

CITY OF PAYNESVILLE, MINNESOTA
MANAGEMENT AND COMPLIANCE LETTERS
YEAR ENDED DECEMBER 31, 2012



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**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT
OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE
WITH GOVERNMENT AUDITING STANDARDS**

Honorable Mayor and
Members of the City Council
City of Paynesville
Paynesville, Minnesota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Paynesville (the City), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated March 28, 2013.

Internal Control Over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and another we consider to be a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies 09-01 to 09-03 described in the accompanying schedule of findings and questioned costs to be material weaknesses.

Honorable Mayor and
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City of Paynesville

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency 12-01 described in the accompanying schedule of findings and questioned costs to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain other matters that we reported to management of the City in a separate letter dated March 28, 2013.

City of Paynesville's Response to Findings

The City's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. The City's responses were not subjected to auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

Alexandria, Minnesota
March 28, 2013



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**INDEPENDENT AUDITORS' REPORT ON COMPLIANCE WITH REQUIREMENTS
THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON
EACH MAJOR FEDERAL PROGRAM, ON INTERNAL CONTROL OVER COMPLIANCE,
AND ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
IN ACCORDANCE WITH OMB CIRCULAR A-133**

Honorable Mayor and
Members of the City Council
City of Paynesville
Paynesville, Minnesota

Report on Compliance for Each Major Federal Program

We have audited the City of Paynesville's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on the City's major federal program for the year ended December 31, 2012. The City of Paynesville's major federal program is identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

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

Auditors' Responsibility

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

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

Honorable Mayor and
Members of the City Council
City of Paynesville

Opinion on Each Major Federal Program

In our opinion, the City of Paynesville complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2012.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as item 12-02. Our opinion on each major federal program is not modified with respect to these matters.

The City of Paynesville's response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The City of Paynesville's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

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

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We identified one deficiency in internal control over compliance that we consider to be a significant deficiency as described in the accompanying schedule of findings and questioned costs as item 12-02.

Honorable Mayor and
Members of the City Council
City of Paynesville

The City of Paynesville's response to the internal control over compliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The City of Paynesville's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Paynesville as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the City of Paynesville's basic financial statements. We issued our report thereon dated March 28, 2013, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

CliftonLarsonAllen LLP

Alexandria, Minnesota
March 28, 2013

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED DECEMBER 31, 2012**

Federal Agency/Pass-Through Grantor/Program Title	Federal CFDA Number	Pass-through Grantor's Number	Federal Expenditures
U.S. DEPARTMENT OF TRANSPORTATION			
Passed Through Minnesota Department of Transportation			
Airport Improvement Program	20.106	SP A7302-16	\$ 135,854
Airport Improvement Program	20.106	SP A7302-17	<u>114,258</u>
Total Department of Transportation			<u>250,112</u>
U.S. ENVIRONMENTAL PROTECTION AGENCY			
Passed Through Minnesota Public Facilities Authority			
Capitalization Grants for Clean Water State Revolving Loan	66.458	MPFA-11-0031-R-FY13	<u>832,358</u>
Total Federal Awards			<u>\$ 1,082,470</u>

Notes to Schedule of Expenditures of Federal Awards:

- Note 1: The Schedule of Expenditures of Federal Awards presents the activity of federal awards expended by the City of Paynesville. The information presented in this schedule is presented in accordance with requirements of the U.S. Office of Management and Budget Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations.
- Note 2: The expenditures on this schedule are on the basis of accounting used by the individual funds of the City, which is described in Note 1 to the basic financial statements of the City. Governmental funds use the modified accrual basis of accounting and the Proprietary funds use the accrual basis of accounting.
- Note 3: No federal grant dollars have been passed-through to subrecipients.

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
YEAR ENDED DECEMBER 31, 2012**

A. SUMMARY OF AUDIT RESULTS

1. The auditors' report expresses an unqualified opinion on the basic financial statements of the City of Paynesville, Minnesota.
2. Deficiencies in internal control were disclosed by the audit of the basic financial statements of the City of Paynesville and they are reported in the "Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards". Findings 09-01 through 09-03 are considered material weaknesses.
3. No instances of noncompliance material to the basic financial statements of the City were disclosed during the audit.
4. An instance involving internal control over compliance was identified during the audit of the major federal award programs for the City of Paynesville that was required to be reported in the "Independent Auditors' Report on Compliance with Requirements That Could have a Direct and Material Effect on Each Federal Major Program, on Internal Control Over Compliance, and on the Schedule of Expenditures of Federal Awards in Accordance with OMB Circular A-133". Finding 12-02 is considered to be a significant deficiency related to the major federal award program.
5. The auditors' report on compliance for the major federal award program for the City of Paynesville expresses an unqualified opinion.
6. Finding 12-02 relative to the major federal award program for the City of Paynesville was disclosed during the audit that is required to be reported in accordance with Section 510(a) of OMB Circular A-133.
7. The program tested as a major program includes:
 - Capitalization Grants for Clean Water State Revolving Loan CFDA No. 66.458
8. The threshold for distinguishing type A and B programs was \$300,000.
9. The City of Paynesville did not qualify, under federal guidelines, as a low-risk auditee.

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012**

B. FINDINGS – FINANCIAL STATEMENTS AUDIT

CURRENT YEAR

09-01 Internal Control over the Financial Reporting Process

Statement of Condition: The City does not have a system of internal controls that would enable management to conclude the financial statements and related disclosures are complete and presented in accordance with GAAP. As such, management requested us to prepare a draft of the financial statements, including the related footnote disclosures.

Criteria: Management is responsible for establishing and maintaining internal controls and for the fair presentation of the financial position, results of operations, cash flows, and disclosures in the financial statements, in conformity with U.S. generally accepted accounting principles (GAAP).

Effect: The City may not be able to prevent or detect material misstatements in the financial reporting process.

Cause of Condition: Limited resources at the City.

Recommendation: We recommend that the City be aware of the requirements for fair presentation of the financial statements in accordance with Governmental Accounting Standards Board Statement No. 34. Should the City elect, based upon an analysis of costs and benefits, to establish a full oversight of the financial statement preparation of an appropriate level, we suggest management establish effective review policies and procedures including but not limited to the following functions: reconciling general ledger amounts to the draft financial statements; review of all supporting documentation and explanations for journal entries proposed by us and approve the disclosure checklist; review and approval of schedules and calculations supporting the amounts included in the notes to the financial statements; apply analytical procedures to the draft financial statements; and perform other procedures considered necessary by management.

Management Response: Due to the small size of the City's staff and the additional costs necessary to ensure proper controls are in place, the City has decided that the costs of implementing the necessary controls for preparing the City's financial statements outweigh the benefits that would be derived. Nevertheless, the City is continually reviewing the situation and establishes controls that the City believes will aid in the fair presentation of the financial statements without significant increases in the costs of implementing those controls.

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012**

B. FINDINGS – FINANCIAL STATEMENTS AUDIT (CONTINUED)

CURRENT YEAR (CONTINUED)

09-02 Limited Segregation of Duties

Statement of Condition: Adequate segregation of duties of the accounting functions necessary to ensure adequate internal accounting control, is not in place. However, the City has reassigned a number of the previously identified responsibilities but due to the number of employees available to assign responsibilities, some weaknesses still exist.

Criteria: City management should constantly be aware of the need to have adequate segregation of duties regarding the processing of transactions for the City. In addition, City management should be aware that the concentration of duties and responsibilities in one or a very few individuals is not desirable from an internal control perspective.

Effect: The design of internal controls over financial reporting could affect the ability of the City to record, process, summarize, and report financial data consistently with the assertions of management in the financial statements. In addition, this lack of segregation of duties may result in the City's inability to prevent/detect misappropriation of assets.

Cause of Condition: Limited resources at the City.

Recommendation: We recommend City management be consistently aware of the lack of segregation of duties within the accounting functions and provide oversight to ensure the internal control policies and procedures are being implemented by City staff.

Management Response: The City will continue to review the accounting functions and segregate them as feasible with the limited number of staff available.

09-03 Material Audit Adjustments

Statement of Condition: As part of the audit, we proposed material audit adjustments to record additional payables, record additional receivables and deferred revenue, record the OPEB liability, and record the cash with escrow for the new bond issue.

Criteria: The City should have controls in place to prevent and detect a material misstatement in the financial statements in a timely manner. Management is responsible for the accuracy and completeness of all financial records and related information. Their responsibilities include adjusting the financial statements to correct material misstatements.

Effect: The design of the internal controls over recording adjusting entries could affect the City's ability to detect or prevent material misstatements.

Cause of Condition: Limited resources at the City.

Recommendation: We recommend City management be consistently aware of all procedures and processes involved in recording transactions and accruals and develop internal control policies to ensure proper recording of these items.

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012**

Management Response: The City will continue to work at eliminating the need for audit adjustments.

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012**

B. FINDINGS – FINANCIAL STATEMENTS AUDIT (CONTINUED)

CURRENT YEAR (CONTINUED)

12-01 Controls over General Disbursements

Statement of Condition: During testing performed we were not provided evidence of management approval on three out of forty disbursements tested.

Criteria: According to standard internal control procedures, all disbursements should have an approval signature prior to payment by City hall staff.

Effect: The City is at an increased risk of paying expenditures that were not authorized by the management.

Cause of Condition: Oversight by Management due to staff turnover.

Recommendation: We recommend City management review their procedures relating to payment of claims and that all disbursements be signed as approved prior to payment.

Management Response: This was an oversight by management due to turnover of staff and vacation by the Administrator. The City will review their procedures to improve their controls.

**CITY OF PAYNESVILLE, MINNESOTA
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED DECEMBER 31, 2012**

C. FINDINGS AND QUESTIONED COSTS – MAJOR FEDERAL AWARD PROGRAMS AUDIT

CURRENT YEAR – CONTROL AND COMPLIANCE FINDING

ENVIRONMENTAL PROTECTION AGENCY, PASSED THROUGH MINNESOTA PUBLIC FINANCE AUTHORITY

12-02 Capitalization Grants for Clean Water State Revolving Loan – CFDA 66.458; Grant Period – Year Ended December 31, 2012

Statement of Condition: The City does not have a process in place to verify if vendors are on the suspended or debarred listing prior to entering into a contract for services nor was the self certification clause in the contract. We were not provided with documentation of checking the list prior to entering into a contract with Bolton & Menk, Inc. for engineering and design services regarding the Wastewater Treatment Facility project.

Criteria: Per federal grant requirements, grantees are required to verify the provider is not suspended from doing business with local governments.

Effect: The City could enter into contracts with vendors that have been suspended or debarred by the federal government.

Cause of Condition: The City was unaware of this federal requirement.

Recommendation: We recommend the City check the sam.gov website listing for all contracts entered into to verify that the vendor is not suspended or debarred or add the self certification clause into the contract wording.

Views of Responsible Officials and Planned Corrective Actions:

Contact Person: Renee Eckerly, City Administrator

Corrective Action Planned: The City will review the listing and contact their engineer to obtain a written contract with the correct verbiage added.

Anticipation Completion Date: December 31, 2013

PRIOR YEAR FINDINGS

None.

INDEPENDENT AUDITORS' REPORT ON MINNESOTA LEGAL COMPLIANCE

Honorable Mayor and
Members of the City Council
City of Paynesville
Paynesville, Minnesota

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of City of Paynesville (the City), as of and for the year ended December 31, 2012, and the related notes to the financial statements, which collectively comprise the City's basic financial statements, and have issued our report thereon dated March 28, 2013.

The *Minnesota Legal Compliance Audit Guide for Political Subdivisions* covers seven categories of compliance to be tested: contracting and bidding, deposits and investments, conflicts of interest, public indebtedness, claims and disbursements, miscellaneous provisions, and tax increment financing.

In connection with our audit, nothing came to our attention that caused us to believe that the City of Paynesville, Minnesota failed to comply with the provisions of the *Minnesota Legal Compliance Audit Guide for Political Subdivisions*. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance. Accordingly, had we performed additional procedures, other matters may have come to our attention regarding the City of Paynesville, Minnesota's noncompliance with the above-referenced provisions.

The purpose of this report is solely to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. Accordingly, this communication is not suitable for any other purpose.

CliftonLarsonAllen LLP

Alexandria, Minnesota
March 28, 2013