

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

EXAMINATION REPORT

OF

SANITARY DISTRICT  
CITY OF HAMMOND  
LAKE COUNTY, INDIANA

January 1, 2010 to December 31, 2010



**FILED**  
09/07/2011



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OFFICIALS

| <u>Office</u>  | <u>Official</u>          | <u>Term</u>          |
|--|--------------------------|----------------------|
| Controller   | Robert Lendi, CPA        | 01-01-10 to 12-31-11 |
| Mayor  | Thomas M. McDermott, Jr. | 01-01-08 to 12-31-11 |
| President of the Board<br>of Sanitary Commissioners  | Stanley J. Dostatni      | 01-01-10 to 12-31-11 |
| President of the Board of<br>Public Works and Safety | William J. O'Conner      | 01-01-10 to 12-31-11 |
| President of the<br>Common Council                   | Anthony Higgs            | 01-01-10 to 12-31-11 |
| Sanitary District Manager                            | Michael T. Unger, Ph.D   | 01-01-10 to 12-31-11 |
| Business Manager                                     | Alan M. Arendt, CPA      | 01-01-10 to 12-31-11 |



**STATE OF INDIANA**  
AN EQUAL OPPORTUNITY EMPLOYER

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INDEPENDENT ACCOUNTANT'S REPORT

TO: THE OFFICIALS OF THE SANITARY DISTRICT,  
CITY OF HAMMOND, LAKE COUNTY, INDIANA

We have examined the accompanying financial statements of the business-type activities of the Sanitary District (District), a department of the City of Hammond, as of and for the year ended December 31, 2010. The District's management is responsible for the financial statements presented herein. Our responsibility is to express an opinion based on our examination.

Except as discussed in the following paragraph, our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting the financial statement presented herein and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

The District did not provide supporting documentation that management approved adjusting entries or provided documentation to support all adjusting entries posted to the 2010 ledger. The lack of oversight, internal controls, and insufficient evidential matter regarding adjusting entries hindered us from performing procedures to ensure that the financial statements were presented fairly, in all material respects.

Since the District lacked sufficient evidential matter regarding adjusting entries, we were unable to apply other auditing procedures to satisfy ourselves as to the completeness and accuracy of the financial statements reported, the scope of our work was not sufficient to express, and we do not express, an opinion on the respective financial statements of the business activities of the District.

The District has not presented Management's Discussion and Analysis that accounting principles generally accepted in the United States of America has determined is necessary to supplement, although not required to be part of, the basic financial statements.

STATE BOARD OF ACCOUNTS

June 8, 2011

SANITARY DISTRICT  
CITY OF HAMMOND  
STATEMENT OF NET ASSETS  
December 31, 2010

|   | 2010                 |                        |                       |                      |
|---|----------------------|------------------------|-----------------------|----------------------|
|   | Sanitary<br>District | Storm Water<br>Utility | Sanitation<br>Utility | Recycling<br>Utility |
| <b>Assets</b>   |                      |                        |                       |                      |
| <b>Current assets:</b>  |                      |                        |                       |                      |
| Cash and cash equivalents                                       | \$ 605,449           | \$ 176,833             | \$ 15,013             | \$ 11,159            |
| Cash with fiscal agent  | -                    | 5,362                  | 77,422                | -                    |
| Accounts receivable (net of allowance)                          | 1,139,280            | 25,032                 | 321,125               | 17,213               |
| Taxes receivable  | 1,662,450            | -                      | -                     | -                    |
| Intergovernmental receivable                                    | 102,749              | -                      | -                     | -                    |
| Interfund receivables:  |                      |                        |                       |                      |
| Interfund loans   | 8,275                | 900,000                | -                     | -                    |
| Inventories   | 760,096              | -                      | -                     | -                    |
| Prepaid items   | 429,319              | -                      | 120,877               | 50,234               |
| <b>Total current assets</b>                                     | <b>4,707,618</b>     | <b>1,107,227</b>       | <b>534,437</b>        | <b>78,606</b>        |
| <b>Noncurrent assets:</b>                                       |                      |                        |                       |                      |
| <b>Restricted cash, cash equivalents and investments:</b>       |                      |                        |                       |                      |
| Bond and interest cash and investments                          | 10,394,781           | -                      | -                     | -                    |
| Cash with fiscal agent - construction                           | 7,894,310            | -                      | -                     | -                    |
| Taxes and accounts receivable                                   | 3,630,367            | -                      | -                     | -                    |
| <b>Total restricted assets</b>                                  | <b>21,919,458</b>    | <b>-</b>               | <b>-</b>              | <b>-</b>             |
| Deferred charges  | 156,189              | -                      | -                     | -                    |
| <b>Capital assets:</b>  |                      |                        |                       |                      |
| Land, improvements to land and construction in progress         | 23,781,655           | -                      | -                     | -                    |
| Other capital assets (net of accumulated depreciation)          | 110,132,430          | -                      | 570,763               | 210,844              |
| <b>Total capital assets</b>                                     | <b>133,914,085</b>   | <b>-</b>               | <b>570,763</b>        | <b>210,844</b>       |
| <b>Total noncurrent assets</b>                                  | <b>155,989,732</b>   | <b>-</b>               | <b>570,763</b>        | <b>210,844</b>       |
| <b>Total assets</b>   | <b>160,697,350</b>   | <b>1,107,227</b>       | <b>1,105,200</b>      | <b>289,450</b>       |
| <b>Liabilities</b>  |                      |                        |                       |                      |
| <b>Current liabilities:</b>                                     |                      |                        |                       |                      |
| Accounts payable  | 883,014              | 5,872                  | 212,341               | 39,186               |
| Interfund payables:   |                      |                        |                       |                      |
| Interfund loans   | 437,697              | -                      | 175,000               | 300,000              |
| Accrued payroll and withholdings payable                        | 292,558              | -                      | 87,938                | 45,262               |
| Tax Anticipation Warrants Payable                               | 1,071,649            | -                      | -                     | -                    |
| Current liabilities payable from restricted assets:             |                      |                        |                       |                      |
| Tax Anticipation Warrants Payable                               | 1,977,706            | -                      | -                     | -                    |
| Accounts payable  | 635,390              | -                      | -                     | -                    |
| Loans payable   | 2,905,000            | -                      | -                     | -                    |
| Bonds payable   | 1,080,000            | -                      | -                     | -                    |
| Accrued interest payable  | 1,074,230            | -                      | -                     | -                    |
| <b>Total current liabilities</b>                                | <b>10,357,244</b>    | <b>5,872</b>           | <b>475,279</b>        | <b>384,448</b>       |
| <b>Noncurrent liabilities:</b>                                  |                      |                        |                       |                      |
| Loans payable   | 37,335,000           | -                      | -                     | -                    |
| General obligation bonds payable (net of unamortized discounts) | 12,710,000           | -                      | -                     | -                    |
| Bond Discount   | (151,642)            | -                      | -                     | -                    |
| Other Post Employment Benefits                                  | 368,310              | -                      | -                     | -                    |
| Compensated absences  | 121,520              | -                      | 9,925                 | 6,352                |
| <b>Total noncurrent liabilities</b>                             | <b>50,383,188</b>    | <b>-</b>               | <b>9,925</b>          | <b>6,352</b>         |
| <b>Total liabilities</b>  | <b>60,740,432</b>    | <b>5,872</b>           | <b>485,204</b>        | <b>390,800</b>       |
| <b>Net Assets</b>   |                      |                        |                       |                      |
| Invested in capital assets, net of related debt                 | 92,740,117           | -                      | 570,763               | 210,844              |
| Restricted for debt service                                     | 14,025,148           | -                      | -                     | -                    |
| Restricted for capital improvements                             | 7,894,310            | -                      | -                     | -                    |
| Unrestricted  | (14,702,657)         | 1,101,355              | 49,233                | (312,194)            |
| <b>Total net assets</b>   | <b>\$ 99,956,918</b> | <b>\$ 1,101,355</b>    | <b>\$ 619,996</b>     | <b>\$ (101,350)</b>  |

The notes to the financial statements are an integral part of this statement.

SANITARY DISTRICT  
CITY OF HAMMOND  
STATEMENT OF REVENUES, EXPENSES, AND OTHER CHANGES IN FUND NET ASSETS  
As Of And For The Year Ended December 31, 2010

|   | 2010                 |                        |                       |                      |
|---|----------------------|------------------------|-----------------------|----------------------|
|   | Sanitary<br>District | Storm Water<br>Utility | Sanitation<br>Utility | Recycling<br>Utility |
| Operating revenues:                           |                      |                        |                       |                      |
| Residential sales                             | \$ 6,175,137         | \$ -                   | \$ -                  | \$ -                 |
| Commercial and industrial sales               | 3,854,372            | -                      | -                     | -                    |
| Municipal sales                               | 1,775,638            | -                      | -                     | -                    |
| Flat rate revenues                            | -                    | 308,740                | 3,965,645             | -                    |
| Other charges for services                    | 2,311,933            | -                      | -                     | -                    |
| Local tax distributions for sewer maintenance | 2,874,812            | -                      | -                     | -                    |
| Sales of materials                            | -                    | -                      | -                     | 224,695              |
| Other   | 736,640              | -                      | 10,369                | 884,252              |
| <b>Total operating revenues</b>               | <b>17,728,532</b>    | <b>308,740</b>         | <b>3,976,014</b>      | <b>1,108,947</b>     |
| Operating expenses:                           |                      |                        |                       |                      |
| Sewer maintenance and utility operations:     |                      |                        |                       |                      |
| Salaries and wages                            | 917,708              | -                      | 1,436,295             | 573,226              |
| Employee pensions and benefits                | 414,124              | -                      | 795,648               | 271,409              |
| Materials and supplies                        | 77,359               | -                      | 74,130                | 21,272               |
| Repairs and maintenance                       | 243,639              | -                      | 123,551               | 75,602               |
| Contractual services                          | 1,001,365            | 187,164                | 1,465,332             | 81,420               |
| Fuel purchased                                | 56,586               | -                      | 136,683               | 32,904               |
| Utilities                                     | 27,858               | -                      | -                     | -                    |
| Insurance                                     | 72,022               | -                      | 106,726               | 51,500               |
| Miscellaneous                                 | 21,393               | 34,916                 | 60,252                | 15,328               |
| Pretreatment:                                 |                      |                        |                       |                      |
| Salaries and wages                            | 65,607               | -                      | -                     | -                    |
| Employee pensions and benefits                | 42,069               | -                      | -                     | -                    |
| Materials and supplies                        | 1,586                | -                      | -                     | -                    |
| Contractual services                          | 390,043              | -                      | -                     | -                    |
| Fuel purchased                                | 4,228                | -                      | -                     | -                    |
| Insurance                                     | 5,490                | -                      | -                     | -                    |
| Miscellaneous                                 | 1,513                | -                      | -                     | -                    |
| Plant maintenance and operations:             |                      |                        |                       |                      |
| Salaries and wages                            | 1,812,656            | -                      | -                     | -                    |
| Employee pensions and benefits                | 998,106              | -                      | -                     | -                    |
| Materials and supplies                        | 277,219              | -                      | -                     | -                    |
| Repairs and maintenance                       | 645,329              | -                      | -                     | -                    |
| Contractual services                          | 2,622,672            | -                      | -                     | -                    |
| Fuel purchased                                | 75,723               | -                      | -                     | -                    |
| Utilities                                     | 1,491,142            | -                      | -                     | -                    |
| Sludge disposal                               | 408,135              | -                      | -                     | -                    |
| Insurance                                     | 291,240              | -                      | -                     | -                    |
| Miscellaneous                                 | 154,180              | -                      | -                     | -                    |
| Collection system:                            |                      |                        |                       |                      |
| Salaries and wages                            | 633,386              | -                      | -                     | -                    |
| Employee pensions and benefits                | 348,763              | -                      | -                     | -                    |
| Repairs and maintenance                       | 149                  | -                      | -                     | -                    |
| Fuel purchased                                | 6,248                | -                      | -                     | -                    |
| Utilities                                     | 651,064              | -                      | -                     | -                    |
| Insurance                                     | 78,583               | -                      | -                     | -                    |
| Miscellaneous                                 | 2,740                | -                      | -                     | -                    |
| Administration and general:                   |                      |                        |                       |                      |
| Salaries and wages                            | 999,055              | -                      | -                     | -                    |
| Employee pensions and benefits                | 899,734              | -                      | -                     | -                    |
| Materials and supplies                        | 122,822              | -                      | -                     | -                    |
| Repairs and maintenance                       | 44,453               | -                      | -                     | -                    |
| Contractual services                          | 302,559              | -                      | -                     | -                    |
| Fuel purchased                                | 3,927                | -                      | -                     | -                    |
| Utilities                                     | 80,162               | -                      | -                     | -                    |
| Insurance                                     | 46,192               | -                      | -                     | -                    |
| Miscellaneous                                 | 348,544              | -                      | -                     | -                    |
| Depreciation                                  | 4,285,765            | -                      | 165,348               | 63,224               |
| <b>Total operating expenses</b>               | <b>20,973,138</b>    | <b>222,080</b>         | <b>4,363,965</b>      | <b>1,185,886</b>     |
| <b>Operating income (loss)</b>                | <b>(3,244,606)</b>   | <b>86,660</b>          | <b>(387,951)</b>      | <b>(76,939)</b>      |

The notes to the financial statements are an integral part of this statement.

SANITARY DISTRICT  
CITY OF HAMMOND  
STATEMENT OF REVENUES, EXPENSES, AND OTHER CHANGES IN FUND NET ASSETS  
As Of And For The Year Ended December 31, 2010  
(Continued)

|  | 2010                 |                        |                       |                      |
|--|----------------------|------------------------|-----------------------|----------------------|
|  | Sanitary<br>District | Storm Water<br>Utility | Sanitation<br>Utility | Recycling<br>Utility |
| Nonoperating revenues (expenses):                |                      |                        |                       |                      |
| Local tax distributions                          | 5,793,629            | -                      | -                     | -                    |
| Interest earned on debt proceeds                 | 124,196              | -                      | -                     | -                    |
| Transfers Out                                    | (1,100,000)          |                        |                       |                      |
| Amortization of Bond Issuance Cost               | (54,760)             | -                      | (7,929)               | -                    |
| Amortization of Bond Discount                    | (8,340)              |                        |                       |                      |
| Gain/Loss on Sale of Assets                      | (343,842)            |                        |                       |                      |
| Interest expense and fiscal agent fees           | (2,852,536)          | -                      | -                     | -                    |
| Total nonoperating revenues (expenses)           | <u>1,558,347</u>     | <u>-</u>               | <u>(7,929)</u>        | <u>-</u>             |
| <br>   |                      |                        |                       |                      |
| Income (loss) before contributions and transfers | (1,686,259)          | 86,660                 | (395,880)             | (76,939)             |
| <br>   |                      |                        |                       |                      |
| Change in net assets                             | (1,686,259)          | 86,660                 | (395,880)             | (76,939)             |
| <br>   |                      |                        |                       |                      |
| Total net assets - beginning                     | <u>101,685,944</u>   | <u>1,014,695</u>       | <u>1,085,284</u>      | <u>21,003</u>        |
| <br>   |                      |                        |                       |                      |
| Prior Period Adjustment (see note III K.)        | (42,767)             | -                      | (69,408)              | (45,414)             |
| <br>   |                      |                        |                       |                      |
| Restated net assets - beginning                  | 101,643,177          | 1,014,695              | 1,015,876             | (24,411)             |
| <br>   |                      |                        |                       |                      |
| Total net assets - ending                        | <u>\$ 99,956,918</u> | <u>\$ 1,101,355</u>    | <u>\$ 619,996</u>     | <u>\$ (101,350)</u>  |

The notes to the financial statements are an integral part of this statement.



SANITARY DISTRICT  
CITY OF HAMMOND  
STATEMENT OF CASH FLOWS  
As Of And For The Year Ended December 31, 2010

|   | 2010                 |                        |                       |                      |
|---|----------------------|------------------------|-----------------------|----------------------|
|   | Sanitary<br>District | Storm Water<br>Utility | Sanitation<br>Utility | Recycling<br>Utility |
| <b>Cash flows from operating activities:</b>  |                      |                        |                       |                      |
| Receipts from customers and users   | \$ 15,894,851        | \$ 309,118             | \$ 3,961,138          | \$ -                 |
| Payments to suppliers   | (9,654,556)          | (216,208)              | (1,924,127)           | (291,221)            |
| Payments to employees   | (6,710,049)          | -                      | (2,219,563)           | (837,402)            |
| Other receipts  | -                    | -                      | -                     | 1,108,947            |
| <b>Net cash provided by operating activities</b>  | <u>(469,754)</u>     | <u>92,910</u>          | <u>(182,552)</u>      | <u>(19,676)</u>      |
| <b>Cash flows from noncapital financing activities:</b>   |                      |                        |                       |                      |
| Proceeds from tax anticipation warrants   | 3,739,908            | -                      | -                     | -                    |
| Principal paid on tax anticipation warrants   | (690,553)            | -                      | -                     | -                    |
| Interest paid on tax anticipation warrants  | (28,247)             | -                      | -                     | -                    |
| Interfund loans received  | 266,725              | 800,000                | 175,000               | 300,000              |
| Interfund loans paid  | (362,303)            | (900,000)              | -                     | (275,000)            |
| Transfers from city   | (1,100,000)          | -                      | -                     | -                    |
| <b>Net cash provided (used) by noncapital financing activities</b>                                    | <u>1,825,530</u>     | <u>(100,000)</u>       | <u>175,000</u>        | <u>25,000</u>        |
| <b>Cash flows from capital and related financing activities:</b>                                      |                      |                        |                       |                      |
| Local tax distributions/community customers debt service  | 5,793,629            | -                      | -                     | -                    |
| Proceeds from bonds   | 9,605,000            | -                      | -                     | -                    |
| Acquisition and construction of capital assets  | (3,248,466)          | -                      | -                     | -                    |
| Principal paid on capital debt  | (3,795,000)          | -                      | (201,081)             | -                    |
| Loan issuance costs paid  | (155,659)            | -                      | -                     | -                    |
| Bond discount paid  | (144,075)            | -                      | -                     | -                    |
| Interest paid on capital debt   | (2,637,109)          | -                      | (7,929)               | -                    |
| <b>Net cash provided (used) by capital and related financing activities</b>                           | <u>5,418,320</u>     | <u>-</u>               | <u>(209,010)</u>      | <u>-</u>             |
| <b>Cash flows from investing activities:</b>  |                      |                        |                       |                      |
| Interest received   | 124,196              | -                      | -                     | -                    |
| <b>Net cash provided (used) by investing activities</b>   | <u>124,196</u>       | <u>-</u>               | <u>-</u>              | <u>-</u>             |
| <b>Net increase in cash and cash equivalents</b>  | <u>6,898,292</u>     | <u>(7,090)</u>         | <u>(216,562)</u>      | <u>5,325</u>         |
| <b>Cash and cash equivalents, January 1</b>   | <u>11,996,248</u>    | <u>189,285</u>         | <u>308,997</u>        | <u>5,834</u>         |
| <b>Cash and cash equivalents, December 31</b>   | <u>\$ 18,894,540</u> | <u>\$ 182,195</u>      | <u>\$ 92,435</u>      | <u>\$ 11,159</u>     |
| <b>Reconciliation of operating income to net cash provided (used) by operating activities:</b>        |                      |                        |                       |                      |
| Operating income (loss)   | \$ (3,244,606)       | \$ 86,660              | \$ (387,951)          | \$ (76,939)          |
| <b>Adjustments to reconcile operating income to net cash provided (used) by operating activities:</b> |                      |                        |                       |                      |
| Depreciation expense  | 4,285,765            | -                      | 165,348               | 63,224               |
| (Increase) decrease in assets:  |                      |                        |                       |                      |
| Accounts receivable   | 10,476               | 378                    | (14,875)              | (17,213)             |
| Taxes receivable  | (1,905,712)          | -                      | -                     | -                    |
| Intergovernmental receivable  | (102,749)            | -                      | -                     | -                    |
| Deferred Debits   | 164,304              | -                      | -                     | -                    |
| Inventories   | (61,539)             | -                      | -                     | -                    |
| Prepaid items   | (31,245)             | -                      | (20,395)              | (11,798)             |
| Increase (decrease) in liabilities:   |                      |                        |                       |                      |
| Accounts payable  | (5,607)              | 5,872                  | 62,941                | 15,817               |
| Accrued payroll and withholdings payable  | 32,739               | -                      | 8,512                 | 8,213                |
| Compensated absences payable  | 20,110               | -                      | 3,868                 | (980)                |
| <b>Total adjustments</b>  | <u>2,406,542</u>     | <u>6,250</u>           | <u>205,399</u>        | <u>57,263</u>        |
| <b>Net cash provided by operating activities</b>  | <u>\$ (838,064)</u>  | <u>\$ 92,910</u>       | <u>\$ (182,552)</u>   | <u>\$ (19,676)</u>   |
| <b>Noncash investing, capital and financing activities:</b>   |                      |                        |                       |                      |
| Acquisition of capital assets through accounts payable (net)  | \$ 557,802           | \$ -                   | \$ -                  | \$ -                 |

The notes to the financial statements are an integral part of this statement.

SANITARY DISTRICT  
CITY OF HAMMOND  
NOTES TO FINANCIAL STATEMENTS

I. Summary of Significant Accounting Policies

A. Reporting Entity

The financial statements reflect only the activity of the Utility and are not intended to present fairly the position of the City of Hammond (City), and the results of its operations and cash flows of its enterprise funds. The Sanitary District, whose operations are controlled by the City, represents a substantial portion of the City's enterprise funds. The Sanitary district comprises the Sanitary District, Storm Water Utility, Sanitation Utility, and Recycling Utility.

B. Fund Financial Statements

Business-type activity financial statements consist of the Statement of Net Assets; Statement of Revenues, Expenses, and Other Changes in Fund Net Assets; and the Statement of Cash Flows. Business-type activities rely to a significant extent on fees and charges for support.

C. Measurement Focus, Basis of Accounting and Financial Statement Presentation

The accounts of the business-type activity are maintained and the financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recognized when incurred.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the enterprise fund statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the option of following subsequent private-sector guidance for their enterprise funds, subject to this same limitation. The Utility has elected not to follow subsequent private-sector guidance.

Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with an enterprise fund's principal ongoing operations. The principal operating revenues of the enterprise funds are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services and administrative costs. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

When both restricted and unrestricted resources are available for use, the Utility's policy is to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, Liabilities and Net Assets or Equity

1. Deposits and Investments

The Utility's cash and cash equivalents are considered to be cash on hand, demand deposits and short-term investments with original maturities of three months or less from the date of acquisition.

SANITARY DISTRICT  
CITY OF HAMMOND  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

State statute (IC 5-13-9) authorizes the Utility to invest in securities, including but not limited to, federal government securities, repurchase agreements, and certain money market mutual funds. Certain other statutory restrictions apply to all investments made by local governmental units.

Debt securities are reported at fair value. Debt securities are defined as securities backed by the full faith and credit of the United States Treasury or fully insured or guaranteed by the United States or any United States government agency.

Money market investments that mature within one year or less at the date of their acquisition are reported at amortized cost. Other money market investments are reported at fair value.

Investment income, including changes in the fair value of investments, is reported as revenue in the operating statement.

2. Property Taxes

Property taxes levied are collected by the County Treasurer and are distributed to the Sanitary District in June and in December. State statute (IC 6-1.1-17-16) requires the Indiana Department of Local Government Finance to establish property tax rates and levies by February 15. These rates were based upon the preceding year's March 1 (lien date) assessed valuations adjusted for various tax credits. Taxable property is assessed at 100% of the true tax value (determined in accordance with rules and regulations adopted by the Indiana Department of Local Government Finance). Taxes may be paid in two equal installments which become delinquent if not paid by May 10 and November 10, respectively.

In accordance with state statutes, all counties were required to reassess property values prior to billings in 2009. Significant delays in the reassessment process have resulted in delays in billing in 2009. The Sanitary District received advance draws of their 2010 taxes from the provisional billing in 2010. The Sanitary District received their final settlement of the 2009 taxes payable in 2010, on January 20, 2011.

3. Inventories, Prepaid Items, and Deferred Charges

All inventories are valued at cost using the first in/first out (FIFO) method. Inventories of governmental funds are recorded as expenditures when consumed rather than purchased.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

Based upon an agreement between user cities/towns and the District, a set rate is paid. Annually, a study is performed to determine if the user cities/towns have underpaid or overpaid. The underpayments or overpayments are reported as deferred charges in addition to the unamortized balance of debt issuance costs.

4. Restricted Assets

Certain resources set aside for the repayment of debt and various Sanitary District improvements are classified as restricted assets on the statement of net assets in accordance with the debt instruments and the grant agreements.

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5. Capital Assets

Capital assets, which include property, plant, and equipment, are reported in the financial statements.

Capital assets are reported at actual or estimated historical cost based on appraisals or deflated current replacement cost. Contributed or donated assets are reported at estimated fair value at the time received.

Capitalization thresholds (the dollar values above which asset acquisitions are added to the capital asset accounts), depreciation methods and estimated useful lives of capital assets are as follows:

|                        | Capitalization<br>Threshold | Depreciation<br>Method | Estimated<br>Useful Life |
|------------------------|-----------------------------|------------------------|--------------------------|
| Land improvements      | \$ 5,000                    | Straight-line          | 25-60 years              |
| Buildings              | 5,000                       | Straight-line          | 60 years                 |
| Buildings improvements | 5,000                       | Straight-line          | 20 to 40 years           |
| Major Equipment        | 5,000                       | Straight-line          | 10 to 40 years           |
| Minor Equipment        | 5,000                       | Straight-line          | 3 to 10 years            |

For depreciated assets, the cost of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Major outlays for capital assets and improvements are capitalized as projects are constructed.

6. Compensated Absences

- a. Sick Leave – Sanitary District employees earn sick leave at the rate of 1 day per month. Unused sick leave may be accumulated up to a maximum of 75 days. For each 5 days earned in excess of the allowable accumulation, the excess days shall be converted to equal 1 regular vacation day. One week of accumulated sick leave is paid to union employees through cash payments upon termination if the employee has accumulated 75 days. Nonunion employees eligible for retirement, or upon separation of employment with at least 10 years of full-time service, will be reimbursed 1 day's pay for each 4 days of unused sick leave up to the accumulation of 75 days. Nonunion employees with at least 15 years of full-time service will be reimbursed 1 day's pay for each 2 days of unused sick leave, up to the accumulation of 75 days.
- b. Vacation Leave – Sanitary District employees earn vacation leave at rates from 10 days to 30 days per year based upon the number of years of service. Vacation leave does not accumulate from year to year.
- c. Personal Leave – Sanitary District employees earn personal leave at the rate of 3 days per year. Personal leave does not accumulate from year to year.

Sick leave is accrued when incurred.

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No liability is reported for vacation and personal leave.

7. Long-Term Obligations

Long-term debt and other long-term obligations are reported as liabilities in the statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

II. Detailed Notes on All Funds

A. Deposits

Custodial credit risk is the risk that in the event of a bank failure, the government's deposits may not be returned to it. Indiana Code 5-13-8-1 allows a political subdivision of the State of Indiana to deposit public funds in a financial institution only if the financial institution is a depository eligible to receive state funds and has a principal office or branch that qualifies to receive public funds of the political subdivision. The District does not have a deposit policy for custodial credit risk. At December 31, 2010, the District had deposit balances in the amount of \$19,180,329.

The bank balances were insured by the Federal Deposit Insurance Corporation or the Public Deposit Insurance Fund, which covers all public funds held in approved depositories.

B. Capital Assets

Capital asset activity for the year ended December 31, 2009, was as follows:

|   | Beginning<br>Balance | Prior Year<br>Adjustment | Restated<br>Balance | Increases | Decreases | Ending<br>Balance |
|---|----------------------|--------------------------|---------------------|-----------|-----------|-------------------|
| Sanitary District:                          |                      |                          |                     |           |           |                   |
| Capital assets, not being depreciated:      |                      |                          |                     |           |           |                   |
| Land  | \$ 497,919           | \$ -                     | 497,919             | \$ -      | \$ -      | \$ 497,919        |
| Construction in progress                    | 19,493,279           | 342,064                  | 19,835,343          | 3,448,393 | -         | 23,283,736        |
| Total capital assets, not being depreciated | 19,991,198           | 342,064                  | 20,333,262          | 3,448,393 | -         | 23,781,655        |
| Capital assets, being depreciated:          |                      |                          |                     |           |           |                   |
| Land improvements                           | 108,457,618          | -                        | 108,457,618         | 5,000     | 193,826   | 108,268,791       |
| Buildings                                   | 41,208,658           | -                        | 41,208,658          | -         | 514,219   | 40,694,439        |
| Buildings improvements                      | 7,088,869            | -                        | 7,088,869           | 191,459   | 169,896   | 7,110,432         |
| Major Equipment                             | 46,037,246           | -                        | 46,037,246          | 205,800   | 795,186   | 45,447,859        |
| Minor Equipment                             | 3,913,655            | -                        | 3,913,655           | 51,831    | 267,499   | 3,697,987         |
| Totals                                      | 206,706,045          | -                        | 206,706,045         | 454,090   | 1,940,626 | 205,219,509       |

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NOTES TO FINANCIAL STATEMENTS  
(Continued)

|   | Beginning<br>Balance  | Prior Year<br>Adjustment | Restated<br>Balance   | Increases           | Decreases         | Ending<br>Balance     |
|---|-----------------------|--------------------------|-----------------------|---------------------|-------------------|-----------------------|
| Sanitary District (continued):                      |                       |                          |                       |                     |                   |                       |
| Less accumulated depreciation for:                  |                       |                          |                       |                     |                   |                       |
| Land improvements                                   | 41,074,864            | 301,554                  | 41,376,418            | 2,109,409           | 160,670           | 43,325,158            |
| Buildings   | 19,682,736            | -                        | 19,682,736            | 654,877             | 359,924           | 19,977,690            |
| Buildings improvements                              | 4,658,088             | -                        | 4,658,088             | 144,809             | 149,975           | 4,652,922             |
| Major Equipment                                     | 24,321,703            | -                        | 24,321,703            | 1,133,745           | 569,654           | 24,885,794            |
| Minor Equipment                                     | 2,179,760             | -                        | 2,179,760             | 249,347             | 183,591           | 2,245,516             |
| <b>Totals</b>                                       | <b>91,917,152</b>     | <b>301,554</b>           | <b>92,218,706</b>     | <b>4,292,187</b>    | <b>1,423,815</b>  | <b>95,087,079</b>     |
| <b>Total capital assets, being depreciated, net</b> | <b>114,788,893</b>    | <b>(301,554)</b>         | <b>114,487,340</b>    | <b>(3,838,098)</b>  | <b>516,812</b>    | <b>110,132,430</b>    |
| <b>Total capital assets, net</b>                    | <b>\$ 134,780,091</b> | <b>\$ 40,510</b>         | <b>\$ 134,820,602</b> | <b>\$ (389,705)</b> | <b>\$ 516,812</b> | <b>\$ 133,914,085</b> |
| Sanitation Utility:                                 |                       |                          |                       |                     |                   |                       |
| Capital assets, being depreciated:                  |                       |                          |                       |                     |                   |                       |
| Major Equipment                                     | \$ 1,094,663          | \$ -                     | \$ 1,094,663          | \$ -                | \$ -              | \$ 1,094,663          |
| Less accumulated depreciation for:                  |                       |                          |                       |                     |                   |                       |
| Major Equipment                                     | 289,044               | 69,508                   | 358,552               | 165,348             | -                 | 523,900               |
| <b>Total capital assets, being depreciated, net</b> | <b>\$ 805,619</b>     | <b>\$ 69,508</b>         | <b>\$ 736,111</b>     | <b>\$ 165,348</b>   | <b>\$ -</b>       | <b>\$ 570,763</b>     |
| Recycling Utility                                   |                       |                          |                       |                     |                   |                       |
| Capital assets, being depreciated:                  |                       |                          |                       |                     |                   |                       |
| Major Equipment                                     | \$ 33,138             | \$ -                     | \$ 33,138             | \$ -                | \$ -              | \$ 33,138             |
| Minor Equipment                                     | 417,164               | -                        | 417,164               | -                   | -                 | 417,164               |
| <b>Totals</b>                                       | <b>450,302</b>        | <b>-</b>                 | <b>450,302</b>        | <b>-</b>            | <b>-</b>          | <b>450,302</b>        |
| Less accumulated depreciation for:                  |                       |                          |                       |                     |                   |                       |
| Major Equipment                                     | 3,734                 | 45,714                   | 49,448                | 22,857              | -                 | 72,305                |
| Minor Equipment                                     | 126,785               | -                        | 126,785               | 40,368              | -                 | 167,153               |
| <b>Totals</b>                                       | <b>130,519</b>        | <b>45,714</b>            | <b>176,233</b>        | <b>63,225</b>       | <b>-</b>          | <b>239,458</b>        |
| <b>Total capital assets, being depreciated, net</b> | <b>\$ 319,783</b>     | <b>\$ (45,714)</b>       | <b>\$ 274,069</b>     | <b>\$ 63,225</b>    | <b>\$ -</b>       | <b>\$ 210,844</b>     |

Depreciation expense was charged to functions/programs of the Utility as follows:

|                                   | <u>2010</u>                |
|-----------------------------------|----------------------------|
| Sanitary District                 | \$ 4,285,765               |
| Sanitation Utility                | 165,348                    |
| Recycling Utility                 | <u>63,224</u>              |
| <b>Total depreciation expense</b> | <b><u>\$ 4,514,337</u></b> |

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C. Construction Commitments

Construction work in progress is composed of the following:

| <u>Project</u>                               | <u>2010</u>                         |                      |                     |
|--|-------------------------------------|----------------------|---------------------|
|  | <u>Expended to<br/>December 31,</u> | <u>Authorized</u>    | <u>Committed</u>    |
| CSO (Combined Sewer Overflow) Storage Basin  | \$ 2,528,050                        | \$ 3,265,952         | \$ 737,902          |
| RAS (Return Activated Sludge) Piping Upgrade | 6,530,076                           | 3,126,102            | (3,403,974)         |
| Generator Kennedy Avenue North Station       | 1,583,184                           | 1,751,455            | 168,271             |
| Columbia Avenue Force Main                   | 6,813,966                           | 6,753,110            | (60,856)            |
| Columbia Avenue Storm Sewer                  | 2,105,510                           | 2,105,507            | (3)                 |
| SCADA  | 635,258                             | 1,200,000            | 564,742             |
| Tertiary Screw Pump                          | 534,372                             | 550,000              | 15,628              |
| New Gas Engine                               | 43,193                              | -                    | (43,193)            |
| Plant Electrical Upgrade 15KV                | 231,905                             | 300,000              | 68,095              |
| Long Term Control Plan                       | 40,068                              | 400,540              | 360,472             |
| Wicker Park Estate Design                    | 56,000                              | 395,000              | 339,000             |
| Sanitary Sewer 165th Street                  | 950,000                             | 1,430,000            | 480,000             |
| Biosolids Project                            | 298,269                             | 318,459              | 20,190              |
| Columbia Avenue Control Room                 | 136,303                             | 150,000              | 13,697              |
| Southwest Interceptor                        | 105,106                             | 105,000              | (106)               |
| Capitalized interest Bond 2010               | 294,495                             | 294,495              | -                   |
| Calumet Munster Project                      | 338,310                             | 550,000              | 211,690             |
| Schoon Ditch                                 | 59,671                              | 94,120               | 34,449              |
| Totals                                       | <u>\$ 23,283,736</u>                | <u>\$ 22,789,740</u> | <u>\$ (493,996)</u> |

D. Interfund Balances and Activity

Interfund Receivables and Payables

The composition of interfund balances as of December 31, 2010, is as follows:

| <u>Due From</u>    | <u>Due To</u>       | <u>2010</u>       |
|--------------------|---------------------|-------------------|
| Recycling Utility  | Storm Water Utility | \$ 300,000        |
| Sanitation Utility | Storm Water Utility | 175,000           |
| Sanitary District  | Storm Water Utility | 425,000           |
| Totals             |                     | <u>\$ 900,000</u> |

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Interfund balances resulted from the time lag between the dates that interfund loans are repaid.

E. Short-Term Liabilities

The Sanitary District may use short-term notes and loans, including tax anticipation warrants to finance operations cash flows due to delay in receipts of property tax collections.

|                                   | Beginning<br>Balance | Issue/<br>Draw | Redeemed/<br>Repayment | Ending<br>Balance |
|-----------------------------------|----------------------|----------------|------------------------|-------------------|
| Tax anticipation warrants payable | \$0                  | \$3,741,199    | \$691,844              | \$3,049,355       |

F. Long-Term Liabilities

1. General Obligation Bonds

The Sanitary District issues general obligation bonds to provide funds for the acquisition and construction of major capital facilities.

General obligation bonds are direct obligations and pledge the full faith and credit of the primary government. General obligation bonds currently outstanding at year end are as follows:

| Purpose                                      | Interest<br>Rates | Amount            |
|--|-------------------|-------------------|
| 2007 Special Taxing District bonds           | 4.25% to 4.5%     | \$ 3,305,000      |
| 2003 Special Taxing District refunding bonds | 6%                | 880,000           |
| 2010 Special Taxing District bonds           | 6%                | 9,605,000         |
| <br>Total                                    |                   | <br>\$ 13,790,000 |

Annual debt service requirements to maturity for the general obligation bonds are as follows:

|           | Principal     | Interest     |
|-----------|---------------|--------------|
| 2011      | \$ 1,080,000  | \$ 551,727   |
| 2012      | 1,310,000     | 500,417      |
| 2013      | 1,360,000     | 443,542      |
| 2014      | 1,080,000     | 394,268      |
| 2015      | 1,115,000     | 353,280      |
| 2016-2030 | 7,845,000     | 2,812,607    |
| Totals    | \$ 13,790,000 | \$ 5,055,841 |



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2. Loans Payable

The Sanitary District has entered into various loans with the State Revolving Loan Fund (SRF). Under the terms of the loans, revenue bonds issued by the Sanitary District have been purchased by the Indiana Bond Bank. The proceeds are set aside to finance the Sanitary District improvements. Funds are loaned to the Sanitary District as costs are accrued, to the maximum allowed. The Sanitary District has drawn down all of the 1993, 1997, 1998, 2001A, 2001B, 2006A, Loan program funds; however, the 2007B Loan Program Funds for \$17,225,000 are still being drawn down. The State placed the loan proceeds into a trust account in the Sanitary District's name, cash draws are made from this account. The remaining cash available to draw for the 2007B Loan is reported as Cash with Fiscal Agent. The balance available to draw is \$6,900,506. Annual debt service requirements to maturity for the loans including interest of \$13,510,968, are as follows:

|            |        |                       |
|------------|--------|-----------------------|
| 2011       | \$     | 4,486,526             |
| 2012       |        | 4,452,514             |
| 2013       |        | 4,390,701             |
| 2014       |        | 3,033,411             |
| 2015       |        | 3,025,216             |
| 2016-2020  |        | 18,035,935            |
| 2021-2025  |        | 11,985,442            |
| 2026-2030  |        | <u>4,341,223</u>      |
| <br>Totals | <br>\$ | <br><u>53,750,968</u> |

3. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2010, was as follows:

|  | Beginning<br>Balance     | Additions               | Reductions              | Ending<br>Balance        | Due Within<br>One Year  |
|--|--------------------------|-------------------------|-------------------------|--------------------------|-------------------------|
| Sanitary District:                     |                          |                         |                         |                          |                         |
| General Obligation                     |                          |                         |                         |                          |                         |
| Bonds payable                          | \$ 5,040,000             | \$ 9,605,000            | \$ 855,000              | \$ 13,790,000            | \$ 1,080,000            |
| Less bond discount                     | <u>(15,907)</u>          | <u>(144,075)</u>        | <u>(8,340)</u>          | <u>(151,642)</u>         | <u>-</u>                |
| Total general obligation bonds payable | 5,024,093                | 9,460,925               | 846,660                 | 13,638,358               | 1,080,000               |
| Loans payable                          | 43,180,000               |                         | 2,940,000               | 40,240,000               | 2,905,000               |
| Other Post Employment Benefits         | -                        | 368,310                 |                         | 368,310                  | -                       |
| Compensated absences                   | <u>105,303</u>           | <u>121,520</u>          | <u>105,303</u>          | <u>121,520</u>           | <u>-</u>                |
| <br>Total Long-term liabilities        | <br><u>\$ 48,309,396</u> | <br><u>\$ 9,950,755</u> | <br><u>\$ 3,891,963</u> | <br><u>\$ 54,368,188</u> | <br><u>\$ 3,985,000</u> |
| <br>Sanitation Utility:                |                          |                         |                         |                          |                         |
| Compensated absences                   | <u>\$ 6,058</u>          | <u>\$ 9,925</u>         | <u>\$ 6,058</u>         | <u>\$ 9,925</u>          | <u>\$ -</u>             |
| <br>Recycling Utility:                 |                          |                         |                         |                          |                         |
| Compensated absences                   | <u>\$ 7,332</u>          | <u>\$ 6,352</u>         | <u>\$ 7,332</u>         | <u>\$ 6,352</u>          | <u>\$ -</u>             |

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G. Restricted Assets

The balances of restricted asset accounts in the enterprise funds are as follows:

|   |                                 |
|---|---------------------------------|
| Bond and interest cash and cash equivalents | \$ 10,394,781                   |
| Cash with fiscal agent-construction         | 7,894,310                       |
| Taxes and accounts receivable               | <u>3,630,367</u>                |
| <br>Total restricted assets                 | <br><u><u>\$ 21,919,458</u></u> |

III. Other Information

A. Risk Management

The risks of torts; theft of, damage to, and destruction of assets; errors and omissions; job related illnesses or injuries to employees; medical benefits to employees, retirees, and dependents including postemployment benefits; and natural disasters are covered by commercial insurance from independent third parties. Settled claims from these risks have not exceeded commercial insurance coverage for the past 3 years. There were no significant reductions in insurance by major category of risk.

Unemployment Compensation

The Sanitary District has chosen to establish a risk financing fund for risks associated with unemployment compensation claims. The risk financing fund is accounted for in the Unemployment Compensation Account where assets are set aside for claim settlements. Provisions are also made for unexpected and unusual claims.

Claim expenditures and liabilities of the fund are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Claim liabilities are calculated considering the effects of inflation, recent claim settlement trends, including frequency and amounts of pay outs, and other economic and social factors.

Changes in the balance of claim liabilities during the past two years are as follows:

|  | 2009                       | 2010                   |
|--|----------------------------|------------------------|
| Unpaid claims, beginning of fiscal year  | \$ -                       | \$ 5,704               |
| Incurred claims and changes in estimates | 21,000                     | 16,411                 |
| Claim payments                           | <u>(15,296)</u>            | <u>(22,115)</u>        |
| <br>Unpaid claims, end of fiscal year    | <br><u><u>\$ 5,704</u></u> | <br><u><u>\$ -</u></u> |

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B. Subsequent Events

Circuit Breaker Tax Credit

Indiana Code 6-1.1-20.6 provides taxpayers with a tax credit (the "Circuit Breaker Tax Credit") for all property taxes in an amount that exceeds two percent (2%) of the gross assessed value of eligible property. Beginning with property taxes due and payable in 2010 and thereafter, the property eligible for the Circuit Breaker Tax Credit is expanded to include all personal and real property of every type. The Circuit Breaker Tax Credit will result in a reduction of property tax collections for each political subdivision in which the Circuit Breaker Tax Credit is applied. A political subdivision may not increase its property tax levy or borrow money to make up for any property tax revenue shortfall due to the application of the Circuit Breaker Tax Credit.

The Department of Local Government Finance (DLGF) has taken an administrative position that existing law requires taxing units to fully fund any levies for the payment of outstanding debt service or lease rental obligations regardless of any reduction in property tax collections due to the application of the Circuit Breaker Tax Credit. The DLGF's position is that property taxes collected by a political subdivision must first be applied to pay debt service or lease rental obligations on all outstanding bonds or lease rental revenue bonds. If property tax collections are insufficient to fully fund debt service or lease rental levies due to the Circuit Breaker Tax Credit, the DLGF has indicated the taxing units must use non-property tax revenues or revenues from property tax levies for other funds (including operating) to offset revenue loss to the debt service fund.

Based on Legislative Services Agency (LSA) data, it is anticipated that the annual trending of assessed value and resulting reduction in tax rates in Lake County will reduce the loss of property tax revenues from the implementation of the Circuit Breaker Tax Credit. In budget year 2010 and thereafter, when the credit is expanded to apply to both real and depreciable personal property, LSA estimates the Circuit Breaker Tax Credit will be approximately \$1,238,581 each year.

C. Contingent Liabilities

There are several pending claims against the Sanitary District for which liability cannot be reasonably estimated; however, it is expected that no pending claim has the potential to exceed the Sanitary District's insurance coverage.

As a result of heavy storms from 2006, 2007, and 2008, property owners within the Sanitary District have alleged damages by unspecified acts of negligence by the Sanitary District and Sanitary District employees. Additionally, several lawsuits seeking damages have been filed against the Sanitary District. The Sanitary District denies that any negligence of its personnel caused or contributed to any injuries or damages. The Sanitary District also believes that it is immune from liability for this kind of event under the terms of the Indiana Tort Claims Act and case law interpreting that Act. The extent of the Sanitary District's exposure is not known; however, the Sanitary District believes that all claims arising out of storm events can be resolved within the limits of the Sanitary District's insurance coverage.

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D. Cash with Fiscal Agent

The Hammond and Munster Water Utilities serve as billing and collection agents for the Sanitary District user charge system. The Hammond Water Utility deposits daily collections directly to the Sanitary District's bank accounts. Thus, the amount reported as Cash with Fiscal Agent represents collections by the Munster Water Utility not yet remitted to the Sanitary District, as well as cash held by the Hammond Water Utility, but not recognized by the Sanitary District as having been received.

In 2007, the Sanitary District obtained a State Revolving Loan from the State of Indiana's State Revolving Loan Fund. The State placed the \$17,225,000 loan proceeds into a trust account in the Sanitary District's name. The Sanitary District will earn the interest from the trust account. Before any disbursements can be made from this trust account, the State must approve the draw down in accordance with the loan agreement. Thus, the amount reported as Cash with Fiscal Agent – Restricted represents the balance in this trust account.

E. Transfers to City

The Sanitary District transferred \$600,348 to the City as payment in lieu of taxes.

F. Consent Decree – Non-compliance

In April of 1999, the Sanitary District entered into a Consent Decree with the United States Environmental Protection Agency (EPA) to implement improvements to address the effects of sediment contamination in the West Branch of the Grand Calumet River.

For CSO Control, the Sanitary District was to initiate construction by May 1, 2004 for new reservoir and pump station improvements, sewer separations, sewer interceptors, and sewer interceptor improvements in order to eliminate the use of the Columbia, Sohl and Johnson Avenues CSOs. The projects were to be completed by May 1, 2009 and achieved operational status for all new or modified components and cease all discharges from Columbia, Sohl and Johnson Avenues CSOs. In accordance with the Consent Decree failure to comply with any completion date specified and to remain in noncompliance for more than 90 days, the Sanitary District shall not thereafter make any new hook-up, connection, or extension to its sewage system until the Sanitary District certified to EPA and Indiana Department of Environmental Management (IDEM) that it has completed the requirement.

For any noncompliance of the Consent Decree requirements noted above, the stipulated penalty would be applicable based on the period of noncompliance. From the first to the 30<sup>th</sup> day of continuous violation, \$500 per day per violation; from the 31<sup>st</sup> to the 60<sup>th</sup> day of continuous violation, \$750 per day per violation; and after 60 days of continuous violation, \$1,000 per day per violation.

The Sanitary District is required to report semi-annually to the EPA and IDEM on the status of the Sanitary District's compliance with all requirements of the Decree.

The semi-annual reports were submitted on June 17, 2010 and December 17, 2010; however the Sanitary District has not completed the CSO Control construction projects due to a lack of funding. As of May 17, 2011, the Sanitary District is negotiating with representatives of the EPA, the U.S. Department of Justice, and the IDEM to modify the terms of the Consent Decree. The

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proposed amended consent decree will establish December 31, 2013 as the deadline for completion of CSO Control measures. The Sanitary District is seeking funding for the projects that will complete the CSO Control measures. As of May 17, 2011, no penalties have been assessed against the Sanitary District.

A permit renewal application was submitted to IDEM on January 29, 1999. A new NPDES Permit was issued in 2006. Due to concerns regarding certain pollutant parameters, the permit has been petitioned by the Sanitary District for administrative review. Also, the Sanitary District has been advised by the EPA and IDEM of their intent to seek civil penalties as provided in the existing Consent Decree. The penalties sought are for certain NPDES Permit pollutant parameter violations alleged to have occurred over the last five years, which the Sanitary District denies the existence and/or the extent of these violations. The Sanitary District estimates the liability for any such penalties to be less than \$250,000.

G. Postemployment Benefits

Plan Description

The Hammond Sanitary District Retiree Healthcare Plan is a single-employer defined benefit healthcare plan administered by the Guardian and Anthem Insurance Companies. The plan provides for postemployment medical, dental, vision and life insurance benefits for eligible retirees and their spouses. The Sanitary District also provides a senior healthcare plan that provides Medicare supplemental insurance coverage to eligible retirees and their spouses. Indiana Code 5-10-8 assigns the authority to establish and amend the plan.

Funding Policy

The contribution requirements of plan members for the Sanitary District's Retiree Healthcare Plan are established and can be amended by the Sanitary District Board. The required contribution is based on projected pay-as-you-go financing requirements. For the year ended December 31, 2010, the date of the most recently completed actuarial study, the Sanitary District contributed \$251,993 to the plan.

Annual OPEB Cost and Net OPEB Obligation

The Sanitary District's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the Sanitary District's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the Sanitary District's net OPEB obligation to the plan:

SANITARY DISTRICT  
CITY OF HAMMOND  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

|  |    |           |
|--|----|-----------|
| Annual required contribution           | \$ | 620,303   |
| Interest on net OPEB obligation        |    | 0         |
| Adjustment to ARC                      |    | 0         |
| Annual OPEB cost                       |    | 620,303   |
| Contributions made                     |    | (251,993) |
| Increase in net OPEB obligation        |    | 368,310   |
| Net OPEB obligation, beginning of year |    | 0         |
| Net OPEB obligation, end of year       | \$ | 368,310   |

Funded Status and Funding Progress

As of December 31, 2010, the most recent actuarial valuation date, the plan was 0% funded. The actuarial accrued liability for benefits was \$9,163,348, and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability (UAAL) of \$9,163,348. Actuarial valuation of an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the type of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the December 31, 2010, actuarial valuation, the projected unit credit cost method was used. The actuarial assumptions included an annual healthcare cost trend rate of 10% initially, reduced by decrements to an ultimate rate of 5% after 10 years. The UAAL is being amortized as a level percentage of projected payrolls on an open group. The remaining amortization period at December 31, 2010 was 30 years.

H. Rate Structure

Wastewater Service Rate Increase

In accordance with Indiana Code 36-9-25-11.3(d)(2)(B), the Sanitary District petitioned the Indiana Utility Regulatory Commission(IURC) for a wastewater service rate increase during 2007. On January 4, 2008, the IURC approved a 38.34% rate increase based upon a cost of service study which results in a greater increase in flow rate for the industrial class when compared to the flow rate increase to the residential/commercial class.

SANITARY DISTRICT  
CITY OF HAMMOND  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

Storm Water Utility

The current rate structure for the storm water customer charge was approved by the Common Council on January 23, 2006.

Sanitation and Recycling Departments

In December 2007, the Sanitary District approved Resolution 56-2007 assuming the cost of providing trash and waste collection and disposal to the residents of the City of Hammond from the City as of January 1, 2008. The Sanitary District also approved Resolution 44-2007 establishing a user fee for the collection of trash and solid waste. The garbage user fee is \$15 per month unless the head of the household is over the age of 65 years or is disabled then such user fee is \$10 per month.

I. Pension Plan

Public Employees' Retirement Fund

Plan Description

The City, including the Utility, contributes to the Indiana Public Employees' Retirement Fund (PERF), a defined benefit pension plan. PERF is an agent multiple-employer public employee retirement system, which provides retirement benefits to plan members and beneficiaries. All full-time employees are eligible to participate in the defined benefit plan. State statutes (IC 5-10.2 and 5-10.3) govern, through the PERF Board, most requirements of the system and give the Utility authority to contribute to the plan. The PERF retirement benefit consists of the pension provided by employer contributions plus an annuity provided by the member's annuity savings account. The annuity savings account consists of member's contributions, set by state statute at three percent of compensation, plus the interest credited to the member's account. The employer may elect to make the contributions on behalf of the member.

PERF administers the plan and issues a publicly available financial report that includes financial statements and required supplementary information for the plan as a whole and for its participants. The report may be obtained by contacting:

Public Employees' Retirement Fund  
Harrison Building, Room 800  
143 West Market Street  
Indianapolis, IN 46204  
Ph. (317) 233-4162

Funding Policy

PERF members are required to contribute three percent (3%) of their annual covered salary. The Utility is required to contribute at an actuarially determined rate; the current rate is six and a half percent (6.75%) of annual covered payroll. The contribution requirements of plan members and the Utility are established and may be amended by the PERF Board of Trustees.

For 2010, the Sanitary District's annual pension cost was \$603,105.

SANITARY DISTRICT  
CITY OF HAMMOND  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

J. Subsequent Events

Capital Lease

The Sanitary District entered into a capital lease for the purchase of a vactor truck for the Sewer Maintenance Department on March 28, 2011. Future minimum lease payments and present values of the net minimum lease payments under the capital lease as of March 28, 2011 are as follows:

|   |                   |
|---|-------------------|
| 2012  | \$ 74,324         |
| 2013  | 74,324            |
| 2014  | 74,324            |
| 2015  | <u>74,324</u>     |
| Total minimum lease payments                | 297,296           |
| Less amount representing interest           | <u>30,593</u>     |
| Present value of net minimum lease payments | \$ <u>266,703</u> |

K. Restatements and Reclassifications

For the year ended December 31, 2009, certain changes have been made to the financial statements for adjustments made to reclassify expenditures to construction in progress (CIP) in the Sanitary District Fund. The following schedule presents a summary of restated beginning balances for construction in progress by project.

|  | <u>Sanitary</u> | <u>Sanitation</u> | <u>Recycling</u> |
|--|-----------------|-------------------|------------------|
| Net Assets as Stated December 31, 2009                     | \$ 101,685,944  | \$ 1,085,284      | \$ 21,003        |
| Additions:   |                 |                   |                  |
| Restatement of Construction in Progress<br>(See note II B) | 342,064         |                   |                  |
| Reductions   |                 |                   |                  |
| Accumulated Depreciation<br>(See Note II B)                | (301,554)       | (69,408)          | (45,414)         |
| Accumulated Miscellaneous Adjustments                      | <u>(83,277)</u> | <u>-</u>          | <u>-</u>         |
| Restated Net Assets at December 31, 2009                   | \$ 101,643,177  | \$ 1,015,876      | \$ (24,411)      |

For the year ended December 31, 2009, changes were made to the Sanitation Utility and the Recycling Utility to record petty cash funds and to revise accumulated depreciation t accumulated depreciation when these utilities were transferred to the Sanitary District from the City of Hammond.



SANITARY DISTRICT  
CITY OF HAMMOND  
NOTES TO FINANCIAL STATEMENTS  
(Continued)

|  | <u>Sanitary</u> | <u>Sanitation</u> | <u>Recycling</u> |
|--|-----------------|-------------------|------------------|
| Net Assets as Stated December 31, 2009                     | \$ 101,685,944  | \$ 1,085,284      | \$ 21,003        |
| Additions:   |                 |                   |                  |
| Restatement of Construction in Progress<br>(See note II B) | 342,064         |                   |                  |
| Reductions   |                 |                   |                  |
| Accumulated Depreciation<br>(See Note II B)                | (301,554)       | (69,408)          | (45,414)         |
| Accumulated Miscellaneous Adjustments                      | <u>(83,277)</u> | <u>-</u>          | <u>-</u>         |
| Restated Net Assets at December 31, 2009                   | \$ 101,643,177  | \$ 1,015,876      | \$ (24,411)      |

For the year ended December 31, 2009 changes were made to accumulated depreciation for 2008 contributed capital for land improvements that was not capitalized or depreciated.

|  | <u>Sanitary</u> | <u>Sanitation</u> | <u>Recycling</u> |
|--|-----------------|-------------------|------------------|
| Net Assets as Stated December 31, 2009                     | \$ 101,685,944  | \$ 1,085,284      | \$ 21,003        |
| Additions:   |                 |                   |                  |
| Restatement of Construction in Progress<br>(See note II B) | 342,064         |                   |                  |
| Reductions   |                 |                   |                  |
| Accumulated Depreciation<br>(See Note II B)                | (301,554)       | (69,408)          | (45,414)         |
| Accumulated Miscellaneous Adjustments                      | <u>(83,277)</u> | <u>-</u>          | <u>-</u>         |
| Restated Net Assets at December 31, 2009                   | \$ 101,643,177  | \$ 1,015,876      | \$ (24,411)      |

SANITARY DISTRICT  
CITY OF HAMMOND  
EXAMINATION RESULT(S) AND COMMENT(S)

***FINANCIAL REPORT OPINION MODIFICATIONS***

The Sanitary District (District) did not provide supporting documentation that management approved adjusting entries or provide any documentation to support all adjusting entries posted to the 2010 ledger as described further in the comment entitled "Internal Controls Over Financial Transactions." Therefore, the State Board of Accounts was unable to provide an unqualified opinion on the Independent Auditors' Report for the financial statements due to insufficient evidential matter.

Accounting records and other public records must be maintained in a manner that will support accurate financial statements. Anything other than an unqualified opinion on the Independent Auditors' Report on the financial statements may have adverse financial consequences with the possibility of an increase in interest rate cost to the taxpayers of the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

***INTERNAL CONTROLS OVER FINANCIAL TRANSACTIONS***

The Sanitary District (District) maintains their records on the accrual basis of accounting as required. As communicated to management during the entrance conference, the financial statements are management's responsibility. Management also has responsibility for adopting sound accounting policies and for establishing and maintaining internal controls that will, among other things, initiate, authorize, record, process, and report transactions (as well as events and conditions) consistent with management's assertions embodied in the financial statements. The entity's transactions and the related assets, liabilities, and equity are within the direct knowledge and control of management.

We noted several weaknesses in the internal control system of the District related to financial transactions. The District did not have proper internal controls in place in order to provide reasonable assurance that the financial information and records were in compliance with laws and regulations. Additionally, proper internal controls were not in place to mitigate the risk of improper activities either due to error or fraud. We have the following concerns as described below:

1. District management was notified in February 2011 that the auditors initiated start of the audit of the City. Preliminary meetings were held with the City Controller, the Water Utility executive director, and the District's business manager to review the expectations of management's completion of their financial presentations. The audit of the District began on April 18, 2011. At that time, the District had not completed posting all year end entries in order to present their financial statements in conformity with generally accepted accounting principles.
2. The District continually revised their trial balance during the audit because adjusting entries continued to be recorded to the ledgers during the course of the audit resulting in account balances to change. In addition, in November and December 2010, the District re-opened the 2009 ledger to record audit adjustments after the completion of the 2009 audit. The audit adjustments for 2009 totaled \$2,495,919; however, the District recorded adjustments totaling \$6,427,317. The District could not provide sufficient documentation of the difference in adjustments.

SANITARY DISTRICT  
CITY OF HAMMOND  
EXAMINATION RESULT(S) AND COMMENT(S)  
(Continued)

3. An entry in the amount of \$1,000,000 was recorded to correct the construction in progress account for the period ending December 31, 2007. However, after our research of the 2007 records we found that the \$1,000,000 was already capitalized by the District and the \$1,000,000 adjusting entry was not necessary. The District subsequently reversed the adjusting entry. The arbitrary recording of such transactions indicates management's lack of expertise or familiarity of historical transactions.
4. A final trial balance, per the financial consultant, was provided to us on May 17, 2011. We also obtained reports which detailed all the adjusting entries made by the District to the 2010 ledgers. Adjusting entries totaling \$7,010,716 were recorded by the financial consultant to Company SP6. Company SP6 is the fund that is used to account for the financial transactions relating to Federal State Revolving Loan Fund. In order to perform certain audit procedures to determine if the adjusting entries were required, we requested the District's business manager and financial consultant for the supporting documentation for the adjusting entries. We were told by the financial consultant that he may have some reports to back up the entries but that the descriptions of the entries were detail enough. Some of the descriptions noted on the adjusting entries were: "to balance," "adj bal," and "adj entry." Since the adjusting entries could not be audited because of the lack of sufficient evidential matter to determine if the entries made were proper, we qualified the Independent Accountant's Opinion.
5. The District's ledgers are set up with accounts numbers that aid in the identification of account types. For example, the 1000 number series of accounts are considered asset accounts, 2000 number series accounts are receivables, 3000 number series accounts are equity, 4000 number series accounts are income, and 5000 number series accounts are expenses. It is common practice that at year end, the income and expense related accounts are "closed" to the equity accounts.

Historically, the District would expense ongoing improvement projects throughout the year rather than record the transactions to a construction in progress account. District officials were instructed that construction in progress account, an asset account, should be used to record these transactions in accordance with generally accepted accounting practice. The District however, opted to reset certain 5000 expense accounts in the computer system not close to equity accounts at year end. This unorthodox method makes it difficult to determine which expense accounts should be capitalized in the construction in progress accounts or reported as current operating expenses.

The District did not reset these 5000 expense accounts in Company R at the end of 2009; therefore, expenses totaling \$3,230,630 which should have been capitalized closed to the equity account. This was not corrected until May 2011.

6. The District recorded additional adjusting entries to cash accounts after the District's year end bank reconcilements were completed. The District did not update the year end bank reconcilements to include the adjustments posted to cash accounts. The District's bank reconcilements did not agree to the ending cash balances per the ledgers.

Between November 2010 and March 2011, the computer system at the Sanitary District allowed users to issue multiple checks with the same check number. It is evident that the computer software lacks sufficient controls over the issuing of checks.

SANITARY DISTRICT  
CITY OF HAMMOND  
EXAMINATION RESULT(S) AND COMMENT(S)  
(Continued)

7. The District maintains a ledger specifically for the State Revolving Loan Fund known as Company SP-6. Monthly entries were not recorded for monthly interest and bank trust fees as noted on the trust statements throughout 2010. Because entries are not made timely this allows management to rely on inaccurate financial information.
8. During our review of the capital asset account, we discovered that 2008 audit adjustments of \$7,538,845 had not been recorded in the ledger or to the capital asset detail. The depreciation expense is calculated in the capital asset detail software and subsequently recorded in the District's ledger. Since these additions were not added in a timely manner, the depreciation expense was not calculated for these capital asset additions and included in accumulated depreciation for 2008 through 2010.

There were two additional audit adjustments from 2008 for capital asset additions that were not recorded in the capital asset detail. The depreciation expense was not calculated for these two assets in the amount of \$69,408 in Sanitation and \$45,414 in Recycling and, subsequently, not recorded in the ledger.

The District's failure to record 2008 and 2009 audit adjustments to the records in a timely manner results in management relying on inaccurate information when making financial decisions.

All documents and entries to records should be done in a timely manner to ensure that accurate financial information is available to allow the governmental unit to make informed management decisions and to help ensure compliance with IC 5-15-1-1 et seq., commonly referred to as the Public Records Law. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

Governmental units should have internal controls in effect which provide reasonable assurance regarding the reliability of financial information and records, effectiveness and efficiency of operations, proper execution of management's objectives, and compliance with laws and regulations. Among other things, segregation of duties, safeguarding controls over cash and all other assets and all forms of information processing are necessary for proper internal control.

Controls over the receipting, disbursing, recording, and accounting for the financial activities are necessary to avoid substantial risk of invalid transactions, inaccurate records and financial statements and incorrect decision making.

Compliance is required, as applicable, with generally accepted accounting principles, and standards issued by the Governmental Accounting Standards Board, Financial Accounting Standards Board, and other standards setting bodies and also with various accounting guides, manuals and other publications. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7)

**EMPLOYEE SERVICE RECORDS**

Of the employee service records reviewed, 18 service records of employees of the Sanitary District and 1 service record for an employee of the Pretreatment Department were not complete. The service records lacked monthly balances of accrued paid time off and lacked a daily detail of hours worked.

SANITARY DISTRICT  
CITY OF HAMMOND  
EXAMINATION RESULT(S) AND COMMENT(S)  
(Continued)

This form (Employee Service Record No. 99A) must be kept by each office or department for each employee in order to properly prepare "Payroll Schedule and Voucher, General Form No. 99." It records the hours or days worked, sick leave, vacation and days lost. It may also be used to comply with the requirements of IC 5-11-9-4 regarding recording hours worked each day by an employee. It is suggested that these be arranged alphabetically in a binder. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 4)

SANITARY DISTRICT  
OF HAMMOND  
EXIT CONFERENCE

The contents of this report were discussed on June 8, 2011, with Robert Lendi, CPA, Controller; Alan M. Arendt, CPA, Business Manager; William Biller, Financial Consultant; and Stanley J. Dostatni, President of the Board of Sanitary Commissioners. The Official Response has been made a part of this report and may be found on pages 29 through 33.

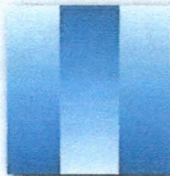
# SANITARY DISTRICT of HAMMOND

5143 COLUMBIA AVENUE  
HAMMOND, INDIANA 46327-1794  
TELEPHONE (219) 853-6412-13-14-88  
FAX (219) 853-6321

RECEIVED  
JUN 20 2011  
DISTRICT OFFICE

Board of Sanitary Commissioners

STANLEY J. DOSTATNI  
KEN JAKUBCZAK  
STEVEN R. FOWLER  
LOUIS KARUBAS  
RUSSEL A. SNYDER



MICHAEL T. UNGER, Ph.D.  
District Manager

WILLIAM E. BILLER, CPA.  
Business Manager

JOSEPH P. ALLEGRETTI  
Legal Counsel

June 17, 2011

State Board of Accounts

ATTN: Mr. Larry Tippin  
302 West Washington Street  
Indianapolis, IN 46204-2765

Dear Mr. Tippin:

On Wednesday June 8, 2011 representatives of the Hammond Sanitary District met with your auditor. The purpose of the meeting was to review the audit results and comments for the 2010 audit. Enclosed is the District's official response to the State Board of Accounts, Audit Results and Comments for the calendar year 2010. Please include this response with the State Board of Accounts' Audit Report.

Sincerely,

Alan M. Arendt  
Business Manager

cc: File

Enclosed is the District's official response to the State Board of Accounts, Audit Results and Comments for the calendar year 2010. Please include this response with the State Board of Accounts' Audit Report.

HAMMOND SANITARY DISTRICT

AUDIT RESULTS AND COMMENTS

FOR THE PERIOD ENDING DECEMBER 31, 2010

1. Auditor's Comment: District management was notified in February 2011 that the auditors initiated start the audit (sic) of the City. Preliminary meetings were held with the City Controller, the Water Utility executive director, and the District's business manager to review the expectations of management's completion of their financial presentations. The audit of the District began on April 18, 2011. At that time, the District had not completed posting all year end entries in order to present their financial statements in conformity with generally accepted accounting principles.

RESPONSE:

District Management was notified on March 15, 2011 at 10:30AM in a meeting conducted in the City Controller's Office. At the time of the start of the audit all year end closing entries were completed before the start of the audit. The entries referred to in the comment above related to audit adjustments proposed by the auditor's during the course of the audit.

2. Auditor's Comment: The District continually revised their trial balance during the audit because adjusting entries continued to be recorded to the ledgers during the course of the audit resulting in account balances to change. In addition, in November and December 2010, the District re-opened the 2009 ledger to record audit adjustments after the completion of the 2009 audit. The audit adjustments for 2009 totaled \$2,495,919; however, the District recorded adjustments totaling \$6,427,317. The District could not provide sufficient documentation of the difference in adjustments.

RESPONSE:

The District adjusted its trial balances during the course of the audit to reflect audit adjustments proposed by the auditors. The District agrees that the 2009 audit adjustments should have been posted in a timelier manner. The present Business Manager was hospitalized for over two months in 2009 and was not present for most of the audit and was not at the 2009 closing conference. The Business Manager made the 2009 audit adjustments as soon as he was made aware of them. Reopening the 2009 ledger was the only way to make the adjustments in the proper year. For the 2010 audit, all entries proposed by the auditor's were made before the close of the audit and are properly reflected in the ledgers for the year ending in 2010.

The District presented the trial balance and adjusting entries for the fund in which the adjustments totaling \$6,427,317 were made during the first week of the audit. The adjustments were only questioned two days before the completion of the audit fieldwork which did not provide the District sufficient time to go over and explain the transactions in sufficient detail. In the future, the District will accumulate sufficient detail and prepare a narrative explaining all material adjustments which will be presented to the auditors at the start of the audit.

3. Auditor's Comment: An entry in the amount of \$1,000,000 was recorded to correct the construction in progress account for the period ending December 31, 2007. However, after our research of the 2007 records we found that the \$1,000,000 was already capitalized by the District and the \$1,000,000 adjusting entry was not necessary. The District subsequently reversed the adjusting entry. The arbitrary recording of such



transactions indicates management's lack of expertise or familiarity of historical transactions.

RESPONSE: Yes The District did record the \$1,000,000 in question as an adjusting entry but does not agree that booking an entry in error indicates a lack of expertise or familiarity with historical transactions. The District also believes that such a comment is unprofessional on behalf of the State Board of Accounts.

4. Auditor's Comment: A final trial balance, per the financial consultant, was provided to us on May 17, 2011. We also obtained reports which detailed all the adjusting entries made by the District to the 2010 ledgers. Adjusting entries totaling \$7,010,716 were recorded by the financial consultant to Company SP6. Company SP6 is the fund that is used to account for the financial transactions relating to Federal State Revolving Loan Fund. In order to perform certain audit procedures to determine if the adjusting entries were required, we requested the District's business manager and financial consultant for the supporting documentation for the adjusting entries. We were told by the financial consultant that he may have some reports to back up the entries but that the descriptions of the entries were detail enough. Some the descriptions noted on the adjusting entries were: " to balance", "adj bal", and "adj entry". Since the adjusting entries could not be audited because of the lack of sufficient evidential matter to determine if the entries made were proper, we qualified the Independent Auditor's Opinion.

RESPONSE:

The fund in question, SP6 is controlled by the State Revolving Fund of the State of Indiana. Cash receipts and disbursements are controlled by the State Revolving Fund. The adjusting entries were made at year end to make the District's records in agreement with the transaction recorded by the State Revolving fund which is in effect a check in balance. The District agrees that it should keep its records current with the transaction made by the State Revolving Fund. Accordingly, the District will institute a monthly reconciliation of transactions recorded by the SRF to ensure the two sets of records are in agreement.

5. The District's ledgers are set up with accounts numbers that aid in the identification of account types. For example, the 1000 number series of accounts are considered asset accounts, , 2000 number series accounts are receivables, 3000 number series accounts are equity, 4000 number series accounts are income, and 5000 number series accounts are expenses. It is common practice that at year end, the income and expense related accounts are "closed" to the equity accounts.

Historically, the District would expense ongoing improvement projects throughout the year rather than record the transactions to a construction in progress account. District officials were instructed that construction in progress account, an asset account, should be used to record these transactions in accordance with generally accepted accounting practice. The District however, opted to reset certain 5000 expense accounts in the computer system not close to equity accounts at year end. This unorthodox method makes it difficult to determine which expense accounts should be capitalized in the construction in progress accounts or reported as current operating expenses.

The District did not reset these 5000 expense accounts in Company R at the end of 2009; therefore expenses totaling \$3,230,630 which should have been capitalized closed to the equity account. This was not corrected until May, 2011.

## RESPONSE

The District agrees and that using different account numbers in the 1000 series to record construction in progress will help prevent the type of error described above. All construction in progress accounts in the 5000 series will be reclassified to an account in the 1000 series.

6. The District recorded additional adjusting entries to cash accounts after the District's year end bank reconciliements were completed. The District did not update the year end bank reconciliements to include the adjustments posted to cash accounts. The District's bank reconciliements did not agree to the ending cash balances per the ledgers.

Between November, 2010 and March, 2011, the computer system at the Sanitary District allowed users to issue multiple checks with the same check number. It is evident that the computer software lacks sufficient controls over the issuing of checks.

## RESPONSE:

The adjusting entries were made to record deposits received by the Hammond Water Department, the District's billing and collection agent, on the last two working days of December. These receipts were not wired into the District's bank accounts until January 2011. These funds are recorded in a special cash account in the ledger to identify them as "Cash with Fiscal Agent." The District provided wire transfer and bank deposit records clearly identifying the transactions and therefore reconciled the cash balances in the bank records with the balances reflected in the District's financial records.

The District has recorded the cash with fiscal agent and reconciled its bank accounts in this manner for the past ten years. This process was previously audited and determined acceptable by the State Board of Accounts.

The District's system of internal controls identified the duplicate check numbers during the monthly bank reconciliation process. All payments made with duplicate check numbers identified were immediately researched to ensure the payments were for properly approved expenditures. No discrepancies were found during this investigation. The District will institute measures to prevent this occurrence in the future.

7. Auditor's Comment: The District maintains a ledger specifically for the State Revolving Loan Fund known as Company SP-6. Monthly entries were not recorded for monthly interest and bank trust fees as noted on the trust statements throughout 2010. Because entries are not made timely this allows management to rely on inaccurate financial information.

## RESPONSE:

The District agrees that the interest and fees which were properly reflected in the year end balances for the fund, although not material in nature, should be recorded on a timelier basis. The District will start recording these transactions monthly.

8. Auditor's Comment: During our review of the capital asset account, we discovered that 2008 audit adjustments of \$7,538,845 had not been recorded in the ledger or to the capital asset detail. The depreciation expense is calculated in the capital asset detail software and subsequently recorded in the District's ledger. Since these additions were not added in a timely manner, the depreciation expense was not calculated for these capital asset additions and included in accumulated depreciation for 2008 through 2010.

There were two additional audit adjustments from 2008 for capital asset additions that were not recorded in the capital asset detail. The depreciation expense was not calculated for these two assets in the amount of \$69,408 in Sanitation and \$45,414 in Recycling and subsequently not recorded in the ledger.

RESPONSE:

There was a change in the District Business Manager in 2008 and the audit adjustments were not included in the turnover file. The error was not brought to the District's attention during the 2009 audit in which the State Board of Accounts compiled the District's financial statements. The error was uncovered during the audit of the 2010 financial records and brought to the attention of the District. The District has corrected the error and believes this error was due to a unique set of circumstances which will not be repeated in the future so no additional control measures are necessary.

9. Auditor's Comment: Of the employee service records reviewed, eighteen service records of employees of the Sanitary District and one service record for an employee of the Pretreatment Department were not complete. The service records lacked monthly balances of accrued paid time off and lacked a daily detail of hours worked.

This form (Employee Service Record No. 99A) must be kept by each office or department for each employee in order to properly prepare "Payroll Schedule and Voucher, General Form No. 99." It records the hours or days worked, sick leave, vacation and days lost. It may also be used to comply with the requirements of IC 5-11-9-4 regarding recording hours worked each day by an employee. It is suggested that these be arranged alphabetically in a binder. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 4).

RESPONSE:

Even though the District has time and attendance records that verified the hours worked, vacation and sick days earned and used for employees it will institute procedures to ensure recording in the approved format on a timelier basis.

RECEIVED

JUN 9 2011

THE BOARD OF ACCOUNTS

*John Co.*