

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

SUPPLEMENTAL COMPLIANCE REPORT

OF

CITY OF SOUTH BEND

ST. JOSEPH COUNTY, INDIANA

January 1, 2016 to December 31, 2016



FILED
09/23/2017

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SCHEDULE OF OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
City Controller	John H. Murphy Jennifer C. Hockenhull	01-01-16 to 07-24-17 07-25-17 to 12-31-17
Mayor	Peter Buttigieg	01-01-16 to 12-31-19
President of the Board of Public Works	Gary A. Gilot	01-01-16 to 12-31-17
President of the Common Council	Tim Scott	01-01-16 to 12-31-17



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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TO: THE OFFICIALS OF THE CITY OF SOUTH BEND, ST. JOSEPH COUNTY, INDIANA

This report is supplemental to our audit report of the City of South Bend (City), for the period from January 1, 2016 to December 31, 2016. It has been provided as a separate report so that the reader may easily identify any Federal Findings that pertain to the City. It should be read in conjunction with our Financial Statement and Federal Single Audit Report of the City, which provides our opinions on the City's financial statement and federal program compliance. This report may be found at www.in.gov/sboa/.

The Federal Findings, identified in the above referenced audit report, are included in this report.

Any Corrective Action Plan for the Federal Findings, incorporated within this report, was not verified for accuracy.

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

August 10, 2017

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CITY CONTROLLER
CITY OF SOUTH BEND

CITY CONTROLLER
CITY OF SOUTH BEND
FEDERAL FINDING

FINDING 2016-001

Subject: Financial Transactions and Reporting
Audit Finding: Material Weakness

Condition

There were deficiencies in the internal control system of the City of South Bend (City) related to financial transactions and reporting of the Century Center, a major fund of the City. There was a lack of segregation of duties as the Century Center transactions were recorded and reported by the City without a system of oversight or review, or other compensating control.

Context

This is a systemic issue, which occurred throughout the audit period.

Criteria

The Indiana State Board of Accounts (SBOA) is required under Indiana Code 5-11-1-27(e) to define the acceptable minimum level of internal control standards. To provide clarifying guidance, the State Examiner compiled the standards contained in this manual, *Uniform Internal Control Standards for Indiana Political Subdivisions*. All political subdivisions subject to audit by SBOA are expected to adhere to these standards. The standards include adequate control activities. According to this manual:

"Control activities are the actions and tools established through policies and procedures that help to detect, prevent, or reduce the identified risks that interfere with the achievement of objectives. Detection activities are designed to identify unfavorable events in a timely manner whereas prevention activities are designed to deter the occurrence of an unfavorable event. Examples of these activities include reconciliations, authorizations, approval processes, performance reviews, and verification processes.

CITY CONTROLLER
CITY OF SOUTH BEND
FEDERAL FINDING
(Continued)

An integral part of the control activity component is segregation of duties. . . .

There is an expectation of segregation of duties. If compensating controls are necessary, documentation should exist to identify both the areas where segregation of duties are not feasible or practical and the compensating controls implemented to mitigate the risk. . . ."

Cause

Management of the City had not established a proper system of internal control.

Effect

The failure to establish controls could have enabled material misstatements or irregularities to remain undetected. The failure to monitor the internal control system placed the City at risk that controls may not have been either designed properly or operating effectively to provide reasonable assurance that controls would have prevented, or detected and corrected, material misstatements in a timely manner.

Recommendation

We recommended that the City's management establish controls to ensure proper reporting of the Century Center transactions, a major fund of the City.

Views of Responsible Officials

For the views of responsible officials, refer to the Corrective Action Plan that is part of this report.



CITY OF SOUTH BEND PETE BUTTIGIEG, MAYOR
DEPARTMENT OF ADMINISTRATION AND FINANCE

CORRECTIVE ACTION PLAN

FINDING 2016-001

Contact Person Responsible for Corrective Action: Jen Hockenhill and John Murphy
Contact Phone Number: 574-235-9822 and 574-235-7678

Views of Responsible Official: We concur with the finding.

Description of Corrective Action Plan:

During the course of the Century Center 2016 fiscal year and audit it became increasingly difficult to reconcile the Century Center records maintained by the City's management company with the records maintained in the City's accounting system. The management company keeps its records based on the accrual basis of accounting (which is typical for private companies) while the City keeps its records based on the cash basis of accounting (during the year for interim reporting and budgeting) and converts the accounts to the accrual basis at year end for the audit and CAFR preparation. In addition, the management company keeps a more detailed chart of accounts for revenue and expenses based on functional cost centers (i.e. Executive, Finance, Sales) while the City keeps broader revenue and expense categories broken into only two divisions—general operations and food & beverage operations.

The City Administration and Century Center management offer the following corrective action plan:

- With the permission of the State Examiner of the State Board of Accounts, the City has adopted the full accrual basis of accounting for Century Center Fund 670 starting in 2017.
- The City has changed its revenue and expenditure accounts to more closely match the accounts used by the management company. This change will also provide the Civic Center Board of Managers and City Administration with more detailed and useful financial information regarding the operations of Century Center. The new accounts will be used beginning January 1, 2018 and are being incorporated into the 2018 budget.
- Effective for the month of April, 2017, the Century Center Finance Director is preparing a monthly reconciliation of management company financial statements with City financial statements and is providing this report to senior finance staff in the Department of Administration and Finance for review and approval.
- Century Center staff has been granted access to the City's shared drive and is completing the City's standard monthly budget to actual reports that all City funds and departments are required to complete. This report is posted on the City website every month.
- The Century Center General Manager has initiated bi-weekly conference calls with senior finance officials in the Department of Administration and Finance to discuss any ongoing accounting and financial reporting issues occurring at Century Center.

- The City Administration and Century Center management have agreed that all bank reconciliations will be completed and sent to the Department of Administration and Finance no later than 20 days after month end. Senior finance staff at the City are reviewing and signing these bank reconciliations in addition to signatures by the Century Center Finance Director and Century Center General Manager.

Anticipated Completion Date: Certain tasks in the corrective action plan have been completed, with full completion of all remaining tasks planned for fiscal year 2018.

CITY CONTROLLER
CITY OF SOUTH BEND
EXIT CONFERENCE

The contents of this report were discussed on August 10, 2017, with John H. Murphy, Chief Financial Officer; Jennifer C. Hockenull, City Controller; Tim Scott, President of the Common Council; Jo M. Broden, Member of the Common Council; Gary A. Gilot, President of the Board of Works; Pamela E. Meyer, Community Investments Director of Neighborhood Engagement; Leanna Belew, Century Center General Manager; and Brandon Gerlach, Finance Director of Century Center.

COMMUNITY INVESTMENT DEPARTMENT
CITY OF SOUTH BEND

COMMUNITY INVESTMENT DEPARTMENT
CITY OF SOUTH BEND
FEDERAL FINDINGS

FINDING 2016-002

Subject: Economic Adjustment Assistance - Special Tests and Provisions -
Increases to RLF Capital Base and Capital Utilization
Federal Agency: Department of Commerce
Federal Program: Economic Adjustment Assistance
CFDA Number: 11.307
Federal Award Number and Year (or Other Identifying Number): 06-19-01251
Compliance Requirement: Special Test and Provisions - Increases
to RLF Capital Base and Capital Utilization
Audit Findings: Material Weakness, Other Matters

Condition

An effective internal control system was not in place at the City in order to ensure compliance with the grant agreement and the Special Tests and Provisions - Increases to RLF Capital Base and Capital Utilization compliance requirement.

The City had not designed or implemented a control system to ensure that it managed its repayment and lending schedules at all times with at least 75 percent of the RLF capital loaned out or committed. The City did not comply; the capital available for lending exceeded 25 percent for 6 of the 12 months in 2016.

Context

This is a systemic issue, which occurred throughout the last six months of the audit period.

Criteria

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over the Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs. . . ."

2 CFR section 200.303(a) states in part:

"Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in 'Standards for Internal Control in the Federal Government' issued by the Comptroller General of the United States and the 'Internal Control Integrated Framework', issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). . . ."

13 CFR 307.16 states in part: "During the Revolving Phase, RLF Recipients must manage their repayment and lending schedules to provide that at all times at least seventy-five (75) percent of the RLF Capital is loaned or committed. . . ."

COMMUNITY INVESTMENT DEPARTMENT
CITY OF SOUTH BEND
FEDERAL FINDINGS
(Continued)

Cause

The City had not established an effective internal control structure that would have ensured compliance with the grant agreement and the Special Tests and Provisions - Increases to RLF Capital Base compliance requirement.

Effect

The failure to establish an effective internal control system enabled noncompliance to go undetected. Noncompliance with the grant agreement or the compliance requirement could have resulted in the loss of federal funds to the City.

Questioned Costs

There were no questioned costs identified.

Recommendation

We recommended that the City's management establish controls to ensure compliance and to comply with the Special Tests and Provisions - Increases to RLF Capital Base compliance requirement.

Views of Responsible Officials

For the views of responsible officials, refer to the Corrective Action Plan that is part of this report.

FINDING 2016-003

Subject: Community Development Block Grants/Entitlement Grants
and Continuum of Care Program - Subrecipient Monitoring
Federal Agency: Housing and Urban Development
Federal Programs: Community Development Block Grant/Entitlement
Grants and Continuum of Care Program

CFDA Numbers: 14.218, 14.267

Federal Award Numbers and Years (or Other Identifying Numbers): B08-MN-18-0011, B11-MN-18-0011,
B14-MC-18-0011, B15-MC-18-0011,
B16-MC-18-0011, IN0009L5H001407,
IN0012L5H001407, IN0012L5H001508

Compliance Requirement: Subrecipient Monitoring

Audit Findings: Material Weakness, Other Matters/Modified Opinion

Condition

An effective internal control system was not in place at the City in order to ensure compliance with requirements related to the grant agreement and the Subrecipient Monitoring compliance requirement.

The City's Department of Community Investment administered all Housing and Urban Development Grants (HUD), which included monitoring subrecipients. The City did not comply with the Subrecipient Monitoring requirement to ensure that its subrecipients complied with federal requirements in a timely manner. The City relied on desktop monitoring to ensure its subrecipients' compliance with the

COMMUNITY INVESTMENT DEPARTMENT
CITY OF SOUTH BEND
FEDERAL FINDINGS
(Continued)

requirements during the grant period. This consisted of reviewing reimbursement claims and the attached supporting documentation submitted by the subrecipients. The supporting documentation provided to the City was not sufficient to ensure that the subrecipients paid for services prior to requesting reimbursement from the City.

Additionally, onsite reviews were performed, but only after the grants had been completed. Based on the City's current practice of performing eight onsite visits each year for any HUD subrecipients, some would not receive an onsite visit for a number of years. In 2016, only one Community Development Block Grant subrecipient received an onsite visit. The onsite visit for the Continuum of Care Program covered grants that were reported in the 2015 Schedule of Expenditure of Federal Awards (SEFA). The current Continuum of Care Program grants reported in the 2016 SEFA were not even scheduled for an onsite visit in 2017.

Context

This is a systemic problem, which occurred throughout the audit period.

Criteria

OMB Circular A-133, Subpart C, section .300 states in part:

"The auditee shall: . . . (b) Maintain internal control over Federal programs that provides reasonable assurance that the auditee is managing Federal awards in compliance with laws, regulations, and the provisions of contracts or grant agreements that could have a material effect on each of its Federal programs. . . ."

2 CFR section 200.303(a) states in part:

"Establish and maintain effective internal control over the Federal award that provides reasonable assurance that the non-Federal entity is managing the Federal award in compliance with Federal statutes, regulations, and the terms and conditions of the Federal award. These internal controls should be in compliance with guidance in 'Standards for Internal Control in the Federal Government' issued by the Comptroller General of the United States and the 'Internal Control Integrated Framework', issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). . . ."

24 CFR 85.40(a) states in part:

"*Monitoring by grantees.* Grantees are responsible for managing the day-to-day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity. . . ."

2 CFR 200.331(d) states:

"Monitor the activities of the subrecipient as necessary to ensure that the subaward is used for authorized purposes, in compliance with Federal statutes, regulations, and the terms and conditions of the subaward; and that subaward performance goals are achieved. Pass-through entity monitoring of the subrecipient must include:

COMMUNITY INVESTMENT DEPARTMENT
CITY OF SOUTH BEND
FEDERAL FINDINGS
(Continued)

- (1) Reviewing financial and performance reports required by the passthrough entity.
- (2) Following-up and ensuring that the subrecipient takes timely and appropriate action on all deficiencies pertaining to the Federal award provided to the subrecipient from the pass through entity detected through audits, on-site reviews, and other means.
- (3) Issuing a management decision for audit findings pertaining to the Federal award provided to the subrecipient from the pass-through entity as required by § 200.521 Management decision."

Community Development Program Contracts - Financial and Administrative Reports state in part:

"The Agency shall submit the Reimbursement and Progress Report supplied by the City upon completion of each purchase. The Agency understands that claims for reimbursement of expenses shall be accompanied by proper documentation (checks copies, invoices, staff time distributions, etc.)

The City reserves the right to refuse any or all claims not properly supported with adequate and proper documentation of claim and activity progress."

Cause

Management of the City had not established a proper system of internal control that would have ensured compliance with the Subrecipient Monitoring compliance requirement.

Effect

The failure to establish an effective internal control system enabled noncompliance to go undetected. Noncompliance with the grant agreement or the compliance requirement could have resulted in the loss of federal funds to the City.

Questioned Costs

There were no questioned costs identified.

Recommendation

We recommended that the City's management establish controls to ensure compliance and to comply with the Subrecipient Monitoring compliance requirement.

Views of Responsible Officials

For the views of responsible officials, refer to the Corrective Action Plan that is part of this report.



CITY OF SOUTH BEND PETE BUTTIGIEG, MAYOR
DEPARTMENT OF ADMINISTRATION AND FINANCE

CORRECTIVE ACTION PLAN

FINDING 2016-002

Contact Person Responsible for Corrective Action: Angelina Billo
Contact Phone Number: 574-235-5838

Views of Responsible Official: We concur with the finding.

Description of Corrective Action Plan:

Per federal requirements, the City's Industrial Revolving Fund (IRF) is required to have a minimum of 75% of its capital loaned out at any point in time during the year. For the City's IRF and other large programs, the Economic Development Administration requires that 80% of the capital be loaned out. The IRF did not satisfy these requirements during 2016.

The City understands this finding but notes the IRF Board is reluctant to make loans that do not have a reasonable chance for success. The use of cash for poorly advised loans does not appear to be a prudent way to run a portfolio. In addition, occasionally IRF loan recipients pay off early which necessitates the need to find replacement loan opportunities in an expedited manner. Having said this, the IRF is pleased to announce that two new loans totaling \$1.2 million dollars were recently approved which reduces the unobligated cash balance in the fund to 13.4% and the IRF is, therefore, currently in compliance with plan loan requirements.

City Administration offers the following corrective action plan:

- The IRF will continue to provide comprehensive monthly financial statements to the IRF Board Members and City Finance Staff that include a balance sheet, income statement, cash position, commitments and applications. The IRF staff will continue to prepare and present to the IRF Board a schedule of outstanding loans, including principal outstanding, interest rates and repayment schedules.
- Included in the monthly IRF financial report noted above is a schedule that calculates compliance with the loan percentage requirements discussed in this audit finding. This calculation will be discussed with IRF Board Members at their meetings.
- The IRF staff will aggressively seek out prudent lending opportunities to small businesses that are both likely to be repaid and will assist in meeting these loan percentage requirements.
- All future loans will continue to be documented to inform IRF Board Members of the loan principal in relation to the current IRF asset balance at the time of the loan initiation.

Anticipated Completion Date: August 10, 2017



CITY OF SOUTH BEND PETE BUTTIGIEG, MAYOR
DEPARTMENT OF ADMINISTRATION & FINANCE

CORRECTIVE ACTION PLAN

FINDING 2016-003

Contact Person Responsible for Corrective Action: Pam Meyer
Contact Phone Number: 574-235-5485

Views of Responsible Official: We do not concur with the finding for the following reasons.

The City Administration disagrees that there was a failure to comply as the established process was followed as approved by the Department of Housing and Urban Development (HUD). There is no federal citation that mandates a predetermined time frame within a contract period in which monitoring is required. Desk top monitoring plus regular meetings and inspections of sub-recipients keep reviews and communications current. Some of the sub-recipients receive multiple program funding and while monitoring may be designated to a certain fund in a particular year, the process and culture of the sub-recipient systems are being reviewed.

Monitoring as noted in the HUD Plan states that the City monitors at least eight sub-recipients from one or more of the funding programs. It does not define a number per program. Further, the internal schedule/process ensures those sub-recipients with larger dollar awards are monitored annually and any new sub-recipient is monitored.

The monitoring does not generally occur for the current year funds because funding is available and contracted so late in the year. Sub-recipients most often have not even started to address the current year funding and monitoring is not prudent or necessary, thus monitoring is performed on the previous year funding/projects.

The Continuum of Care funds are grants that cover two years as they are not a January-December grant. Toward the end of the 2016, the SEFA reported on grants covering the 2016-2017 time frame. Monitoring in 2017 is appropriate for this type of contract.

Finally, it was noted that supporting documentation was not always sufficient to ensure sub-recipients paid for services prior to requesting reimbursement from the City.

Description of Corrective Action Plan:

City Administration offers the following corrective action plan:

- The City will consider modification of the monitoring schedule with its next substantial amendment to the current 2014-2019 HCD Plan. This could include a number of options such as denoting monitoring a certain number of sub-recipients per program per year and/or establishing a dollar amount of the award that would trigger an annual monitoring visit.
- The City Administration will consider two options for the program based on the sub-recipient capacity. The first method would be a reimbursement method which would require requested documentation to include, but not limited to, payment documentation by sub-recipients. The cash advance method would also require documentation to be provided at the end of the agreement period. The contracts will be revised to reflect any changes made.

Anticipated Completion Date: December 31, 2017

COMMUNITY INVESTMENT DEPARTMENT
CITY OF SOUTH BEND
EXIT CONFERENCE

The contents of this report were discussed on August 10, 2017, with John H. Murphy, Chief Financial Officer; Jennifer C. Hockenull, City Controller; Tim Scott, President of the Common Council; Jo M. Broden, Member of the Common Council; Gary A. Gilot, President of the Board of Works; Pamela E. Meyer, Community Investments Director of Neighborhood Engagement; Leanna Belew, Century Center General Manager; and Brandon Gerlach, Finance Director of Century Center.