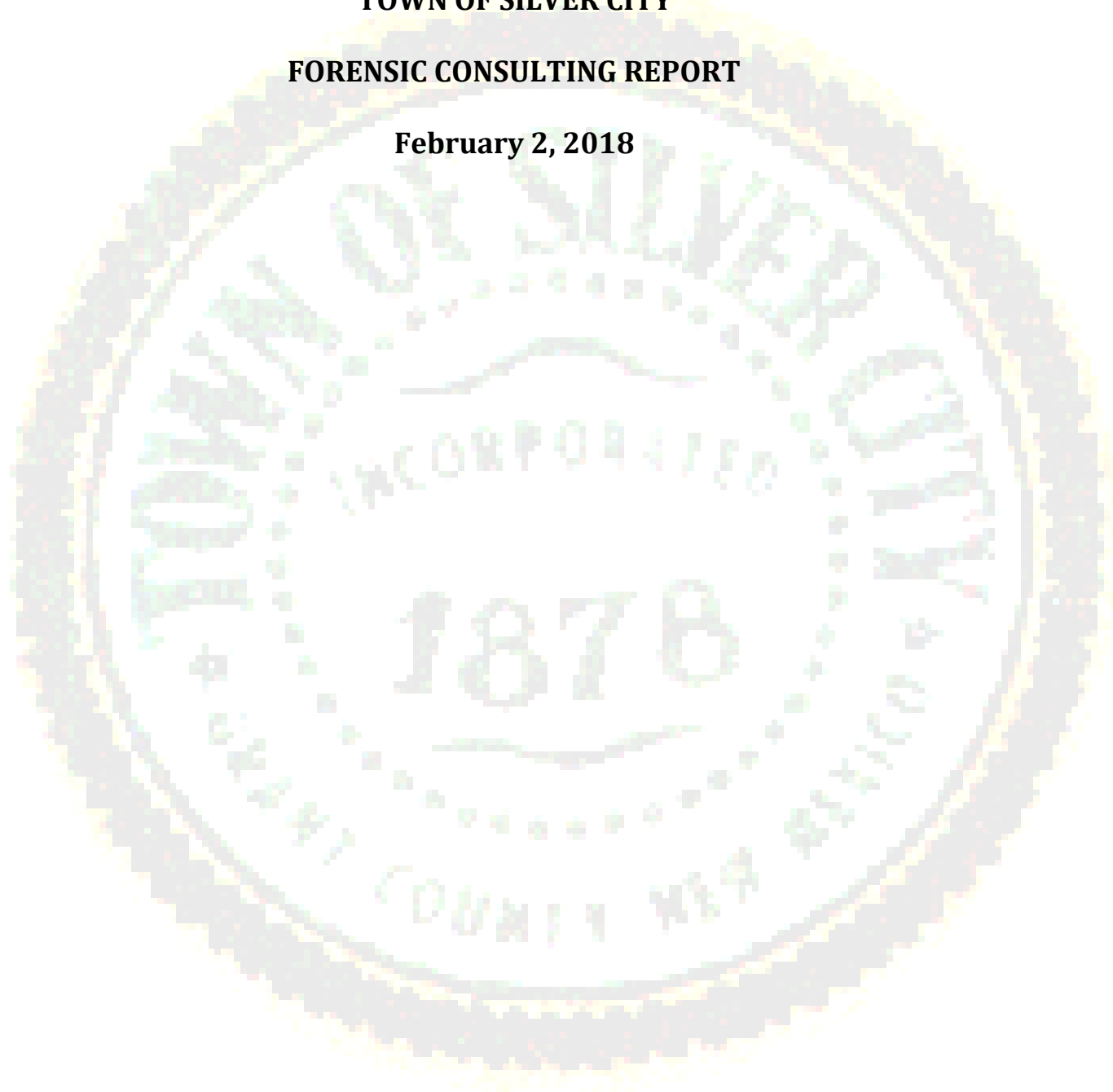


**TOWN OF SILVER CITY**  
**FORENSIC CONSULTING REPORT**

**February 2, 2018**



**SOUTHWEST ACCOUNTING SOLUTIONS, LLC**  
**Certified Public Accountants**



Auditors~Consultants~CPA

February 2, 2018

Mr. Ken Ladner  
Town Mayor  
101 W Broadway St  
Silver City, New Mexico 88061

Mr. Wayne Johnson  
New Mexico State Auditor  
Santa Fe, New Mexico

Thank you for the opportunity to provide forensic consulting services to the Town of Silver City (the "Town") to determine if one of the Town's personnel exploited control weaknesses in the Town's credit card requisition process to facilitate misappropriation of Town's assets. This report summarizes our forensic consulting procedures, findings, and recommendations as it relates to our assistance with your evaluation of the Town's control environment surrounding the credit card requisition process for the period from July, 1 2012 through June 30, 2017.

This engagement was performed in accordance with Standards for Consulting Services established by the American Institute of Certified Public Accountants as outlined in our contract dated November 29, 2017 and engagement letter dated January 8, 2018. The scope of this engagement is outlined in the body of our report. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Town Management is responsible for maintaining the accounting records and for establishing and maintaining effective internal control over compliance with applicable laws, regulations, and related credit card policies of the Town. We were not engaged to, and did not conduct an audit or examination, the objective of which would be the expression of an opinion on the internal controls, or activities of the Funds under attestation standards. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you. In addition, our consulting procedures do not provide legal determination of the Town's compliance with applicable laws and regulations.

This report was developed based on information obtained from our interviews with current employees of the Town, our observations of the operations, and review of selected supporting documentation and records.

This report is intended solely for the use of the Town's Management, Council members, and their designated Legal Counsel and the New Mexico Office of the State Auditor. This report should not be disclosed to, used or relied upon by any other third-party. Southwest Accounting Solutions, LLC does not accept any responsibility to any other party to whom this report may be shown or whose possession it may come into.

We appreciate the opportunity to help you with this matter. Please do not hesitate to call me at (505) 610-4455 if you have any questions or need further assistance regarding this important matter. Southwest Accounting Solutions, LLC would like to sincerely thank the staff of the Town for their help in assisting us with our procedures.

Sincerely,

Robert Peixotto, Managing Member for  
Southwest Accounting Solutions, LLC  
Albuquerque, New Mexico

**Table of Contents**

**Town of Silver City  
Forensic Consulting Report**

	<b><u>Page No.</u></b>
<b>EXECUTIVE SUMMARY .....</b>	<b>5-6</b>
<b>BACKGROUND .....</b>	<b>6-7</b>
<b>OBJECTIVE AND SCOPE .....</b>	<b>7</b>
<b>PROCEDURES PERFORMED .....</b>	<b>7-8</b>
<b>FINDINGS AND RECOMENDATIONS .....</b>	<b>8-14</b>
<b>EXIT CONFERENCE.....</b>	<b>15</b>

## **EXECUTIVE SUMMARY**

The Town's Management and its Council members are responsible for providing Town citizens reasonable assurance that the Town's assets are safeguarded from theft and misappropriation, and that the Town has an adequate system of internal accounting and operational controls necessary to meet these responsibilities. The procedures performed in this report were developed with the Town to assist the Town in determining if one of the Town's personnel exploited control weaknesses in the Town's credit card requisition process and may have misappropriated the Town's assets for the period from July 1, 2012 through June 30, 2017.

This report is the result of concerns reported by the Town to both the Office of the State Auditor and to the independent auditor who performed their fiscal year 2017 financial statements audit.

Concepts of importance in this report relate to the Committee of Sponsoring Organizations (COSO) internal control integrated framework. Internal Control is a process for assuring achievement of an organization's objectives in operational effectiveness and efficiency, reliable financial reporting and compliance with laws, regulations and policies. There are five components of internal control as follows:

### **A. Control Environment**

The control environment sets the tone of an organization and influences the control consciousness of its employees. It is the foundation for all other components of internal control, because it provides discipline and structure. Control environment factors include the integrity, ethical values and competence of the people associated with the entity, including management and employees; management's philosophy and operating style; the methods by which management assigns authority and responsibility, and organizes and develops its employees; and the attention and direction provided by the Town Council and Mayor.

### **B. Risk Assessment**

Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, which should be linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the entity's objectives, which includes forming a basis for determining how the risks should be managed. Economic, industry, regulatory and operating conditions will inevitably continue to change in any business environment, therefore, mechanisms are needed to identify and deal with the special risks associated with such changes.

### **C. Control Activities**

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks, in order to achieve the Town's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities including approval, authorization, verification, reconciliation, and review of operating performance, security of assets, and segregation of duties.

### **D. Information and Communication**

Pertinent information must be identified, captured, and communicated in a form and timeframe that enable employees and management to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the Town. They deal not only with internally generated data, but also information about external events, activities, and conditions necessary to make informed business decisions and comply with necessary external reporting. Effective communication must also occur in a broader sense, flowing down, across, and up the organizational chain. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. Employees must understand their own role in the internal control system, as well as how individual activities relate to the work of others. There must be a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and citizens.

### **E. Monitoring**

Internal control systems need to be monitored through a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take to perform their duties. The scope and frequency of separate evaluations depends primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the Town's governing body.

## **BACKGROUND**

The Town had an individual who was the administrator for the Town's employee credit card program who left her position in November of 2016. Upon a new individual taking over the position she noted discrepancies in their predecessor's credit card information. The Town's independent auditor and the Office of the State Auditor were informed and the

Town contracted to have forensic consulting procedures performed which are described below.

## **OBJECTIVE AND SCOPE**

The procedures listed below were developed with the Town to assist in determining if one of the Town's personnel exploited control weaknesses in the credit card requisition process to facilitate misappropriation of Town's assets for the period from July 1, 2012 through June 30, 2017.

## **PROCEDURES PERFORMED**

This section describes the procedures performed to accomplish the objectives of the forensic consulting procedures as specified in our Contract. Southwest Accounting Solutions, LLC performed the following forensic consulting services for the Town.

1. Policies and Procedures: we will obtain, review, and summarize all relevant policies and procedures of the Town to note any control weaknesses.
2. Duplicate Vendor Invoices: we will review a sample of purchases made during fiscal years 2013 through 2017 to see if duplicate vendor invoices were submitted for multiple payments or to provide supporting documentation for potentially fraudulent purchases.
3. Review credit card information for the suspect employee: we will review all credit card bank statements for suspect employee's Town credit card purchases between fiscal year 2013 through 2017 to determine if purchases appeared reasonable and if supporting documentation was altered to provide support for possible fraudulent credit card purchases.
4. Vendor listing: we will review the vendor listing for reasonableness of vendors and controls implemented in maintaining the vendor listing.
5. Review vendor reward points applied: We will review a sample of vendor reward points applied and trace where reward points were used.
6. Review vendor order history and shipping addresses: We will review a sample of suspect employee's credit card purchases to verify where items were shipped.
7. Review IT Controls: We will review the currently implemented financial management system and IT controls to determine if duties are properly segregated.

We interviewed the following personnel in January of 2018: Town Manager, Deputy Finance Director, Purchasing Agent, Accounts Payable Clerk 1 and 2, the previous Accounts Payable Clerk, Information Technology Director, and the New Mexico State Police Agent of

the Investigation Bureau assigned to the case. We obtained financial accounting records and other documents relative to the consulting procedures we were engaged to perform. Based on our review of the supporting documentation and the procedures we performed, we noted the following issues:

## **FINDINGS AND RECOMMENDATIONS**

### **Finding #1 – Lack of Controls Over Credit Card, Accounts Payable, and Purchasing Policies and Procedures**

**Condition:** During our review of credit card, accounts payable and purchasing policies and procedures we noted the following deficiencies:

During our review of the credit card policies and procedures we noted the following issues:

- The credit card policy does not outline key controls and segregation of duties.
- The credit card manual states department heads are responsible for maintaining fiscal oversight for their department's credit card purchases but there are no key controls outlined or described which should be employed to accomplish this oversight.
- The policies and procedure requires random audits of credit card transactions which were not being properly performed in fiscal years 2013 – 2017.
- The individual responsible for administrating and overseeing the credit card process was issued a credit card.

During our review of the accounts payable policies and procedures we noted the following issues:

- The Accounts payable policy does not outline key controls and segregation of duties.
- The accounts payable clerks has access to checks, has possession of the Town Manager's payment stamp, can create vendors in the vendor listing, can approve payments on purchase orders (PO) in excess of 10% of the PO amount, has unlimited access to the financial management system (FMS) and has access to multiple employees log in information. Further, the Town requires a second check signer, however the results of our testwork indicated this individual does not conduct an adequate review of what they are signing.
- Town had a policy in place in which GRT payments should not to be paid for Town purchases other than construction, services, and leases, but this policy was noted as frequently not being followed.



- Checks made out to Wells Fargo for credit card payments were not being signed by the authorized check signers. These checks were stamped with a stamp reading “NON-NEGOTIABLE”.

During our review of the purchasing policies and procedures we noted the following issues:

- The purchasing policy does not outline key controls and segregation of duties into the procurement process.
- The purchasing officer had access to checks, had the ability to perform accounts payable functions, was able to obtain access to the Town Manager’s check stamp, was able to log in the financial management system as the accounts payable clerk, had unlimited access to modules in the financial management system, was able to add, delete, and modify the vendor listing, was issued a credit card and was responsible for reconciling and approving credit card reports.

**Criteria:** The Committee of Sponsoring Organizations (COSO) internal control integrated framework consists of five critical elements that must be present in carrying out the achievement objectives of an organization. These elements are known as the control environment, risk assessment, control activities, information and communication and monitoring.

**Effect:** Without all of the five elements of the COSO framework present, the Town is exposing itself to the risk of misappropriation of assets and that mistakes and fraud will not be detected and corrected in a timely manner.

**Cause:** The Town has not performed a formalized and documented risk assessment process for key controls to be in place to prevent and detect errors or fraud. The Town does not review and update their policies and procedures on an annual basis to address changes in their control activities. The Town’s FMS is not adequately designed to segregate incompatible duties within the Town. Also, the Town does not have an IT policy and procedures in place.

**Recommendation:** It is our recommendation that Town update their financial accounting policies and procedures which should be designed to implement control activities in all areas of the financial accounting process. On an ongoing basis the Town should monitor whether key controls are operating as intended to ensure that controls are effective. Department heads and supervisors should regularly review available documentation and accounting records to confirm that controls are being executed as designed. The individual assigned the responsible for signing checks should conduct an adequate review of the checks they are signing. We recommend the three main duties to be segregated in the Town are the authorization to execute a transaction, the recording of the transaction, and the custody of assets involved in the transaction. Further, we recommend the Town update their FMS.

**Management Response:** Management is in the process of creating and updating detailed policies and procedures to segregate incompatible duties in the Town. Management is also working to update our FMS to a new version of the software to enable more controls to be implemented in the accounting system. Management also intends on having employees attend training classes so understandings of the policies and procedures can be implemented in a timely manner.

## **Finding #2- Duplicate Transactions in Accounts Payable**

**Condition:** During our testwork we noted the following issues related to duplicate transactions:

- We reviewed a sample of 80 transactions between fiscal year 2013 - 2017 and noted 1 duplicate transaction in the amount of \$626.44 that was processed for payment.
- We reviewed all the suspect employees' credit card transactions between 2013 - 2017 and noted 7 instances totaling \$2,555.26, where duplicate transactions appeared to be processed to provide support for potentially fraudulent credit card payments.

**Criteria:** The Committee of Sponsoring Organizations (COSO) internal control integrated framework consists of five critical elements that must be present in carrying out the achievement objectives of an organization. These elements are known as the control environment, risk assessment, control activities, information and communication and monitoring.

**Effect:** Without all of the five elements of the COSO framework present, the Town is exposing itself to the risk of misappropriation of assets and that mistakes and fraud will not be detected and corrected in a timely manner.

**Cause:** The Town has not implemented a formalized and documented risk assessment process for key controls to be in place to prevent and detect errors or fraud. The Town's policies and procedures in place during the fiscal years 2013 - 2017 allowed an employee to override controls by having the ability to make credit card purchases, approve their credit card purchases, and record the transaction in the FMS. Further the Town's FMS and internal controls are not adequately designed to segregate duties, produce reports and use adequate information which would assist the Town in detecting and correcting misstatements related to errors and fraud.

**Recommendation:** It is our recommendation that the Town update policies and procedures so key controls are in place surrounding payments of vendor invoices as well as implement all five components of the COSO internal control integrated framework in the financial accounting process. We also recommend the Town update their FMS at the

earliest convenience so proper segregation of duties is implemented into the various functions of the FMS.

**Management Response:** Management is in the process of updating the FMS, which will allow for improved tracking of duplicate transactions. We are also creating and updating policies and procedures to implement key controls surrounding vendor invoices.

### **Finding #3 - Review of Credit Card Transaction and Use of Office Depot Rewards of Suspect Employee**

**Condition:** During our testwork we noted the following issues related to the suspect employees use of the Town's credit card and use of the Town's Office Depot reward points in the years 2013 - 2017.

- We noted 54 instances totaling \$11,610.85 that are potentially fraudulent use of the suspect employee's Town credit card as well as 42 instances totaling \$1,198.44 that involve potentially fraudulent use of the Town's Office Depot account. There are various issues in relation to this potential abuse which are noted below and are included in these totals.
- We noted 5 instances where the suspect employee used the Town's Office Depot reward points of \$309.99 to have items delivered to their home address.
- We noted 3 instances totaling \$89.90 where the suspect employee used the Town's Office Depot reward points to have items delivered to their new place of employment after leaving the employment of the Town.
- We noted 45 instances totaling \$9,554.20, where the suspect employee appeared to alter her personal purchase reports to remove the apparently fraudulent transactions.
- We noted 5 instances totaling \$1,237.51, where signatures may have been forged to provide support for the above transactions.
- We noted 45 instances totaling \$9,554.20, where credit card transactions appeared to lack additional supporting documentation required by the Town for approval of purchase.
- We noted 52 instances totaling \$10,989.82, where the vendor invoices appeared to be altered to provide support for fraudulent credit card transactions.

**Criteria:** The Committee of Sponsoring Organizations (COSO) internal control integrated framework consists of five critical elements that must be present in carrying out the

achievement objectives of an organization. These elements are known as the control environment, risk assessment, control activities, information and communication and monitoring.

**Effect:** Without all of the five elements of the COSO framework present, the Town is exposing itself to the risk of misappropriation of assets and that mistakes and fraud will not be detected and corrected in a timely manner. As a result an individual was able to obtain management override of controls and circumvent control activities to make fraudulent purchases with their Town issued credit card.

**Cause:** Inadequate policies and procedures were implemented in fiscal years 2013 – 2017 which allowed the suspect employee to override controls and circumvent controls by using duplicate receipts and altered reports to provide support for fraudulent credit card transactions.

**Recommendation:** It is our recommendation that the Town update their credit card policies and procedures to integrate control activities that are designed to segregate incompatible duties so errors and fraud are detected and corrected in a timely manner. We recommend that employees who use Town credit cards have their department head review the monthly copy of the credit card statement produced by the bank and approve their purchases on a monthly basis. We recommend purchasing agent review a copy of all department heads bank credit card statements on a monthly basis. We recommend that purchasing agent who reviews and approves credit card transactions not have access to a credit card, and not have access to the accounts payable modules in the FMS.

**Management Response:** Management is in the process of updating our credit card policies and procedures so incompatible duties are segregated and the above recommendations are incorporated into our system of internal controls.

#### **Finding #4 - Vendor Listing**

**Condition:** During our review of the vendor listing we noted the following issues:

- The vendor listing consists of 5,674 vendors. It was noted that on average only 600-700 active vendors are consistently used.
- Individuals in accounts payable, purchasing, and finance all have the ability to modify the vendor listing.
- The FMS will not allow the Town to delete vendors out of the vendor listing and retain detailed vendor activity reports.
- We noted 65 instances of duplicate vendors entered into the vendor listing.

**Criteria:** The Vendor listing should be used as a key control so payments made to unauthorized vendors in the accounts payable cycle are likely to be detected and corrected in a timely manner. The three main duties to be segregated are the authorization to execute a transaction, the recording of the transaction, and the custody of assets involved in the transaction.

**Effect:** It is possible for payments to be made to unauthorized vendors in the accounts payable check run which exposes the Town to the risk of misappropriation of assets and that mistakes and fraud will not be detected and corrected in a timely manner.

**Cause:** The Town's FMS and policies and procedures do not integrate key controls surrounding the maintenance of, and the ability to modify the vendor listing.

**Recommendation:** It is our recommendation that Town create and implement detailed policies and procedures so access to modify the vendor listing is segregated in a manner which does not allow individual to authorize to execute a transaction, record the transaction, and have custody of the assets involved in the transaction.

**Management Response:** Management is in the process of updating our FMS so modifications to the vendor listing will be centralized to the purchasing agent. When the FMS is updated we will be able to delete inactive vendors out of the FMS without losing date. We are also in the process of creating and updating detailed policies and procedures to integrate key controls in the FMS and the Town's accounting system.

### **Finding #5- IT Controls**

**Condition:** During our testwork we noted the following deficiencies with the Town's IT controls:

- The Town's FMS is not currently designed to adequately segregate the authorization to execute a transaction, the recording of the transaction, and the custody of assets involved in the transaction.
- Each user of the FMS has access to system controls in their user profiles. This enables the user to expend there access to the FMS to an unlimited extent.
- User names and passwords are commonly shared among different employees in the Town.
- When employees are terminated their user account is not deactivated.
- Passwords to user accounts were noted as never being changed.
- The FMS does not allow the Town to accurately monitor the general ledger balances that could be entered in error, or are incorrect.

- The Town's FMS has not been updated in over 22 years resulting in a system that is not capable of producing standard reports that are useful in identifying and communicating information that would enable personnel and management to effectively monitor controls.

**Criteria:** The Committee of Sponsoring Organizations (COSO) internal control integrated framework consists of five critical elements that must be present in carrying out the achievement objectives of an organization. These elements are known as the control environment, risk assessment, control activities, information and communication and monitoring.

**Effect:** Without having a properly designed and implemented FMS and IT controls the Town is unable to adequately integrate a sufficient internal control framework designed to correct and detect misstatement due to fraud or errors.

**Cause:** The Town's FMS, and information and technology policies and procedures should allow the Town to adequately segregate duties, and implement the COSO framework through the Town's operations. The Town FMS has not been updated in over 22 years and IT controls have not been created to meet the changing needs of the Town. Further, the FMS in place is not designed to properly segregation incompatible duties within the Town..

**Recommendation:** It is our recommendation that Town update their FMS and create detailed IT policies and procedures so one individual does not have the ability to execute a transaction, record the transaction, and have custody of the resources involved in the transaction. We recommend that user accounts have limited access to modify the FMS according to their positional needs and not have the ability to extend their own access within the FMS. We recommend users not share their passwords in the FMS, passwords to user accounts be changed 2 -3 times per year, and when employees are terminated their user account be deactivated or deleted.

**Management Response:** Management is in the process of updating the FMS, and having detailed policies and procedures created surrounding information technology to enable proper segregation of duties in the Town. In our information technology policies and procedures we will address limitations of FMS access to various employees, the sharing of user log in information, and requirements for passwords to be updated every a minimum of two times per year.

**STATE OF NEW MEXICO  
TOWN OF SILVER CITY  
EXIT CONFERENCE**

**An exit Conference Was held on February 2, 2018. In attendance were the following:**

**Representing the Town of Silver City:**

Alex Brown    Town Manager / Finance Director

**Representing Southwest Accounting Solutions, LLC:**

Robert Peixotto, CPA    Managing Member

Geoff Mamerow, CFE    Audit Manager