

MUNICIPALITY OF SPENCER
INTERNAL CONTROL REVIEW
July 17, 2017

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AUDITOR GENERAL

REPORT ON THE LIMITED STUDY OF INTERNAL CONTROL
PERFORMED IN ACCORDANCE WITH SOUTH DAKOTA CODIFIED LAW 4-11-4.1

Governing Board
Municipality of Spencer
Spencer, South Dakota

We have made a study of selected elements of internal control of the Municipality of Spencer (Municipality) in effect at July 17, 2017. Our study was performed pursuant to South Dakota Codified Law (SDCL) 4-11-4.1 and was limited to selected accounting controls contained in the codified laws and other selected controls we felt were significant to the Municipality. Our study was not conducted in accordance with the standards established by the American Institute of Certified Public Accountants for the purpose of giving an opinion on internal control in effect at the Municipality.

The management of the Municipality is responsible for establishing and maintaining internal controls. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control policies and procedures. The objective of internal controls is to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of general purpose financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in internal controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the internal controls 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 operations of policies and procedures may deteriorate.

Our study was more limited than would be necessary to express an opinion on internal control of the Municipality. Also, our study would not necessarily disclose all significant weaknesses in internal controls of the Municipality. Accordingly, we do not express an opinion on internal control of the Municipality in effect at July 17, 2017.

However, our study did disclose weaknesses in internal controls of the Municipality in effect at July 17, 2017 as discussed below:

- a. The Municipality maintained a Second Penny Sales Tax Fund to account for the 2% sales tax collections which had a balance of approximately \$52,800 as of December 31, 2016. There were no state statutes, outside party restrictions or sales tax ordinance provisions that required the Municipality to account for the sales tax proceeds in a separate fund. We recommend the Municipality report the Second Penny Sales Tax Fund as a part of the General Fund.
- b. The Municipality maintained a special revenue fund (Disaster Relief Fund) which was established through donations to rebuild infrastructure damage caused by the 1998 tornado. The Disaster Relief Fund had a balance of approximately \$68,400 as of December 31, 2016 with no outstanding liabilities. The Municipality indicated that infrastructure expenditures were previously made from the General Fund which could have been charged to the Disaster Relief Fund. We recommend the Municipality review and document whether these previous General Fund infrastructure expenditures could have been charged to the Disaster Relief Fund and discuss with legal counsel the course of action needed to legally close this Fund.
- c. Personal property inventories were not filed annually on the thirty-first day of December, or within ten days thereafter as required by SDCL 5-24-1. We recommend the Municipality annually perform personal property inventories as required by SDCL 5-24-1.
- d. The Municipality did not properly maintain the following necessary records:
 1. Cash General Ledger by Fund
 2. Revenue Budget Record
 3. Expenditure Budget Record

We recommend the Municipality properly establish and maintain the necessary accounting records. We have provided assistance to the Finance Officer to establish these records.

- e. The Municipality has a 30 year South Dakota Department of Environment and Natural Resources Clean Water Loan with a principal outstanding balance at December 31, 2016 of \$116,971.78. The 2015 and 2016 annual financial reports did not include a Schedule of Long-Term Debt as required. We recommend the Municipality include the Schedule of Long-Term Debt in the annual financial report.
- f. In August of 2002 the South Dakota Governor's Office transferred the remaining balance of the Spencer Tornado Relief Fund (not a Municipality fund) to the South Dakota Community Foundation, with the stipulation that the South Eastern Council of Governments (SECOG) be appointed as the entity responsible for approving the invoices. SECOG approved the use of the money from the Spencer Tornado Relief Fund in 2003 for chip sealing municipal streets and in 2005 for work on main street sidewalks, re-roofing the concession stand building and funding for the 125-year celebration of Spencer. Although approved by SECOG, the Mayor informed us that they did not request any funding for the 125-year celebration.

In 2007 the Municipality purchased a building and lots for the intended purpose of establishing and operating a coffee shop and recreation center for the citizens of Spencer. The Municipality held a public meeting on September 12, 2007 and adopted a resolution approving the purchase of the building and lots for \$45,000.00. The resolution stated that the Municipality would request disbursement from funds maintained at the South Dakota Community Foundation to assist in the purchase. On January 8, 2008, the Municipality received the final disbursement from the Spencer Tornado Relief Fund in the amount of \$43,095.71, which was the remaining balance of the Spencer Tornado Relief Fund.

The Spencer Coffee and Card Club and Wellness Recreation Center (Center) was created and is located in the building owned by the Municipality. The Center is run by volunteers and supported with voluntary membership contributions and donations. The operation of the Center was proposed to be operated independent of the Municipality and managed by a volunteer committee of four members.

We also noted that the Center had established a checking account entitled the Town of Spencer Community Coffee Shop which used the Municipality's Federal Tax ID number. We reviewed the transactions of this checking account for the past 18 months and did not note any issues of non-compliance of recording or documenting transactions. We did note that the Center had not remitted state sales tax since its inception. The Center checking account had a balance of approximately \$60,500 at December 31, 2016.

If the Center's operation had been recognized as an operation of the Municipality, it would have been accounted for in the Municipal records; there would have been additional internal controls, such as, Municipal board oversight over the revenues and expenditures, formal approval and publication of expenditures and inclusion in the Municipal annual reports.

We recommend that the Municipality consult with legal counsel and formally establish a status for the operation of the Center either as a part of the Municipality or consider placing the operations under another entity, perhaps a non-profit organization.

We also recommend the Municipality contact the South Dakota Department of Revenue to resolve the question of sales tax collection and remittance.

- g. We noted that a Town of Spencer Fun Day checking account had been established for an annual community celebration which used the Municipality's Federal Tax ID number. The Spencer Fun Day committee operated independent of the Municipality. We reviewed the transactions of this checking account for the past 12 years and did not note any issues of non-compliance of recording or documenting transactions. The Fun Day checking account had a balance of approximately \$2,800 at December 31, 2016.

We also noted that a Spencer Little League checking account had been established for operation of the little league concessions stand which used the Municipality's Federal Tax ID number. The Spencer Little League is operated independent of the Municipality with the profits from the concession stand operation being used for the baseball program. The account had a balance at September 30, 2017 of \$2,045.92 and has not had any activity since September 30, 2015.

We recommend that the Municipality consult with legal counsel and formally establish the status for the operation of the Spencer Fun Day account and the Spencer Little League account either as a part of the Municipality or consider placing the operations under another entity, perhaps a non-profit organization.

This report is intended solely for the use of management and the governing board and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report, which is a matter of public record.

A handwritten signature in black ink, appearing to read "Martin L. Guindon". The signature is fluid and cursive, with a large initial "M" and "G".

Martin L Guindon, CPA
Auditor General

July 17, 2017