



City of Santa Fe New Mexico

Finance Department

Memorandum

9/27/2017

TO: Mayor Javier Gonzales and City Council Members

VIA: Brian Snyder, City Manager

FROM: Adam Johnson, Finance Director

EXECUTIVE SUMMARY

In February 2017, after four months of observation as Finance Director, I identified significant red flags of the kind often associated with financial misstatements from fraud or error, and an environment where these things are likely to occur. In concurrence with the City Manager, the City engaged the professional services of Janet McHard, Beth Mohr and Anne Layne of McHard Accounting Consulting LLC (McHard) to conduct a Fraud Prevention Engagement. On September 25th their firm issued a fraud risk assessment report based upon their observations and interviews of various City employees. The report identifies 62 issues, which confirm my original observations and identifies additional conditions which need to be addressed. The report does not specifically identify fraud or material misstatements in the City's financial statements, but it does provide a basis for further inquiry to determine whether or not either of these have occurred in the past. This inquiry should include not just E-1, the ERP in use for the last decade, but also its predecessor.

Financial misstatements due to fraud or error can occur for a variety of reasons ranging from clerical errors to intentional manipulation. All finance professionals upholding the fiduciary standard have an obligation to perform their duties with due care, in a manner that any individual in the same capacity is expected to perform. This level of professionalism requires action to determine whether the identified red flags resulted in fraud or material misstatements. Prior to the work conducted by McHard I elevated the following to the City Manager as examples of my concerns in the Finance Department:

- an overly complicated chart of accounts;
- lack of documented internal controls; over reliance on manual processes and journal entries;
- consolidated control of posting transactions;
- manual production of financial statements;
- an environment of bullying and suppression of inquiry;
- cavalier comments about asset balances in the financial statements;

- an approach of non-transparency with external auditors;
- fixed asset balances that do not tie from 2015 – 2016; over use of the general ledger for all transactions; and
- significant personnel turnover, including the position of Finance Director.

This is not an exhaustive list, but is comprehensive enough to call for third party expert assistance to confirm or deny the gravity of the problem, and to make recommendations.

McHard began their interview and observation work in March 2017. Within the first few days, the firm discovered processes and conditions that corroborated my observations. The report documents in detail the results of their review. Many of the issues they identified were brought to my attention as they were discovered and as a result, we have either resolved or significantly mitigated them. Some of these initiatives were already underway with the support of the Governing Body, including the new Enterprise Resource Planning (ERP) software and the Compensation and Classification study. In addition, we have undertaken the reorganization of the Finance Department and a number of staff training initiatives.

In my professional opinion, there are six core issues raised by the report:

- the failed implementation of the E-1 system currently in use;
- promotions of personnel beyond their capabilities;
- an environment that historically has not embraced the need for professionally trained, competent, and adequately compensated individuals in key positions;
- a lack of professional due care by individuals in key positions in the Finance Department;
- Poor continuity at the executive management level, resulting in inconsistent practices and procedures over time; and
- the failure of external and internal auditors to identify these concerns and raise them with management.

McHard's work provided grounds to pursue additional investigation and test work to uncover possible fraud. The results of the initial follow up investigation relate to personnel and are thus confidential. In addition, the identification of inadequate internal controls and unfettered access to the financial system and City assets requires further test work to determine whether or not the City's trial balances require material adjustments, whether due to fraud or error. Contracts for the additional work will follow the normal contracting procedures.

In the interim, we have retained, under the City Manager's approval authority, the expert third party services of Anderson Consulting (Anderson) to support my efforts and maintain continuity of financial operations as we continue to implement recommendations made in the report. Anderson specializes in this type of urgent and temporary financial operations assistance. I will also be recommending to the Governing Body additions to the Anderson scope to facilitate completion of the 2017 Comprehensive Annual Financial Report (CAFR), assist in the



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implementation of TylerMunis, collaborate with other external professionals and recommend additional forensic accounting investigations if warranted.

As noted above, the Governing Body and the current administration should be credited with undertaking over the last several years a number of initiatives to address many of the issues identified in the report. These policy actions and commitments represent a consistent resolve to tackling challenges head on. I look forward to continuing these efforts.

It is absolutely the case that current and past administrations and elected officials must be able to rely on laws, policies and procedures, processes, outside expert observation and testimony, and professional staff to prevent a systemic failure of this magnitude. My own signature on the CAFR stands as an example of reliance on the work of professionals charged with the responsibility to perform their duties under a standard of due care. Unfortunately, in many instances we were let down.

The Office of the State Auditor (OSA) was informed of the fraud prevention engagement as well as the subsequent investigation. Upon public disclosure of this memo and the Fraud Prevention Report, City executive staff will meet as required with the Audit Committee, OSA and the State of New Mexico Department of Finance Administration to determine whether our planned courses of action and remedies are sufficient from their perspectives, or if additional actions and remedies are needed.

It is important to remember that the errors of some do not reflect the dedication and hard work of many staff members, who were not encouraged to ask questions or to pursue professional development. This is exactly the behavior that must ultimately be eradicated so an environment where questions are welcomed and change can flourish.

The proposed path forward is aimed at being as transparent as possible, surrounded by credentialed third party experts to increase the probability of getting it right, and inclusive of oversight agencies to ensure we are accountable. With careful handling, we can emerge from this as a trusted organization that all people with democratically elected institutions deserve.