

STATE OF MICHIGAN

Rick Snyder, Governor

DEPARTMENT OF TREASURY

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Local Audit and Finance Division
Bureau of Local Government Services

VILLAGE OF ELBERTA
COMMENTS AND RECOMMENDATIONS

MATERIAL WEAKNESSES IN INTERNAL CONTROL

Preparation of Financial Statements in Accordance With GAAP

Finding: IC2013-01

Condition: As many small and medium-sized governmental entities do, the Village of Elberta (Village) has historically relied on its independent external auditors to assist in the preparation of the government-wide financial statements, fund financial statements, and notes to financial statements as part of its external financial reporting process. Accordingly, the Village's ability to prepare financial statements in accordance with generally accepted accounting principles (GAAP) is based, in part, on its reliance on its external auditors, who cannot by definition be considered to be a part of the Village's internal controls.

Criteria: All Michigan governments are required to prepare financial statements in accordance with GAAP. This is the responsibility of the Village's management. The preparation of financial statements in accordance with GAAP requires internal controls over both: 1) recording, processing and summarizing accounting data (maintaining internal accounting books and records); and 2) reporting government-wide and fund financial statements, including the related notes to financial statements (external financial reporting).

Effect: The books of the Village are not in compliance with GAAP until after the close of the year when the audit is conducted.

Cause: This condition was caused by the Village's decision that it is more cost effective to outsource the preparation of its annual financial statements to the auditors than to incur the time and expense of obtaining the necessary training and expertise required for Village personnel to prepare them internally.

Recommendation: We recommend that the council designate a responsible Village official to carefully review the draft financial statements, including the notes, prior to approving them and accepting responsibility for their content and presentation.

This weakness was noted in the latest financial audit and is still an issue.

Lack of Monitoring/Segregation of Duties

Finding: IC2013-02

Condition: As is the case with many organizations of similar size, the Village lacks a sufficient number of accounting personnel in order to ensure a complete segregation of duties within its accounting function. Ideally, no single individual should ever be able to authorize a transaction, record the transaction in the accounting records, and maintain custody of the assets resulting from the transaction. Effectively, proper segregation of duties is intended to prevent an individual from committing an act of fraud or abuse and being able to conceal it.

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MATERIAL WEAKNESSES IN INTERNAL CONTROL (Continued)

We noted the following internal control weaknesses which should be addressed or corrected by the Village Council:

1. The Treasurer has access and ability to prepare water and sewer bills, investigate discrepancies related to cash, reconcile bank statements, and investigate discrepancies relating to expenditures without management oversight by the Village Council.
2. The Clerk is responsible for opening the mail, collecting money, and posting the water and garbage payments to the computer.

Both the clerk and the Treasurer accept payments for water and sewer bills. The clerk prepares disbursements and the Treasurer verifies and signs the checks. The Clerk and the Treasurer verify the water and sewer bill with the deposits made.

Criteria: The Standards of Internal Control for the Federal Government (which is a good general standard for all types of municipalities) defines monitoring as assessing the quality of performance over time and ensuring that the findings of audits and other reviews are promptly resolved. It further states that internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties.

According to the Michigan Uniform Accounting Procedures Manual, someone other than the person who writes receipts or posts the accounting records must be responsible to verify that collections received in the mail are properly receipted. Also, when possible, collections must be reconciled by an individual not involved in the receipt process. Key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud.

Cause: This condition is a result of the Village's limited resources and the small size of its accounting staff.

Effect: As a result of this condition, the Village is exposed to an increased risk that misstatements or misappropriations might occur and not be detected by management in a timely basis. The effect of this finding is that individuals have too much responsibility without adequate review of others.

Recommendation: We recommend that the Village Council establish procedures to segregate duties to ensure that the one individual is not solely responsible for the bank accounts and payroll functions. We would encourage the Village Council to actively seek ways to further strengthen its internal controls by requiring as much independent review, reconciliation, and approval of accounting functions by qualified members of management as possible.

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COMMENTS AND RECOMMENDATIONS

MATERIAL WEAKNESSES IN INTERNAL CONTROL (Continued)

Disbursement Procedures

Finding: IC2013-03

Condition: We noted the following weaknesses during the testing of the internal controls over the cash disbursement process:

- 1) There were no pre-approvals for Department of Public Works (DPW) expenditures; no approved Purchase Orders are used.
- 2) Account classifications were not indicated on vendor invoices.
- 3) Vendor invoices did not include management approval.
- 4) The amount of approved disbursements was not indicated in the Council minutes.
- 5) The check sequence used for the approved disbursements were not included in the Council minutes or separately accounted for by an independent person.
- 6) There was no independent management review of bank reconciliations.
- 7) Credit card payments were not supported with signed receipts.

Criteria: MCL 64.6 states: "(1) The clerk shall be the general accountant of the village. (2) Claims against the village shall be filed with the clerk for adjustment. After examination, the clerk shall report the claims, with the accompanying vouchers and counterclaims of the village, and the true balance, to the council for allowance. After the claims are allowed by the council, the clerk shall present check disbursement authorizations to the treasurer for payment of the claims, designating the fund from which payment is to be made, and take proper receipts."

MCL 65.7 states: "(1) The council shall audit and allow all accounts chargeable against the village. An account or claim or contract shall not be received for audit or allowance unless it is accompanied with a certificate of an officer of the village, or an affidavit of the person rendering it, that the services therein charged have been actually performed or the property delivered for the village, that the sums charged therefor are reasonable and just, and that to the best of his or her knowledge and belief, no set-off exists, and no payment has been made on account thereof, except such set-offs or payments as are endorsed or referred to in the account or claim. Each account shall exhibit in detail all the items making up the amount claimed, and the date of each. The council may adopt a different procedure for the audit and allowance of accounts, claims, and contracts than that provided by this subsection."

The Uniform Accounting Procedures Manual states: in part that each local unit must establish and maintain an adequate system of internal control which includes, in part, the following:

- Bank accounts must be promptly reconciled (within the month following the bank statement date) by an individual not involved in the receipt/bank deposit process. In small units of government when segregation of duties is not possible, a second official must review the reconciliation;
- All functions (i.e., deposit, write checks, issue/send checks, reconcile account) regarding a checking account should not be performed by the same individual.

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MATERIAL WEAKNESSES IN INTERNAL CONTROL (Continued)

Cause: The cause of this finding is unknown.

Effect: The effect of this finding is that invoices many not be properly approved.

Recommendation: We recommend that the Village implement the above criteria to improve the internal controls over the cash disbursement process. The Village should focus on the following areas:

- 1) Administrative approval by the clerk must be indicated on each claim.
- 2) Account classifications must be indicated on each claim.
- 3) Bank accounts reconciliations must have a second official review the reconciliation.

Several of these deficiencies were noted during the most recent audit and are still an issue.

Payroll--Lack of Documentation and Approval

Finding: IC2013-04

Condition: There are only four employees on staff for the Village. The employees are paid on an hourly basis for duties performed for the general government operations, DPW, Major and Local Street, and Water/Sewer Operations. There is no documentation to indicate management approval of the employee's hours, except for the DPW Superintendent signing off on the other DPW employee's time sheet. In addition, there appears to be no oversight of over-time hours of the two DPW employees.

Withholdings and other deductions must be remitted as required by law. Payroll tax returns must be filed as required by law.

The Village should adhere to the manual's best practices which require:

- Timekeeping and attendance records should be created for each employee, and signed or initialed by the employee;
- Time records should be approved by appropriately authorized personnel prior to preparing payroll;
- Payroll duties should be adequately segregated between the following: payroll master file (including maintenance of pay rates), payroll check preparation, and payroll distribution;
- A written policy should specify the duties of each position;

Recommendation: We recommend that a formal timesheet be used for all employees of the Village. The timesheet should include the duties performed and it should be approved by the Village Council.

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MATERIAL WEAKNESSES IN INTERNAL CONTROL (Continued)

Interfund Borrowing Due To/Due From Accounts – Lack of Approval *Finding: IC2013-05*

Condition: As of February 28, 2013, there was a total of \$124,722 that the General Fund owed the Village's five other funds. This interfund borrowing was not approved by the Village Council. In addition, the Village has not repaid these balances for numerous years.

Criteria: These accounts are set up to record short-term amounts to and from various funds. Further, the Uniform Chart of Accounts indicates these accounts are "to record short-term amounts due to/from other funds within the local unit."

Cause: Village personnel did not review these balances.

Effect: The effect is that the General Fund owes the other funds of the Village funds without Council approval.

Recommendation: We recommend that these accounts be periodically reviewed to ensure that they are in balance throughout the year. Further, we recommend that these balances be repaid to the funds making the short-term loans or that the balances be reclassified as long-term advances.

OTHER MATTERS RELATED TO INTERNAL CONTROL

Capital Assets

Finding: IC2013-06

Condition: We noted during our review that the Village does not maintain adequate internal controls for capital assets. We found that a capital asset listing is not maintained in accordance with generally accepted accounting principles. The balances reported in the Village's audit report were maintained by the Village's auditor.

We also noted during our review that the Village has not formally adopted a capitalization policy to determine a "threshold" to capitalize an asset or record it as an expense. It appears that in the past, the Village utilized a capitalization threshold of \$500. However, no official policy was adopted by the Village council.

Criteria: It is the responsibility of the Village to update the capital assets listing for additions and disposals. For the governmental funds, assets purchased during the year and recorded as capital outlay should equal the additions to the capital asset records. For the enterprise funds, assets purchased during the year should be recorded as increases in the capital asset account and not as an expense. Depreciation expense is also to be recorded for the enterprise funds. Depreciation for governmental capital assets should be recorded on the capital asset schedule. Disposals should equal the reductions to the capital asset records.

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OTHER MATTERS RELATED TO INTERNAL CONTROL (Continued)

Effect: The lack of a comprehensive listing may lead to insurance listings not being updated and the control over assets being limited without documentation of what assets the Village actually owns. Not posting the depreciation expense to the enterprise funds creates a material understatement of the operating expenses.

Cause: The Village has relied upon its external auditor to maintain the capital asset listing.

Recommendation: We recommend that the Village implement procedures to record the assets and depreciation expense as listed above. We also recommend that the Village adopt a capitalization policy to determine a threshold to capitalize an asset or record it as expenditure.

Lack of Control over DPW Fuel Usage

Finding: IC2013-07

Condition: We noted during our review that the Village maintains tanks of gasoline and diesel fuel for DPW activities. There appears to be a lack of internal control over fuel usage. The fuel expenditures for the fiscal years ended February 28, 2011 through February 28, 2013 were \$4,480, \$9,243.50, and \$10,615.14, respectively. The fuel expenditures for the first six months of the 2014 fiscal year amounted to \$7,322.

Criteria: MCL 65.7 states: "(1) The council shall audit and allow all accounts chargeable against the village. An account or claim or contract shall not be received for audit or allowance unless it is accompanied with a certificate of an officer of the village, or an affidavit of the person rendering it, that the services therein charged have been actually performed or the property delivered for the village, that the sums charged therefor are reasonable and just, and that to the best of his or her knowledge and belief, no set-off exists, and no payment has been made on account thereof, except such set-offs or payments as are endorsed or referred to in the account or claim. Each account shall exhibit in detail all the items making up the amount claimed, and the date of each. The council may adopt a different procedure for the audit and allowance of accounts, claims, and contracts than that provided by this subsection."

Effect: There is a possibility that since there is a lack of control over DPW fuel usage, more fuel is being used than needed, possibly for unauthorized purposes.

Cause: The cause of this finding is unknown.

Recommendation: We recommend that gas/fuel usage be closely monitored with the tank keys kept in a secure location and the amount of fuel pumped maintained and signed for by DPW employees.

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COMMENTS AND RECOMMENDATIONS

OTHER MATTERS RELATED TO INTERNAL CONTROL (Continued)

State and Federal Wage Reporting

Finding: IC2013-08

Condition: We noted during our review that a Council member worked as a contractor and received approximately \$4,400 for services rendered and was not issued a Form 1099.

Criteria: According to IRS Publication 15a and Instructions for Form 1099--You must file Form 1099-MISC, Miscellaneous Income, for each person to whom you have paid during the year: At least \$10 in royalties or broker payments in-lieu-of dividends or tax-exempt interest (see *Box 8* on page 6); At least \$600 in rents, services (including parts and materials), prizes and awards, other income payments, medical and health care payments and you must report attorneys' fees, regardless of whether they are a corporation (in box 7) or gross proceeds (in box 14), there is an exception made to corporations that provide legal services.

Form W-9, "Request for Taxpayer Identification Number and Certification," should be completed by the nonemployee and filed with the Village.

Cause: The cause of this finding is unknown.

Effect: The effect of this finding is that the contractor may not have all of the necessary information needed to complete income tax returns and the Village is not in compliance with IRS regulations.

Directive: We direct that a W-9 form be filed for all non-incorporated vendors (except attorneys, who should always get one) that provide services to the Village and a Form 1099 be submitted for those payments of \$600 or more made to those vendors.

This deficiency was noted during the most recent audit.

NONCOMPLIANCE WITH STATE STATUTES

Our examination revealed the following instance of noncompliance with State statutes.

General Fund Deficit

Finding: IC2013-09

Condition: The Village's General Fund has been in deficit for over five years. As of March 31, 2013, the General Fund Deficit was (\$558,496). The Deficit Elimination Plans submitted by the Village were denied for fiscal years 2011 and 2012. The Village has also failed to submit quarterly reports including cash flows, accounts payable, and budget to actual in connection with deficit monitoring by the Michigan Department of Treasury.

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NONCOMPLIANCE WITH STATE STATUTES (Continued)

Criteria: MCL 141.921 (2) states: For a fiscal year of a unit of local government ending on or after October 1, 1980 or any year thereafter, if a local unit of government ends its fiscal year in a deficit condition, the local unit of government shall formulate and file a financial plan within 90 days after the beginning of the fiscal year to correct this condition. Upon request of a local unit of government the department of treasury may assist that local unit in the formulation of the financial plan to correct the deficit condition. The local unit of government shall file the financial plan with the department of treasury for evaluation and certification that the plan ensures that the deficit condition is corrected. Upon certification by the department of treasury, the local unit of government shall institute the plan. An amount equal to 25% of each payment to a local unit of government entitled to payments under this act may be withheld until requirements of this subsection are met.

Directive: We direct the Village to file the required quarterly reports including cash flows, accounts payable, and budget to actual in connection with deficit monitoring with the Michigan Department of Treasury as required by PA 275 of 1980, as amended. We also direct the village to make the necessary adjustments to its budget in order to eliminate the accumulated deficit while filing a plan that would be approved by the Department of Treasury.

Budgets Were Not Amended Throughout the Fiscal Year

Finding: IC2013-10

Condition: We noted during our review of the minutes that amendments to the budgets were not presented or approved by the Council throughout the year.

Criteria: According to MCL 141.437, Sec. 17. (1) Except as otherwise provided in section 19, a deviation from the original general appropriations act shall not be made without amending the general appropriations act. Subject to section 16(2), the legislative body of the local unit shall amend the general appropriations act as soon as it becomes apparent that a deviation from the original general appropriations act is necessary and the amount of the deviation can be determined. An amendment shall indicate each intended alteration in the purpose of each appropriation item affected by the amendment. The legislative body may require that the chief administrative officer or fiscal officer provide it with periodic reports on the financial condition of the local unit.

(2) If, during a fiscal year, it appears to the chief administrative officer or to the legislative body that the actual and probable revenues from taxes and other sources in a fund are less than the estimated revenues, including an available surplus upon which appropriations from the fund were based and the proceeds from bonds or other obligations issued under the fiscal stabilization act, 1981 PA 80, MCL 141.1001 to 141.1011, or the balance of the principal of these bonds or other obligations, the chief administrative officer or fiscal officer shall present to the legislative body recommendations which, if adopted, would prevent expenditures from exceeding available revenues for that current fiscal year. The recommendations shall include proposals for reducing appropriations from the fund for budgetary centers in a manner that would cause the total of

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NONCOMPLIANCE WITH STATE STATUTES (Continued)

appropriations to not be greater than the total of revised estimated revenues of the fund, or proposals for measures necessary to provide revenues sufficient to meet expenditures of the fund, or both. The recommendations shall recognize the requirements of state law and the provisions of collective bargaining agreements.

Effect: The Village Council may not be working with the most useful information when comparing budgeted amounts to actual if the budgets were not amended throughout the year.

Cause: The cause of this finding is unknown.

Recommendation: The Council should make periodic comparisons of budget to actual and make amendments as needed.

Final (Only) Budget Amendments Made After the End of the Fiscal Year *Finding: IC2013-11*

Condition: We noted during our review that the Village only amended the budget one time for the fiscal year ended February 28, 2013, and when it did make the amendments, it was after the end of the February 28, 2013 fiscal year on May 16, 2013.

Criteria: Once an appropriation year has ended, no additional amendment can be made to a budget.

Effect: The Village Council may not be working with the most useful information when comparing budgeted amounts to actual.

Cause: The cause of this finding is unknown.

Recommendation: We recommend that budget amendments be made throughout the fiscal year and the final amendments must be made before the end of the fiscal year.

Investment and Banking Policy

Finding: IC2013-12

Condition: The investment and banking policy adopted by the Village does not comply with all the elements of State statute and does not include Government Accounting Standard Board (GASB) Statement No. 40 risk assessment criteria. The Village policy, dated May 19, 2011, appears to be a combination of an investment policy and a resolution for designation of depositories.

Criteria: Public Act 20 of 1943, as amended, requires every local unit governing body to adopt an investment policy which includes at a minimum the following:

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NONCOMPLIANCE WITH STATE STATUTES (Continued)

- a) A statement of purpose, scope, and objectives of the policy, including safety, diversification, liquidity, and return on investment.
- b) A delegation of authority to make investments.
- c) A list of authorized investment instruments. If the policy authorizes an investment in mutual funds, it shall include whether the authorization is limited to securities whose intention is to maintain a net asset value of \$1.00 per share or also includes securities whose net asset value per share may fluctuate on a periodic basis.
- d) A statement concerning safekeeping, custody, and prudence.

The provisions of GASB Statement No. 40 are effective for financial statements for periods beginning after June 15, 2004.

The GASB Statement No. 40 summary states, in part: "The deposits and investments of state and local governments are exposed to risks that have the potential to result in losses. This Statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this Statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this Statement also should be disclosed."

Cause: The lack of knowledge related to the statute.

Effect: The Village is in violation of State statute.

Directive: We direct the Village Council to establish an investment policy in accordance with the requirements in PA 196 of 1997, and GASB Statement No. 40. We also recommend that the designation of depositories be adopted separately at least every four years when a new Village Council takes office.

Electronic Transactions of Public Funds

Finding: IC2013-13

Condition: The Village of Elberta had not adopted a resolution to authorize electronic transactions and does not have an ACH policy.

Criteria: According to MCL 124.303: "A local unit shall not be a party to an Automated Clearing House (ACH) arrangement unless the governing body of the local unit has adopted a resolution to authorize electronic transactions and the treasurer or the Electronic Transaction Officer (ETO) of the local unit has presented a written ACH policy to the governing body.

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NONCOMPLIANCE WITH STATE STATUTES (Continued)

The ACH policy shall include all of the following:

- (a) That an officer or employee designated by the treasurer or ETO is responsible for the local unit's ACH agreements, including payment approval, accounting, reporting, and generally for overseeing compliance with the ACH policy.
- (b) That the officer or employee responsible for disbursement of funds shall submit to the local unit documentation detailing the goods or services purchased, the cost of the goods or services, the date of the payment, and the department levels serviced by payment. This report can be contained in the electronic general ledger software system of the local unit or in a separate report to the governing body of the local unit.
- (c) A system of internal accounting controls to monitor the use of ACH transactions made by the local unit.
- (d) The approval of ACH invoices before payment.
- (e) Any other matters the treasurer or ETO considers necessary.”

Cause: The cause of this finding is unknown.

Effect: The effect of this finding is that the Village could conduct electronic transactions of public funds and have those funds be at risk.

Directive: We direct the Village to adopt a resolution to authorize electronic transactions and to adopt a policy that includes the above mentioned items.

This deficiency was noted during the most recent audit and is still an issue.

Conflict of Interest Policy

Finding: IC2013-14

Condition: We noted during our internal control review, the Village has not adopted a Conflict of Interest Policy.

Criteria: Members and participants in government at every level must be diligent in avoiding unethical conduct and conflicts of interest. A Conflict of Interest Policy is a useful tool to help prevent unethical conduct and conflicts of interest from occurring in local units of government.

According to the Michigan Department of Treasury's Accounting Procedures Manual for Local Units of Government in Michigan, each local unit should adopt a policy which generally addresses the following aspects:

- General prohibition against entering into any business relationships that would put an employee or official into conflict with their obligations to the local unit of government.
- Requirement to disclose any personal transactions, in excess of a dollar threshold, entered into with any vendor that also does business with the local unit.

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NONCOMPLIANCE WITH STATE STATUTES (Continued)

- Disclosure or prohibition of gifts received from vendors in excess of a dollar threshold.
- Explicit expectation that in the performance of their duties, the employee/official will work in the best interest of the local unit.
- An explicit expectation that all information provided will be truthful and complete.

This policy should also support the identification and disclosure of related party transactions.

Cause: The cause of this issue is unknown.

Directive: We direct that the Village adopt a Conflict of Interest Policy.

Noncompliance with Treasury Oversight and State Statute

Finding: IC2013-15

Condition: As has been shown above, the Village is in noncompliance with various State statutes and Treasury regulations such as incurring deficits, not amending budgets, and not complying with mandatory monthly reporting requirements.

Criteria: The Village must comply with State statute and Treasury regulation.

Cause: Unknown

Directive: We direct the Village to comply with all applicable State statutes and Treasury regulations. In order to ensure compliance, we direct the Village to work with Treasury's Office of Fiscal Responsibility to help remedy these and other issues the Village may have.