

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

SUPPLEMENTAL COMPLIANCE REPORT
OF

SANITARY DISTRICT
CITY OF HAMMOND
LAKE COUNTY, INDIANA

January 1, 2014 to December 31, 2015



FILED
01/06/2017

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SCHEDULE OF OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Controller	Robert Lendi, CPA (Vacant) Heather Garay	01-01-14 to 04-30-14 05-01-14 to 05-14-14 05-15-14 to 12-31-16
Mayor	Thomas McDermott, Jr.	01-01-12 to 12-31-19
President of the Board of Public Works and Safety	Robert Lendi, CPA Edward Krusa Stanley J. Dostatni	01-01-14 to 05-07-14 05-08-14 to 10-28-15 10-29-15 to 12-31-16
President of the Common Council	Michael Opinker Janet Venecz	01-01-14 to 07-28-16 07-29-16 to 12-31-16
Sanitary District Manager	Marty J. Wielgos	01-01-14 to 12-31-16
Business Manager	Rachel Montes	01-01-14 to 12-31-16
President of the Sanitary District Board of Commissioners	Stanley J. Dostatni Dean Button	01-01-14 to 12-31-15 01-01-16 to 12-31-16



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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

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

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

This report is supplemental to our examination report of the Sanitary District (District), City of Hammond, for the period from January 1, 2014 to December 31, 2015. It has been provided as a separate report so that the reader may easily identify any Examination Results and Comments that pertain to the District. It should be read in conjunction with our Financial Statements Examination Report of the District, which provides our opinion on the District's financial statements. This report may be found at www.in.gov/sboa/.

As authorized under Indiana Code 5-11-1, we performed procedures to determine compliance with applicable Indiana laws and uniform compliance guidelines established by the Indiana State Board of Accounts. The Examination Results and Comments contained herein describe the identified reportable instances of noncompliance found as a result of these procedures. Our tests were not designed to identify all instances of noncompliance; therefore, noncompliance may exist that is unidentified.

Any Official Response to the Examination Results and Comments, incorporated within this report, was not verified for accuracy.

Paul D. Joyce
Paul D. Joyce, CPA
State Examiner

November 3, 2016

SANITARY DISTRICT
CITY OF HAMMOND
EXAMINATION RESULTS AND COMMENTS

INTERNAL CONTROLS OVER FINANCIAL STATEMENTS

The District did not have a proper system of internal controls in place to prevent, or detect and correct, errors in the preparation of the financial statements. The District should have proper controls in place over the preparation of the financial statements, notes to financial statements, and required supplementary information to ensure accurate and reliable reporting of the District's financial activity. In addition, adequate internal control requires sufficient supervision and oversight to ensure complete and accurate financial reporting. Due to the lack of internal controls the following material misstatements in the financial statements prepared by the District were undetected:

1. In 2014, the District entered into a financing agreement with the Hammond Sanitary District Building Corporation (Building Corporation). The Building Corporation was solely created to provide financing to the District. The District failed to properly report the Building Corporation as a blended component unit in the financial statements and the notes to the financial statements in accordance with Government Accounting Standards. This resulted in the incorrect classification of the debt and an understatement of interest payable for both 2014 and 2015 by \$291,030. In addition, the proper note disclosure defining the blended component was not included.
2. Based upon agreements between the District and customer cities/towns, a set rate was paid for services. Annually, a study was performed to determine if the customer cities/towns have underpaid or overpaid. Depending on the results of the study, a receivable or payable amount existed. However, an amount was not considered in the financial statements for 2014 or 2015. This resulted in an understatement of Accounts Receivable - Customer Communities and the related revenue by \$910,413 and \$1,099,751 as of December 31, 2014 and 2015, respectively. In addition, in 2015 the District agreed upon a \$350,000 settlement payment for the years 2011 through 2014. The District overstated 2015 revenue by \$319,500 for the amounts that were attributable to 2011 through 2013.
3. In 2015, the County began billing and collecting MS4 Stormwater fees on the property tax bills. The District failed to contact the county to obtain the information needed to calculate an accounts receivable at year end. This resulted in an understatement of the Storm Water Utility accounts receivable and the related revenue by \$253,475 as of December 31, 2015.
4. The District's Statements of Net Position - Capital Assets sections reported a negative amount in Other Capital Assets for 2014 and 2015, showing the assets were depreciated below their cost. However, it was determined depreciable Land Improvements were incorrectly classified as part of Land and Construction in Progress. This caused the Land and Construction in Progress account to be overstated and Other Capital Assets to be understated by \$177,340,271 and \$177,734,808 in 2014 and 2015, respectively.
5. The Statement of Cash Flows required material adjustments to accurately reflect the cash activity for both years 2014 and 2015.
6. In 2014 and 2015, several current year transactions were recorded as adjustments to Net Position (Equity). For example, in 2014 the Contributed Capital from the City was recorded to Equity instead of revenue. This resulted in an understatement of Capital Contributions revenue and an overstatement of Net Position by \$329,300 and \$989,604 for 2014 and 2015, respectively. In addition, the District recorded the entry to reverse the beginning Taxes

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EXAMINATION RESULTS AND COMMENTS
(Continued)

Receivable to Net Position (Equity) and not revenue. This resulted in an overstatement of 2015 Local Tax Distribution revenues by \$757,611 and an understatement of Net Position. Furthermore, the District recorded interest expense for a current bond issue to Net Position (Equity) and not expense. This resulted in an understatement of 2015 interest expense by \$348,605 and an overstatement of Net Position. Entries made to Net Position (Equity) should be limited to material prior period adjustments.

7. A capital lease payable was reported in the Storm Water Utility for 2014 and 2015 with no related capital asset. The related capital asset was reported in the Sanitary District's capital assets.
8. The Cash and Cash Equivalents balance at December 31, 2014, was overstated by \$145,188. The District failed to post all interest and disbursements of a trust account to the unit's ledger.
9. The Cash and Cash Equivalents balance at December 31, 2015, was overstated by \$776,787. The District failed to post all interest and disbursements of a trust account to the unit's ledger.

Audit adjustments were proposed for the material items, accepted by the District, and made to the financial statements, notes to the financial statements, and required supplementary information.

In addition to the material items notes above, internal controls were not sufficient in the following areas:

1. On the Statement of Net Position, Compensated Absences should have a current portion. The governing body should have an approved policy that describes the basis for the determination of the noncurrent estimate.
2. The reporting of a Bond Discount and Issuance Costs are separate accounting principles and are to be reported on the financial statements separately in accordance with generally accepted accounting principles. On the Statement of Revenues, Expenses and Changes in Net Position, amortization of discounts and issuance costs should be reported as interest expense and amortization expense, respectively. The District classified the amortization of issuance costs as either a Loss on Sales of Assets or as Issuance Costs. In 2015, even though issuance costs were expensed, they were also included in the amortization of issuance costs.
3. The Statement of Net Position presented for examination failed to classify certain accounts properly when compared to the ledgers. Current Cash with Fiscal Agent was reported in Non-Current Cash with Fiscal Agent - Construction.
4. Internal controls did not prevent the computerized accounting system from printing duplicate checks and allowed changes to be made to disbursement information after a check was issued. Checks with duplicate check numbers occurred on a monthly basis.

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.

SANITARY DISTRICT
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EXAMINATION RESULTS AND COMMENTS
(Continued)

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. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7; Accounting and Uniform Compliance Guidelines Manual for Special Districts, Chapter 10)

CURRENT PAYMENT OF CLAIMS

The District was delinquent in the payment of gas and electric services invoices of \$3,207,429 and \$2,216,497 as of December 31, 2014, and December 31, 2015, respectively.

Officials and employees have the duty to pay claims and remit taxes in a timely fashion. Failure to pay claims or remit taxes in a timely manner could be an indicator of serious financial problems which should be investigated by the governmental unit. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7; Accounting and Uniform Compliance Guidelines Manual for Special Districts, Chapter 10)

DELINQUENT WASTEWATER ACCOUNTS

Delinquent wastewater fees and penalties were not certified to the County Auditor nor recorded with the County Recorder in 2014.

Indiana Code 36-9-25-11(g) states in part:

" . . . fees assessed against real property under this section also constitute a lien against the property assessed. The lien attaches at the time of the filing of the notice of lien in the county recorder's office. The lien is superior to all other liens except tax liens, and shall be enforced and foreclosed in the same manner as is provided for liens under IC 36-9-23-33 and IC 36-9-23-34."

Indiana Code 36-9-23-33 states in part:

"(c) Except as provided in subsection (m), the officer charged with the collection of fees and penalties assessed under this chapter shall enforce their payment. As often as the officer determines is necessary in a calendar year, the officer shall prepare either of the following:

- (1) A list of the delinquent fees and penalties that are enforceable under this section, which must include the following:
 - (A) The name or names of the owner or owners of each lot or parcel of real property on which fees are delinquent.
 - (B) A description of the premises, as shown by the records of the county auditor.
 - (C) The amount of the delinquent fees, together with the penalty.
- (2) An individual instrument for each lot or parcel of real property on which the fees are delinquent.

SANITARY DISTRICT
CITY OF HAMMOND
EXAMINATION RESULTS AND COMMENTS
(Continued)

(d) The officer shall record a copy of each list or each individual instrument with the county recorder. . .

(f) . . . Using the lists and instruments prepared under subsection (c) and recorded under subsection (d), the officer shall, not later than ten (10) days after the list or each individual instrument is recorded under subsection (d), certify to the county auditor a list of the unpaid liens for collection with the next May installment of property taxes. . . ."

CAPITAL ASSET ADDITIONS

Assets below the \$5,000 threshold were capitalized in 2014, contradictory to the Fixed Asset (Capitalization) Policy (52-2002) of the District at that time.

Resolution 52-2002 states in part "Purchases of projects, with a value greater than \$5,000 that will significantly increase the efficiency of, or remaining life of a facility, its major components; or a piece of equipment should be a fixed asset (capitalized). New non-components or stand alone equipment, with a value greater than \$5,000 should be a fixed asset (capitalized)."

Assets below the \$25,000 threshold were capitalized in 2015, contradictory to the Fixed Asset (Capitalization) Policy (45-2015) of the District at that time. Building repairs totaling \$97,760 were also incorrectly capitalized in 2015.

Resolution 42-2015 states in part:

"To be considered a capital asset for financial reporting purposes an item must have a unit historical cost meeting or exceeding the applicable cost thresholds shown below . . .

Land	N/A
Land Improvements	\$25,000
Collection System Infrastructure	\$25,000
Buildings and Building Improvements	\$25,000
Major Equipment	\$25,000
Fixed Equipment	\$25,000
Vehicles	\$25,000
Computer Software	\$25,000
Construction-in-Progress	n/a"

Resolution 42-2015 states in part:

"While substantial repairs and renovations are reviewed for potential capitalization, most of these expenditures will likely be expensed in the year incurred. These expenses, although often of a relatively high cost, merely restore the asset to the original service level potential but do not necessarily improve the asset. Further, repairs and maintenance generally make it possible for an asset to achieve its original estimated life expectation. . . ."

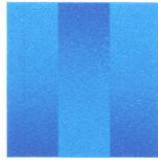
Each governmental unit is responsible for complying with the ordinances, resolutions, and policies it adopts. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 7; Accounting and Uniform Compliance Guideline Manual for Special Districts, Chapter 10)

SANITARY DISTRICT of HAMMOND

5143 COLUMBIA AVENUE
HAMMOND, INDIANA 46327-1794
TELEPHONE (219) 853-6413
FAX (219) 853-6321

Board of Sanitary Commissioners

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MICHAEL DYE
MATTHEW J. MUTA
SAM DIMOPOLOS
MICHAEL R. HAWKINS SR.



THOMAS MCDERMOTT, JR.
Mayor

MARTY WIELGOS
District Manager

RACHEL MONTES
Business Manager

JOSEPH P. ALLEGRETTI
Legal Counsel

November 15, 2016

State Board of Accounts
302 West Washington Street, Room E418
Indianapolis, IN 46204-2765

Re: State Board of Accounts Examination and Audit Results and Comments
(Exam Period: January 1, 2014 – December 31, 2015)

Internal Controls Over Financial Statements

Examination Position

The Sanitary District (District) did not have a proper system of internal controls in place to prevent or detect and correct errors in the preparation of the financial statements. The District should have proper controls in place over the preparation of the financial statements, notes to financial statements, and required supplementary information to ensure accurate and reliable reporting of the District's financial activity. In addition, adequate internal control requires sufficient supervision and oversight to ensure complete and accurate financial reporting. Due to lack of internal controls the following material misstatements in the District prepared financial statements were undetected:

Response

The Sanitary District will ensure that internal control standards and procedures are developed and adopted by December 2016. A consultant will be hired to review internal controls, make recommendations to strengthen internal control procedures, and assist with the implementation.

Examination Position

1. In 2014, the District entered into a financing agreement with the Hammond Sanitary District Building Corporation (Building Corporation). The Building Corporation was solely created to provide financing to the District. The District failed to properly report the Building Corporation as a blended component unit in the financial statements and the notes to the financial statements in accordance with Government Accounting Standards. This resulted in the incorrect classification of the debt and an understatement of interest payable for both 2014 and 2015 by \$291,030. In addition, the proper note disclosure defining the blended component unit was not included.

Response

Going forward, the District will include the Building Corporation as a blended component unit in the financial statements and notes to the financial statements.

Examination Position

2. Based upon agreements between the District and customer cities/towns, a set rate is paid for services. Annually, a study is performed to determine if the customer cities/towns have underpaid or overpaid.

Depending on the results of the study, a receivable or payable amount exists. However, an amount was not considered in the financial statements for 2014 and 2015. This resulted in an understatement of Accounts Receivable – Customer Communities and the related revenue by \$910,413 and \$1,099,751 as of December 31, 2014 and 2015, respectively. In addition, in 2015 the District agreed upon a \$350,000 settlement payment for the years 2011 through 2014. The District overstated 2015 revenue by \$319,500 for the amounts that were attributable to 2011 through 2013.

Response

Going forward, the District will post a receivable or payable on the financial statements and ensure that revenue is posted and correctly recorded.

Examination Position

3. In 2015, the county began billing and collecting MS4 Stormwater fees on the property tax bills. The District failed to contact the county to obtain the information needed to calculate an accounts receivable at year end. This resulted in an understatement of the Storm Water Utility accounts receivable and the related revenue by \$253,475 as of December 31, 2015.

Response

Going forward, the District will notify the county to obtain the information needed to calculate an accounts receivable at year end and ensure that a receivable is posted and correctly recorded on the financial statements.

Examination Position

4. The District's Statements of Net Position – Capital Assets sections reported a negative amount in Other Capital Assets for 2014 and 2015, showing the assets were depreciated below their cost. However, it was determined depreciable Land Improvements were incorrectly classified as part of Land and Construction in Progress. This caused the Land and Construction in Progress account to be overstated and Other Capital Assets to be understated by \$177,340,271 and \$177,734,808 in 2014 and 2015, respectively.

Response

Going forward, the District will review the capital assets and ensure they are classified and booked correctly.

Examination Position

5. The Statement of Cash Flows required material adjustments to accurately reflect the cash activity for both years 2014 and 2015.

Response

Going forward, the District will have proper controls in place to provide reasonable assurance that transactions are posted and correctly recorded reducing the number of material adjustments.

Overdrawn Cash Balances

Examination Position

The financial statement in the Financial Statement and Federal Single Audit Report included the Sewer fund with an overdrawn cash balance of \$589,868 and \$69,979 in 2014 and 2015, respectively.

Response

The Sanitary District makes every effort to eliminate overdrawn cash balances. Deficit balances gradually accumulate due to diminished property taxes collections and the circuit breaker credit. The District is reviewing its options to eliminate the overdrawn cash balances.

Current Payment of Claims

Examination Position

The Sanitary District was delinquent in the payment of gas and electric services invoices of \$3,207,429 and \$2,216,497 in 2014 and 2015, respectively.

Response

Examination Position

The Sanitary District was delinquent in the payment of gas and electric services invoices of \$3,207,429 and \$2,216,497 in 2014 and 2015, respectively.

Response

The Sanitary District is currently paying its gas and electric utility bills on time. The District has entered into a repayment plan with the utility vendor for the past due amounts. The District should be current on its utility bills as of July 2017.

Delinquent Wastewater Accounts

Examination Position

Delinquent wastewater fees and penalties had not been certified to the County Auditor nor recorded with the County Recorder in 2014 and 2015.

Response

The District instituted a process to notify the County when wastewater charges are delinquent. Wastewater charges not paid by the due date (approximately __ days after the becoming due) shall be considered delinquent. Such delinquent charges, together with any penalties, shall constitute a lien against the property, shall have a lien filed with the County Auditor and recorded with the County Recorder. Annually, the District will certify the lien delinquencies with the County Auditor.


(Signature)

Rachel Montes, Business Manager

(Title)

November 15, 2016

(Date)


(Signature)

Marty Wielgos, District Manager

(Title)

November 15, 2016

(Date)

SANITARY DISTRICT
CITY OF HAMMOND
EXIT CONFERENCE

The contents of this report were discussed on November 3, 2016, with Heather Garay, City Controller; Thomas McDermott, Jr., Mayor; Janet Venecz, President of the Common Council; Kimberly Fabris, Deputy City Controller; Mark McLaughlin, Mayor's Chief of Staff; Marty J. Wielgos, Sanitary District Manager; Rachel Montes, Sanitary District Business Manager; Dean Button, President of the Sanitary District Board of Commissioners; and Joseph P. Allegretti, Sanitary District Attorney.