

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

SUPPLEMENTAL COMPLIANCE REPORT

OF

CITY OF NAPPANEE

ELKHART COUNTY, INDIANA

January 1, 2016 to December 31, 2016



FILED
03/15/2018

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SCHEDULE OF OFFICIALS

| <u>Office</u> | <u>Official</u> | <u>Term</u> |
|--|-------------------|----------------------|
| Clerk-Treasurer | Kathy L. Brown | 01-01-16 to 12-31-19 |
| Mayor | Philip W. Jenkins | 01-01-16 to 12-31-19 |
| President of the Board of Public Works and Safety | Philip W. Jenkins | 01-01-16 to 12-31-19 |
| President of the Common Council | Philip W. Jenkins | 01-01-16 to 12-31-19 |
| Superintendent of Utilities | Gale Gerber | 01-01-16 to 12-31-18 |



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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TO: THE OFFICIALS OF THE CITY OF NAPPANEE, ELKHART COUNTY, INDIANA

This report is supplemental to our audit report of the City of Nappanee (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 and Audit Results and Comments 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 and should be viewed in conjunction with the Audit Result and Comment as described below.

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 Audit Result and Comment contained herein describes the identified reportable instance 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 Corrective Action Plan for the Federal Findings and Official Response for the Audit Result and Comment, incorporated within this report, were not verified for accuracy.

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

January 30, 2018

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CLERK-TREASURER
CITY OF NAPPANEE

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS

FINDING 2016-001

Subject: Financial Transactions and Reporting
Audit Findings: Material Weakness, Noncompliance

Condition

There were deficiencies in the internal control system of the City related to financial transactions and the input of financial information entered into the Indiana Gateway for government units financial reporting system (Gateway), which is the source for the Annual Financial Report (AFR) and the financial statement. Financial information was prepared and submitted into the Gateway without effective oversight, review, approval, or other compensating control to ensure the accuracy of the information prior to submission. As a result, the following errors occurred:

1. The 2016 AFR did not agree to the City Fund Report and Utility's Ledger of Receipts, Disbursements, and Balances. As a result, beginning cash and investment balances were overstated by \$1,284,862, receipts were understated by \$7,337,168, and disbursements were understated by \$7,805,196. As a result, ending cash and investment balances as of December 31, 2016, were overstated by \$1,752,890.
2. Depository reconciliations of the fund balances to the bank account balances were incorrect. The bank reconciliations for the City, Wastewater, and Water accounts were not reconciled to the Annual Financial Report. Several bank reconciliations were presented for audit. The City hired several consultants to assist them in preparing the reconciliations during the audit period.

Audit adjustments were proposed, accepted by the City, and made to the AFR and financial statement.

Context

The lack of internal controls was a systemic problem 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 the 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.

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. . . ."

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

Indiana Code 5-11-1-4(a) states:

"The state examiner shall require from every municipality and every state or local governmental unit, entity, or instrumentality financial reports covering the full period of each fiscal year. These reports shall be prepared, verified, and filed with the state examiner not later than sixty (60) days after the close of each fiscal year. The reports must be in the form and content prescribed by the state examiner and filed electronically in the manner prescribed under IC 5-14-3.8-7."

Cause

The City's management had not established a proper system of internal control to ensure proper reporting of the AFR and financial statement.

Effect

The failure to establish controls enabled material misstatements or irregularities to remain undetected.

Recommendation

We recommended that the City's management establish controls to prevent, or detect and correct, errors on the AFR and financial statement.

Views of Responsible Officials

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

FINDING 2016-002

Subject: Preparation of the Schedule of Expenditures of Federal Awards
Audit Finding: Material Weakness

Condition

The City did not have a proper system of internal control in place to prevent, or detect and correct, errors on the Schedule of Expenditures of Federal Awards (SEFA). The City relied on one employee to prepare the SEFA. There was no evidence of a control, such as an oversight, review, or approval process by the City, to ensure federal awards information entered and submitted was correct.

Context

The lack of internal controls was a systemic problem 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 the 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:

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

"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.

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 had not established a system of internal control that would ensure proper reporting of the SEFA.

Effect

The failure to establish controls could have enabled material misstatements or irregularities to remain undetected.

Recommendation

We recommended that the City establish a system of internal controls related to preparation of the SEFA.

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: Water and Waste Program Cluster - Cash Management and Reporting
Federal Agency: Department of Agriculture
Federal Program: Water and Waste Disposal Systems for Rural Communities
CFDA Number: 10.760
Federal Award Number and Year (or Other Identifying Number): 92-01
Compliance Requirements: Cash Management, Reporting
Audit Finding: Material Weakness

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 Cash Management and Reporting compliance requirements.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

Cash Management

The City was required to disburse grant funds to vendors within ten days of receipt of the drawdowns. There was no oversight, review, or approval process in place to ensure compliance with this requirement.

Reporting

The Project Expenditure Report was prepared by one employee. There was no oversight, review, or approval process in place to ensure compliance with this requirement.

Context

The lack of controls was a systemic issue, which occurred throughout the audit period.

Criteria

2 CFR 200.303 states in part:

"The non-Federal entity must:

- (a) 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 or the 'Internal Control Integrated Framework', issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). . . .

Cause

The City's management had not developed a system of internal controls that would have segregated key functions.

Effect

The failure to establish an effective internal control system placed the City at risk of noncompliance with the grant agreement and the compliance requirements. A lack of segregation of duties within an internal control system could also allow noncompliance with compliance requirements and allow the misuse and mismanagement of federal funds and assets by not having proper oversight, reviews, and approvals over the activities of the program.

Questioned Costs

There were no questioned costs identified.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

Recommendation

We recommended that the City's management establish controls, including segregation of duties, to ensure compliance with the Cash Management and Reporting compliance requirements.

Views of Responsible Officials

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



City of Nappanee

300 West Lincoln Street
P.O. Box 29
Nappanee, IN 46550-0029

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Office of
CLERK-TREASURER
Kathy L. Brown
kbrown@nappanee.org

CORRECTIVE ACTION PLAN

FINDING 2016-001

Contact Person Responsible for Corrective Action: **Kathy L. Brown**
Contact Phone Number: **574-773-2112**

Views of Responsible Official: We had one employee run the reports and other employees pull their portion of the Gateway items needed. The Clerk-Treasurer pulled this information all together and entered into Gateway, however our secondary control did not work and that employee was terminated in 2016.

Description of Corrective Action Plan:

One Staff Employee will start of the process of Bank Reconciliation and run the financial reports at **month end** (Fund, Appropriation and Revenue). The Employee will also put their initials on the front page of the report for Audit testing. The Clerk-Treasurer will verify the reports and bank reconciliations. Then close the month so no further changes can be made and will initial any reports verified.

The Clerk-Treasurer will put the information into Gateway and initial. A Staff Employee will run an independent report and verify the correctness of the report then initial this has been done.

Anticipated Completion Date: January 26th, 2018.

Kathy L. Brown
(Signature)

Clerk - Treasurer
(Title)

1-26-18
(Date)



City of Nappanee

300 West Lincoln Street
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(Date)

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Office of
CLERK-TREASURER
Kathy L. Brown
kbrown@nappanee.org

CORRECTIVE ACTION PLAN

FINDING 2016-002

Contact Person Responsible for Corrective Action: **Kathy L. Brown**
Contact Phone Number: **574-773-2112**

Views of Responsible Official: On the SEFA report we were not using the bank reconciliation software and items were not getting captured correctly for Gateway.

Description of Corrective Action Plan:

A staff employee of the Clerk-Treasurer will look at the bank reconciliation and fund report to make sure when given to the Clerk-Treasurer to enter into Gateway all items are correct. The employee will then initial the paperwork and give to the Clerk. The Clerk-Treasurer will verify that reports are correct and enter into Gateway. The staff employee will verify by an independent report that the information in Gateway matches what has been entered. Both the employee and the Clerk-Treasurer will initial all reports.

Anticipated Completion Date: 1-26-18

Kathy L. Brown
(Signature)

Clerk - Treasurer
(Title)

1-29-18
(Date)



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Kathy L. Brown
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CORRECTIVE ACTION PLAN

FINDING 2016-003

Contact Person Responsible for Corrective Action: **Kathy L. Brown**
Contact Phone Number: **574-773-2112**

Views of Responsible Official: **Per USDA every meeting they ask the Vendors if they have received their check for the previous month. Due to the amount of the bond that must be kept we tried to keep this project with as few hands as possible.**

Description of Corrective Action Plan:

A staff employee of the Clerk-Treasurer will look at the IN-Guide 3 that is sent to USDA and will look at each check to verify they are written to the correct Vendor and the dollar amount is correct. They will verify per the Board of Work Check Register and the UB-Guide 3. The Guide 3 will then be sent to USDA with two different sets of initials showing we have complied with our new internal controls.

Bank statements are currently done by a staff member and the Clerk-Treasurer. We started this in January of 2017. They will now have signatures or stamps of who has done the bank statement and who verifying the bank statement.

Anticipated Completion Date: 1-26-18

Kathy L. Brown
(Signature)

Clerk - Treasurer
(Title)

1-26-18
(Date)

CLERK-TREASURER
CITY OF NAPPANEE
AUDIT RESULT AND COMMENT

SUPPLEMENTAL SCHEDULES

Supplemental Schedules were required to be reported annually on the Indiana Gateway for Government Units reporting system. The following supplemental schedules contained errors as noted below:

1. The City reported debt; however, there were various corrections required to accurately report the December 31, 2016 amounts. Total debt was understated by \$18,412,244.
2. The City reported its capital assets, but the Governmental Activities were overstated by \$11,184,826; the Wastewater Utility was understated by \$6,894,189; and Water Utility understated by \$6,322,157.

Audit adjustments were proposed, accepted by the City, and made to the Annual Financial Report Supplementary Schedules.

Indiana Code 5-11-1-4(a) states:

"The state examiner shall require from every municipality and every state or local governmental unit, entity, or instrumentality financial reports covering the full period of each fiscal year. These reports shall be prepared, verified, and filed with the state examiner not later than sixty (60) days after the close of each fiscal year. The reports must be in the form and content prescribed by the state examiner and filed electronically in the manner prescribed under IC 5-14-3.8-7."



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Office of
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Kathy L. Brown
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OFFICIAL RESPONSE TO 2016 AUDIT

January 31, 2018

State Board of Accounts
302 W Washington St, Room E 418
Indianapolis, IN 46204-2765

To Whom It May Concern:

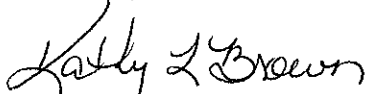
I was appointed to the position of Clerk-Treasurer by Caucus on July 1, 2014, and was elected to that position in 2016. I assumed office from a Clerk-Treasurer who had held the position for approximately 24 years and she had trained me for four months prior to my appointment. At the time that I took office, the department was staffed by five staff members whose years of employment ranged from five years to fifteen years. The Deputy who did bank reconciliation and month-end reports had been in that position for over twelve years. With all of their experience, I initially relied upon every staff member to know their individual job responsibilities and the proper way to do them.

In 2015, I began to make changes on how some things were done. My end goal was accuracy. I wanted to cross train and shift staff workloads to create more internal controls and less overtime. I met with a lot of resistance from the Deputy who did bank reconciliation and month-end reports to the point that we had many verbal conversations and then written warnings. The directive I gave her was to seek help if and when she could not balance. She assured me that she was balancing and I spot checked and she always had answers to the outstanding items. I began to notice that she was becoming belligerent if someone tried to help her. I continued to follow the progressive discipline model. After her termination, I became aware of how poorly she had performed. I then hired an accounting consultant to work on the bank reconciliation going back to the last audit in 2013 then moving forward.

My staff worked side-by-side with the consultant during the bank reconciliation process. I had implemented cross training and believed that I had effectively put internal controls in place. With this audit, my first, I discovered that cross-training was not enough of an internal control and, thanks to the recommendations of the auditors, I have taken corrective action. I will continue to make changes, and to periodically review processes to ensure a paper trail exists to show which employees worked on any tasks, and who confirmed the work. I have also put a plan in place to have all reports on Gateway looked at by a second employee, who will then run her own report to make sure we catch any errors, with special emphasis on debt and capital assets.

Thanks to this audit, I have learned to look at the functions of my department from a testing perspective and not just an implementation perspective. I now realize that auditors need to be able to identify the individuals who work on each project in order to test the process. I strongly believe that moving forward all concerns have been addressed.

Sincerely,

A handwritten signature in cursive script that reads "Kathy L. Brown". The signature is written in black ink and is positioned above the printed name and title.

Kathy L Brown
Clerk-Treasurer

CLERK-TREASURER
CITY OF NAPPANEE
EXIT CONFERENCE

The contents of this report were discussed on January 30, 2018, with Kathy L. Brown, Clerk-Treasurer; Philip W. Jenkins, Mayor, President of the Board of Works and Safety, and President of the Common Council; Jake Dermott, Common Council member; Dana Hollar, Common Council member; Todd Nunemaker, Common Council member; Wayne Scheumann, Board of Public Works member; Brian Hoffer, City Attorney; Nikki L. Ramer, Office Manager; and Margaret M. Marnocha, Attorney.