

# What Charter School Board of Directors and Administrators Need To Know About Charter School Fraud

Sponsored by:

California Charter Schools Association

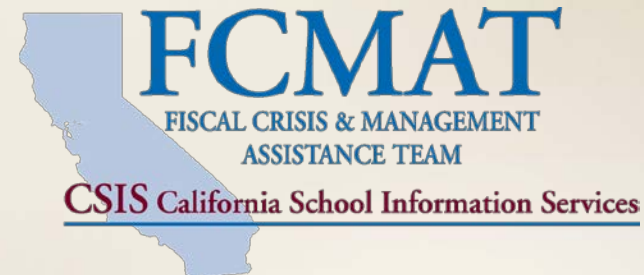
September 21-22, 2017

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Presented by FCMAT Intervention Specialists:

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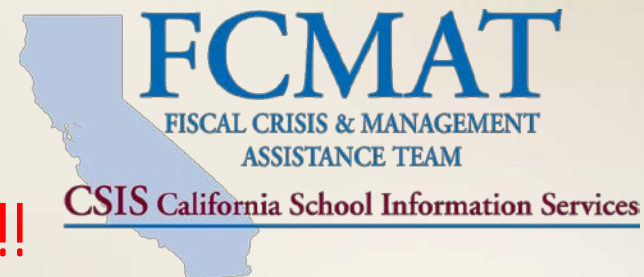
Michael W. Ammermon, CPA, CFE, CRFAC



# Who is FCMAT and What Services Are Provided?

- We are former education professionals just like you!
- The team spends the majority of its time in school districts and charter schools providing:
  - Management Assistance
  - Technical Assistance
  - Professional Development
  - Fiscal Crisis Intervention
  - Data Management Support

We are a part of your support system!!



# Who is FCMAT?, cont.

- Descriptions of FCMAT and its services are well documented on our website at [www.fcmat.org](http://www.fcmat.org).
- Some of the services and resources that are available to the field include:

Fiscal tools

[Listservs](#)

Online request system

[Manuals](#)

Budget Explorer\*\*

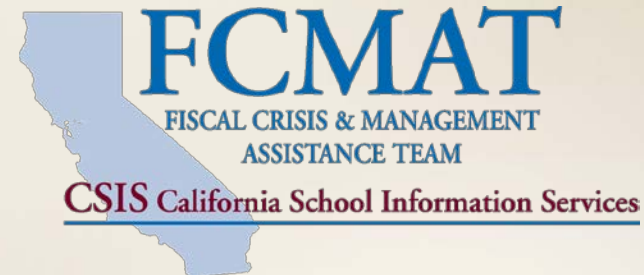
[Daily news headlines](#)

Help desk

[Report archives](#)

Charter Oversight Checklist

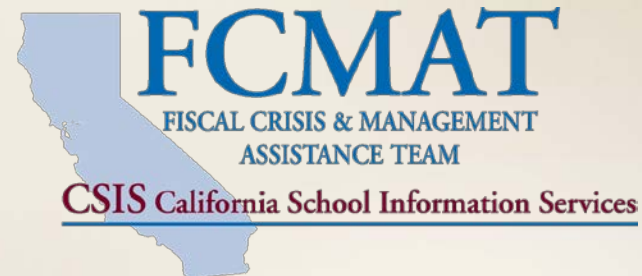
[LCFF Calculator](#)



\*\*Soon to be Projection Pro

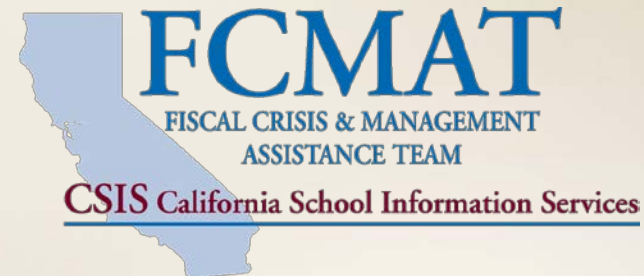
# Fraud Happens!

- Fraud happens more often than you think.
- Fraud may occur for many reasons.
- You must be vigilant and understand fraud can happen in your organization.
- Fraud may go undetected; therefore, you need a good internal control system to detect irregularities.
- Your organization may be accused of fraud or fiscal mismanagement even if the accusation is untrue.



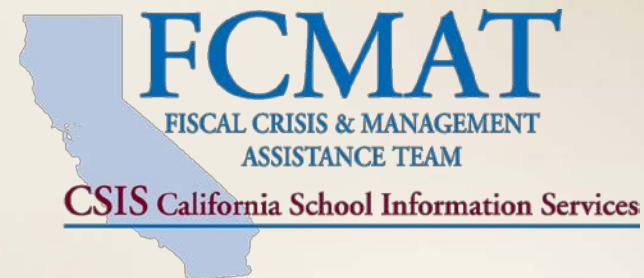
# Allegations of Fraud

- An **allegation** of fraud may result in sufficient evidence that fraud may have occurred.
- Fraud allegations may be based on:
  - Factual or circumstantial evidence
  - Hearsay
  - Other motives (dislike, jealousy, misunderstanding)
  - Poor internal controls
- **Strong internal controls** are critical to protect any organization (discussed more later).



# AB 139 Process

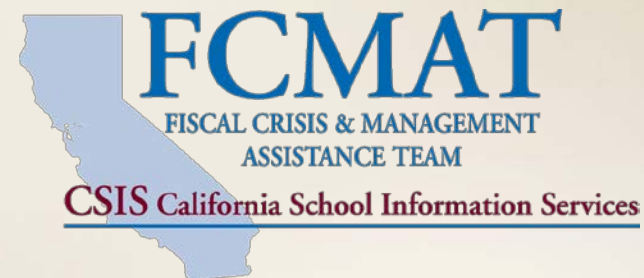
**Education Code Section 1241.5(b)(c)** permits a county superintendent of schools to review or audit the expenditures and internal controls of any school district or charter in that county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination.



## AB 139 Process, cont.

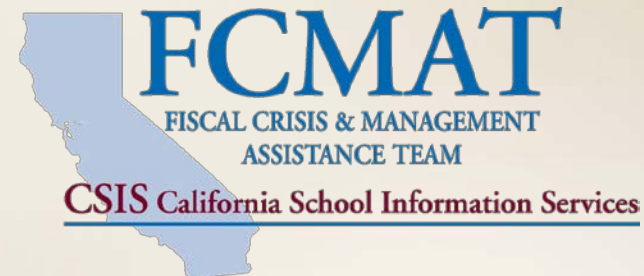
Education Code Section 47604.4(a) states as follows:

In addition to the authority granted by Sections 1241.5 and 47604.3, a county superintendent of schools may, based upon written complaints by parents or other information that justifies the investigation, monitor the operations of a charter school located within that county and conduct an investigation into the operations of the charter school located within that county and conduct an investigation into the operations of that charter school.



# AB 139 Process – County Superintendent's Role

- The authority to call for an investigation rests with the county superintendent of schools.
- The examination determines if sufficient documentation and evidence exists to further investigate the findings, or if there is evidence of criminal activity that should be reported to the local district attorney's office for further investigation by law enforcement.
- **ONLY** the district attorney determines whether to prosecute the alleged perpetrator.

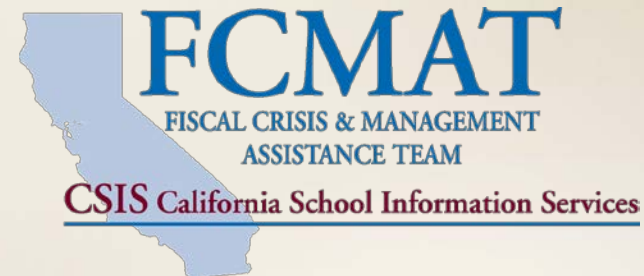




# AB 139 Process – County Superintendent's Role, cont.

- To engage a potential AB139 audit:
  - Notify your immediate supervisor of the alleged fraud
  - Ensure all evidence is documented
  - Notify your county office of findings/alleged fraud\*\*
- Next Step: County office contacts FCMAT.

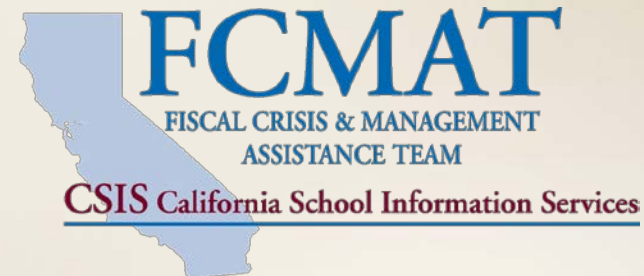
\*\*You should also notify your authorizer.



# What is Fraud?

“...**all** multifarious **means** which human ingenuity can devise, and which are resorted to by one individual **to get an advantage over another** by false suggestions or suppression of the truth. It includes all surprise, trick, cunning or dissembling, and any unfair way **by which another is cheated.**”

**Intent** is a critical element.

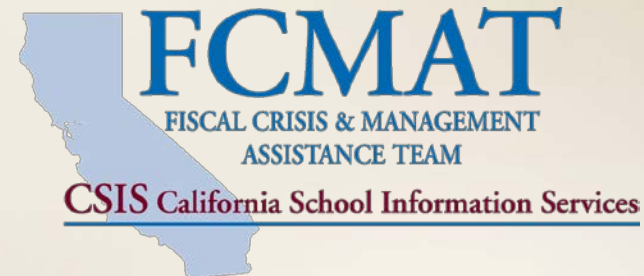


# Misappropriation – Another word for Fraud

"...**misappropriation** is the intentional, illegal use of the property or funds of another person for one's own use or other unauthorized purpose, particularly by a public official, a trustee of a trust, an executor or administrator of a dead person's estate or by any person with a responsibility to care for and protect another's assets (a fiduciary duty)."

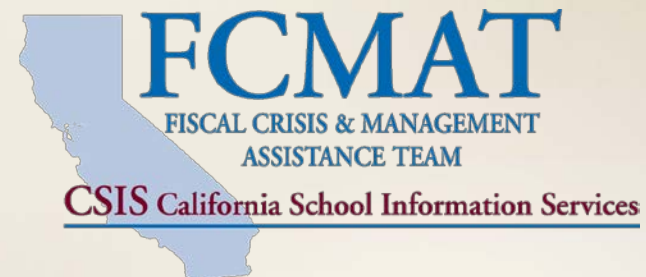
# Theft – Another Word for Fraud

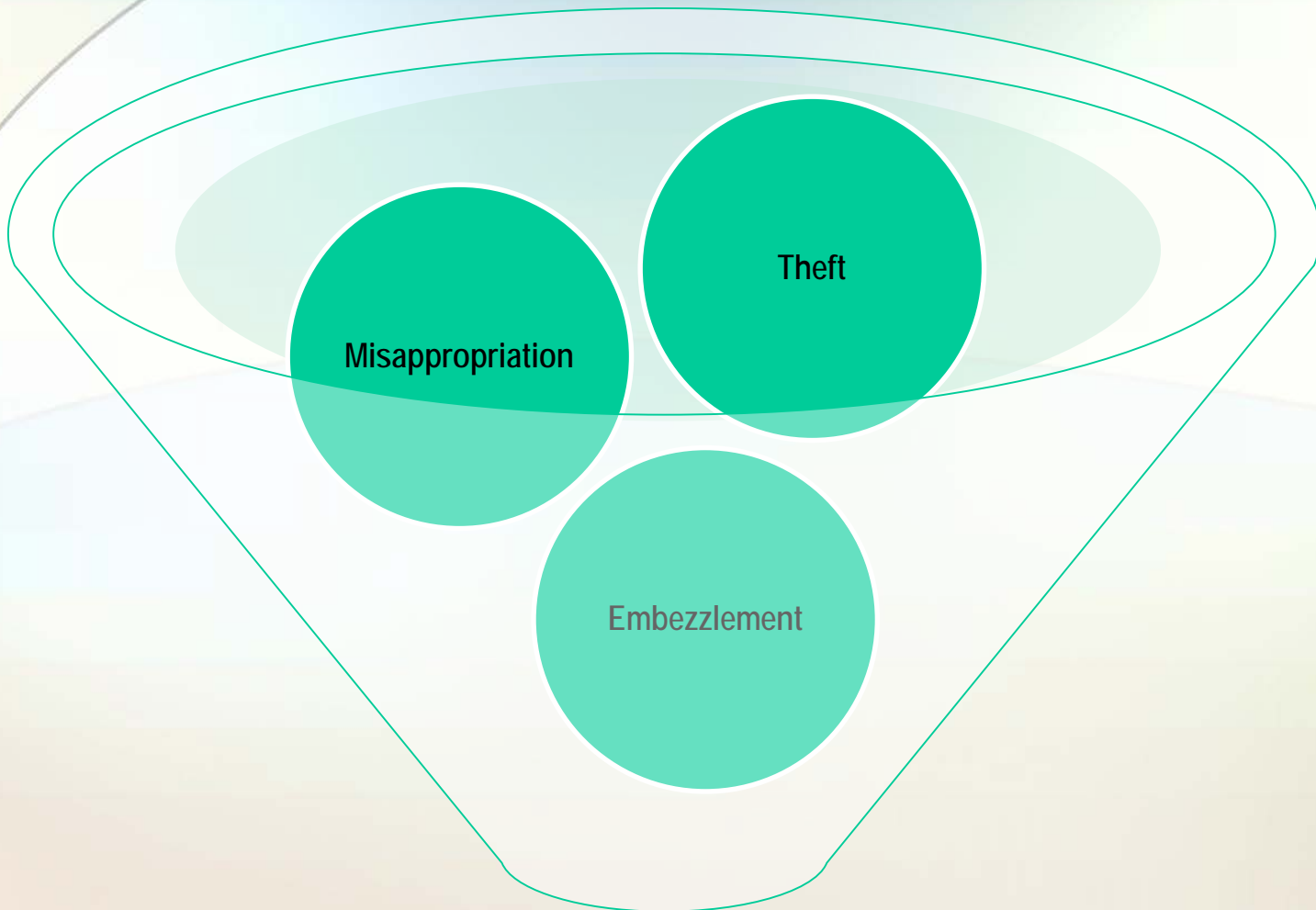
**Theft** involves knowingly obtaining or exerting unauthorized control over the property of another, with intent to deprive the owner of his/her property.



# Embezzlement – Another word for Fraud

**Embezzlement** is an act of **dishonestly withholding assets** for the purpose of conversion of such assets, by one or more persons to whom the assets were entrusted, **either to be held or to be used for specific purposes.**





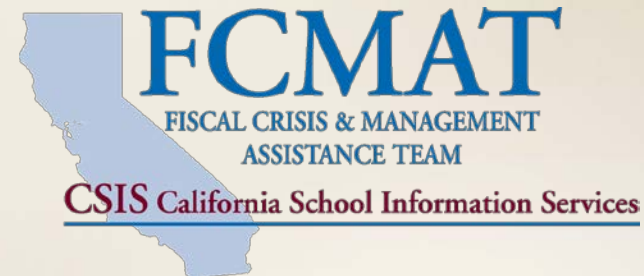
**Fraud**

# Best Practices for Fraud Oversight

- Create strong governing board policies and procedures.

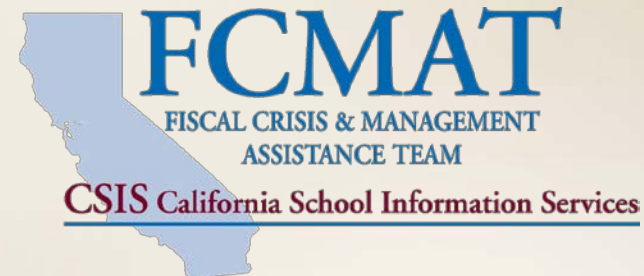
Did you know that the governing board of the charter is ultimately responsible for everything that happens in the charter school?

- Have a strong **ethical tone at the top** starting with the board and management.
- Ensure strong **internal controls** starting with a comprehensive business policies and procedures manual and employee manual, and training for all employees.



# Best Practices for Fraud Oversight, cont.

- **The governing board:** Establishes parameters for the charter's operations through board policies and regulations.
- **The administration:** Is responsible for establishing and monitoring the procedures to carry out the policies and regulations adopted by the governing board.
  - Remember: Charter board policies are additional laws the charter must follow.
  - Be aware of your fiduciary responsibilities.





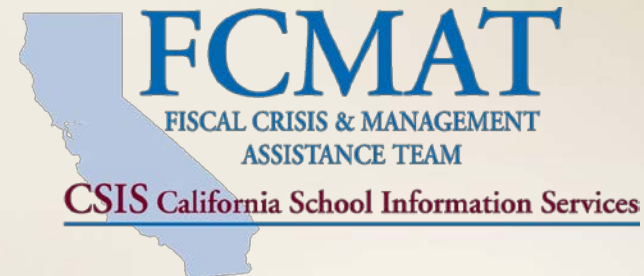
# Fiduciary Responsibilities

**Fiduciary Responsibilities (duty) is  
the Highest Standard of Care**

A **fiduciary** is a person who holds a **legal or ethical relationship** of trust with one or more other parties (person or group of persons). Typically, a fiduciary **takes care of money or other assets** for another person.

Examples include:

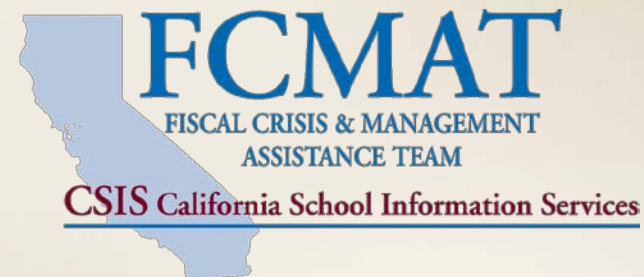
- **Governing Board**
- **Administration/Management**



# Fiduciary Responsibilities, cont.

**Duty of Care:** Before making a decision, collect all evidence and information available.

- Do your “**due diligence**” and review all the information and evidence available – don’t just accept the information as it is presented.
- **Assess information** with a critical eye and **ask questions: Who, what, when and where.**
- Your job is to **protect the assets of the charter school.**



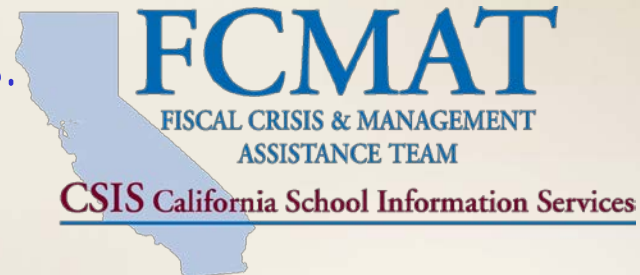
# Fiduciary Responsibilities, cont.

**Duty of Loyalty:** You cannot use your position in the organization to further your private interests.

- Avoid anything that might injure the charter. (When in doubt, don't do it).
- Think about how this might look in the newspaper headlines!

**Duty of Good Faith:** Advance the interests of the charter.

- Do not violate the law.
- Fulfill your duties and responsibilities.

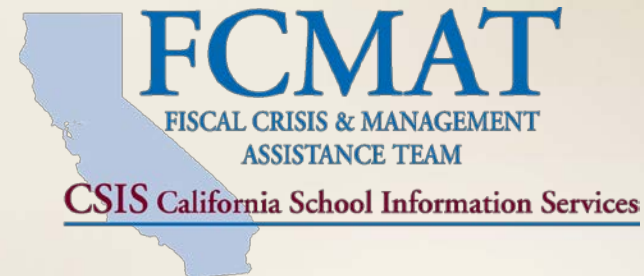


# Fiduciary Responsibilities, cont.

**Duty of Confidentiality:** Keep confidential matters confidential and **never disclose confidential information** to avoid personal liability.

**Duty of Prudence:** **Be trustworthy** to a degree of care and skill that a prudent board member, member of management, or fiduciary would exercise.

- Prudent means **acting with wisdom and care**, including **exercising good judgment**.

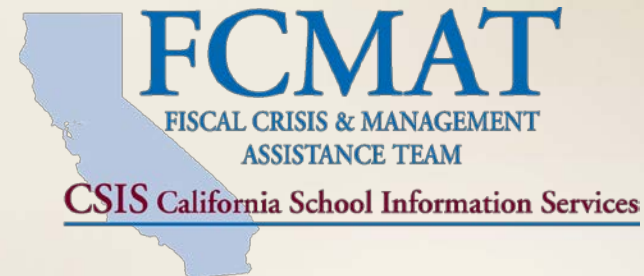


# Fiduciary Responsibilities, cont.

**Duty of Disclosure:** To act with complete candor.

- Be open, sincere, and honest.
- Be transparent.
- Disclose all financial interests on Form 700, Statement of Economic Interests.

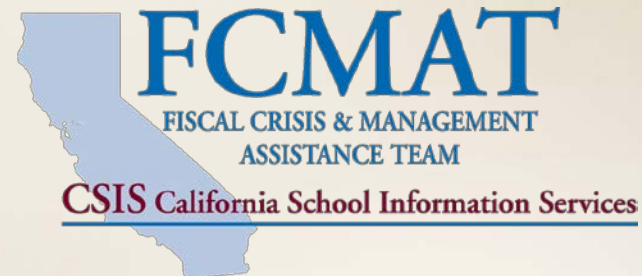
*"If in doubt, fill it out."*



# Fraud Overview

## Know Your Opponent

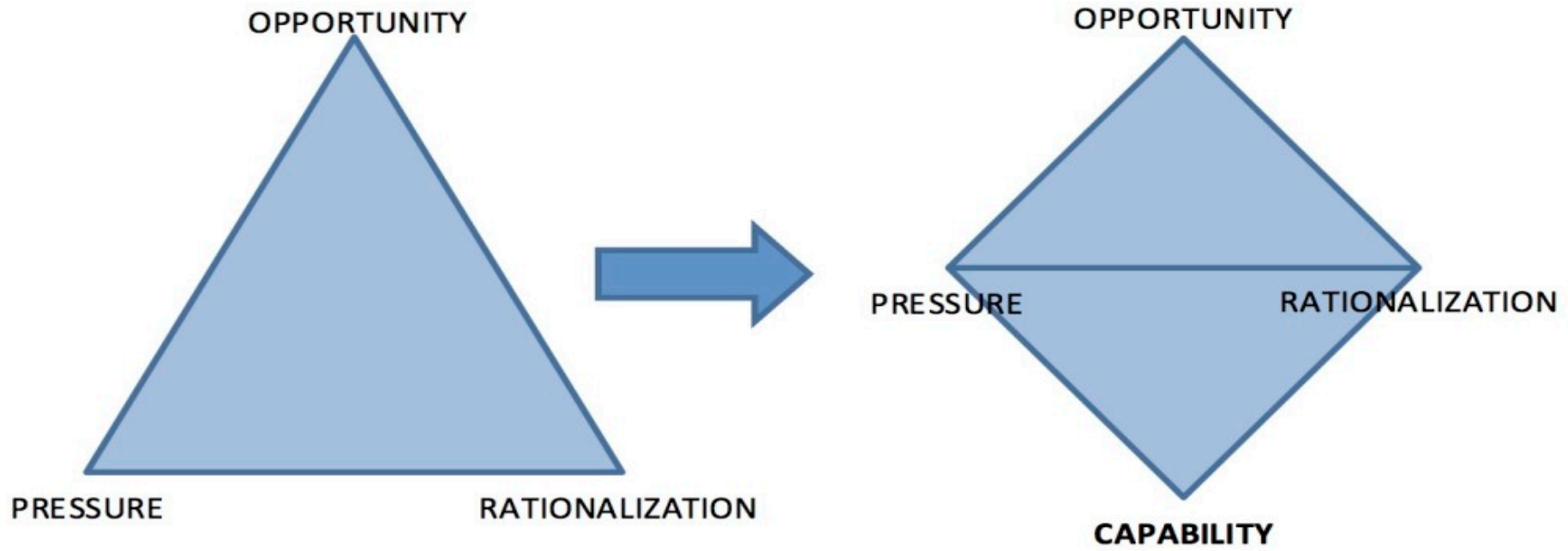
Often, fraud is committed by someone in a position of trust.



# Perception – Fraud/Unethical Behavior

- Perception is a very important factor when talking about fraud.
- Perception becomes reality left unchecked!
- Pressure is one of the keystones of the Fraud Triangle – those that commit fraud face **some form of pressure** to commit fraud.

# Fraud Triangle to Diamond

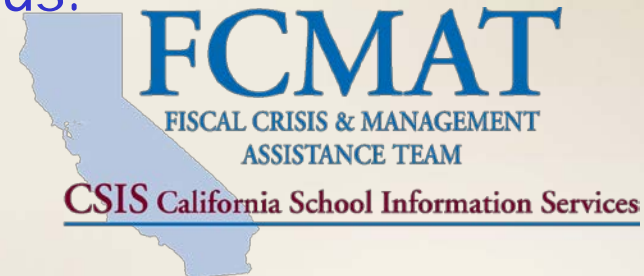


Source: ACFE



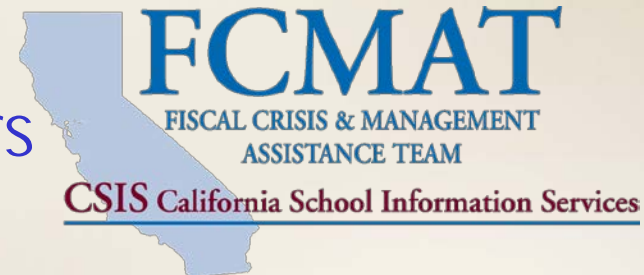
# Opportunity

- Opportunity is created when there are weaknesses in internal controls, ineffective governance, or lack of oversight.
- Opportunity means people will take advantage of the circumstances.
- Fraudsters believe an opportunity exists and assumes that:
  - No one is aware.
  - No follow up for employees that violate policy takes place.
  - No one will consider the offense serious.
  - No one will care.



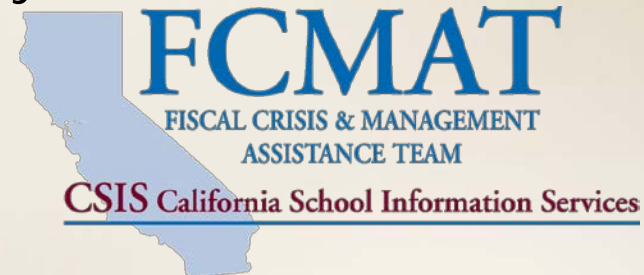
# Pressure

- Pressure or incentive is the motivation that leads to unethical and fraudulent behavior. It can be triggered by:
  - Sudden financial shortfalls
  - Living beyond one's means
  - Greed
  - Poor credit standing and inability to obtain credit
  - Unexpected expenditures
  - Family or peer pressure
  - Gambling losses
  - Alcohol, drugs, or extramarital affairs



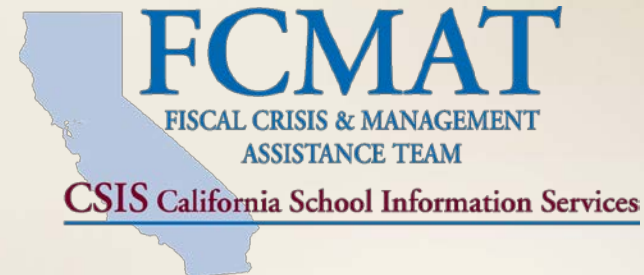
# Rationalization

- The fraudster must justify his or her actions. For example:  
“This is just a loan. I’ll pay it back when I get paid.”
- Myths, Fallacies and Justification
  - “Everyone does it.”
  - “I’m worth it; I’ve earned it.”
  - “The district won’t miss it; they can afford it.”
  - “I work hard and haven’t had a raise in five years!”
  - “I’m borrowing the money and will pay it back.”



# Capability

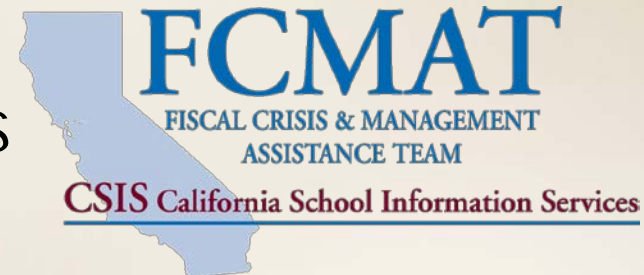
- Having the necessary skills, or abilities to pull it off.
- Recognizing the opportunity to commit fraud and having the ability to turn it into reality.
- Position, ego, intelligence, coercion, deceit and stress are supporting elements of capability.
- Capability is needed to not only carry out fraud, but more importantly, to conceal it.
- Capability represents skills to understand existing internal controls and exploiting weaknesses in those internal controls to plan and implement fraud.



# How to Protect Your Charter School

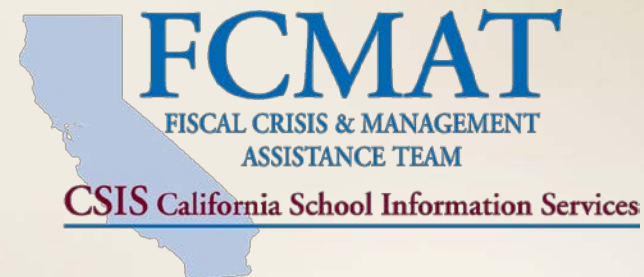
## Strong Internal Controls are Essential

- The most effective protection is an independent third party FRAUD HOTLINE or other type of third party fraud reporting.
- Strong internal controls are your first line of defense.
- Without a strong internal control system, you have your most important red flag that problems are heading your way.
- Board member and management actions, philosophy, tone, and culture are critical.
- Transparency and clear documentation of written board policies and procedures is a must.



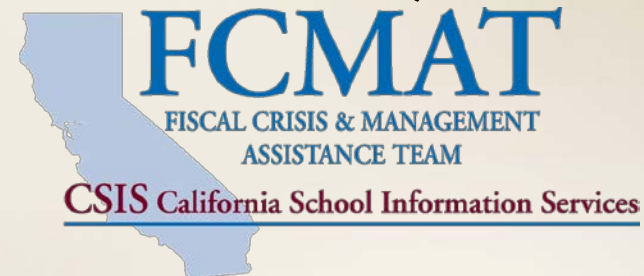
# Internal Controls

- Effective internal control processes provide reasonable assurance that a charter school's operations are effective and efficient, that the financial information produced is reliable, and that the organization operates in compliance with all applicable laws and regulations.
- Internal controls are the principal mechanism for preventing and/or deterring fraud or illegal acts, misappropriation of assets or other fraudulent activities.



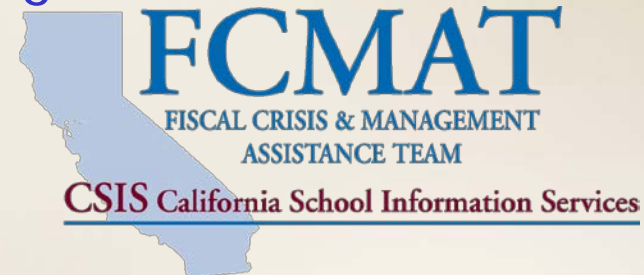
# Internal Controls, cont.

- Policies and procedures designed to provide the governing board and management with reasonable assurance that the organization achieves its objectives and goals.
- Ensure that all management and other employees are following policies and procedures.
- Internal controls include:
  - Management review and approval (signatures, initials, and dates).
  - Timely reconciliations (signatures, initials, and dates).
  - Limit access to assets.



# Internal Controls, cont.

- Maintain and update written policies, procedures and standards of conduct (comprehensive manuals), but make sure employees are following them.
- Appropriate board and management tone – “tone at the top.”
- Performance evaluations.
- Training programs (e.g. attendance, accounting, proper paperwork, Form 700, conflicts of interest, ethics).
- Efficient and effective written accounting and business practices, policies and procedures.
- Segregation of duties.





# Internal Controls, cont.

- Internal controls are **CRITICAL** to:
  - Protect the charter school's **assets**.
  - Protect **students, employees and staff** who handle cash.
- Hire qualified management and employees.

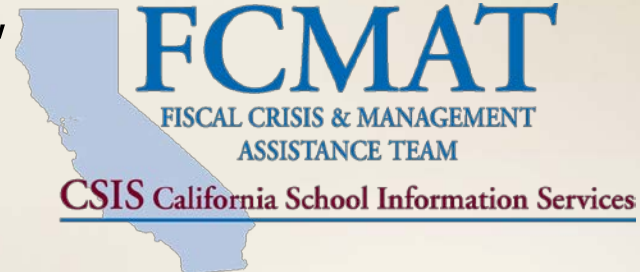
# What is Critical for Internal Controls?

Essential that the organizational culture promotes awareness and takes fraud seriously at all levels.

When employees and/or the public perceive the governing board or management is not engaged, does not take fraud seriously, and is not interested in a strong internal control system, **problems are heading your way!**

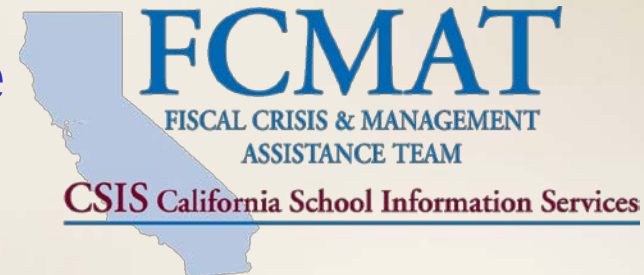
# Do's and Don'ts of Internal Controls

- Ensure purchase order/requisition is complete before purchase.
- Make certain proper forms are used, completed, and properly signed/dated.
- Keep checkbook and extra check stock in a secure place.
- Void checks that are incorrect or not issued.
- Have backup signers -- never sign checks in advance.
- Never make check out to "cash."
- Do not cash personal or third-party checks.
- Use checks in proper sequence.
- Ensure there are two signatures on checks.
- Endorse all checks – "For Deposit Only ..."



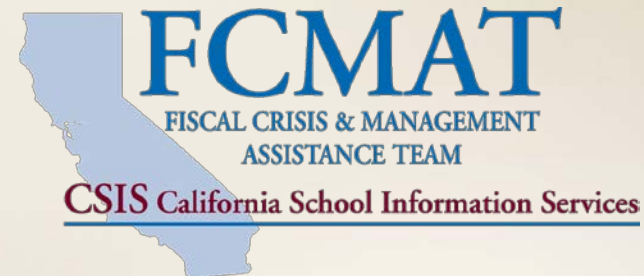
# Do's and Don'ts of Internal Controls, cont.

- Cash is never counted alone. Always have a witness present.
- Cash receipts are issued from a prenumbered, multi-copy receipt book controlled where it is stored. (white, yellow and pink).
- Proper cash handling and physical chain of custody for all cash receipts.
- People are not allowed to walk funds unescorted to the safe or bank.
- Funds are transported in tamper proof, sealed plastic bank bags.
- No commingling of receipts from separate events.



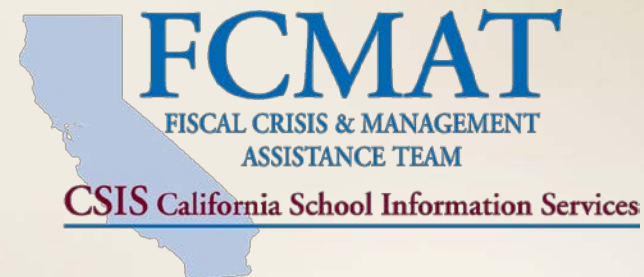
# Do's and Don'ts of Internal Controls, cont.

- Secure safes with limited access at each location.
- Funds should never be taken home, put in a desk drawer or in a locked file cabinet.
- Timely monthly financial reports signed, initialed, and dated.
- Timely deposits. Board policy should define "timely".
- Financial and reconciliation reports are issued timely and reviewed/approved by management.
  - Discrepancies are investigated and resolved timely.
- Separate user IDs and passwords issued to each system user.



# Do's and Don'ts of Internal Controls, cont.

- Identify the personnel charged with terminating user access when employee terminated or resigns.
- Bank reconciliations should be completed within two weeks of receiving bank statement including proper review, approval, and signatures.
- Goods and services **MUST BE RECEIVED** and authorized before payment.
- Payments or disbursements made **ONLY** when original documents/receipts exist (e.g., proof of purchase).

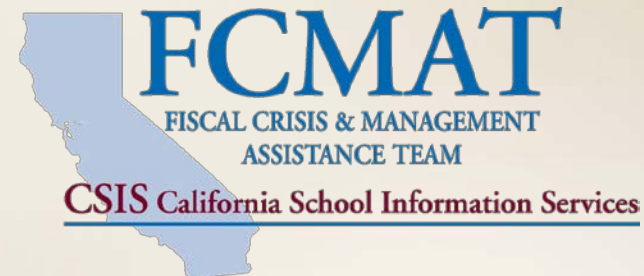


# Do's and Don'ts of Internal Controls, cont.

- A process to report overages and shortages.
- Attendance software data reconciles to reports and limited access to attendance software. (Attendance software should have an audit tracking feature showing who used the software, etc.)

# Do's and Don'ts of Internal Controls, cont.

- Transparent and full disclosure of affiliate or related parties (Related party relationships are not illegal or bad; failure to disclose is.)
- Clear board member, executive team, and staff spending, reimbursement and authorization parameters and limits
- Governing board approving the check run/cash disbursements journal
- Donation acceptance and issuance policy
- Vendor approval/acceptance/vetting policy

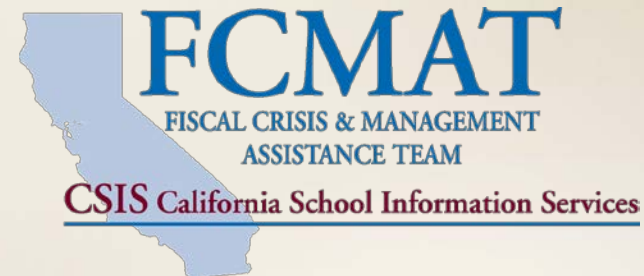




# What the Charter Board Should See

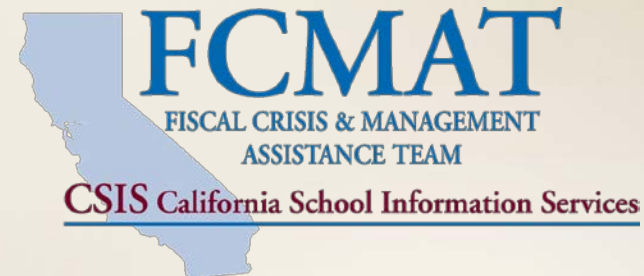
Anything the board requests should be available promptly.

- Payroll and account payable registers
- Contracts
- Documentation for large transactions (Generally over a defined dollar amount.)
- Monthly financial and attendance reports
- Balance sheet and Income statement
- Cash flow statement
- Loan/lease documents



# What the Charter Board Should See, cont.

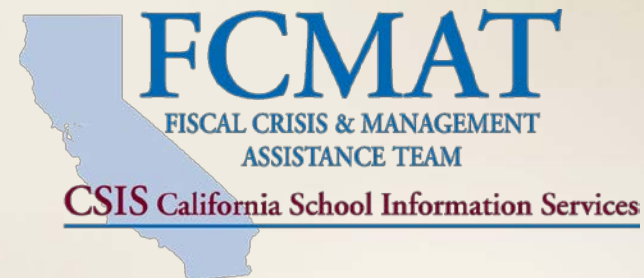
- Employment agreements
- Compensation and benefits changes
- Contract changes
- Outside agency reports, requests, or notices (i.e. IRS, FTB, Oversight Agency, etc.)
- Any document or agreement that requests the charter to waive its rights (representation, contractual, etc.)
- Changes in policies and procedures



# Steps to Help Prevent Fraud

## Step One: Be Proactive

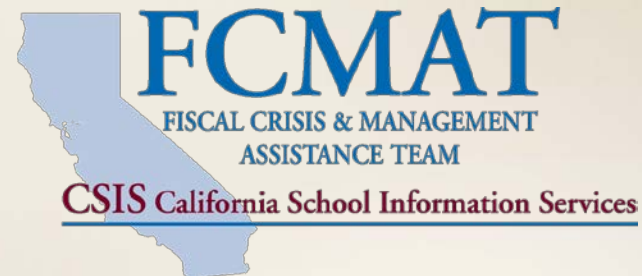
- Establish and maintain **internal controls** designed to prevent and detect fraud.
- Create an independent third party **fraud hotline** or **other third party reporting service** and provide **training** to employees on how to access and report unusual behavior.



# Steps to Help Prevent Fraud, cont.

## Step One: Be Proactive, cont.

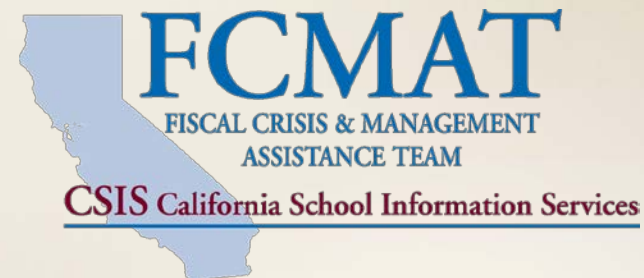
- Adopt a **code of ethics** for management and employees.
- Set a **tone at the top** that the company will not tolerate any unethical behavior.



# Steps to Help Prevent Fraud, cont.

## Step Two: Establish Hiring Procedures

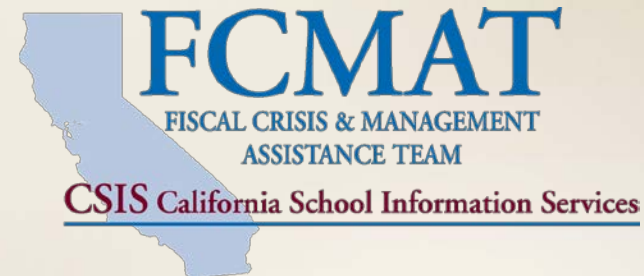
- When hiring staff, conduct thorough background investigations.
- Check educational, employment history, and references.
- Incorporate evaluation of the employee's compliance with annual ethics training.



# Steps to Help Prevent Fraud, cont.

## Step Three: Train Employees in Fraud Prevention

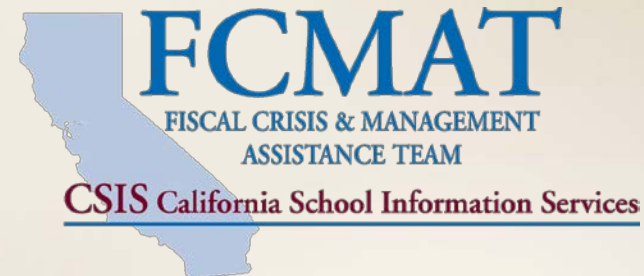
- Once carefully-screened employees are on the job, are they **aware of procedures** for reporting suspicious activity by customers or co-workers?
- Do employees **know how to access** the fraud hotline or other fraud reporting service?
- Ensure that staff know some **basic fraud prevention techniques**.



# Steps to Help Prevent Fraud, cont.

## Step Four: Conduct Regular Audits

- High-risk areas need extra internal controls and periodic audits:
  - Accounts payable,
  - Payroll,
  - Construction, and
  - Inventory

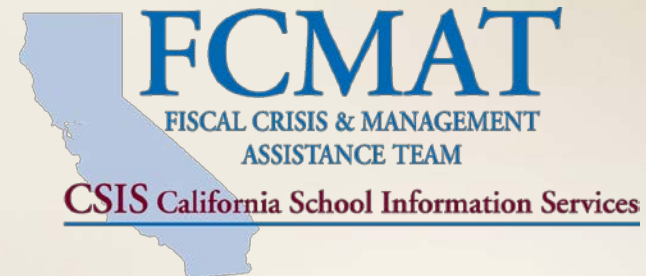


# And Remember...

Not everything that looks suspicious is fraud,

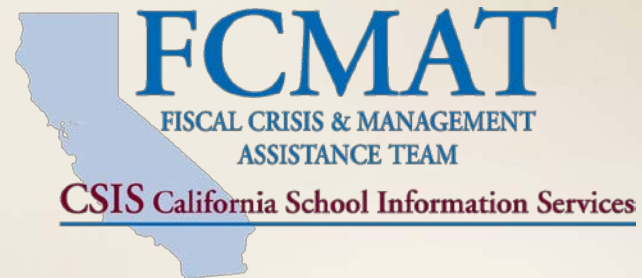
but .....

Almost all fraud generally looks suspicious.





Any Questions???



**Thank You For Attending**

