

**STATE OF NEW MEXICO**  
**VILLAGE OF HATCH**  
**FORENSIC AUDIT SERVICES FOR THE**  
**FISCAL YEARS ENDED**  
**JUNE 30, 2012 AND 2013**

**STATE OF NEW MEXICO**  
**VILLAGE OF HATCH**  
**FORENSIC AUDIT**  
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## Forensic Auditors' Report

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and  
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Village of Hatch, New Mexico  
Hatch, New Mexico

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### I. Background

On September 18, 2014, Kubiak Melton & Associates, LLC (KMA) was engaged by the Village of Hatch, New Mexico (Village) to conduct a forensic audit for the fiscal years ending June 30, 2012 and 2013. Based upon this initial meeting with the Village, a forensic audit was commenced which included the following procedures:

- Interviews of Village Trustees, management, employees and other individuals that have ties to the Village (i.e. lawyers, former lawyers and vendors)
- Reviews of relevant accounting information
- Reviews of relevant documentation to support policies and actions made by the Village Trustees

KMA also obtained risk assessment and other relevant information from the New Mexico State Auditor's Office (NMSAO) in an effort to identify areas of significant concern. We were able to identify and narrow areas of significant concern during our interviews of individuals connected with the Village, which are combined with documentary support, where available, and summarized below.

Concepts of paramount importance in this report relate to the components of Internal Control. *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:

## **1. 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 Village Trustees and Mayor.

## **2. 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.

## **3. 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 achievement of the Village'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.

## **4. 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 Village. 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 shareholders.

## **5. 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 Trustees.

## **II. Executive Summary**

The forensic audit commenced when KMA obtained documentation from the NMSAO and met with various individuals from, or associated with, the Village. The Village's goal was to identify whether there was any wrong doing in the time period identified, in an effort to increase transparency to the Village citizens and the State of New Mexico. KMA's assignment was to interview relevant individuals at the Village, perform forensic audit techniques, and provide the Village with a report identifying the results of our procedures.

## **III. Scope**

The objective of the forensic audit team was as follows:

- Perform a forensic audit for the fiscal years ending June 30, 2012 and 2013.
- Identify and investigate causes of concern that individuals connected to the Village have expressed.
- Identify and investigate causes of concern that have been reported to the NMSAO.

During the audit, KMA addressed five items, which were pervasively brought to our attention as concerns of the Village's Trustees, NMSAO, management and employees. These items included:

## **IV. Identified Concerns**

### **Concern #1 - MVD Deposit**

Fees obtained by the Motor Vehicle Department (MVD) in the normal course of business that should have been deposited but were not. Instead, the money was allegedly held by former Village Clerk, Mr. James Schoonover, in a drawer or safe. The allegations were that Mr. Schoonover planned to use the money for the Village Christmas party if the New Mexico Taxation and Revenue Department (NMTRD) did not recognize that the deposit did not reconcile to the daily sales and thus figure out that money was missing.

*Note: This item did not fall within the scope of the fiscal years we were engaged to audit.*

### **Concern #2 – Payroll Withholding**

The accounting software miscalculated employee withholdings during the fourth quarter of fiscal year 2012. Consequently, withholdings for employees were under withheld for that period. In order to rectify this issue, there had to be an extra payroll withholding by the Village to make up for employee withholdings that had previously been under withheld.

### **Concern #3 – Employee Benefits Request for Proposal**

Allegations that a request for proposal for employee benefits was written specifically for a company out of Albuquerque, NM that employed the son of the former Village Clerk, Mr. Schoonover.

*Note: This item did not fall within the scope of the fiscal years we were engaged to audit.*

### **Concern #4 – Accounting for Rio Grande Natural Gas Association's Sale of Assets**

The Village of Hatch and the City of Las Cruces made up the Joint Venture known as the Rio Grande Natural Gas Association (RGNGA). In November of 2009, Zia Natural Gas Company made an offer to purchase the assets, including the customers, of RGNGA from the Village and the City of Las Cruces. The Village passed a resolution in August, 2010 agreeing to sell their portion of the RGNGA's assets for Nine Million Dollars (\$9,000,000).

The Village intended to create a *Permanent Fund* and an *Income Fund* with the proceeds from the sale of their interest in RGNGA. Proper accounting principles required the Village to hold the money in a fiduciary capacity (agency fund) until the time RGNGA was dissolved and the assets (cash) were distributed pursuant to the dissolution plan. An *agency fund* should have been created to report these amounts until the time they could be disbursed to the Village.

On July 12, 2011, the Village passed Ordinances 367 and 368 in order to create an Income Fund and a Permanent Fund. The effective date of these ordinances was July 17, 2011. Six Million Dollars (\$6,000,000) was deposited into the *Permanent Fund* bank account in January, 2012.

As a result of how these funds were accounted for, the financial statements for the Village were materially misstated, which led to a qualified opinion on its audit for the fiscal year ending June 30, 2012.

## **Concern #5 – Picacho Mountain Investment/Loan/Purchase - Use of Permanent Funds**

With the money described in Concern #4, specifically, the Permanent Fund, the Village ultimately purchased land in Picacho Mountain located in Las Cruces, Dona Ana County, New Mexico. Robert H. Pofahl, through his ownership of Picacho Land Development, LLC (PLD) solicited the Village with an Investment Package dated April 26, 2012, which eventually led to the purchase. The Investment Package offered the Village two options:

- (1) Investment/ (2) Loan Amount: \$2,000,000
  - a. Interest: 6% per annum plus participation interest in project profits
  - b. Term: 10 years
  - c. Security: First Lien on:
    - 21 Finished lots in a gated community
    - 125 Acres of land zoned commercial/residential
    - Original Appraisal \$7.075M (Note: this appraisal was completed on April 23, 2008)

Initially, Mr. Pofahl solicited the Village to make an “investment in PLD”. The other option was for them to make a loan of Two Million Dollars (\$2,000,000) in PLD. The terms of the investment look somewhat like a loan, and is described as follows:

- 6% Interest for 10 years

On May 8, 2012 the Village Trustees passed Resolution No. 825 to approve the investment. However, ultimately on May 29, 2012 the transaction changed from an investment to a purchase. Resolution No. 828 subsequently approved the purchase of the land from PLD. The facts regarding how the Village transitioned from investing the money to purchasing the land are ambiguous.

There were several concerns raised regarding this transaction, they are as follows:

1. The Village used Permanent Funds to fund the purchase. Per New Mexico law, Permanent Funds may only be expended pursuant to voter approval. In this situation, the Village initiated the transaction with a resolution passed by the Village Trustees (Resolution No. 825). Therefore, the Village was in violation of Sections 6-10-10 NMSA 1978, which govern the “investment” of public funds held by a municipality. The primary issue is that New Mexico law does not allow investment in land for resale by municipalities. Essentially, municipalities are not in the business of purchasing and reselling land for profit.
2. The circumstances in which the land was purchased are troublesome. The facts of the situation were essentially that the Village came into money through the sale of their interest in RGNGA, Mr. Pofahl solicited the Village via former Mayor Nordyke and

former Village Clerk/Administrator James Schoonover for an “investment/loan” opportunity, and the “investment/loan” then inexplicably turned into a purchase of land.

3. The Village relied on an appraisal for the land that was completed in 2008 instead of acquiring a more recent, time appropriate appraisal. There is general knowledge that real estate values decreased significantly after 2008. Since there was no request for an updated appraisal for the land prior to completing the purchase, whether the purchase price represented fair market value cannot be verified.
4. It was reported that some citizens were concerned that Mr. Schoonover, the Village Clerk/Administrator at the time of the investment turned purchase, may have been additionally involved with the sale and purchase of the land in his capacity as a broker, which appeared to be a conflict of interest. Mr. Schoonover was a licensed Qualifying Broker in New Mexico and was associated with Garland Realty during the relevant time period. There were suspicions raised that Mr. Schoonover may have brokered the deal between the Village and PLD, and possibly could have taken a commission.

## **V. Procedures to Address Concerns**

Based on the concerns listed above, we performed procedures in order to address each concern.

### **Address Concern #1 - MVD Deposit**

The MVD fees collected, in the amount of Seven Hundred Dollars and Sixty Cents (\$700.60), were supposed to be deposited into the NMTRD MVD bank account. The Village of Hatch Police Department performed an investigation regarding the allegations of misconduct related to the money and deposit, and KMA reviewed the report dated January 23, 2014. KMA notes that the events described in the Police Report occurred in May, 2011, which is prior to the fiscal years of 2012 and 2013, and thus did not occur during the time period in which we were engaged to conduct our audit.

Nevertheless, KMA obtained an understanding of the events as they relate to instances of possible risk of fraud for the years under audit, and weaknesses in internal controls. Our investigation indicates there was an abuse by management of state funds, however it was promptly detected and corrected due to the internal controls within the NMTRD. For further information on this instance please request the Village of Hatch Police Report case number 2014-00023.



### **Address Concern #2 – Payroll Withholding**

**Condition:** Additional amounts for Social Security and Medicare were withheld from employee's paychecks for the pay date of January 24, 2013. This amounted to an additional withholding that averaged \$186 per employee for a total amount of \$3,710 for the Village employees.

**Criteria:** The Village is responsible for withholding amounts for employees pursuant to the Federal Insurance Contributions Act (FICA) also known as Social Security and Medicare. The Village is then responsible for timely remitting those withholdings.

**Cause:** Due to a payroll software error, payroll withholdings for Social Security and Medicare were under withheld from employees' paychecks during the fourth quarter of fiscal year 2012.

**Effect:** Employees initially reaped the benefits of larger paychecks because their Social Security and Medicare was under withheld. When this issue was caught, the employees were then affected when the additional correct amounts were withheld in a single pay period.

**Recommendation:** It is our recommendation that the Village accounting staff and Clerk monitor payroll and withholding amounts in each pay period to verify they are correct. It is further our recommendation that additional withholdings to correct mistakes be withheld over a reasonable period, rather than in a single pay period. Corrections made during one pay period can adversely affect the Village's employees as they could potentially cause employees to be default on their own personal obligations when they do not receive the pay amounts they are accustomed to receiving.

### **Address Concern #3 – Employee Benefits Request for Proposal**

With respect to insurance purchased for seventeen (17) Village employees from Strategic Employees Benefits Services, a division of Northwest Mutual Insurance, we note that the RFP was written in November, 2013, which means it occurred after fiscal year 2012 and 2013, and therefore was not within the time period in which we were engaged to audit. Given the nature of the concern, however, KMA was obligated to obtain an understanding of the events surrounding this transaction, as it could relate to possible risk of fraud for the years under audit and weaknesses in internal controls. We noted that the Sweetser Forensic Accounting's invoices referred to modifications made to the RFP pursuant to requests from Mr. Schoonover, who was the Village Clerk/Administrator at the time the RFP was drafted. It is further understood that Northwestern Mutual successfully won the contract with the Village during a time in which Mr. Schoonover's son, Christopher Schoonover, worked at Northwestern Mutual.

On November 13, 2014, KMA discussed this situation with Jonathan Berg, President of Strategic Employees Benefits Services, and specifically Christopher's role in the proposal process. Mr. Berg indicated that Christopher Schoonover was responsible for winning the contract with the Village. Mr. Berg also stated that a commission was paid, but Christopher received no commission. Jonathan Berg stated that all the commission was paid to himself.

**Address Concern #4 – Accounting for Rio Grande Natural Gas Association’s (RGNGA) Sale of Assets**

**Condition:** The sale of RGNGA’s assets and customers to Zia Natural Gas Company yielded Ten Million Dollars (\$10,000,000) for the Village. However, the Village was not supposed to use the money until RGNGA was dissolved through the New Mexico Secretary of State and the dissolution plan identified what was to be done with the remaining assets. The money should have been held in an *Agency Fund* until that time. Furthermore, some of the money was spent for the benefit of the Village, which violates the Village’s fiduciary responsibility with respect to RGNGA’s cash.

**Criteria:** The Village had custody of the cash on behalf of RGNGA that resulted from the sale of assets and customers. The Village was in a fiduciary capacity as the fiscal agent of RGNGA. The proceeds from the sale should have been held by the Village in an *Agency Fund* as required by Governmental Accounting Standards Board. The purpose of an *Agency Fund* is as follows:

*Agency funds are used to account for the assets held for distribution by the state as an agent for another entity for which the government has custodial responsibility and accounts for the flow of assets. Agency funds are custodial in nature and do not involve measurement of operations and provide the most appropriate mechanism for accounting for assets and liabilities.*

**Cause:** The Village did not have the expertise, nor did it employ a person or entity with the necessary expertise in an effort to identify the type of accounting for this money. The legal advice received regarding this situation was found to be incorrect, and was the cause of the Village’s improper accounting.

**Effect:** Money received by the Village was not accounted for correctly. Furthermore, because of the lack of understanding of the Village’s fiduciary capacity, the Village deposited a portion of the money into a Permanent Fund bank account and a portion of the money into its General Fund. To date, the Village has spent several million dollars out of the General Fund and purchased land with funds originally deposited into the Permanent Fund (See Concern #5).

The Village’s financial statements were materially misstated due to the way it recorded the distribution from RGNGA, which subsequently led to a Qualified Opinion on its audit for the fiscal year ending June 30, 2012.

Currently, the Village has approximately Four Million Dollars (\$4,000,000) remaining of the total amount received from the sale of RGNGA’s assets.

**Recommendation:** It is pertinent to consult with accountants and attorneys who understand the reporting requirements for New Mexico municipalities. We recommend that the Village use consultants who are recognized as having significant experience in the subject matter for any given situation in which the Village needs guidance.

## **Address Concern #5 – Picacho Mountain Investment/Loan/Purchase - Use of Permanent Funds**

**Condition:** The Village purchased land with Permanent Funds pursuant to a resolution passed by Village Trustees. The purchase of the land was intended to be an investment of Permanent Funds. The Village approved the investment via Resolution instead of a vote of the citizens as required by law.

**Criteria:** Section 6-10-10 NMSA 1978 governs the “investment” of public funds held by a municipality. Land for resale is not an option available to a municipality for investment of public funds.

Section 6-6-19 (B) NMSA 1978 indicates that “Money in the Permanent Fund may be appropriated or expended only pursuant to approval of the voters of the county or municipality”

**Cause:** Due to the lack of knowledge within the Village and/or counsel employed by the Village, the Village initiated Permanent Fund expenditures that were not in the scope of expenditures that are allowed by New Mexico law, except with voter approval.

Furthermore, there is evidence that the *control environment* of the Village during this time period was conducive to questionable decisions. Given all the concerns listed above, it is clear that the tone at the top allowed for the Village to initiate transactions that ultimately would be questioned by the citizens within the Village, as well as the Department of Finance and Administration. It is important to note, however, that the personnel directly involved in the questionable decision making are no longer associated with the Village.

**Effect:** Village Trustees were misled by inaccurate legal advice as well as statements and facts regarding the circumstances made by management, including former Mayor Judd Nordyke and Former Village Clerk/ Administrator Jim Schoonover.

KMA did not find any evidence that supported the concern that Mr. Schoonover brokered the deal between the Village and PLD, nor was there evidence that Mr. Schoonover received a commission.

**Recommendation:** We recommend the Village continue to pursue and adhere to strict internal controls. The most crucial component of internal control is *control environment*. We recommend that the Village strive to strengthen the *tone at the top*, which will involve ensuring that all Village Trustees, the Mayor, and Village management create an environment in which laws, regulations and policies are strictly adhered to. The Village must focus its efforts on ensuring complete transparency with Village operations and avoiding the appearance of conflicts of interest.

## VI. Other Procedures Performed

As a part of our audit procedures, we have subjected data from the Village's accounting system to various alternative procedures in an effort to uncover potentially fraudulent activity. Below is a discussion of the procedures performed and the results of those procedures:

**Procedure #1:** KMA obtained the following data from the Village's accounting system for the fiscal years ending 2012 and 2013:

- A database of all vendors including addresses
- A database of all employees including addresses

We subjected this data to analysis by which we compared addresses of employees to addresses of vendors to determine if any matched. For the fiscal year ending 2013 and 2012, we identified twenty-nine (29) and forty-four (44) transactions with vendors that had the same address as an employee of the Village, respectively. We then scanned the expenditures made to the same household for reasonableness. We identified four transactions during fiscal year 2013 and eight transactions for fiscal year 2012 requiring further investigation. We requested backup documentation and reviewed the backup documentation to analyze whether the expenditures were appropriate.

**Result #1:** Based on our testwork, the expenditures tested had supporting documentation and appeared reasonable.

**Procedure #2:** Based on items brought up in Concern #3 above, we reviewed the New Mexico Secretary of State's database of all corporations and limited liability companies that are registered to, or have officers with the last name "Schoonover". Our objective was to potentially identify any companies Mr. Schoonover, or his family, had a link to that also conducted business with the Village. We performed the following procedures with the nine (9) companies identified that either had a director or officer with the last name Schoonover.

- Provided the list to Elizabeth Porras, deputy clerk of the Village, to review and identify any of the companies that may have been vendors of the Village.
- Compared the companies identified to the Village's vendors during fiscal year 2012 and 2013.

**Result #2:** Based on our testwork, we noted that these companies identified in Procedure #2 had no transactions with the Village during fiscal year 2012 or 2013. We recognize, however, that the search of companies associated with the name "Schoonover" might not result in a complete disclosure of any and all companies associated with Mr. Schoonover or his family members, but that such disclosure would be almost impossible to create.

**Procedure #3:** Due to a possible concern regarding lack of transparency covering financial information in *Law Enforcement Protection Fund*, and due to turnover of the police chief position during the fiscal years under audit, we performed procedures outside of the scope we were originally engaged to audit. KMA obtained the general ledger detail for the *Law Enforcement Protection Fund* for the dates of January 1, 2014 through November 12, 2014. We then sat with the Village's Police Chief and asked him to review all expenditures incurred in the fund during his tenure with the Village. All questioned costs highlighted by the Village's Police Chief were investigated.

**Result #3:** All costs originally questioned or noted by the Village's Police Chief were investigated and no instances of misuse of funds were found. This review adequately addressed the risk that expenditures for other funds were being charged incorrectly to the *Law Enforcement Protection Fund*.

**Procedure #4:** KMA reviewed the entire check register for all transactions that occurred on Saturdays and Sundays during the fiscal years 2012 and 2013. The objective of this procedure was to identify any unusual activity in the accounting records. In many instances when fraud is occurring, in an effort to conceal the fraud, perpetrators will often go in to the work place on the weekends to process fraudulent or improper transactions.

**Result #4:** KMA noted no unusual or unreasonable activity based on this procedure performed.

**Procedure #5:** KMA compared the check register to the approved vendor listing for the fiscal years 2012 and 2013. We identified the following transactions that deviated from our expectations:

- 2012 - Four transactions
- 2013 - Eight transactions

**Result #5:** Upon further investigation, we found these transactions to be within the normal course of business for the Village. There was no evidence indicating otherwise.

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## VII. Conclusion

Based on all audit work performed, KMA concludes that during the period under audit, there was a *control environment* which allowed for the concerns listed above. It appeared that some of the consultants procured by the Village did not have the necessary expertise to properly counsel the Village. This resulted in, among other issues, a material misstatement on the financial statements for the year ended June 30, 2012. KMA does note that, of importance, the *control environment* and the individuals that were in management and other top positions within the Village during the time period in review has completely changed since the events that are described herein took place. KMA further notes that the Village has employed KMA moving forward to assist with drafting and implementation of internal controls suggested, including policies and procedures and training of employees. Finally, KMA concludes that the Village is headed in the proper direction, or soon will be, as a result of its interest in hiring KMA to identify and address concerns such as those detailed above.

Very truly yours,

*Kubiak Melton & Associates, LLC*

Kubiak Melton & Associates, LLC  
Albuquerque, New Mexico  
March 25, 2015