

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, 2016 to December 31, 2016



FILED
03/20/2018

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SCHEDULE OF OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
Controller	Heather Garay	01-01-16 to 12-31-18
Mayor	Thomas M. McDermott, Jr.	01-01-16 to 12-31-19
President of the Board of Public Works and Safety	Stanley J. Dostatni	01-01-16 to 12-31-18
President of the Common Council	Michael Opinker Janet Venecz	01-01-16 to 07-28-16 07-29-16 to 12-31-18
Sanitary District Manager	Marty J. Wielgos	01-01-16 to 12-31-18
Business Manager	Rachel Montes	01-01-16 to 12-31-18
President of the Sanitary District Board of Commissioners	Dean Button	01-01-16 to 12-31-18



STATE OF INDIANA
AN EQUAL OPPORTUNITY EMPLOYER

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

This report is supplemental to our audit report of the Sanitary District, City of Hammond, 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 Audit Results and Comments that pertain to the Sanitary District. It should be read in conjunction with our Financial Statement and Federal Single Audit Report of the Sanitary District, which provides our opinions on the Sanitary District's financial statement and federal program compliance. 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 Audit 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 Audit Results and Comments, incorporated within this report, were not verified for accuracy.

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

February 7, 2018

SANITARY DISTRICT
CITY OF HAMMOND
AUDIT RESULTS AND COMMENTS

INTERNAL CONTROLS OVER FINANCIAL TRANSACTIONS AND REPORTING

A similar comment also appeared in prior Reports B45301 and B47498, entitled *INTERNAL CONTROLS OVER FINANCIAL STATEMENTS*.

There were several deficiencies in the internal control system of the Sanitary District related to financial transactions.

1. Lack of Segregation of Duties: The Sanitary District had not separated incompatible activities as follows:

- A. The Accounts Payable Clerk recorded the invoices to the accounting system, generated the checks for payment, and prepared the envelopes, with the checks inserted, for mailing.

- B. The Payroll Manager was responsible for the entire payroll process and was able to make payroll rate changes in the computer system. The Sanitary District Manager implemented a procedure to select up to 15 employees each pay period whose payroll records were audited by an accountant. That audit did not include a verification of the pay distribution to the proper funds and accounts.

- C. The Business Manager was responsible for many of the account balances reported in the financial statements. The Business Manager performed many of the calculations or determinations using spreadsheets, then entered these amounts into the General Ledger (GL) accounting system via a journal entry or provided the calculated amounts to various staff to enter into the GL thru the normal course of business. The Business Manager then entered the amounts from the various GL reports into a spreadsheet that was the basis for the financial statements.

The account balances include Deferred Inflows and Outflows, Net Position, and many of the receivables and payables. As the offset to activity entered into the account balances would be revenue and expense transaction accounts, errors in entries to the account balances would affect the transaction action accounts as well. There is a lack of segregation of duties as many of the amounts reported in the financial statement are determined by the Business Manager, who also prepared the financial statements.

- D. The Business Manager obtained the information and computed the taxes receivable (net of allowance for doubtful accounts). The computations were submitted to the City Controller with supporting documentation for review. Taxes receivable was overstated by \$517,820 due to the following:

- (1) The Sanitary District's calculation of taxes receivable was based only upon the current year's notice (taxes to be billed) less actual distributions from the county. It did not take into account the actual delinquent taxes tracked by the county, which covers several years of billings. The Sanitary District's calculation of the taxes receivables was also reduced by Financial Institution tax, Excise tax, and Commercial Vehicle Excise tax, which are intergovernmental receivables and not property tax receivables. The Sanitary District's calculation should only include the property tax portion and the actual delinquency amount from the county (not just current year).

SANITARY DISTRICT
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AUDIT RESULTS AND COMMENTS
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- (2) In reviewing the Sanitary District's computation of the allowance, it was determined that there was a difference in the interpretation of the allowance policy. This interpretation resulted in the Sanitary District's calculated allowance percentage to be lower, which resulted in a higher receivable recorded by the Sanitary District. The Sanitary District included the audit year's rate of collection of current taxes (which always has the highest collection rate). Inclusion of the current year, skewed the three-year history of delinquent receivable as it is a collection of current billings and not delinquent amounts.
2. Monitoring of Controls: An evaluation of the Sanitary District's system of internal control had not been conducted. Additionally, the Sanitary District had no process to identify or communicate corrective actions to improve controls. Effective internal controls over financial reporting required the Sanitary District to monitor and assess the quality of the system of internal control.
3. Preparing Financial Statement: Effective internal control over financial reporting involved the identification and analysis of the risks of material misstatement to the Sanitary District's audited financial statement and then determining how those identified risks should have been managed. The Sanitary District had not identified risks to the preparation of a reliable financial statement and, as a result, has failed to design effective controls over the preparation of the financial statement to prevent or detect material misstatements, including notes to the financial statement. In addition, management of the Sanitary District had not established a process for final review of the financial statement after compilation.

We identified several deficiencies in the internal control system of the Sanitary District related to reporting. Due to the deficiencies, the following material (either individually or cumulatively) misstatements in the financial statements prepared by the Sanitary District were undetected by management:

A. Several current year transactions were recorded as adjustments to Net Position (Equity) which affected the Reporting in the Statement of Revenues, Expenses and Changes in Net Position:

- (1) The Sanitary District recorded the entry to reverse the beginning Taxes Receivable to Net Position and not revenue. This resulted in a \$986,217 overstatement of Local Tax Distribution revenues and an understatement of Net Position.
- (2) The Sanitary District had performed an analysis on the prior year's costs to determine if the customer cities owed additional amounts for the services provided. Based upon the analysis, the Sanitary District recorded additional receivable of \$769,138 to Net Position and not revenue. This resulted in an understatement of Revenues and overstatement of Net Position.

The Sanitary District entered into an agreement in 2016 with a customer city to be reimbursed for a portion of prior capital costs in the amount of \$2,350,000. As part of the agreement, the Sanitary District also agreed to a \$428,468 reduction of amounts owed to the Sanitary District for services. The transaction was posted to Net Position and not the proper revenue or expense accounts. This resulted in a \$2,350,000 understatement of capital contributions revenue, a \$428,628 understatement of bad debt expense, and \$1,921,532 overstatement of Net Position.

SANITARY DISTRICT
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AUDIT RESULTS AND COMMENTS
(Continued)

- (3) The Sanitary District recorded the entry to reverse the \$254,636 beginning Storm Water Utility accounts receivable to Net Position (Equity) and not revenue. Additionally, \$69,094 of the ending receivable was recorded as a reduction of Net Position. It should have been recorded as an addition to revenue. These entries resulted in an understatement of Revenue and Net Position of \$185,542.
 - (4) A \$19,636 current year transfer between the Sanitary District and Storm Water Utility was recorded as a prior period adjustment and not reported as a transfer in/out between the Utilities on the Statement of Revenues, Expenses and Changes in Net Position.
 - (5) The change (reduction) in the Allowance for Doubtful Accounts for the year was recorded against Net Position, resulting in an overstatement of Net Position and understatement of revenue of \$9,654.
 - (6) Amounts received for refund of prior period expense, and an older outstanding check which was voided in the audit period, should have been recorded in revenue in the current period when received and not to Net Position. This resulted in a \$10,918 understatement of revenue and Net Position.
- B. A prior year's \$20,816 expense was capitalized in the current year, then expensed again in the current year. This resulted in inaccurate amounts reported for beginning Net Position.
- C. The Business Manager recorded adjustments to the GL in June 27, 2017, for 2016, which were not reflected in the financial statements. The adjustment resulted in a reduction of bonds payable and an increase in the loans payable for \$1,635,000, which did not appear in the financial statement.
- D. A spreadsheet was used to compile operating expense information for the financial statement. Due to a formula error in the spreadsheet, only one side of a transaction was reported, which resulted in a \$348,509 overstatement of nonoperating expenses.
- E. The Statement of Cash Flows prepared by the Business Manager included the following errors:
- (1) Temporary loan activity between the Sanitary District and the Storm Water Utility was not presented. Additionally, transfers between the two Utilities did not agree. The Storm Water Utility reported transfers out of \$854,701, while the Sanitary District Utility reported transfers in of \$435,605.
 - (2) The calculation of receipts from customers and users included changes in Deferred Inflows and Deferred Outflows, which relate to pension costs and should have been applied to the calculation of amounts paid to employees instead.
 - (3) The calculation of amounts paid to employees did not include the change in the Net Pension Obligation, nor was it reported in the reconciliation of operating income section. Additionally, the amounts used as the basis for amounts paid to employees was overstated by \$2,258,987 and did not agree to the Statement of Revenues, Expenses and Changes in Net Position.

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AUDIT RESULTS AND COMMENTS
(Continued)

- (4) Certain noncash activities occurred which required a separate disclosure with the cash flow statement, which were not reported. These omitted disclosures consisted of contributions of capital assets and transfer of completed construction in progress for \$539,893 and \$1,925,842, respectively.
- (5) Other amounts required correction due to errors noted above to the financial statements.

F. Various schedules in the Notes to the Financial Statements did not agree to audited amounts reported in the financial statements or were incomplete, which also required adjustment.

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

In addition to the items noted 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 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. . . ."

"The Green Book identifies a list of control activity categories that are meant only to illustrate the range and variety of control activities; the list is by no means all inclusive, but is reproduced here for reference purposes: . . .

- Accurate and timely recording of transactions. . . ."

SANITARY DISTRICT
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AUDIT RESULTS AND COMMENTS
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"Evaluations are used to determine whether each of the five components of internal control is present and functioning. These evaluations may be conducted on an ongoing or periodic basis. The criteria used are developed by the oversight body, elected officials, management, governing boards, or recognized standard-setting bodies or regulators."

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. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 1)

DELINQUENT WASTEWATER ACCOUNTS

The same comment also appeared in prior Reports B47498 and B45301.

Delinquent wastewater fees and penalties had not been certified to the County Auditor, nor recorded with the County Recorder in 2016.

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.

(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 (c), certify to the county auditor a list of the unpaid liens for collection with the next May installment of property taxes. . . ."

SANITARY DISTRICT of HAMMOND

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Board of Sanitary Commissioners

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THOMAS MCDERMOTT, JR.
Mayor

MARTY WIELGOS
District Manager

RACHEL MONTES
Business Manager

JOSEPH P. ALLEGRETTI
Legal Counsel

February 21, 2018

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, 2016 – December 31, 2016)

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

Going forward, the District will hire a consultant to evaluate all deficiencies noted in the 2016 audit and place proper controls for the accounts payable department, payroll department and financial statement preparation.

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 2016.

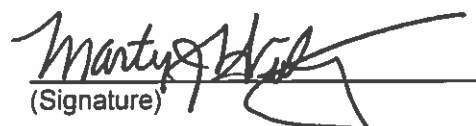
Response

The District will meet with the District attorney and City Controller to evaluate the process needed to comply with Indiana Code 36-9-23-33.


(Signature)

Rachel Montes, Business Manager
(Title)

February 21, 2018
(Date)


(Signature)

Marty Wielgos, District Manager
(Title)

February 21, 2018
(Date)

SANITARY DISTRICT
CITY OF HAMMOND
EXIT CONFERENCE

The contents of this report were discussed on February 7, 2018, with Heather Garay, Controller; Thomas M. McDermott, Jr., Mayor; Janet Venecz, President of the Common Council; Marty J. Wielgos, Sanitary District Manager; Rachel Montes, Sanitary District Business Manager; Michael Dye, Sanitary District Board of Commissioners member; Michael Hawkins, Sanitary District Board of Commissioners member; Pat Moore, Sanitary District Board of Commissioners member; Phil Taillon, Chief of Staff; Dan Spitale, Common Council member; Mark Kalwinski, Common Council member; Anthony Higgs, Common Council member; William Emerson, Sr., Common Council member; Dave Woerpel, Common Council member; and Karl Cender, Sanitary District Financial Advisor.