



REBECCA OTTO
STATE AUDITOR

STATE OF MINNESOTA OFFICE OF THE STATE AUDITOR

SUITE 500
525 PARK STREET
SAINT PAUL, MN 55103-2139

(651) 296-2551 (Voice)
(651) 296-4755 (Fax)
stateauditor@osa.state.mn.us (E-mail)
1-800-627-3529 (Relay Service)

December 13, 2007

The Honorable Jim Hermanson
Mayor, City of Henning
P.O. Box 132
Henning, Minnesota 56551

The Honorable John Koch
Council Member, City of Henning
503 Third Street
Henning, Minnesota 56551

The Honorable Carl Linderkamp
Council Member, City of Henning
23211 Airport Road
Henning, Minnesota 56551

The Honorable David Brutlag
Council Member, City of Henning
98 Jensen Street
Henning, Minnesota 56551

The Honorable Steven Ellenson
Council Member, City of Henning
50743 State Highway 210
Henning, Minnesota 56551

Dear Mayor and City Council Members:

The Office of the State Auditor reviewed certain utility accounts for the City of Henning for the time period of December 2005 through June 2007. Our review disclosed an unexplained variance of \$16,307.02. We provided a full summary of our analysis to the Otter Tail County Attorney and to the Otter Tail County Sheriff's Office.

During our review, we identified a number of weaknesses in the City's internal controls and management practices. The purpose of this letter is to provide the City with recommendations to better protect City funds in the future. However, our recommendations are based upon the systems in place during our review. It is our understanding that, since the period included in our review, the City has purchased new utility billing software. We encourage the City to work with the new billing system and its outside auditor to determine whether some of the issues identified during our review have already been resolved. We remain available to assist the City in its efforts.

Background

During the period of our review, the City had approximately 700 utility accounts. The accounts included electric, natural gas, water and sewer billings. The City's former utility billing clerk prepared billings on a monthly basis. Some of the accounts were paid

with automatic bank deposits, some were paid through an Energy Assistance program, and others were paid by cash or check. Upon receiving payment, the City's former utility billing clerk was to record the payments into a manual utilities receipt ledger. In addition, the City's former utility billing clerk was to post the payment to the customer's account in the computer.

When utility payments were prepared for deposit in the City's accounts, the City's Clerk-Treasurer would obtain and compare the relevant manual utilities receipt ledger, a computer-generated "Utility Payments Edit Report" prepared by the City's former utility billing clerk, and the deposit slip. After confirming that these documents agreed with each other, the deposits were made and recorded into the City's general ledger system.

Recommendations

We recognize that the limited number of City personnel prevents the segregation of accounting functions necessary to ensure adequate internal accounting control. While this situation is not unusual in cities the size of Henning, the City Council and the City's Clerk-Treasurer should constantly be aware of this condition and realize that the concentration of duties and responsibilities in a limited number of individuals is not desirable from an internal control point of view.

Generally, responsibilities among employees should be separated so a single employee is not able to authorize a transaction, record the transaction in the City's accounts, and be responsible for the receipts resulting from the transaction. As a result, someone other than the person collecting and receipting cash should review the monthly general ledger and make deposits of receipts. Generally, the person collecting and receipting cash should not:

- Post receipts to or maintain the general ledger system;
- Make bank deposits or wire transfers;
- Make general journal entries; or
- Prepare billings.

In situations where it is not possible to segregate duties to a desirable level, implementation of proper management oversight procedures becomes an integral part of internal control. We believe that, even with the limited size of the City's staff, there are steps the City should consider to improve internal control and better protect City funds.

1. ***More than one person should be familiar with the City's computerized utility billing system.***

During the period of our review, the City's former utility billing clerk was the only City employee knowledgeable about the City's computerized billing system.

We recommend that someone in addition to the City's utility billing clerk becomes familiar with the City's utility billing software. Both the new utility billing clerk and the Clerk-Treasurer should obtain training on the City's new utility billing system. Cross-training on the system will allow a second person to operate the system when the utility billing clerk is on leave or otherwise unavailable. Having a second person operate the system from time-to-time is also a method to detect any irregularities created by the person primarily responsible for the City's utility billing operations. Finally, cross-training will provide continuity during periods of employee transition.

2. *A formal written policy should identify procedures for account adjustments and write-offs.*

We found that adjustments (e.g., to correct an error) and write-offs (e.g., uncollectible accounts) to utility accounts were recorded in the utility billing system as receipts.

We recommend that the City develop and follow a written policy for making adjustments or write-offs to utility accounts. Adjustments and write-offs should not be recorded as receipts. Instead, adjustments and write-offs should be made using the proper function in the City's utility billing software package so the transactions are properly identified. The written policy should also identify when the City's utility billing clerk must obtain authorization (e.g., from the Clerk-Treasurer) for an adjustment. A list of potential write-offs should be prepared by the utility billing clerk and presented to an appropriate level of management (e.g., the Clerk-Treasurer) or the City Council for approval. Prior to approving a write-off for an account, management (e.g., the Clerk-Treasurer) should review the account's balances to determine if the proposed write-off is reasonable and consistent with the account balances. Follow-up should be done for any suspicious or unusual items. The approved write-off list should be maintained by someone other than the utility billing clerk.

3. *Special care should be taken for accounts paid in cash.*

We found the unexplained variance in accounts that we understand were paid in cash.

Cash transactions are the most susceptible to fraud. If the City's utility software system permits, the method of payment (e.g., cash, check, etc.) should be noted. Pre-numbered receipts should be provided to all customers paying for their accounts in person by cash or check. The Clerk-Treasurer should periodically review the pre-numbered receipts to confirm that they agree with the entries in the City's computerized utility billing system.

Some utility billing systems provide a computerized cash receipt ledger. If the City continues to use the manual utilities receipt ledger, the manual ledger should be expanded to reflect the number of the receipt provided to the customer, the payment method (e.g., cash), the account number and name, and the person from whom payment was received,

if other than the person named on the account. The manual utilities receipt ledger should be reviewed periodically by the Clerk-Treasurer.

4. *The utility billing software's reporting features should be used.*

If the new utility billing system permits, we recommend the City:

- Create monthly billing reports and compare them with actual receipts;
- Reconcile monthly receipts to bank deposits and insure that all items receipted in the utility billing system were timely deposited; and
- Create aged receivable reports to be reviewed by management (e.g., the Clerk-Treasurer) to determine any excessively old or unexpected outstanding balances.

5. *The City should determine that appropriate employees are bonded.*

Minnesota law requires city clerks and treasurers to be bonded, and allows a City Council to require bonds of any other officers or employees.¹ In order to minimize the risk of loss, the city should determine which City officers and employees should be bonded, set the appropriate amount of the bonds, and make sure that all required bonds are in place.

Conclusion

The City is responsible for establishing and maintaining internal controls. We understand that the City has already taken steps to address some of the issues raised in this letter. We remain available to consult with the City and its auditor to improve any remaining weaknesses.

If you have any questions about the recommendations contained in this letter, please do not hesitate to contact me at 651-297-5853.

Sincerely,

/s/

Nancy J. Bode
Assistant Legal Counsel
Office of the State Auditor

cc. Ms. Wilma Morse, Clerk-Treasurer
Mr. Daniel Rollie, City Auditor
Detective Marlys Adams, Otter Tail County Sheriff's Office
Assistant Otter Tail County Attorney Kurt Mortenson

¹ See Minn. Stat. § 412.111.