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CITY OF CAMBRIDGE
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EXECUTIVE DEPARTMENT
ROBERT W. HEALY
City Manager

RICHARD C. ROSSI
Deputy City Manager

September 16, 1996

To The Honorable, The City Council:

With reference to Awaiting Report Item No. 14, regarding a report on certain financial improprieties, please find attached a response from City Auditor James A. Lindstrom.

Very truly yours,

Robert W. Healy
City Manager

RWH/mec
attachment

CITY OF CAMBRIDGE

CITY HALL, CAMBRIDGE, MASSACHUSETTS 02139 . TEL. 349 - 4240

James A. Lindstrom

City Auditor

96 SEP -5 AM 11:34

RECEIVED

OFFICE OF THE CITY MANAGER

TO: Robert W. Healy
City Manager

FROM: James A. Lindstrom
City Auditor

RE: Council Order #098, dated 7/29/96
Report on Certain Financial Improprieties

DATE: September 5, 1996

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The City Council, through you, has asked for a report on the recent charges against Systems Accountant Charles Reale of the Auditor's Office regarding the theft of City funds. Since that report was requested, Mr. Reale has pleaded guilty to twenty-four counts (eight each) of Larceny over $250, Forgery, and Uttering. The total amount involved is $17,708.90. Mr. Reale was sentenced on one count each of larceny, forgery, and uttering to two years probation, fined $5000, must perform 500 hours of community service, and make full restitution of the $17,708.90 involved. The remaining charges have been placed on file pending satisfactory completion of the sentence. The District Attorney's office has credited the City's records and the cooperation of City personnel for the speed with which this case was brought to conclusion. The Council has asked for an explanation of how this happened and what steps have or will be taken to prevent their recurrence.

How did this happen?

The Auditor's Office receives checks that relate to the expenditure or "outflow" part of the City's operations. All checks regarding revenues or "inflow", by far the bulk of money received by the City, are processed in the Treasurer's Office and do not flow through our Office. Checks are received by the Auditor's Office for a number of reasons:

the vendor may not be able to determine what the check is for the check may have been mailed to an incorrect address

the check may have been for an incorrect amount

the sender may be reimbursing the City for all or a portion of the expenses involved

We receive these checks directly through the mail or via another department. Checks not involving a change in the payment history of a vendor are processed immediately. Those affecting the payment history of a vendor are retained in the office and processed on a Refund Warrant, generally on a monthly basis due to the small number and/or amount of money involved. Until the checks have been processed, there has been no formal record of their existence in the City's financial system.

What Mr. Reale apparently did was to intercept checks when they were received in our office. They were endorsed by him and deposited in his personal checking account; the mailing address of that account was in his name to City Hall. The bank noticed that some of these checks were made payable to the City of Cambridge and notified City officials, who then notified the appropriate law enforcement agencies. Their investigation involved a review of Mr. Reale's accounts covering at least a year. With a couple of minor exceptions, the violations occurred during the period from May 22 to their detection by the bank June 18, a total of 27 days.

Internal detection could have occurred in two ways. The department submitting the checks would notice that they had not received the credits they had anticipated, or there would be some imbalance in the accounting system. That imbalance would be reflected in a cash difference between what the City's financial system showed and its actual cash position via the bank statements, or an imbalance in a set of accounts that ought to be equal. Given that the bulk of activity occurred in June, these differences would not have shown up until the end of the month. The bank detected these violations before June came to a close.

How can this be prevented in the future?

Following the discovery, we reviewed step-by-step our internal processing of these checks and developed a set of procedures that were put into place July 8. Those procedures call for a formal recording in the Office when a check is received, a written acknowledgment to the department that it has been received, and a guarantee that any check received by the our Office would be processed by the close of the month. When a check has been processed, a formal notification is given to the department. Checks are physically secured in a locked container with limited access. Reconciliations between the amounts we should have received via the formal recording and the total of the checks physically in the secured container are performed by separate individuals. As a result, the Department has a system in place internally to detect a potential loss and has strengthened the outside oversight through guaranteeing to the Department that their checks would be processed by a certain date. Variances in the City's financial system are being investigated monthly.

Our auditors, KPMG Peat Marwick, have reviewed these procedures and have indicated that while they are a good first step, the City should develop a set of procedures to identify the causes for, and therefore reduce the risk from, these checks being returned in the first place. The procedures should also strive to eliminate the receipt and handling of these checks by any department other than the Treasurer's Office. We will be working with them, the Treasurer's Office and other City Departments to accomplish these objectives.

It is obviously disappointing, to say the least, that this incident involved an employee of long service and high position in the Auditor's Office, with whom we had invested a great deal of trust. It demonstrates the risks involved in human trust and the importance of having an independent system of checks and balances in place, including separate oversight of its functioning. As this case demonstrates, however, no system can fully prevent a criminal action from occurring, especially if the perpetrator has an intimate knowledge of how it functions. Nevertheless, the improvements we have put into place should reduce the liklihood of recurrence and improve our ability to detect such incidents in the future.

Consent Agenda #9 5-456

Relative to Awaiting Report Item Number Fourteen, regarding a report on the certain financial improprieties.

In City Council September 16, 1996

PLACED ON FILE