

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, 2018 to December 31, 2018



FILED
10/28/2019

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SCHEDULE OF OFFICIALS

<u>Office</u>	<u>Official</u>	<u>Term</u>
City Controller	Heather Garay	01-01-18 to 12-31-19
Mayor	Thomas M. McDermott, Jr.	01-01-18 to 12-31-19
President of the Board of Public Works and Safety	Stanley J. Dostatni Heather Garay	01-01-18 to 02-04-18 02-05-18 to 12-31-19
President of the Common Council	Janet Venecz Robert Markovich	01-01-18 to 12-31-18 01-01-19 to 12-31-19
Sanitary District Manager	Marty J. Wielgos	01-01-18 to 12-31-19
Business Manager	Rachel Montes	01-01-18 to 12-31-19
President of the Sanitary District Board of Commissioners	Sam Dimopoulos	01-01-18 to 12-31-19



STATE OF INDIANA
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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 (Sanitary District), City of Hammond, 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 Audit Results and Comments that pertain to the Sanitary District. It should be read in conjunction with our Financial Statements Audit Report of the Sanitary District, which provides our opinion on the Sanitary District's financial statements. 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 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 Official Response to the Audit Result and Comment, incorporated within this report, was not verified for accuracy.

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

September 11, 2019

SANITARY DISTRICT
CITY OF HAMMOND
AUDIT RESULT AND COMMENT

FINANCIAL TRANSACTIONS AND REPORTING

A similar comment also appeared in prior Reports B45301 and B47498, entitled *INTERNAL CONTROLS OVER FINANCIAL STATEMENTS*, Report 49698, entitled *INTERNAL CONTROLS OVER FINANCIAL TRANSACTIONS AND REPORTING*, and Report B51313, entitled *FINANCIAL TRANSACTIONS AND REPORTING*.

Condition and Context

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

1. Lack of Segregation of Duties: The Sanitary District had not separated incompatible activities as follows:
 - A. The Payroll Manager was responsible for the entire payroll process and was able to make payroll rate changes in the computer system. A verification or review process to ensure that employees were paid from the correct fund and at the correct rate was not established. The Sanitary District instituted additional payroll processing procedures in 2019.
 - B. The Business Manager was responsible for the preparation of the financial statements, notes to the financial statements, and the required supplementary information. After the financial statements were completed by the Business Manager, an outside consultant reviewed the financial statements, the notes to the financial statements, and the required supplementary information; however, there was not an effective documented review performed by the Sanitary District of the work performed by the outside consultant or any adjustments made by the Business Manager after the advice received from the outside consultant.
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 monitoring control changes when the control environment changes (i.e., when contracting with outside consultants). Effective internal controls over financial reporting required the Sanitary District to monitor and assess the quality of the system of internal control.

The Sanitary District prepared the financial statements in accordance with generally accepted accounting principles (GAAP). The financial statements prepared on the GAAP basis and accompanying notes to the financial statements were prepared by the Business Manager with the assistance of an outside consultant. These financial statements and notes lacked a documented review after changes recommended by the outside consultant were made, which allowed the following errors to occur and not be detected or corrected:

1. The Statement of Net Position and Statement of Revenues, Expenses, and Changes in Net Position included the following errors:
 - a. Reclassification of the \$3,018,124 bond premium from a separately identified account to be reported as Bonds payable (net of unamortized bond discount and premium) on the Statement of Net Position.

SANITARY DISTRICT
CITY OF HAMMOND
AUDIT RESULT AND COMMENT
(Continued)

- b. Per the Statement of Net Position, the Net invested in capital assets, net of related debt was understated by \$25,872,531 due to the incorrect calculation for the related debt amount. The Restricted for capital improvements was overstated by \$11,883,884 for the amount of bond proceeds on hand at year end that was included in the calculation of the Net invested in capital assets, net of relate debt. These two items resulted in the overstatement of the unrestricted net position by \$13,988,647.
- c. The Statement of Revenues, Expenses, and Changes in Net Position overstated Amortization of prior bond issuance costs by \$465,712 for the new bond issuance costs that was expensed.
2. The Statement of Cash Flows excluded adjustments for the following items:
- a. The receipt of \$22,311,429 in bond proceeds.
 - b. The \$21,523,450 payment of bonds refunded, including the call premium.
 - c. The \$726,453 payment of bond issuance costs.
 - d. The \$61,526 payment of interest paid on bonds refunded.
3. Notes to the Financial Statements included the following errors:
- a. Portions of the Other Post-Employment Benefits (OPEB) note disclosures were presented in error as Requirement Supplementary Information and not reported in the Notes to the Financial Statements.
 - b. Subsequent Events note contained the prior year's disclosures and did not contain a material contract award for improvements in the subsequent period.
 - c. A Refunding of Debt note to provide a general description of the transactions, the difference between the cash flows required to service the old debt, and the cash flows required to service the new debt and complete the refunding and the economic gain or loss resulting from the transaction was not presented as required.
 - d. An Adoption of Governmental Accounting Standards Board (GASB) Statement 75, Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions, disclosure was not presented as required.
 - e. A number of items regarding language in various notes were also noted and discussed with Management.

Audit adjustments were proposed and accepted by the Sanitary District to correct the Statement of Net Position; Statement of Revenues, Expenses, and Changes in Net Position; Statement of Cash Flows; and Notes to the Financial Statements.

SANITARY DISTRICT
CITY OF HAMMOND
AUDIT RESULT AND COMMENT
(Continued)

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. . . ."

"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)

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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

September 19, 2019

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, 2018 – December 31, 2018)

Internal Controls Over Financial Transactions and Reporting

Examination Position

1. **Lack of Segregation of Duties:** The District had not separated incompatible activities as follows:
 - a. The Payroll Clerk was responsible for the entire payroll process and was able to make payroll rate changes in the computer system. A verification or review process to ensure that employees were paid from the correct fund and at the correct rate was not established. The Sanitary District instituted additional payroll processing procedures in 2019.
 - b. The Business Manager was responsible for the preparation of the financial statements, notes to the financials statements and the required supplemental information. After the financial statements were completed by the Business Manager and outside consultant reviewed the financial statements, the notes to the financials statements, and the required supplementary information; however, there was not an effective documented review performed by the Sanitary District of the work performed by the outside consultant or any adjustments made by the Business Manager after the advice received from the outside consultant.
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 monitoring control changes when the control environment changes. Effective internal controls over financial reporting required the Sanitary District to monitor and assess the quality of the system of internal control.

Response

1. **Payroll Clerk**
 - a. A second payroll clerk position was created and the payroll process has been modified as of May 2019. The Payroll Clerk enters all hours and rates into the accounting system. The Lead Payroll Clerk verifies all pay distribution to the proper funds and cost centers as reflected on the employee's timesheets compared to our accounting system's daily work window. The

SANITARY DISTRICT
CITY OF HAMMOND
EXIT CONFERENCE

The contents of this report were discussed on September 11, 2019, with Heather Garay, City Controller; Robert Markovich, President of the Common Council; Phil Taillon, Chief of Staff; Marty J. Wielgos, Sanitary District Manager; Michael Dye, Vice President of the Sanitary District Board of Commissioners; and Rachel Montes, Business Manager.