



GLENN A. CUNHA
INSPECTOR GENERAL

The Commonwealth of Massachusetts
Office of the Inspector General

JOHN W. McCORMACK
STATE OFFICE BUILDING
ONE ASHBURTON PLACE
ROOM 1311
BOSTON, MA 02108
TEL: (617) 727-9140
FAX: (617) 723-2334

January 7, 2019

Jadeane Sica, President
Malden City Council
110 Pleasant Street, 3rd floor
Malden, MA 02148

**Re: Internal Control Review following Larceny and Embezzlement in Permits,
Inspections, and Planning Services Department**

Dear Ms. Sica:

The City of Malden (“the City”) requested that the Office of the Inspector General (“OIG”) review the conditions that led to the arrest and indictment of a former employee of the City’s Permits, Inspections, and Planning Services (“PIPS”) Department. On November 1, 2018, the former PIPS employee admitted to sufficient facts pursuant to charges of larceny over \$250, uttering, forgery, and embezzlement before the Middlesex Superior Court. The PIPS employee agreed to pay restitution, received two years of probation, and had his case continued without a finding for two years. A case against another defendant who allegedly assisted the former employee is ongoing.

In response to the City’s request, the OIG reviewed and evaluated the PIPS payment intake process. The OIG found that outside parties, such the Department of Revenue (“DOR”) and external auditors, have repeatedly informed city officials that weak financial controls made it vulnerable to embezzlement and other fraud; and, that the City has failed to address these deficiencies by implementing documented, sustainable, cross-departmental controls.

Background

In November 2014, the Malden Police Department (“MPD”) investigated an allegation that a check given to the City as payment for a permit fee had been altered and cashed. The MPD confirmed the check tampering and that the City had not received the proceeds of the check. The MPD’s investigation identified a PIPS employee as the suspect.

The OIG's review focused on the PIPS payment intake process and internal controls at the time of the embezzlement. The OIG also examined policy revisions PIPS adopted after the theft was identified. Lastly, the OIG followed up with the City in July 2018 after the City appointed a new PIPS director and a new Treasurer.

Findings

1. Control and oversight deficiencies enabled the embezzlement from PIPS.

In 2014, PIPS both collected payment for and issued various permits. PIPS did not have an adequate system for logging payments when they came into the department. Instead, PIPS employees recorded payments on the Form 910, the City's paper revenue transmittal form, only when they transferred funds to the Treasury. The City also made no attempt to reconcile permits issued with payments made to the Treasury. The lack of reconciliation allowed the PIPS employee to issue permits without remitting the accompanying payment.

The PIPS department maintained inadequate security for checks and cash. Staff left checks and cash unsecured: unattended on desks or in unlocked drawers. The MPD recovered more than 70 non-negotiated checks issued to the "City of Malden" at the home of the PIPS employee who recently admitted to sufficient facts. Since there was no requirement to log checks when they came into PIPS, managers were unaware of the missing funds.

The department lacked adequate segregation of duties, an essential internal control for any agency that collects funds. Each PIPS clerk had the ability to accept applications, collect payment, maintain custody of the payments, and log the payments into the software system that allowed inspectors to approve and issue permits.

The PIPS office had a closed-circuit security camera; however, at the time of the theft, the camera was disconnected from its power source. The City had no archival footage so no one could determine how long the camera had been offline.

In summary, the internal control environment for handling checks and cash was extremely weak, lacking some basic controls including: segregation of duties, regular reconciliations, safeguarding assets, employee accountability and monitoring.

2. The City reacted to the embezzlement by implementing some improved financial policies and procedures as well as certain basic financial controls. However, the City failed to formalize those improved financial policies and basic internal controls. When the OIG conducted follow-up in 2018 to reassess the PIPS operations following management turnover, some of the improved procedures and controls were no longer in effect.

After discovering the theft in 2014, the City made changes in PIPS to improve oversight of the payment intake process. The most significant change was that PIPS stopped accepting

permit payments with the exception of those that came in the mail. Individuals seeking to pay for permits at city hall were directed to the Treasurer's department. The Treasurer, then, provided the individual with a receipt to be presented to PIPS for a permit.

In 2016, the PIPS department developed a policy for payment reconciliation. The Treasurer sent a revenue report to PIPS which was matched with the electronic permit records. The process enabled the timely detection of discrepancies between the number of permits issued and the payments transmitted to the Treasurer.

The IT Department upgraded the computer software used for issuing permits. The IT Department also upgraded the cameras and began monitoring the system to ensure its continuous functionality. Also, around the time that the City discovered the embezzlement, the Controller began creating a *Financial Policies and Procedures Manual* to create uniform controls.

In 2018, when the OIG reassessed the PIPS controls following management turnover, separation of duties and other basic controls within PIPS were still in place. In addition, PIPS permit fees are now remitted through the City's online payment system. However, the new Treasurer was unaware of the embezzlement and his department no longer had a role in assisting PIPS with reconciling payments with the permits issued. Unfortunately, the Controller also reported that the manual was still not complete.

This lack of documented policies and procedures exposes the City to unnecessary internal control vulnerabilities.

- 3. A number of the deficiencies that enabled the theft from PIPS had already been identified in 2009 by the City's outside auditor who recommended that the City hire a Chief Financial Officer ("CFO") to oversee its entire financial operation. While the City has authorized incorporating a CFO-like oversight role into either its Treasurer or Controller or Assessor positions, it has repeatedly failed to fund the additional responsibilities or assign them to a particular employee.**

The City has suffered financially for many years due to weak internal controls that make it vulnerable to fraud and waste. In 2009, Malden's outside auditor recommended the City hire a CFO to exercise broad oversight of its financial operations. In 2011, following the embezzlement of more than \$500,000 from the Treasury department, the City requested a financial review by the DOR. DOR identified more than 30 financial management weaknesses and recommended appointing a CFO who would be responsible for creating a strong internal control environment across all departments and financial functions in the City.

At numerous meetings since 2010, both the Finance Committee and the City Council discussed the CFO position at length. In 2012, the City Council revised the city charter to include CFO responsibilities into existing positions such as the Controller, Treasurer, and Assessor.¹

¹ http://www.cityofmalden.org/sites/default/files/code2016chap_1-12.pdf

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However, the City has failed to fund the additional responsibilities or assign them to one of the incumbents. Nevertheless, a CFO should be appointed.

Recommendations

PIPS conducted its financial operations with an isolated approach and narrowly focused controls in 2016. Going forward, the City should hire a CFO charged with overseeing financial operations across all government departments. A CFO should be involved in the City's day-to-day processes and be able to effectively utilize an integrated approach to oversee the City's financial system and establish internal controls that deliver accountability and adequate fiscal oversight.

To add much needed accountability and leadership in the City's financial management, the CFO's role should be separate from other operation functions. The duties of a CFO are too important to have CFO-related functions incorporated into the existing positions of Treasurer, Controller or Assessor. An experienced CFO with a proven, successful track record in fiscal management would be able to effectively establish accounting standards and strengthen overall internal controls.

In the meantime, the Controller should finalize the *Financial Policies and Procedures Manual* before the end of the fiscal year. It should be distributed and implemented by all the City departments. Meaningful, well-written policies and procedures based on a full risk assessment will not only ensure departmental compliance with best practices, they will also enable early detection of financial misconduct. Employees should sign a receipt and acknowledgment form and receive training in critical areas. The City should also consider creating an internal controls working group to review and discuss risks inherent in the financial operations of the City. This group should also periodically review the *Financial Policies and Procedures Manual* and revise it as needed.

Thank you for your attention to this matter. If the City needs any assistance in pursuing these recommendations, fraud prevention programs, or other control measures, please do not hesitate to call me at 617-722-8853.

Sincerely,



George Xenakis

Director

Audit, Oversight and Investigations

cc: The Honorable Gary Christenson, Mayor
Kathryn M. Fallon, City Solicitor