



# McHard Accounting Consulting LLC

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Via email only to Brian K. Snyder [bksnyder@santafenm.gov](mailto:bksnyder@santafenm.gov) and  
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Re: City of Santa Fe  
Fraud prevention engagement  
Issues identified and recommendations for improvement

Dear Mr. Snyder and Mr. Johnson,

Thank you for the opportunity to assist the City of Santa Fe, New Mexico. This report sets forth the findings, conclusions, and recommendations for improvement developed during an on-site fraud prevention engagement, also known as a fraud risk assessment, conducted by McHard Accounting Consulting LLC, regarding the City of Santa Fe (the "City").

For this engagement, our scope of work included conducting on-site interviews of appropriate finance, accounting and managerial personnel, and collecting and examining accounting and financial data, as well as the collection and analysis of other documents. We analyzed internal controls, and conducted appropriate analysis, which included forensic accounting and statistical analytics solely for the purposes of determining fraud risk. Analysis occurred in the field, as well as additional follow-up and analysis at our Albuquerque office. The City requested that we perform additional tasks, including analysis of different locations, physical security needs of an additional location, and additional meetings, including meeting with the City's new financial statement auditor to update them as to our findings and recommendations.

This report outlines our findings, along with recommendations for improvement in all appropriate areas, including areas such as finance and accounting, management and governance, policies, training, and human resources.

This report is generally organized by department or other business unit, so that each unit may address their own findings. We tried to put the most concerning findings first, by department, but ultimately it is the job of the City Manager, Director of Finance, City management and elected officials to implement whichever findings they see fit, in any priority they determine to be most appropriate.

The findings and recommendations are broad and all encompassing, more than we could have imagined when we began this process, so it is important that the City prioritize the recommendations in this report and implement them in a logical, meaningful and cost-effective

way. To attempt to implement too many recommendations at once, much less all of the recommendations simultaneously, would doom the City to failure of their efforts.

Because of the extent and seriousness of some of our findings here, many of which should have been identified and addressed either by the external auditor, the internal auditor, or both, we recommend that a qualified forensic accounting investigative firm be hired to conduct investigations into many of the areas listed here. It cannot be known whether, or to what extent, fraud has occurred due to the conditions discussed in this report.

The engagement culminating in this report cannot, and was never designed to determine whether, or to what extent, fraud has already occurred. Only by conducting investigations in each area and at each business unit, might it be determined whether or to what extent fraud has already occurred. Given the issues discussed below, such investigations will be a difficult set of inquiries.

As we worked on this engagement, we provided a series of interim oral reports to the City Manager and Director of Finance, and others, as appropriate. We have been told that many of the recommendations we discuss here have already been put into place by the City Manager and Director of Finance. The City requested that we delay this report for a period of time, so that we could conduct an investigation into some of the most serious issues. During that period of time, the requested work expanded to include additional site visits, interviews, analysis and meetings. In this report, we do not attempt to identify or verify corrections to those issues which the City has addressed after our interim oral reports were provided to City management.

### **EXECUTIVE SUMMARY:**

This fraud risk assessment revealed that the City of Santa Fe has extremely high risks of fraud, due to the almost complete lack of internal controls present in the City's system of accounting and financial affairs. The lack of internal controls is due to a series of issues including: an antiquated accounting system that requires multiple points of hand-keyed entry where errors or manipulations can occur, lack of control over computer access rights, a complete lack of financial and other written policies and procedures, a lack of appropriate cash-handling processes, a procurement and vendor payment system which is ineffective and lacks controls, ineffective revenue collection systems, and employees who have had no training for their jobs, and thus use self-made work-arounds for key business processes.

A contributing factor to the issues above is an Internal Auditor's Office which failed to uncover or address many obvious issues over the years; external auditors also failed to note these issues. Several key employees have access to virtually all computer, accounting and banking systems, and could commit fraud in a multitude of ways not easily found.

Throughout this report we discuss these issues by department, and recommend improvements. We also recommend that the City consider conducting numerous forensic accounting investigations to determine whether, and to what extent, fraud is occurring or has occurred. We reported the most serious issues to the Finance Director as we found them. We have been told that many of the issues discussed in this report have been addressed, or are in the process of being addressed at this time.



**OVERARCHING ISSUES WHICH ARE CITY-WIDE:**

*Issue:* A number of people, including certain key employees in the Finance and Accounting Department, have complete and unfettered access to every City of Santa Fe system. For such employees, most notably, but not exclusively, the Assistant Finance Director, there are no internal controls to limit their access to funds, nor any "safety net" to catch a mistake, whether honest or intentional. The Assistant Finance Director has complete access to the accounting system, including the ability to change any transaction without any supervisory approval, she has unfettered access to all banking functions including outgoing wire transfers in any amount, and check-writing and signature authority for any amount, payable to anyone. She has access to payroll and human resources ("HR") systems, including the ability to enter a new employee, enter and approve that employee's pay, and to generate payroll for that employee.

The Assistant Finance Director also has the ability to change any employee's rate of pay or leave accrual, and can generate reimbursement checks to any employee. She has complete access to the procurement software, and can create a contract, enter a vendor, enter invoices and generate payment in any amount to any vendor. She can enter or change any accounting transaction, including having the ability to go back to prior years and change any accounting entry, all without any risk of detection. In short, she has the "keys to the kingdom". There is no safety net for this employee; nothing would catch an honest mistake, and defalcation would be extremely difficult to detect.

*Recommendation:* We recommend that the City hire a forensic accounting firm to conduct an in-depth investigation of transactions made by key employees who currently lack a safety net. This investigation should be focused in the areas of fraud risk weaknesses identified in this report.

Additionally, we recommend that this investigation include a component focused on determining whether information technology ("IT") system controls and user roles are appropriate for the employee's current positions. No employee should ever have the unfettered access described above, much less a government employee entrusted with public money.

*Issue:* The City uses J.D. Edwards, a DOS-based green-screen AS400 accounting system which is outdated and has extremely limited functionality compared to modern enterprise accounting programs. They also use J.D. Edwards "E-1" system, which is a program with Windows-style graphical interface over the original green-screen system. Different tasks are performed in different J.D. Edwards programs, and must be "batched" by hand from one system to the other, then individually approved in batches by the Finance and Accounting Department, specifically, the Assistant Finance Director or Senior Financial Analyst.

Despite the length of time J.D. Edwards has been the City's accounting software, employees are not well-trained on this system, and are limited by both their own lack of knowledge and the reports the system is capable of generating.

To bridge the gap in knowledge, training and system functionality, employees have created unique-to-them Excel spreadsheets and forms, which are not standardized, are not available to others, and have not been checked for errors or omission. Each time data is transferred in or



out of the accounting system to Excel, error can be introduced, either accidentally or maliciously, such as for the purposes of furthering a fraud scheme. Many employees did not even know they could copy and paste batch numbers from one system to the other using the "Ctrl-c" and "Ctrl-v" keystrokes, and were hand-keying dozens of individual batch numbers, which is a great risk for the introduction of error. We found obvious errors in the documents provided to us from these Excel spreadsheets.

*Recommendation:* The City needs to upgrade its accounting system to a modern Windows-based Enterprise system with adequate functionality. This will require a major investment in hardware and software, to bring infrastructure, software and employee training up to modern governmental standards.

*Issue:* The City lacks policies and procedures for virtually all departments. Policies and procedures do not exist for the Finance and Accounting Department, nor for any of the departments we examined. We asked virtually every employee we interviewed if they had access to current policies and procedures for their department and positions, many employees simply laughed out loud at the question; none were able to provide us with current policies, and in most cases, could not provide us with any written policies and procedures at all.

Employees are trained by other employees, and everyone "just does their best". Most employees work very hard, and are earnest in their efforts to do their best, however, even good employees who are trying to do their best are hamstrung by the lack of policies and procedures. For those who are not doing a good job, the lack of policies and procedures makes progressive discipline difficult and time-consuming.

*Recommendation:* Each department must develop their own appropriate written policies and procedures. Having each employee develop their own way of doing their jobs – of "doing the best they can" – is neither efficient nor effective, and is fundamentally unfair to employees. Employees must have clear policies and procedures that guide their actions. These policies must be communicated to employees, and employees should sign-off on having received and understood them.

*Issue:* The City of Santa Fe is behind in computerization of internal functions, email and customer service functions, as well as accounting systems. The City does not have a unified email system, but has a fragmented system in which some employee emails are [employee@ci.santa-fe.nm.us](mailto:employee@ci.santa-fe.nm.us) and others are [employee@santafenm.gov](mailto:employee@santafenm.gov).

*Recommendation:* The City needs to standardize email for employees and elected officials. We found City employees with a variety of email addresses, which deliver email with a variety of levels of reliability. City employees stated that depending on which address they had, they might or might not receive all of their email.

The City should claim [SantaFe.gov](http://SantaFe.gov) by going to the website [www.dotgov.gov](http://www.dotgov.gov) and following the registration and verification protocols as directed. There are many advantages to the .gov address, including cost savings and the legitimacy of a .gov address.

For example, free law enforcement specific online training is only available to police officers with a .gov email address; others are not allowed to register. Many law



enforcement providers' automated systems do not recognize the suffix ".nm.us" as a government email, as their automated systems only accept emails ending ".gov". Thus, law enforcement officers are missing out on free training and legal updates that would otherwise be available to them.

*Issue:* The City of Santa Fe is spread out geographically among several locations, leaving many departments physically isolated. This physical isolation causes increased fraud risk due to a lack of consistency of internal controls at each location. The City's lack of a centralized or coordinated enterprise software further increases the risk of fraud at outlying locations.

*Recommendation:* The physical isolation of the various departments makes it even more important to have a shared, coordinated enterprise computer system so that information can be easily shared among departments and so that software controls can be used to help mitigate fraud risk. We also recommend that improved communication be established between City Hall and the various satellite City offices, for general business communication, but especially in communication of issues of policy, internal controls and fraud risk concerns.

*Issue:* The City has high costs for certain departments, and could consider outsourcing or conducting managed competitions to determine which departments could be effectively outsourced. When we discussed the idea of managed competitions with the Procurement Director, who would be the person responsible for supervision of such a program, he was not even familiar with the concept.

"Managed competition" is an alternative to privatization or outsourcing, in which city departments compete with private industry for the right to continue providing a service. The managed competition begins like a regular request for proposal ("RFP") for provision of services, and standards for bidding are set. Once the guidelines are set, the city department competes with any RFP respondents for the right to provide the service. Adjustments must be made to the department's submission to account for overhead costs, such as benefits, payroll, HR services, etc. The idea is that the city department and private industry will have a level playing field to compete to see who can provide the service in the most efficient and cost-effective way. The City of Albuquerque has successfully held managed competitions for airport landscaping installation and maintenance, and for jail transportation services. For more information on managed competition, see the article at: <http://www.govtech.com/transportation/governments-save-money-using-managed-competition.html>. A good policy to emulate is the City of San Diego's Managed Competition Guide, complete with process overview and decision tree, is available online at: <https://www.sandiego.gov/sites/default/files/legacy/managedcompetition/pdf/100726managedcompguide.pdf>.

*Recommendation:* We recommend that the City consider managed competition, in addition to outsourcing or privatization for some of their provision of service, to determine if the current arrangement using City employees is the most efficient and cost-effective means of service provision. It is our understanding that this effort, if the City desires its undertaking, would require a change in legislation or statute to allow outsourcing, including managed competitions. Services in the City which would lend themselves to managed competition include internal audit, solid waste, IT, payroll or



management of the Genoveva Chavez Community Center ("GCCC"), as just a few suggested examples.

#### **FINANCE AND ACCOUNTING DEPARTMENT:**

*Issue:* Upon our arrival, we inquired about access to the audit trail for the accounting software, and we were told by individuals in the IT Department that it had never been activated, purportedly to save memory and speed up the system. An "audit trail" is a security-relevant, chronological, electronic record which records changes to entries in the accounting system, as well as tracking the individual user making the changes, and details about the change, such as date and time, amount, and the resulting effect on the accounts. No accounting software for any municipal organization should ever be without an audit trail.

The lack of a functioning audit trail is something that the Internal Audit Department should have discovered and rectified many years ago. Because this feature was never activated, the City has not had an audit trail on their accounting system for many years. Whether this was done intentionally to commit fraud or another defalcation, or through lack of knowledge on the part of the vendor or City employees involved, cannot be known.

When we notified the Finance Director that the system had no audit trail, the audit trail was turned on for the City of Santa Fe's accounting system during the first weeks of our engagement.

*Recommendation:* We recommend that an analysis be conducted of the audit trail to detail which transactions were changed during and after our work, in order to determine if anyone has gone back and changed the accounting records for any reason, including to cover up any errors, omissions or defalcation.

Further, we recommend that the audit trail always be on, with no option for removal or shut-down. As the City implements the new enterprise system, the City must ensure that the audit trail is robust and secure, locked down from any tampering, including programmers and so-called "super-users". The audit trail should be regularly reviewed by Internal Audit, looking for red flags of fraud.

*Issue:* The chart of accounts is needlessly complex and includes many obsolete and inactive accounts. This is an area of fraud risk, as the complexity of the chart of accounts makes it easy to hide activity in unused or inactive accounts and funds, or in places where nobody would know to look for it. Specifically, accounting software systems do not always gather information from every account and this can be exploited for fraudulent purposes by hiding fraudulent transactions in unused or obsolete accounts.

The chart of accounts for the general ledger has not been adjusted or updated to meet the current needs of the City. As City departments have grown, have changed, or have been consolidated, the chart of accounts has not been updated. This has resulted in too many general ledger accounts, general ledger account configurations that are confusing and difficult to understand, and defunct accounts that are still active. Allowing accounts for discontinued business units to remain active results in items being posted to these accounts in error. It is a



significant fraud risk as it allows City employees to purposely hide transactions in these accounts as they are not regularly reviewed.

*Recommendation:* As part of the implementation of a new enterprise resource planning accounting system ("ERP system"), the City of Santa Fe should create a new chart of accounts to increase functionality and clarity. Any discontinued business units should be excluded from the new ERP system. The structure should be planned to allow for growth and change. The chart of accounts should be reviewed annually as part of the budget process to ensure that accounts and funds that are no longer needed are deactivated, and any new line items are added and follow the agreed upon structure.

*Issue:* We found evidence that the City has no meaningful system of reconciling cash accounts. We found instances where checks were returned for "not sufficient funds" ("NSF"), but the bounced checks were not discovered for long periods of time. Such instances include one check that was not deposited at all, where it was only discovered months later after the customer called and questioned why the check was still outstanding. In that case, the cashier had put the check stub into the deposit bag, instead of the check itself.

The current process of cash reconciliation consists of a new and inadequately trained employee, with authority at a very low-level, who has been trained to essentially reconcile the bank account to the bank account, rather than reconciling the bank account to the accounting records. Little or no effort appears to be made to reconcile the accounting system transactions to the bank. Therefore, any errors or omissions in the accounting system are simply changed to match the bank statement with little or no investigation of what happened.

In the example mentioned above, the bank corrected the deposit for the missing check, but an appropriate cash reconciliation was never conducted. It appeared that someone just changed the deposit amount in the accounting system to comport to the bank's amount. If that instance had been a cash theft, instead of just a lost check, the theft would have never been discovered. Additionally, it is at least possible that the bank could make a mistake, in such a case, the City's accounting is being forced to match the bank's error, rather than finding out what actually happened.

*Recommendation:* The City must assign a highly qualified employee to perform cash reconciliations of all accounts; this person must not be a clerk. Ideally, this person would have an accounting degree and many years of municipal accounting experience with a large city.

Prompt and accurate cash reconciliations of all accounts are one of the City's best defenses against fraud; fraud schemes are frequently caught during the cash reconciliation. This can only occur if an experienced employee is doing the work. Additionally, all cash reconciliations must be verified and approved by a supervisor who does not have access to change transactions in the accounting system.

We recommend that the City engage a qualified forensic accounting firm to investigate instances where cash reconciliations have been "plugged", or in which the accounting has been changed to match the bank statement, rather than appropriately reconciling a difference.



*Issue:* The City does not have appropriate accounts receivable ("AR") procedures in place, particularly around receipt of cash. The specific areas of grants receivable and Lodgers Tax receivable are covered separately in this report. However, overall there appears to be a lack of control and reconciliation over all receivable areas leading to considerable work being performed to include these balances in the financial statements at year-end. There is also a significant use of suspense accounts for receivables and cash reconciliations, resulting in large balances at year-end that have to be reconciled or written off during the financial statement preparation. All of these issues impede the City's ability to track and collect potential revenues.

Further, such suspense accounts are good places to hide fraudulent transactions. The write-off of such balances makes the fraud concealed in suspense accounts extremely difficult to find, absent a complete accounting reconstruction.

*Recommendation:* We recommend the City create and adopt policies and procedures for cash handling, as well as for recording and reconciliation of AR. These procedures should include regular reconciliation of all receivable balances, processes for estimating the allowance for doubtful accounts, procedures for monitoring aging of receivables and policies regarding write-offs. Reconciliation needs to occur on a monthly basis to prevent use of large suspense accounts and additional work at year-end during preparation of the financial statements. Amounts in suspense accounts should be investigated, not written-off without inquiry.

*Issue:* The City's Internal Auditor expressed concern over cashiers and cashier supervisors manipulating or "smoothing" their drawers in order to balance. These practices are unacceptable and should be halted and investigated thoroughly and immediately. Cashier drawers can be out of balance due to error and/or fraud and blatant manipulation of the cash drawers would prevent any patterns or repeat problems from being reported.

We learned that appropriate controls are not in place over cashier balancing, both at the main Cashier's Office and at the Utility Department. Several different employees described a communal "jar" that was previously maintained at a Cashier's Office, where any cashier overages were put in the jar and any shortages were taken out of the jar. At the end of the month if funds remained in the jar, the employees would take the money and go out for lunch. These practices are unacceptable and should be halted and investigated immediately. Part of these issues are due to the fact that the City has no written or even consistent cash handling procedures.

Further compounding the lack of controls over cash handling, cashier supervisors are themselves acting as cashiers, frequently taking over another cashier's drawer for a period of time to accomplish this. This renders the supervisor incapable of supervising or disciplining the cashier, since the supervisor themselves may have committed the error resulting in drawer being over or short.

*Recommendation:* Cashier balancing procedures for all City Cashier's Offices need to be created and implemented immediately. Policies and procedures should include acceptable over/short limits including amounts and frequency. The policy should also address progressive discipline for cashiers who are regularly out of balance. Additionally, cash drawers should always be balanced in the presence of another employee who can





ensure “force balancing” is not occurring. Force balancing cash drawers should be a terminable offense.

Cashier supervisors should not be substituting for employees to cover breaks and lunches at another employee’s drawer. Supervisors should avoid being cashiers themselves, but if they simply must cashier on a temporary basis, they must have their own drawer, which is counted down with another employee.

We recommend an investigation into likely cash losses at the City. This investigation should be performed by a competent forensic accounting firm, and should cover at least one full fiscal year. The investigation should encompass all cashier offices and all cashiers.

*Issue:* The accounting system currently applies the signature of the Mayor or other signers to checks, without any specific authorization by the individual. In practical terms, this means that the accounts payable (“AP”) clerk who enters the payment and prints the check is a de-facto signer on the account. Since the City of Santa Fe has no meaningful controls around the entry of new vendors, a clerk with fraudulent intent (as well as lots of other people who are not specifically locked out of the system) has the ability to enter a vendor, submit an invoice, write a check to the vendor, print said check with a signature, pick up the check to save the City a stamp, and deposit it directly into their own fake-business account, instead of mailing it to their fake-business address. Since over 85% of the vendors in the AP system have no tax identification number on file, we cannot say the extent or amount to which this has actually occurred.

*Recommendation:* Before the system applies a signature, the person whose signature is being applied should be required to log onto the system, review the checks they are about to approve for signature, decline any individual checks for which they have questions, and then approve the application of their signature to those checks they approve. The AP clerk should never be the de-facto check signer. This is a module available in most ERP systems and should be included in the new ERP system which is being implemented. Additionally, we recommend that the City hire a forensic accountant, or qualified internal auditor, to investigate vendors without tax identification information who have received sizeable payments. (Please see our discussion of vendors lacking tax identification information in the Procurement section of this report).

*Issue:* Our interviews revealed that financial statements are created by a single person, with little supervision or oversight, and it is unclear whether the audited financial statement ties to the accounting system. The financial statements provided for audit are created each year in Excel, not the accounting software, and are subject to error and manipulation as a result.

While various members of the Finance and Accounting Department reported working on parts of the City’s annual financial statements, they all reported that the sections they worked were very limited. They then gave their work product to one person who created the financial statements and disclosures. One person we interviewed commented that they were not sure whether the reported financial statements actually tied back to anything in the JD Edwards system; the person spot-checked some numbers and was unable to figure out what combination of line items from the JD Edwards general ledger totaled the final reported (and audited) numbers.



*Recommendation:* A team of qualified Finance, Accounting, Budget and Management personnel should work together to create accurate financial statements that tie to real numbers in the accounting system, and ensure that no one person controls the flow of information to the auditors.

*Issue:* While the City of Santa Fe has changed audit firms, some members of the audit team have not changed and have stayed on the City's financial statement audit engagement. Thus, individual members of the City's audit team have remained the same for many years. This leads to a level of familiarity and complacency that can result in missed findings. The reason for the audit rule regarding changing auditors is so that every few years the City's financials are viewed with fresh eyes. There are many issues of concern in this report that we would have expected the City's external auditor to have addressed in prior years.

*Recommendation:* We recommend that the City institute a rule that the audit firm and members of the entire audit team completely change every 3 years. We understand the City has hired a new audit firm for Fiscal Year 2017 financial statements.

*Issue:* We were told that the Assistant Finance Director is virtually the only person who meaningfully interacts with the auditors; we were told this by many employees, including the Assistant Finance Director herself. According to these sources, the auditors do not interact with management, other than the Assistant Finance Director, to any significant degree. Since the Assistant Finance Director herself was formerly an auditor for the outside firm that audited the City, she stated in her interview with us that she has familiarity with the external auditors' needs. She stated that she knows what the auditors need, and saves time by just giving them all the materials she knows they'll need, instead of allowing them to pull their own testwork samples.

*Recommendation:* We recommend that the auditors primarily interact with the Finance Director and City Manager, as well as the Audit Committee, rather than all information funneling through only one person. At minimum, the audit exit conference should involve the Mayor, the City Manager, the Finance Director, the Human Resources Director, and the City Treasurer. The City Manager, Finance Director, and Human Resources Director should ensure that remedial action is accomplished from audit findings, up to and including employee training and disciplinary action.

*Issue:* Finance and Accounting Department and the Budget Department do not seem to have well defined roles as described to us during interviews. If they do have well-defined roles, it appears that some employees are bleeding the functions together. During our interviews, we found that the Finance and Accounting Department performs many budget tasks, and Budget Department performs some accounting tasks. These two departments should have separate and well-defined roles, and should not be mixing roles or sharing work. The current arrangement is inefficient, duplicates work and mitigates internal controls.

*Recommendation:* Budget and Finance and Accounting are both essential functions to the City, but should be kept separate with clear and distinct roles. During the process of writing policies and procedures for Finance, Accounting and Budget, these roles should be clearly defined and delineated; a more efficient and effective organization will result.



*Issue:* Accounting-related training issues exist at the various department levels as well as in the Finance and Accounting Department. Finance and Accounting Department employees told us that accounting personnel embedded in various departments are not well-trained. Departmental accountants told us that the Finance and Accounting Department is inefficient and ineffective and requires ridiculous and antiquated procedures which serve no purpose.

Departmental employees stated that they have been bullied by Finance personnel, causing them to cease asking internal control related or process improvement related questions. Bullying employees to stop asking questions about internal control related concerns is a serious red flag of fraud. In fact, bullying is the number one type of misconduct connected with large fraud cases, according to the Association of Certified Fraud Examiners' *2016 Report to the Nations* available at <http://www.acfe.com/rtnn.aspx>.

The City has serious training issues in general, and with accounting-tasked employees specifically. Communication and training between and among the departments is poor, and is especially noticeable around accounting issues.

*Recommendation:* All City employees who perform accounting tasks of any kind, along with all cashiers, need additional training. We recommend that along with the implementation of the new system, the City should ensure that employees are appropriately trained, that current policies and procedures exist, and that employees are well-trained on these. There are good online training programs, which are reasonably priced per employee, to train appropriate employees on the basics of accounting, cash handling, red flags of fraud and internal controls, just to name a few. Employees should always be encouraged to ask questions, particularly when they have concerns about internal controls or fraud. If employees experience bullying under these circumstances, they should report it to their supervisor and/or call the City's Hotline.

*Issue:* The City has multiple areas where revenue enters the city. This includes wire transfers directly to City bank accounts, ACH (automated clearinghouse, i.e. electronic payments) payments to City bank accounts, and currency/check collection at various Cashier's Offices. There are basically no clear policies and procedures regarding revenue acceptance. The Finance and Accounting Department has employees create "deposit" slips to account for revenues and transfers, including electronic revenues and transfers between City accounts or departments. The purpose of this procedure is to support journal entries to record the revenues. Cash account reconciliations are also performed daily and are rolled up into a monthly reconciliation. While these, on the surface, appear to be effective procedures, they are not.

The "deposit" slips used are created in Excel and printed and are used to record both electronic transactions and transfers from other accounts. In many instances, the funds coming in are not new revenues but are transfers of funds between the accounts held by the City.

While the City performs a daily cash reconciliation, it is unclear that this reconciliation is meaningful, or performed in a manner that is an effective control. (See our detailed discussion above.) Currently, the low-level employee who is performing the reconciliation is finding transactions that have been processed through the bank account but have not been recorded in the general ledger. This employee will then inform the appropriate employee that a deposit has been made, and then a "deposit" slip is created and the transaction is recorded in the general ledger. The flow of information is reverse of what it should be, i.e. with transactions being



recorded in the general ledger and compared to the bank. Additionally, the "deposit" slip creates the appearance of documentation, when in fact, no real documentation exists.

*Recommendation:* We recommend that the City immediately begin properly using the electronic systems at their disposal. Where new funds are entering the bank account, such as wires and electronic transactions, Finance and Accounting Department employees should verify incoming transactions using their bank's online banking system. This system allows the employee to print any documentation required to support a journal entry recording the deposit. Completing an erroneously named "deposit" slip as support really provides no form of support or control; it is just a meaningless piece of paper. Additionally, all currency or check deposits should be processed by the Cashier's Office. This would create a record of the transaction through the point of sale system and would not require the use or creation of a separate "deposit" slip.

We further recommend the City revamp and formalize revenue-receiving policies in the Finance and Accounting Department. Revenues coming in via any method other than wire transfer, account transfer, or ACH should be processed through the Cashier's Office. Finance employees should reconcile receivables daily by viewing cash accounts on their bank's online banking system. Reconciling receivables should include the process of recording amounts received in the bank account in the general ledger.

*Issue:* City departments and employees have the ability to post invoices or other transactions into previous fiscal years – either on purpose or by error. This can result in changes to previous accounting periods which should have been closed. It can also result in fraudulent transactions simply being recorded in a previous period to prevent detection. Finally, this can result in transactions being posted to the wrong fiscal year at year-end resulting in misreporting of transactions in the financial statements.

*Recommendation:* We recommend the City of Santa Fe purchase and implement a modern ERP system. As part of implementation, system controls, internal controls and policies need to be developed to ensure proper cut off. Once a year has been closed, system controls should be in place to prevent posting of any transaction to prior years.

*Issue:* Several employees expressed that NSF checks are a substantial problem at the City. Reconciling and researching NSF payments takes several hours a week – which is very inefficient and is a waste of employee time. Employees who have spent time researching NSF checks have mentioned that often the same individuals are writing NSF checks repeatedly for payments. Additionally, if an individual provides an NSF check for payment, that individual is allowed to produce a check to substitute the NSF check. In many instances, the replacement check will be returned as well. The City does not currently have a policy in place regarding receipt of NSF checks from individuals.

*Recommendation:* We recommend the City implement a strong NSF check policy. If a check is returned to the City as NSF, the individual who provided payment should be charged a fee by the City to help recoup any fees the City incurs from the bank. This fee should be required to be paid before any replacement for payment is accepted. Any replacement for payment due to an NSF check must be paid in guaranteed funds (i.e. cash, money order or cashier's check). Once an individual writes an NSF check three times, all future payments must be made in guaranteed funds. This type of policy should



result in reduced NSFs, which will reduce the amount of fees being paid by the City and improve the efficiency of the cash reconciliation.

*Issue:* All accounting data is recorded via journal entry which increases the likelihood of errors in the accounting data. In many instances, a receivable is not created in the general ledger for incoming funds. Currently, the employee who is performing the cash reconciliation is finding transactions that have been processed through the bank account but have not been recorded in the general ledger. There may be instances where there are items in the bank that are not in the general ledger, but this should be the exception and not the rule.

*Recommendation:* As part of the recommended purchase and implementation of a modern ERP system, that system should allow for automatic posting between various modules to the general ledger. This would allow all transactions processed through point of sale terminals, AP, accounts receivable, and payroll to automatically post to the general ledger without manual journal entry required. This will improve the accuracy of the accounting data and will reduce the number of discrepancies found during the cash reconciliation process, thus increasing efficiency and reducing the likelihood of error or fraud. This system should include Continuous Automated Auditing Techniques (also known as CAATs) capability, which constantly looks through data and transactions for exceptions and issues which require human review and intervention.

*Issue:* Finance and Accounting Department personnel have significant training needs. At the same time, certain lower level Finance and Accounting Department employees that have qualifications, education and experience, including being CPAs and possessing advanced degrees, are not being optimally utilized. We were told by numerous employees that Finance and Accounting Department employees have not had raises in quite some time, and the department has fallen behind in competitive pay rates.

Additionally, we were told that the City of Santa Fe has the same number of finance and accounting positions that it did in the 1980s. Since that time, the City's population has doubled, and the City's budget has expanded enormously, yet the same number of finance positions handle the City's money, using outmoded and inefficient systems.

*Recommendation:* We recommend that the Finance and Accounting Department's position descriptions be reviewed, and current employees' experience be evaluated for a possible reorganization, or change in assignments to better match training and experience to needs.

Minimum educational requirements should be set for each position, and if current employees do not meet the requisite levels of education, proper HR action should be initiated. We recommend that both the Finance Director and Assistant Finance Director have a degree in accounting, finance, economics, public administration, a business degree, or similarly applicable degree; a Master's degree in an applicable field would be preferred. A certification such as Certified Government Financial Manager or a Certified Public Accountant is also preferred.

*Issue:* The City of Santa Fe uses irregular, outmoded and meaningless job title naming conventions that add to the issues around employee qualifications. Many City employees, including those performing financial tasks, told us that they did not know their actual job title.



The job title “accountant” is actually a very low-level job, yet “accountant” jobs attract grossly overqualified employees, including CPAs. Meanwhile, the title “financial analyst”, which is normally a low-level analyst or clerical position, is among the most responsible of those performing accounting functions, and the “Senior/Supervising Accounting Analyst”, also known as the “Senior Finance Analyst”, is the second in command with access to everything and the ability to change anything in the accounting system. Because of the job title of financial analyst, applicants for these important positions consist of entry-level and less qualified individuals, and in some cases, the qualifications of important job functions have been filled with unqualified or minimally qualified individuals from within the City.

*Recommendation:* We recommend that the City of Santa Fe undertake a complete HR and Compensation Study, probably with the assistance of an outside vendor. Reorganization and appropriate naming conventions for positions, along with updated position descriptions, will greatly raise the quality of employees in many jobs. There should never be a situation where an employee doesn’t know their own job title.

*Issue:* The City uses processes which may have made sense in the past, but no longer make any sense at all, and yet employees are still following the same practices. Additionally, even where the processes really are necessary, virtually all of these systems are paper intensive, requiring that paperwork is passed around and signed by hand. This is slow and cumbersome, making the processes vulnerable to loss, tampering or interception.

As an example, currently credit card payments to the Water Utility are entered by hand as a pending receivable in cash, and sent to a Finance and Accounting employee. The card payments are then reversed out the following day, or sometimes later the same day, and put back in as collected. This is an artifact of a time when credit cards were swiped by hand onto carbon copies, which were physically sent to the bank for processing or reversal. This process is repeated at all City departments where credit cards are accepted.

Nowadays, the credit card is immediately debited to the cardholder’s account and credited to the City; it is known immediately if the card will be declined. Any charge-backs or disputes are handled weeks or even months later, in a completely separate process. Thus, the entire daily process of entering credit cards as pending then backing them out again, is a needless waste of hours of time of one employee in the Water Department and another employee in Finance and Accounting. This antiquated practice should be done away with immediately.

Employees told us that the processes control and drive their actions, rather than the needs of the City driving efficient and effective processes. When we first arrived, the City was mapping processes to convert them to electronic processes for the new enterprise system. This will only take absurd and archaic processes and make them occur slightly faster in an electronic realm, but will not be more efficient or effective in any way.

*Recommendation:* The process mapping work should cease, and the City should use the industry best practices built into the software to guide their actions, and adapt their process and systems accordingly. Employees in each department already know which processes are useless or wasteful. Each department should work to eliminate these processes wherever possible.



### **GRANT ACCOUNTING:**

*Issue:* Employees working on grant accounting told us that systems are incompatible with the numbering conventions used in the chart of accounts. Thus, accounting for capital expenditures under grants cannot always be properly tracked. As we have discussed, the City of Santa Fe currently has an outdated enterprise accounting system and also has an overly complex series of processes related to processing financial transactions. Part of the overly complex processes is the chart of accounts. The chart of accounts is so complex, and corresponding naming conventions are so long, that the open government budget program designed to increase transparency in the budget office cannot accommodate all of the subaccount numbers.

*Recommendation:* As part of the implementation of a new ERP system, the City of Santa Fe should create a new chart of accounts to increase functionality and clarity. The chart of accounts should be reviewed annually as part of the budget process to ensure accounts that are no longer needed are deactivated and any new line items are added and follow the agreed upon structure. Additionally, the City should take care that functionality of software programs is reviewed prior to purchase and that the chart of accounts is designed to work with any other software the City may be using.

*Issue:* We were told that City employees are applying for grants at the department level, rather than running all grant applications through the City Manager and administrative process. As a result, there is lack of communication about grants, and grants are sometimes received that are not particularly beneficial to the City of Santa Fe; for example, grants that have arduous administrative requirements for a small amount of money.

Interviews revealed that grants are sometimes received and no one seems to know what the grants are for or why they were received. As previously discussed, there are no policies and procedures in place over the grant initiation, acceptance or accounting. Most departments apply for grants on their own and do not necessarily report grants to the Finance and Accounting Department. This results in grants not being properly included in accounting records and significant year-end entries to report grants and record them in the Schedule of Expenditures of Financial Awards. This process prevents the Finance and Accounting Department from contributing to the acceptance discussion regarding matching requirements, reporting requirements, or any potential cost/benefit issues. In instances where grants are funded up front, the lack of communication surrounding grants prevents the Finance and Accounting Department from knowing about potential deferred revenues and from having the information necessary to maintain appropriate cash balances related to deferred revenues.

We were told by those performing grant accounting, that the same person creates the grant entries, receives checks for grant payments, takes those payments to the cashiers himself or herself, relieves receivables for grants, and prepares journal entries which are approved for grant accounting with no documentation. Like much of the incoming money to the City, grant receivables are not posted to the AR module, but are recorded via journal entry. Having a single person control every bit of this process is a serious fraud risk, leaves the employee without a safety net, and is a violation of basic internal controls.

*Recommendation:* The City needs to centralize the grant process. While grant writers and analysts at different departments should be involved, the Finance and Accounting Department needs to be aware of all grant awards and needs to be aware of all finance-



related grant requirements. The Finance and Accounting Department should be regularly updating and reconciling grants receivable or deferred revenues related to grants.

We recommend that the City consider having a specific Grant Accounting Department, which maintains responsibility for all grant accounting. This team would work closely with grant recipients and administrators to ensure that grants are appropriately applied for, implemented, tracked and accounted for appropriately.

*Issue:* It was reported to us that expenses paid through grants are not reviewed for grant compliance, and thus are disallowed after the money is spent. This results in a loss to the General fund, when appropriate spending might have been reimbursed under the grant.

*Recommendation:* All grant spending should be checked for compliance prior to a purchase being made. This is particularly true for cost reimbursement grants.

*Issue:* Vacations should be mandatory for Finance and Accounting Department employees. Mandatory vacations help detect when employees are involved in malicious activity, such as fraud or embezzlement. For fraud schemes of any substantial size to succeed, an employee would need to be constantly present in order to manipulate records and respond to inquiries that could uncover the fraud. On the other hand, if an employee is forced to be absent for at least five consecutive workdays, the likelihood of any illegal actions succeeding is reduced, since someone else would be required to answer the queries during the employee's absence.

*Recommendation:* Annual vacations of no fewer than five consecutive work days, excluding holidays, should be required for all Finance and Accounting Department employees, including the Director. This control only succeeds if employees are cross-trained, and another employee covers the duties of the vacationing employee while they are gone, including answering their phone, checking their email, and responding to complaints.

### **ACCOUNTS PAYABLE:**

*Issue:* Our analysis of payments made to vendors in Fiscal Year 2016 ("FY16") reveals hundreds of check payments issued for amounts of less than \$5. The City generated and mailed 256 checks for one penny (\$0.01) during FY16, this is not a good use of employee time or City resources. Based on our review, 879 checks were issued for under \$5.00 in FY16. These checks totaled \$2,211.51.

According to an analysis conducted by Wells Fargo to educate City management, the City pays about \$14 dollars in real costs to issue a check. Therefore these 879 checks cost the City \$13,185, thus it costs the city about six times more to send the checks than the actual value of the funds dispersed.

*Recommendation:* The City should implement policies and procedures that would prevent mailing checks for small dollar amounts. Payments to vendors should be combined into one payment whenever possible. Any small amounts due to vendors should be applied to the next purchase or any outstanding invoice balances. While using ACH will reduce the cost of these small payments, it is still not an efficient use of





employee time to initiate a payment for \$0.01. Any amounts less than \$25 should be left to combine with a future payment. If the vendor desires immediate payment of small amounts, they should be able to pick up a payment voucher at AP that entitles them to receive cash at the Cashier's Office.

*Issue:* Accounts payable has been holding checks for vendors or for employees to pick up. Also, department employees have been holding checks for vendors to pick up, at the vendors request, or have allowed employees to pick up checks to allegedly deliver to vendors. This must stop immediately, it is a significant fraud risk for fraudulent vendors or fraudulent payments being generated to real vendors.

*Recommendation:* All vendor payments should go via ACH. Any checks generated for vendors MUST go through the United States Postal Service, and must never be picked up by vendors, or worse, held by employees to supposedly give to vendors. If AP employees are ever asked or ordered to violate this policy, they should notify their supervisor and/or call the City's fraud Hotline immediately.

*Issue:* A new external fraud scheme which has become prevalent this year, involves fraudsters sending in new ACH payment information for an existing vendor. The fraudsters call or send in a form to "update" the ACH information for real vendors so that funds go to the fraudsters' account. The real vendors are publicly known, because of transparency initiatives. Once the fraudulent change has been requested, the fraudsters wait until payment comes in, then quickly transfer the funds to a different offshore account. This has happened to the City of Albuquerque, which lost \$420,000 to the fraud; other governmental entities and organizations have been victimized as well.

*Recommendation:* We recommend that any requests to change ACH be verified by calling the vendor at their original, known phone number, or via USPS mail. No phone requests to change ACH information should be honored, and all electronic or paper requests should be verified by a supervisor, with a telephone call to a known number, prior to any change in the system.

## **LODGERS TAX:**

*Issue:* There are multiple issues with the City's "system" of Lodgers Tax Collection. The City is likely missing out on a great deal of revenue, because Lodgers Tax is not billed to customers, or collected in any systematic way, but rather is collected on "the honor system". There are multiple issues with the Lodgers Tax collection protocols, which we will discuss as separate paragraphs here.

Lodgers Tax is frequently not collected from temporary guest quarters, such as "Air BNB" ([www.airBNB.com](http://www.airBNB.com)), casitas, guest houses and bed and breakfast establishments. Occasionally hotels simply fail to pay their Lodgers Tax as well. There is no automated system for the collection or tracking of Lodgers Tax, and no bills or reminders are generated except by hand. The current system involves two employees who are responsible for Lodgers Tax manually tracking Lodgers Tax in Excel spreadsheets to which only they have access. Their work is not subject to any meaningful oversight or review. They print out a spreadsheet for their



supervisor, but admitted that the report provided to supervisors is an edited version of the original spreadsheet in which they work on a daily basis.

These employees stated that they never seek out new sources of Lodgers Tax, such as searching the internet for advertisements for bed and breakfast or other temporary lodging which would be subject to the tax but has not paid. They stated that they do not have time for such efforts. A quick internet search found over 300 listings just on [www.AirBNB.com](http://www.AirBNB.com) in the City of Santa Fe, not including other peer-to-peer rental or lodging websites, or even telephone directory listings. Many, and perhaps most, of these do not regularly pay Lodgers Tax owed.

The employees stated that they rarely send letters demanding payment of Lodgers Tax, and even less frequently ask the City Legal Department for collection assistance. The employees stated that they call to remind taxpayers of the payment due when they have time, but complained that Lodgers Tax is not easy to collect.

The employees responsible for Lodgers Tax pick up and open their own mail, and thus could intercept checks at any time. This is a serious fraud risk. There is no reason for these employees to pick up their own mail. The Cashier's Office should receive and deposit all Lodgers Tax payments and give copies of the checks or other documentation to the employees responsible for tracking purposes. The employees should never have access to the unopened mail or any original checks. The current system lacks any safety net whatsoever for these employees, either against actual fraud or against untrue allegations of fraud.

There is no system of oversight in place to prevent these employees from accepting gratuities or kickbacks to overlook missed Lodger's Tax payments. Since there is no oversight over this process, it would be a simple matter for employees to arrange to ignore unpaid Lodgers Tax in exchange for payment or some other valuable consideration. It is unknown whether, or to what extent, this has occurred, nor would it be a simple matter to either prove or disprove any allegations in this regard, due to the lack of records and oversight. Again, the current system lacks any safety net whatsoever for these employees, either against actual fraud or against untrue allegations of fraud.

When Lodgers Tax is collected, it is not booked as a receivable by taxpayer, but is entered in batches as a journal entry, subject to error or manipulation in several ways by employees dealing with the Lodgers Tax and by employees in the Finance and Accounting Department. The only detail specific to individual or corporate taxpayers is kept in the private Excel spreadsheet.

The City is unquestionably missing out on Lodger's Tax revenue due to the current off-the-books method of tracking and collection. The amount collected last year was approximately \$10 million dollars; it cannot be known how much additional revenue was lost due to the current work process.

*Recommendation:* We recommend that the City consider outsourcing all or part of Lodger's Tax collection to a third party who would have a financial incentive to collect it from all sources. The City will need to procure a legal opinion from a qualified source to determine the extent to which this is allowed, prior to a request for quote or RFP going out.



In the alternative, the City will need to purchase and install the appropriate accounting module for tracking and receiving Lodger's Tax. All potential sources will need to be billed via monthly reminder notices. If the taxpayer does not have any lodging to report, they will need to file a report stating that they did not have lodgers during the month, and have zero tax to pay.

Additionally, employees will need to investigate new revenue sources, including Air BNB and similar programs, and aggressively collect tax due. Air BNB and other similar sites show dates of availability, non-available dates should be assumed to be rented and invoices sent. All late or non-payments must receive notices and violators sent to City Legal or another collections method. The accounting module for tax collections must have an audit trail and be regularly reviewed by the supervisor; no off-the-books Excel spreadsheets should be allowed.

Further, mail must be opened and checks received by the Cashier's Office. Employees collecting Lodger's Tax must never have access to unopened mail or original checks. Finally, the supervisor will need to spot check sources and collections weekly to ensure that employees are seeking out and collecting from all sources as required by law.

We recommend that the City hire a qualified forensic accounting firm to investigate whether, or the extent to which, Lodgers Tax has either not been collected, or has been diverted from City coffers to an inappropriate person or organization.

*Issue:* Other taxes and fees are not booked as receivables, and are not well accounted for, including landfill receivables, false alarm fees and other non-Utility receivables which are not booked as receivables, but are transferred via journal entry or not at all. These fees and taxes, including Fire and Ambulance receivables and Lodgers Tax, are not reconciled back to collections or any other documents. The entire system is open to error and manipulation both at the department level and in the accounting journal entry process.

*Recommendation:* Each of these revenue sources must be appropriately accounted for, including booking receivables when expected.

*Issue:* Payments by credit cards are not handled in an appropriate way in many departments. Fire and Ambulance collections are outsourced, but payments for ambulance services by credit cards are only accepted at the City. Thus, customers call in to pay, and their credit card information is written on a sticky note and hand-carried to the Cashier, who runs the card. It is unknown the extent to which these sticky notes are shredded or otherwise destroyed, and nothing stops employees from copying and using the card numbers, nor are the employees protected from false allegations in that regard.

*Recommendation:* Any and all third-party collections must accept credit cards via phone and online, there should never be a situation where a City employee has to write down or save a credit card number. If a City employee must accept a credit card over the telephone, the customer should be kept on the line while the employee directly inputs the credit card information and waits for the transaction to be approved or declined. If someone who does not have this access answers the telephone, the customer's phone call should be transferred to the Cashier's Office, who can input the transaction live, without writing down credit card numbers.



### **INTERNAL AUDIT DEPARTMENT:**

*Issue:* Our work revealed that the Internal Audit Department, which consists of a single individual, is out of compliance with both Generally Accepted Government Auditing Standards (“GAGAS”), and the City’s own Internal Audit Ordinance (§2012-32 and §2013-34, Section 2-22 Santa Fe City Code 1987). Both the City Ordinance and GAGAS requirements for an Independent Internal Auditor requires formal peer review. We saw no evidence that the Internal Auditor is peer-reviewed, and in the auditor’s reports we inspected, we found numerous serious issues that put the Office out of compliance with GAGAS, the Ordinance and American Institute of Certified Public Accountant Professional Standards.

The Internal Audit office does not appear to have been particularly effective. The office has failed to address most of the issues noted in this report, including such basics as implementing a City-wide cash handling policy, addressing obvious issues with cash reconciliations, insisting that the accounting software audit trail be activated, looking at employee computer user rights, and addressing issues with the Water Department and Parking cash handling and revenue issues, as well as taking the lead in following up on all Hotline complaints.

Per the Internal Auditor’s web page, during four out of the last five years, the Internal Auditor has produced either one report or no report for the entire year. Whether this lack of work product and efficacy is due to the lack of peer review, inadequate staffing of the office, or inadequate training and experience of the Internal Auditor, is unclear. The current Internal Auditor is not a Certified Fraud Examiner (“CFE”), which we would consider to be preferable experience for this position, particularly if the office is to consist of a single individual.

*Recommendation:* We recommend that the Internal Audit Department functions be outsourced to an accounting firm with the appropriate experience and certifications to comply with GAGAS and the Ordinance, including peer-review. If the current Internal Audit Department is to be retained, the City must immediately initialize a process of formal peer-review to comply with GAGAS, the Ordinance and AICPA professional standards.

*Issue:* The Internal Audit Department is housed in a remote building outside City Hall. While the space is quite homey, (the space came with a kitchen, and at the time of our visit there was a yoga studio space set up by the Internal Auditor, and root vegetables ready to be prepared in the oven), this proximity away from City Hall is an impediment to communication and the efficacy of the Internal Auditor. The Internal Auditor stated that she is loath to visit City Hall, but does sometimes have to go there when people won’t respond to her emails.

*Recommendation:* We recommend that the Internal Auditor be moved to an office within City Hall, or at least to a downtown office within a brief walking distance from City Hall, such as the Convention Center. The Internal Auditor should be working with the City Manager, Finance Director and department heads on a regular basis. The Internal Auditor should be a ubiquitous presence in City Hall, and regularly visiting many City departments.

*Issue:* The City has a Hotline for employees, contractors, vendors or citizens to file a complaint of fraud, ethical violations, government waste or abuse, either as an anonymous or identified party. However, we saw little evidence that anyone outside of a few City employees were aware



of the Hotline. The Hotline was not well advertised, it is being used by some employees, but is not advertised to all employees, nor available to vendors and citizens.

Additionally, we were told by the Internal Auditor that the Hotline reports go to Constituent Services, which in our opinion is absolutely the wrong place for these reports to be directed. Others told us that Hotline reports go directly to the Internal Auditor, which is problematic since the Internal Auditor stated that is not what occurs. Still others told us that the reports go to Human Resources.

Hotlines can allow safe reporting of fraud, waste and abuse, as well as serious HR issues such as sexual harassment, discrimination or favoritism, and other ethical concerns such as kickbacks or request for kickbacks, bid rigging, theft and so on.

A Hotline is of particular importance given that departments are geographically separated, and at times isolated by management silos, and lack of communication, in addition to such allegations as bullying directed towards personnel who ask questions regarding breaches of internal controls. Citizens may only be able to complain to the person who is part of the problem, and employees may fear retaliation if they are only able to complain to their supervisor who may be part of the issue. Additionally, vendors or contractors may not wish to complain about requests for kickbacks for fear of being passed over for a future job or RFP. An anonymous reporting mechanism, such as a Hotline, addresses each of these issues.

*Recommendation:* The City should reintroduce an anonymous reporting Hotline mechanism in a big roll-out. We recommend that the Mayor, City Manager, Council and other top City officials conduct the roll-out as a unified group, with much fanfare. The Hotline should be advertised, posted in public and employee areas at every City division, as well as being printed on all check-stubs to employees, vendors and contractors, and put on the water bills and other mailings to residents. The Hotline information should be absolutely ubiquitous in all public spaces, as well as employee spaces.

We suggest that emailed Hotline reports or transcripts of the calls simulations go to the Deputy City Manager, Finance Director, Internal Auditor, City Attorney and Human Resources Director. The Deputy City Manager should be responsible for keeping a written log of each and every Hotline call received. Each of the other group members will be responsible for reading the Hotline calls. The Deputy City Manager will assign the complaints to a particular person for investigation and follow-up. For most calls, it will be obvious which person will take the lead on investigation of the complaint or issue, HR issues will be investigated by the HR Director, and so on. This group should meet frequently at first, to get this system running smoothly, then should meet quarterly to go over Hotline complaints. If at any point, Hotline call numbers begin to decline, the group will know it is time to do another round of Hotline advertisement.

For additional information on how to set up a Hotline and the benefits that arise from a Hotline, please visit our website and download our article "Hotlines for Heroes", at the bottom of the "What We Do" page at [www.theMcHardfirm.com](http://www.theMcHardfirm.com), click on the article name to download the article PDF.



**PROCUREMENT DEPARTMENT:**

*Issue:* The City's procurement practices are time-consuming and inefficient and do not lead to cost savings for the City, nor are these procedures aligned with either the New Mexico State Purchasing Rules nor the City's own policy. Indeed, the procurement practices likely lead to higher costs, and put the City at greater risk for fraud schemes and policy violations, such as splitting purchases to keep amounts under a cap, entering duplicate vendors to split purchases, or improperly using sole-source exceptions.

The Procurement Department misunderstands and misapplies State Regulations regarding contracts, effectively limiting contractors to a single contract of less than a cumulative \$50,000 per contractor, every four years, regardless of the legitimacy of separate contracts for different tasks. This is a misunderstanding of the statute which states that contracts *may not exceed four years*. As a result, needless RFPs slow down the procurement process, and increase the likelihood of procurement policy violations, including potential fraud and kickbacks.

The City has frequently failed to take advantage of appropriate "piggy-back" contracts through the State of New Mexico's statewide price agreements or through intergovernmental cooperative purchasing groups such as the Houston-Galveston Area Council's HGAC Buy ([www.hgacbuy.org](http://www.hgacbuy.org)). Such organizations have already done the work of competitively bidding products and vendors, with everything from police cars and fire trucks to case paper ready for purchase at the negotiated price.

*Recommendation:* The City should begin using the State's statewide price agreements, and investigate other possible opportunities, such as HGAC Buy. In cases where the City would prefer to use local vendors, the City should partner with Santa Fe County and other local governments to share the work and costs of RFPs and jointly benefit from negotiated pricing.

The City should have their current practices reviewed by competent legal counsel, and have Procurement employees retrained to eliminate their misunderstanding and misapplication of New Mexico State Statutes regarding Procurement.

We recommend that the City hire a qualified forensic accounting firm to conduct an investigation on the Procurement Department, to determine whether, or the extent to which fraud has been occurring, including possible kickbacks, bid rigging, collusion with vendors or other procurement fraud.

*Issue:* There has not been any Procurement training within the City of Santa Fe within the past ten years, according to the Procurement Director. He described many employees as "untrainable", and complained of high turnover in procurement positions that contributed to the lack of cohesive knowledge, but he also admitted that he has not conducted any internal training at all within the past ten years. He stated that he had insufficient time to conduct training as part of his regular job duties. This is despite the fact that the Procurement Director travels throughout the State giving procurement certification training to employees of other entities.

*Recommendation:* We recommend that the City immediately institute basic procurement training for all departmental employees for whom procurement is a job duty. Further, we recommend that the Procurement Director be precluded from spending City time



conducting procurement training for others until such time as all appropriate personnel within the City of Santa Fe are properly trained.

*Issue:* Vendors lacking tax identification numbers are receiving payments from the City. We performed data analysis over vendor payments and vendor information as part of this engagement. The City of Santa Fe currently has over 93,000 vendors included in their AP system. Of these, 79,855 vendors (over 85%) do not have tax identification information in the system. Of the vendors that do not have tax identification information, 3,629 were issued payments in FY16. Virtually any City employee may enter a vendor; this results in multiple incomplete vendor profiles, and is also a serious fraud risk.

Internal Revenue Service (“IRS”) regulations require the City of Santa Fe to issue Forms 1099 to most vendors with payments for services in excess of \$600. Considering the lack of tax identification information in the accounting system, it is unclear how the City is complying with IRS regulations and properly issuing Forms 1099.

Additionally, during our analysis of vendor data we found that there are multiple duplicate vendors. For example, just a search of vendors beginning with the letter “A” revealed that that ABF Freight was listed 4 times, Allstate was listed 6 times, the American Bar Association was listed 6 times, and the American Planning Association was listed 8 times under its full name and 7 times as APA. It was not clear why these duplicates existed. There is nothing in the system which would combine those vendors for issuance of an appropriate Form 1099, so it is possible that having the vendors under so many duplicate listings has led to improper issuance of Forms 1099. Also, there were also instances where a vendor file would indicate that particular vendor number was out of date and should not be used, but the vendor was still issued a payment in FY16.

*Recommendation:* We recommend the City perform an internal audit of its vendor listing. All vendors should be updated with proper tax identification information. A formal process for vendor creation should be completed and followed. A formal process for producing Forms 1099 at year-end should also be completed and followed. We further recommend that the new system reject duplicate vendor names, and that vendors be reviewed by tax identification number to determine where duplicates with very different names exist. If it is discovered that vendors with multiple entries now add up to an amount that would have required the issuance of a Form 1099, we recommend that the City consult with a competent tax attorney to determine if corrected Forms 1099 should be issued.

*Issue:* The City’s lack of purchasing card system (commonly called “p-cards”) for efficient buying of frequently used, low dollar items, breeds inefficiency in purchases and costs the City more in time and money than could ever be saved through the needless RFPs the system requires.

*Recommendation:* The City should investigate the option of a robust p-card system, which have dollar amount and purchase type limitations. For example, a maintenance worker could use their card at Home Depot for up to \$100 in parts, but not at Men’s Wearhouse.



*Issue:* Procurement is spread between the Procurement Department and the departments who are purchasing goods. This is an inefficient system that is neither centralized nor decentralized, but instead incorporates the worst traits of both systems with none of the benefits. For example, procurement knowledge is closely held by the Procurement Department, yet most of the buying occurs out in the departments. For some projects, however, the Procurement Department appears to have prevented any purchases being made at all (please see our discussion of the lack of functioning camera system at the GCCC, under the GCCC section of this report).

*Recommendation:* We recommend that the City review its entire system of procurement management. The City should either have a centralized system where qualified buyers run all RFPs and contractual work with the assistance of subject matter experts from the departments, or the City should decide to de-centralize procurement and have a trained buyer attached to each City Department.

*Issue:* Vendors are entered into the system from multiple sources – leading to multiple issues. Vendors can be added to the system by the departments, as well as by Procurement and AP personnel, and by any number of other people who are not specifically excluded from doing so by the system. While this is a fraud risk in and of itself, it also means that by having many points of entry not all the necessary documentation, including Form W-9 and ACH information, is collected.

*Recommendation:* A comprehensive new vendor packet should be put together for all vendors to provide current Forms W-9, verify the address and other contact information, as well as providing ACH information. All new vendors should be entered with this information, and payment should not be made to any vendor who does not have a tax identification in the system, along with an address and ACH information. Vendor payments should be held until such information is provided in writing. This way, all active vendors will be brought current in short order, and new vendors will be entered correctly in the future. Departments must have this packet for their vendors; payment will not be made without complete information being in the system.

## **INFORMATION TECHNOLOGY:**

*Issue:* The City's overarching IT user controls are designed for all users to have all rights, after which individuals are then supposed to be locked out of specific features that they do not need, or to which they should not have access. This is never the recommended way for system security and control to be set up. Users should start with no IT rights at all, and then specific modules should be opened up to them, not the other way around.

Because the City has this paradigm set up backwards, there are users who have rights to every single system that the City has in place. We found employees who could access all accounting, banking, HR, payroll and procurement functions – in other words, there was not a single City system that they were not entitled to fully access. This defeats any internal controls put in place elsewhere, and makes the City completely vulnerable to virtually every kind of fraud scheme.





Additionally, the City has multiple computer software programs and complete stand-alone specialty software systems that do not interface at all. Even the two accounting systems do not talk to each other, but instead require hand-entry of batches of transactions to transfer transactions from the AS-400 "green screen" version of JD Edward to the "E-1" Windows-like version of JD Edwards. Each time a batch is hand-keyed, there is an introduction point for error or defalcation.

*Recommendation:* The City must have an IT system by which users start out with no system rights and then are specifically issued only the user rights they need for their current job function.

We recommend that during the process of implementing an enterprise accounting system, that all other city software systems be evaluated for compatibility and appropriateness. Software systems should be replaced or upgraded as needed to ensure automated compatibility without numerous points of hand-key entry.

*Issue:* In addition to employees that have excessive user rights, we also found that when employees change departments or jobs that their IT access controls are not adjusted accordingly. Employees who formerly worked in Finance and Accounting still have full accounting access rights, even though their new positions do not entitle them to that access. As a result, people continue to field questions and make unauthorized entries and changes to the accounting system in order to help people who ask, or to make their current jobs easier.

We found multiple instances in which employees kept their usernames and passwords posted in places accessible to other employees, or even the public. This means that computer activity can be completed under another person's user name, bypassing any internal controls supposedly built into the system.

Additionally, our investigation revealed that one IT employee who changed his own rate of pay in order to "save work for Payroll" in having to change it for him. This is a breach of basic internal controls, and a fraud risk. Any employee who changes their own rate of pay, whether the change is authorized or not, should be immediately terminated.

We determined that one former programmer has taken a different City job outside of IT, but has never had programming rights removed that she had in her prior position. This employee still has rights to the underlying data tables, and could change virtually anything at all within the City's accounting or data systems. The City would have no idea that the change occurred, and it would be difficult, or possibly impossible, to determine that the change had even occurred. This is not fair to the employee, providing no "safety net" against errors, nor any protection against either actual or false accusations of manipulation or fraud.

*Recommendation:* Anytime an employee changes positions, their IT access rights should be evaluated, and all inappropriate access should be immediately removed. Additionally, employees who are asked to perform tasks of their former positions should decline to do so, and refer the person to the appropriate department. HR should ensure that IT is notified of all employee position changes. Users must never make their passwords available to others, either by sharing information or by posting information where it is visible. Individuals posting or sharing passwords should be subject to progressive disciplinary action, up to and including termination.



### **HUMAN RESOURCES DEPARTMENT:**

*Issue:* At least one department allegedly requested currency to pay temporary off-book employees. We were told by more than one employee that a department requested currency to pay day workers for convention set-up tasks. Fortunately, their request was denied, and this did not occur. The risks of hiring such employees for currency “under-the-table”, as was allegedly requested, include hiring undocumented workers, failing to have an I-9 on file for the employees, IRS violations and more. The other possibility is that the currency was simply going to be pocketed, while regular City employees or authorized temps were used to perform the tasks.

*Recommendation:* Hiring of temporary employees should only be done through the City’s regular HR process, or through a temp agency awarded a contract through RFP. Any future requests for currency to hire temporary employees under the table should be cause for disciplinary action, up to and including termination.

We recommend that the City conduct an internal audit to determine whether or not any temporary or off-books employees have been paid currency for City work, as well as determining whether any “temporary” employees have received long-term employment without appropriate benefits, including PERA.

*Issue:* The City employs family members that are in positions to defeat internal controls or collude to commit fraud. For example, the Assistant Finance Director has user rights to change both her own rate of pay and that of her husband. The Senior Financial Analyst has user rights to change any employees’ pay, including her own and that of her husband; this is further complicated by the fact that her husband has job duties that would allow them to conspire and collude in a number of ways.

*Recommendation:* Whenever family members are in a position to collude, the risk of fraud always increases. We recommend that the Internal Audit Department regularly review the positions of related employees for fraud risk. Studies show that collusion in fraud cases cause losses that are about three times higher than when a single individual is perpetrating fraud. The median loss is \$85,000 for an individual fraudster, the median loss with some collusion is \$242,000, and when five or more collude the median loss is \$633,000 (from the 2016 Association of Certified Fraud Examiners *Report to the Nations*, accessible at: <https://www.acfe.com/rtnn>.)

*Issue:* Few employees have received any formal training for their jobs, and only received on-the-job training from others who were never formally trained themselves. This perpetuates the problem of lack of training, and contributes to the passing down of needless processes. We interviewed employees who had no training at all, and who figured out how to do their jobs on their own, as best they could. We interviewed employees who figured out how to do some of their job tasks by going onto [www.YouTube.com](http://www.YouTube.com) and watching a video that someone else made; the qualifications of the videographer are entirely unknown.

*Recommendation:* We recommend that the City form a Training Department, housed inside of HR, which is responsible for ensuring that training is available to employees, so that each person knows how perform the essential functions of their positions. This will not be a quick process, but eventually, these training deficits can be corrected.



*Issue:* As part of this assessment, we conducted basic public record searches on key employees with access and control over City funds. We found that some City personnel who had access to City funds also had civil judgements for unsatisfied debt, had foreclosures on a home, had outstanding tax liens, or had filed for bankruptcy. Each of these issues is a non-sharable financial need or “pressure” that leads to fraud risk. Please see our discussion of the Fraud Triangle for more information on fraud risk and pressure, rationalization and opportunity.

*Recommendation:* We recommend that a public record search be conducted every year for key employees who have rights to transfer funds via ACH, make journal entries, sign contracts or issue RFPs. Obvious signs of financial pressure should be considered when assigning job duties and setting levels of system access.

*Issue:* Employees told us that hourly employees in various departments are being treated like salaried employees. Witnesses stated that employees are made to work overtime and are not paid overtime. Employees claimed they are either told to take comp hours one-for-one within the same pay period, but then not always allowed to take the hours, or are simply expected to work additional hours without additional pay. This is a likely Fair Labor Standards Act (“FLSA”) violation. Seasonal recreation employees are exempt from FLSA in certain circumstances, but care must be used to ensure that violations do not occur.

*Recommendation:* We analyzed some limited payroll record data, and did not see any obvious evidence of these issues, however, we recommend that the HR and Legal departments coordinate to ensure that FLSA rules are being followed.

The City must follow the FLSA rules. The FLSA (and the IRS) are very clear about which employees can be salaried employees, and which are hourly. Hourly employees must be paid overtime for hours over 40 hours per week, or allowed to bank compensatory time-off, and also to use such time off, without disrupting the work of the agency. For more information, see <http://nmml.org/?s=flsa>.

#### **WATER UTILITY DEPARTMENT:**

*Issue:* The City does not have appropriate AR reconciliation procedures in place at the Utility Department. There appears to be a lack of control and reconciliation over all receivable areas leading to considerable work being performed to include these transactions in the financial statements at year-end. However, this work is being performed by the City Finance and Accounting Department without any communication with the Utility Department, and was generated with no known documentation, oversight or supervision. There are also no procedures for monitoring AR aging, which has allowed significant aged balances to accrue. These balances were written off in Fiscal Year 2017, resulting in a multi-million-dollar write-off.

*Recommendation:* We recommend that the 2017 write-off be the subject of a forensic accounting investigation to determine whether or not the write-off was appropriate, legal and in accordance with governmental accounting standards. Documentation and justification for this write-off must be verified, or the write-off should be reversed and handled appropriately.



Additionally, we recommend that the Utility Department adopt policies and procedures for recording and reconciliation of AR. These procedures should include regular reconciliation of all receivable balances, process for estimating the allowance for doubtful accounts, procedures for monitoring aging of receivables and policies regarding write-offs. Reconciliation needs to occur on a monthly basis to prevent significant write-offs in future years.

*Issue:* The Water Utility accepts large payments in currency. Water Utility customers frequently pay their bills in currency and it is not uncommon for these payments to be in amounts between \$1,000 and \$30,000 in currency. This is a huge risk to the Water Utility and its employees for potential robberies or cash skimming thefts, as well as calling into play currency reporting requirements.

*Recommendation:* We recommend that the City of Santa Fe set a policy that they do not accept more than \$1,000 in currency from any customer. This should apply to cashiers City-wide, including the Water Utility. Customers who wish to pay more than \$1,000 in currency should be told to come back with a cashiers' check or money order for the entire amount. The risks to the cashiers and the City is simply too high when tens of thousands of dollars of currency is being received by cashiers.

*Issue:* Water utility cashiers have been inappropriately trained for robberies at the cashier's window. They told us that they were trained to attack anyone who attempts to rob them, even if the person is armed. This is entirely inappropriate training for cashiers. It appears that the cashiers received "active shooter" training from the Santa Fe Police Department, and since that's the only training they received, they applied it to cashiering situations.

*Recommendation:* In actuality, the appropriate training for cashiers is to train them to give the robber some money and get the robber out the door as quickly as possible, so that no one gets hurt and no hostages are taken. This the same training that bank cashier tellers receive, and it is the training that all cashiers at the City should receive. If cashiers also receive "active shooter training", they must be trained to differentiate between a robber who just wants to get money and leave, and an active shooter situation where their response should be much different.

*Issue:* The Water Department's office and physical space organization is not optimal. Employees are counting currency within sight of the walk-up customers. An odd office cubicle, filled with a huge assortment of personal mementoes, sticks out into the lobby. That office cubicle spoils security sight-lines for cashiers and security employees.

*Recommendation:* We recommend that the Water Department's space use be reevaluated. Security concerns dictate that the person counting currency not be visible to the public, but yet be in an area monitored by cameras or the supervisor. The strange cubicle in the middle of the lobby should be demolished, and a small counter installed for the receptionist that does not destroy security sight-lines. Additionally, City-wide policy should dictate that offices open to the public's view be professional in appearance.

*Issue:* The Water Utility and other City cashiers have failed to file currency transaction reports as required by law (IRS Form 8300 for businesses accepting currency, referred to here as CTR reports). Water Utility employees stated that the Cashier's Office at Water Utility has received



as much as \$30,000 in currency at the window from a single customer. At times, customers literally bring in duffel bags of currency to pay bills for several properties, or to settle up an old debt. These amounts are well in excess of the \$10,000 amount which triggers IRS reporting using Form 8300. Multiple payments exceeding \$10,000 in a short time requires the filing of a suspicious activity report, also on Form 8300.

The Water Utility has never filed any type of currency transaction report (Form 8300) that any employee was aware of, and each occasion where they have failed to do so within 15 days is a violation of Federal law which can result in a fine. The IRS written opinion that states that utilities are required to comply with Federal law and file Forms 8300 is available here: <https://www.irs.gov/pub/irs-wd/1309005.pdf>.

*Recommendation:* If the Water Utility and City Cash Handling Policy precludes the acceptance of currency amounts greater than \$1,000, as recommended earlier in this report, then the City should never have to worry about filing IRS Forms for single transactions. If customers are structuring payments of a series of smaller currency transactions, filing a Form 8300 to report suspicious activity could still be necessary. We recommend that the City consult competent legal counsel to determine what, if any, action is appropriate with respect to their failure to file IRS Forms 8300 in the past.

*Issue:* Currently, utility payments are moved over into the City's Utility Fund through a series of manual journal entries, in batches which separate the customer information from the payment. This is entirely unacceptable, and is a serious fraud risk, because it makes it easier for cash to be skimmed and batches simply deleted or not transferred over. In addition, refund fraud becomes easier, and it is easier for payments to be misapplied either accidentally or as part of a fraud lapping scheme.

*Recommendation:* The implementation of a modern enterprise accounting system should solve the problem of customer information being stripped from accounting data.

*Issue:* Utility refund customers are set up as "vendors" in the procurement system for payment of utility refunds. Refunds can be generated for individuals or entities who were not previously listed as a Water Department customer. Each customer who receives a refund is put into the system as a "vendor" usually with little information other than the name and address. These refund "vendors" lack tax identification numbers, and thus clog the vendor payment and procurement system with meaningless entries. No one could explain how these refund "vendors" were differentiated from actual vendors who should receive Forms 1099 for payments from the City in excess of certain amounts, generally \$600.

During our work in the Water Utility Department, we noted an instance in which a utility refund was generated for \$700, instead of the actual amount of \$70. In this case, the error was caught by accident, but there is currently no process in place to catch either an error or an intentional fraud using this scheme. The Water Utility Department has serious risk of fraud.

*Recommendation:* We recommend that utility refunds be given first as a credit to the account. If the account is closed, and a check must be generated, the Utility should be able to generate the refund check themselves, as a customer refund. Any refund over \$250 should require an additional level of approval prior to a check being cut, this will help ensure that fraudulent refunds are not being given in large amounts.



The City has multimillion dollar write-offs scheduled to occur in the Water Utility Department at the time of this writing. We recommend that prior to those write-offs occurring, that the City hire a qualified forensic accounting firm to investigate the causes of these write-offs, to determine whether they are related to fraud.

### **PARKING DEPARTMENT:**

*Issue:* The City's Parking employees told us that parking and the parking collection system is outdated, and essentially broken. We were told that entry swipe cards for the City Hall/Convention Center parking lot cannot be remotely cancelled. Thus, someone who has not paid their monthly fees can continue to park for free. We were told that there is no way to determine how many cards are being used for free parking, nor is there any way to lock non-paying customers out of the garage.

Additionally, the same parking lot lacks a point-of-sale system, or any system capable of reading the daily parking tickets. Thus, parking booth employees look at the time and date stamp on the pull-ticket and calculate the time and amount due in their heads, and tell the customer what is owed. This system is fraught with opportunities for error, theft or fraud, the combined effect of which could be large, particularly when combined with the free parkers discussed above.

*Recommendation:* We are told that the City is in the process of procuring a new, modern parking payment system for this parking lot, which would solve both the problem of free monthly parkers whose swipe cards cannot be shut off, and also the lack of point-of-sale system and accurate calculation and collection of amounts due. We recommend that this purchase be prioritized, as it would pay for itself in short order. We also recommend that Internal Audit conduct a reconstruction of the downtown Parking's receipts, and attempt to determine the extent to which theft or fraud is occurring, as opposed to human error.

### **GENOVEVA CHAVEZ COMMUNITY CENTER:**

*Issue:* The GCCC is a one-of-a-kind facility in State of New Mexico. The facility includes a 50-meter pool, a therapy pool, and kids wading pool/leisure pool with a huge water slide, full-size ice arena with skate and hockey equipment rentals, indoor walking/running track, gymnasium, weight room, cardio and spin facility, rental and community space, and more. The facility is currently being expanded to include an outdoor skate park.

Despite being a world-class facility, the GCCC lacks a professional manager with experience in this type of facility. We observed that the facility lacks physical security for cash-handling employees, lacks security generally, and lacks camera coverage for safety and liability purposes.

GCCC has a perversely confusing membership system, which takes up an entire wall of signage to explain the choices. There are over 40 choices, plus options for low-income membership that is not even depicted on the website or signage.

The membership and admission options posted on the website are as follows:





Adult GCCC	\$40.00
Adult Multi-Facility	\$50.00
Adult Couple GCCC	\$65.00
Adult Couple Multi-Facility	\$75.00
Senior GCCC	\$20.00
Senior Multi-Facility	\$30.00
Senior Couple GCCC	\$33.50
Senior Couple Multi-Facility	\$43.50

**Corporate Rates are also available - call for information**

**Fitness/Water Aerobics/Ice  
 Punch Pass Rates**

	<b>25 Class Pass</b>	<b>11 Class Pass</b>	<b>Single Class</b>
Adult Members	\$120.00	\$54.00	\$6.00
Youth Members	\$60.00	\$28.00	\$3.00
Senior Members	\$60.00	\$28.00	\$3.00
Adult Non-Member	\$160.00	\$ 72.00	\$ 8.00
Youth Non-Member	\$100.00	\$45.00	\$5.00
Senior Non-Member	\$100.00	\$45.00	\$ 5.00
Ice Member Punch Pass	\$120.00	\$54.00	\$-
Ice Non-Member Punch Pass	\$160.00	\$ 72.00	\$-

The plethora of choices are confusing. The daily rate does not include taking a class, and paying for a class is not intended to provide use of the pool, etc. This leads to “cheating”, wherein people pay the daily rate and take a class, which is supposedly prohibited, or pay for the class, then use the entire facility without paying the daily rate.

*Recommendation:* We recommend that GCCC significantly streamline its membership options. Rates can be raised slightly and incorporate all classes and facilities. The daily rate should include classes and all facilities, this will discourage “cheating”, and encourage facility use. Class participation will no doubt skyrocket, since classes will be included in the price. If the point of a facility like GCCC is to drive resident health and fitness, while providing recreational and community opportunities, then including classes in the base-price is the logical choice.

*Issue:* GCCC Cashiers are sitting behind a counter with no other protections afforded cashiers at other City locations. There is nothing to keep anyone from simply jumping the counter and taking money, or robbing the cashiers.

*Recommendation:* We recommend that the City install cashier cages similar to those provided for cashiers at other City facilities, which include thick glass physically separating cashiers from customers, with a window for transactions to take place. This is currently a





serious liability issue for the City, particularly since cashiers at other locations have safer working conditions.

We suggest that all of the security upgrades, including the camera system, be put into place prior to opening the skate park, so that training and expectations around monitoring of security cameras can be completed.

*Issue:* The GCCC's camera systems do not function properly, with several non-working cameras, including some in cash handling or counting areas. We were told that Purchasing had refused to allow GCCC to repair, replace or upgrade these camera systems for no fewer than three years, despite numerous written requests. The lack of cameras poses serious liability issues for the City, both from security and safety concerns, but also around concerns for child abduction, inappropriate conduct with children, and sexual harassment.

*Recommendation:* We recommend security camera systems with large data storage capability, be placed in the following areas:

- Each cashier station - placed so the cashier's activities are clearly visible, along with a clear depiction of the customer.
- Cash counting areas - so that both people counting down cash, or cashiers counting down their drawers in back, can be clearly seen.
- Pools - placed so each pool can be monitored by security and supervisors, so that anyone in distress would be quickly seen, as well as anyone acting inappropriately.
- Weight rooms - placed in each weight workout area so that someone in distress would be quickly seen, as well as anyone acting inappropriately.
- All exterior entrances - including the back door by the therapy pool, and all employee-entrance areas.
- Parking lots - in employee parking areas, as well as guest parking areas.
- Skate park - the skate park, when built, must have cameras covering the entire skate park.
- We also recommend the installation of panic buttons in areas such as the pool, weight rooms, and other select areas. Panic buttons should sound a general announced alarm so that anyone nearby can respond to help.

*Issue:* Currently, the "back door" by the therapy pool is completely unmonitored. This door is left open and/or unlocked so that disabled people and those on stretchers can easily access the therapy pool. Unfortunately, this access also means that people can sneak in for free, and provides an easy access and egress for someone intending to abduct or injure a child. Additionally, it was reported to us that current and possibly some former employees have keys to get into the facility. We were told that employees sometimes use the facility as their own private party site, after hours.

*Recommendation:* We recommend that GCCC implement key-fob or card swipe security system, which will track entry/exit by person, and where access can be remotely removed when employees no longer work at the facility. We also suggest that GCCC have emergency push-bars so that people can leave in an emergency, but an alarm will sound if the door is pushed open without an employee's fob or badge being scanned.



*Issue:* The GCCC is one of the most comprehensive facilities of its kind in New Mexico, providing an amazing inventory of options and services for the community. However, at the time of our visit, the facility was managed by some very pleasant and well-intentioned people, who nevertheless had no professional experience running a facility of this type.

*Recommendation:* We recommend that the GCCC be staffed by professional managers with experience with running a facility of this type and size. In the alternative, the City could consider having a managed competition, or outsourcing management of the GCCC to professionals. (Please see our discussion of managed competition under the Procurement Department section).

### **MISCELLANEOUS:**

*Issue:* We learned during interviews that proper internal controls are not in place around the fuel inventory at the City. The City uses a key fob system to allow employees to fuel City vehicles at City-owned fuel stations. These fobs are assigned to a vehicle and vehicles are then assigned to specific departments and employees. We were told that currently there is no monitoring process in place over fuel usage. Fuel fobs have also been removed from vehicles and placed in different vehicles, or vehicles have been assigned to a different department and the corresponding key fob has not been updated. Considering the mobility of the key fobs and the lack of monitoring, it would be very easy for employees to fuel personal vehicles using a City-issued key fob.

*Recommendation:* We recommend the City perform an internal audit of fuel usage. The City should also implement policies and procedures for monitoring usage of fuel for City vehicles. City fuel could be outsourced to one of the many commercial fuel distributors, probably at a lower cost than the current system. If the City continues to purchase and dispense its own fuel, a dual-authentication method should be used that tracks the vehicle and mileage of the vehicle being fueled as well as the identity of the person fueling the vehicle. If not already in place, surveillance cameras should be installed at all fuel stations to allow for investigation into possible theft of fuel.

*Issue:* We were told that proper internal controls are not in place around the vehicle inventory at the City; the City's inventory in the accounting system appears not to have been corrected or updated in some time. Vehicles have been moved to different departments without the person accounting for fleet being notified. This leads to vehicle-related charges being expensed to the wrong departments. In some instances, these expenses are being recorded in general ledger accounts for discontinued business units.

*Recommendation:* We recommend the City complete a vehicle inventory. The vehicle inventory should be completely updated appropriately. Any missing or damaged vehicles should be investigated, and if appropriate to do so, the City's inventory and accounting system should be updated accordingly.

*Issue:* Finance and Accounting Department employees are able to view incoming transactions using their bank's online banking system. Not all finance employees currently have access to this system, including those who use it on a daily basis. Employees have been sharing

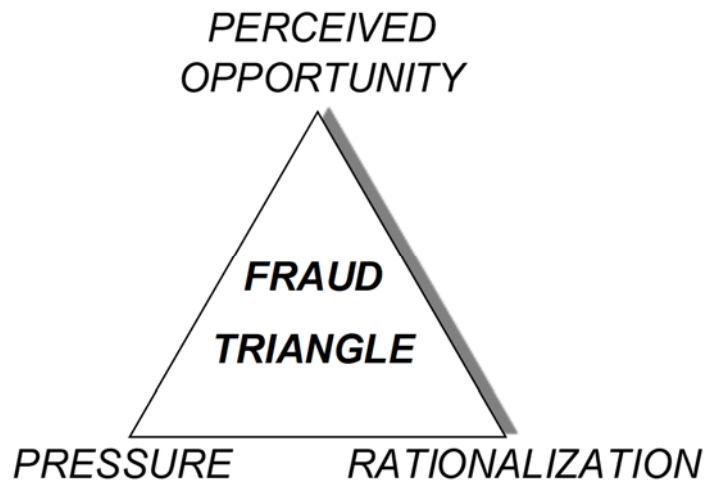


usernames and password information for the online banking system, this could give them access that is not appropriate for their position.

*Recommendation:* Each employee should have their own user access to the system with appropriate system controls in place. User access to banking information should not be shared between employees in *any* circumstances. Access should also be updated whenever an employee transfers or employment is terminated.

### **THE FRAUD TRIANGLE: Discussion of how fraud occurs within an organization**

In the late 1940s and early 1950s Donald R. Cressey created the Cressey Hypothesis, which is now known as The Fraud Triangle.



[graphic copyright by the Association of Certified Fraud Examiners, Austin, TX]

Cressey hypothesized that three things are present when trusted employees become trust violators. He said those three things are opportunity, rationalization and what he termed “non-shareable financial problem” which has come to be known as “pressure”. (Statements of Auditing Standards 99 adopted the term “pressure” when describing the non-shareable financial problem in the Fraud Triangle and this term has become an accepted replacement from Cressey’s original research and writing.)

Opportunity is defined in the *2012 Fraud Examiners Manual*:

*In Cressey’s view, there were two components of the perceived opportunity to commit a trust violation: General information and technical skill. General information is simply the knowledge that the employee’s position of trust could be violated. This knowledge might come from hearing of other embezzlements, from seeing dishonest behavior by other employees, or just from generally being aware of the fact that the employee is in a position where he could take advantage of his employer faith in him. Technical skill refers to the abilities needed to commit the*



*violation. These are usually the same abilities that the employee needs to have to obtain and keep his position in the first place.*

*2012 Fraud Examiners Manual p. 4.505-4.506 [emphasis in original]*

According to Cressey, rationalization is a component that takes place before any embezzlement takes place. Per the *2012 Fraud Examiners Manual*, "Because the embezzler does not view himself as a criminal, he must justify his misdeeds before he ever commits them." (*2012 Fraud Examiners Manual* p. 4.506) Often the rationalization is the perpetrator is just borrowing the money from the employer. Other rationalizations recognized by Cressey include the notion that "their employers were cheating them financially" (*2012 Fraud Examiners Manual*, p. 4-507)

The final element of Cressey's hypothesis is that a non-shareable financial problem is present. Cressey noted that what is considered "non-shareable" is wholly in the eyes of the trusted employee. Different trusted employees might react differently in a situation because one person believes the problem is non-shareable while another person does not believe he or she can share it. Further Cressey said it must be a problem that could be solved financially, with additional cash or assets. Generally, "non-shareable problems threatened the status of the subjects, or threatened to prevent them from achieving a higher status than the one they occupied at the time of their violation." Examples of non-shareable financial problems we have seen in our practice are drug, alcohol, gaming or other addictions by the employee or a loved one, extramarital affairs, or simply being over-burdened by debt.

Employees must have a "safety net" to catch honest mistakes, as well as catching attempted frauds. Such a safety net includes strong internal controls, minimizing opportunity. The safety net must also include an atmosphere where fraud and dishonesty are not tolerated, the perception of detection is high, and trust violators are disciplined or terminated. Finally, there must be an atmosphere where the psychological cost of committing fraud, as well as rationalizing fraud, is difficult to overcome. This includes the tone at the top of the organization being strongly anti-fraud, having a Hotline which is promoted and available, as well as having an organization where concern of internal control weakness is rewarded, not punished.

Many of the recommendations in this report, if properly implemented, will directly resolve the problems of employees with no meaningful oversight or safety net in their positions.

#### **TECHNICAL NOTES:**

Our opinions are related solely to the accounting issues as discussed above; no legal conclusions are either offered or intended.

Our work is not a financial statement audit and should not be relied on for such purposes. We did not perform testwork related to the business purpose of specific transactions. We also did not perform any analysis of specific software or IT processes. We did not conduct any review of financial statements, as the term "review" is defined by the accounting standards.

Our findings are based solely on the extensive interviews we conducted as noted above, and limited testwork of financial transactions we performed, along with our observations, training, experiences and expertise. For the most part, employees were eager to tell us about issues of concern; they expressed frustration over the lack of internal controls, lack of training and lack of



written policies and procedures to guide their work. Wherever possible, we verified the details of employee interviews against details of other employee interviews, or against system attributes. However, we relied on employee representations as part of this examination.

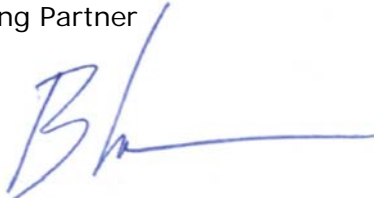
In conducting this examination, McHard Accounting Consulting LLC was provided with documents including financial records, reports from the accounting system, both printed and electronic, as well as other documents. We relied on these documents during this fraud risk assessment engagement and in forming our opinions as to this matter. If documents later become available which supersede, update or correct the documents we relied on, we reserve the right to examine the new documentation to inform and potentially revise relevant facts and our opinions stated here.

We appreciate the opportunity to assist you with this matter. Please do not hesitate to contact us if you have any questions.

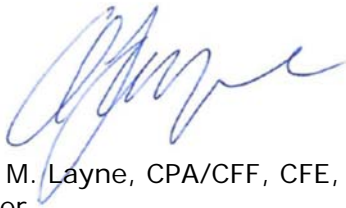
Sincerely,



Janet M. McHard, CPA, CFE, MAFF, CFF  
Founding Partner



Beth Mohr, CFE, CAMS, CCCI, PI<sup>1</sup>  
Managing Partner



Anne M. Layne, CPA/CFF, CFE, CAMS  
Partner

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<sup>1</sup> Private Investigator license #2503

