

# K-12 Schools Series: Risks of Occupational Fraud Facing Schools

July 16, 2020

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# Learning Objectives

At the end of this session, you will be able to:

- List the eight important facts of fraud
- Discuss the latest fraud risks affecting schools
- Identify actual instances of fraud that have recently occurred within schools
- List and describe the most common fraud schemes
- Identify common red flags and indicators of fraud
- Recognize what internal control activities could have been in place to prevent the fraud from occurring or at least detect the malfeasance earlier



# Introduction

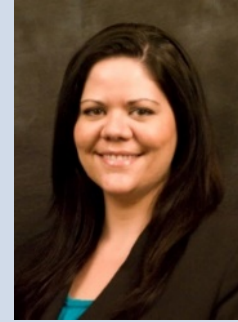
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# Speaker Introduction

Signing Director  
*CLA's Forensic Practice*

Over 19 years of experience leading fraud investigations, forensic accounting projects, and internal control reviews for large government organizations, education institutions, nonprofits, and commercial businesses.



**Jenny  
Dominguez**

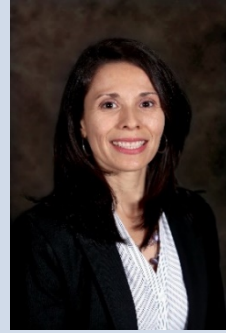
CPA/CFF, CFE

# Speaker Introduction

Manager

*CLA's Forensic Practice*

Seven years of experience performing forensic accounting engagements, fraud investigations, and internal control assessments for governmental, educational, and private entities.



**Ana  
Rodriguez**

CPA, CFE



# Eight Important Facts of Fraud

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## Association of Certified Fraud Examiners (ACFE)

- World's largest anti-fraud organization
- Provides Certified Fraud Examiner (CFE) credential
  - Requires meeting professional, educational, and ethical standards and passing a rigorous exam on the four major disciplines that comprise the fraud examination body of knowledge: Fraud Prevention and Deterrence, Financial Transactions and Fraud Schemes, Investigation, and Law
- Headquartered in Austin, TX
- 85,000+ members
- Local Chapters

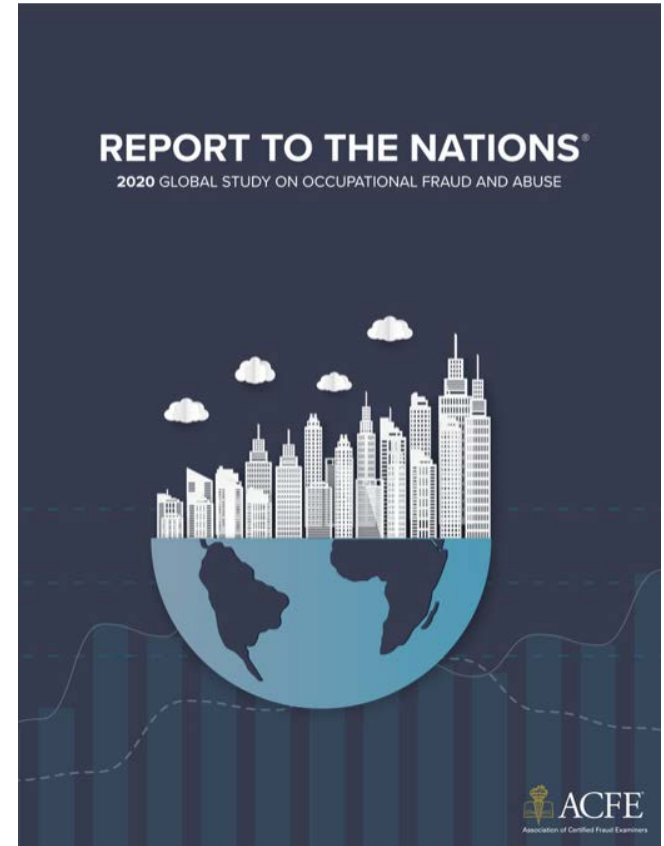


From ACFE website: [www.acfe.com](http://www.acfe.com)



## ACFE Report to the Nations 2020

- Report to the Nations 2020 Global Study on Occupational Fraud and Abuse
- Bi-Annual Report
- Analysis of 2,504 cases of occupational fraud across 125 countries
- Results based on 2019 *Global Fraud Survey* opened to CFEs about their single largest fraud case investigation completed between January 2018 and September 2019
- First ACFE Report to the Nations was issued in 1996



<https://www.acfe.com/report-to-the-nations/2020/>

# Types of Occupational Fraud - Categories

## *Corruption*

- schemes in which an employee misuses his or her influence in a business transaction in a way that violates his or her duty to the employer in order to gain a direct or indirect benefit (e.g., schemes involving bribery or conflicts of interest)

## *Financial statement fraud*

- schemes in which an employee intentionally causes a misstatement or omission of material information in the organization's financial reports (e.g., recording fictitious revenues, understating reported expenses or artificially inflating reported assets)

## *Asset misappropriation*

- schemes in which an employee steals or misuses the organization's resources (e.g., theft of company cash, false billing schemes, or inflated expense reports)

# Occupational Fraud by Category - Frequency

FIG. 2 How is occupational fraud committed?

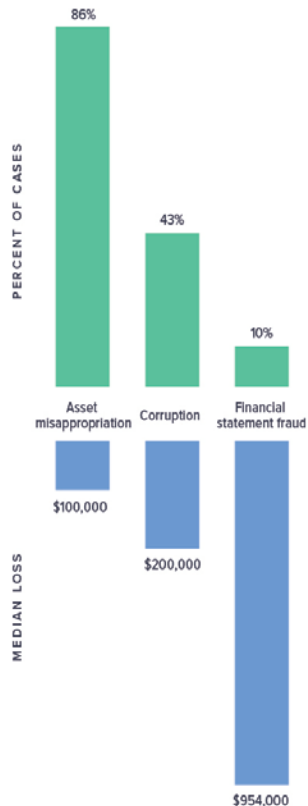
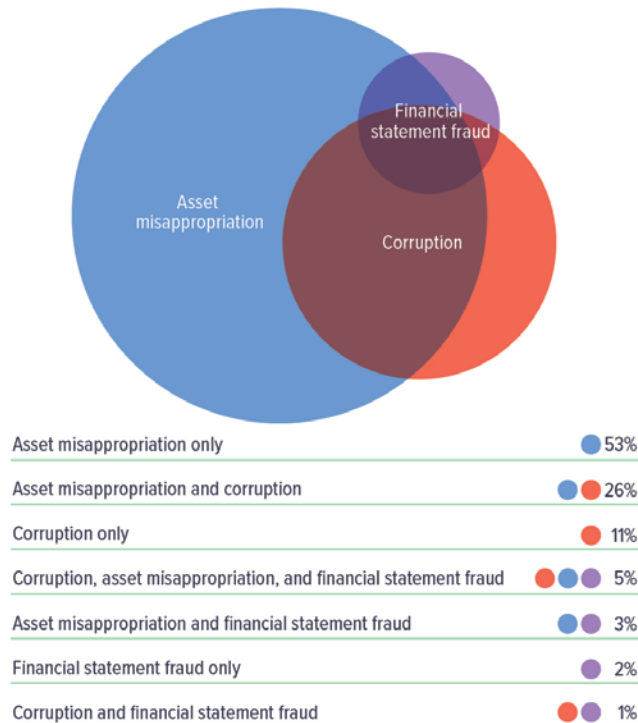


FIG. 4 How often do fraudsters commit more than one type of occupational fraud?



Source: ACFE 2020 Report to the Nations

# Occupational Fraud by Organization Type

FIG. 14 What types of organizations are victimized by occupational fraud?

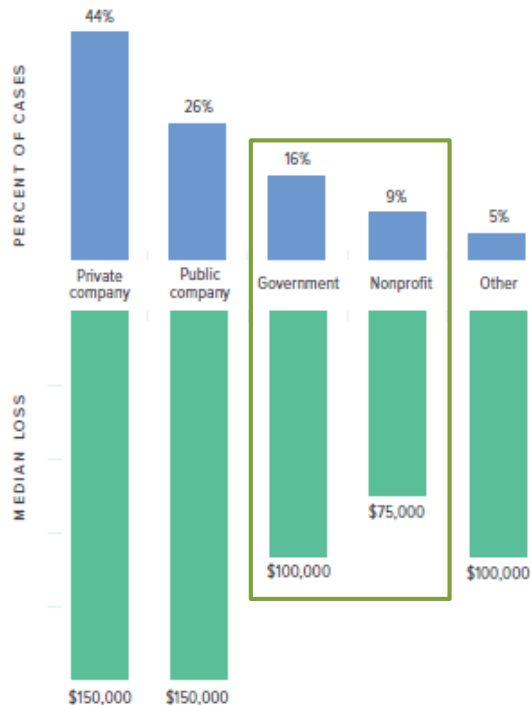
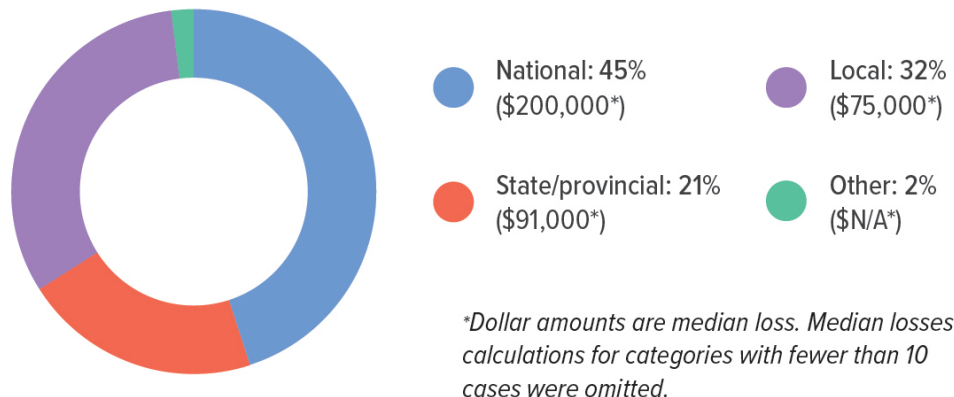


FIG. 15 What levels of government are victimized by occupational fraud?



Source: ACFE 2020 Report to the Nations

## Eight Key Facts from the *Report to the Nations* and Our Experience

1. Typical organizations lose 5% of revenue in a given year as a result of fraud
2. Fraud exists in every organization and every industry type – **top 5** industries with the highest occurrence of fraud:
  - Banking and financial services
  - Government and public administration
  - Manufacturing
  - Health care
  - Energy
3. Prominent weakness – lack of internal controls



## Eight Key Facts from the *Report to the Nations* and Our Experience

4. Most common form of occupational fraud – asset misappropriation
5. Check tampering and billing schemes represent the greatest risk
6. Most perpetrators are first time offenders (only 4% had prior convictions)
7. Frauds with highest frequency occur in operations, the accounting department, and in executive/upper management
8. The majority of occupational frauds are not material to the financial statements (frequent, small transactions taking place over an extended period of time)

DEPARTMENT	Cases
Operations	288
Accounting	277
Executive/upper management	234
Sales	225
Customer service	175
Administrative support	116
Finance	101
Purchasing	96





# The Fraud Triangle

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# The Fraud Triangle



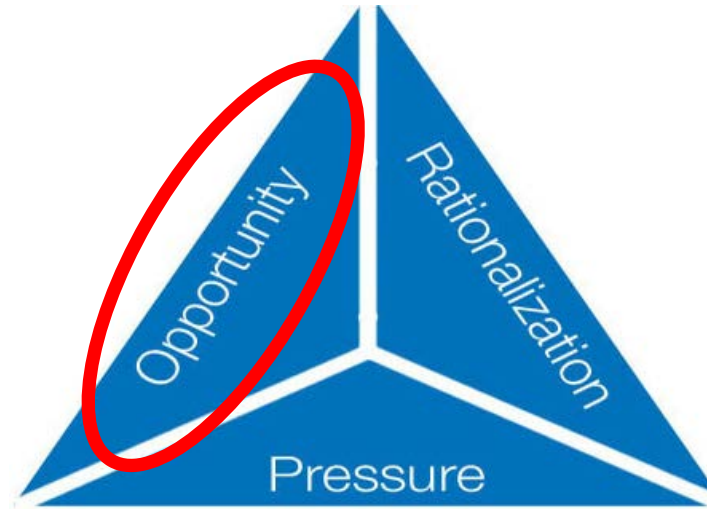
Understanding the Fraud Triangle is critical to:

- Minimize the risk of abuse
- Minimize the risk of fraud
- Develop strong internal controls



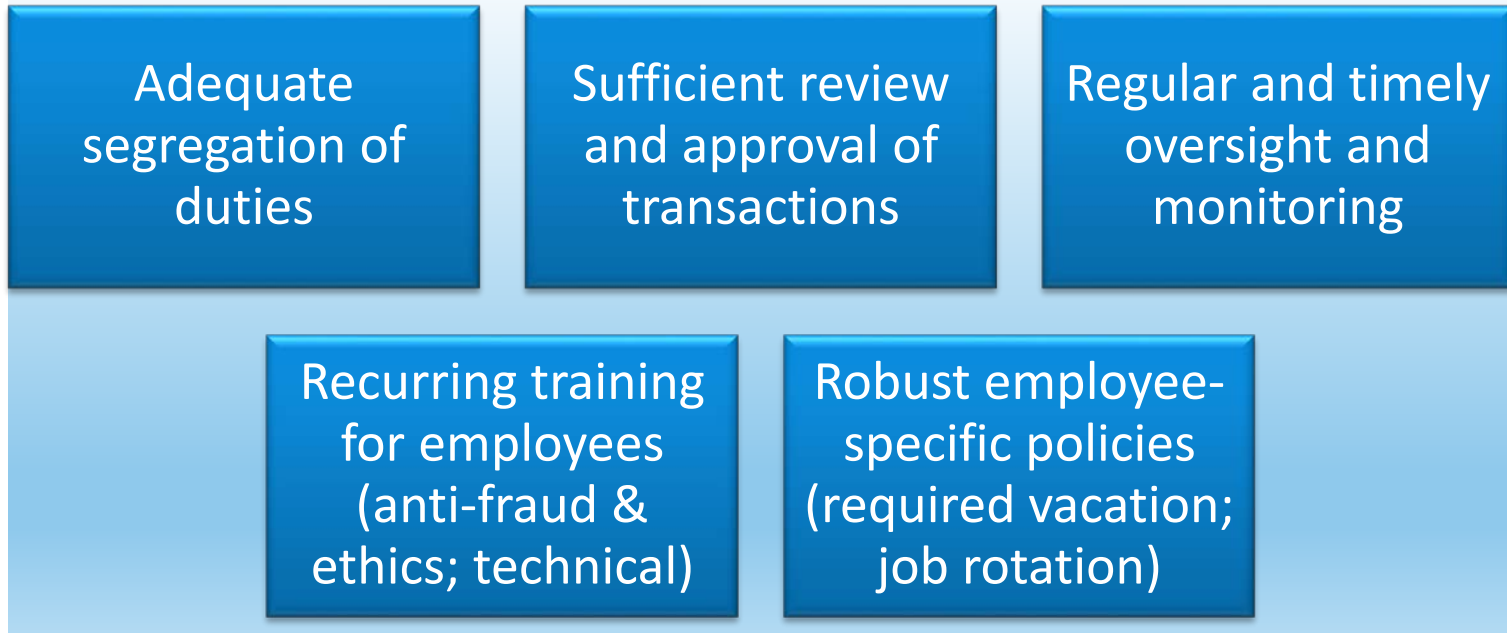
# The Fraud Triangle

**What aspect of the Fraud Triangle does your organization have some control over?**



# The Fraud Triangle

How can your organization reduce opportunity for fraud?



# The Fraud Triangle

## What has been the impact of COVID-19 on internal controls?

1. Fewer staff (reduced segregation of duties)
2. Revised approval processes
  - a) Approvals by email only (no electronic or wet signature)
  - b) Fewer approvals required
  - c) Original documents not available for review
3. Less oversight and monitoring
4. Heightened risk of cyber-crimes



# Actual Instances of Fraud that Have Recently Occurred within Schools

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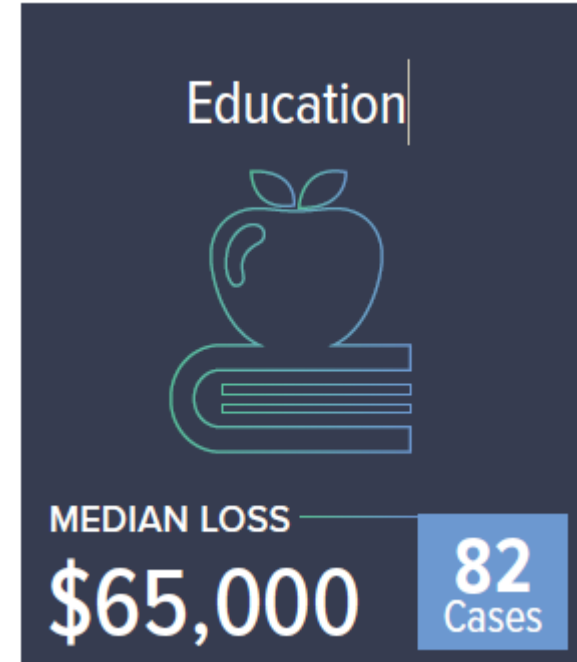
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# Why Should We Care?

## Why Should Schools Be Concerned About Fraud?

# Fraud in Schools

1. Credit card use
2. Purchasing process
3. Student activities/Team fundraisers
4. Booster clubs
5. General IT vulnerabilities including phishing emails (increased risk with remote work)
6. Public integrity & conflicts of interest



# Impact of Fraud – More than Just Money

## Monetary

- Actual loss
- Costs and time spent by investigators/attorneys

## Reputation

- Media attention (newspapers, social media)
- Loss of confidence by community, donors, etc.

## Increased Costs

- High risk audit / increased audit costs

# School Fraud in the News

**As Lennox School District wrestled with dire finances, some officials spent freely on district credit cards**

One former board member racked up more than \$5,000 in questionable expenses in a 5-month period

Former Esperanza High School employee under investigation for allegedly stealing from student programs, district officials say

**KY school official admits stealing \$1.6 million, laundering money through a church**

Los Angeles Times

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Parent volunteer arrested on suspicion of embezzling money from North Hollywood school

Former PTO President Arrested For Theft



# Fraud Schemes

1. As school district wrestled with dire finances, some school officials spent freely on District credit cards
  - One former board member spent more than \$5,000 in questionable expenses
  - Spent at local restaurants, fast-food outlets, 7-Eleven, and Starbucks
2. School official admits stealing \$1.6 million
  - Created fake invoices from vendors the district worked with
  - Wrote checks to self
  - Laundered money through a church where she was the treasurer

# Fraud Schemes

3. ASB Finance Clerk suspected of embezzling at least \$859,000 from student council
  - Finance Clerk viewed as strict, overbearing , and not easily approachable when questioned regarding ASB transactions
  - ASB advisor's signature on paid invoices had been forged
4. Parent volunteer arrested on suspicion of embezzling money from school's nonprofit organizations
  - Nonprofit organization raises money for field trips and after-school programs
5. Elementary school PTO president charged with theft
  - PTO president made repeat cash withdrawals from the PTO Bank account that coincided with deposits into personal checking account



# What were the fraud schemes?

1. Credit card misuse (billing scheme)
2. Fictitious invoices (disbursement scheme)
3. Check and payment tampering (disbursement scheme)
4. Theft of receipts/donations
5. Theft of receipts/donations



# Most Common Fraud Schemes Affecting Schools

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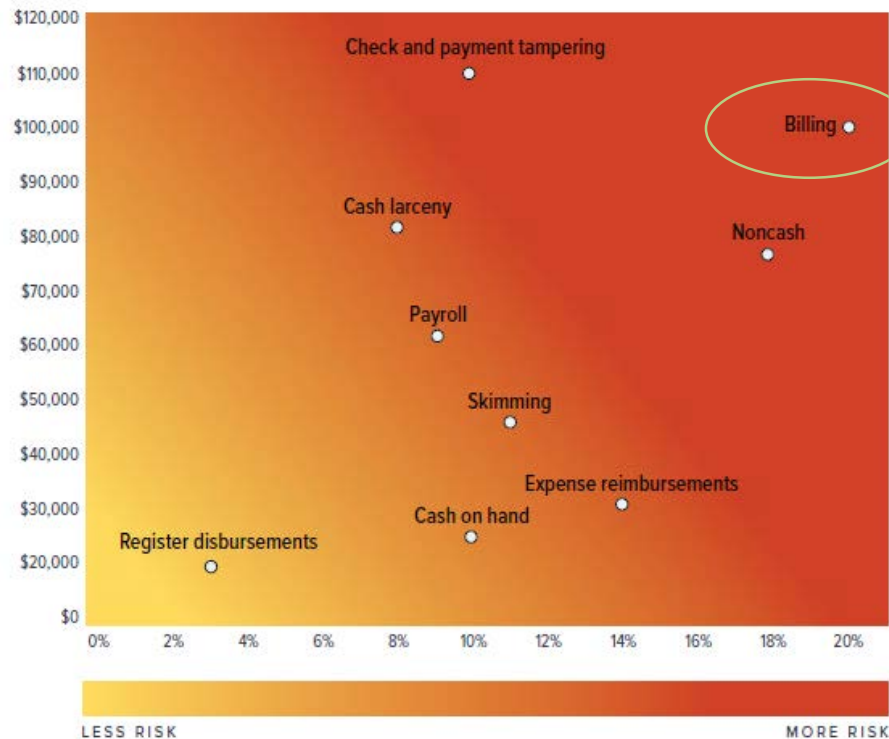
# Credit Card Abuse/Misuse

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# Credit Card Abuse/Misuse (Personal Purchases)

FIG. 5 What asset misappropriation schemes present the greatest risk?

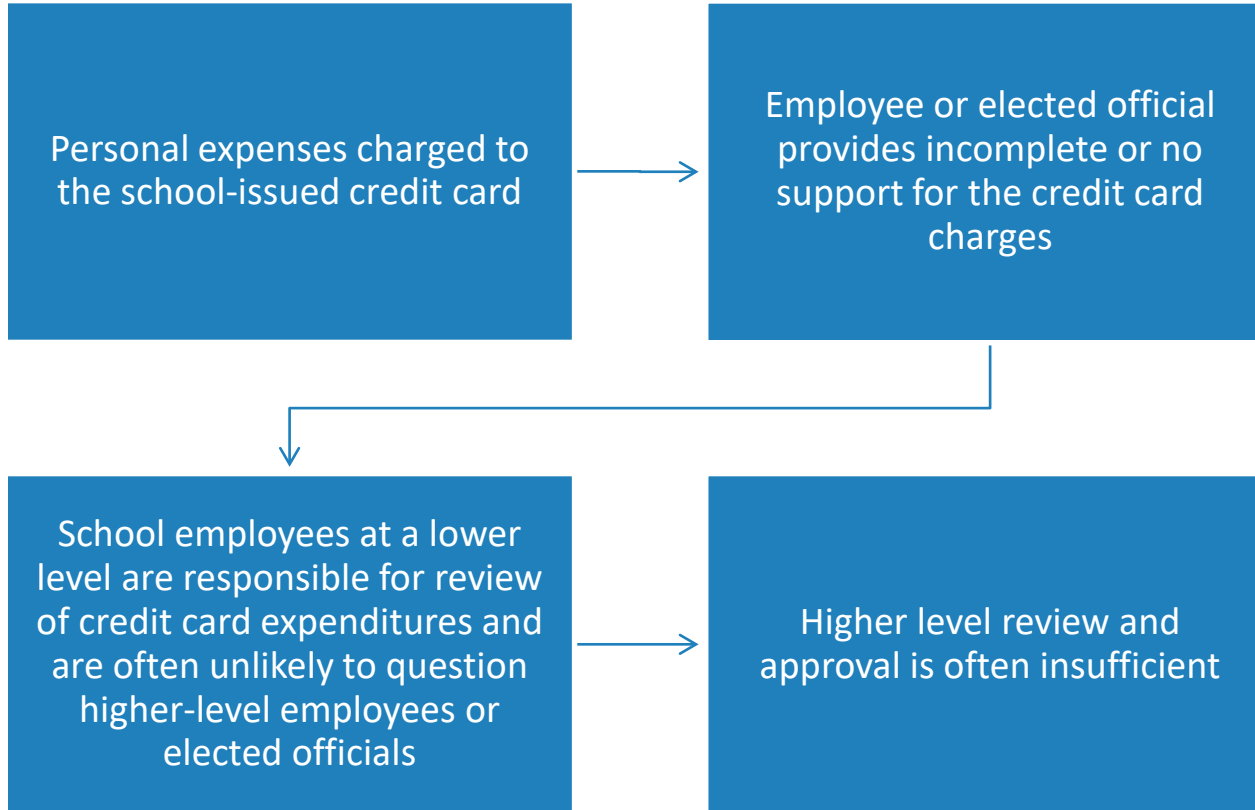


Source: ACFE 2020 Report to the Nations

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# Credit Card Abuse/Misuse - Scheme





# Example #1: Credit Card Abuse/Misuse

## School Board Official:

- Financially strapped school district was borrowing money from the county to pay its bills, while school officials were allowed to abuse district credit cards
- Administrators failed to enforce policies requiring officials to justify expenses
- Not clear whether the board reviewed each of the officials' credit card expenditures
- Abuse went on undetected for more than five months
- Over \$5,000 spent at local restaurants, convenience stores, and Starbucks

# Credit Card Abuse/Misuse

## Red Flags & Risk Areas:

- No form delineating appropriate use of the school-issued credit card is provided to and signed by the recipient
- No discussion on what constitutes appropriate documentation to be submitted and the timing of these submissions
- No board review of the credit card expenses of elected officials or of the superintendent/CEO/president
- Employee reviewing the credit card expenses are often not trained appropriately on the steps they need to take when identifying questionable expenses
- **Heavier reliance on credit card payments due to COVID-19 (urgency; ease)**




# Credit Card Abuse/Misuse



- Appropriate training to individuals receiving a school issued credit card
- Provide credit card policy and request that recipient read and sign and keep a copy
- Require that sufficient supporting documentation be turned in on monthly basis – consider timing of no later than one week after month end
- **Establish a policy with consequences if sufficient supporting documentation is not turned in timely (put credit card on hold) and enforce the policy**
- **Establish higher level review and approval - for example the credit card expenditures of superintendent or board members must be reviewed/approved by the board)**

# Credit Card Abuse/Misuse



## Internal Control Considerations:

- Set monthly spending limits with credit card company
- Limit the types of purchases allowed on a credit card
- Require documented pre-approval for purchases
- Implement regular monitoring of credit card activity
- Restrict purchases at merchants with certain merchant codes (i.e., liquor store, spas, apparel stores, jewelry stores, theatre, medical, etc.)
- Require detailed receipts be submitted, not just the credit card slip



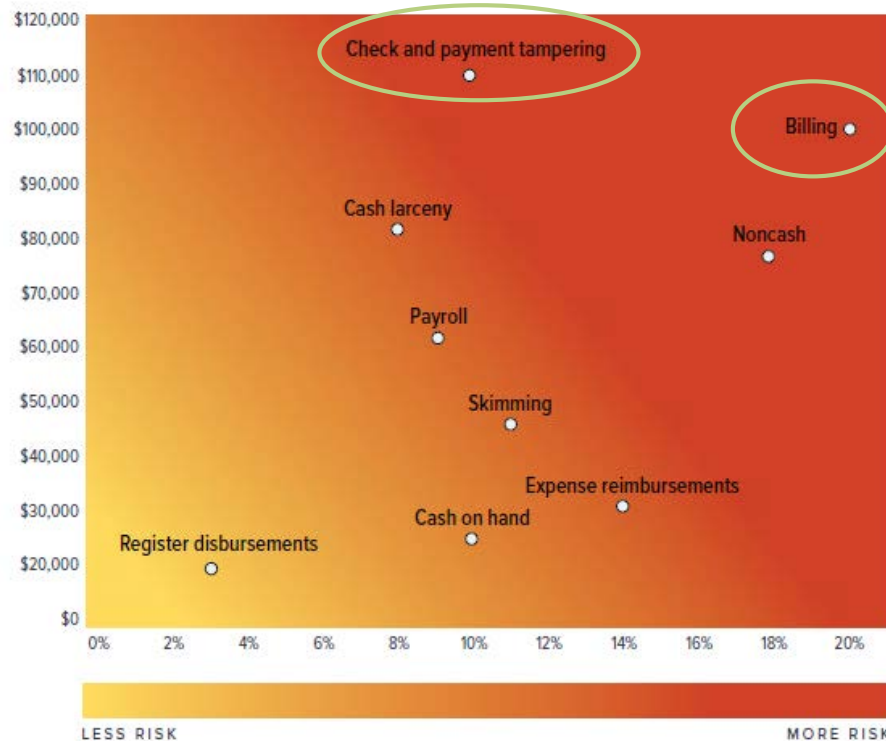
# Billing / Check & Payment Tampering

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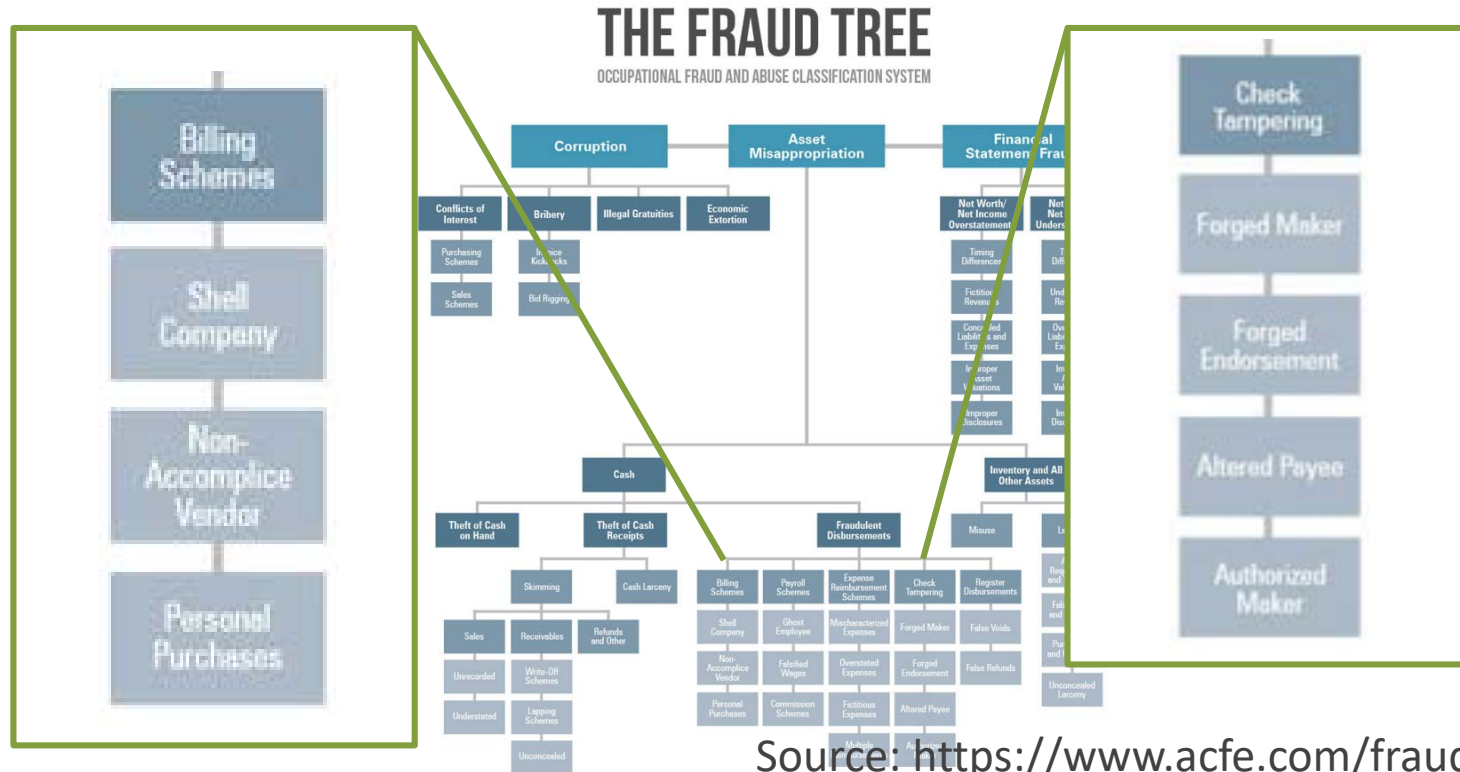
# Greatest Fraud Risks: Billing / Check Tampering

FIG. 5 What asset misappropriation schemes present the greatest risk?



Source: ACFE 2020 Report to the Nations

# Greatest Fraud Risks – Billing / Check Tampering



Source: <https://www.acfe.com/fraud-tree.aspx>

# Billing

## Scheme:

- Employee knowingly processes or approves payment on inflated invoices
- Employee causes payments to be made to fictitious vendor and/or for fictitious invoices
  - Employee causes a new (fictitious) vendor to be added to vendor list and the name and address are affiliated with the employee (shell company)
  - Employee requests a change (e.g. address) to an existing vendor (dormant vendor) on the vendor list to cause payments to be sent to the employee (non-accomplice vendor)
- Employee requests and has approved vendor payments for personal services (small construction, supplies, credit cards, fuel cards, etc.)



# Check & Payment Tampering

## Scheme:

- Employee requests/issues fictitious refunds or records fraudulent payments as refunds
- Employee steals outgoing checks and deposits them into a personal account (forged endorsement)
- Employee issues checks to self or for personal expenses and forges authorized signature (forged maker)
- Employee alters payee name on checks and records as legitimate vendor in accounting system (sticky note; QuickBooks)



# Example #2 Billing / Check & Payment Tampering

## School Finance Director:

- Finance director resigned amid FBI investigation
- Accused of embezzling \$1.5M over nearly 10 years
- Credit union alerted investigators it received a suspicious check
- FBI contacted the school district regarding the investigation
- Resigned the same day FBI contacted the school
- Admitted to everything FBI questioned about
- Created fake invoices for real vendors that the district worked with
- Corresponding check would be cut and finance director altered the check to change the name and address, sometimes to her own



# DISCUSSION

What control deficiencies may have existed in this scenario?

1. Not adequate segregation between the person(s) approving the invoice, preparing the check, and signing the check.
2. Employee had access to checks after they were signed. Checks should always be mailed immediately after being signed.
3. Inadequate purchasing documents (approved contract, purchase order, etc.).
4. No review of disbursements by higher level management.
5. Ability to request (or enter) address or other information change for vendor



# Billing Schemes

## Red Flags & Risk Areas:

- Poor controls over vendor master list
  - AP personnel can add/revise vendors
  - Employees can request/submit changes to vendor information
  - Vendor master list not cleaned up regularly
  - Dormant vendors not made inactive
- One-time (temporary vendor) number
- Employees can request that checks be routed back to themselves
- Employees can pick-up checks from accounting
- Payments to individuals (consultants), new vendors, unknown vendors
- Round dollar payments, payments just below approval thresholds



# Billing Schemes

## Red Flags & Risk Areas:

- Excessive use of one account type by a single employee
- Vendor used by only one employee
- Lack of detail on the supporting invoice
- Consecutively numbered invoices / duplicate invoice numbers
- Lack of a physical address on the invoice



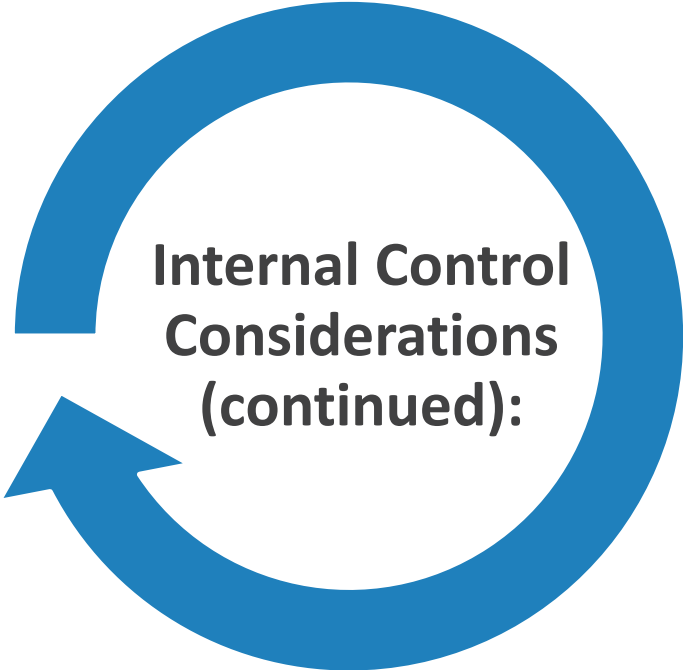
# Billing Schemes



## Internal Control Considerations:

- Ensure segregation of duties between purchase initiation and payment process
- Maintain an approved vendor list with access restrictions
- Payments to and expenses for Executive Director/CEO should be reviewed and approved by the board
- Implement a management and board review process

# Billing Schemes



## Internal Control Considerations (continued):

- Do not allow employees to pick-up vendor checks from accounting (if this is allowed, it should be on a very limited basis and a record should be kept of these occurrences)
- Do not allow employees to request changes to the vendor master list

# Check & Payment Tampering

## Red Flags & Risk Areas (School):

- Unexpected, unexplained, or unusual number of checks payable to “cash”
- Check recorded for zero dollars
- Voided checks that are not documented and destroyed
- Non-payroll checks made payable to or endorsed by an employee
- Unusual, altered, or dual endorsements on canceled checks
- Canceled checks that appear to have been prepared, signed, and endorsed in the same handwriting
- Payments lacking supporting documentation





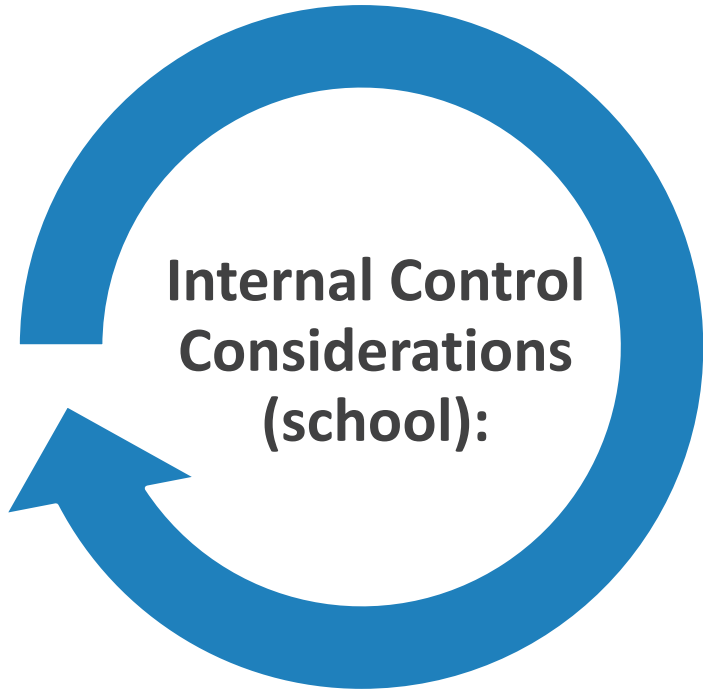
# Check & Payment Tampering

## Red Flags & Risk Areas (School):

- Route back requests (not directly mailed to vendors/recipients)
- One-time vendor accounts or temporary vendor accounts
- Complaints by vendors of late payments
- Expenses exceed budget or are increasing over time
- Multiple payments to vendors that should be paid only monthly (utilities, credit cards, office/home supplies, construction)
- Missing, out-of-sequence, out-of-range, or duplicate check numbers



# Check & Payment Tampering



- Implement positive pay (identifies altered checks only)
- Payments to and expenses for Executive Director/CEO should be reviewed and approved by the board
- Never sign or approve disbursements without attached supporting documentation
- Implement a process whereby all electronic payments require a separate approver before issuance

# Check & Payment Tampering



## Internal Control Considerations (school - continued):

- Mail payments directly to vendors after signing checks
- Implement a management and board review process
- Conduct regular and timely bank reconciliations

# Example #3 Check & Payment Tampering

## ASB Finance Clerk:

- Suspected of embezzling at least \$859,000 from Student Council
- Identified 270 questionable checks where the ASB advisors' signatures had been forged by ASB finance clerk
- Majority of those checks made out to finance clerk
- ASB funds in question were raised by students for various activities
- Finance clerk was overbearing and not easily approachable when anyone asked questions on transactions
- Because finance clerk was considered an expert, any explanation provided was never questioned

# DISCUSSION

What control deficiencies may have existed in this scenario?

1. Not adequate segregation between the person(s) approving the invoice/payment, preparing the check, and signing the check.
2. Inadequate review of the beginning/ending check numbers by the ASB Advisor as checks were being signed
3. Inadequate oversight/monitoring of disbursements by ASB Board
4. Limited or no review of activity by the school?
5. Insufficient follow-up on concerns/issues

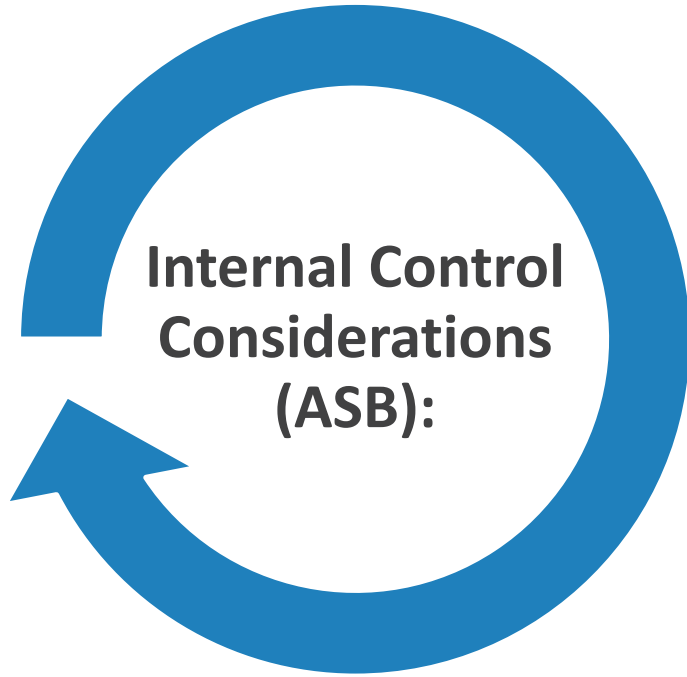
# Check & Payment Tampering

## Red Flags & Risk Areas (ASB):

- Regular reporting on financial activities are not provided to ASB clubs
- Inadequate financial reporting to the school/main accounting office
- Appropriate and sufficient supporting documentation not include for all expenditures
- Limited supervision/review by club advisors of clubs receipts and expenditures
- Late or inaccurate bank reconciliations



# Check & Payment Tampering



- Require monthly reconciliations
- Require disbursement listing be provided to ASB Board and clubs
- Require at least quarterly revenue/expenditure reports be provided to ASB clubs
- Conduct surprise internal audits of the ASB funds



# Theft of Cash Receipts

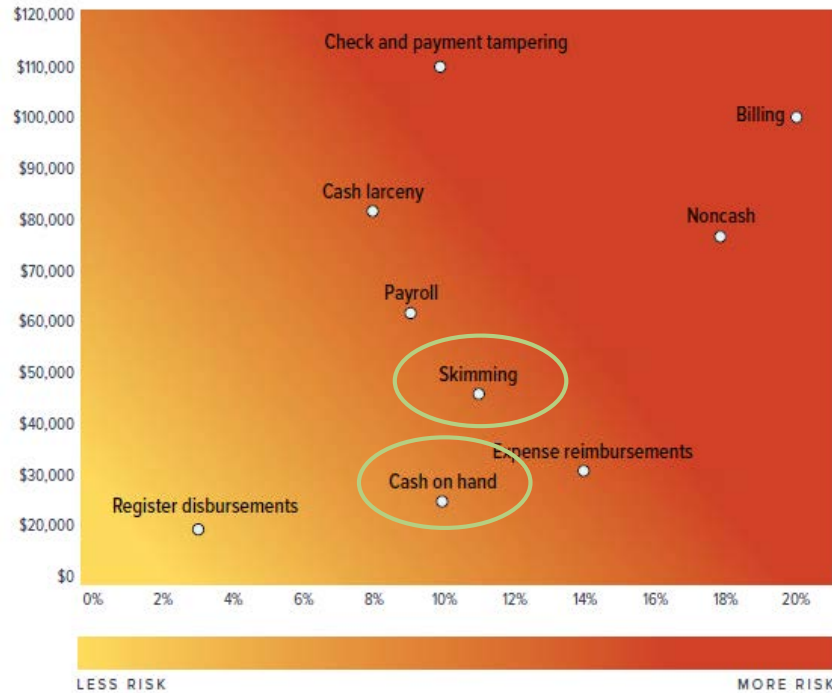
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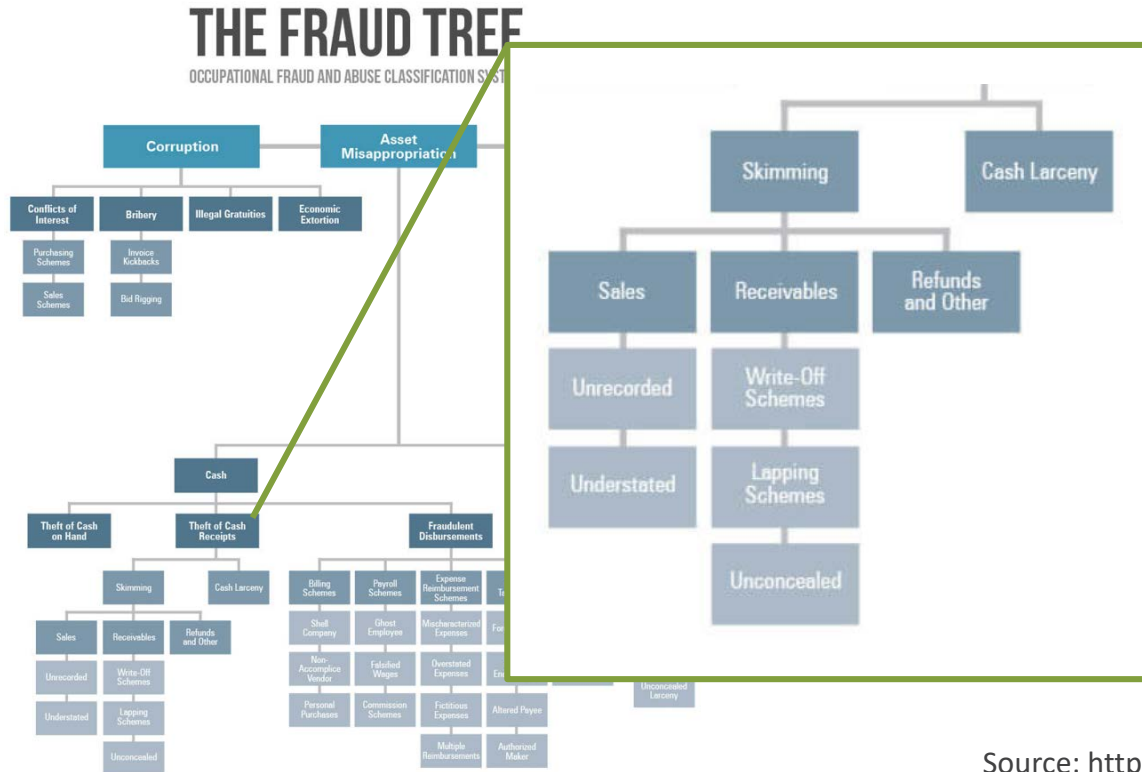
# Theft of Cash Receipts

FIG. 5 What asset misappropriation schemes present the greatest risk?



Source: ACFE 2020 Report to the Nations

# Theft of Cash Receipts



Source: <https://www.acfe.com/fraud-tree.aspx>

# Theft of Cash Receipts

## Scheme:

- Employee or volunteer takes incoming cash or checks for personal use
- Checks made out to any payee can be deposited into a bank account without suspicion or question (banks are not an internal control)
- Unexpected receipts are particularly susceptible to theft (donations, fundraising activity, refunds, facility use contracts/fees, etc.)
- Use of an “unknown” bank account in organization’s name

## Example #5 & #6: Theft of Cash Receipts

### **Parent volunteer embezzlement:**

- Parent volunteer accused of embezzling money from the school's nonprofit organization which raised funds for field trips and afterschool programs
- Unclear how much money was stolen

### **PTO president embezzlement:**

- PTO president charged with theft of over \$14,000 of PTO funds
- Made numerous withdrawals from the PTO account, which aligned with cash deposits into the personal bank account

# DISCUSSION

What control deficiencies may have existed in this scenario?

1. No separate review or monitoring of bank activity / bank reconciliation
2. No reconciliation of cash collections to actual bank deposits
3. No reconciliation of activity to collections and deposits (i.e., number of tickets sold)
4. Use of cash withdrawals
5. Insufficient oversight and monitoring of activity

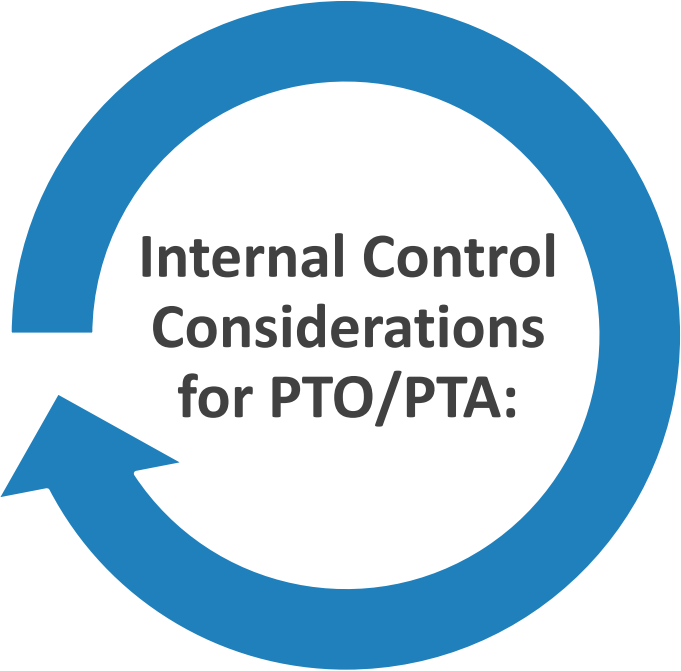
# Theft of Cash Receipts

## Red Flags & Risk Areas:

- Bank account balances that appear low for the PTO/PTA
- Poor controls over cash collection processes
  - Insufficient or no segregation of duties
  - No reconciliation of sales/collection activity
- Decentralized collections of cash/checks
- Insufficient training of parent volunteers
- Poor controls over bank account management
  - Process for opening a new bank account
  - Are unused accounts closed when no longer in use?



# Theft of Cash Receipts



## Internal Control Considerations for PTO/PTA:

- Review bank statements and check register at PTO/PTA meetings
- Enlist someone other than that president and treasurer to receive mailed bank statements
- Reconcile sales/collection activity
- Count money from events as a group
- Deposit money from events promptly
- Verify collections to deposits (someone other than treasurer)
- Identify opportunities to separate duties



# General Internal Control Considerations

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# General Internal Control Considerations

- Develop written policies and procedures
  - Conduct appropriate training for new employees
  - Conduct ongoing training for existing employees
  - Ensure board members are aware of their oversight requirements
- Provide anti-fraud and ethics training for employees and board
- Ensure adequate technical training for employees
- Consider whether organization has resources for internal audit function
  - Surprise audits
  - Financial analytics and transaction review



# General Internal Control Considerations

- Implement the use of an anonymous fraud hotline
- Subordinate level employees should not be responsible for the review/approval of a supervisor's activity (expense reports, credit cards, etc.)
- Rotate job functions / cross-training
- Require employees take vacation





# Process of a Fraud Investigation

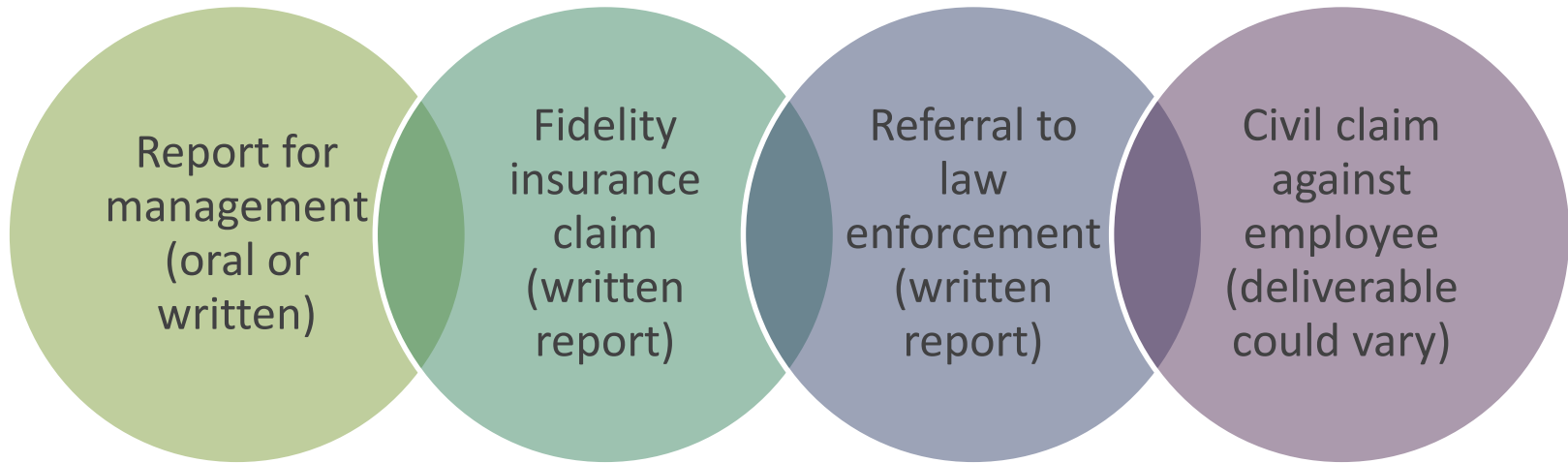
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# Process of a Fraud Investigation



# Possible Deliverables and Outcomes





# Open Discussion and Q&A

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