

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, 2018 to December 31, 2018



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	01-01-18 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, 2018 to December 31, 2018. 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 Results and Comments 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 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 Corrective Action Plan for the Federal Findings and 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

August 26, 2019

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CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS

FINDING 2018-001

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

Repeat Finding

This is a repeat finding from the immediately prior audit. The prior audit finding number was 2017-001.

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 receipts, disbursements, and Payroll fund activity.

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 made during the audit period for the debt and CSO payments that were not included in the claims docket 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 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 \$13,855 with a projection to the population of \$92,793. Of four sampled payroll processing reports prepared by the service organization and tested to the Payroll fund account, disbursements were overstated by \$56,994 with a projection to the population of \$354,753.

Context

The lack of controls and noncompliance related to disbursements and Payroll fund activity 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:

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. . . .

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. . . ."

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)

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 2018-002

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 2017-002.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

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. Amounts reported as passed through to subrecipients were overstated by \$5,427,037.
2. Grant expenditures were erroneously reported on the SEFA which overstated the federal expenditures by \$139,923.

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. . . ."

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

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.
- (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.
- (5) 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.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

FINDING 2018-003

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

Repeat Finding

This is a repeat finding from the immediately prior audit. The prior audit finding number was 2017-003.

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.

Context

The lack of internal controls was a systemic issue 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 implemented a system of internal controls to ensure compliance with the grant agreement and the Procurement and Suspension and Debarment compliance requirement.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

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.

FINDING 2018-004

Subject: Water and Waste Disposal Systems for Rural Communities - Reporting
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: Reporting
Audit Findings: Material Weakness, 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 Reporting compliance requirement.

The City had not designed or implemented adequate policies and procedures to ensure that the Statement of Budget, Income, and Equity (Form 442-2) as well as the Balance Sheet (Form 442-3) reports were accurately prepared and reviewed prior to submission.

The amounts reported for operating income and operating expenses on the Statement of Budget, Income, and Equity (Form 442-2) for 2018, did not agree with the supporting documentation provided for audit.

Context

The lack of effective controls and noncompliance were systemic issues throughout the audit period.

CLERK-TREASURER
CITY OF NAPPANEE
FEDERAL FINDINGS
(Continued)

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). . . ."

2 CFR 200.302(b)(2) states in part: "Accurate, current, and complete disclosure of the financial results of each Federal award or program in accordance with the reporting requirements set forth in §§ 200.327 Financial reporting and 200.328 Monitoring and reporting program performance. . . ."

2 CFR 200.302(b)(3) states:

"Records that identify adequately the source and application of funds for federally-funded activities. These records must contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, expenditures, income and interest and be supported by source documentation."

Cause

The City's management had not developed a system of internal controls that would have ensured compliance with the Reporting compliance requirement.

Effect

The failure to establish an effective internal control system enabled material noncompliance to go undetected. Noncompliance with the grant agreement and the Reporting 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 comply with the grant agreement and the Reporting 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 2018-001

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.

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 was not corrected properly in 2018 either. This process has been changed and is documented in August 2019. 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 2018-002

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

Fiscal year in which the finding initially occurred: 2018

Federal Grantor Agency, if direct: USDA
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 SEFA was incorrect in reporting the USDA grant and loan. They were combined in error. I feel part of this finding is due to the timing of the audit of 2017 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 initials that this has been done prior to submitting the SEFA.

Anticipated Completion Date: December 31, 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 2018-003

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

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 the timing of the 2018 Audit we were unable to correct this until August of 2019.

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)

8-22-19
(Date)

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-14-

Nappanee is an Equal Opportunity Employer



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

CORRECTIVE ACTION PLAN

FINDING 2018-004

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

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: I concur with the Audit Findings

Description of Corrective Action Plan: The original 442-2 and 442-3 USDA Reports for 2018 were done with the USDA Representative. The handwritten information reflected the USDA and Clerk-Treasurer's handwritten numbers and notes. In the future this report will be done by the Clerk-Treasurer with a Staff Member as a secondary control. The numbers will be pulled from the Annual Financial Report in Gateway as well as reports run from the City's Financial Software to make sure all numbers match and are correct. These reports will then be sent to the USDA Representative for review and a signature to prove the USDA has received and approved the 442-2 and 442-3 Reports. The Clerk-Treasurer will also make sure that USDA signed copies of the 442-2 and 442-3 are put in with the CSO project for audit review in the future.

Anticipated Completion Date: January 31, 2020

Kathy L Brown, IAMC
(Signature)

Clerk-Treasurer
(Title)

8-22-19
(Date)

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CLERK-TREASURER
CITY OF NAPPANEE
AUDIT RESULTS AND COMMENTS

FUND SOURCES AND USES

The same comment also appeared in the prior 2017 Supplemental Compliance Report.

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, 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	\$ 21,834
Water Utility-Operating	State/Local	12,468
Water Utility-Operating	PERF	17,296
Water Utility-Operating	Uniforms	720
Wastewater Utility-Operating	Federal	18,692
Wastewater Utility-Operating	State/Local	11,036
Wastewater Utility-Operating	PERF	18,371
Wastewater Utility-Operating	Uniforms	623
Parks and Recreation	Uniforms	360
General - City Planning	Uniforms	23

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)

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, 2018 amounts. The Taxable Sewage Revenue & Refunding Revenue Bond of 2016 Series A ending principal balance was understated by \$6,785,000 and the Taxable Sewage Revenue & Refunding Revenue Bond of 2016 Series C ending principal balance was overstated by \$6,838,000.
2. The City reported its capital assets, but the Water Utility was overstated by \$14,523,341.

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

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](#)."

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, Council member; Elizabeth Watson, Deputy Treasurer; and Brian Hoffer, City Attorney.