
JEMEZ MOUNTAINS ELECTRIC COOPERATIVE, INC.

INTERNAL CONTROL PROCESS CONSULTATION REPORT
August 18, 2022



Dawson Forensic Group

Lubbock, Texas

JEMEZ MOUNTAINS ELECTRIC COOPERATIVE, INC.

Internal Control Process Consultation Report
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INTERNAL CONTROL PROCESS CONSULTATION Executive Summary

OVERVIEW

This engagement is designed to apply to Jemez Mountains Electric Cooperative, Inc. ("JMEC", the "Cooperative"), headquartered at the Española office located in Hernandez, New Mexico. JMEC is a member-owned electric cooperative that provides power services to its designated service area.

JMEC has offices in the New Mexico cities of Española, Jemez Springs, and Cuba.

Scope: Forensic Investigation

This engagement was based on the desire of the Board of Trustees and Audit Committee to perform a forensic investigation of certain areas of concern predicated upon past and current history and knowledge of Cooperative operations. Additionally, the Audit Committee sought and included input from the membership regarding concerns that may need to be investigated or reviewed.

Before a forensic investigation can begin, there must be predication (probable cause) to conduct the investigation. This predication is exhibited by the existence of information or documentation that at least indicates that a fraud may have been committed. In the absence of that type of information or documentation, we cannot legally perform a forensic investigation.

Often, a forensic investigation results in the identification of a presentable case of fraud to a trier of fact for the rendering of a verdict. *Internal Fraud* can be defined as fraud (misappropriation, theft, embezzlement, corruption, financial misstatement) that is perpetrated against an organization by its own people either individually or in collusion with others, including other outside parties such as suppliers/vendors. Accordingly, the focus is not related to any form of external attack such as cyber-security attacks or other types of theft solely perpetrated by actors external to the organization.

Scope: Internal Control Process Analysis

As the scope of the forensic investigation issues was being developed, it became apparent that there were several areas of concern that should be investigated, but that did not exhibit the necessary predication to legally investigate. As such, it was determined that these areas would be subjected to an internal control process analysis. In this type of engagement, the internal controls over the financial transaction processing and reporting areas are reviewed for effectiveness and efficiency. We then develop recommendations for controls and processes that we believe serve to strengthen the overall soundness of the financial transaction and reporting processes.

If, during the course of this analysis, issues of predication are identified, we would then be able to perform a forensic investigation into these issues.

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As such, this Report presents the results of the internal control process consultation. The results of the forensic investigation are presented in a separate forensic investigation report.

This engagement was performed in accordance with Statement on Standards for Forensic Services No. 1 issued by the American Institute of Certified Public Accountants, the Code of Ethics of the Association of Certified Fraud Examiners, and in accordance with lawful forensic techniques which include, but are not limited to, examination of books and records; voluntary interviews of appropriate personnel; and other such evidence-gathering procedures as considered necessary under the circumstances.

In performing this engagement, we represent that we have no prior personal or business relationships with employees, members of the Board of Trustees, members of the Audit Committee, Mr. Michael Hastings, or members of the Cooperative.

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INTERNAL CONTROL PROCESS CONSULTATION Executive Summary

SCOPE AND OBJECTIVES

Ultimately, the Scope of the forensic services was defined as follows:

Internal Control / Process Analysis - Scope	
1	New Building Construction Process and Accounting
2	Capital Credit Allocations / Retirements / Overall Accounting
3	Credit Card Usage and Accounting Process
4	Policy / Bylaw Review
Forensic Investigation - Scope	
1	Solar Projects: Cuba and Alcalde
2	Former Executives - Process for Separation from Service Payments

Internal Control Process Analysis: Goals

The overall goals are to assess/advise on current fraud-related policies, and then focus on the internal controls within specific areas of transaction processing. We seek to ensure that any "holes" in the current system are exposed and addressed.

Internal Controls Process Analysis: Objectives

The objectives of this engagement include:

- Recommendation of revisions to, or the adoption of policies that address internal fraud, including at a minimum:
 - Code of Ethics
 - Fraud Policy / Fraud Reporting Policy (Combined)
 - Removal of Employees' Presumption of Privacy Policy Provisions
 - Anti-Bribery / Anti-Corruption Policy
- Review of relevant accounting and financial reporting processes in place to gain an understanding of the status of transactional performance, recording, and reporting,

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SCOPE AND OBJECTIVES

- Development of related recommendations of new performance processes that include internal controls considered necessary to enhance performance, recording, and reporting of financial transactions,
- Assistance with the implementation of any new internal control processes selected,
- Instruction to staff regarding the initial monitoring for effectiveness and efficiency of the new internal control / anti-fraud program structure – for the purpose of determining if any modifications need to be made to the newly implemented internal controls.

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ELEMENTS OF EFFECTIVE INTERNAL CONTROL / ANTI-FRAUD PROGRAM DESIGN

A standard internal control process analysis includes an analysis of all six design elements of an internal control / anti-fraud program as follows:

- Anti-Fraud Environment
- Fraud Risk Assessment
- Control Activities
- Documentation of Internal Controls / Anti-Fraud Program
- Communication: Anti-Fraud Program / Fraud-Awareness Training
- Monitoring and Routine Maintenance

These elements are further described as follows:

Anti-Fraud Environment

The control environment speaks to issues of the “tone at the top”. Specifically, what is the attitude of those in control (Board of Trustees and Senior Management) regarding the importance of internal controls and the prevention of fraud? If the leadership is not concerned with the design and development of sound internal controls, then no one else will be. The control environment is evidenced by certain policies that serve as the foundation for the internal control structure / anti-fraud program. These foundational policies include an ethics policy, a fraud / fraud reporting policy, and policies that address the removal of employees’ presumptions of privacy. Recommendations in this area focus on new policy adoptions or existing policy revisions that lead to establishing a foundation for a proper anti-fraud environment.

Fraud Risk Assessment

Fraud risk assessment speaks to the issue of a constant awareness and analysis of fraud risk that may be present within Cooperative operations. Leadership should be in a constant mode of analyzing the risks associated with the performance, recording, and reporting of financial transactions. Thus, the fraud risk assessment process, as its name implies, identifies those areas of financial transaction processing and reporting with the greatest risks of fraud.

Control Activities

Control activities represent those processes and checks and balances that are implemented to address the risks of fraud identified in the fraud risk assessment. This type of engagement serves to supplement existing processes as a general rule, and to provide recommendations on new processes as needed.

Program Documentation

This element addresses how the internal control structure / anti-fraud program is documented. The program in place should be committed to written form for constant reference purposes. This also serves to provide ease of transition into different job responsibilities for employees, whether from transfers within the Cooperative or from the hiring of new employees. This insures that, over time, the performance of processes and the reasons for these processes are not lost. In the absence of written documentation, the purposes and objectives of certain processes can become diluted and somewhat invisible as the Cooperative experiences turnover.

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ELEMENTS OF EFFECTIVE INTERNAL CONTROL / ANTI-FRAUD PROGRAM DESIGN

Communication: Anti-Fraud / Fraud-Awareness Training

This element includes how and when policies and internal controls are communicated to the workforce. A properly designed program is worth nothing if it is only a paper document that has not been properly communicated. Thus, the communication element is the overall Cooperative-wide anti-fraud program / fraud awareness training program.

Monitoring / Routine Maintenance

The final element of a properly functioning anti-fraud program is Monitoring. If the operation of the program is not monitored for compliance, there is no measurement by which the effectiveness of the design or operation of the program can be made. The Monitoring element also serves as the basis for the identification of any program changes that may be necessary as the nature of operations change.

These elements have been considered in the analysis of the various areas reviewed and serve as the basis for any recommendations presented in the Report.

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METHOD OF PRESENTATION

Based on the Scope and stated Objectives, this Report is presented in a format that recognizes these Objectives, along with references to the six elements of an effective Anti-Fraud Program, as may apply.

Guiding Principles of Internal Control Design

The recommendations presented in this Report have been developed using several guiding principles of internal control design as follows:

Principle #1

“Always design the internal control around the position, never around the person in that position”.

The person serving in a particular position may be the most trustworthy person in the Cooperative. However, there is no real guarantee that the person will be in that position the next day. If the person in a position changes, and the internal controls were designed around that previous trustworthy person; and if the new person in that position is not trustworthy, he/she may be getting ready to reap the benefits of that position’s weak internal controls.

In developing our recommendations, we must be guided by this principle to remove any bias towards our personal positive or negative assessments about a person. As such, our recommendations are formulated regardless of “who” is serving in a particular position.

Principle #2

“The perception of detection is the strongest internal control that can ever be implemented”.

Many of the recommendations in this Report are sourced in increasing this perception. Updated policies, along with training on these policies serves to raise the overall level of fraud awareness. Additionally, periodic Cooperative-wide training that focuses on “what fraud is” can substantially raise the perception of detection since the workforce knows that Cooperative leadership takes seriously the risk of internal fraud.

Prevention Controls versus Detection Controls

Internal control recommendations included in this Report can be categorized as either Prevention controls or Detection controls. Prevention controls serve to reduce the probability that fraud will occur, while Detection controls presume that the fraud is going to occur but will be detected quickly by the detection control.

In some financial transaction processing areas, there simply are not enough employees to provide an adequate segregation of duties which is necessary for a sound internal control structure. As such, no certain prevention control will help. Thus, the detection control is designed to quickly detect those fraud transactions that cannot be prevented.

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NEW BUILDING CONSTRUCTION PROCESS AND ACCOUNTING

Section A

Procedures Performed

We obtained the documentation associated with the construction of the new headquarters location. This documentation included contracts, invoices, tracking schedules, and all related information regarding this project.

We interviewed Karen Wisdom ("Wisdom"), Senior Manager of Contract Administration and Compliance as she was the lead Cooperative employee associated with this project.

Background

At the end of 2016, the request for proposals for the design architect were issued. At that time, the project was earmarked for \$7 million dollars.

Those that bid provided their bids based on what could be done for \$7 million dollars.

Through a proper bid awarding process, the bids were scored and the top two were presented to the building committee, which then presented to the Board of Trustees. Fanning, Bard & Tatum (FBT Architects, "FBT") was selected for the project. FBT was the lowest bidder for the project.

This project was not subject to Rural Utilities Service ("RUS") requirements since no RUS loans funds were to be used for the construction project.

Subsequent to this process, it was determined that the project would not be able to be completed at the \$7 million level due to existing construction industry costs. Ultimately, it was approved to be adjusted to a \$10 million project, more specifically \$10,299,009.38. This is considered a contract adjustment to the original contract rather than what is typically referred to as a change order.

In 2018, through a proper bid process, Bradbury Stamm Construction Company ("Bradbury Stamm") was selected as the general construction contractor. Bradbury Stamm was the lowest bidder of the three bids received.

Control Processes / Diligence Processes

The process was established whereby Bradbury Stamm would submit the periodic pay applications to FBT Architects to review the accuracy of the billing based on their review of the construction process that they monitored throughout the process.

The Cooperative would not pay these billings until approved as proper by FBT Architects.

Wisdom met with FBT Architects and Bradbury Stamm every Tuesday during the construction process to review progress and to ensure that the Cooperative received credit for items that were different from the original construction plans.

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NEW BUILDING CONSTRUCTION PROCESS AND ACCOUNTING

Section A

Additionally, Wisdom reviewed all change orders and submitted to the Board of Trustees for approval.

Back in 2014 when Wisdom first took her current position, she established a logbook for governing body and management officials to be able to come in and review contracts, contract amendments, change orders, etc., without the risk of those contracts being unofficially released. This diligence process continues to the present time.

Project Status

As of the dates of our on-location fieldwork,

- the construction process is substantially complete but is open for issues associated with resolution on what may be done with the old headquarters building,
- A net total of \$767,490.82 has been added to the contract through change orders to arrive at the current contract sum of \$11,066,500.20,
- A total of \$10,612,650.86 had been paid against the construction contract,
- Thus, the balance to complete construction, per the contract, amounted to \$453,849.34.
- This completion amount may be subject to change based on the decision as to the future use of, or ultimate destruction of the old headquarters building.

Additional Procedures Performed

In addition to validating disbursements related to the construction and architectural contracts, we reviewed the nature and need of the amounts included as change orders and change orders credits to the construction contract.

This analysis reflects various smaller dollar amounts for items considered typical to these types of contracts such as, access control for gates, valve replacements, track lighting, etc. However, it was noted that two of the major change orders dealt with the information technology ("IT") system for the new building such as the necessary access for a communications and data connection installation, and for IT network switches. These two change orders accounted for a total of \$468,330.18 of the total of all change orders.

Other Issues

We also received information regarding allegations that the Cooperative spent \$1 million on a new board room table and over \$30,000 on the bronze dedication plaque installed in the new building's entryway foyer.

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NEW BUILDING CONSTRUCTION PROCESS AND ACCOUNTING

Section A

To address these issues, we physically inspected the board room table in the new board room and noted that this is the old board table from the old headquarters building. We then reviewed disbursements for furniture and equipment for the new building noting that no board table was purchased for the new building's board room.

Regarding the bronze plaque, we obtained the invoices and payments for the casting and installation of the plaque. In total, the Cooperative paid \$12,500.

Conclusions

Typical construction contracts of this nature include the following processes:

- Concept / Idea
- Request for Proposals – Architects
- Bid Analysis
- Bid Award
- Request for Proposals – Construction General Contractor
- Bid Analysis
- Bid Award
- Review and Approval of Invoices
- Review and Approval of Disbursements
- Review and Approval of Change Orders
- Project Tracking

In each of the processes, the parties performed these functions in an exemplary manner. In fact, regarding these types of projects, the processes and documentation in support of the processes are considered to be some of the best we have encountered.

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INTERNAL CONTROL PROCESS CONSULTATION Executive Summary

CAPITAL CREDITS ACCOUNTING AND PROCESSING

Section B

Synopsis

The allocation, retirement, accounting for, and quality of subsidiary records related to members' capital credits is paramount to the successful operation as a cooperative and the maintaining of value of membership to its members.

There have been several general ledger accounting issues in the past that have been rectified through the work of Johnny Valerio, Carmen Campbell, Geraldine Romero, and Karen Wisdom over the past several years.

The reconciliation of these general ledger accounts has involved these individuals as well as outside consultants.

These accounts affect several different accounting areas such as members' equity, amounts payable to the Foundation, and bank accounts.

Current Status

At this time, the most recent allocation of capital credits was for the 2018 year. The most recent capital credit retirement occurred in 2017.

Recommendations

Efforts should continue to prioritize the finalization of allocated capital credit subsidiary records.

Additionally, the Cooperative should adopt a goal of capital credit retirements in a pattern that will bring retirement status to a 25 to 30 year rotation.

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CREDIT CARD USAGE AND ACCOUNTING PROCESS

Section C

Typically, this area in organizations is subject to the most fraud and/or abuse. We review the process of accounting for credit card use and the processes associated with obtaining support for credit card charges.

Background

Currently, there are six credit cards in use through the Wells Fargo platform; two with \$10,000 limits and four with \$5,000 limits. For travel purposes, the Cooperative utilizes per diems for meals and incidentals and does not provide cash travel advances.

In the event an employee uses their personal vehicle for business travel, they are reimbursed at the then existing IRS standard mileage rate.

As part of the month-end closing process, Geraldine Romero (Acting Chief Financial Officer), accesses the online Wells Fargo credit card activity screens and screenshots the charges. She sends these screenshots to the users and requests that all receipts be provided for all charges.

She creates a reconciliation spreadsheet that includes these charges and uses this to track when the supporting documentation (receipts) are received.

Geraldine follows up with the users to determine if there is any missing documentation.

The charges are then coded to the appropriate general ledger account.

This process is rotated periodically with Erlinda in accounting.

Once the bill payment is due, the payment on the cards is auto-drafted by Wells Fargo.

Procedures Performed

We obtained these spreadsheets that reflect this process for various months between February of 2021 through March of 2022.

We analyzed for adherence to the process noted in the background section.

We reviewed the receipts provided for charges included on the spreadsheet.

Results of Procedures Performed

We noted very few instances where the receipts had not been obtained prior to the auto-draft by Wells Fargo. This level of occurrence represents good adherence to the process. Regardless, it takes cooperation from all levels of the workforce, not just accounting, to ensure that all receipts are obtained in support of all credit card charges.

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CREDIT CARD USAGE AND ACCOUNTING PROCESS

Section C

The process is considered to be well-designed, well-followed, and documented appropriately. Additionally, the rotation of this function lends to the overall strength of this process.

Recommendations

The importance of retaining receipts for all credit card usage should be recommunicated to the workforce.

Accounting staff strives for perfection in tracking these receipts. However, this can only be attained by cooperation from anyone and everyone that uses a credit card.

Particularly for business meals, the date, time, purpose, and attendees at these meals should be noted on the receipt. Additionally, it was noted that tips for meals varied from large dollar amounts to none.

As such, the Cooperative should adopt a tip guideline to ensure consistency.

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INTERNAL CONTROL PROCESS CONSULTATION Executive Summary

POLICIES / BYLAWS REVIEW

Section D

Synopsis

As stated in the Overview, the contracting for an internal control process consultation such as this is indicative of the importance that the Board of Trustees, Audit Committee, and Management place on internal controls designed to safeguard assets. Because the Environment is a representation of the "tone-at-the-top", this fact alone provides a certain strength in the Cooperative's anti-fraud environment.

We reviewed existing board policies, employee policies, and Bylaws for purposes of determining additions and/or modifications which could serve to strengthen the overall anti-fraud / internal control foundation for the Cooperative.

In reviewing these items, our focus was centered on certain anti-fraud provisions that we believe to be of utmost importance.

General Comments

Regarding the Bylaws, we offer no recommendations since the content is a matter of the joint desires of the membership, the Board of Trustees, senior management, and external legal counsel. Any comments made regarding this area are made in the context of anti-fraud / internal control related items.

Currently, the existing policies include many of the provisions we look for in analyzing and assessing anti-fraud policies. The policies indicate that they have been amended periodically and may need to be consolidated in several areas as a refinement of the overall policy structure.

Additionally, within Board policies, employee policies, and the Bylaws, there are various areas that address conflicts of interest. Our comments regarding the content of these policies basically takes the position that they are adequate in design and should be diligently followed.

Recommendation

As relates to conflicts of interest, all efforts should be made to adhere to the content of policies that address these areas. For employees, full disclosure should be made of any conflicts that may exist regarding financial interests with those the Cooperative may conduct business. Additionally, for the Board of Trustees, care should be taken to recuse themselves from voting on a matter that involves a real or perceived conflict of interest.

We recommend that a Conflict of Interest Form as referenced in Section E; a sample attached to this Report as **Exhibit E3**, be completed at least annually by all employees and Board of Trustee members to enhance and encourage full disclosure which results in all parties being perceived as operating beyond reproach in conducting the business of the Cooperative.

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POLICIES / BYLAWS REVIEW

Section D

Board / Employee Policies

A sound anti-fraud program environment includes a foundation made up of policies that address the overall atmosphere of the leadership in communicating the position that fraud will not be tolerated. The strength of the anti-fraud environment is evidenced by the existence and content of policies directed at anti-fraud measures. These policies and policy provisions normally should include the following:

- Code of Ethics
- Fraud / Fraud Reporting Policy (Combined)
- Removal of Employee Presumption of Privacy Provisions
- Anti-Bribery / Anti-Corruption Policy
- Prohibited Use of Heavy Equipment / Power-Operated Equipment

Specific Comments

Code of Ethics

A code of ethics is a general policy that sets out the expectations for the conduct of the workforce that communicates that fraud will not be tolerated.

More specifically, this policy addresses,

- Fair Competition,
- Conflicts of Interest,
- Gifts,
- Outside Employment,
- Confidential Information,
- How to Report Violations.

The Cooperative does have a Code of Conduct and other policies that, when considered together, includes the various components referenced here.

Attached as **Exhibit D1** is a sample Code of Ethics that may be used in the event that refinements or consolidation of existing policies is desired.

Fraud / Fraud Reporting Policy (Combined)

The Cooperative's current policies include various provisions typically included in a fraud / fraud reporting policy. However, additional provisions, and the consolidation of existing provisions into one policy, can serve to enhance the overall effectiveness of the anti-fraud environment.

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POLICIES / BYLAWS REVIEW

Section D

A typical fraud / fraud reporting policy provides that fraud will not be tolerated, provides general examples of fraud, provides what will happen if fraud is suspected, provides whistleblower protection, and provides a framework for reporting suspicions of fraud.

Recommendation

Exhibit D2 to this Report provides a sample combined fraud / fraud reporting policy that the Board of Trustees should use as a guide to develop and adopt a formal policy and process. This policy should not be implemented without the review and approval of outside legal counsel.

Removal of Employee Presumption of Privacy Provisions

These provisions generally speak to the issue that the Cooperative provides the tools necessary for an employee to perform their assigned functions such as:

- Computer,
- Email,
- Internet Access,
- Phones,
- Tablets,
- Office, Desk.

As such, the Cooperative has the right to monitor and/or inspect activity within these items and an employee should have no presumption that these items are private and inaccessible.

Currently, the Cooperative addresses this removal of the presumption of privacy in Section V(M) – General Policies that addresses the use of the telephone. Without specifically stating that there is no presumption of privacy, the policy does state that the Cooperative has the right and responsibility to monitor or inspect if necessary.

Included as **Exhibit D3** to this Report is a document that includes examples of the various provisions for removal of presumptions of privacy. In the event that leadership determines to enhance various applicable policies, this information may be used as a reference.

Anti-Bribery / Anti-Corruption Policy

Due to numerous fraud cases industry-wide regarding purchasing; relationships with suppliers; awarding and administration of contracts, and collusion between organizations and outside vendors, we include this policy as a necessary foundational policy.

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POLICIES / BYLAWS REVIEW

Section D

Recommendation

Exhibit D4 to this Report provides a sample Anti-Bribery / Anti-Corruption policy that the Board of Trustees should use as a guide to develop and formally adopt. This policy should not be implemented without the review and approval of outside legal counsel.

This policy applies not only to Cooperative officials and employees, but also to outside organizations that the Cooperative does or may do business with. As such, this policy should be provided to these outside organizations as applicable.

Prohibited Use of Heavy Equipment / Power-Operated Equipment

A policy of this type basically states that, "No one will be permitted to utilize for personal use or benefit, heavy / power-operated equipment, material, or facilities in possession of or owned by the Cooperative".

Recommendation

We recommend this strict stance that no personal use of this type of equipment should be allowed.

One of the areas where we have encountered the most fraud in Cooperatives is in this very area. As an example, if employees are allowed to use a trencher owned by the Cooperative (and thus owned by the members it serves); we have seen this open the door to an entire membership that believes they should be afforded the same ability to use the equipment.

In fact, we have encountered a circumstance within the past two years where this very issue resulted in a membership upheaval that resulted in the removal of the entire Board of Directors.

Other associated issues include the wear and tear on this equipment that benefits employees, but not the membership that the equipment is supposed to serve.

Finally, we believe the liability issues associated with personal use of this type of equipment is substantial.

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ADDITIONS TO SCOPE

Section E

Synopsis

As typically occurs in an engagement of this nature, we encountered several other areas related to the controls and processes for transaction processing and reporting that we determined beneficial to analyze. As such, these specific areas were added to the scope of this part of the engagement.

NEW VENDOR ESTABLISHMENT / VENDOR INFORMATION CHANGE PROCESSES

We have encountered a significant increase nationwide in shell company fraud, vendor disbursement fraud, and preferential disbursements over the past several years. The risk of this type of fraud can be mitigated through proper vendor establishment procedures, vendor information change procedures, and the use of a Conflict of Interest form.

While our Report is focused on the prevention and detection of internal fraud, the vendor disbursement process in many organizations remains an area of operation where external attacks can proliferate. We have encountered a significant increase in “social engineering” schemes, primarily the “man-in-the-middle attack”. These schemes are described as follows:

Social Engineering

“Social engineering attacks typically involve some form of psychological manipulation, fooling otherwise unsuspecting users or employees into handing over confidential or sensitive data.

Commonly, social engineering involves email or other communication that invokes urgency, fear, or similar emotions in the victim, leading the victim to promptly reveal sensitive information, click a malicious link, or open a malicious file. Because social engineering involves a human element, preventing these attacks can be tricky for enterprises”. – Nate Lord - *Social Engineering Attacks: Common Techniques and How to Prevent an Attack*, Published at DigitalGuardian.com, July 11, 2018

Man-in-the-Middle Attack

A Man-in-the-Middle (“MITM”) scheme is an attack whereby the attacker secretly relays and possibly alters the communication between two parties who believe they are directly communicating with each other. Most commonly, social engineering of email communication is the method used. An example of this scheme is when the attacker, posing as the vendor, establishes communication with a Company employee. The attacker then, posing as a Company employee, establishes communication with the vendor. The attacker then requests a change in the ACH payment information (such as bank routing number and bank account number) from the valid vendor’s bank account to the attacker’s bank account.

For the Cooperative, validation-type information currently obtained for new vendors is the IRS Form W-9 – Request for Taxpayer Identification Number and Certification.

For vendor information changes, such as addresses or payment information, there is no validation process currently in place.

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ADDITIONS TO SCOPE

Section E

Recommendations

To mitigate these areas of exposure, we provide the following recommendations:

A formal validation process for adding new vendors should be considered for adoption. The obtaining of a signed W-9 from the vendor is, by itself, not adequate. Additional validation procedures should be performed that include,

- Obtaining organizational documents
- Performing test emails and phone calls
- Validation of web presence – website and other social media, Google, and Google Maps
- Performing searches for duplicate address and contact information against employee database and existing vendor database
- Performing searches for duplicate bank account information against employee database and existing vendor database
- Assignment of a Vendor Information Change Code to be used for validation of future vendor-requested changes

Since Common MITM attacks focus on “changes” in vendor ACH payment information, we recommend the establishment of a formal process, including a formal form, that should be used for processing vendor-requested changes such as address and payment related information.

This process should include validation using the previously established vendor information change code, along with the completion and dual authorization of a Vendor Information Change Form.

A sample New Vendor Establishment Form **Exhibit E1**, and a sample Vendor Information Change Form **Exhibit E2**, are included as exhibits to this Report.

Additionally, for purposes of prevention of shell company fraud, we recommend that each employee and Trustee be required to complete a Conflict of Interest Form on an annual basis. This form elicits information that could identify those customers and suppliers for which the employee and/or Trustee has a financial and/or personal relationship. While fictitious shell companies would not be expected to be disclosed by a party committing shell company fraud, the requirement to complete the form increases the perception of detection substantially, which may serve to stop the committing of shell company fraud. A sample Conflict of Interest Form is included as **Exhibit E3** to this Report.

The Cooperative should conduct periodic training to raise the level of awareness of MITM attacks and the importance of adhering to proper processes to avoid being the victim of social engineering.

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ACH PAYMENTS TO VENDORS

Future processes will be established whereby vendors will be paid through the ACH process rather than with paper checks. Once established, the following base recommendation should be considered for implementation:

Recommendation

Once it is determined that ACH payment will be adopted for vendors, we recommend they be required to complete an ACH Authorization Form that is maintained under strict control of the Chief Financial Officer, the Controller, and the designated Accounts Payable Clerk. The ACH Authorization Form should include the same Vendor Information Change Code assigned as part of the recommendations included previously in this Report.

PURCHASE ORDER SYSTEM

Currently, there is a purchase order (PO) system in place for materials and supplies inventory, but not for non-inventory purchases. The Cooperative also has a purchase requisition form, but it generally is signed after the purchase.

Since purchasing fraud is a primary type of fraud that occurs in this industry, we believe the following recommendations should be considered for implementation:

Recommendations

Implement a PO system for all purchases, not just inventory related purchases.

Establish preapproval requirements (as evidenced by signatures) for a purchase requisition. Once approved, assign a proper PO to the purchase.

Once the item is received, require matching of the packing slip with the PO and the requisition.

Once the invoice is received, require matching of the invoice to the previously validated PO, purchase requisition, and packing slip.

STOCK INVENTORY

For purposes of this section, stock inventory refers to those items necessary for fleet maintenance such as anti-freeze, oil, filters, etc. There is an inherent difficulty in properly tracking usage of these types of items. Currently, the Cooperative has a fleet management software that is not being used. However, with the proper training and commitment, use of this software could strengthen the overall control of these items.

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Recommendation

Staff should experiment with the implementation of this software to determine an ultimate cost-benefit analysis of its use.

For example, if the cost to maintain the use of this software is more than the cost of large periodic adjustments due to not tracking, then acceptance of these adjustments may be the most cost-efficient scenario, and vice versa.

However, it should be noted that when unsubstantiated adjustments are allowed, it removes from the process any ability to identify theft and/or inefficiencies that may exist.

SMALL INVENTORY

Additionally, it was noted that there are times when small dollar items of inventory, such as ground rods, are purchased and coded to the Stores Clearing account. When it is time to issue to a workorder, the item is not there. This is due primarily to managing and processing transactions for three warehouses at the same time. This results in the unnecessary preparation of paperwork to create an item so that it can then be issued to a project workorder.

Recommendation

It is our understanding that staff are implementing quarterly inventory physical counts during the summer of 2022, including these types of items, in an effort to improve this processing inefficiency. We concur with this process as an attempt to improve this area of transaction processing.

As with stock inventory, the accepting of periodic adjustments as just part of the accounting process removes the ability to identify theft and/or inefficiencies that may exist.

CONTRIBUTIONS IN AID TO CONSTRUCTION

Currently, the Cooperative is behind on collection of amounts due from members under contributions in aid to construction agreements. This has been caused by the lack of assignment of a specific employee to the collecting of these amounts.

Over the past approximate twelve months, the follow-up on the more current outstanding amounts are being processed more efficiently and effectively than in the past.

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The amounts due to the Cooperative, by year, are as follows:

<u>Year</u>	<u>Amount</u>
2013	\$ 1,062.16
2014	5,927.89
2015	194,781.88
2016	56,218.15
2017	46,533.82
2018	27,404.30
2019	215,185.69
2020	27,270.24
2021	158,127.93
2022	12,002.14
	<u>\$ 744,514.20</u>

Recommendation

A single staff member should be assigned the responsibility for the monthly billing and collection of these amounts, including calls and letters communicating delinquency status to the applicable members. Depending on availability, the plant side of accounting (workorder) side may best be assigned this function.

In that manner, the accounting department can then review the status of uncollectible amounts and outstanding balances, and reconcile these amounts to the general ledger as part of its monthly closing functions.

In order to facilitate collection efforts, the Cooperative should implement a policy/process to determine how amounts are to be collected and/or charged-off. This process could include provisions such as,

- Notice mailed after 10 days delinquent,
- Phone call to the member after 20 days delinquent,
- Charge-off after six months delinquency with no efforts by the member to bring the balance to a current status,
- Submission of charged-off amounts to collection agency

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OTHER PLANT ACCOUNTING ISSUES

Currently, standard transformer installation costs and cost of removal amounts have not been updated in several years. Additionally, it was noted that there is currently a large number of open workorders.

Recommendations

There has been turnover in the workorder processing function. At this time, with some stability in that position, efforts should be continued to clean up and close as many open workorders as possible to bring this area to a more current status.

Efforts should be directed at updating standard installation costs and costs of removal. This should be prepared by someone in the plant department other than the workorder processing employee.

ACCOUNTS RECEIVABLE BILLING ADJUSTMENTS

Billing adjustments represent one of the most abused areas in cooperative operations nationwide. This type of fraud is specific to the cooperative industry since employees and board members are also typically cooperative members.

While we did not encounter this type of fraud in the Cooperative, we believe processes should be redesigned to prevent the possibility of this common type of fraud occurring. Process and control recommendations are as follows:

Recommendations

A process should be adopted that includes the prohibition of employees transacting on their own and/or family member accounts.

All member accounts receivable transactions should reflect the same process as that of members of the Cooperative such as disconnect fees, budget billing, etc.

Billing adjustments, fee reversals/removals, budget billing arrangements, payout arrangements, should be subject to the authorization of two billing related supervisors, with a final third authorization provided by the signatures of Michael Hastings or Karen Wisdom.

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WRITTEN PROCESS DOCUMENTATION – Overall Recommendation

As applies to all internal control processes, not just to the recommendations included in this Report, all processes (accounting, transactional, reporting) should be committed to written form. This is not a task that is completed quickly, but rather over an extended period of time.

Development of this type of information does not just include documentation such as narratives and screenshots of how to maneuver through the IT system to perform assigned functions, but more importantly includes those steps that the employee has developed instinctively over time that is part of what they do, even though it is not part of the written documentation. This is one of the primary reasons why this process takes so long.

The Cooperative has employees with many years of experience that know *how* to do their jobs, know *how best* to do their jobs, and know *why* they perform their assigned functions in the manner they perform. The loss of this type of experience and education through attrition is difficult. However, with proper written process documentation, the negative effects of attrition can be somewhat lessened.

This type of documentation serves to ensure the consistent application of job functions by employees as attrition occurs. These written processes should be designed so that the next person in a position can step into the new position with a clearer understanding of *why*, *how*, and *how best* to perform their assigned function.

ESTABLISHMENT OF INTERNAL AUDIT RELATED PROCEDURES

Currently, the Cooperative does not have an internal audit function in place. As the complexity of operations continues to grow, the performance of certain internal audit related procedures may be necessary to enhance the Monitoring and Routine Maintenance element of the anti-fraud program. These procedures focus on the previously referenced vendor establishment, disbursement, and information change processes and can be performed by existing personnel without the need to add to current staff.

Recommendations

We recommend that the Chief Financial Officer or the Controller, or a combination of both, perform the following internal audit related procedures:

Vendor Data Analytics - Master File Data

To determine if an employee may be perpetrating shell company fraud, perform an information search for duplicates between the master vendor file database and the human resources (employee) database for:

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1. Vendor address match to human resources database
2. Vendor bank account information match to human resources database
3. Query for vendors with no address
4. Query for vendors with missing or no contact information

To determine if the identity of a dormant/inactive vendor has been taken over:

5. Query for address changes on dormant/inactive vendors
6. Query for bank account information changes on dormant/inactive vendors
7. Query for contact information changes on dormant/inactive vendors

To determine the existence of hidden shell company vendors:

8. Search for duplicate information between vendors including Contact Information, Addresses, and Bank Account Information

Vendor Data Analytics – Transactional File Data

9. Invoice Number – Query for Sequential Patterns or Low Starting Numbers
10. Date Field:
 - Query for Invoice Dates that precede the Purchase Order Dates
 - Query for Unusual Speed of Payment Processing (invoice date compared to payment date)
11. Invoice Amount – Query for amounts below the established control threshold

Other Periodic Compliance / Audit Procedures

12. Compliance review of adherence to new vendor establishment and vendor information change processes
13. Compliance review of adherence to previously established parameters for classification as dormant/inactive vendors
14. Review of System Administrator changes to assigned employee system access
15. Performance of Benford's Law Analysis on company disbursements

Included as **Exhibit E4** to this Report is an extract from a recent training seminar we presented that introduces Benford's Law and its use for fraud detection and/or for the identification of inefficiencies in processing financial transactions. We remain available to provide additional information or training regarding Benford's Law upon request.

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FRAUD RISK ASSESSMENT

Section F

As stated previously in this Report, fraud risk assessment speaks to the issue of a constant awareness and analysis of fraud risk that may be present within Cooperative operations. Leadership should be in a constant mode of analyzing the risks associated with the performance, recording, and reporting of financial transactions. Thus, the fraud risk assessment process, as its name implies, identifies those areas of financial transaction processing and reporting with the greatest risks of fraud.

The information that follows is presented to address the “how to” of the *documentation* of a fraud risk assessment process:

Guidelines for a Formal Fraud Risk Assessment

The standard objective of a fraud risk assessment is not to prevent fraud, but rather to determine what “frauds” need to be prevented. These identified fraud risks are then used as a focus of where new internal control activities / processes should be directed.

A properly designed fraud risk assessment includes appointing a team that includes a representative from each functional area of the Cooperative (billing, accounting, human resources, etc.). This team is charged with the responsibility of asking and answering the questions...

“How can someone steal (misappropriate funds) from our Cooperative?”

“How can someone misstate our financial statements?”

This type of brainstorming session will breed a discussion that results in the identification of fraud risks. The process does not need to be any more difficult than this.

Once the fraud risks are identified, those risks should be documented in written form for submission to those responsible for development of new internal controls to address these identified risks.

Recommendation

Consideration should be given to performing formal fraud risk assessments on a periodic schedule that addresses each area of Cooperative operations at least once every two years. To facilitate the performance and documentation of the process, we have provided the following exhibits:

Exhibit F1 – Fraud Risk Assessment Tool

This document is a 35-page questionnaire that assists in breeding discussion within the fraud risk assessment team meeting(s).

Exhibit F2 – Fraud Risk Assessment Framework

This form is used to formally document the fraud risks identified in the team meeting(s) for submission to those responsible for the development of new internal controls.

We remain available to assist with future implementation of the Fraud Risk Assessment process as needed.

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DOCUMENTATION OF INTERNAL CONTROLS / ANTI-FRAUD PROGRAM

Section G

This section is provided for your reference and future use since this engagement does not include creating the documentation of the anti-fraud program.

The purpose in properly documenting internal controls included in an anti-fraud program is to ensure continuity in the application of controls over an extended time period. Over time, staff may not recall the intricacies of the controls in place and thus it becomes watered-down, or less than effective. Over time, as new employees are trained, some of the intricacies of the controls may not be communicated in their entirety, thus rendering the design of the control ineffective.

Previously in this Report, we provided the recommendation that all processes in place regarding accounting and transaction processing be committed to written form as "process documentation". However, the recommendations addressed in this section include the overall documentation of internal controls included in the anti-fraud program rather than the aforementioned process documentation.

This documentation should be simple, yet complete. The information that follows represents our recommendations regarding the process of documenting an anti-fraud program.

Recommendations

The documentation of the anti-fraud program should begin with an overall introduction which includes the purpose of the program. The narrative includes information that can be used in the periodic Cooperative-wide fraud awareness training that is recommended in the following section.

An example of this documentation is provided below:

JEMEZ MOUNTAINS ELECTRIC COOPERATIVE, INC. Company Anti-Fraud Program
<p style="text-align: center;"><i>Introduction</i></p> <p>The Board of Trustees, Audit Committee, and Management of Jemez Mountains Electric Cooperative, Inc. (the "Cooperative"), has established this program to address the risk of occurrences of internal fraud. Internal fraud is defined as fraud perpetrated against the Cooperative by our own people. The purpose also includes the establishment of an environment that promotes and recognizes honesty and integrity in the workforce, and a safe and pleasant working atmosphere.</p> <p>Internal fraud includes three types of fraud: Misappropriation, Corruption, and Financial Statement Fraud, illustrated as follows:</p> <p><i>Misappropriation:</i> This is defined as the taking of cooperative assets whether cash, inventory, or other fixed assets. This is the most common type of fraud.</p> <p><i>Corruption:</i> This type of fraud is represented by collusion between at least two individuals (one employee and a non-employee, or two employees) that includes conflicts of interest in purchasing and sales schemes; bribery in kickbacks and bid-rigging schemes; illegal gratuities; and economic extortion.</p> <p><i>Financial Statement Fraud:</i> This fraud includes the intentional misrepresentation of the financial position or results of operations of the Cooperative.</p>

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Section G

The Introduction continues as follows:

This Anti-Fraud Program, through the collective efforts of the Board of Trustees, Audit Committee, and Management has been developed to address the risk of internal fraud. The contents of this Anti-Fraud Program are required to be in written form. As such, this Anti-Fraud Program documentation is intended as the complete documentation necessary to evidence the Program.

Management is responsible for documenting all aspects of this Program. Upon completion of the various documentation forms (fraud risk assessment framework, control activities forms), the responsible parties shall forward that information to management for the assembly into this formal Anti-Fraud Program.

The communication of and staff training for this Program is conducted periodically. However, the Program is available at all times on the Cooperative intranet and is provided to each employee whether through printed form or through electronic distribution through the Cooperative email system.

The next section includes an introduction to the existence of policies that address the risk of internal fraud.

Policies of Protection

Certain policies have been established that provide protection for not only the Cooperative, but for each employee as well. On the date of employment, each employee will receive an Employee Handbook that includes the complete text of Cooperative policies. As relates to fraud, the following policies have been adopted:

Code of Ethics

Our Cooperative is committed to conducting our business with the highest level of integrity. We have adopted this Code to set expectations of ethical performance of job functions, and to exhibit to the general public and our members our commitment to excellence in service provision.

Fraud Policy / Fraud Reporting Policy

We want you to know that we take the issue of internal fraud seriously. We have adopted a "no tolerance" position regarding fraud occurrences and desire that the workforce joins us in this level of dedication to fraud prevention and detection. This policy was adopted to provide information about fraud, what to do if you suspect fraud, and our obligations to investigate suspicions of fraud. The policy also outlines the administrative actions that will be applied if you are suspected of the perpetration of internal fraud.

This policy provides you the opportunity to anonymously report suspicions of fraud. A healthy workforce environment is the result of you feeling as if you have someone to turn to in reporting suspicions. The policy outlines the process to follow in reporting any suspicions and our responsibilities to investigate these issues.

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Section G

Program documentation continues with outlining the purposes and processes related to the Fraud Risk Assessment Process.

Fraud Risk Assessment

Introduction

A formal fraud risk assessment process is required by this Anti-Fraud Program. The fraud risk assessment is to be performed periodically by the Fraud Risk Assessment Team as identified below.

The purpose of the fraud risk assessment process is to identify those areas of transaction performance and recording that are most vulnerable to fraud. Control activities to address these identified areas are developed by the Control Activities Development Team as identified in the Control Activities section of this program.

Fraud Risk Assessment Team

The fraud risk assessment team shall include staff positions from various areas within the Cooperative such as:

- Management (Executive and Middle)
- Chief Financial Officer
- Controller
- Human Resources
- Billing / Purchasing
- Customer Service
- Construction / Engineering

The Fraud Risk Assessment shall be documented utilizing the Fraud Risk Assessment Framework included as Appendix A to this Program.

Once completed, the Fraud Risk Assessment Framework shall be provided to the Control Activities Development Team to serve as a guide for the performance of their responsibilities as defined.

The risk assessment team should remain aware of operational changes that could result in additional vulnerabilities to fraud.

The facilitator of the risk assessment team shall inform executive management of any new vulnerabilities that may be identified in-between fraud risk assessments. Executive management has the responsibility to present these new vulnerabilities to the Control Activities Development Team for inclusion in the Anti-Fraud Program if determined necessary.

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Section G

In keeping with the framework of the six elements of an anti-fraud program, Control Activities are presented:

Control Activities

Introduction

Control Activities are defined as those activities, controls, checks, and balances, and processes that have been implemented to address the risks of internal fraud in our Cooperative.

A Control Activity can be as simple as the requirement for two authorized signatures on checks over a certain dollar amount, to as complex as a complete policy such as the Expense Reimbursement Policy.

Control Activities Development Team

The Control Activities Development Team shall include at least the following staff positions:

- Executive Management
- Chief Financial Officer
- Controller

Upon receipt of the Fraud Risk Assessment Framework, the team shall develop certain and specific Control Activities that address the identified fraud risks. Control Activities shall be documented using the Control Activities form included as Appendix B to this Program.

Communication of Control Activities

The complete Anti-Fraud Program, including Specific Control Activities will be issued in its entirety at the bi-annual deadline of June 1st utilizing the following means of communication:

- Electronic Distribution: Cooperative Intranet, Email
- Print Distribution: As a part of this Anti-Fraud Program
- Continuous Training: As directed by this Program

The level of communication and training related to Control Activities will be conducted to ensure a thorough understanding of the requirements imposed upon all staff positions.

Compliance with Control Activities

Control Activities have been developed over time with an extensive amount of effort. It is required that Control Activities applying to your specific position will be followed. We encourage staff to ask questions if there is a lack of understanding of any Control Activity. Failure to adhere to the various Control Activities will result in the following:

- First Violation: Formal reprimand, and re-training if necessary
- Second Violation: Termination

As a part of the on-going Monitoring aspect of this Program, we encourage you to submit to the Control Activities Development Team any suggestions you may have for improving specific Control Activities.

Specific Control Activities

Specific Control Activities that have been placed into operation are included as Appendix C to this Program.

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Section G

The information presented above represents the narrative portion of documenting the anti-fraud program.

Included as **Exhibit G1** to this Report is a sample Control Activities Documentation Form that can be used to document the specific control activities that have been placed in operation. This is a generic sample and thus does not purport to represent the control activities placed in operation for Jemez Mountains Electric Cooperative, Inc.

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MONITORING AND ROUTINE MAINTENANCE

Section I

Increasing the perception of detection is a leading objective of an effective monitoring program. Monitoring of the operation and effectiveness of internal controls leads to increasing this perception of detection.

The monitoring element includes two primary "question" areas as follows:

1. How are the controls working out?

Through the testing of compliance with existing internal controls, the effectiveness of the control can be assessed. In some circumstances, problems can be categorized as a human problem (adherence to the control) or a design problem, or both. In any circumstance, employees can be re-trained to address the human problem, and controls can be modified to address the design problem.

2. What employee input can we obtain into the proper functioning or design of the anti-fraud program?

Obtaining the involvement of employees in the monitoring process then serves to obtain their "buy-in" of the overall fraud prevention process. It is noted that buy-in is a continuous process since change is a continuous process.

The addition of a formal monitoring structure can only serve to strengthen the overall control structure. The performance of certain Internal Audit Related Procedures as has been presented in this Report represents a major part of the Monitoring process.

Recommendations

The Cooperative should consider the establishment of this formal Monitoring / Routine Maintenance process.

Periodic meetings with employees should occur that solicits answers to the two question areas of a monitoring system. These meetings can include a review of the compliance audit programs and working papers to breed discussion on any modifications that need to be made to the existing internal controls. As a result, Control Activities documentation can be amended and thus kept current as part of the overall anti-fraud program.

Another by-product of these meetings is a workforce that understands the "whys" of processes, the "hows" of processes, and establishes ownership in the processes. With ownership of the process, the desired outcome is that the employee becomes less likely to violate the process through the committing of internal fraud.

The Cooperative should consider implementing the performance of internal audit related procedures as recommended previously in this Report.

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MONITORING AND ROUTINE MAINTENANCE

Section I

Exhibit I1 – Compliance Audit Program, and **Exhibit I2** – Compliance Audit Workpaper represent samples that can be used to document the performance of compliance reviews as a part of the performance of the internal audit related procedures.

Once completed, a formal written report to the Board of Trustees, Audit Committee, and Management should be prepared. This can be referred to as an “Internal Control Report”, an “Anti-Fraud Program Report” or any similar type of name as determined best fits the nature of Cooperative operations.

Issues that may be addressed in this type of reporting are as follows:

- New controls / control processes implemented and an explanation of the reasons for their establishment
- Results of compliance audit procedures performed during the most recent reporting period
- Revisions of existing controls / control processes and an explanation of the reasons for the modification
- Training – addressing fraud awareness and/or fraud risks specific to the Cooperative
- Informing or updating on instances of internal fraud discovered at the Cooperative

Included as **Exhibit I3** is a sample reporting format that can be used to accomplish this reporting objective.

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COMPLETION ISSUES

We remain available to advise on drafts of new policies or existing policy revisions in conjunction with your legal counsel.

We remain available to conduct the training necessary to communicate new or revised policies and procedures to the workforce as determined necessary by the management team.

As stated in this Report, we desire this engagement to be the start of a continuing relationship that provides Cooperative staff with the ability to consult with us as needed as operations change and as new control issues arise. As an example, if the Cooperative develops wholesale ACH payment processes for vendor payments as a replacement for the writing of checks, this will create the need for advice on specific controls necessary for electronic payment versus hard copy check payment.

It should also be understood that the implementation of the processes and recommendations included in this Report will be a lengthy process that occurs over a period of several years. As such, the atmosphere of a continuing relationship is not only helpful, but necessary.

Throughout this Report we have stated that we remain available to assist the Cooperative with implementation of the various recommendations. We believe that much of the value of an internal control process consultation is realized after the issuance of the Report. As such, the issuance of this Report is intended to represent a beginning, rather than a completion of the consulting process. We encourage you to view this process in this manner in order to maximize the benefit received from this engagement.