Total minimum lease payments	\$ 26,986
Less: amount representing interest	<u>(6,677)</u>
Present Value of Net Minimum Lease Payments	<u>\$ 20,309</u>

8. Early Access Housing Loan Program

POP has initiated the "Phillips Early Access Loan Program" to be funded by the NRP. The early access loan program consists of loans in the amount of \$739,950: \$259,950 for a "Deferred Loan Fund" for direct loans for home improvements on existing owner-occupied homes within the program area; and \$480,000 for a "Guarantee Fund" used to purchase guaranteed loans made by the servicing agent for home improvements. The program is administered by TCF Bank Minnesota, a federal savings bank, under the guidelines of the program.

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

9. Related Organization - Phillips Community Office Center, Inc.

Phillips Community Office Center, Inc., (PCOCI) is a § 501(c)(25) corporation created to hold title and operate an office property at 1014 East Franklin Avenue. PCOCI was incorporated by the American Indian Business Development Corporation, Phillips Community Development Corporation (PCDC), and POP. All incorporators are nonprofit organizations and each is an equal partner in the corporation. PCDC and POP are tenants of the building and, as such, pay rent to PCOCI.

10. Related Party Transactions

On December 4, 1996, the Executive Director made a loan of \$5,000 to POP. There is no supporting documentation as to the terms of the loan. The loan was repaid on December 18, 1996.

11. Subsequent Events

Staff Departures

POP had approximately 30 staff members depart between January and mid-May of 1997 because it was unable to meet payroll requirements.

Internal Revenue Service Seizures

The Internal Revenue Service froze the operating bank account and seized deposits of approximately \$19,196 for nonpayment of payroll and withholding taxes, penalty, and interest on October 29, 1997.

Liens

During 1997, two mechanics liens existed on the Youth Enterprise Center building which is included in POP's fixed assets. Thor Construction has a lien for \$33,446 and North Country Concrete for \$2,500.

MANAGEMENT AND COMPLIANCE SECTION

**Schedule of Findings
and Recommendations**

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

Schedule 1

**SCHEDULE OF FINDINGS AND RECOMMENDATIONS
FOR THE YEAR ENDED DECEMBER 31, 1996**

INTRODUCTION

In February 1997, the People of Phillips, Inc. (POP) and the Minneapolis Neighborhood Revitalization Policy Board (NRP) requested that the Office of the State Auditor (OSA) perform a financial and compliance audit of POP for the year ended December 31, 1996. The request was precipitated by concerns regarding the financial management of POP and other activities of its organization.

Prior to commencement of fieldwork in August 1997, the majority of POP's employees, including the Executive Director, either resigned or were terminated. The departures also affected employees of the Housing Resource Clearing House of Phillips (HRCP), a related organization which was taken over by POP near the end of 1996. Due to this attrition, the number of POP employees went from 30 in January 1997 to only five in May 1997. Following these departures, POP retained the services of two individuals on personal service contracts--one to act in the capacity of Executive Director and the other to manage financial affairs.

Because most employees having institutional knowledge or responsibility for the financial activities of POP during 1996 were no longer employed, we were unable to corroborate certain conditions concerning the accounting records and other activities of POP. In addition, many source documents such as receipts, bank statements and deposits, canceled checks, vendor invoices, and employee time sheets were either missing or filed in boxes in a haphazard fashion. A general ledger had been maintained by an outside accounting service and, though it served as the starting point for POP's financial activities, we found it to be incomplete. Because of these conditions, the OSA had to spend an inordinate amount of time reconstructing, to the best of our abilities, the financial activities of POP for 1996. As a result, various account balances and specific transactions could not be completely verified, and have resulted in our disclaiming an opinion on the financial statements. In addition, our report includes material findings related to POP's internal control structure and questioned costs of either NRP contracts or federal grants received by POP.

The overall results of our review found the following:

1. Internal Controls

The internal controls at POP were not sufficient to adequately safeguard assets. For numerous transactions, documentation was not on hand to verify that collections were deposited intact or that disbursements were appropriate. Fixed assets of POP were missing and no one could locate them.

2. Accounting Records

Rudimentary accounting records, such as receipts journals, accounts receivable and payable details, vacation and compensatory time for employees, and ledgers or journals documenting the restriction of funds from granting agencies and foundations were either incomplete or missing.

3. Federal Regulations

POP failed to comply with state and federal regulations regarding to the payment of employee and employer withholdings and sales tax collections. Also, POP failed to prepare IRS 1099 forms for 1996.

4. City Store

The City Store, a subcomponent operation of POP, had insufficient controls in place to ensure that goods received from police jurisdictions were either sold or disposed of properly. City Store has not reimbursed the City of Minneapolis for its share of the proceeds of property sold.

5. Cable Television Contract

Accounting controls and records for POP's cable television operation were not sufficient to ensure that the proper fees were charged, that collections on account were complete, or that all outstanding accounts were known by POP's administration.

6. Leases

Actions taken by POP's management to lease its office space may have been an attempt to circumvent the spirit of NRP regulations relative to the purchase of real property. POP became a party to a partnership that purchased a building; the building was then leased by the partnership to POP and another nonprofit organization. Also, equipment was leased for excessive amounts and reflects poor business decisions on the part of POP management.

7. POP Council Approval of Agreements

POP's Council was not participating in the approval of major transactions involving grants from various organizations, construction contracts, hiring staff, and incurring debt.

8. Questioned Costs

In testing NRP contracts and federal programs for compliance, we questioned costs (disbursements), totaling \$295,415, either because of their ineligibility or lack of documentation. Questioned costs represent those items which may not be allowable under terms of the contracts/programs. The ultimate permissibility of these costs must be determined by the granting agencies.

The above-mentioned deficiencies occurred due to mismanagement by POP's officials. POP has no written policies and procedures to follow in accounting for financial activities and maintaining adequate internal controls. Accounting disciplines necessary to ensure an adequate internal control structure were not present. The monitoring of expenses according to individual contracts and programs was extremely deficient. This condition caused cash overdrafts to occur during the year because funds were not requested from NRP in a timely manner. Also, based on the amounts budgeted for salaries under NRP contracts, POP may have retained more employees than it could fund through its contracts and programs with the various funding sources.

In order to eliminate these conditions, POP must develop internal controls that are sufficient to manage the level of funding it receives. Qualified employees must be trained to follow written policies and procedures. Management must maintain an awareness that financial activities are occurring and being recorded as prescribed. In addition, POP's management must give more attention to monitoring the progress of individual contracts to ensure that program objectives are being met within the financial parameters established. Given the number of individual contracts POP has, the development of a cost allocation plan is also recommended. This plan should receive approval from NRP and Minneapolis Community Development Agency officials.

DETAILED FINDINGS AND RECOMMENDATIONS

I. GENERAL COMPLIANCE--NRP CONTRACTS

The People of Phillips, Inc., (POP) entered into a number of contracts with the Minneapolis Neighborhood Revitalization Program (NRP) Policy Board. The audit of POP included a review of all the contracts between POP and the NRP Policy Board that had activity during 1996. We found the following findings and questioned costs pertaining to those contracts. A summary of questioned costs can be found on pages 67 and 68.

NRP Contract C95-3903

Timeliness in Requesting Reimbursements

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. Reimbursement requests relating to the Franklin Theatre grant took up to nine weeks to prepare after monthly costs were incurred. The reimbursement request for July 1996 expenses was not completed until September 19, 1996. The amount of costs incurred on the contract exceeded the amount previously advanced. In order to cover these expenses, POP borrowed from other funding sources until they received additional funds from the NRP. This condition unnecessarily diminished POP's cash position and was a contributing factor to the overdrafts incurred by POP in 1996.

We recommend that POP prepare reimbursement requests for all reimbursement-based grants within ten days after monthly costs are incurred.

Questioned Cost for Undocumented Expense

Check number 5562 was issued for professional service fees in the amount of \$900. No vendor invoice was located to support the \$900 disbursement.

Because we were unable to verify the validity of the payment, we question the charge of \$900 to this NRP contract.

Questioned Cost for Amount Claimed After End of Contract Period

Contract C95-3903 expired July 1, 1996. Reimbursement request numbers 13 and 14 were paid to POP by NRP and included disbursements made by POP after July 1996. According to terms of this contract, since these disbursements occurred after the contract period ended, they are not eligible for reimbursement. Total disbursements made after July 1, 1996, were \$4,657.

Because these costs were not incurred within the grant period, we are questioning the charges of \$4,657 to this NRP contract.

NRP Contract C95-4018

Timeliness in Requesting Reimbursements

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. Reimbursement request number 14 covered costs incurred from August 1 to October 31, 1996. The grant provisions allowed costs to be reimbursed on a monthly basis. By not requesting reimbursement on a monthly basis, the cash flow of the entire organization was diminished.

We recommend, as stated above, that POP prepare reimbursement requests within ten days after monthly costs are incurred.

Questioned Cost for Rent Reimbursements Not Allowed Under the Contract

This contract allowed for reimbursement from the NRP Policy Board of \$9,600 in quarterly rent expenses for POP's offices. We found that POP had two separate lease agreements for its space. One agreement required POP to make quarterly payments of \$9,600 to the lessor and the other required monthly payments by POP of \$2,400 to the lessor, for total rent payments of \$67,200 annually. It is unclear why two separate agreements exist.

In our review of reimbursement requests for this contract, we found that in request number 10, POP was reimbursed \$2,400 for rent expense. However, based on our review of the contract terms, the \$2,400 payment did not appear to be eligible for reimbursement under this NRP contract. Only the \$9,600 quarterly payments were eligible for reimbursement under this contract.

Under the terms of the contract, POP was ineligible to receive reimbursement for the \$2,400 rent expense and we question this charge to the NRP.

NRP Contract C95-4062

Timeliness in Requesting Reimbursements

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. Reimbursement requests relating to the Lead Collaborative contract took up to 15 weeks to prepare after monthly costs were incurred. The reimbursement request for August 1996 expenses was not completed until November 19, 1996. The costs incurred exceeded the amount previously advanced, causing POP's other funding sources to cover the excess amounts until receipt of the additional NRP funds. This condition resulted in unnecessarily diminishing POP's cash position and was a contributing factor to the overdrafts incurred by POP in 1996.

We recommend that POP prepare reimbursement requests for all reimbursement-based grants within ten days after monthly costs are incurred.

Questioned Cost for Undocumented Expenses

Check numbers 5117 and 5302 were issued in the amounts of \$253 and \$160, respectively. No vendor invoices were located to support either disbursement.

Because the OSA was unable to verify these payments, we are questioning the validity of these charges to this contract.

Questioned Cost for Amount Claimed Twice

Reimbursement request number 8 included \$4,000 advanced to POP from the NRP Policy Board for training ten employees. The amount was to be paid to the trainers at the time of training. Under reimbursement request number 12, POP again received \$4,000 from the NRP Policy Board for the same training, for a total of \$8,000 in training reimbursements. It is not clear why POP twice requested reimbursement for these training expenses.

Because POP received reimbursement twice for the same services, we are questioning the charge of \$4,000 to this contract.

Questioned Cost for Salary Charges Exceeding Support

According to reimbursement request number 12, 50 percent of the salary expenses of the Assistant Executive Director were billed to this contract for the two-week pay period ended April 26, 1996. However, the employee's time sheet supports no more than 25 percent as being charged to this

contract. Since information on the time sheet is not sufficient to accurately calculate the exact amount of time incurred on this contract, we cannot precisely determine the amount of excess charges to this contract. However, it is at least \$648.

Because the Assistant Executive Director's time sheet does not support the salary charges from request number 12, we are questioning the charges of \$648 to this contract.

Questioned Cost for Rent Charges Not Eligible Under Contract

We found that the NRP Policy Board reimbursed POP for check numbers 5329, 5346, and 5418 for \$1,200 each (\$3,600 total). These amounts were reported to NRP as rent expense and were applied to the contract's line item budget of \$54,000 for rent. However, according to the Minneapolis Community Development Agency's (MCDA) staff person administering this contract, the budget of \$54,000 was to be used for renting lead safe homes, not for general rent expenses of POP. A line item budget of \$1,920 was included in this contract for general rent/utilities expenses.

It is unknown why the \$3,600 was charged under the incorrect budget line in the contract. However, since the expenses exceeded the amount budgeted for rent/utilities by \$1,680 (\$3,600 less \$1,920), we are questioning the charges of \$1,680 to this contract.

NRP Contract C95-4312

Timeliness in Requesting Reimbursements

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. Reimbursement requests relating to the "Revolving Loan Administration" grant took up to eight weeks to prepare after monthly costs were incurred. The reimbursement request for August 1996 expenses was not completed until October 30, 1996. The amount of costs incurred exceeded the amount previously advanced, causing POP's other funding sources to cover the excess amounts until receipt of the additional NRP funds. This condition diminished POP's cash position and was a contributing factor to the overdrafts incurred by POP in 1996.

We recommend that POP prepare reimbursement requests for all reimbursement-based grants within ten days after monthly costs are incurred.

Lack of Detail from Time Sheets to Support Salary Expense Charged

We found that for pay periods ended August 16 and August 30, 1996, the Executive Director charged his time, according to his time sheet, to Program 700 (Housing Program). We also found that for pay periods ended May 24 and November 17, 1996, the Assistant Executive Director charged her time, according to her time sheets, to Program 700. There are four NRP contracts which report activities under Program 700 on POP's general ledger. Despite the fact that the Director's and Assistance Director's time sheets did not specify a contract to which their salary expenses should be billed, all salary expenses were billed to one contract--contract 4312. These salary costs were reimbursed under contract 4312, whose expenses are recorded under Program 700.

Because time sheets did not support the salary charges charged to contract 4312, we question the costs billed to this contract. The costs for the Executive Director and Assistant Executive Director were \$2,898 and \$3,127, respectively, for a total of \$6,025.

Questioned Costs for Undocumented Expenses

No vendor invoices were found to support the following payments:

<u>Check Number</u>	<u>Amount</u>
5101	\$ 700
5164	136
5249	241
5321	60
5358	400
5456	77
5520	549
5798	<u>48</u>
Total	<u>\$ 2,211</u>

Because we were unable to verify the validity of the payment due to the absence of documentation, we are questioning the charges of \$2,211 to this NRP contract.

NRP Contract C95-4335

Timeliness in Requesting Reimbursements

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. Reimbursement requests relating to the "NRP Implementation" contract took up to seven weeks to prepare after monthly costs were incurred. The reimbursement request for June 1996 expenses was not completed until August 20, 1996. The amount of costs incurred exceeded the amount previously advanced causing POP's other funding sources to cover the excess amounts until receipt of the additional NRP funds. This condition reduced POP's cash position and was a contributing factor to the overdrafts incurred by POP in 1996.

We recommend that POP prepare reimbursement requests for all reimbursement-based grants within ten days after monthly costs are incurred.

Questioned Cost for Rent Reimbursements Not Allowed Under the Contract

The following payments by POP were charged to this contract under the utilities budget line. Our review of documentation, however, found that the payments were actually for rent expense, which does not appear to be an allowable expense item under this contract. Because these disbursements do not appear to be eligible for this contract, we question the charges totalling \$1,632.

<u>Check Number</u>	<u>Amount</u>
5887	\$ 456
5996	456
6097	<u>720</u>
Total	<u>\$ 1,632</u>

Questioned Cost for Undocumented Expenses

Vendor invoices could not be located for the following checks:

<u>Invoice Number</u>	<u>Amount</u>
5185	\$ 150
5222	150
5261	100
5308	332
5423	834
5549	225
5564	592
5705	204
5824	400
5876	350
6049	142
6271	<u>1,316</u>
Total	<u>\$ 4,795</u>

Because we were unable to verify these payments, we question these charges to this NRP contract.

Questioned Cost for Excessive Charges

Reimbursement request number 5 included reimbursement for check number 5228, reported as \$500, for preventive maintenance. The general ledger indicates that this check was voided and a new check (same number) was disbursed for \$45.

Because the actual amount disbursed was less than the amount requested for reimbursement, we are questioning the charge of \$455 (\$500 less \$45) to this NRP contract.

Excessive Salary Expense Reimbursements

According to terms of this contract, salary expenses are to be reimbursed based on a percentage of the total salaries paid. However, we found that POP received reimbursement for 100 percent of the following employee's salaries:

<u>Employee Title</u>	<u>Amount Reimbursed</u>	<u>Amount Allowed</u>	<u>Excess Reimbursed</u>
Executive Director	\$ 20,639	\$ 10,155	\$ 10,484
Assistant Executive Director	5,714	2,196	3,518
District Organizers	43,325	18,200	25,125
Economic Development	7,240	3,000	4,240
Clerical	<u>4,061</u>	<u>2,090</u>	<u>1,971</u>
Total	<u>\$ 80,979</u>	<u>\$ 35,641</u>	<u>\$ 45,338</u>

This contract has not yet expired and there are unspent funds remaining on the contract. However, POP does not appear to monitor the manner in which it requests reimbursement for salary expenses relative to the terms of this contract. Because the amounts reimbursed to POP on a reporting period basis were exceeding the percentages established under this contract, we are questioning the charges totaling \$45,338.

NRP Contract C96-10661

Timeliness in Requesting Reimbursements

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. The reimbursement requests for costs incurred in the months of August, September, and October were all prepared in November. The grant allows for reimbursement requests to be prepared and submitted on a monthly basis. These delays in requesting reimbursements from NRP caused unnecessary reductions to POP's cash position and were a contributing factor to the overdrafts incurred by POP in 1996.

We recommend that POP prepare reimbursement requests for all reimbursement-based grants within ten days after monthly costs are incurred.

Absence of Documentation for Disbursements

We found no vendor invoices to support the following checks:

<u>Check Number</u>	<u>Amount</u>
5887	\$ 24
6046	32
6097	24
6130	40
6141	73
6227	21
6253	134
6260	31
6271	16
6275	<u>500</u>
Total	<u>\$ 895</u>

Because we were unable to verify the payments, we are questioning the charges of \$895 to this NRP contract.

Questioned Cost for Rent Reimbursements Not Allowed Under the Contract

Check numbers 5887, 5996, 6097, and 6227 for \$24, \$48, \$24, and \$21, respectively, were billed to NRP under the utilities budget line item for this contract. However, our review of the documentation for these disbursements found that the expenses were actually for rent expenses. Based on our examination of the contract budget, there does not appear to be an allowance for rent to be reimbursed.

Because the above disbursements do not appear to be eligible under this contract, we are questioning the charges of \$117.

NRP Contract C96-10717

Insufficient Documentation for Reimbursement Requests

We were informed by POP staff that detailed documentation exists to support the dollar amount requested from Minneapolis Employment Training Program (METP) for Jobs Training Program. However, no support could be located by POP staff for the program's disbursements.

Because we were unable to verify any of the program's payments, we are questioning the total amount of reimbursements made to POP of \$27,231.

NRP Contract C96-10899

Timeliness in Requesting Reimbursement

This contract allows for monthly requests for reimbursement to be submitted to the NRP Policy Board. The reimbursement requests for costs incurred in the months of August, September, October, and November were all completed December 17, 1996. The grant allows for reimbursement requests to be prepared and submitted on a monthly basis. These delays in requesting reimbursements from NRP caused unnecessary reductions to POP's cash position and were a contributing factor to the overdrafts incurred by POP in 1996.

We recommend that POP prepare reimbursement requests for all reimbursement-based grants within ten days after monthly costs are incurred.

Reimbursement for Computer Purchases Not Requested

In 1996, the Housing Resource Clearing House of Phillips (HRCP) incurred expenses exceeding \$10,000 for the purchase of computers. Based on a review of the NRP reimbursement requests, there is no evidence that these costs were billed to NRP. The HRCP administration grant, contract number 10899, includes a line item for the purchase of computers, not to exceed \$6,000. These costs may be an allowable expense for which POP could have received reimbursement, up to \$6,000.

We recommend that the administration of POP develop procedures to ensure that expenses eligible for reimbursement are requested.

Double Billings

Because of the numerous deficiencies with internal controls, we extended our procedures to search for items which POP erroneously double-billed to NRP contracts. The OSA found that approximately ten percent of the checks reviewed had been double-billed to the NRP. The following represents those contracts that were incorrectly charged because payment was already received by POP from a previous reimbursement request.

<u>Contract Number</u>	<u>Amount Billed Twice</u>
3903	\$ 90.01
4062	2,242.12
4312	1,222.11
4335	18,710.57
10661	<u>80.00</u>
Total	<u>\$ 22,344.81</u>

Other Ineligible Amounts Charged to NRP Contracts

Our expanded testing found that POP received reimbursement from NRP for certain costs for which they were not eligible to receive payment. Under contracts 4312 and 4335, POP requested and received payment for \$262.50 and \$4,388.47, respectively. POP's accounting records do not support these amounts and, therefore, we question these costs.

II. FEDERAL COMPLIANCE--SPECIFIC REQUIREMENTS

Community Development Block Grant (CDBG) Program - CFDA #14.218

Questioned Cost for Payroll Advance

Check number 6283, included on payment request number 5, was a payment for \$100 to an employee for advance of payroll. The amount was recorded on the general ledger as a receivable due from an employee. The use of federal funds to make payroll advances is not an allowable cost under CFDA #14.218.

Because employee advances is an not an authorized charge to this program, we are questioning \$100 that was reimbursed to POP.

III. FEDERAL COMPLIANCE--GENERAL REQUIREMENTS

Davis-Bacon Act

Empowerment Zone Program - CFDA #93.585 - Youth Enterprise Center

Construction costs funded through federal programs must comply with the requirements of the Davis-Bacon Act, relating to the payment of prevailing wages. The construction contract for rehabilitation costs of the Youth Enterprise Center did not contain a provision requiring a contractor to pay prevailing wages. POP administration failed to monitor the project to ensure that prevailing wages were paid.

We recommend that POP administration adhere to Davis-Bacon Act requirements when federal construction dollars are expended. The Act requires construction contracts to include a paragraph requiring the payment of prevailing wages and the monitoring of such to ensure that adequate wages are being paid.

Federal Financial Reports

John Heinz Program - CFDA #14.242 - Credit Union

The financial report due to the Department of Housing and Urban Development on January 1, 1996, was submitted on May 29, 1996, five months after the due date. The financial report due April 1, 1996, was submitted on July 29, 1996, four months after the due date.

We recommend that POP take the necessary steps to ensure that federal financial reporting requirements are met.

Allowable Costs/Cost Principles

Presently, no formal plan exists for allocating costs to POP's various grant programs. Allocation to the various grants, for the most part, appears to be based on funds available at the time of disbursement. POP should be allocating to the various grants based on an indirect cost plan, in accordance with Office of Management and Budget Circular A-87.

We recommend that a cost allocation plan be prepared by POP and submitted to the MCDA and NRP for approval. Preparation of this plan by POP may require assistance of the granting agencies.

Drug-Free Workplace Act

We found that POP's drug policy consisted of a statement in its personnel policy that an employee would be suspended and further disciplinary action was possible if he/she was found under the influence of alcohol or drugs at the workplace. Pursuant to federal requirements, the policy should also include provisions regarding ongoing drug awareness programs available to employees and the penalties for being convicted of drug-related offenses occurring in the workplace.

If POP is going to receive federal funds directly, it should develop a more comprehensive workplace drug policy.

IV. GENERAL INTERNAL CONTROLS

Segregation of Duties

By late 1997, many of the employees, including the Executive Director, who worked for POP in 1996 had severed their employment with POP. Because of this and other factors, we could not confirm whether an adequate segregation of accounting functions existed during 1996. Depending on the number of staff to be employed in the future, and their duties, it may not be possible to have an adequate segregation of duties necessary to ensure that adequate internal controls exist. If this occurs, the POP Council should 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.

Accounting Policies and Procedures

POP has no written policies and procedures for its financial activities. Given the size of the organization, policies and procedures should exist to set forth requirements to account for such matters as receipt and deposit of funds; purchase of goods and services; approval and payment of bills; reconciliation of bank accounts; maintenance of various files (contracts, invoices, and personnel information); accounting for fixed assets; accounting for vacation, sick, and compensatory (comp) time earned and taken; accounting for the use of restricted funds and reimbursable grants; and maintenance of the general ledger. Without written procedures to follow, there can be no assurance that accounting records and files will be maintained as intended.

We recommend that POP develop written policies and procedures for its financial activities.

Absence of Documentation for Vendor Payments

Our review of cash disbursement activities showed a material absence of information to support payments to vendors. An extensive search of POP's accounting records and files was performed by auditors looking for missing invoices. Those that were found, however, could not mitigate the condition of so many missing supporting documents.

In numerous instances, the only documentation for payments consisted of a check request form. Such forms may sometimes be acceptable as the only documentation necessary to support payments. However, we found the reliance on check request forms to be excessive for supporting POP's disbursements. Many of these disbursements were to businesses or organizations that would have been sending invoices for goods and services as a normal course of doing business. Specific examples where documentation was either insufficient or lacking are as follows:

1. The employee overseeing the POW WOW event asked for and received \$4,110 to cover related expenses with no receipts or other evidence provided to account for that amount. Additionally, residents and businesses contributed only \$3,660 for the event, causing other funding sources of POP to pay the difference.
2. The Treasurer of POP was retained under two personal service contracts. Under one contract, we were informed that the Treasurer was to be paid \$9.50 per hour for services in connection with the Theatre Task Force. We were also informed that the other contract called for the Treasurer to be paid \$25.00 per hour to startup a property management and rehab crew. We could not locate either of the contracts to verify the terms of the agreements and related compensation.
3. Prior to becoming an employee of City Store, an individual was retained by POP on a personal service contract. We were told that the individual was to be paid \$25.00 per hour. However, we could not locate this contract to verify terms of the agreement and the compensation stipulated.
4. Expense reimbursements to one POP employee acting in the positions of Council Treasurer, Phillips Housing Trust (PHT) Director, and PHT Foreman totaled \$7,481 in 1996, of which only \$3,630 was documented with receipts. In some instances, check request forms were completed to serve as support. However, in our opinion, POP's staff should have presented receipts for the remaining \$3,851 in order to be reimbursed.

We recommend that POP develop specific policies and procedures to be followed in allowing claims to be paid. Ensuring staff adherence to these policies is the responsibility of POP management. In addition, POP must ensure that it has sufficient documentation to support its claims for costs. If this documentation is not produced, it may negatively impact funding from the federal grant as well as NRP. However, the granting authorities will be the ultimate judge of whether the costs questioned in this audit will be allowed.

Approvals for Payments

Approval of Vendor Payments

For 26 of 60 items tested, no evidence was present on either the vendor invoice or the check request form to indicate that items had been approved prior to check preparation and payment. In fact, for all 26 items, the approval line on the check request form was left blank.

We recommend that all items be approved by the Executive Director prior to preparation of the check.

Conflict of Interest

In 1996, POP's Treasurer entered into two personal service contracts with POP--one involving a Theatre Task Force and a second contract to provide services for the start-up of a Property Management Rehab Crew. After the contracts expired, this individual was hired in February 1996 as the Director/Foreman of PHT, a division of HRCP. While employed by HRCP, the individual continued to serve as Treasurer of POP's Council. As Treasurer, he was an authorized signatory on the POP checking account, and as Director of PHT he was also an authorized signatory on the PHT checking account.

As Director of PHT, this individual approved bills for submission to POP--the fiscal agent for receiving City funding for PHT activities. After these bills were accepted by POP for payment, this individual, as Treasurer of POP, would sign the checks to be disbursed.

The ability of one person to perform the above-related duties, at a minimum, gives the appearance of a potential conflict of interest. We further note that there was no discussion in the minutes that disclosed this situation to the HRCP Board or POP Council. POP's personnel policies and procedures are silent on personal service contracts; however, policies do require that Council

members of POP step down if they take a permanent position with POP. Based on the close relationship in which these two organizations were involved, the POP Treasurer should have been removed from that position to avoid a potential conflict of interest.

We recommend that the personnel policies and procedures be updated to address the avoidance of conflicts of interest when forming personal service contracts with Board members. Also, we recommend that in situations which may give rise to a potential conflict of interest, that a conflict of interest statement be signed and disclosed to the POP Council by the affected individual.

Auditing of Vendor Invoices

There was no evidence on vendor invoices or check requests to indicate if the items were checked for accuracy prior to payment. The auditing of vendor invoices should include an indication, such as the initials of the individual reviewing the bills, to provide assurance that vendor invoices have been checked for clerical accuracy.

We recommend that all documentation be initialed by those reviewing the bills.

Cancellation of Invoices

In 39 of 60 items tested, the supporting documentation (vendor invoices or check requests) did not have any evidence of being canceled.

We recommend that, to avoid reuse of invoices, all supporting documentation be marked with check number and date paid to show they have been canceled.

Absence of Cost Allocation Plan

For 1996, POP did not have a plan for allocating costs to its various programs. It appears that expenses were charged directly to programs whenever possible. In some instances, if more than one program was involved with a vendor invoice, the bill was divided by the number of programs affected, with no regard to actual work performed. In other instances, it appeared that the claims were charged to the program that still had funds remaining.

Some of POP's expenses could be attributed directly to a specific program. However, many of the expenses incurred by POP were eligible for a variety of its funding sources. Without a plan to allocate these expenses, there can be no assurance that resources are being utilized effectively and in the manner intended by the funding agencies. Program budgets cannot be prepared or managed by POP without a documented plan for expending the funds.

Program budgets become meaningless when there is no actual plan in place to control the basis under which funds will be charged to programs for their portion of POP's expenses. We find this condition to be a significant deficiency in the control and management of POP's funds.

We recommend that POP administration develop a cost allocation plan to allocate costs that are not directly associated with a program. This plan should be reviewed annually and updated, as deemed appropriate. Also, this plan should be considered in preparing future grant budgets.

Separate Accounting for Fund Raising Activities

Statement of Financial Accounting Standards No. 117, paragraphs 26-28, requires fund raising activities to be reported separately as a functional expense of the entity. POP's fund raising activities were not accounted for under a separate category within the accounting records. As a result, the functional expenses of POP, as presented in the financial statements, are not in accordance with generally accepted accounting principles.

We recommend that POP establish a functional expense category in its general ledger to account for fund raising activities.

Accounting for Donated Services

We found no procedure existing to account for donated services that POP may receive. Since management and other key staff are no longer employed at POP, inquiry regarding this matter was limited. Statement of Financial Accounting Standards No. 116 requires that the value of donated services be recorded in the general ledger if certain criteria are met.

We recommend that a policy and procedure be established to recognize and account for donated services, materials, and facilities.

Safeguarding of Assets

During our fieldwork, we noted several instances wherein fixed assets were lost or missing from POP's offices or properties.

1. In our tests to verify the existence of fixed assets on hand, we attempted to visually observe the existence of a bus used for various purposes. When we proceeded to the towing lot where it was stored, we learned that an unidentified individual had checked out the bus about a week earlier without written authorization or having to provide identification. As of the completion of our audit, we were not informed whether the bus had been found.

2. The PHT Program was a training program for construction work. We believe that a significant amount of tools were purchased with public funds for this program. These tools should be assets of POP. It appears that no tools remain at POP's offices.
3. In our tests to verify the existence of fixed assets on hand, we could not locate a laptop computer that had been purchased by POP. Staff at POP remembered seeing the computer, but it could not be located.
4. During our audit, we were informed that a television and VCR were missing from POP's offices and presumed stolen. It is not clear how the items disappeared since we were told that there was no forced entry into the building.

In order to better safeguard its assets, POP must develop policies and procedures which address the physical protection of these assets. These procedures should include periodic observations of the assets and comparisons with inventory records.

General Condition of Accounting Records

Basis of Accounting

The basis of accounting followed in POP's general ledger had been the accrual basis of accounting. However, we found that in May 1996, the basis of accounting was changed to the cash basis. As a result, postings to increase or decrease accounts containing outstanding receivables and liabilities no longer occurred. This condition could have misled management and Board members as to the financial position of POP and the status of grant activities.

If the level of financial activities remains the same in future periods, we recommend that the accrual basis of accounting be maintained.

Receipts Journal Not Located

We were told by POP's staff that a receipt journal had been maintained in 1996. However, the journal could not be located. Receipt journals serve as a source record for all funds collected by POP. The absence of this record reduces the reliance that can be placed on bank deposits and general ledger recordings.

We recommend that a receipts journal be maintained for all funds received by POP. Recordings in the journal should be performed by someone who is not associated with making bank deposits or recordings in the general ledger. Information in the journal should include date received, remitter of funds, contract number (if available), and the POP program to be credited.

Timeliness of Deposits

We found several deposits in 1996 were not made in a timely manner. Timely deposits help safeguard assets as well as improve POP's cash flow.

We recommend that collections be deposited at least weekly.

Retention of Documentation for Deposit Slips

Documentation for deposits made to the Marquette Bank savings account could not be located in POP's offices. We were able to retrieve copies of the information from POP's outside accountant. It is unclear why this documentation was not on hand at POP's offices. POP should not rely on the outside accountant for information relating to bank deposits.

We recommend that procedures be established to ensure that all documentation for deposits be retained in POP's offices.

Cash Withheld from Deposit

In a March 1996 deposit, we found that \$800 had been withheld from the gross amount of the deposit. There was a note attached that \$400 was to be used for an employee advance and \$400 was to be used for a vendor claim. The withholding of cash should not be allowed. Such a practice weakens internal controls since it makes it easier for the misuse or theft of funds to occur.

We recommend that collections be deposited intact and the practice of withholding cash from deposits not be allowed.

Undocumented Withdrawals from Savings Account (Charged to METP Program)

During our review of activities in the Marquette Bank savings account, we found four withdrawals totaling \$9,443 for which no documentation could be found. This is yet another example of an internal control weakness where cash withdrawals from POP's accounts cannot be substantiated.

We recommend that cash withdrawals be discouraged. If vendors will accept only cash or a cashier's check, then cashier's checks should be obtained. Copies of the cashier's checks should be attached to the original vendor bills. Also, since two of these withdrawals, totaling \$7,891, were charged to the METP, a program funded with federal money, we are reporting these withdrawals as questioned costs under our report section titled "Federal Internal Controls" (page 60).

Receipt of Funds for Purchase of Building Not Recorded in POP's Records

In 1996, the Youth Enterprise Center building was purchased by POP. Funding for the purchase was provided by the City of Minneapolis. The City's check sent to POP for the purchase was never deposited in POP's bank account. POP's Executive Director endorsed the check over to the title company. It is unclear why the City's check was not deposited into POP's bank account.

The practice of endorsing checks over to a third party should not occur. This practice reduces reliability of POP's internal control procedures for receipting funds and could cause funds to be intentionally diverted.

We recommend that POP's policies for receiving and depositing funds prohibit POP's management from endorsing checks over to a third party.

Recognition of Restricted Funds

Some of the funding received by POP has specific restrictions placed on it by contributors. In order to ensure such funds are spent for the purposes intended, the funds should be identified in the general ledger as restricted funds. POP's general ledger has no such restricted accounts. In 1996, POP received \$95,000 in restricted funds. There was a lack of accountability for expenditure of these funds in the general ledger. It appears there were no efforts made to ensure these funds were spent for their intended use.

We recommend that POP's general ledger be modified so that restricted funds are identified as such. Additional procedures should also be established to provide assurances to the contributors that their funds are being spent appropriately.

Timely Bank Reconcilements

We found no evidence that the Marquette Bank savings account recorded in the general ledger had been reconciled during the year. All bank accounts should be reconciled on a monthly basis or, in the case of savings accounts, as frequently as bank statements are received.

We recommend that POP establish procedures to ensure that all bank accounts are reconciled soon after bank statements are received. Those preparing the reconciliations should initial and date the statements. The reconciliations should be presented to the Board for review.

Retention of Canceled Checks

We found that 167 canceled checks from the Riverside Bank account could not be located at POP's offices. We also found that when POP-issued checks were returned due to insufficient funds, a second check would be issued using the same check number and the returned check would be discarded.

Due to the numerous deficiencies in internal controls, we requested copies of the canceled checks, on a sample basis, from the bank. No unusual circumstances were noted in reviewing the copies.

We recommend that all canceled checks be retained in check number order. Checks returned as NSF should also be retained along with the canceled checks.

Voided Checks Not Recorded in the General Ledger

POP-issued checks which had been voided by POP, totaling \$5,052, were not properly recorded in the general ledger. This caused the cash balance in the general ledger to be understated.

We recommend that all voided checks be properly recorded in the general ledger.

Fixed Asset Records

No Capitalization Policy

POP does not have a capitalization policy for fixed assets. Such a policy would set a dollar value at which a fixed asset should be recorded. We recommend that a capitalization policy be developed and approved by POP's Council. The policy should take into account any grant requirements pertaining to purchases of fixed assets.

No Records of Fixed Assets

POP reports the purchases of fixed assets on specific reimbursement requests; however, no central record is maintained showing all fixed assets of POP. We recommend that records be maintained listing all fixed assets, together with related depreciation, according to its capitalization policy. The record should include, but not be limited to, the following:

- Date of purchase
- Description
- Serial number
- Funding source
- Purchase price
- Useful life

Payroll Records and Related Expenses

Payroll Withholdings and Unemployment Insurance

We found that state and federal withholdings, as well as unemployment insurance amounts owing the state, were not paid when due. At December 31, 1996, \$83,219, including penalties and interest, was in arrears to the state and federal governments, as follows:

Federal withholdings	\$ 64,366
State withholdings	18,307
Unemployment insurance	<u>546</u>
Total	<u>\$ 83,219</u>

POP had been reimbursed by the NRP Policy Board for withholding amounts. POP provided the NRP Policy Board with check numbers and amounts to be paid to the state and federal governments. However, several of these checks were never, in fact, issued by POP and resulted in the above liabilities.

POP's management must improve its ability to manage financial affairs within its budget constraints and must request reimbursement only for amounts actually paid.

Reimbursements for Salary Expenses Not Supported by General Ledger

In reviewing employee time sheets, we found that the programs charged on the time sheets did not always identify the specific contract to be charged within the program. Since some programs recorded in POP's general ledger contain more than one contract, employee time sheets must specify which contracts should be charged. Numerous instances of this condition were found. Due to the significance of this condition, some City and NRP contracts may have been incorrectly charged for salaries of POP employees.

In order to correct this condition, POP management must establish procedures to ensure that time sheets indicate both the contract and program to be charged so that expenses are recorded properly in the general ledger.

Vacation Accrual and Compensatory (Comp) Time

POP's general ledger included an account to record employee vacation earned and taken. We were unable to locate any detail, by employee, for the balance in this account at December 31, 1996. As a result, we were unable to determine if this account balance was fairly stated.

We recommend that POP maintain a subsidiary ledger to record all vacation as well as comp time that has been earned and taken by employees. The total liability from this ledger should be reconciled with the general ledger account balance at least annually.

Lack of Control in Accounting for Compensatory (Comp) Time Earned and Taken

The following conditions were found regarding comp time:

- POP's personnel policy requires that comp time earned by employees during a pay period must be taken in the following pay period. We found that employees were not adhering to this policy. Comp time was taken whenever the employees chose to take it. Some employees took comp time in the same period earned, while others carried their comp time balance into pay periods beyond the next period.

We recommend that POP management enforce its policy relative to the taking of comp time.

- POP's personnel policy requires comp time to be earned after an employee has worked 40 hours in a week's time. We found that employees were calculating comp time earned on a daily basis, that is, time exceeding an eight-hour day.

We recommend that POP management enforce its policy relative to the earning of comp time.

- It appeared that neither management nor employees kept an accurate accounting of vacation, sick leave, and comp time earned and taken. Some of the time sheets used by employees did not provide for balances to be recorded. Some employees entitled to the leave were not recording it on their time sheets. Based on our review of these records, it appears employees were allowed unilaterally to decide how they would earn and take comp time.

Further, POP's personnel policy requires the Executive Director and the immediate supervisor to review any condition where employees are consistently working comp time. We found that many of POP's employees were reporting comp time earned throughout the year on their time sheets yet there was no indication from existing records that any of the employees' claims for comp time earned had been reviewed for propriety.

We recommend that POP management institute oversight procedures to ensure that vacation, sick leave, and comp time are recorded properly by employees in accordance with its personnel policies.

Approval of Time Sheets for Employees and the Executive Director

Our review of employee time sheets found that many had not been signed by a supervisor. We found that time sheets for POP's Executive Director and HRCP's Executive Director also had not been approved by anyone for the entire year. Approvals of employees' time worked are an essential element to any system of internal controls.

We recommend that all time sheets be approved each pay period by the appropriate supervisor. Time sheets of executive directors should be reviewed and signed by a delegated member of POP's Council.

IRS 1099 Forms Issued for 1996

We found that POP failed to issue federally required IRS Form 1099's for 1996. According to IRS regulations, these forms must be issued to individuals who received compensation from POP for services performed. We are aware of at least four individuals who received a combined total of \$57,000 in 1996.

We recommend that POP adhere to IRS requirements for issuing 1099 forms. We also recommend that the IRS be contacted to determine if additional actions by POP are necessary due to the failure to issue forms for 1996.

Excessive Payment to Employee

We found that an employee who terminated his employment July 2, 1996, was actually paid through August. No evidence was found that authorized payments beyond the termination date. POP's personnel policy allows unused vacation to be paid at termination.

The employee received excess compensation of \$3,608. We recommend that severance payments to employees only be based on amounts earned in accordance with the personnel policies.

Advances to Employees

POP's Executive Director and Assistant Executive Director authorized payroll advances to employees. It appears the advances were never authorized by POP's Council. Payroll advances recorded in the general ledger at December 31, 1996, were for \$3,235. In early 1997, POP had a significant lay-off of its employees. A limited review of POP's 1997 general ledger did not indicate any repayments of the advances.

We recommend that the practice of allowing payroll advances be discontinued. Given the period of time that has elapsed since the advances were made, it is unlikely they will be collected. This may require the write-off of the advances in the general ledger.

Grant Administration

Process for Authorizing Grants to Be Received

We could find no evidence to indicate that POP's Council was involved with approving grants for its organization. It appears the Council is presented with a report titled "Operational Revenue." This report is a schedule listing the grants that have been applied for and the status of each grant which indicates

either received, pending, or declined. The minutes did not indicate that the Council had taken formal action to approve each of the grants, either for application or for authorization of acceptance.

We recommend that the Council approve, on an individual basis, the grants to be pursued and authorize the Executive Director to execute specific grant agreements upon acceptance by the granting agency.

Interim Reporting of Grant Activities to Executive Council

The "Operational Revenue" report noted above does not include specific grant information such as: (1) total grant amount to be received; (2) total received to date; (3) grant expenditures for the period; or (4) total grant expenditures year-to-date. We found that the Council is presented with monthly financial statements; however, the information presented is not always sufficiently current to be of value to the Council. For example, the December 18, 1996, Council meeting included July month-end interim financial statements and the January 17, 1997, Council meeting included October month-end interim financial statements.

We recommend that grant information presented to POP's Council include the specific grant information noted above. We also recommend that interim financial reports be presented to the Council in a timely manner.

Monitoring Grant Expenses for Intended Use

No formal policies and procedures exist for the monitoring of grants. POP receives funding from a variety of sources, some of which contain specific terms as to the use of the funds. It was communicated to the auditors that POP staff did its best to ensure grant expenses were made in accordance with the terms of grant agreements.

We recommend that formal policies and procedures be developed and implemented for the monitoring of grants to ensure that expenses are made in accordance with the terms of each grant.

City Store

Absence of Written Operating Procedures

The Business Plan developed for City Store states that "bookkeeping activities" will be the responsibility of City Store with business reports prepared monthly and forwarded to POP. There are no written policies and procedures that indicate how the bookkeeping activities are to be performed.

We recommend that POP administration and City Store staff develop written policies and procedures to ensure that appropriate records are maintained by City Store to account for activities. The procedures should take into account specific requirements for records to be maintained and retained and internal controls to ensure that financial information will be accurate and complete. In addition, we recommend that the Council approve the policies and procedures prior to implementation since City Store is an activity of POP.

Absence of Approved Pricing Policies

There are no written policies or procedures to describe how items should be priced. We were informed by City Store staff that the methods used to price items are pricing books, phone calls to vendors, or having vendors come to the City Store to review and suggest a price for items. The prices for items held at City Store are apparently set by the same two employees who also receive the inventories and are responsible for all financial information relating to sales. There appears to have been no oversight from POP administration in 1996 for determining or reviewing the pricing of goods received for sale.

We recommend that POP develop written policies and procedures that identify how merchandise will be priced. These procedures should also include the requirement for periodic oversight by POP to ensure that the pricing practices are being followed.

Segregation of Duties

Due to the limited number of staff within City Store, segregation of the accounting activities and other operating functions necessary to ensure adequate internal controls, is not possible. This is not unusual in operations the size of City Store; however, POP's administration and Council should be aware of this condition and realize the concentration of duties and responsibilities in a limited number of individuals is not desirable from an internal control point of view.

No Authorization for Sales Amounts Withheld for Refunds

The City Store staff has retained \$660 in a locked box that is for refunds of returned items. The \$660 was withheld from daily receipts. There was no authorization from POP's administration or Council for the \$660 to be withheld from receipts and retained at City Store for refunds. Also, there are no records to account for the amount of refunds made with this fund and how often the fund was reimbursed from daily sales.

We note that signs within City Store state that all sales are final and, therefore, we question the need for the refund amount to be set aside. However, if refunds are to be made, we recommend that POP's administration develop a refund policy and determine the procedure to be followed in making such refunds.

Sales Activities Not Recorded in POP's General Ledger

In 1996, POP established a separate savings account to deposit the proceeds from City Store sales. Periodically, amounts would be withdrawn from the savings account and deposited to the general checking account of POP. As deposits were made to POP's checking account, revenue was recorded in the general ledger. This practice omitted from the general ledger sales amounts still residing in the savings account. At December 31, 1996, the City Store savings account had a balance of \$4,000, which was not recorded in POP's general ledger.

In order to provide an adequate accounting for City Store activities, we recommend that:

- a separate program be established to account for all revenues and expenses associated with City Store operations;
- consideration be given as to whether a separate savings account is needed for City Store sales; and
- POP's general ledger be updated to record City Store sales when bank deposits are made.

Inventory Stock Numbers

- Some stock numbers assigned to the City of Minneapolis' property were missing from City Store's inventory report.

The inventory listing provided to the OSA was an accumulation of items received from the start of operations in October 1996. The listing tracks inventory by property and evidence numbers of the different jurisdictions sending items to City Store. In 198 instances, inventory items sent by the City of Minneapolis did not appear on the inventory listing.

We recommend that all inventory items sent to City Store by the different jurisdictions be accounted for on the inventory listing.

- According to a City Store worksheet maintained by staff, some items marked as defective appear to have been sold.

When receiving merchandise from jurisdictions, the City Store is also provided a listing, or working copy, of the items submitted. It is used to compare the actual items received to what the jurisdictions indicate they sent. In 174 instances, items listed on the working copy were identified as being either defective or broken. However, the OSA found these same items on the City Store's inventory listing, showing that they had either been sold or were available for sale. Because of this conflicting information, it could not be determined if the merchandise was defective and could not be sold or if it was actually sold.

We recommend that records maintained at City Store present information in a manner that provides an accurate accounting for goods received.

- In 58 instances, inventory numbers were listed twice on City Store's inventory records. In some cases, the descriptions of the items were the same; in others, different descriptions were used for the same number. In two instances, the same inventory number was recorded three times with three different descriptions.

We recommend that greater care be given to ensure that inventory numbers are used only once.

Controls for Items Determined to Be Defective

No formal policies and procedures exist to account for the proper disposition of defective items. City Store staff determine which items are defective and then is responsible to dispose of such items. One method of disposition is to throw the items directly into the garbage. Under these practices, there is no assurance that all items suitable for sale are actually being accounted for through City Store's sales records. There is no control to determine that items classified as defective by City Store staff are, in fact, defective.

We recommend that all items determined by City Store staff to be defective be corroborated by POP administration and then returned to the jurisdiction that provided them.

Timeliness of Deposits

We found that sales proceeds were accumulated up to a week before a deposit was made. We were told that bank deposits occurred when time permitted.

We recommend that deposits be made on a daily basis.

Daily Sales Journal/Ledger Not Maintained

City Store staff did not maintain a journal or ledger to account for daily sales, overages/shortages, other reductions from sales, and amounts deposited in the bank. The detailed daily reports produced through the cash register (Daily Transaction Journal, Daily Transaction Tax Audit, Cash Drawer Summary, and General Ledger Summary) were not maintained on a consistent basis for each day of operation in 1996. Without these records and reports, information to support amounts being deposited is insufficient.

We recommend that a daily sales journal/ledger be maintained that, at a minimum, shows the daily sales (from Daily Transaction Journal or Cash Drawer Summary cash register reports), overages/shortages, and net deposit.

Deposits Incomplete

We found that bank deposits were incomplete when compared to sales records. Sales amounts from the cash register did not agree with amounts deposited. Because other sales information was incomplete, and because we were told that proceeds were also used for incidental operating costs for which no records were provided to us, we could not determine what amounts should have been deposited in the bank.

As recommended above, maintaining a sales journal or ledger that shows daily sales, overages/shortages, and net deposit amount will provide the necessary documentation to account for bank deposits.

No Record Found to Account for Incidental Operating Expenses

We were informed by City Store staff that a ledger had been kept to record the purchases of goods and services with cash they had removed from the cash register. When the ledger was requested, it could not be located by City Store staff. According to City Store staff, approximately \$1,455 in incidental expenses were incurred in 1996.

We recommend that removal of cash from daily sales be prohibited. If the City Store staff requires cash for incidental expenses, then the POP Council should authorize a petty cash fund for such purposes. If a petty cash fund is authorized, City Store staff must retain all receipts to document the use of the fund.

Amounts Owing to City of Minneapolis at December 31, 1996

As of November 1997, the City of Minneapolis has not been paid for sales made for the fourth quarter of 1996. From our review of POP bank accounts, we found that City Store sales proceeds were deposited into a savings account. Periodically, funds were transferred from the savings account to a general operating account of POP. There was no separate accounting by POP for revenues and expenses of City Store activities.

Given the extent of internal control weaknesses with City Store operations and records, it is difficult to accurately calculate the exact amount owing to the City of Minneapolis. However, we conservatively estimate this amount to be \$9,328.

We recommend that this amount be paid to the City of Minneapolis immediately.

Sales Tax Owing to State of Minnesota at December 31, 1996

We found that the State of Minnesota was not paid for sales tax on sales for the fourth quarter of 1996 until July 1997. As with our previous comment relating to calculations of amounts owing, it is difficult to accurately calculate the exact amount owing at December 31, 1996. However, based on sales at the City Store, we estimate the amount to be \$1,540.

We recommend that sales tax amounts owing to the State of Minnesota be paid in a timely manner.

Records to Document Physical Counts of Inventory

The City Store staff indicated they frequently took physical counts of the inventory. However, no evidence of such counts was provided to the auditors.

We recommend that POP administration develop written policies and procedures for taking physical counts of inventory. The policies and procedures should dictate: (1) frequency of counts, with year-end as a minimum; (2) how counts will be performed; (3) procedures for following up on differences; and (4) retention of documentation used in the counts.

Records to Support Basis for Expending Sales Proceeds of Specific Items Contributed

We were informed by City Store staff that the City Store has an agreement for the use of sales proceeds from certain goods on consignment from a private business. According to staff, the proceeds from these sales are to be retained by City Store and used for entertaining student workers. Staff of City Store could not provide the agreement, items sold, items on hand, total sales, expenses incurred, or funds available for expending under this arrangement.

We recommend the POP Council give prior approval for any such arrangements. We also recommend that these funds be controlled and accounted for by POP's administration, not the City Store staff.

Phillips Community Television (PCTV)

Absence of Approved Fee Schedule

We were informed by POP's staff that a fee schedule had been set establishing user rates for those parties utilizing the services of PCTV. However, we were also told that the experience of the program director was relied upon for determining the amount to be charged. We asked for a copy of the fee schedule, but staff was unable to provide us with one. From our review of Council minutes, there was no indication of fee schedules being presented for approval.

We recommend that the PCTV fee schedule for services performed be presented and approved by the Council. The fee schedule should then be followed for billings to clients.

Absence of Controls Over Billing and Collection Process

We found the following deficiencies over PCTV's billing and collection process:

- The PCTV program director determines the amount that will be billed for services performed.
- The program director prepares the invoices for services performed and mails them to clients. POP's central office had no information on outstanding receivables.

- Collections on accounts are received at POP's central office, although we did become aware of some collections in which checks were made out to the program director.
- There does not appear to be adequate communication between the program director and POP's administration.

We recommend that POP's administration develop written policies and procedures to be followed for the billing and collection of services provided to PCTV clients. The procedures should require control by POP's central office of all billing forms used for client charges. The forms should list POP's central office address for remittances. These policies and procedures, together with a fee schedule, should then be submitted to POP's Council for formal approval. Once approved, the program director should not deviate from these procedures or the fee schedule without written approval from POP's administration.

Phillips Housing Trust (PHT)

Absence of Controls Over Billing and Collection Process

While reviewing the records of HRCP, it came to our attention that PHT billed private parties for work performed. POP's administration could not locate a billing and/or receivable system for PHT. The only information found relating to these receivables were three invoices attached to checks that were deposited, two invoices that were mixed in with other records of HRCP/PHT, and an accounts receivable listing as of November 26, 1996. The listing was insufficient for auditors to confirm.

HRCP programs are no longer in operation and funding has been terminated. Because there are no longer any HRCP staff employed at POP to help reconstruct or locate information pertaining to a billing system, it is unlikely that any additional information on PHT charges and collections will be found. As a result, it is possible that assets in the form of receivables and cash may have been lost.

Receipts Journal Not Located

We were informed by POP's staff that a receipts journal had been maintained for PHT in 1996. However, this journal could not be located. Copies of checks received amounting to \$24,585 were located. However, \$40,510 was recorded as deposits in PHT's bank account during 1996.

Receipt journals and/or copies of checks received serve as the source record for all funds collected by POP. The absence of the receipt journal and/or copies of checks received to reconcile with bank deposit amounts reduces the reliance that can be placed on bank deposits.

Because of these conditions, and since there no longer are any staff available to provide additional information, we cannot rely on the accuracy of PHT revenues as reported in the accompanying financial statements. The Council and POP's administration must be aware of the consequences of inadequate control over accounting records.

PHT Checking Account

1. Authorization of Checking Account

HRCP maintained a checking account at TCF Bank for PHT. POP was the fiscal agent for HRCP. There was no evidence in the minutes for either POP or HRCP that the checking account at TCF was an approved depository of either organization.

We recommend that the use of specific bank accounts receive formal authorization by POP's Council annually and that the authorization be documented in the Council's minutes.

2. Authorized Signatories of PHT Checking Account

Authorized signatories of the PHT checking account were the Executive Director of HRCP and the Director of PHT. There was no evidence in the minutes for either POP or HRCP that HRCP's Executive Director and PHT's Director had been formally authorized as signatories of the checking account.

We recommend that signatories to bank accounts be authorized by POP's Council and that such authorization be documented in the minutes.

3. Recording of PHT Checking Account Activity to a General Ledger

We were unable to locate a general ledger that recorded the activities of the PHT checking account. The types of transactions recorded and processed through PHT's checking account were either similar or identical to transactions processed by POP, on behalf of PHT, and recorded in POP's general ledger. Because some transactions were only found in the checking account and other transactions were only recorded by POP, there was not a central accounting for PHT financial activities. This condition precluded an accurate accounting of PHT financial

activities throughout the year and could have caused program activities to be misstated.

Since any current activities under PHT are now administered entirely by POP, the condition noted above can be avoided by eliminating the checking account and processing all activities through POP's general ledger and checking account. We recommend that this practice be followed.

Timely Bank Reconcilements

We found no evidence that the PHT checking account at TCF Bank had been reconciled during the year. Our review of this account also found that:

- A deposit of \$100 from November 26, 1996, and a deposit of \$3,440 from December 5, 1996, were not entered into the checkbook ledger.
- The checkbook ledger balance was not maintained in a consistent manner. For example, a balance was not calculated for a total of 26 checks written between October 15 and November 21, 1996.

We recommend that checking accounts be reconciled monthly to the bank statements and that differences be resolved before the next statement is received.

Undocumented Withdrawal from Checking Account

We found that \$1,807 was recorded on the bank statement as being withdrawn from the checking account without the issuance of a check. Copies of cashiers checks were the only supporting documentation found for the transaction. No vendor invoices were found to support the amounts of the cashiers checks. One cashiers check was to an electrical contractor for \$1,407 and the other was to a lumber supply company for \$400.

We recommend that all disbursements from checking accounts be made by check and not cashiers check. If the vendor will accept only a cashiers check, then staff should reference on the bank statement the name of the vendor, the cashiers check number, and where the invoice can be found.

Approvals for Payments

In ten of 15 items tested, we did not find any evidence that vendor invoices or employee reimbursements were approved for payment prior to preparation of the check.

We recommend that all bills be approved prior to payment and evidenced as such with the initials of the reviewer.

Canceled Checks

In four of 15 items tested, the canceled check could not be located. Without the canceled check, we were unable to determine if the vendor paid from the check was the same as the vendor indicated in the checkbook ledger.

We recommend that all canceled checks be retained in check number sequence. If, by the nature of the account, the bank is not required to return the canceled checks, then carbon copies of the check should be retained.

Inadequate Documentation for or Improper Vendor Payments

During our testing of 15 checks disbursed from the PHT checking account, the following items were found:

- For ten items totaling \$6,845, no vendor invoices were found to support the disbursements.
- For check number 2590, the amount of the check was \$178.81 and the invoice amount was \$94.58. No evidence could be found to support the higher check amount.
- For check number 2537, the amount of the check was \$371.79. The supporting documentation (Menards cash register receipt) shows that the total amount owed was \$91.80 and change of \$279.99 was received. No evidence could be found to indicate that the change was used to purchase additional goods or services. In addition, no evidence was obtained to indicate that the change received was deposited back in to the PHT checking account.
- Check number 2554 was for \$355. The check was written to the Anoka County Courthouse for payment of a traffic violation on behalf of an employee.

- Check number 2550 was for \$70. The check was written to an employee for an advance of payroll. No evidence was obtained to indicate that the advance amount was repaid to PHT.

The conditions noted above cause any existing control procedures to be unreliable and can lead to misuse or abuse of the organization's funds. These conditions can also lead to questions by granting authorities as to whether their funds are being spent correctly.

We recommend that all disbursements be properly documented and that the documentation be consistent with POP's objectives in carrying out its programs with public support.

Lead Safety Net Program (LSNP)

Receipts Journal Not Located

We were informed by POP's staff that a receipts journal had been maintained for LSNP in 1996. However, staff could not locate the journal. We located copies of checks received totaling \$3,345. However, \$14,712 was recorded as deposits in LSNP's bank account during 1996.

Receipt journals and/or copies of checks received serve as the source record for all funds collected by POP. The absence of the receipt journal and/or copies of checks received to reconcile with bank deposit amounts reduces the reliance that can be placed on bank deposits.

Because of these conditions, and since there no longer are any staff available to provide additional information, we cannot rely on the accuracy of LSNP revenues as reported in accompanying financial statements. The Council and POP's administration must be aware of the consequences of inadequate control over accounting records.

LSNP Checking Account

1. Authorization of Checking Account

HRCP maintained a checking account at TCF Bank for LSNP. POP was the fiscal agent for HRCP. There was no evidence in POP's or HRCP's minutes that the checking account at TCF Bank was an approved depository of either organization.

We recommend that the designation of bank accounts receive formal authorization by POP's Council annually and that the authorization be documented in the Council's minutes.

2. Authorized Signatories of LSNP Checking Account

Authorized signatories of the LSNP checking account were the Executive Director of POP and the Director of LSNP. The minutes of POP or HRCF contain no indication that these individuals had been formally authorized as signatories of the checking account.

We recommend that signatories to bank accounts be authorized by POP's Council and that such action be documented in the minutes.

3. Recording of LSNP Checking Account Activity

We were unable to locate a general ledger that recorded the activities of the LSNP checking account. The types of transactions recorded and processed through LSNP's checking account were either similar or identical to transactions processed by POP, on behalf of LSNP, and recorded in POP's general ledger. Because some transactions were only found in the checking account and other transactions were only recorded by POP, there was not a central accounting for LSNP financial activities. This condition precluded an accurate accounting of LSNP financial activities throughout the year, and may have caused program activities to be misstated.

Since any current activities under LSNP are now administered entirely by POP, the condition noted above can be avoided by eliminating the checking account and processing all activities through POP's general ledger and checking account. We recommend that this practice be followed.

Timely Bank Reconcilements

We found no evidence that the LSNP checking account maintained at TCF Bank had been reconciled to the bank statements during the year. In addition, it appears that the status of the checkbook balance was not monitored regularly by POP staff. This condition is evidenced by the fact that:

- A deposit of \$350 from November 22, 1996, was never entered into the checkbook ledger.

- For the last seven months of 1996, the balance of the checkbook ledger was calculated only eight times to verify the adequacy of the account balance prior to disbursing funds.

We recommend that checking accounts be reconciled monthly to the bank statements and that differences be resolved before the next statement is received. We also recommend that checkbook balances be monitored by POP staff at least weekly to ensure that funds are available to satisfy obligations.

Inadequate Documentation for Vendor Payments

Our testing of 15 checks disbursed from the LSNP checking account revealed the following:

- For nine items, the disbursement was supported only by a check request.
- For two items, no vendor invoice or check request was found.

The conditions noted above cause any existing control procedures to be unreliable and can lead to misuse or abuse of the organization's funds. These conditions can also lead to questions by granting authorities as to whether their funds are being spent correctly.

Approvals and Cancellations for Payments Made

In all of 15 items tested, we did not find any evidence that vendor invoices or employee reimbursements were approved for payment prior to preparation of the check. In 14 of the 15 items tested, we noted no cancellation of the invoices or check requests.

We recommend that all bills be approved prior to payment and be evidenced as such with the initials of the reviewer. Invoices and check requests should be marked with the check number and date of payment.

Accounting for Leases

The LSNP program provided a lead-free living environment for individuals or families that became displaced while lead abatement activities occurred in their homes. HRCP leased the homes that were lead free from the Minneapolis Community Development Agency (MCDA) and Lutheran Social Services. HRCP then formed subleases between itself and those being displaced. When we asked for the subleases with the displaced individuals and families, they could not be located by anyone at POP. It appears that POP's current administration has no information regarding its obligations

under the leases or the obligations of the tenants.

We recommend that POP's administration obtain copies of the current leases with tenants as soon as possible.

V. FEDERAL INTERNAL CONTROLS

Minneapolis Employment Training Program (METP) Questioned Costs - CFDA #17.250

We found that payments totaling \$18,903 (\$7,891 in cash and \$11,012 in checks) were made to the Anishinabe Council in 1996, for which there was no invoice or other form of documentation to support the amounts paid. Two of the payments had check request forms attached to the canceled check; however, we do not consider these forms adequate support for the payments.

Because there was no documentation on hand to support the payments, we are questioning costs of \$18,903.

Community Development Block Grant (CDBG) Program - Timeliness in Requesting Reimbursements - CFDA #14.218

We found that reimbursement requests for August and September 1996 were prepared in November 1996. These reimbursement requests totaled \$9,119. Though \$5,000 had been advanced on this grant, the lack of timely requests for reimbursement of expenses caused this program to be funded from other sources for the remaining balance until CDBG funds were received. If reimbursement requests were prepared more timely, this condition could be avoided.

We recommend that the preparation of requests for reimbursement of grant funds be performed as soon as possible after month-end, preferably within ten days into the next month.

Empowerment Zone Program (City Contract C96-10551) Claims for Reimbursements - CFDA #93.585

We were informed by POP staff that detailed documentation existed to support the amounts requested from the City of Minneapolis under this grant. However, the detail could not be located by POP's staff.

Because documentation for the grant expenses could not be located, we were precluded from performing any tests of the costs for compliance with terms of the grant agreement. As a result of this condition, we are questioning the costs of the entire grant amount expended. The grant amount expended was \$146,019.

VI. MANAGEMENT PRACTICES

Questionable Transactions

Lease of POP Offices

NRP funds cannot be used to purchase buildings. Funding is allowed only for the payment of rent expense.

We found that in 1992, POP entered into a partnership agreement with the American Indian Business Development Corporation and Phillips Community Development Corporation, known as the Phillips Community Office Center, Inc. (PCOCI). The purpose of the PCOCI, according to its articles of incorporation, was to acquire and hold title to real property, collect income that might accrue from the property, and remit such income to members of the corporation.

In 1993, PCOCI acquired property at 1014 East Franklin by a contract for deed. The property was refinanced with a mortgage from National City Bank. Once acquired, the property was leased to POP and the Phillips Community Development Corporation on May 1, 1993. POP's monthly lease payments were \$2,400, or \$28,800 annually, and monthly payments for the Phillips Community Development Corporation were \$800, or \$9,600 annually. In addition to the lease agreement mentioned above, a second lease agreement was formed on the same date between POP and PCOCI calling for an additional \$3,200 monthly. Combined with the first lease, POP's total annual rent expenses were \$67,200 in 1996. The second lease payments did not commence until 1995 and were structured in a manner that coincided with the mortgage payments of \$9,600 per quarter made by PCOCI. From our review of POP's records, it appears all rent expense was funded through NRP contracts.

Our concern is that POP entered into a partnership to acquire property. POP is providing NRP funds to the partnership to retire the debt on that property and, as a result, POP will become partial owner of this property. This arrangement is in violation of the requirement that NRP funds be used for payment of rent expense, not the purchase of property. We believe the nature of these actions were not in the spirit intended by NRP requirements.

Leases for Equipment

- In 1996, POP entered into a five-year lease with AT&T for a telephone system. Annual payments on the lease were approximately \$5,500, resulting in total payments over the life of the lease in excess of \$27,500. The cost of this system is exorbitant given the nature and size of POP's organization. Due to financial difficulties, we have been informed that POP is currently not paying on this lease. However, the equipment is still located at POP's offices.

- In 1996, POP entered into three-year lease agreements for six computers and two printers. Total payments over the life of the leases were to be \$19,900. The leases were structured as operating leases so that at the end of the lease periods, the equipment would be returned to the lessor. Total costs are quite high for the equipment being leased. As with the lease noted above, we were informed that POP is currently not paying on these leases due to financial difficulties. However, the equipment is still located at POP's offices.

- In 1996, POP entered into a three-year lease for a clothes washer and dryer to be used for its lead-safe homes. Total payments over the life of the lease were to be \$1,460. This lease was also structured as an operating lease so that at the end of the lease period, the equipment would be returned to the lessor. Since POP would not own this equipment at the end of the lease period, we question whether the amount expended was beneficial to POP.

- In 1996, POP entered into a three-year lease for a FAX machine. Total payments over the life of the lease were to be \$2,160. This lease was also structured as an operating lease so that at the end of the lease period, the equipment would be returned to the lessor. Since POP would not own this equipment at the end of the lease period, we question whether the amount expended was beneficial to POP.

The above leases were funded with City and NRP contracts. In our opinion, POP's management did not exercise sound business judgment in entering into the leases for equipment. Some of the equipment could have been acquired, based on competitive quotes from vendors, at lower amounts. The purchase of equipment is an allowable expense of NRP contracts.

We recommend that POP's management team give more careful consideration to long-term transactions that will obligate the neighborhood organization into the future. Because funding for such activities will be provided by outside sources, POP's management should not lessen its efforts to make prudent decisions on the use of those funds.

Minutes of Meetings

Maintenance of Records

We found that POP's minutes for 1996 were maintained by month through the use of binder clips. The binder clips were kept in a file folder. POP's bylaws require minutes of all meetings to be kept in a formal minute book and be available upon request.

We recommend that records of POP's minutes be kept according to the bylaws.

Signing of Meeting Minutes

Our review of POP Council meeting minutes found that the minutes were not signed by the Chair or other designated member of POP or its Council. It appears that the minutes are reviewed, modified if necessary, and approved by the Council at its next meeting.

We recommend that, once approved by the full Council, the minutes be signed by the preparer and the Council's Chair to indicate that they are the official record of all that occurred at Council meetings.

Absence of Certain Council Actions

During our review of the Council's activities, we found that:

- The Council was not taking action to approve grants, approve contractors for work, and hire staff; the Council was notified after such actions were performed by POP's administration.
- The Council did not approve certain indebtedness transactions, such as promissory notes and lines of credit.
- For projects requiring competitive bidding, there was no indication in the minutes that bids were received and their individual amounts disclosed to the Council. It appears the Council was informed only of the bids received after the contracts were executed by POP's administration. As a result, it appears either the Council was not approving contracts or the process followed by the Council was not fully documented through the minutes.

We recommend that grants, contracts and their related bids, and debt transactions be presented to the Council for its approval prior to execution of the transaction. The minutes should document all such approvals and the amounts involved with individual transactions and bids.

Designation of Bank Accounts at Different Institutions

For 1996, POP maintained bank accounts at the following financial institutions:

- Checking account at Riverside Bank
- General savings account at Marquette Bank
- City Store savings account at Marquette Bank
- PHT checking account at TCF Bank
- LSNP checking account at TCF Bank

To transfer funds from savings accounts to checking accounts, cash was withdrawn from savings and taken to the other financial institution for deposit.

Since POP experienced several cash flow problems during 1996, it is unclear why funds were deposited in savings accounts during the year, or why these accounts were not located at the same bank as the checking account (Riverside Bank). Having accounts maintained at the same financial institution would allow for greater ease in transfers between accounts. If the continued maintenance of accounts with different financial institutions is considered necessary, arrangements should be made to use wire transfers for any transfers of funds.

We recommend that, whenever possible, POP maintain its bank accounts at the same financial institution.

1996 Bank Charges

In 1996, POP incurred bank charges of \$3,074 on its checking account at Riverside Bank. The bank charges consisted of overdraft charges and service charges. During 1996, POP's checking account had negative balances for 65 days. It appears the negative balances were caused, at least in part, because POP was not requesting reimbursement for grant expenses from its granting authorities in a timely manner. As a result, the checking account balance was not sufficient at times to cover expenses until the funding was received. It appears that POP's management did not adequately monitor its cash position, though we were not able to fully confirm this point.

We recommend that reimbursement requests for grant expenses be submitted to the granting agencies on a timely basis in order to maintain a positive cash flow. Also, we recommend that POP's management monitor its cash position as funds are received and expended.

Expense Reimbursements to Employees

We found that 280 of 1,194 checks written from the vendor check sequence for the year, or 23 percent, were for reimbursement to employees for expenses incurred. As discussed above, POP does not have formal accounting policies and procedures. It appears that employees would use personal funds to incur expenses, at their own discretion, knowing that they would be reimbursed by POP. We could not find any evidence to indicate prior approvals were received for such purchases.

We previously recommended that POP develop written policies and procedures for its financial activities. We also recommend that these policies include the process to be followed for the purchasing of goods and services by employees.

Use of Charge Accounts

We found that charge accounts had been established with a hardware store and lumber company. These accounts were apparently used in conjunction with HRCP's activities.

Presently, funding for HRCP-related activities has been terminated and there are no expenses being incurred. However, as a general procedure, we would discourage the practice of charge accounts. If it is deemed that a charge account is appropriate, we recommend that such accounts be first approved by POP's Council.

Adherence to Personnel Policies and Procedures Manual

Absence of Job Descriptions for Employees

According to POP's personnel policies and procedures, job descriptions are to exist for all positions of the organization. For 18 of 36 employees tested, no job descriptions were located.

We recommend that POP administration ensure that job descriptions exist for all employees in accordance with its policies and procedures.

Absence of Insurance Information in Employee Files

For eight of 36 employees tested, no documentation existed in the employees' files to indicate if they were to receive insurance benefits. These eight employees were included on the insurance vendor's invoices. Since insurance was taken out for these employees, forms should be maintained in employee files to substantiate the premiums being paid.

We recommend that insurance benefit information be filed in each employee's file.

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

SUMMARY OF QUESTIONED COSTS

<u>Contract</u>	<u>Reason for Questioned Cost</u>	<u>Questioned Cost</u>
NRP Contracts		
C95-3903		
Franklin Theatre	Undocumented expense	\$ 900
	Double billings	90
	Expense incurred after contract end date	<u>4,657</u>
Subtotal C95-3903		\$ 5,647
C95-4018		
Early Access	Rent reimbursements not allowed by contract	2,400
C95-4062		
Lead Collaborative	Undocumented expenses	\$ 413
	Amount claimed twice	4,000
	Double billings	2,242
	Salary charges in excess of support	648
	Rent reimbursements not allowed by contract	<u>1,680</u>
Subtotal C95-4062		8,983
C95-4312		
Revolving Loan Administration	Time sheets do not support salary expense charged	\$ 6,025
	Double billings	1,222
	Not eligible for NRP reimbursement	263
	Undocumented expenses	<u>2,211</u>
Subtotal C95-4312		9,721
C95-4335		
Implementation	Rent reimbursements not allowed by contract	\$ 1,632
	Double billings	18,711
	Not eligible for NRP reimbursement	4,388
	Undocumented expenses	4,795
	Excessive charge	455
	Time sheets do not support salary expense charged	<u>45,338</u>
Subtotal C95-4335		75,319
C96-10661		
Arts and Culture	Undocumented expenses	\$ 895
	Double billings	80
	Rent reimbursements not allowed by contract	<u>117</u>
Subtotal C96-10661		1,092
C96-10717		
Jobs Training Program	Insufficient documentation for reimbursement requests	<u>27,231</u>
Total NRP Contracts		<u>\$ 130,393</u>

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

**SUMMARY OF QUESTIONED COSTS
(Continued)**

<u>Contract</u>	<u>Reason for Questioned Cost</u>	<u>Questioned Cost</u>
Federal Program Contracts		
CFDA #14.218 CDBG - Citizens Participation	Payroll advance	\$ 100
CFDA #17.250 Jobs Training Program	Undocumented expenses	18,903
CFDA #93.585 Empowerment Zones Program	Insufficient documentation for reimbursement requests	<u>146,019</u>
Total Federal Program Contracts		<u>\$ 165,022</u>
Total Questioned Costs		<u>\$ 295,415</u>

Client's Response



January 17, 1998

Judith H. Dutcher, State Auditor
and Greg Hierlinger, Deputy State Auditor
State of Minnesota
Office of the State Auditor
Suite 400
525 Park Street
St. Paul, Minnesota 55103-2139

Dear Ms. Dutcher and Mr. Hierlinger:

As the current chair of People of Phillips' board, I would like to extend my sincere appreciation to you for your thorough and detailed review of POP's financial status. The very serious problems identified in your "Independent Auditor's Report," many of which have already come to our attention as we attempted to cope with the circumstances inherited from the previous administration, require immediate and decisive corrective action. Some of these corrective measures we have already taken and others are scheduled for implementation in the very near future.

As you know, when the newly elected POP board discovered the full extent of the organization's financial and managerial deficiencies, we retained the consulting firm of Marsh-West & Associates and Jacquie Meyer, CPA, to provide professional guidance in correcting these deficiencies. Marsh-West immediately initiated a "30-60-90 Day Stabilization Plan" to address the most critical financial shortfalls and return some order to POP operations. (This plan did not include the City Store operations.)

In addition to a suspension of all non-critical agency functions, radical reductions in staff and operating expenses, and establishing the budget and management systems detailed below, Marsh-West assisted POP's leadership in the preparation of an overall restructuring plan finalized in May 1997. This plan provided a critical assessment of POP's board structure, internal policies and procedures, and its relationship with the larger Phillips community. We are quite aware that this extensive restructuring effort is essential to return POP to sound operational status and prevent any repeat of the situation your audit has disclosed.

Page 69

POP has, with extensive community participation, tightened its focus and recommitted to its original mission as the Phillip's citizen participation and leadership organization. This has entailed a systematic reduction of POP's involvement in direct service activities in real estate and housing management, youth services, community safety, and other areas. These reductions will continue into 1998 with the spin-off of PCTV, City Store, and other such projects until we are no longer in the direct service business. POP will, however, continue to function as Phillips' NRP administrative agent.

POP has also planned and approved a major reorganization of its board and board committees to more efficiently and responsibly conduct business. These changes include:

- combining the Executive Council and the Neighborhood Congress into a single "Neighborhood Council" which shall serve as the board of directors for People of Phillips;
- improving the process by which board members and officers are elected to ensure the best possible representation of the community and the effective conduct of business, resulting in specific bylaws recommendations now being drafted and reviewed by the community;
- streamlining POP's standing committees to ensure greater efficiency and accountability;
- strengthening POP's conflict of interest policies and means of enforcement (currently underway);
- extensive review and revision of personnel policies now ready for implementation;
- approving a new staffing structure reflecting POP's tightened focus.

Many more actions on board structure and operations, staffing needs (including hiring a new executive director and revising job descriptions), policies and procedures, communications, and community relations are planned for 1998.

In addition to these measures, the following specific improvements in our financial management systems have been completed, with more underway:

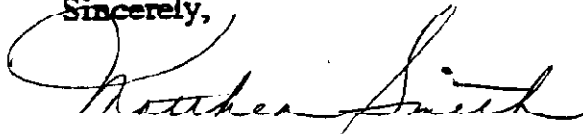
- Finance Committee now meets monthly
- monthly financials ready by every second Thursday
- retention of a payroll service which ensures timely filing of taxes and quarterly reports
- vacation and disability leave records now computerized
- account balances now verified at Riverside Bank before checks are dispersed
- receivables tracked for timely reimbursement
- cash projections now completed monthly

- NRP contracts (except Lead) now billed 10 days after payroll
- computerized on-site accounting system established for cash and billings
- blank checks locked in safe with restricted access
- all checks greater than \$500 signed by two board members, one signer if less
- no checks signed unless supported by invoice
- paid invoices maintained intact (complete) and filed securely in executive director's office
- unpaid invoices maintained in separate file by due dates
- accounting procedures manual now in place
- cost allocation by program approved by board of directors, in progress with NRP
- system for receipt and deposit of funds now in place
- executive director approval now required on all invoices
- cancellation stamps now used on all invoices and checks
- in-kind donated services now documented on sign-up sheets
- accrual basis now used for financials

I hope the actions we have taken during the past year, and those to which we are committed in the coming year, clearly demonstrate our determination that POP will survive this crisis, learn from its mistakes, and emerge better able to perform its mission in the Phillips community. Please be assured of our complete cooperation in the resolution of all remaining issues with respect to POP's past performance and future capacity.

I look forward to your continued advice and guidance as we respond further to the findings of your audit.

Sincerely,



Matthea Smith, Chair
Board of Directors
People of Phillips

Other Required Reports



JUDITH H. DUTCHER
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**REPORT ON COMPLIANCE BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Neighborhood Council
People of Phillips, Inc.

We were employed to audit the financial statements of People of Phillips, Inc., (POP) as of and for the year ended December 31, 1996, and have issued our report thereon dated December 19, 1997. We have disclaimed an opinion on the financial statements.

Compliance with laws, regulations, contracts, and grants applicable to POP is the responsibility of POP's management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of POP's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed instances of noncompliance, as listed in the Schedule of Findings and Recommendations, that are required to be reported herein under *Government Auditing Standards*.

This report is intended for the information of People of Phillips, Inc., Neighborhood Council and its management. However, this report is a matter of public record and its distribution is not limited.

JUDITH H. DUTCHER
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997



JUDITH H. DUTCHER
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**SINGLE AUDIT REPORT ON COMPLIANCE WITH SPECIFIC
REQUIREMENTS APPLICABLE TO MAJOR AND NONMAJOR
FEDERAL FINANCIAL ASSISTANCE PROGRAMS AND TRANSACTIONS**

Neighborhood Council
People of Phillips, Inc.

We were engaged to audit the financial statements of People of Phillips, Inc., (POP) as of and for the year ended December 31, 1996, and have issued our report thereon dated December 19, 1997. We have disclaimed an opinion on the financial statements.

We were also engaged to audit the compliance of POP with the requirements governing the types of services allowed or unallowed, level of effort, federal financial reports, and claims for advances and reimbursements that are applicable to its major federal financial assistance program, which is identified in the accompanying Supplemental Schedule of Federal Financial Assistance for the year ended December 31, 1996. The management of POP is responsible for compliance with those requirements.

We were unable to obtain sufficient documentation supporting compliance of POP with the requirements of the major program, Empowerment Zone Program.

Because of the matter described in the preceding paragraph, the scope of our audit work was not sufficient to enable us to express, and we do not express, an opinion on POP's compliance with the specific requirements referred to in the second paragraph that are applicable to its major federal financial assistance program for the year ended December 31, 1996.

In connection with our consideration of POP's control structure used to administer federal financial assistance programs, as required by Office of Management and Budget (OMB) Circular A-133, we selected transactions applicable to certain nonmajor federal financial assistance programs for the year ended December 31, 1996. As required by OMB Circular A-133, we have performed auditing procedures to test

compliance with the requirements governing types of services allowed and eligibility that are applicable to those transactions. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on compliance with these requirements. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the preceding paragraph. With respect to items not tested, nothing came to our attention that caused us to believe that POP had not complied, in all material respects, with those requirements. However, the results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Findings and Recommendations.

This report is intended for the information of People of Phillips, Inc., Neighborhood Council and its management. However, this report is a matter of public record and its distribution is not limited.

JUDITH H. DUTCHER
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997



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**SINGLE AUDIT REPORT ON COMPLIANCE WITH
THE GENERAL REQUIREMENTS APPLICABLE TO
FEDERAL FINANCIAL ASSISTANCE PROGRAMS**

Neighborhood Council
People of Phillips, Inc.

We were engaged to audit the financial statements of People of Phillips, Inc., (POP) as of and for the year ended December 31, 1996, and have issued our report thereon dated December 19, 1997. We have disclaimed an opinion on the financial statements.

We have applied procedures to test compliance with the following requirements applicable to its federal financial assistance programs, which are identified in the Supplemental Schedule of Federal Financial Assistance, for the year ended December 31, 1996:

- Political activity
- Davis-Bacon Act
- Civil rights
- Cash management
- Federal financial reports
- Allowable costs/cost principles
- Drug-Free Workplace Act
- Administrative requirements

Our procedures were limited to the applicable procedures described in the Office of Management and Budget's *Compliance Supplement for Single Audits of Institutions of Higher Learning and Other Nonprofit Institutions*. Our procedures were substantially less in scope than an audit, the objective of which is the expression of an opinion on compliance with the requirements listed in the preceding paragraph. Accordingly, we do not express such an opinion.

With respect to the items tested, the results of those procedures disclosed no material instances of noncompliance with the requirements listed in the second paragraph of this report. With respect to the items not tested, nothing came to our attention that caused us to believe that POP had not complied, in all material respects, with those requirements. However, the results of our procedures disclosed immaterial instances of noncompliance with those requirements, which are described in the accompanying Schedule of Findings and Recommendations.

This report is intended for the information of People of Phillips, Inc., Neighborhood Council and its management. However, this report is a matter of public record and its distribution is not limited.

JUDITH H. DUTCHER
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997



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**REPORT ON THE INTERNAL CONTROL STRUCTURE BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Neighborhood Council
People of Phillips, Inc.

We were engaged to audit the financial statements of People of Phillips, Inc., (POP) as of and for the year ended December 31, 1996, and have issued our report thereon dated December 19, 1997. We have disclaimed an opinion on the financial statements.

The management of POP is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure 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 financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any internal control structure, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the structure 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 our engaged to audit of the financial statements for the year ended December 31, 1996, we obtained an understanding of the internal control structure of POP. With respect to the internal control structure, we obtained an understanding of the design of relevant policies and procedures and whether they have been placed in operation, and we assessed control risk 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 structure. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The reportable conditions pertaining to general internal controls can be found in the Schedule of Findings and Recommendations.

A material weakness is a reportable condition in which the design or operation of one or more of the specific internal control structure elements does not reduce to a relatively low level the risk that errors and irregularities 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 structure would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters that we consider to be material weaknesses as defined above:

- The adequacy of the segregation of accounting duties necessary to ensure that internal controls exist could not be determined.
- Vendor payments were not adequately supported.
- The recognition of funds to be restricted was not controlled.
- The absence of control over accounting for the accrual of vacation and compensatory time.
- The absence of controls for the billing and collection process for the Phillips Housing Trust, a division of the Housing Resource Clearing House of Phillips.

This report is intended for the information of People of Phillips, Inc., Neighborhood Council and its management. However, this report is a matter of public record and its distribution is not limited.

JUDITH H. DUTCHER
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997



JUDITH H. DUTCHER
STATE AUDITOR

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**SINGLE AUDIT REPORT ON THE INTERNAL CONTROL STRUCTURE
USED IN ADMINISTERING FEDERAL FINANCIAL ASSISTANCE PROGRAMS**

Neighborhood Council
People of Phillips, Inc.

We were engaged to audit the financial statements of People of Phillips, Inc., (POP) as of and for the year ended December 31, 1996, and have issued our report thereon dated December 19, 1997. We have disclaimed an opinion on the financial statements. We were also engaged to audit the compliance of POP with requirements applicable to major federal financial assistance programs and have issued our report thereon dated December 19, 1997. We disclaimed an opinion on POP's compliance with requirements applicable to its major federal financial assistance program.

In planning the engagement to audit for the year ended December 31, 1996, we considered the internal control structure of POP in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and on the compliance of POP with requirements applicable to major programs, and to report on the internal control structure in accordance with OMB Circular A-133. This report addresses our consideration of internal control structure policies and procedures relevant to compliance with requirements applicable to federal financial assistance programs. We have addressed internal control structure policies and procedures relevant to the financial statements in a separate report dated December 19, 1997.

The management of POP is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control structure policies and procedures. The objectives of an internal control structure 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,
- transactions are recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles, and
- federal financial assistance programs are managed in compliance with applicable laws and regulations.

Because of inherent limitations in any internal control structure, errors, irregularities, or instances of noncompliance may nevertheless occur and not be detected. Also, projection of any evaluation of the structure 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.

For the purpose of this report, we have classified the significant internal control structure policies and procedures in the following categories:

Accounting Controls

Receipts/revenues
 Disbursements/expenses
 Payroll
 Cash management

General Requirements

Political activity
 Davis-Bacon Act
 Civil rights
 Cash management
 Federal financial reports
 Allowable costs/cost principles
 Drug-Free Workplace Act
 Administrative requirements

Specific Requirements

Types of services allowed or unallowed
 Level of effort
 Other requirements

- Federal financial reports
- Claims for advances and reimbursements

For all of the internal control structure categories listed above, we obtained an understanding of the design of relevant policies and procedures and determined whether they have been placed in operation, and we assessed control risk.

During the year ended December 31, 1996, POP expended 77 percent of its total federal financial assistance under a major federal financial assistance program.

We performed tests of controls, as required by OMB Circular A-133, to evaluate the effectiveness of the design and operation of internal control structure policies and procedures that we considered relevant to preventing or detecting material noncompliance with specific requirements, general requirements, and requirements governing claims for advances and reimbursements that are applicable to the major federal financial assistance program of POP, which is identified in the accompanying Supplemental Schedule of Federal Financial Assistance. Our procedures were less in scope than would be necessary to render an opinion on these internal control structure policies and procedures. Accordingly, we do not express such an opinion.

We noted certain matters involving the internal control structure and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect POP's ability to administer federal award programs in accordance with applicable laws and regulations.

Reportable conditions described in the Schedule of Findings and Recommendations pertain to questioned costs, timeliness of reimbursement requests, and support for claims for reimbursement.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level of risk that noncompliance with laws and regulations that would be material to a federal award program 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 structure policies and procedures used in administering federal awards would not necessarily disclose all matters in the internal control structure that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, we noted the following matters involving the internal control structure and its operations that we consider to be material weaknesses as defined above:

- the questioned costs
- timeliness of reimbursement requests
- support for claims and reimbursement

This report is intended for the information of People of Phillips, Inc., Neighborhood Council and its management. However, this report is a matter of public record and its distribution is not limited.

JUDITH H. DUTCHER
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997



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**REPORT ON SUPPLEMENTAL SCHEDULE
OF FEDERAL FINANCIAL ASSISTANCE**

Neighborhood Council
People of Phillips, Inc.

We were engaged to audit the financial statements of People of Phillips, Inc., (POP) as of and for the year ended December 31, 1996, and have issued our report thereon dated December 31, 1996. These financial statements are the responsibility of POP's management. We have disclaimed an opinion on the financial statements.

We were also unable to audit the Empowerment Zone Program because the underlying documentation was either insufficient or unavailable.

We were engaged to audit the financial statements for the purpose of forming an opinion on the financial statements of POP taken as a whole. The accompanying Supplemental Schedule of Federal Financial Assistance is presented for purposes of additional analysis and is not a required part of the financial statements. Because we have disclaimed an opinion on the financial statement and for the reason described in the preceding paragraph, we were unable to perform adequate accounting procedures on the schedule and we are unable to render an opinion on whether it is fairly stated in relation to the financial statements taken as a whole.

JUDITH H. DUTCHER
STATE AUDITOR

GREG HIERLINGER, CPA
DEPUTY STATE AUDITOR

December 19, 1997

**PEOPLE OF PHILLIPS, INC.
MINNEAPOLIS, MINNESOTA**

Schedule 3

**SUPPLEMENTAL SCHEDULE OF FEDERAL FINANCIAL ASSISTANCE
FOR THE YEAR ENDED DECEMBER 31, 1996**

Federal Grantor Pass Through Agency Grant Program Title	Federal CFDA Number		Expenditures
U.S. Department of Housing and Urban Development			
Direct			
John Heinz Neighborhood Development Program (Credit Union)	14.242	a	\$ 75,000
Passed Through the City of Minneapolis			
Community Development Block Grant (CDBG)	14.218		<u>19,372</u>
Total Department of Housing and Urban Development			<u>\$ 94,372</u>
U.S. Department of Labor			
Passed Through Minnesota Department of Economic Security and City of Minneapolis			
JTPA - Training - Disadvantaged Youth and Adults	17.250		<u>\$ 19,568</u>
U.S. Department of Health and Human Services			
Passed Through Minnesota Department of Economic Security and City of Minneapolis			
Empowerment Zone Program (Youth Enterprise Center)	93.585	b	\$ 232,182
Empowerment Zone Program (Property Management)	93.585	b	<u>146,019</u>
Total Department of Health and Human Services			<u>\$ 378,201</u>
Total Federal Financial Assistance			<u>\$ 492,141</u>

a - Statement of Financial Accounting Standards No. 116 requires the nonprofit entity to recognize unconditional promises to give as restricted revenue in the year the promise was received regardless of when funds are actually received or expended. The above grant was recognized in the previous audit but not reported as part of the Schedule of Federal Financial Assistance. There will not be a corresponding revenue on the Statement of Activity for this grant.

b - Major federal program as defined by the Single Audit Act.