



CSIS California School Information Services

Fresno County Office of Education

Extraordinary Audit of the Westside Elementary School District

July 29, 2014

Joel D. Montero
Chief Executive Officer







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Jim Yovino, Superintendent
Fresno County Office of Education
1111 Van Ness Avenue
Fresno, CA 93727

Dear Superintendent Yovino:

In February 2014, the Fresno County Office of Education and the Fiscal Crisis and Management Assistance Team (FCMAT) entered into an agreement to conduct an AB 139 extraordinary audit to determine if fraud, misappropriation of funds or other illegal activities may have occurred at the Westside Elementary School District. Specifically, the agreement states that FCMAT will perform the following:

1. The Fresno County Office of Education has requested that the team provide for the assignment of professionals to conduct an AB 139 Extraordinary Audit. Pursuant to Education Code section 1241.5 (b), the superintendent of Fresno County Office of Education has reason to believe that fraud, misappropriation of funds or other illegal practices may have occurred and shall conduct a review of the Westside Elementary School District.

The primary focus of this review is to provide the COE and the Westside Elementary School District with reasonable assurances based on the testing performed that adequate management controls are in place regarding the district's reporting and monitoring of financial transactions, and that fraud, misappropriation of funds or other illegal activities have not occurred. Management controls include the processes for planning, organizing, directing, and controlling program operations, including systems for measuring, reporting, and monitoring performance. The expenditure of funds for salary and benefit compensation including overtime, stipends, vacation, sick leave; conflicts of interest related to construction projects; and the use of credit cards can be areas of high risk in which potential fraud issues such as fictitious employees or vendors, or misappropriation of assets including cash, may be detected during an audit. Specific audit objectives will include evaluating the policies, procedures, and internal controls and transactions performed by the district.

FCMAT

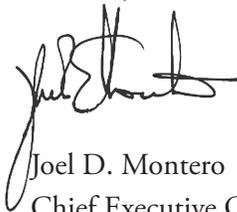
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The team will sample test data from the current and two prior fiscal years and include a review of the expenditures made for administrative positions to determine if fraud, misappropriation of funds or other illegal activities have occurred. Testing associated with this review will be based on the sample selection; it will not include testing of the complete list of all transactions and records for this period. Sample testing and review results are intended to provide reasonable, but not absolute, assurance as to the accuracy of the district's transactions and financial activity.

This final report contains the study team's findings and recommendations in the above areas of review. FCMAT appreciates the opportunity to serve you and extends thanks to all the staff of the Fresno County Office of Education and the Westside Elementary School District for their cooperation and assistance during fieldwork.

Sincerely,

A handwritten signature in black ink, appearing to read "Joel D. Montero". The signature is stylized with a large initial "J" and a long horizontal stroke at the end.

Joel D. Montero
Chief Executive Officer

Table of Contents

About FCMAT	iii
Introduction	1
Background	1
FCMAT Fieldwork	1
Scope and Procedures.....	2
Study Guidelines	2
Study Team.....	3
Definition of Fraud and Internal Controls.....	5
Occupational Fraud.....	5
Control Environment	5
Findings and Recommendations.....	7
Payment of Excessive Overtime	7
Accounts Payable – Five Star Market.....	11
Internal Controls.....	12
Job Descriptions and Duties	17
Organizational Structure	18
Prevention and Detection.....	20
Conclusion.....	21
Appendix.....	23

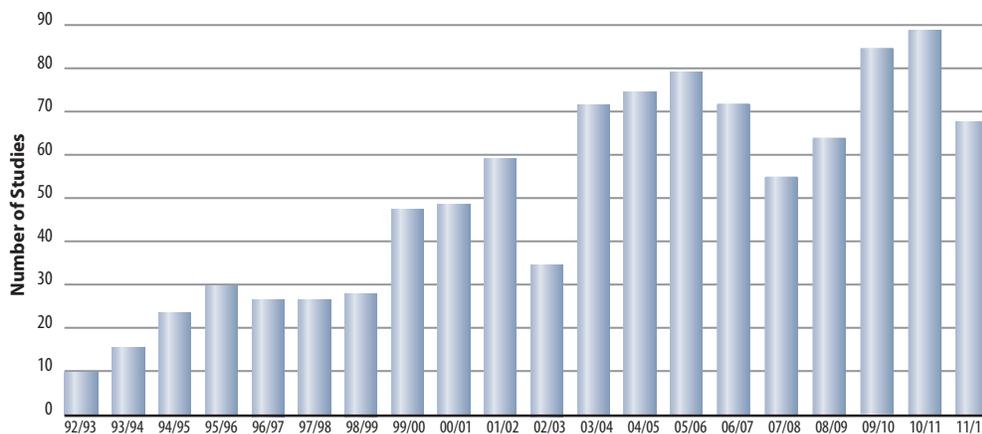
About FCMAT

FCMAT's primary mission is to assist California's local K-14 educational agencies to identify, prevent, and resolve financial and data management challenges. FCMAT provides fiscal and data management assistance, professional development training, product development and other related school business and data services. FCMAT's fiscal and management assistance services are used not just to help avert fiscal crisis, but to promote sound financial practices and efficient operations. FCMAT's data management services are used to help local educational agencies (LEAs) meet state reporting responsibilities, improve data quality, and share information.

FCMAT may be requested to provide fiscal crisis or management assistance by a school district, charter school, community college, county office of education, the state Superintendent of Public Instruction, or the Legislature.

When a request or assignment is received, FCMAT assembles a study team that works closely with the local education agency to define the scope of work, conduct on-site fieldwork and provide a written report with findings and recommendations to help resolve issues, overcome challenges and plan for the future.

Studies by Fiscal Year



FCMAT also develops and provides numerous publications, software tools, workshops and professional development opportunities to help local educational agencies operate more effectively and fulfill their fiscal oversight and data management responsibilities. The California School Information Services (CSIS) arm of FCMAT assists the California Department of Education with the implementation of the California Longitudinal Pupil Achievement Data System (CALPADS) and also maintains DataGate, the FCMAT/CSIS software LEAs use for CSIS services. FCMAT was created by Assembly Bill 1200 in 1992 to assist LEAs to meet and sustain their financial obligations. Assembly Bill 107 in 1997 charged FCMAT with responsibility for CSIS and its statewide data management work. Assembly Bill 1115 in 1999 codified CSIS' mission.

AB 1200 is also a statewide plan for county offices of education and school districts to work together locally to improve fiscal procedures and accountability standards. Assembly Bill 2756 (2004) provides specific responsibilities to FCMAT with regard to districts that have received emergency state loans.

In January 2006, SB 430 (charter schools) and AB 1366 (community colleges) became law and expanded FCMAT's services to those types of LEAs.

Since 1992, FCMAT has been engaged to perform more than 1,000 reviews for LEAs, including school districts, county offices of education, charter schools and community colleges. The Kern County Superintendent of Schools is the administrative agent for FCMAT. The team is led by Joel D. Montero, Chief Executive Officer, with funding derived through appropriations in the state budget and a modest fee schedule for charges to requesting agencies.

Introduction

Background

The Fresno County Office of Education (county office) identified payroll irregularities and questionable expenditures at Westside Elementary School District. Because of concern that these allegations may have violated government and education codes related to fraud and/or misappropriation of assets, the county superintendent initiated an investigation to determine whether sufficient evidence of fraud, misappropriation of funds or other illegal activities may have occurred to merit reporting the matter to the local district attorney's office for further investigation. Under the provisions of Education Code section 1241.5 (b), In February 2014, FCMAT entered into a contract with the Fresno County Office of Education to conduct an AB 139 extraordinary audit.

The Westside Elementary School District is approximately 45 miles southwest of Fresno, California and serves approximately 240 students in grades K-8. The district encompasses 142 square miles in an agricultural area, and the ethnic makeup of the students is approximately 99% Hispanic. Pursuant to Education Code section 47605, the district is the authorizing agency for two direct-funded public charter schools: Crescent View South, and Opportunities for Learning.

In August 2013, the county office conditionally approved the district's 2013-14 adopted budget under Education Code section 42127(d); the budget letter included specific recommendations for revisions needed as conditions for budget approval by the county office. In September 2013, as part of the conditional budget approval, the district requested and received a loan in the amount of \$365,820.66 from the county office under a memorandum of understanding to pay all outstanding liabilities to the Crescent View South Charter School for unpaid transfers of in lieu of property taxes. The stay and rescind authority mutually agreed upon by the county office and the district includes all actions taken by the district that may be inconsistent with the district's ability to meet its financial obligations, until the loan is fully repaid.

On October 3, 2013, the district adopted a revised 2013-14 adoption budget that included the county office's recommendations and that the county office subsequently approved.

FCMAT Fieldwork

Investigating allegations of fraud requires a number of steps including interviews with potential witnesses and gathering evidence from internal and external sources. FCMAT reviewed, analyzed and tested business records including time sheets, cash disbursements, general ledger activity, vendor master files, financial reports, board policies and administrative regulations, board meeting minutes, and internal documents secured from the county office, the district, and independent third-party sources.

FCMAT also conducted interviews with former management personnel, business office staff, and other district staff to obtain information related to general business practices and events that transpired during the current and two preceding fiscal years, including any alleged mismanagement, fraud or abuse.

Although there are many different types of fraud, occupational fraud is common when employees are in positions of trust and have access to assets. Embezzlement occurs when someone who is lawfully entrusted with property takes it for his or her personal use. Common elements in all fraud include the following:

- Intent or knowingly committing a wrongful act

- Misrepresentation to accomplish the act
- Reliance on weaknesses in the internal control structure
- Concealment to hide the act

Scope and Procedures

The primary focus of this review is to determine and report to the Fresno County Office of Education and the district whether there are reasonable assurances, based on testing, that adequate management controls are in place for the district's reporting and monitoring of financial transactions, and whether fraud, misappropriation of funds or other illegal activities may have occurred.

Fraud investigations consist of gathering adequate information about specific allegations and performing audit test procedures to determine whether fraud may have occurred; evaluating the associated loss; determining who was involved and how it may have occurred; and providing this information to help prevent future occurrences.

During interviews, FCMAT team members asked questions pertaining to policies and procedures, job responsibilities, cash handling, purchasing and expenditure practices, expenditure authorization, the receipt of cash, equipment and other assets from outside parties, and open-ended questions designed to elicit information about other possible irregularities related to the scope of work.

FCMAT's findings and recommendations are the result of the above audit procedures.

Study Guidelines

FCMAT provides a variety of services to school districts and county offices of education upon request. Education Code section 1241.5(b) permits a county superintendent of schools to review or audit the expenditures and internal controls of any school district 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. According to the Education Code, the review or audit conducted by the county superintendent will focus on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and is to be conducted in a timely and efficient manner. This is in accordance with Education Code section 42638(b), which states the following:

If the county superintendent determines that there is evidence that fraud or misappropriation of funds has occurred, the county superintendent shall notify the governing board of the school district, the State Controller, the Superintendent of Public Instruction, and the local district attorney.

Therefore, FCMAT focused on the allegations of misappropriation of assets, payment of overtime, and specific expenditures related to local purchases to determine whether the Westside Elementary School District and/or its personnel may have been involved in or committed fraudulent activities.

FCMAT visited the district in February and March 2014 to conduct interviews, collect data and review documents. This report is the result of those activities.

Study Team

The study team was composed of the following members:

Anthony L. Bridges, CICA, CFE
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Templeton, CA

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FCMAT Fiscal Intervention Specialist
Templeton, CA

John Lotze
FCMAT Technical Writer
Bakersfield, CA

Definition of Fraud and Internal Controls

Fraud can include an array of irregularities and illegal acts characterized by intentional deception and misrepresentations of material facts. One of the main issues in evaluating the Westside Elementary School District was the payment of overtime hours for management personnel and whether misappropriation of funds may have occurred in this area.

A material weakness is a deficiency in the internal control process whereby errors or fraud may occur. Because of the weakness, employees in the normal course of business may not detect errors in time to correct them. A material weakness also can be a violation of law or regulations.

Although all employees have some degree of responsibility for internal controls, the governing board, superintendent and senior management are ultimately responsible.

Occupational Fraud

Occupational fraud occurs when an organization's owners, executives, managers or employees use their occupation to deliberately misuse or misapply the employer's resources or assets for personal benefit. The three main types of occupational fraud are asset misappropriation, corruption, and financial statement fraud.

Asset misappropriation includes cash skimming, falsifying expense reports and/or forging company checks. Corruption involves an employee or employees using influence in business transactions to obtain a personal benefit that violates that employee's duty to the employer or the organization. Financial statement fraud includes the intentional misstatement or omission of material information in financial reports.

Occupational fraud is one of the most difficult types of fraud and abuse to detect; however, the most common method of detection is receiving tips from current and/or former employees. This occurs three times more frequently than any other prevention method for this type of fraud and accounts for 42.2% of all detections. According to the 2014 *Report to the Nations on Occupational Fraud and Abuse* conducted by the Association of Certified Fraud Examiners (ACFE), corruption schemes accounted for 36.8% of all occupational fraud cases reported, with a median loss of \$200,000.

This same study also indicates there is a direct correlation between the perpetrator's position and authority in an organization and the losses incurred. Approximately 42% of fraud perpetrators were employees; 36.2% were managers; 18.6% were owners/executives; and 3.2% were "others." Although owner/executives are the second lowest percentage of fraud perpetrators, this group generated the largest median loss of any group: \$500,000 for the 646 cases reported in the United States.

Control Environment

The internal control environment is critical because it establishes the moral tone of the organization. Though intangible, it begins with the leadership and consists of employees' perception of the ethical conduct displayed by the governing board and executive management.

The control environment is a prerequisite that enables other components of internal controls to be effective in preventing and/or deterring fraud or illegal acts. It sets the tone for the organization, provides discipline and control, and includes factors such as integrity, ethical values, and competence of employees.

The control environment can be weakened significantly by a lack of experience in financial management and internal controls.

Control Activities

Control activities are a fundamental element of internal controls, and are a direct result of policies and procedures designed to prevent and identify misuse of a district's assets, including preventing any employee from overriding controls in the system. Control activities include the following:

- Performance reviews, which compare actual data with expectations. In a business office, this most often occurs when budgeted amounts are compared with actual expenditures to identify variances, then followed up with budget transfers to prevent overspending.
- Information processing, which includes the approvals, authorizations, verifications and reconciliations needed to ensure that transactions are valid, complete and accurate.
- Physical controls, which are the processes and procedures designed to safeguard and secure assets and records.
- Segregation of duties, which consists of processes and procedures that ensure that no employee or group is placed in a position that enables them to commit and conceal errors or fraud in the normal course of duties. In general, segregation of duties includes separating the custody of assets, the authorization or approval of transactions affecting those assets, the recording or reporting of related transactions, and the execution of the transactions. Adequate segregation of duties ensures separate processing by different individuals at various stages of a transaction as well as independent review of the work. This reduces the likelihood that errors will remain undetected.

Findings and Recommendations

Payment of Excessive Overtime

FCMAT found that the district's control environment is lacking in the areas of governance, payroll and accounts payable. For the district to perform and emulate best business practices, it is crucial for the district to develop a code of ethics and communicate its expected standards of conduct to the administration and staff.

Payroll schemes carried out by management personnel or in collusion with other employees are almost impossible to detect; however, the district can examine its internal control structure to ensure that appropriate checks and balances exist and are implemented.

The district has operated under board policies and administrative regulations that were not routinely updated and in many cases did not keep pace with changes in law. FCMAT reviewed board policies created in 1995-96. The district was updating its board policies during the review period using sample policies from another school district, but no revised policies had been provided to the board of trustees for review and action. As a result, the district's policies and practices are sometimes inconsistent with provisions of the Labor, Education, and Government codes. For example, Administrative Regulation (AR) 4153 describes extra pay for extra work, but has no supporting documentation for employee guidance and so may be in violation of the Fair Labor Standards Act (FLSA).

FCMAT found that the district's employees lack a basic understanding regarding the purpose and structure of business transactions related to the internal control environment, specifically essential checks and balances. During interviews the director of business, the assistant financial secretary/cafeteria manager, and the transportation/custodian/grounds director stated that they did not understand that as management employees on the classified salary schedule they were exempt from overtime or extra time compensation. The district's 2013-14 classified management salary schedule has no reference to or restrictions regarding overtime or extra pay. The district's board policy binder contained an index for Board Policy 4151, Salary Guides; Board Policy 4152, Salary Checks and Deductions; and Board Policy 4153, Extra Pay for Extra Work. However, further examination revealed that no board policies were contained in the board policy manual. All employees interviewed reported that their supervisors, including the superintendent and the director of business, were aware of the monthly overtime requests and payments.

The district lacks strong, effective processes and procedures and does not have board policies and administrative regulations for managing routine operations. As a result, individual employees have developed informal, unwritten systems that the superintendent is working to revise, define, or in some cases dismantle. Because of the lack of formal policies and proper management oversight, the district's culture and business environment was such that payment of overtime became routine and acceptable and was afforded to all employees in the business office.

California Overtime Pay Laws

Overtime pay is additional compensation for working more than 40 hours in a week or (in California) more than eight hours in a day. Whether an employee should receive overtime pay depends on the work that they perform and is determined by the following rules and regulations:

- California pay laws are designed to protect employees, and the legal system construes them to provide employees the maximum protection. Employees are presumed to be entitled to overtime pay and, under California and federal law, the employer, not the employee, has the burden of proof to show that it properly paid the employee.
- An employee's right to overtime pay does not depend on whether an employee is salaried; many salaried employees are entitled to overtime pay.
- Work activities, not job titles or responsibilities, govern whether an employee is entitled to overtime pay. In California, the law applies to what employees do during more than half of their work time. Although employers may give employees job titles in an attempt to avoid overtime pay, this may not affect employees' rights.
- An employer must pay overtime unless it can prove that an employee is exempt from the overtime law requirements. Exempt employees are not paid overtime pay.

The exemptions are as follows:

- **Executive Exemption:** This applies to employees who spend more than half their work time managing businesses or departments of a business.
- **Administrative Exemption:** This applies to employees who spend more than half their work time assisting the employer or other exempt individual in servicing a business in matters of significance.
- **Professional Exemption:** This applies to employees who have certain licenses to practice a profession or who work in a learned or artistic profession.
- **Computer Software Professional Exemption:** This exemption applies to employees who work on highly theoretical aspects of computer software.

It is the district's legal responsibility to keep time and pay records, including board policies and administrative regulations, regarding the payment of overtime for its employees. School districts have a legal obligation to record the dates of the work week, the regular hourly rate, the hours worked each day, weekly totals, regular wages paid, and overtime paid. If an employer does not follow this law and does not keep accurate time or monitor the pay records, the law may not penalize the employee who cannot produce accurate time records. Specifically, the law may not require an employee to produce proof of hours worked and wages paid when the employer has failed to monitor, record or evaluate the pay records. In the district's case, neither the superintendent nor the director of business provided the necessary oversight or monitoring of overtime and extra time being accrued and paid to staff. In the case of the director of business, the superintendent did not monitor or evaluate the amount of overtime or extra time being paid to her.

The commonly accepted legal standard for proving that overtime wages are owed does not mandate that an employee prove each hour of overtime work with absolute accuracy or certainty. In instances in which neither the employer nor the employee has precise time and pay records, the legal solution is not to penalize the employee by denying him or her any recovery simply because he or she is unable to prove the precise extent of uncompensated work. Thus the legal standard places a premium on an employer's need to keep proper records in conformity with their statutory duty.

FCMAT reviewed time sheets submitted by the district's business office employees for the current and two prior fiscal years and found the following:

- All management positions, including the director of business, director of transportation and custodial operations, and assistant financial secretary/cafeteria manager, reported and were paid overtime and/or extra time compensation during the three-year review period.
- Overtime payments required advance approval using the appropriate forms prior to payment. However, this requirement and process was consistently ignored by all employees at all levels of the organization.
- All positions in the business office were classified as management employees and should have been exempt from overtime or extra hours.
- All three positions mentioned above are on the district's classified management salary schedule and were paid for reported overtime and extra time during the review period.
- For the purposes of this report, certifying officials include the superintendent and the director of business services. Required signatures from certifying officials such as the superintendent or director of business were not on the time sheets.
- Certifying officials reviewed the time sheets without reviewing or questioning the reasonableness of the overtime hours claimed. For example, the superintendent was responsible for certifying the overtime requests for the director of business. During interviews, the superintendent stated that he was aware that the director of business was working additional hours and submitting overtime, and would verbally approve the overtime, but did not understand the aggregate monthly or annual cost or the fiscal impact to the district's budget until he was briefed on the results by the Fresno County Office of Education. The director of business entered all time sheets and was aware of the monthly amounts for herself and all other employees receiving overtime or extra pay. However, the director of business did not perform the necessary due diligence in reviewing subordinate employees' overtime or its fiscal impact.
- Certifying officials were often at off-site locations such as the charter schools or working from home and so did not directly oversee and/or supervise employees claiming overtime or extra time.
- The superintendent and the director of business indicated that the organization had not established internal procedures to monitor or oversee overtime hours claimed by employees. Establishing such procedures should be one of the director of business's duties.

The law is clear in cases in which an employer fails to keep accurate time and pay records or monitor overtime for employees. In some instances, an employee need only prove that he or she has performed work for which they were compensated and produce sufficient evidence to show the amount and extent of that work to achieve a just and reasonable inference of hours worked. The burden shifts to the employer to invalidate the employee's calculations by documenting evidence of the precise amount of work performed or with evidence to negate the reasonableness of the inference drawn from the employee's documentation or time sheets.

FCMAT's review of the district's overtime and extra pay records indicates that the superintendent did not monitor or review the director of business's time sheets for overtime and only provided verbal approval. Because the director of business entered all time worked into the financial system, the director of business did by default monitor the amount of overtime or extra time requests. However, the director of business did not exercise the necessary due diligence in

reviewing subordinate employees' overtime or extra time requests in a timely manner or receive written approval from the superintendent regarding her own overtime or extra time pay requests.

A review of the payroll records indicates that the overtime requests became a matter of routine and appear to be excessive. Best practices in the case of sustained overtime include either the hiring of additional personnel or examining the workflow to make it more efficient through streamlining processes, updating systems, and/or eliminating manual entry. All employees interviewed were aware of the overtime practices, and only the director of business identified the annual cost and impact on the district's budget. All management employees interviewed contend that additional duties required because of the district's authorization of two charter schools and acceptance of an external transportation contract with a neighboring school district warranted and contributed to the ongoing and regular overtime and extra time. FCMAT reviewed the time sheets of the management employees and found little or no detailed documentation that would identify the cause for overtime. The following table summarizes the district's additional payroll earnings for the three-year period reviewed.

***Westside Elementary School District Overtime, Extra Time and Vacation Earnings,
January 1, 2010 through December 31, 2013***

	Director of Business Services		Transportation/Custodian/Grounds Director		Assistant Financial Secretary/Cafeteria Manager	
	Amount	Hours	Amount	Hours	Amount	Hours
2010-11						
Overtime (OT)	\$21,396.60	754.73	\$5,391.20	210.75	\$6,306.35	424.67
Extra Pay (NMX)	\$0.00		\$0.00		\$0.00	
Vacation	\$2,721.60					
2011-12						
Overtime (OT)	\$23,731.50	837.07	\$18,423.51	707.58	\$10,081.67	678.90
Extra Pay (NMX)	\$2,892.27	102.02	\$1,705.04	66.01	\$0.00	
Vacation	\$3,175.20					
2012-13						
Overtime (OT)	\$29,466.71	1,039.39	\$27,602.71	1,068.63	\$13,582.80	771.75
Extra Pay (NMX)	\$2,168.21	76.48	\$400.00	20.00		
Vacation	\$3,402.00					
2013-14 through December 2013						
Overtime (OT)			\$6,994.76	270.80	\$8,844.00	502.50
Extra Pay (NMX)	\$15,860.97	559.47	\$6,513.55	252.17		
Vacation						

Accounts Payable — Five Star Market

Because of the district's rural location, fuel, food and other supplies were purchased daily, weekly or monthly from the local Five Star Market. The market is less than one half mile from the district office and there are no other services in the immediate area. FCMAT reviewed financial transactions provided by the county office fiscal consultant and extracted from the district's financial system for the three-year review period. The total payments report included a detailed vendor list from July 1, 2011 through March 17, 2014. FCMAT did not detect any purchases that warranted additional review or met the materiality threshold for additional evaluation by FCMAT (the report did not include any cancellations or adjustments). There were instances when employees purchased food items or gas without the proper receipts. After further discussion with the superintendent about the county office's concern regarding the lack of oversight of these types of transactions, the superintendent stated that the district would discontinue purchasing from the local market until proper procedures could be established. The following table shows the total value of purchases for each fiscal year examined:

Fiscal Year	Amount
2010-11	\$149.15
2011-12	\$349.91
2012-13	\$2,860.47
2013-14 year to date	\$1,616.90

Internal Controls

It is often difficult for a small school district to achieve optimal internal controls, including segregation of duties, checks and balances and other control elements. However, an organization establishes control over its operations by setting goals, objectives, budgets and performance expectations, and this has not occurred in the Westside Elementary School district.

The district lacks board policies, administrative regulations, performance expectations, and sufficient oversight by management. Several factors influence the effectiveness of internal controls, including the social environment and how it affects employees' behavior; the availability and quality of information used to monitor the organization's operations; and the policies and procedures that guide the organization. The district has tried to create more of a family-like organizational structure, which may have caused the superintendent to err in the oversight of district office employees. Internal controls help an organization obtain timely feedback on its progress in meeting operational goals adhering to guiding principles, producing reliable financial reports, and ensuring compliance with applicable laws and regulations. Internal controls provide the means to direct, monitor and measure an organization's assets and resources, and thus play an important role in protecting it from fraud, abuse or misappropriation of assets.

All educational agencies need internal control procedures to accomplish the following:

1. Prevent management from overriding internal controls.
2. Ensure ongoing compliance with state and federal regulations.
3. Assure the governing board that the internal control system is sound.
4. Help identify and correct inefficient processes.
5. Ensure that employees are aware of the expectation that proper internal controls will be used.

Effective internal controls include the following five components:

- **Control Environment** is the tone of the organization and influences employee behavior. It is the foundation for all other components of internal control.
- **Risk Assessment** identifies and analyzes the risks that may prevent the organization from achieving its objectives. This component forms the basis for how these risks should be managed.
- **Information and Communication** require systems that identify, gather and exchange information in a format and time frame that enable the people in the organization to successfully perform their duties.
- **Control Activities** help ensure that management directives are carried out. Control activities are also designed to prevent errors and irregularities, and to find them if they have occurred.
- **Monitoring** is used to assess the quality of internal control performance over time.

Each individual in an organization is responsible for internal control in some capacity because nearly everyone either produces information used by the internal control system or takes action to implement organizational control. Further, each individual should take responsibility for communicating and reporting issues with operations, noncompliance with policies, or illegal

actions. Ultimately, internal control should pervade every level of an organization; however, the governing board members and the superintendent have specific roles and a higher duty to protect district assets and enforce best practices, including implementing and monitoring internal controls.

As the organization's leader and chief executive, the superintendent sets the organizational tone that influences decisions, activities, and the internal control environment and culture among employees. Factors that contribute to a positive control environment include integrity, ethical values, management philosophy and operating style, organizational structure or configuration, assignment of authority and responsibility, and employee expertise and proficiency. Best practice would have been for the district's superintendent and director of business to integrate the five internal control components listed above into one cohesive structure; however, this did not occur.

Following are best practices for management and administrative personnel that can help ensure strong internal controls:

The administrative team provides leadership and direction to managers, and reviews and gives them feedback on their internal control decisions. In turn, the managers assign responsibility for establishing specific internal control policies and procedures, control activities, and the monitoring of personnel responsible for different functions.

The governing board works as one unit to provide governance, guidance and oversight. Individual board members improve the control environment when they are informed, free of bias, inquisitive, conduct themselves in a principled and ethical manner, and expect the same standard of conduct from everyone in the organization.

Independent auditors assess whether the controls are properly designed, implemented, and monitored, and whether the controls are working effectively. They also make recommendations for improving internal controls.

The district recently experienced the voluntary resignation of the director of business, which is a major change in leadership. Changing leadership brings new ideas and approaches. Although this can be stressful, staff interviewed by FCMAT were generally engaged, thoughtful, open and responsive.

The district's internal control environment lacks essential elements in the business office. The district lacks board policies regarding a code of ethics professional standards, as well as written policies and procedures regarding internal controls and best practices. Part of this report provides assistance with the district's written policies and procedures as they relate to administrative business functions.

The district's internal control environment would be further strengthened by communicating to employees that they are expected to comply with all policies and procedures, code of ethics and standards of conduct, and that they are to understand key factors that create the internal control environment. Specifically, employees should understand the following:

- Personal and professional leadership is based on the highest levels of integrity.
- Leadership philosophy and operating style can promote internal control throughout the district.
- Accountability is improved by assigning authority and responsibility at the highest possible level.

- All employees must know and understand the district's policies and procedures including those specifically related to the area in which they operate.
- Employees must be aware of their internal control responsibilities.
- Fraud (e.g., embezzlement, stealing, misuse of equipment, technology or supplies) is not tolerated.
- Employees are responsible to continually self-monitor operations and job performance.

Occupational Fraud – Causes and Prevention

Occupational fraud is a global problem in business. As previously mentioned, the 2014 report by the ACFE concluded that organizations lose up to 5% of their annual revenue to fraud. The sectors most commonly victimized in the study included government and public administration. Given the high costs of occupational fraud, all organizations need a strong fraud prevention and detection program.

Fraud and the misuse of physical or cash assets occur when three factors converge: pressure or motive; opportunity; and rationalization or lack of integrity. This is known as the fraud triangle. When two of the three factors are present, the probability that fraud will occur increases. When all three factors are present, it is almost certain that fraud will occur.

The opportunity for fraud varies throughout the district depending on the duties assigned to an employee. Rationalization and lack of integrity are more likely to be present in organizations that do not implement and/or promote anti-fraud policies. In the case of Westside Elementary School District, FCMAT identified unacceptable past practices that had been occurring for many years in an environment with no internal control structure, no policies or procedures and no checks and balances.

Ongoing employee education can help prevent and detect occupational fraud; however, the district does not have an employee training and awareness program. Employees need regular training in what constitutes fraud, how it hurts everyone in the organization, how to understand common fraud schemes, and how to recognize behaviors that may indicate fraud. Employees need to have several avenues for reporting improprieties and need to be encouraged not to ignore warning signs. Risk awareness training about suspicious situations that merit reporting can help create a districtwide culture that supports effective reporting.

The district needs to implement common fraud detection methods such as an anonymous employee hotline, random audits, or fraud risk assessments. According to the ACFE 2014 report, "the presence of a reporting hotline had a substantial impact on the initial fraud detection method" in all the cases analyzed. Tips received account for 42.2% of all detection methods, but when coupled with a hotline, the impact of fraud reporting was considerably increased. The study further states, "employees were the source of almost half of all tips that led to the detection of fraud."

Risk Assessment

As is common in smaller organizations, the risk assessment component of internal control has been assigned to the district's independent auditors as part of their annual audit. However, because the auditors' review is limited to internal controls as a basis for designing audit procedures, they do not express an opinion on the effectiveness of the district's internal controls and thus should not be the district's sole means of monitoring internal controls.

The district's 2012 and 2013 independent audit reports included material weaknesses in internal controls related to financial statement reporting, and the 2012 audit identified material weaknesses in compliance with state and federal programs. These weaknesses could result in a material misstatement of finances or in material noncompliance with a program requirement because the district's internal controls may not prevent, detect, and correct problems in a timely manner.

Further, the audit reports for two years cite instances of significant deficiencies in internal controls. Some of these findings and recommendations occur in more than one year, such as issues with associated student body funds. The district has not consistently responded to or followed up on these audit findings and exceptions. Findings and recommendations from the independent auditors should elicit a response from the district that includes corrective measures. Consistent review and follow-up by the board on audit findings and exceptions will help strengthen the district's control activities.

Internal Control Systems and Procedures

The following systems and procedures help ensure a strong internal control structure:

- **System of checks and balances** – Formal procedures to initiate, approve, execute, record and reconcile transactions. The procedures should identify the employees responsible for each step and the time period for completion. Key areas requiring checks and balances include payroll, purchasing, accounts payable and cash receipts.
- **Segregation of duties** – Internal accounting procedures and changes to segregate job duties and protect the district's assets. No single employee should handle a transaction from initiation to reconciliation, and no single employee should have custody of an asset, such as cash, and maintain the records of its transactions.
- **Staff cross-training** – Training to ensure that more than one employee can perform each job. Each staff member should be required to use accrued vacation, and another staff member should be assigned to perform those duties at that time. Inadequate cross-training is often a problem regardless of an organization's size.
- **Asset security** – This includes depositing cash daily and securing other district property such as computers and other equipment. Access to supplies, including but not limited to stores, food, tools, and gasoline, should be restricted to designated employees.
- **Timely reconciliations** – Bank statements and account balances need to be reconciled monthly by an employee other than the individual assigned to the original transaction and recording. For example, the office employee who reconciles the checking account should not also maintain the check stock.
- **Comprehensive annual budget** – The budget needs to include sufficient detail regarding revenue and expenditures by school site, department and resource to identify variances and determine whether financial goals were achieved. Material variances in revenues and expenditures should be investigated promptly and thoroughly.
- **Inventory records** – These should identify the items and quantities purchased, sold, or designated as surplus. Physical inventory should be taken periodically and reconciled with inventory records. Inventoried items particularly susceptible to misappropriation include computer equipment, warehouse supplies, food service commodities, maintenance and transportation parts, and student store goods.

Because of changes resulting from the departure of the director of business, the district has determined the need to review processes and procedures related to governance, payroll, and accounts payable, and to cross-train business and administrative office staff. Cross-training can be difficult in small districts; however, at least one additional employee is being trained in accounts payable and cash receipts so they can temporarily perform critical duties in the absence of a director of business. This process will need to continue once a new director of business is hired so that office functions can continue in the event of illness, vacation or resignation. This will enable the district to continue essential business office functions without interruption.

Governance

Board policies and administrative regulations are based on laws and regulations in numerous documents, including the California Constitution, Education Code, Code of Regulations, Government Code, federal regulations, case law, and industry practice. Board policies and regulations provide guidelines and directives for the operation of the district and its personnel, and are a key component of internal controls. It is important to ensure that board policies are updated to reflect changes in legislation.

In designing board policies and administrative regulations, management is responsible for designing and implementing a system of internal controls over financial reporting. This system should provide reasonable assurance that misstatements and/or noncompliance affecting the financial statements are prevented or detected and corrected through normal operating procedures. When adopting board policy, the district will need to carefully consider guidelines that promote behaviors that help protect assets from misuse or fraud.

Job Descriptions and Duties

FCMAT reviewed the duties of support staff in the business office. This included reviewing the job descriptions for all management employees including the director of business services; the transportation, custodial and grounds director; and the cafeteria manager. FCMAT also conducted on-site observations and interviewed staff.

The district's job descriptions for management positions do not accurately identify these positions' responsibilities and duties, which have changed with the addition of two charter schools and external transportation contracts. Any time there are major organizational changes, job descriptions need to be reviewed, updated to include or revise duties and other items, and approved by the governing board.

Confidential Employees

No employees in the district's business office knew whether their positions were classified as confidential, or if they were exempt from overtime pay.

Districts commonly assume that a position should be confidential if it has access to information that is not public, such as some parts of personnel files. Under Government Code section 3540.1, a position is confidential if it has access to the employer's collective bargaining information. An employee who holds such a position cannot belong to any bargaining unit. Government Code section 3540.1(c) defines confidential employee as follows:

. . . an employee who is required to develop or present management positions with respect to employer-employee relations or whose duties normally require access to confidential information that is used to contribute significantly to the development of management positions.

The district will need to review employees' positions and duties and reclassify them accordingly based on the responsibilities and duties they perform in light of the above definitions.

Organizational Structure

In best practice, a school district's organizational structure establishes the framework for leadership and the delegation of duties and responsibilities, and adapts to changes such as enrollment increases or declines. It is best practice to staff a district according to generally accepted theories of organizational structure and the standards used in other school agencies of similar size and type. The most common theories of organizational structure are span of control, chain of command, and line and staff authority.

Line and Staff Authority

Line authority is the relationship between supervisors and subordinates. It refers to the direct line in the chain of command. For example, in the district, the superintendent has direct line authority over the director of business. Conversely, staff authority is advisory in nature. Staff personnel do not have the authority to make and implement decisions; rather, they support supervisory personnel. The organizational structure of local educational agencies includes both line and staff authority.

The purpose of any organizational structure is to help a district's management make key decisions to facilitate student learning while balancing financial resources. An effective organizational design will outline the management process and its specific links to the formal system of communication, authority and responsibility necessary to achieve the district's goals and objectives.

Authority in a school district originates with the elected governing board, which hires a superintendent to oversee the district. Through the superintendent, authority and responsibility are delegated to the district's administration and staff. The superintendent may make decisions about district operations within the parameters of the law and board policy, and is to provide leadership in developing the organizational structure. The Westside Elementary School District lacks specific board policy regarding authority, responsibilities and roles. Although the district is small, the organizational structure should accurately delineate lines of authority.

Communication and Operational Continuity

Management Meetings

Staff indicated that the district does not conduct monthly meetings with staff to provide information on changes in district policies, procedures or other critical fiscal or academic issues.

Manuals and Cross-Training

The district lacks manuals of policies and procedures. These types of manuals can help plan and outline internal controls and written standards for business office and other district employees.

The district also lacks desk manuals that include step-by-step procedures for each position's job duties. Desk manuals that include policies and procedures help ensure proper internal controls, provide a better understanding of each position's responsibilities, and help staff complete necessary functions when the employee normally assigned to a particular duty is absent.

The district has not cross-trained staff. Payroll tasks are essential to the district's operations, and the lack of cross-training in this area could place the district at risk. Cross-training is essential to ensure that operations can continue uninterrupted when an employee is absent or a position is vacant, and to ensure that employees are able to use their accrued vacation time.

Recommendations

The district should:

1. Adopt board policies and corresponding administrative regulations as needed to ensure compliance with applicable federal and state laws regarding payment of overtime, and to ensure consistent treatment of all employees subject to such policies and laws.
2. Ensure that overtime is paid for work in excess of the established workday or workweek, in accordance with Fair Labor Standards Act and board policy or applicable collective bargaining agreements, as follows:
 - a. Overtime accrues only when the non-exempt employee performs work.
 - b. No overtime shall be scheduled or worked without prior approval from the employee's immediate supervisor.
3. Hold regular meetings of all district office staff to discuss the workload and duties of all staff members during peak workload times. Immediately address the conflicts and issues that exist among business office staff regarding board policies and regulations, and define job duties so responsibilities and professional standards are clearly understood.
4. Develop specific performance objectives to maintain a high level of accountability for all district office positions.
5. Communicate expectations regarding the standards for working together and the consequences of not following board policies and administrative regulations.
6. Communicate with all employees in the organization regarding changes made in responsibilities and processes.
7. Assign each district office staff member to complete step-by-step procedures for each of their job duties, and to include these procedures in a desk manual.
8. Ensure that employees are cross-trained in all tasks essential to operational continuity.
9. Adopt board policies that include measures to prevent fraud.
10. Adopt board policies that include adequate internal controls and segregation of duties for the business office.

Prevention and Detection

As discussed previously, the integrity and ethics of leaders set the tone of an organization and are an essential part of the internal control environment. They demonstrate to others that dishonest or unethical behavior will not be tolerated.

An atmosphere in which employees feel safe to communicate concerns is a fundamental component of a strong and effective internal control environment.

Managers are in a position of authority and therefore have a higher standard of care to establish the ethical tone and serve as examples to other employees. Employees with administrative responsibility have a fiduciary duty to the organization to ensure that activities are conducted in compliance with all applicable board policies, laws, regulations, and standards of conduct. Management personnel are entrusted to safeguard the district's assets and ensure that internal controls function as intended.

Although the governing board and all employees in the organization have some responsibility for internal controls, the superintendent has a fiduciary duty to ensure that the fiscal policies and procedures established by the governing board are up to date, ethical, and carried out responsibly. In the district's case, the superintendent failed to update board policies and hold managers and staff accountable for overtime and extra pay.

Conclusion

Internal controls are vital to any fraud prevention program. Although all of the district's employees have some responsibility for internal controls, the superintendent and director of business had the authority and responsibility to account for all overtime and extra time requests. The district's failure to implement board policies and controls may have led to thousands of dollars in overtime payments that were not properly certified or accounted for using best practices. The director of business denied any allegations that she paid herself unauthorized overtime, extra time or vacation time. This individual voluntarily resigned in March of 2014 after a meeting with the district's legal counsel. As managers of the department, both the superintendent and director of business have the ultimate responsibility for the proper custody and accounting for all district funds.

Based on the evidence presented to FCMAT, it was not possible to determine if fraud was committed by any specific district employee. Any determination regarding the existence of fraud is solely the purview of courts and juries, and FCMAT will not make statements that could be construed as a conclusion that fraud has occurred. However, there are questionable transactions that demonstrate mismanagement and misappropriation of district funds and assets, as well as significant material weaknesses in the district's internal control environment, which are conditions that increase the probability of fraud and/or abuse. These findings should be of great concern to the district and require immediate intervention to limit the risk of fraud and/or misappropriation of assets in the future.

Education Code Section 42638(b) states that action by the county superintendent shall include the following:

If the county superintendent determines that there is evidence that fraud or misappropriation of funds has occurred, the county superintendent shall notify the governing board of the school district, the state controller, the superintendent of public instruction and the local district attorney.

Education Code Section 1241.5(b) states that the county superintendent shall report the findings and recommendations to the governing board of the district at a regularly scheduled board meeting within 45 days of completing the audit. Within 15 days after receipt of the report, the governing board of the school district shall notify the county superintendent of its proposed actions related to the county superintendent's recommendations.

Recommendation

The county superintendent should:

1. Notify the governing board of the school district, the state controller, the superintendent of public instruction, and the local district attorney that fraud or misappropriation of district funds and/or assets may have occurred.

Appendix

Study Agreement



CSIS California School Information Services

**FISCAL CRISIS & MANAGEMENT ASSISTANCE TEAM
AB139 STUDY AGREEMENT
February 14, 2014**

The Fiscal Crisis and Management Assistance Team (FCMAT), hereinafter referred to as the team, and the Fresno County Office of Education, hereinafter referred to as the COE, mutually agree as follows:

1. BASIS OF AGREEMENT

The team provides a variety of services to school districts and county offices of education upon request. Pursuant to the provisions of Education Code Section 1241.5 (b), a county superintendent of schools may review or audit the expenditures and internal controls of any school in his or her county if he or she has reason to believe that fraud, misappropriation of funds, or other illegal fiscal practices have occurred that merit examination. The extraordinary audits conducted by the county superintendent shall be focused on the alleged fraud, misappropriation of funds, or other illegal fiscal practices and shall be conducted in a timely and efficient manner.

All work shall be performed in accordance with the terms and conditions of this agreement.

2. SCOPE OF THE WORK

A. Scope and Objectives of the Study

The Fresno County Office of Education has requested that the team provide for the assignment of professionals to conduct an AB 139 Extraordinary Audit. Pursuant to Education Code section 1241.5 (b), the superintendent of Fresno County Office of Education has reason to believe that fraud, misappropriation of funds or other illegal practices may have occurred and shall conduct a review of the Westside Elementary School District.

The primary focus of this review is to provide the COE and the Westside Elementary School District with reasonable assurances based on the testing performed that adequate management controls are in place regarding the district's reporting and monitoring of financial transactions, and that fraud, misappropriation of funds or other illegal activities have not occurred. Management controls include the processes for planning, organizing, directing, and controlling program operations, including systems for measuring, reporting, and monitoring performance. The expenditure of funds for salary and benefit

compensation including overtime, stipends, vacation, sick leave; conflicts of interest related to construction projects; and the use of credit cards can be areas of high risk in which potential fraud issues such as fictitious employees or vendors, or misappropriation of assets including cash, may be detected during an audit. Specific audit objectives will include evaluating the policies, procedures, and internal controls and transactions performed by the district.

The team will sample test data from the current and two prior fiscal years and include a review of the expenditures made for administrative positions to determine if fraud, misappropriation of funds or other illegal activities have occurred. Testing associated with this review will be based on the sample selection; it will not include testing of the complete list of all transactions and records for this period. Sample testing and review results are intended to provide reasonable, but not absolute, assurance as to the accuracy of the district's transactions and financial activity.

B. Services and Products to be Provided

1. Orientation Meeting - The team will conduct an orientation session at the district to brief management and supervisory personnel on the team's procedures and the purpose and schedule of the study.
2. On-site Review - The team will conduct an on-site review at the district office and at school sites if necessary, and will continue to review pertinent documents off-site.
3. Progress Reports - The team will inform the COE of material issues as the review is performed.
4. Draft Reports – When appropriate, electronic copies of a preliminary draft report will be delivered to the COE's administration for review and comment on a schedule determined by the team.
5. Final Report - Electronic copies of the final report will be delivered to the COE and/or district following completion of the review. Printed copies are available from the FCMAT office upon request.
6. Follow-Up Support – If requested, the team will meet with the COE and/or district to discuss the findings and recommendations of the report.

3. PROJECT PERSONNEL

The study team will be supervised by Anthony L. Bridges, CFE, CICA, Deputy Executive Officer, Fiscal Crisis and Management Assistance Team, Kern County Superintendent of Schools Office. The study team may also include:

To be determined	FCMAT Consultant
To be determined	FCMAT Consultant

Other equally qualified staff or consultants will be substituted in the event one of the above individuals is unable to participate in the study.

4. **PROJECT COSTS**

The cost for studies requested pursuant to E.C. 42127.8 (d) (1) shall be:

- A. \$800 per day for each staff team member while on site, conducting fieldwork at other locations, presenting reports, or participating in meetings. The cost of independent FCMAT consultants will be billed at their actual daily rate.
- B. All out-of-pocket expenses, including travel, meals and lodging.

Based on the elements noted in Section 2A, the total estimated cost of the study will be \$18,000.

- C. Any change to the scope will affect the estimate of total cost.

Payments for FCMAT services may be reimbursed from funds pursuant to EC 1241.5 set aside for this purpose. Other payments, when deemed necessary, are payable to Kern County Superintendent of Schools - Administrative Agent.

5. **RESPONSIBILITIES OF THE COE AND/OR DISTRICT**

- A. The district will provide office and conference room space during on-site reviews.
- B. The district will provide the following if requested:
 - 1. Any documents requested on the attached document list. Documents requested on the list should be provided to FCMAT only in electronic format; if only hard copies are available, they should be scanned by the district and sent to FCMAT in an electronic format
 - 2. Documents should be provided in advance of field work; any delay in the receipt of the requested documents may affect the start date of the project. Upon approval of the signed study agreement, access will be provided to FCMAT's online SharePoint document repository, to which the district shall upload all requested documents.
- C. The COE will review a preliminary draft copy of the study. Any comments regarding the accuracy of the data presented in the report or the practicability of the recommendations will be reviewed with the team prior to completion of the final report.

Pursuant to EC 45125.1(c), representatives of FCMAT will have limited contact with pupils. The district shall take appropriate steps to comply with EC 45125.1(c).

6. PROJECT SCHEDULE

The following schedule outlines the planned completion dates for different phases of the study:

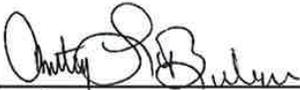
Orientation	February/March, 2014
Staff Interviews	To be determined
Exit Interviews	To be determined
Preliminary Report Submitted	To be determined
Final Report Submitted	To be determined
Board Presentation	To be determined

7. CONTACT PERSON

Contact: Jamie Perry
 Telephone: (559) 497-3771
 E-mail Address: jperry@fcoe.org



 Jim Yovino, Superintendent
 Fresno County Office of Education
 Date 2/14/14



 Anthony L. Bridges, CFE, CICA
 Deputy Executive Officer
 Fiscal Crisis & Management Assistance Team
 Date February 14, 2014