

Is Your District In Danger of Being a Victim of Fraud?

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Does your district have the practices and policies in place to prevent or detect fraud? In light of the corporate scandals that have occurred over the past few years, regulations and standards are changing to combat financial mismanagement and fraud in the workplace. One of these new standards is Statement on Auditing Standards No. 99, Consideration of Fraud in Financial Statement Audits. This standard is required to be implemented for all school districts beginning with fiscal year ending June 30, 2004. This standard calls for auditors to hold brainstorming sessions with their entire engagement team to discuss how fraud might occur in a school district. The standard also requires auditors to increase scrutiny of documentation, interview district employees and implement other measures to reduce the risk of fraud. According to SAS 99, three fundamental conditions are generally present when fraudulent financial reporting occurs: 1) incentive or pressure to perpetrate fraud, 2) an opportunity to carry out fraud, and 3) an attitude or rationalization to justify the fraudulent actions.

Some examples of financial mismanagement and fraud that could occur in school districts, include the misappropriation of assets, employee theft and lack of timely and accurate financial reporting. Misappropriation of assets includes cash and non cash items. The misappropriation of cash includes skimming, which is stealing money from the district before it is received and recorded; larceny, which is the theft of money after the district has received and recorded it; and fraudulent disbursements which involves fraudulent billings for services that are not rendered to the district. The misappropriation of noncash items includes the theft of fixed assets, supplies or inventory items.

The consequence of such misdeeds for both the district and the community it serves can be severe. Not all instances of fraud can be uncovered by examining the books and records. It is also important to ask the right questions. School boards, district administrators, external auditors and internal auditors are expected to take a more active role in preventing and detecting fraud. School districts should establish three fundamental practices including establishing a culture of honesty and high ethics, instituting antifraud processes and controls, and implementing an appropriate oversight process.

The most important way for management to prevent fraud is to communicate effectively that it will not be tolerated. Management should set a tone at the top by establishing a code of conduct. This code should discuss ethics, confidentiality, conflicts of interest, and fraud. Management should back up this code by creating a work culture that rewards ethical actions and does not tolerate dishonest behavior. Trust is an important element of business. Never having faith in your employees is a bad thing; so is always trusting them. The goal is to strike a balance between the two. As Mark Twain said, "Trust everybody, but make sure you cut the cards." Poor morale can affect employee attitudes about

committing fraud. Employees who engage in workplace abuse, such as excessive absenteeism and pilfering are at a high risk to commit fraud. By creating a positive work environment, employees will practice oversight. Districts should establish a process for employees to report in confidence any actual or suspected violation.

The following are possible antifraud processes and controls a school district could implement:

- ◆ Introduce processes and procedures that protect assets, curtail abuse of personal expenditures; including cash controls, monitoring fixed assets, approval processes for bills, purchase orders, and the use of new vendors.
- ◆ Segregate the duties of financial and administrative personnel to the greatest extent possible, so that no one person has control. Where duties can not be segregated, administrators should review and scrutinize transactions more closely.
- ◆ Employees should be encouraged to report to their supervisor any suspicion of wrongdoing.
- ◆ An accounting manual should be developed outlining the duties and responsibilities of the various accounting personnel. This can be used as a reference for current staff, new staff and management.
- ◆ Background checks should be performed prior to hiring new employees especially those responsible for handling cash.
- ◆ Inventory observations and asset verifications of the district's fixed assets and inventory items should be conducted periodically and compared to purchases. Material assets should be safeguarded by locking doors and cabinets.
- ◆ Review purchase orders to verify that goods purchased are both billed and shipped to the school district. Approve the receipt of goods by utilizing receiving reports.
- ◆ Vendor lists should be reviewed periodically for names not recognized and to verify that addresses don't match another vendor or employee.
- ◆ Payroll observations should be conducted periodically to ensure there are no fictitious employees being paid. Do not allow the person who prepares payroll also distribute the paychecks. Review timesheets and/or other documents and pay particular attention to overtime.
- ◆ Periodic review of internal reports including warrants, revenue reports, appropriation status reports, cash flows, fund balance projections, and treasurer reports can uncover such fraud indicators as rising expenses, declining revenues, unfamiliar vendors or other payees and excessive spending by employees.
- ◆ Review computer controls and security measures to ensure only a limited number of employees have access to important school district data.
- ◆ Be aware of an increase in employee spending habits in relation to current income and prior spending habits.
- ◆ Require all employees to take a vacation and implement a policy of rotating duties and job responsibilities.
- ◆ When receiving cash, have a second employee involved in verifying incoming receipts by agreeing the cash receipts per the log to the ledger entry and deposit slip. Cash should be deposited daily whenever possible to avoid the temptation for theft.

Appropriate oversight is a practice instrumental in preventing financial mismanagement and fraud. Every member of the board of education needs to be aware of his or her role and responsibility with respect to financial matters. School board members can be educated by attending school board workshops in the area of financial management. They should thoroughly review all monthly financial reports, including appropriation status reports, warrants, revenue reports, and treasurer reports. If certain monthly activity is unusual, school board members need to ask questions at that time to determine if there are any irregularities. The board should also review the management letter with emphasis on prior year comments still not implemented. To assist them in evaluating the adequacy of the internal controls, the board should appoint an internal auditor independent of the district, well versed in school district policies, procedures and regulations.. If a district currently has an internal auditor, it should expand his or her current role to monitor cash disbursements as well as other controls that need additional scrutiny.

Fraud and financial mismanagement has been on the rise in all industries including school districts. A complete review of your current controls, climate, and oversight would assist the District tremendously in reducing your exposure to fraud. There is no full proof method of preventing fraud in your district, but taking the necessary steps can reduce your chances of being a victim.