



Fraud and Internal Control for School Based and Central Administrators

Jim Kaplan CIA CFE
Internal Auditor
Superintendent's Office





Agenda

- ◆ Internal Controls in FCPS
- ◆ Definition and Role of Internal Controls?
- ◆ Management's Role vs. Auditor's Role
- ◆ What Constitutes Fraud?
- ◆ Other Peoples Money Video
- ◆ The Red Flags of Fraud
- ◆ Minimizing Fraud Risks
- ◆ Procedures for Reporting Fraud



Internal Controls Defined

- ◆ Integral component of an organization's management, providing reasonable assurance that objectives are being achieved
- ◆ Checks and balances against:
 - Mission failure
 - Fraud, Waste and Abuse
- ◆ First line of defense to prevent and detect fraud



What is Internal Control?

- ◆ Internal control is anything that you do to safeguard FCPS assets or to make more efficient or effective use of these assets. Internal controls help your school or department achieve its objectives.



Examples of Internal Controls

- ◆ You probably practice good internal controls everyday without thinking of them as "internal controls." Some examples of internal controls are:
- ◆ Locking your desk and office when not there.
- ◆ Keeping your computer passwords secret.
- ◆ Verifying the accuracy of another staff's work.
- ◆ Reviewing monthly financial reports.
- ◆ Depositing receipts daily with the finance office.



Internal Controls

- ◆ Continuous built-in component of operations
- ◆ Actions and activities occurring throughout operations on an ongoing basis
- ◆ Affected by people
- ◆ Reasonable but not absolute assurance that assets and resources are safeguarded.



Why We Need Controls

- ◆ Ensure mission accomplishment
- ◆ Reduce fraud opportunities
- ◆ Prevent loss of funds or other resources
- ◆ Establish standards of performance
- ◆ Assure compliance
- ◆ Preserve integrity
- ◆ Eliminate adverse publicity
- ◆ Assure public confidence



Consequences of Weak Internal Controls

- ◆ Waste of FCPS assets
- ◆ Inaccurate or incomplete information
- ◆ Misuse of FCPS assets
- ◆ Embezzlement and theft






Internal Controls: Who is responsible?

The School Board provides important oversight




Stuart Gibson, School Board Chairman




Internal Controls: Who is responsible?

The Superintendent provides leadership and direction to the leadership team.




Dr. Daniel A. Domenech, Superintendent



Internal Controls: Who is responsible?


The Superintendent, along with the Leadership team are responsible for establishing the presence of ...


- ✓ Integrity
- ✓ Ethics
- ✓ Competence
- ✓ Positive Control Environment



Internal Controls: Who is responsible?







The Superintendent, along with the leadership team and other senior administrators, are responsible for establishing major operating policies that form the foundation of the internal control system






Internal Controls: Who is responsible?

The leadership team provides direction and oversight to senior administrators in major functional areas (e.g. instruction, departments, auxiliary operations and support services)










Deputy Superintendent, Assistant Superintendent Facilities Services, Legal Counsel & Cluster Director pictures not available



Internal Controls: Who is responsible?


School administrators, directors, and department heads execute those major district-wide control policies and procedures






Internal Controls: Who is responsible?


School administrators, directors, and department heads design and implement control systems at detailed levels within their specific units






Internal Controls: Who is responsible?


Managers and other supervisory personnel are responsible for executing control policies and procedures at detailed levels within their specific school or units






Internal Controls: Who is responsible?


Each individual within a school or unit is responsible for being cognizant of proper internal control procedures associated with their specific job responsibilities





Internal Controls: Who is responsible?

Internal auditors are responsible for examining the adequacy and effectiveness of the district's internal controls, and making recommendations where control improvements are needed



Internal Controls: Who is responsible?

Internal auditors contribute to the effectiveness of the controls, but they are not responsible for establishing or maintaining them



Internal Controls: Who is responsible?

◆ Every administrator, manager and staff member is responsible for assuring that established internal controls are followed and applied.



Other Peoples Money – Video





What is Fraud?

- ◆ Intentional false representation or concealment of a material fact for the purpose of inducing another to act upon it for personal benefit.
- ◆ Elements of the definition:
 - intent
 - deception
 - harm

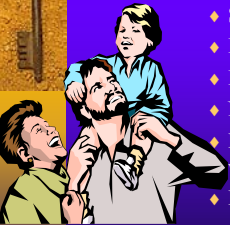


Types of Frauds


- | | | |
|----------------------|--------------|--------------|
| Conflict of Interest | Nepotism | Gratuities |
| False Statements | Omissions | Favoritism |
| False Claims | Forgery | Kickbacks |
| Misappropriation | Conspiracy | Alterations |
| Breach of Duty | Bribery | Substitution |
| Impersonation | Embezzlement | Extortion |



Characteristics of Trustworthy People




- ◆ No arrest record
- ◆ Socially conforming
- ◆ Educated beyond high school
- ◆ Likely to be married
- ◆ Not likely divorced
- ◆ Member of a religious house of worship
- ◆ Holds position of responsibility




Characteristics of Fraudster

- ◆ No arrest record
- ◆ Socially conforming
- ◆ Educated beyond high school
- ◆ Likely to be married
- ◆ Not likely divorced
- ◆ Member of a religious house of worship
- ◆ Holds position of responsibility



WHY?

- ◆ Why are the characteristics of honest, trustworthy citizens the same as those of the fraudster?




BECAUSE

- ◆ Fraud is committed by one who is capable of deceiving another.
- ◆ A position of trust is sometimes necessary to obtain access to items of value.
- ◆ Fewer restrictions or controls are placed on individuals that appear trustworthy.



Profiling fraudsters

- ◆ Male or Female
- ◆ Any age
- ◆ Work long hours
- ◆ Never take much leave
- ◆ Not necessarily have direct access to cash
- ◆ Appear to be honest and trustworthy






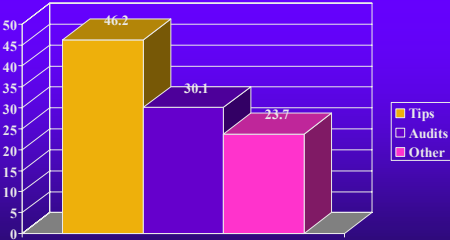
Fraud Detection

- ◆ Relatively few fraud and abuse offenses are discovered through routine audits. Most fraud is uncovered as a result of tips and complaints from other employees and citizens.





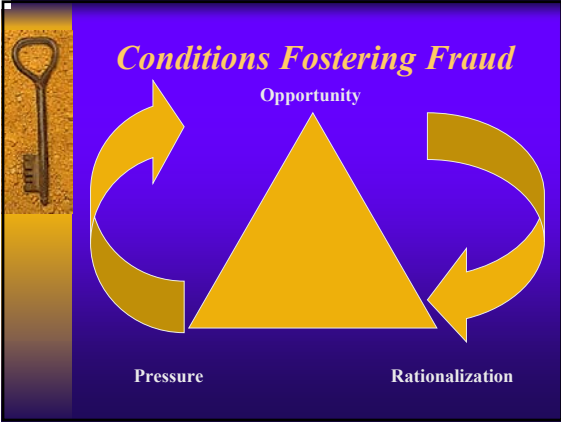
How Fraud is Detected



Method	Percentage
Tips	46.2
Audits	30.1
Other	23.7


Other includes accidental discovery

Source: Association of Certified Fraud Examiners




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- Why We Are Susceptible to Fraud?**
- ◆ Inconsistent Application of Controls
 - Trust rather than control
 - Organizational changes
 - ◆ Unethical/Illegal behavior results from:
 - Little or no recognition of achievements
 - Personal financial worries/greed

-
- The FCPS Files
Fraud Report Cases**
- ◆ Diversion of Cash Receipts
 - ◆ Billing for Services not Performed
 - ◆ Ghost Employees
 - ◆ Payroll fraud
 - ◆ Phantom Vendors
 - ◆ Use of school facilities for personal benefit



Fraud in FCPS

MYTHS	TRUTH
◆ Most people will not commit fraud	Opportunity, pressure and rationalization anyone will commit fraud
◆ Fraud is usually not material	FCPS Frauds range from \$100 to over \$200K
◆ Fraud goes undetected	Fraud is usually detected
◆ Fraud is usually well concealed	Most frauds are not concealed (Red Flags)



Fraud in FCPS


MYTHS	TRUTH
◆ Can't happen in my school/office	Historical evidence suggest contrary
◆ Auditors find fraud	Most fraud is discovered by accident
◆ Trusted employees do not commit fraud	Trusted employees know the system



Red Flags of Fraud



- ◆ Lifestyle and personality
- ◆ Organizational
- ◆ Financial documents
- ◆ Accountability and control



Top Ten Fraud Risk Indicators

1. Key documents missing
2. No separation of financial duties
3. Accounting system in disarray
4. Lack of policies that establish controls
5. Inadequate monitoring to ensure these controls work as intended
6. Ineffective accounting, information technology or IA staff
7. Documentation that is photocopied or lacking essential information
8. Unusual employee behavior
9. Tips or complaints about fraud
10. Lack of established code of ethical conduct

Source: Ohio State Auditor reporting on School Districts in Ohio




Common Red Flags

- ◆ Personal financial pressure
- ◆ Vices such as substance abuse and gambling
- ◆ Extravagant purchases or lifestyle
- ◆ Real or imagined grievances against the company or management
- ◆ Increased stress
- ◆ Short vacations and unexplained hours
- ◆ "Missing" files or data




LIFESTYLE AND PERSONALITY RED FLAGS

- ◆ Wheeler Dealer
- ◆ Dominating Personality
- ◆ Living beyond means
- ◆ Poor money management
- ◆ Dissatisfied worker
- ◆ Unable to relax
- ◆ No vacation/sick time
- ◆ Close customer/vendor relationship
- ◆ Unusual or change in personality (alcohol, drugs, sleep, irritable, defensive, argumentative)
- ◆ Too good to be true performance
- ◆ Excessive overtime



Organizational Red Flags

- ◆ No communication of expectations
- ◆ Too much trust in key employees
- ◆ Lack of proper authorization procedures
- ◆ Lack of attention to detail
- ◆ Changes in organizational structure
- ◆ Tendency towards crisis management



Financial Document Red Flags

- ◆ Missing documents
- ◆ Altered documents
- ◆ Excessive number of voided documents
- ◆ Documents not numerically controlled
- ◆ Questionable handwriting or authorization
- ◆ Duplicate payments
- ◆ Unusual billing addresses
- ◆ Address of employee same as vendor
- ◆ Duplicate or photocopied invoices
- ◆ Invoices not folded for envelope



Accountability and Control Red Flags

- ◆ Lack of separation of duties
- ◆ Lack of physical security and/or key control
- ◆ Weak links in chain of controls and accountability
- ◆ Missing independent checks on performance
- ◆ Lax management style
- ◆ Poor system design
- ◆ Inadequate training




How to Minimize Fraud Risk

- ◆ Adhere to policies/procedures (especially documentation and authorization)
- ◆ Ensure physical security over assets
- ◆ Provide proper training to employees
- ◆ Independently review and monitor tasks
- ◆ Provide for segregation of duties
- ◆ Establish clear lines of authority
- ◆ Rotate duties in positions susceptible to fraud
- ◆ Ensure employees take regular vacations
- ◆ Schedule regular independent audits of areas susceptible to fraud



How to Minimize Fraud Risk


- ◆ Ensure background checks for employees handling financial transactions
- ◆ Make sure internal controls are being followed
- ◆ Review! Review! Review!
- ◆ Ask for documentation
- ◆ Ensure that one person does not have total responsibility for a process
- ◆ Evaluate performance regularly
- ◆ Report suspicious activity



Who You Gonna Call?


FCPS Regulation on Fraud


- ◆ Regulation 1410 – Procedures for Reporting and Investigating Fraud and Embezzlement
- ◆ If you suspect fraud
 - Notify Supervisor
 - Notify Internal Audit or Internal Investigator
 - Cooperate
 - Secure records if possible



What Not to Do

- ◆ Do not investigate
- ◆ Do not discuss with anyone other than supervisor, principal, department director or those investigating





Tools and Additional Material

- ◆ Internal Control Guide
- ◆ Fraud assessment checklist
- ◆ [Red flags of fraud and other common situations](#)
- ◆ [The Missing Factor in Accountability: Improving Internal Control Practices for School Financial Management](#)



Questions and Closing



Fairfax County Public Schools

INTERNAL AUDIT

10521 Judicial Drive, Suite 305
Fairfax, Virginia 22030
703-591-2590 Fax 703-591-4113



E-mail jim.kaplan@fcps.edu
