

Fraud zone defense

An effective anti-fraud program can protect against painful losses



Linda M. Saddlemire

You may not realize it, but in comparison to other industries, the occurrence of fraud in education is significant. In its “2008 Report to the Nation on Occupational Fraud and Abuse,” the Association of Certified Fraud Examiners ranked education sixth out of the 21 industries studied, accounting for approximately 6.5 percent of the cases reported. (The banking and financial services industry ranked highest with 14.6 percent.) Considering that the 2008 average loss due to fraud was \$175,000, school board members should be aware of the risks and take action to reduce them.

Five essentials for establishing an effective anti-fraud program

For a school board, the risk of fraud may be an unknown factor—a silent enemy waiting in ambush to steal resources, reputation and credibility. As education’s first and last line of defense against fraud, the board must be committed to effective anti-fraud measures that significantly reduce the risk of loss. The vast majority of school employees are honest, upright staffers, of course, but it’s the exceptions who

board can also send frequent, powerful messages about its expectations for ethical behavior.

1. **Tone at the top: Establish a culture of integrity and ethics**

While administrators and staff will likely implement the day-to-day application of anti-fraud measures, the school board should ensure that the tone set from the top is one of high ethical standards. The message must be clear and consistent, both in word and in actions, that fraud will not be tolerated. The American Institute of Certified Public Accountants suggests that defining an organization’s core set of values as a formal code of conduct is the first step toward reducing wrongdoing. Delineating expected ethical and business behavior, frequently addressing the topic and following through with disciplinary measures sends a clear message that ethics matter.

Morale plays a critical role in fraud prevention as well. Workplaces that promote healthy collaboration and provide a supportive environment for employees are less likely to experience fraud. Whatever is most highly valued by the board will be practiced by administrators and staff.

Certified fraud examiners expect that the occurrence of fraud will continue to rise this year. Establishing an effective anti-fraud program is a critical safeguard.

prove the rule. The question becomes, where is a school district or county office of education most vulnerable?

Investigators agree that when *pressures* mount, *opportunity* exists, and *rationalization* occurs, there can be an ethical breakdown leading to fraud. Experts call it the “fraud triangle,” and it can thrive in the current economic conditions. Opportunity and rationalization are the triangle’s hot zones, where the board must bolster defenses to reduce risk. The five effective measures outlined below can limit opportunities to commit fraud arising from poor internal controls or inadequate oversight. The

2. **Internal controls:**

Tighten accounting operations

Each financial operation within the educational organization must have strong internal controls that help to prevent fraud. This applies to all key areas, from payroll, transportation and food services to purchasing, inventory, cash collections and beyond. So often when fraud occurs, proper controls are either missing or circumvented.

The most critical control is the segregation of duties, which refers to the separation of three functions: authorization of a transaction (management), recording of the transaction

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(accounting), and custody of the asset involved (supervision). No one person should control more than one of these responsibilities. When accounting functions are properly segregated, for example, deliberate fraud is more difficult because it requires collusion of two or more persons, and it is much more likely that inadvertent errors will be found. The segregation of duties can become lax in times of economic hardship, when districts are consolidating accounting duties within a possibly smaller staff, but failure to separate functions drastically increases the risk for fraud.

3. External and internal audits:

Make the oversight process meaningful

External audits are required by law in part because they provide an independent evaluation of the financial processes in place. The resulting

audit report can act like a metal detector sweeping over a mine field, exposing financial variances or weaknesses in internal controls. Pay attention to any financial adjustments the external auditors make to the organization's financial statements, which are required disclosures in the annual audit report. The adjustments may lead to areas that need improvement. Weak internal controls create a higher risk of fraud.

Because of their unique perspective and access to financial processes at all levels, internal auditors can effectively reduce fraud risks, especially when they report directly to the school board. For example, an administrator who is perpetrating fraud may use undue pressure or concealment of fact to get other employees involved. Mid- to low-level employees may not recognize a superior's misconduct, but an internal auditor can spot

management overrides within the financial reporting process. Quarterly reports from the internal auditor should include the results of tests on specific departments, accounts and/or individual functions. The areas tested may be identified by the external audit as potential risk areas or may be designated annually by the board. Conducting surprise audits is also effective.

4. Training: Institute regular ethics and fraud awareness training

Educating employees at all levels provides a critical piece of fraud prevention. When a training policy originates with the board, it communicates that fraud will not be tolerated—a perfect example of setting the tone at the top. Similar to sexual harassment training, fraud training should be conducted at least annually so that employees are familiar with the definition of fraud, their duty to report it, how to recognize various schemes, and how to report suspicious activities. Board members can assist administrators in thinking creatively about conducting training that is cost-effective.

5. Hotline: Implement an anonymous mechanism for reporting fraud

Establishing a mechanism for anonymous, confidential reporting, such as a hotline, is a low-cost, frontline defense against fraud. In 2008, the ACFE reported that 46 percent of fraud cases were detected because of a tip, and that victimized organizations that had a hotline in place had an average dollar loss of 60 percent less than those with no hotline. Two key explanations are at play. First, a board that has implemented a confidential reporting mechanism and educated its employees has communicated that fraud is not acceptable and that it will listen to an employee's concerns. This builds confidence and morale in the workplace—a sense of loyalty and ethics. Second, losses due to fraud are drastically reduced when the scheme is detected early. Many employees hesitate to report suspicions, fearing that they won't be believed or that they could lose their job for making an accusation. A confidential reporting mechanism allows an employee to blow the whistle without risking retaliation.

Eighty-eight percent of certified fraud examiners expect the occurrence of fraud to continue to rise this year. Establishing an effective anti-fraud program is a critical safeguard board members must responsibly consider. Each of these essentials will help school boards avoid fraud, but combining the five—tone at the top, tight internal controls, meaningful internal and external audits, fraud awareness training, and the implementation of a hotline—can save considerable resources and reduce the likelihood of fraud in our educational system. **S**



PROBLEM: Education placed 6th out of 21 industries in the highest number of fraud cases reported in 2008 – this equates to 6.5% of all reported fraud cases.
2008 ACFE Report To The Nation On Occupational Fraud & Abuse

PROBLEM: In 2009, 50% of the Certified Fraud Examiners surveyed, reported an increase in both the number of fraud cases and the dollar amount lost to fraud.
2009 ACFE Occupational Fraud: A Study of the Impact of an Economic Recession

PROBLEM: For the 2009-10 academic year for California K-14 education, \$7.7 billion has been removed from their operating budgets – this equates to a 13.25% decrease year over year.
2009 School Innovation & Advocacy: 2009 Summer Budget Briefings

SOLUTION: **VLS Fraud Solutions, with over 50 years combined experience, helps local education agencies build frontline protection with affordable and effective anti-fraud programs – *Fraud Alert Hotline, Ethics and Fraud Awareness Training, Fraud Investigation Services, Internal Control Advisors.***

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