

**STATE BOARD OF ACCOUNTS**  
**302 West Washington Street**  
**Room E418**  
**INDIANAPOLIS, INDIANA 46204-2769**

AUDIT REPORT

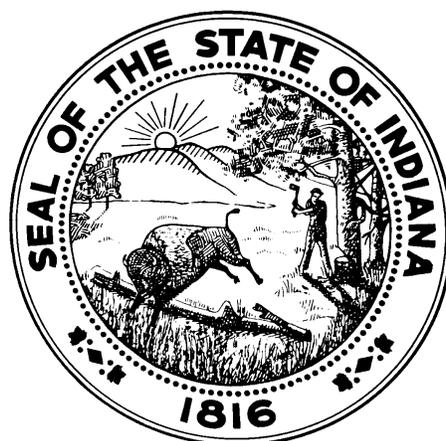
OF

CITY CONTROLLER

CITY OF SOUTH BEND

ST. JOSEPH COUNTY, INDIANA

January 1, 2008 to December 31, 2008



**FILED**  
09/30/2009



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CITY OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Controller	John H. Murphy (Interim) M. Catherine Fanello	01-01-08 to 03-02-08 03-03-08 to 12-31-11
Mayor	Stephen J. Luecke	01-01-08 to 12-31-11
President of the Public Works	Gary Gilot	01-01-08 to 12-31-09
President of the Common Council	Timothy A. Rouse Derek Dieter	01-01-08 to 12-31-08 01-01-09 to 12-31-09



**STATE OF INDIANA**  
AN EQUAL OPPORTUNITY EMPLOYER

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STATE BOARD OF ACCOUNTS  
302 WEST WASHINGTON STREET  
ROOM E418  
INDIANAPOLIS, INDIANA 46204-2769

Telephone: (317) 232-2513  
Fax: (317) 232-4711  
Web Site: [www.in.gov/sboa](http://www.in.gov/sboa)

TO: THE OFFICIALS OF THE CITY OF SOUTH BEND

We have audited the records of the City Controller for the period from January 1, 2008 to December 31, 2008, and certify that the records and accountability for cash and other assets are satisfactory to the best of our knowledge and belief, except as stated in the Audit Results and Comments. The financial transactions of this office are reflected in the Annual Report of the City of South Bend for the year 2008.

STATE BOARD OF ACCOUNTS

June 9, 2009

CITY CONTROLLER  
CITY OF SOUTH BEND  
AUDIT RESULTS AND COMMENTS

PENALTIES, INTEREST, AND OTHER CHARGES

As a result of a special Internal Revenue Service (IRS) audit, on February 11, 2009, the City paid the IRS \$59,338 for backup withholdings for failure to furnish and file Form 1099 for the years 2005 and 2006. The audit showed taxes for these 1099s totaled \$1,070,744. This was reduced \$1,011,406 for businesses and individuals who returned statements that they included the income on their tax returns. Penalties for not furnishing and filing the form 1099 are \$18,600 and the City will have 10 days to pay this after billed by the IRS.

Also, as a result of the IRS audit, the City paid the IRS \$62,367 for additional taxes for taxes related to under reporting employee fringe benefits for the years 2005 and 2006. These fringe benefits were for cell phones and for vehicle use.

Officials and employees have the duty to pay claims and remit taxes in a timely fashion. Failure to pay claims or remit taxes in a timely manner could be an indicator of serious financial problems which should be investigated by the governmental unit.

Additionally officials and employees have a responsibility to perform duties in a manner which would not result in any unreasonable fees being assessed against the governmental unit.

Any penalties, interest or other charges paid by the governmental unit may be the personal obligation of the responsible official or employee. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

OVERDRAWN CASH BALANCES

The cash balance of the Parking Garage Fund and Central Services Fund were overdrawn as of December 31, 2008, \$178,158 and \$533,049, respectively. A similar audit exception has been included in many previous audits, the most recent being prior Report B32565.

The cash balance of any fund may not be reduced below zero. Routinely overdrawn funds could be an indicator of serious financial problems which should be investigated by the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

CITY CONTROLLER  
CITY OF SOUTH BEND  
AUDIT RESULTS AND COMMENTS  
(Continued)

OVERPAYMENTS ON FIREFIGHTERS' PENSIONS

Overpayments were made to six deceased widows of firefighter pensioners in the amount of \$6,716.38, with \$3,318.60 of that amount reimbursed to the City, for a net overpayment of \$3,397.78.

Another deceased widow received pension payments for eleven months following the month she passed, with nine of the checks cashed by her son. The City has filed a Complaint for Fraud and Forgery in St. Joseph County Circuit/Superior Court in order to recover \$10,860.44 in net pension checks cashed by the deceased widow's son.

One pensioner received the incorrect pension amount the month of his death, resulting in an overpayment of \$345.66. His widow was not paid any pension for the month of his death, and she was not paid the full amount of her pension the following month, resulting in an underpayment to the widow of \$526.24.

One retiree was overpaid the first month of his retirement in the amount of \$172.20.

The total amount of the overpayments in 2008, net of the \$10,860.44 pursued in court and reimbursements of \$3,318.60, is \$3,915.64. The total amount of the underpayments in 2008 is \$526.24.

In 2007, an overpayment of \$2,248.39 was made to one deceased retiree. The deceased retiree was overpaid for one month and nine days after he passed away. The City has not collected the overpaid pension, nor has it pursued legal action in order to recover the overpayment. This overpayment was shown in the prior Report B32565.

Governmental units should collect any overpayments made. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

CITY CONTROLLER  
CITY OF SOUTH BEND  
EXIT CONFERENCE

The contents of this report were discussed on June 9, 2009, with M. Catherine Fanello, Controller; Stephen J. Luecke, Mayor; and Derek Dieter, President of the Common Council. The official response is included on pages 7 and 8.



County-City Building  
227 W. Jefferson Blvd. 12<sup>th</sup> Floor  
South Bend, IN 46601-1830

Phone: 574.235.9216  
Fax: 574.235.9928  
TDD: 574.235.5567

City of South Bend                      Stephen J. Luecke, Mayor  
**Department of Administration and Finance**  
M. Catherine Fanello, Controller

June 25, 2009

State Board of Accounts  
302 West Washington Street  
Room E418  
Indianapolis, IN 46204-2769

To Whom it May Concern:

The City of South Bend offers the following comments on the audit report to the City Controller for the year ended December 31, 2008.

Penalties, Interest and Other Charges

Prior to 2006, the City operated under a decentralized accounts payable (AP) system where all city departments entered their department invoices and were responsible for collecting the IRS form W-9. During 2005, the Controller reviewed the decentralized system and deemed it ineffective in ensuring compliance with proper accounts payable processing, which included W-9 collection and processing of IRS 1099-MISC forms and other 1099 forms. As a result, the accounts payable function was centralized in 2006 along with collection of the IRS form W-9.

The conversion to a centralized AP system took place during 2006. Improvement in the issuance of 1099 Miscellaneous (MISC) forms is evidenced by the fact that for calendar year 2006, 27 additional 1099-MISC's form were issued. For calendar year 2007, a full year after the conversion to a centralized accounts payable system, 79 additional 1099-MISC forms were issued, as compared to 2006. This was a 54% increase in 1099-MISC forms issued compared to 2005. For calendar year 2008, the number of 1099-MISC forms issued was comparable to the number of forms issued for 2007. However, the IRS audit covered the periods of 2005 and 2006 before the centralized AP system was fully implemented.

In all years prior to 2007, the City of South Bend used the IRS method called the Commuting Value to value the vehicle fringe benefit on the employee annual W-2. This rule states that the value added to the employee's income is \$1.50 *per trip* for commuting to or from work. The City, therefore, added income of \$3.00 per day to the employee annual W-2 for a daily round trip

commute to and from work. Total income added to City employee annual W-2's was \$59,344 for 2005 and \$60,303 for 2006. By adding the income to the employee annual W-2, the employee was responsible for all income tax on the added value of the vehicle benefit.

However, after consultation with the IRS in early 2007, the City determined under IRS guidelines that the vehicle fringe benefit for some employees falls under the Annual Lease Value method due to the varying type and extent of business use. The City began the Annual Lease Value method for calendar year 2007 for various employees and continues to use both methods mentioned depending on the type and extent of business use of the vehicle. Employees continue to be responsible for all income taxes on the added value of a vehicle fringe benefit, although, the City did pay the additional income tax assessed by the IRS for 2005 and 2006 on the employee's behalf.

The IRS requires that all business cell phone use must be substantiated by keeping a log of each phone call, even if there is a policy prohibiting personal use, such as the one implemented by the City of South Bend. According to the IRS, lack of business substantiation of each cell phone call implies a personal income benefit to the employee and, therefore, must be added to the employee annual W-2. The City paid the income tax assessed by the IRS for 2005 and 2006 on behalf of the employee. However, the employees paid their own income tax on the cell phone fringe benefit for calendar year 2007 and 2008. In 2009, the City moved to a cash allowance for employees whose job duties require extensive time out of the office, in lieu of City owned cell phones, due to the harsh IRS substantiation requirements required for each cell phone call.

#### Overpayments on Firefighter's Pensions

The pension secretary is proceeding with collecting the 2007 overpayment.

Sincerely,

A handwritten signature in cursive script that reads "M. Catherine Fanello". The signature is written in black ink and is positioned above the typed name and title.

M. Catherine Fanello, CPA  
Controller