

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, 2017 to December 31, 2017



FILED
09/23/2019

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SCHEDULE OF OFFICIALS

| <u>Office</u> | <u>Official</u> | <u>Term</u> |
|--|-------------------|----------------------|
| Clerk-Treasurer | Kathy L. Brown | 07-01-16 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 | 01-01-17 to 12-31-19 |



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, 2017 to December 31, 2017. 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 to the Audit Result and Comment, incorporated within this report, were not verified for accuracy.

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

August 26, 2019

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CLERK-TREASURER
CITY OF NAPPANEE

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS

FINDING 2017-001

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

Condition

There were several deficiencies in the internal control system of the City related to financial transactions and reporting. The City had not established effective internal controls over activities related to cash and investments, receipts, disbursements, Payroll fund activity, and financial close and reporting.

Cash and Investments

There was no documented oversight, review, or approval process by two separate individuals to ensure bank reconciliations were complete, accurate, and done timely. The City completed 136 monthly bank reconciliations during the audit period. Of 21 monthly bank reconciliations sampled, 8 bank reconciliations were not completed timely. The 8 bank reconciliations were completed between 3 to 11 months after the month end.

Receipts

There was no documented oversight, review, or approval process by two separate individuals to ensure receipts were properly entered into the City's accounting system and deposited.

Disbursements

There were Accounts Payable Vouchers during the audit period for debt and CSO payments that were not included in the claims dockets to be approved by the governing board.

Payroll Fund Activity

The City used a service organization to process payroll during the audit period. Receipts and disbursements posted into the City's Payroll fund by the Clerk-Treasurer's office were often duplicated from other holding payroll accounts. Furthermore, entries made into the City's Payroll fund did not correlate with the payroll processing reports from the service organization. Of four sampled payroll processing reports prepared by the service organization and tested to the Payroll fund account, receipts were overstated by \$10,977 with a projection to the population of \$79,493. Of four sampled payroll processing reports prepared by the service organization and tested to the Payroll fund account, disbursements were overstated by \$44,160 with a projection to the population of \$301,320. Of the four payroll processing reports prepared by the service organization and tested, receipts and disbursements were not posted in a timely manner.

Financial Close and Reporting

Financial information was entered into the Indiana Gateway for Government Units financial reporting system, which was the source for the Annual Financial Report (AFR) and financial statement, by the Clerk-Treasurer. The AFR and financial statement included a prior period adjustment that overstated receipts and disbursements by \$4,522,702 and \$4,523,304, respectively.

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

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

Context

The lack of controls and noncompliance related to cash and investments, disbursements, Payroll fund activity, and financial close and reporting were systemic issues, which occurred throughout the audit period. The lack of controls related to receipts was 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 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. . . ."

Indiana Code 5-13-6-1(e) states: "All local investment officers shall reconcile at least monthly the balance of public funds, as disclosed by the records of the local officers, with the balance statements provided by the respective depositories."

Posting to appropriation accounts is to be made from the individual payroll schedules and vouchers for the gross amount of the pay. Posting to the respective fund accounts is to be made from the regular city or town warrants issued for transfer of funds to the payroll fund. The totals of amounts posted to the appropriation accounts and the respective fund accounts must agree. Posting to the payroll fund is to be made from the payroll warrants. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 4)

All documents and entries to records must be made in a timely manner to ensure that accurate financial information is available to allow the 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)

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

Management of the City had not established a proper system of internal control. An evaluation of the City's system of internal control had not been conducted.

Effect

The failure to establish a system of internal controls enabled material misstatements or irregularities to remain undetected.

Views of Responsible Officials

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

FINDING 2017-002

Subject: Preparation of the Schedule of Expenditures of Federal Awards
Audit Findings: Material Weakness, Noncompliance

Repeat Finding

This is a repeat finding from the immediately prior audit. The prior audit finding number was 2016-002.

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 failed to properly review the federal grant information prepared and submitted in the Indiana Gateway for Government Units financial reporting system, which is the source of the SEFA. One employee prepared the grant information for the federal awards without a system of oversight or review to detect and correct errors before submission.

Context

Due to the lack of controls, the SEFA presented for audit included the following errors:

1. The Water and Waste Disposal Systems for Rural Communities grant was omitted, which understated the federal expenditures by \$16,745,892.
2. Grant expenditures were erroneously reported on the SEFA, which overstated the federal expenditures by \$82,934.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

Audit adjustments were proposed, accepted by the City, and made to the SEFA.

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. . . .

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. . . ."

2 CFR 200.508 states in part:

"The auditee must: . . .

- (b) Prepare appropriate financial statements, including the schedule of expenditures of Federal awards in accordance with § 200.510 Financial statements. . . ."

2 CFR 200.510(b) states:

"*Schedule of expenditures of Federal awards*. The auditee must also prepare a schedule of expenditures of Federal awards for the period covered by the auditee's financial statements which must include the total Federal awards expended as determined in accordance with § 200.502 Basis for determining Federal awards expended. While not required, the auditee may choose to provide information requested by Federal awarding agencies and pass-through entities to make the schedule easier to use. For example, when a Federal program has multiple Federal award years, the auditee may list the amount of Federal awards expended for each Federal award year separately. At a minimum, the schedule must:

- (1) List individual Federal programs by Federal agency. For a cluster of programs, provide the cluster name, list individual Federal programs within the cluster of programs, and provide the applicable Federal agency name. For R&D, total Federal awards expended must be shown either by individual Federal award or by Federal agency and major subdivision within the Federal agency. For example, the National Institutes of Health is a major subdivision in the Department of Health and Human Services.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

- (2) For Federal awards received as a subrecipient, the name of the pass-through entity and identifying number assigned by the pass-through entity must be included.
- (3) Provide total Federal awards expended for each individual Federal program and the CFDA number or other identifying number when the CFDA information is not available. For a cluster of programs also provide the total for the cluster.
- (4) Include the total amount provided to subrecipients from each Federal program.
- (5) For loan or loan guarantee programs described in § 200.502 Basis for determining Federal awards expended, paragraph (b), identify in the notes to the schedule the balances outstanding at the end of the audit period. This is in addition to including the total Federal awards expended for loan or loan guarantee programs in the schedule.
- (6) Include notes that describe that significant accounting policies used in preparing the schedule, and note whether or not the auditee elected to use the 10% de minimis cost rate as covered in § 200.414 Indirect (F&A) costs."

Cause

The City's management had not established a system of internal control that would have ensured proper reporting of the SEFA.

Effect

The failure to establish an effective internal control system enabled material misstatements to go undetected. The SEFA contained the errors identified in the *Context*.

Views of Responsible Officials

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

FINDING 2017-003

Subject: Water and Waste Disposal Systems for Rural Communities - Suspension and Debarment
Federal Agency: Department of Agriculture
Federal Program: Water and Waste Disposal Systems for Rural Communities
CFDA Number: 10.760
Federal Award Numbers and Years (or Other Identifying Numbers): 92-01, 00-02, 92-03, 00-04, 92-05
Compliance Requirement: Procurement and Suspension and Debarment
Audit Finding: Material Weakness

Condition

The City had not implemented an effective control system related to the grant agreement and the suspension and debarment requirements of the Procurement and Suspension and Debarment compliance requirement.

The City relied on the contracted engineer to ensure that the suspension and debarment requirements were met without an oversight or approval process.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

Context

The lack of internal controls was a systemic issue throughout the audit period.

Criteria

2 CFR section 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 implemented a system of internal controls to ensure compliance with the grant agreement and the Procurement and Suspension and Debarment compliance requirement.

Effect

The failure to establish an effective internal control system placed the City at risk of noncompliance with the grant agreement and the Procurement and Suspension and Debarment compliance requirement. A lack of segregation of duties within an internal control system could have also allowed noncompliance with the compliance requirement and allowed the misuse and mismanagement of federal funds, which 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 with the Procurement and Suspension and Debarment compliance requirement.

Views of Responsible Officials

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



KATHY L. BROWN
Clerk - Treasurer
kbrown@nappanee.org

CORRECTIVE ACTION PLAN

FINDING 2017-001

Contact Person Responsible for Corrective Action: Kathy L Brown, IAMC, Clerk-Treasurer
Contact Phone Number: 574-773-2112

Views of Responsible Official: I concur with the Audit findings.

Description of Corrective Action Plan: From this date forward we will make sure any audit adjustments made for previous years are put into new receipt/disbursements accounts that are stated Audit Adjustments for previous years, so that these items will be easily discernable when it is time to do the Annual Financial Report. This will also be added to the internal control manual.

Cash/Investments are reviewed with our third party contractor. As of September 30, 2019 we will make sure all Fund and Investment Reports are run monthly and correctly reflect the bank reconciliation that is sent monthly.

Receipts will be reviewed by two separate individuals and stamped with their initials on a daily basis.

The disbursements for the CSO Operating Fund has resolved itself in 2019 as there will be no contractor/engineering checks coming out of that account. The unit will also make sure every APV voucher goes onto the check register for the appropriate board to approve.

We changed to a third party in 2017 for payroll and brought in a consultant to help us set up the payroll accounts when the third party was unable to help us which was mid-year 2017. The consultant showed us how to make the corrections, however we did not follow through with all of the corrections for 2017 after the consultant left, thus the receipts/disbursements were overstated in some instances. This process has been changed and is documented. I currently have a consultant working with the City to make the corrections for 2017, 2018 and 2019 to be completed prior to September 30, 2019.

Anticipated Completion Date: September 30, 2019

Kathy L Brown, IAMC
(Signature)

Clerk - Treasurer
(Title)

8-22-19
(Date)

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KATHY L. BROWN
Clerk - Treasurer
kbrown@nappanee.org

CORRECTIVE ACTION PLAN

FINDING 2017-002

Contact Person Responsible for Corrective Action: Kathy L. Brown, IAMC, Clerk-Treasurer
Contact Phone Number: 574-773-2112

Views of Responsible Official: I concur that the USDA grant was omitted. It was shown as debt but was not uploaded onto the SEFA with the Waste Water Disposal. I feel part of this issue was due to the timing of the 2016 audit and the misunderstanding I had concerning how the dollars should be recorded for the SEFA

Description of Corrective Action Plan: The Clerk-Treasurer will re-train the Deputies and Office Manager to make sure they understand the SEFA and loan documents better to look for mistakes as the secondary signature for better internal controls. The Clerk-Treasurer will verify the information in Gateway and initial. A Staff Employee will run an independent report and verify the correctness of the report then initial that this has been done.

Anticipated Completion Date: December 2019

Kathy L. Brown, IAMC
(Signature)

Clerk-Treasurer
(Title)

8-20-19
(Date)

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KATHY L. BROWN
Clerk - Treasurer
kbrown@nappanee.org

CORRECTIVE ACTION PLAN

FINDING 2017-003

Fiscal year in which the finding initially occurred: 2017

Federal Grantor Agency, if direct: USDA

Contact Person Responsible for Corrective Action: Phil Jenkins, Mayor and Kathy L Brown, IAMC, Clerk-Treasurer

Contact Phone Number: 574-773-2112

Views of Responsible Official: Due to changes in Management in 2016 and the USDA loan process starting years before the loan closed in 2016, we believe this was done but do not have the records to reflect this.

Description of Corrective Action Plan: The Mayor and Clerk-Treasurer will make sure that all grant agreements have a secondary check by the City for vendors to make sure that they are in compliance in regard to suspension and debarment requirements in writing prior to loan closing. All documentation will be put with all loan closing documents.

Anticipated Completion Date: August 1, 2019

Kathy L Brown, IAMC
(Signature)

Clerk - Treasurer
(Title)

8-20-19
(Date)

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CLERK-TREASURER
CITY OF NAPPANEE
AUDIT RESULT AND COMMENT

FUND SOURCES AND USES

The City used a service organization to process payroll during the audit period. The service organization provided the City with payroll registers to post earnings and deductions in the City's fund ledger. The Clerk-Treasurer's office receipted employee deductions of federal, state, local, and uniforms into the Payroll fund from gross payroll; however, the employee deductions were also charged from the following departmental funds: Water Utility-Operating, Wastewater Utility-Operating, Parks and Recreation, Motor Vehicle Highway, and City Planning from the General fund. Therefore, the Payroll fund has excess funds from employee deductions that must be paid back to the following departmental funds.

| Fund | Employee Deduction Type | Owed by Payroll fund |
|------------------------------|-------------------------------|----------------------------|
| Water Utility-Operating | Federal | \$ 22,625 |
| Water Utility-Operating | State/Local | 10,832 |
| Water Utility-Operating | PERF | 10,822 |
| Water Utility-Operating | Uniforms | 709 |
| Wastewater Utility-Operating | Federal | 15,999 |
| Wastewater Utility-Operating | State/Local | 7,981 |
| Wastewater Utility-Operating | PERF | 14,679 |
| Wastewater Utility-Operating | Uniforms | 495 |
| Parks and Recreation | Uniforms | 285 |
| Motor Vehicle Highway | Uniforms | 383 |
| General - City Planning | Uniforms | 158 |

Sources and uses of funds must be limited to those authorized by the enabling law, ordinance/resolution, or grant agreement. (Accounting and Uniform Compliance Guidelines Manual for Cities and Towns, Chapter 1)

CLERK-TREASURER
CITY OF NAPPANEE
EXIT CONFERENCE

The contents of this report were discussed on August 26, 2019, with Kathy L. Brown, Clerk-Treasurer; Philip W. Jenkins, Mayor; Jacob Dermott, Common Council member; Elizabeth Watson, Deputy Clerk-Treasurer; and Brian Hoffer, City Attorney.