



Avoiding a Scandal

As incidents of fraud and mismanagement rise across the country, school leaders can take steps to increase oversight and save money and resources for their districts

A

certified public accountant in Tulsa, Okla., Jay Jenkins had built a solid business working with area school districts, annually reviewing their financial records, casting an opinion on their veracity, and making recommendations on how to improve processes.

It was steady and predictable work. That is, until 2008, when Skiatook Public Schools retained Jenkins' services, setting off a chain of events no one could have predicted—although there were signs from the beginning that things might not be as they seemed.

Months into his review, Jenkins would unearth a series of unsettling financial findings that would ultimately topple

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the head of the school system, incite a public outcry, and lead to several indictments.

"This was definitely the biggest thing I ever discovered," Jenkins says.

Unfortunately, such incidents are not rare—mismanagement, waste, and outright fraud have been on the rise within school districts across the country in the last several years.

In New Jersey, for instance, the state auditor found Trenton Public Schools shelled out more than \$300,000 in bogus payments to home tutors in 2008 and 2009, with one teacher claiming to provide 2,000 hours of in-home instruction while teaching regular classes and attending grad school.

In neighboring New York, state auditor and former school board member Thomas DiNapoli—whose precedes-

sor resigned amid charges he accepted bribes and used public resources for personal use—has zealously worked to restore faith in the system, using audits to uncover more than \$3 million in wasteful spending and fraud, including nearly a quarter-million dollars in health care for dead or ineligible district retirees from 2008 to 2010.

And then, of course, there was Atlanta Public Schools, where a state investigation last year implicated 178 educators in the largest test cheating scandal, to date. Georgia lawmakers recently ruled that the bonuses given to those charged should be rescinded.

These mishaps have come at a time when public trust in government is shaky and public resources are scarce. In response, audits and other formal reviews of key district operations have grown in number and scope—although their true capabilities have yet to be fully understood.

“There’s no district that can be audited enough,” says New Mexico state auditor Hector Balderas, who believes that statement is true for all public systems. “At the same time, you should not be overconfident that an audit report will provide corrective action. It’s a common misperception that, once issues are identified, they resolve themselves.”

Audits growing, budgets shrinking

That was certainly the case in Skiatook, where annual audits failed to detect the unethical channels being developed within the school district. Jenkins himself had nearly wrapped up his review of Skiatook’s financial records when he received a letter from the previous auditor. A standard correspondence between the outgoing and incoming auditor, the predecessor’s letter must divulge any angst about the firm’s credibility.

“It’s basically anything that would make you question the integrity of management,” says Jenkins, who mailed the missive later than usual, expecting the same old reply. “Ninety-nine percent of the time, there’s no question with the integrity of management. Districts change auditors mostly because they want to save money or a new superintendent comes in.”

This letter was different. It pointed out a whole host of murky practices, including an especially cozy relationship between the superintendent and a local business owner.

“We had a board meeting [to present the audit], and we had to cancel because I got this predecessor letter and I said, ‘Wow.’ I learned my lesson on that one,” Jenkins says.

While Jenkins primarily performs financial audits for some 60 school districts, the practice of reviewing important functions within a school system has grown to encompass performance audits (which look at the efficiency and integrity of whole programs in reaching their objectives), security audits (which test areas like IT and safety protocols), health eligibility audits (which examine medical claims and the eligibility of recipients), and energy audits (which analyze the

energy input and output of school systems).

“The auditing profession has been impacted ever since 2001,” says National State Auditors Association President David Vaudt, referring to the accounting scandals of Enron and WorldCom, which ushered in a heightened level of scrutiny and tighter federal regulations.

But schools have been slow to follow, and are harder to regulate than corporate America for a number of reasons. School districts, especially large ones, are highly decentralized, making monitoring difficult.

“If you think about it, there are lots of cash transactions occurring all over the place; the school lunch program, the student activity funds, the PTA,” says Vaudt.

Small school systems have challenges of their own. Proper protocol calls for an appropriate segregation of duties. But small districts, with smaller budgets and a smaller workforce, typically can’t afford the kind of oversight necessary to ensure checks and balances are being carried out.

“In small districts, you might see one payroll clerk do everything from add employees to change salaries and deductions. From an internal control standpoint, that’s not good,” says Gina Bliss, a CPA and senior manager with New York’s EFP Rotenberg LLP, a firm of certified public accountants and business consultants that performs internal audits for nearly 30 districts annually.

Bliss says districts need to get creative about building strong internal controls and procedures on a shoestring budget.

“Sometimes it’s finding someone with a little capacity and having them do something like open all the mail and list all the checks before it goes to the treasurer,” Bliss says. “There are a lot of things you can do that aren’t too painful.”

In fact, Vaudt advises school boards to take a hands-on approach to financial oversight by having bank statements mailed directly to them, for instance, and scanning and reviewing actual checks.

“It’s important that school boards be a champion for strong internal control, because that will deter fraud in the long term,” says Vaudt, who also serves as Iowa state auditor. “But I also remind boards that, even with good controls, someone can always override them.”

Like the business manager in a recent case who, it turns out, was manually writing checks even though everything was supposed to be electronically generated. Even watertight policies, like requiring dual signatures for checks, can be nullified if a rubber stamp can serve as the signature.

“We see so much is about blind trust, especially in small communities like we have in Iowa, where everyone knows everyone,” Vaudt says. “We tell the board, ‘It’s not that you don’t trust people, but that you verify they are doing what they should be doing.’”

That can be difficult, however, when you aren’t even sure

what to look for and whom to ask.

Who's looking over whom?

"In many cases, school boards are in over their heads when it comes to their fiduciary responsibilities," says New Mexico's Balderas. "I find most school boards are good members and want to understand, but they don't ask questions because they are embarrassed and afraid."

This tendency turned out to be disastrous for the Jemez Mountain School District, which in 2009 discovered its long-time business manager, Kathy Borrego, had embezzled close to \$3.4 million over six years. The amount is astounding, considering the district serves fewer than 400 students. Tragically, Borrego committed suicide days before she was to be sentenced.

"The business manager just had too much control, the school board trusted her too much, and the oversight agen-

cies had become too lax," Balderas says. "It was a massive systemic failure."

Since then, Balderas, whose office has one of the broadest jurisdictions in the country with authority to audit every public entity within its borders, has been on a mission to achieve systemic reforms as much as to halt illegal activity.

"I get more work, another tip, and another concern every place I visit," says Balderas, who notes that about half of all fraud schemes come to light through tips.

That's how it happened with Jenkins, who was floored when he read some of the intimations his predecessor made, causing him to take a deeper look into the school district's records.

"One of the tricky things about auditing is, if the people giving you the information are the perpetrators of the crime, they can really have you believing there is nothing going on," Jenkins says.

Tips for staying financially safe and sound

Here are a few more pointers to help you in your journey toward creating the most efficient and transparent district in the country.

Don't shortchange your finance office.

While corporate America has invested heavily in creating robust finance offices, public entities are going in the opposite direction, cutting staff while piling on additional responsibilities. It's a recipe for disaster, says New Mexico state auditor Hector Balderas.

"A superintendent will not succeed or may expose themselves to a high liability if they don't have a strong finance office," he says. "You are putting yourself at risk."

Stay vigilant.

Sadly, most fraud occurs at the hands of a trusted veteran worker. Most cases of white-collar crime are perpetrated by individuals with no criminal history, says Balderas, which is why it continues to be a difficult public policy problem. "Everyone wants to believe these are isolated incidences, but it's up to the districts to be proactive and not wait for something to happen," he says.

Invest in your own financial literacy.

Ideally, school boards will include someone with

a financial background or some business acumen. But if not, reach out to the community for that expertise, says National State Auditors Association President David Vaudt, who recommends boards establish audit committees and invite CPAs to join. In the same vein, Balderas suggests boards reach out to local lawmakers and their state school boards associations to get up to speed on relevant rules and regulations.

Establish a direct line of communication with your auditor.

Vaudt advises school boards to hear it from the horse's mouth when it comes to audit findings. "I remind them that auditors work for the board, not the management," he says. "I've found instances of fraud in Iowa, where the board didn't meet with auditors and instead got all of the information filtered through the superintendent or business manager."

Use audits as a management tool, not just as a punitive process.

"Audits are for honest operations as well. It's not just about trying to get bad guys," says Balderas, who recommends boards set auditing goals, just as they would set academic ones. School boards, for example, can set a goal to clear and retest the auditor's findings, strengthen the review process, or increase the frequency of internal tests.

Perform multiple audits.

For every program and process there is an audit, and boards would do well to conduct formal reviews of multiple areas like transportation, lunchrooms, overtime, discretionary funds, construction, and bonds, all of which have become high-risk areas for abuse. Balderas says one of the most alarming areas for waste and fraud is asset protection. "Most governments don't do a good job of protecting assets like computers, vehicles, and electronic equipment," he says.

Create a whistleblower program.

It's been said before and bears repeating again: About half of all fraudulent cases are brought to light through tips. Create independent channels like an anonymous hotline to encourage people to come forward with important information.

Don't take chances with your greatest resource.

"The most important asset we have is public trust, and I think some of these scandals have made taxpayers really upset about how their public dollars are being wasted," says Vaudt. "Regrettably, we find people fall into thinking everything is OK, and then they don't carry out their fiduciary responsibilities."

Another misconception: The auditing process combs through everything. It does not. Annual financial reviews are conducted by scrutinizing samples and using isolated testing procedures.

In the original tests, Jenkins says, he examined a sample size of purchase orders, verifying that the requisitions had been approved, invoices had been signed off, and the check and invoice amounts agreed. These basic internal controls appeared to be in order, and Jenkins was about to sign off on Skiatook when the letter suggested he look into the relationship between then-Superintendent Gary Johnson and business owner Rick Enos, who sold the district various goods—even though he operated as a tax service provider.

Paper products, vacuum cleaners, security cameras, cleaning supplies—you name it, Enos got it for the district, which Jenkins found strange. Stranger still, the same items seemed to be ordered again and again, while important documents like packing slips and 1099 forms were missing.

In one spectacular example, Jenkins asked the superintendent for the district's purchasing policy, expecting a document that included a flowchart or definition of who has which responsibilities and an articulation of tasks. Instead, he got a single page on which the sentence stating that the school board gave the superintendent authority to purchase was highlighted.

"The question for me throughout the whole process is: Who is the higher level of authority?" Jenkins says.

Practices, attitude shifting toward audits

In Palm Beach County, Fla., district officials are banking that a separate oversight structure and strong ethics are the answer.

Dozens of elected and government officials in Palm Beach County have resigned and gone to jail in recent years for accepting kickbacks and bribes from developers and other businesses. In just the latest sting, the county state's attorney arrested 13 individuals last year on racketeering, bribery, and money-laundering charges. Seven are current or former city and county employees.

While most of the fraud has occurred at the county and city levels, the school district has had its share of swindlers, too, including former band director Ernest Brown, who raided the band account to take friends and family on trips to London and Paris.

"We've had a lot of issues," says Palm Beach County school board member Karen Brill, the self-described driving force behind getting the district to create its own inspector general office, or IG.

A largely investigative unit originally created by federal law to detect fraud, waste, and mismanagement, the IG's office has made its way into many of the largest school systems in the country, including Chicago and Los Angeles.

"I wanted someone to look at everyone and everything;

no function would be sacred, to make sure we were doing everything honestly and transparently," Brill says.

Creating the right support structure to actually achieve that has proven to be harder than originally thought, as board members work through questions like what the responsibilities of the IG's office should be and to whom they report.

"We had our legal department meet with the county IG as well as people from the clerk and comptroller's office to get their input and make sure we were doing it right," Brill says. "We don't really know how the whole thing is going to play out, but ultimately we tried to build in as much independence as possible."

Just as important as creating its own watchdog office, Brill says, is that the district is focused on creating a culture of ethics through proper training, strong messaging, and reporting tools such as an anonymous hotline.

"When [fraud] happens, the public is upset and rightly so. We want them to know we take this very seriously, that the school board is willing to turn over every stone to make sure this doesn't happen again," Brill says. "That includes the education side. We need to educate people on proper practices and investigate when people aren't following them."

It's a message Skiatook officials have apparently assimilated. Outraged by Jenkins' findings and the subsequent state investigation that showed the district paid more than \$570,000 in markups for supplies, including \$1,500 for vacuums and \$60 for trash cans, the public convened a grand jury, ultimately indicting Johnson and former school board member Kenneth Cooper on charges of mismanagement, bribery, and embezzlement. Both resigned and Johnson pled guilty to four counts of bribery. Enos also faces bribery charges and is awaiting trial.

Since then, a new board has instituted many of the recommendations made by the grand jury and auditors, including shoring up the district's purchasing processes and adopting a whistleblower policy. That policy encourages and offers protection to anyone who comes forward with information about waste, mismanagement, and fraud occurring in the district.

For Jenkins, it's been a long and emotional journey, and he's glad it's over.

"When all this started happening, I didn't take it well. I lost a lot of sleep, my blood pressure went up, but I felt it needed to be done," says Jenkins. The year the story broke, Jenkins lost business for the first time in his 15 years of operation, but has since rebounded.

"This would be an easy job if you just gave clean audits, but you can't do that when faced with information that indicates otherwise," he says. "If it meant scaring off some bad apples, it was probably for the better." ■

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