



Fraud Vulnerability Assessment

Prepared for

Wake County Board of Education



March 7, 2006

BY HAND DELIVERY

Member
Wake County Board of Education
Wake County School System Administrative Office
3600 Old Wake Forest Road
Raleigh, NC 27609

Dear Board Member:

Attached is a copy of the Fraud Vulnerability Assessment we prepared for you. It is a report of our findings concerning and recommendations for the Wake County Public School System.

We are pleased to provide this report to you. Thank you for the confidence you have placed in our firm.

Respectfully submitted,

SUMMERFORD ACCOUNTANCY, PC



Kelly J. Todd, CPA, CVA
Senior Engagement Manager

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EXECUTIVE SUMMARY

Summerford Accountancy, PC has conducted a fraud vulnerability assessment for the Wake County Public School System (“WCPSS”). Covering the period from July 1, 2002, through December 31, 2005, our assessment was accomplished by identifying fraud exposures, determining the susceptibility of assets to misappropriation, and identifying and evaluating fraud symptoms in areas where fraud exposures were identified. This report details identified internal control weaknesses and fraud exposures. Throughout our work the staff of WCPSS has been extremely cooperative.

Because we applied data mining techniques to the entire population of transactions and account balances, our testing touched upon all departments within WCPSS. In addition to the application of data mining techniques, we conducted compliance testing at multiple schools and various departments, including:

- Accounting
- Budget
- Compensation Services
- Human Resources
- Purchasing
- Maintenance and Operations
- Facilities
- Child Nutrition Services
- Community Services

Our task was to conduct a fraud assessment, and if we determined there was sufficient predication, to advise the Board of our findings and commence a fraud examination if the Board deemed necessary. Our assessment has not identified any area where we believe sufficient predication exists to commence a fraud examination. However, our assessment has identified specific weaknesses we believe may foster the opportunity, if not corrected, to allow a fraud to be perpetuated and, perhaps, go undetected for a long period of time.

We have made recommendations that will reduce the opportunity for a fraud to be committed. Foremost among these recommendations is the addition of a proactive internal audit approach, which we believe is a top priority in reducing the risk that fraud will occur and remain undetected. Until recently, the internal audit function has been executed by one individual. Consequently, through no fault of the internal auditor, the department has been (and continues to be) operating in a reactive state. For a proactive audit approach to be effective it must include:

- a. A risk based audit program - The department is in the process of establishing such a plan; however there is currently nothing formalized. We recommend this process be completed at the earliest possible date.
- b. An internal audit program that utilizes data mining technology – The use of data mining software allows the auditor to significantly increase the ability to detect fraud.

Additionally, we recommend the integration of all WCPSS information systems. Several departments use disparate systems to provide specialized management, analytic and reporting tools unique to each department. Because these systems are not integrated with Oracle (WCPSS' primary financial reporting system) and not monitored through computer assisted audit techniques, it is our opinion that the vulnerability to fraudulent activity and its concealment is greatly increased.

Assessment of Internal Control

The organization's control environment is the foundation for all components of an effective internal control system. Commonly referred to as the "tone at the top," the control environment sets the tone for the organization and influences the control consciousness of its people. We found the overall control environment to be positive and to be operating effectively.

The continued development of a more effective internal control structure requires a delicate balance between many factors including cost, burden on the organization's ability to function efficiently, and its people's trust. In our opinion, especially considering the additional control procedures that have been implemented in the last 18 months, WCPSS' internal controls are operating effectively. We do not, however, believe that the current procedures alone are sufficient to adequately reduce the risk of future improprieties. For this reason, it is critical that WCPSS implement a proactive audit approach and a risk based internal audit program to sufficiently manage its risk of vulnerability to fraud, waste and abuse.

FRAUD VULNERABILITY ASSESSMENT – BACKGROUND

Because of separate frauds perpetrated in the Garner High School cafeteria and the Transportation Department of the Wake County Public School System (“WCPSS”), the Wake County Board of Education (“the Board”) sought proposals from independent qualified firms to perform a fraud vulnerability assessment in accordance with the specifications set forth in the Request for Proposal for Audit Services (“RFP”). Through a competitive bidding process, Summerford Accountancy, PC was awarded the contract to perform forensic services.

Summerford Accountancy, PC, located in Birmingham, Alabama, specializes in fraud examination and forensic accounting. Its accountants are trained to analyze, interpret, summarize and present complex financial and business related issues in a manner that is both understandable and properly supported. To become specialists, the experts at Summerford Accountancy, PC have combined their backgrounds in financial accounting and auditing with investigative skills. The result of this combination is what is termed a “forensic accountant.” That is, a person who uses his or her accounting, auditing and investigative skills to assist in the resolution of matters in dispute or litigation. The firm does not perform accounting services in the traditional forms of audits, tax return preparation or financial statement preparation. By exclusively providing fraud, forensic, and valuation services to our clients, we are better able to focus our efforts and to remain current on the latest techniques and technology.

The team that was assembled for this project was comprised of specialists with a broad range of experience and knowledge in the investigation of fraud, waste and abuse. Additionally, through an alliance with the Winston Salem, North Carolina firm of Daniel Professional Group, Inc. we utilized two individuals from its governmental accounting practice area to perform a portion of the fieldwork on this engagement.

SUMMERFORD ACCOUNTANCY ENGAGEMENT TEAM

Kelly J. Todd, CPA, CVA – Senior Engagement Manager

Kelly J. Todd is a Senior Engagement Manager at Summerford Accountancy. Since joining Summerford Accountancy in 1999, she has demonstrated her skills and analytical abilities in over 50 cases including the Los Angeles Unified School District (the second

largest school district in the U.S.). Of particular note, in a joint venture with another accounting firm, Ms. Todd was integral in bringing closure to a case involving alleged fraudulent financial reporting. She accomplished this by using her data mining, analytical, reasoning and supervisory skills, coordinating the work of over 80 accountants from two different firms to show that a company's sales were significantly overstated. Prior to joining Summerford Accountancy, Ms. Todd was an internal auditor for Alabama's Robert Trent Jones Golf Trail. In addition to the audit function, she was responsible for the development, implementation and training in the use of information systems for a network of eight golf courses and their reservations department.

Ms. Todd is a faculty member of the Association of Certified Fraud Examiners. She is dedicated to the education and training of other professionals in the areas of prevention, detection and deterrence of fraud. In addition, she is a frequent guest lecturer at colleges, universities, and professional conferences and a contributor to trade publications.

Lisa D. Robbins, CFE

Lisa D. Robbins is a Senior Investigator with Summerford Accountancy, specializing in the areas of fraud examination and forensic accounting. Her work has included financial and white-collar investigations in areas such as asset misappropriation, embezzlement and financial statement fraud. Ms. Robbins works with the latest technology to analyze and interpret electronic data. She was instrumental in the firm's investigation of the Los Angeles Unified School District, employing her skills to extract and analyze information using data mining techniques. Similarly, she has employed her skills in investigations of the Huntsville (Alabama) City School System, the Florence (Alabama) City School System, six automobile dealerships, five banks and over 40 other agencies and businesses.

Lindsay H. Gill, CFE

Lindsay H. Gill is a forensic analyst with Summerford Accountancy. Ms. Gill assists senior investigators with numerous assignments involving database and document analysis. She also creates charts summarizing her findings that can be used for information purposes and trial exhibits. She has assisted in cases involving financial and white-collar investigations. Prior to joining Summerford Accountancy, Ms. Gill was an internal auditor at a major health care conglomerate, where her audit duties included making recommendations to management for correction of deficiencies, improvement of operations and reductions in costs.

Engagement Review

Ralph Q. Summerford, CPA, CFE, CVA, CIRA – President

Prior to starting Summerford Accountancy, PC in 1992, Ralph Q. Summerford was employed by the international accounting firm of Ernst & Young. He also co-founded what has become one of the largest local accounting firms in the state of Alabama. At that firm, he was the member in charge of all audit and consulting services. Having been a CPA for over 34 years, Mr. Summerford has performed hundreds of audits and assisted over 1,000 clients with financial accounting matters.

Mr. Summerford's experience as an investigator began before he became a Certified Fraud Examiner in 1993. He assisted many of his audit and consulting clients in the investigation and resolution of matters of fraud and abuse. Mr. Summerford became a faculty member of the Association of Certified Fraud Examiners. For over eight years he has traveled throughout the United States and abroad teaching fraud examination courses to auditors, examiners, investigators, law enforcement, attorneys and financial analysts. He continues to be rated one of the Association of Certified Fraud Examiners best instructors, earning outstanding reviews from his students.

Mr. Summerford was elected by the Association of Certified Fraud Examiners membership to serve a three year term (2000 – 2003) on its Board of Regents. His fellow Regents elected him to serve as the Board's Vice Chairman. He continues to serve the Association of Certified Fraud Examiners as one of three members of its Board of Review.

FORENSIC ASSESSMENT APPROACH

Techniques for the assessment and examination of fraud differ considerably from those traditionally used in financial statement auditing. To begin an examination, a fraud examiner makes an *assessment* to determine if sufficient predication exists to commence a fraud examination. The Association of Certified Fraud Examiners defines predication as:

The totality of circumstances that would lead a reasonable, professionally trained, and prudent individual to believe a fraud has occurred, is occurring, and/or will occur.

This *assessment* is what may commonly be referred to as a fraud audit. If the fraud examiner finds sufficient predication as a result of the fraud audit, he or she will then

begin a fraud examination. In the fraud examination, the examiner follows what is known as the *Fraud Theory Approach*, including the following steps:

- Analyzing available data
- Creating a theory or assumption
- Testing the theory
- Refining and amending the theory as necessary

Forming the basis of the Fraud Theory are the following fraud axioms:

1. **Fraud is Hidden** – Concealment is the methodology of fraud. Numerous methods, some ingenious, are used to conceal activities or schemes. It is for this reason that we (nor anyone, in our opinion) cannot guarantee that all fraud has been identified nor that any additional fraud has occurred.
2. **Use Reverse Proof** – To prove fraud has occurred, proof must include attempts to prove fraud has not occurred (the reverse is also true). In law, it is our understanding that proof of fraud must preclude any explanation other than guilt.
3. **Existence of Fraud** – The determination of fraud is solely within the purview of the courts and juries.
4. **Predication** – as described above, our assessment was to consider the totality of circumstances that would lead us to believe that a fraud has occurred. This is the basis upon which an examination is commenced.

Our approach to each engagement includes understanding and application of the each of the above steps, the facts and circumstances surrounding the engagement, and what has been specifically requested of us. The Board’s RFP stated that it was seeking assurance “that internal controls are reasonable and effective, and sufficient to expose and prevent fraud and abuse and that policies and procedures are being followed by School System employees and whether misappropriations of assets have occurred.”

Other than the frauds discovered in WCPSS’ Transportation Department and Garner High School cafeteria, we are not aware of other specific allegations of fraud. Consequently, our task was to conduct an assessment (fraud audit), and if we determined there was sufficient predication to begin a fraud examination to advise the Board of our findings.

To achieve the assurances requested by the Board, we could have recommended that we be allowed to thoroughly investigate all aspects of WCPSS’ financial operations. Clearly, such an approach would be unduly burdensome and impractical. The specific steps involved in determining if fraud is occurring and if the system of internal controls is working are a matter of judgment. Our approach led us to:

- Identify fraud exposures through an understanding and tests of internal controls.
- Identify the susceptibility of assets to fraud, waste and abuse.
- Identify and evaluate fraud symptoms in the areas where fraud exposure was identified.
- Consider the pressures and motivations to commit fraud.

As we undertook each objective of our approach, we searched for signs (anomalies) indicative of fraud, waste, and abuse. As anomalies were identified, we assessed the circumstances surrounding each anomaly to determine if there was sufficient predication to perform a fraud examination. This was accomplished through techniques commonly used by fraud examiners, including the following:

- Evaluation of existing internal controls
- Document examination
- Analytical techniques
- Interviews

Our approach was developed to accomplish multiple objectives, including:

- To evaluate the adequacy and effectiveness of the current system of internal controls.
- To make recommendations for additional and/or improved internal controls.
- To evaluate and make recommendations concerning organizational structure, administrative structure, and information technology in context of the system of internal accounting controls.
- To assess WCPSS' vulnerability to fraud and the risk that fraud may exist.
- To make recommendations for proactive audit techniques to assist in the prevention and early detection of fraud, waste, and abuse.
- To determine if there is sufficient predication, to commence a fraud examination.

SCOPE AND METHODOLOGY

Our work in this matter covered the period from July 1, 2002 through December 31, 2005.¹ We began with obtaining an understanding of the systems and procedures which are currently in place. It is this understanding which provides the basis for the assessment of the WCPSS' internal control structure, the identification of fraud exposures and the evaluation of fraud symptoms.

ASSESSMENT OF INTERNAL CONTROL AND THE IDENTIFICATION OF FRAUD EXPOSURES

Broadly defined, internal control is a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

Effective internal control is perhaps the most important deterrent to fraud. Strong internal control can prevent or detect most types of fraud, waste and abuse. During our assessment of the current system of internal control, not only were we concerned with the controls in place but just as importantly whether those controls were operating as prescribed. As we identified fraud exposures and controls in a given area, we created procedures to test for compliance. The majority of our testing for compliance (as well as the identification and evaluation of fraud symptoms described below) was conducted by applying data mining techniques to WCPSS' electronic data. Electronic data and data mining techniques are invaluable when identifying and evaluating fraud exposures and

¹ Exceptions to scope include:

- Oracle financial system beginning fiscal year 2002 through December 31, 2005. This exception provided us with a basis upon which to analyze changes over time.
- Compensation payment detail (Oracle) from January through December 31, 2005. We originally requested detail of payroll deductions and earnings for the time period from July 1, 2001 to December 31, 2005. Due to the enormous amount of data involved and the undue burden such a request placed on the on WCPSS' Technology Department, we agreed to accept data from calendar year 2005 for testing purposes with the stipulation that once testing for 2005 was completed, we might deem it necessary to expand the data request to include additional periods. We did not find it necessary to lengthen the testing period.
- Win SNAP data July 1 through December 31, 2005.
- MAXIMO data was tested from July 2001 (its implementation date) through December 31, 2005.
- Prism data from its implementation date through February 8, 2006.

symptoms. One of the many advantages of using such technology is the ability to examine 100% of the population (rather than a mere sample) throughout the majority of our testing and examination.

Accounts that are manipulated in order to effect or conceal fraud may as a result show unusual relationships with other accounts that have not been manipulated. Also, fraudulent activity may result in causing erratic patterns in monthly, quarterly or annual balances. Analytical procedures, especially those conducted using data mining techniques are highly effective in assessing the risk that fraud has occurred and in identifying anomalies. Various analytical procedures are commonly used including horizontal analysis, vertical analysis, ratio analysis, budgetary comparisons. Additionally, data mining techniques allow the user to identify suspicious transaction patterns, trends, anomalies, and control gaps or weaknesses.

In those instances where data mining techniques could not be used, it was necessary to test for compliance with control procedures by using hard copy source documents. There we utilized discovery sampling. The objective in such a sampling plan is to evaluate the effectiveness of, or compliance with, a prescribed control procedure. Discovery sampling is commonly used when investigating for fraud. The basis of discovery sampling is an expected error rate of zero. It is used to determine whether a population contains *any* error indicative of fraud. When even one such error is found, the sampling is stopped and other procedures are applied to the population.

By virtue of the data mining techniques applied to the entire population our testing touched upon all departments within the organization. In addition, we conducted compliance testing using discovery sampling at multiple schools and various departments, including:

- Accounting
- Budget
- Compensation Services
- Human Resources
- Purchasing
- Maintenance and Operations
- Facilities and Construction
- Child Nutrition Services
- Community Services

IDENTIFICATION AND EVALUATION OF FRAUD SYMPTOMS

After identifying fraud exposures, we began to look for symptoms suggesting that fraud has occurred, is occurring, and/or will occur. It is at this point in the engagement that we considered the totality of the circumstances to evaluate if there was sufficient predication to commence a fraud examination. Fraud symptoms are generally classified in the following categories:

- Analytical symptoms
- Accounting symptoms
- Internal control deviations
- Tips and complaints
- Employee symptoms

GENERAL FINDINGS

We believe that our work in conducting a fraud vulnerability assessment for the Board of WCPSS has been completed, with the exception of a very limited amount of follow up work still to be performed.² This assessment has not identified any areas where we believe sufficient predication exists to commence a fraud examination. However, our assessment has identified specific weaknesses we believe may foster the opportunity, if not corrected, to allow a fraud to be perpetuated and, perhaps, go undetected for a long period of time.

In the following sections of this report we have detailed the identified internal control weaknesses and fraud exposures. Included with these findings you will find our specific recommendations to correct these weaknesses.

ASSESSMENT OF INTERNAL CONTROL

CONTROL ENVIRONMENT

The foundation for all components of an effective internal control system is the organization's control environment. The control environment (commonly referred to as the "tone at the top"), which includes management's philosophy, oversight and responsibility, sets the tone of the organization and influences the control consciousness of its people. Without an effective control environment all other areas of internal control are likely to fail – they are only as good as the foundation upon which they are created.

² Assessment of the Prism system at page 23 and compilation of Win SNAP analysis at page 25.

Throughout our assessment we found the control environment within WCPSS to be operating effectively. With the exception of recommendations to improve the communication of certain policies (as detailed in the Fraud Prevention section) the overall positive culture, tone and attitude of the entire organization is, in our opinion, an adequate and proper control environment. We also do not believe the control environment has changed to the observed positive environment as a simple result of the improprieties discovered within the Transportation Department. The environment already existed because in our experience, it be would be difficult, if not impossible, to alter the entire organization's culture in such a short period of time. It is probable that changes could be expected from a few key individuals, but not the entire organization.

ADDITIONS TO CONTROLS

The development of an effective internal control structure is a delicate balance between many factors including cost, burden on the organization's ability to function efficiently and its people's trust. WCPSS has implemented numerous additional control procedures subsequent to the discovery of the improprieties. These controls, which we have determined to be operating effectively, were a necessary part of reducing the risk within WCPSS to future fraud, waste and abuse. We do not, however, believe that those procedures alone are sufficient to adequately reduce the risk of future improprieties.

Monitoring the balance between cost, burden and trust is crucial to an effective internal control system, especially when an organization is in a continued state of growth similar to WCPSS. Consequently, a continual "risk assessment" is imperative to determine if the structure of the internal control system and implemented control procedures are relevant and can address those risks. We believe that WCPSS must implement two very critical components to sufficiently manage the risk of WCPSS' vulnerability to fraud, waste and abuse. Namely, those components are:

- (1) A risk based audit program
- (2) A proactive audit approach

We fully describe these recommendations in the Internal Audit Function section (page 17).

TRANSPORTATION FRAUD

The fraud in the Transportation Department was conducted primarily through kickback and over billing schemes. Kickbacks are undisclosed payments made by vendors to employees of purchasing entities.³ The purpose of the kickback is usually to enlist the corrupt employee in an over billing scheme. At the heart of these schemes is collusion.

³ Wells, Joseph T., CFE, CPA. Occupational Fraud and Abuse. Austin: Obsidian Publishing Company, 1997.

Collusion, a secret agreement or cooperation especially for an illegal or deceitful purpose⁴, allows controls to be circumvented with far less effort than an individual acting alone. Collusion may also make the concealment of improprieties easier and/or allow the fraud scheme to go undetected for a longer period of time.

While some fraud schemes are more difficult than others to detect even though control procedures were circumvented, most frauds can be detected far sooner through analytical procedures that are designed to drill down into financial data to identify suspicious transaction patterns or trends. For example, suspicious transactions were revealed to us time and again during our electronic data analysis as follows:

- In an analysis of payments to vendors we quickly saw that payments to Barnes Motor and Parts (a co-conspirator in the Transportation fraud scheme) increased **342%** from 2002 to 2003 (an increase in excess of \$3,700,000).
- When we performed an analytical review of invoices just under the bid limit, Barnes Motor and Parts stood out glaringly since two-thirds of its invoices were less than \$2,500 and did not have a corresponding purchase order.
- Another anomaly we quickly recognized was that almost 100% (99.957%) in one year and 100% in another year of all invoices from Barnes Motor and Parts were less than \$2,500. This is a clear indication of a possible circumvention of bidding policies.
- When we performed an analysis of vendor invoice dates, we learned that on 24 occasions 50 or more invoices with the same invoice date from Barnes Motor and Parts were submitted for payment. Also a majority of those invoices bore consecutive invoice numbers. Below is a table summarizing those invoices:

⁴ Merriam-Webster Online Dictionary, <http://www.m-w.com>

Table of Invoices From Barnes Motor and Parts Where Over 50 Invoices Submitted On One Day		
Date On Invoices	Total of Invoices	No. Invoices Submitted This Date
5/8/2002	\$226,945.69	113
1/9/2003	146,667.97	76
5/26/2003	53,108.59	50
6/2/2003	144,766.59	74
6/4/2003	550,262.68	282
6/5/2003	173,395.40	91
6/6/2003	701,979.40	348
6/9/2003	479,341.09	236
6/10/2003	909,266.47	466
6/11/2003	122,277.30	68
2/9/2004	75,330.12	65
2/12/2004	191,411.84	104
2/19/2004	76,509.21	60
3/1/2004	71,614.04	64
4/6/2004	76,312.23	53
5/14/2004	69,931.86	53
5/18/2004	108,385.68	80
5/19/2004	135,584.65	103
5/20/2004	125,868.41	87
5/24/2004	267,257.65	150
5/26/2004	168,728.63	124
6/9/2004	619,387.29	397
6/10/2004	406,594.44	198
6/11/2004	267,317.66	304

ORGANIZATIONAL STRUCTURE

Several changes have been made to WCPSS' organizational structure subsequent to the discovery of the fraud in the Transportation Department.

FISCAL ADMINISTRATORS

Six fiscal administrators have been added to provide accounting and budgetary oversight to key areas of the organization:

- Transportation
- Facilities Department / Maintenance and Operations
- Technology Services Division / Superintendent's Office / Internal Audit / Area Assistant Superintendents
- Curriculum and Instruction Department / Instructional Services Division / Communications / Community Services
- Special Education and Human Resources
- Child Nutrition Services

With the exception of the fiscal administrator over the Facilities Department, all fiscal administrator positions have been added within the last fiscal year. Because of this the role of each continues to evolve. All fiscal administrators report directly to the finance officer.

Recommendations: It is our opinion that the fiscal administrators in these key areas were a necessary addition to WCPSS, given its size and continued growth. We recommend a well planned and executed monthly analytical review of key financial indicators as part of the responsibilities of each fiscal administrator. Furthermore, we recommend analytical review be completed at the earliest possible date each month.

BOARD OF EDUCATION

Audit Committee - Although not defined by Board policy, historically the Board Chair, the Chair of the Board finance committee, the School System Finance Officer and Deputy Superintendent function as an audit committee.

The Board is reviewing the feasibility of forming an audit committee. It is our understanding that nothing has been formalized at this time.

Recommendation: We recommend that an audit committee be formed of independent members. According to the American Institute of Certified Public Accounts “an audit committee should be organized as a standing committee of the board composed mainly as nonofficer directors.”⁵ An independent director is someone who is not directly involved in management of the organization. It is our opinion that because the WCPSS Finance Director and Deputy Superintendent are both management and employees of the organization independence may be compromised.

INFORMATION TECHNOLOGY

There are numerous WCPSS departments that maintain individual software programs. Each of these programs provides additional management tools with capabilities beyond that afforded by Oracle (see page 20). These programs are not integrated with Oracle. The departments that utilize these additional software tools have employees who function in a maintenance and support role, acting as liaisons between departmental staff and the software service provider. More important, these employees function independent of the Technology Department, without its oversight.

Recommendation: We recommend that all employees functioning in a technology capacity report to the Technology Department. In our opinion when employees performing technology functions operate independently of the Technology Department (as some do now), this compromises internal control as well as the objectives of the Board.

AREAS OF NOTED WEAKNESS

INTERNAL AUDIT FUNCTION

Wake County Public School System’s Internal Audit Department is currently comprised of three individuals operating under a charter approved by the Board.⁶ According to the charter the department reports functionally to the Board and administratively to the chief executive officer. As noted in the charter the Internal Audit Department reports to the Board on a quarterly basis.

Prior to discovery of improprieties in the Transportation Department, the entire internal audit function was executed by one individual. Consequently, through no fault of the internal auditor, the department has been operating (and continues to be) in a reactive state. There has been no time for proactive audit work. While the department does have

⁵ American Institute of Certified Public Accountants, *Audit Committees, Answers to Typical Questions About Their Organization and Operations* (New York: AICPA, 1978), p. 11.

⁶ WCPSS Board Policy 2220

the proactive data mining software tool ACL (which we highly recommend), the application of the enormous capabilities of the program has been nonexistent.

The determination of departments and areas to be audited has been strongly influenced by the Superintendent and Associate Superintendents with little or no input from the internal audit director. It is our understanding that the internal audit department is planning to move towards a risk based audit plan (which we discuss later); however, such a plan has not been formalized.

When audits are conducted by your staff they are usually announced to the target department two weeks in advance to allow that department time to prepare for the impending audit. Audit results and recommendations are communicated to the proper parties, who respond in writing to the internal audit department.

Recommendations

Proactive Audit Approach

According to the Association of Certified Fraud Examiners *2004 Report to the Nation*, more than 60% of all frauds that are detected are initially uncovered by tip or by accident. What this means is that while internal audit, internal control and external audit all play an important role in the prevention and detection of fraud, they are not enough. The addition of a proactive audit approach is a **priority** in reducing the risk that fraud will occur. This is confirmed by the discovery of the frauds WCPSS has suffered.

Utilizing a combination of both electronic data and hard copy source documents is, in our opinion, the single most effective way for an internal audit department to prevent and detect fraud. All too often, auditors resort to a manual review of documents when testing for fraud. Because it is not cost effective to examine every individual transaction, the auditor is limited to testing transactions on a sample basis. The use of data mining software and transaction analysis allows the auditor to more effectively and efficiently detect fraud. Some advantages of electronic data analysis include:

- Analysis of **all** transactions – rather than reviewing merely hard copy source documents on a test basis.
- Ability to analyze unlimited amounts of data.
- Analysis close to the time of the transaction – helping to detect fraud far sooner and much more efficiently than having to wait to retrieve documents, or simply missing the fraud altogether.
- Ability to compare data from operational systems that are not fully integrated with your primary financial software (Oracle) - which is true for the maintenance and operations management software (MAXIMO),

the food service point of sale and inventory system (Win SNAP) and the rental management system (Prism).

1. We recommend that the entire audit staff be sufficiently trained to become **proficient** in the use of a data mining computer program such as ACL. Typically the creation of a proactive program with ACL is best served with at least one user designated as an ACL “super-user” - that is a person whose time is devoted primarily to monthly, quarterly and annual audit programs utilizing ACL. It is important to note that each program which is developed can be automated to save valuable time and resources and can be implemented as part of a regular proactive process.
2. We believe it is imperative that a risk based audit program be implemented for the internal audit department to function proactively. An audit plan that is strongly influenced by management raises concerns regarding auditor independence and in our opinion does not meet the Board’s audit objectives. While we understand the internal audit department is in the process of establishing such a plan, there is currently nothing formalized. We recommend this process be completed at the earliest possible date.
3. A risk based audit program should be monitored by the internal audit director at least annually to make certain the program is accomplishing the department’s and Board’s goals. Monitoring is crucial to an effective internal control system. Because organizations and personnel change, controls must be monitored over time to determine whether they continue to be relevant and can address new risks. WCPSS’ continuing growth makes monitoring all the more important. The nature of changes occurring within the organization, their associated risks, and the competence and experience of personnel implementing controls are all important factors to monitor.
4. WCPSS should increase its audit staff to a size sufficient to meet the needs of the audit plan. To determine the structure of audit departments in public school systems, a survey entitled “100 Largest School Districts Audit Survey 2005”⁷ was conducted by James M. Kaplan, CIA, CFE and the Fairfax County Public Schools Internal Audit Office. The following table compares WCPSS to other districts included in this survey:

⁷ *100 Largest School Districts Audit Survey* conducted by James M. Kaplan, CIA, CFE and the Fairfax County Public Schools Internal Audit Office, April 2005.
www.fcps.edu/Superintendent/InternalAudit/School%20Survey.html

Public School System Audit Function

	<u>Average System</u>	<u>Wake County System</u>
Average Number Students	114,660	114,068
Average Budget (billions)	\$1.20	\$1.26
Audit Department Staff	7	3
Audit Department Budget	\$614,707	\$248,317

Mr. Kaplan stated the survey's goal was to establish a benchmark that could be used to demonstrate whether a public school system's audit function had sufficient resources when compared to other school districts. WCPSS was a participant in this study, and as you can see WCPSS is very similar in average students and school budget to the average system surveyed. There is a vast difference, however, when you compare the size of the audit staff and audit budget.

The survey did not address the use of proactive audit approaches nor the effective use of data mining technology, the subject of our first recommendation above. We do not have first hand knowledge, but we do not believe that the survey schools effectively use data mining technology. It is our opinion that effective use of such tools can result in the need for smaller audit staffs and budgets. WCPSS should consider both of these factors when evaluating the need to hire additional auditors and increase its audit budget.

5. There should be appropriate follow-up work to ensure that internal audit recommendations are implemented. Due to inadequate staffing and the reactive basis upon which the department has been functioning, it is understandable why follow-up has been difficult to achieve. We recommend a structured follow-up process commensurate with the audit plan. This recommendation goes hand in hand with adequate audit staffing and a proactive audit approach.
6. Audits should be conducted unannounced to the extent possible. While this can be burdensome for the department being audited, it is crucial to the audit results. Where it is deemed necessary to inform the department prior to the audit, requests should remain vague to avoid alerting management and staff exactly what will be reviewed.

Other Recommendations

We believe the Board should investigate the use of a structured risk management plan to establish long-term corporate governance and risk management practices. You may quickly accomplish such a plan with a prepackaged software product. Furthermore, you can limit the cost and achieve a well structured plan. For example, Paisley Consulting provides organizations with accountability solutions needed for operational risk management, and auditing. They offer a product called Risk Navigator, which is used to establish long-term corporate governance and risk management practices.

Corporate governance includes the responsibility of the Board to inform, direct, manage and monitor the organization's activities aimed toward the achievement of its goals. A software product such as Risk Navigator allows the organization to distribute the responsibility of risk management throughout the organization and improve data integrity. Risk Navigator offers several features including control self-assessment surveys, hard coded reports with drill down capability, fully customizable to meet the unique needs of an organization. We are not saying that you should buy Risk Navigator. Instead, you should investigate the available software products and choose the one that best fits your needs.

INFORMATION SYSTEMS INTEGRATION

Oracle, WCPSS' financial system, is designed to address financial reporting needs for the entire organization, but not necessarily provide detailed management tools often needed by individual departments. As a result several of the departments use disparate systems to provide specialized management, analytic and reporting tools unique to each department.

During our assessment we identified several departments that are using disparate systems:

- Community Services – *Prism*, a reservation tracking program
- Child Nutrition Services – *Win SNAP*, point of sale and inventory management
- Maintenance and Operations – *MAXIMO*, work order management system
- Facilities – *Expedition*, project management system
- Schools – *School Funds*, activity fund accounting system
- Transportation – *BSIP*, for fleet maintenance

Each of these information systems has the ability to provide valuable resources to WCPSS and its departments. However, because these systems are not integrated with Oracle, and not monitored through proactive computer assisted audit techniques (as described in the Internal Audit Function section) in our opinion the vulnerability to fraudulent activity and its concealment is greatly increased. For example, the fraud in the Garner High School cafeteria may have been discovered much sooner had detailed transactional data from Win SNAP been monitored through computer assisted audit techniques.

We analyzed transaction data from several of these specialized systems. Our findings and recommendations follow:

COMMUNITY SERVICES

The Community Services Department (“Community Services”) manages public use of school facilities during non-school hours (Community Use programs) and provides lifelong educational opportunities in both traditional settings and through online learning (Lifelong Learning and Online Learning programs).

Community Use

Prior to January 2005, Community Services collected, recorded and deposited cash receipts for the services it provided. Both the reservation and the payment of Community Use services provided were recorded through the Prism reservation tracking program. Since January 2005, reservations are still recorded using Prism, but payments for Community Use are collected and deposited by the Accounting Department.

Prism was developed by a programmer under the direction of the Community Services Department. Prism was fully implemented in fiscal year 2005. The programmer remains an employee of Community Services and is the sole individual familiar with the inner workings of the software program. From inception, Prism was designed as purely a rental management system with little or no consideration of financial ramifications. Since implementation, the program has been augmented to accommodate financial and accounting considerations. Key controls, though, were compromised which could allow for numerous improprieties. For example:

- Rental reservations for school space and subsequent generation of invoices can be deleted and/or changed without maintaining a record of the original transaction detail.
- Invoice numbers can be reassigned after a deletion, erasing history of the original issuance of these numbers (removing the audit trail).
- The system does not create an auditable control number for each reservation number and invoice. As a result it is impossible to determine

if all reservations, invoices and revenues have been properly recorded and reported.

- Fees for reservations can be overridden by reservation technicians without supervisor authorization.
- Policy states that all rental fees are due ten days prior to facility use. It was noted during our work, however, that many users had past due bills and were allowed to use the facility without making payments prior to use of the facilities.

Prism is not integrated (nor can it be) with Oracle. As a result, reconciliation between results of applying the two programs is problematic. Beginning in late 2004 discussions began between the two departments to develop a solution. Significant progress has been made to resolve accountability issues.

Lifelong Learning

The lifelong learning program offers educational opportunities from within the community, providing evening courses at 12 schools throughout Wake County. Fees for courses are paid directly to the instructor. A payment is then remitted by the instructor to the Community Services Department based on the number of students attending a class and its duration. Site coordinators (WCPSS employees) report to the lifelong learning coordinator the number of students that attended each class. This allows the lifelong learning coordinator to determine the expected fee for each class.

Revenue for the lifelong learning program is tracked through an Excel spreadsheet in the Community Services Department. When fees are received they are recorded on the Excel spreadsheet and deposited into an account maintained and reconciled by the Department.

Online Learning

The online learning program offers nationally recognized and accredited courses administered through www.ed2go.com. Payment for registration can be done online by credit card or by check through the Community Services Department. Online learning reservations are tracked through an Access database maintained by the Community Services Department. All payments for online learning are deposited in a depository account maintained by the Community Services Department. Credit card payments are tracked through the Prism system. Check payments are tracked through the Access database.

Findings and Recommendations

Prism

In our opinion, regardless of the progress that has made in the reconciliation process with the Accounting Department for Community Use proceeds, significant questions remain regarding the integrity of the information input into and reported by Prism. As a result of these weaknesses we requested data from the Prism system.

The data collection process we used was based on the possibility that the integrity of the data has been or could be compromised. As a result, it was imperative for us to begin with data in a state that would least likely be corrupted. Additionally, we needed assurance that what was collected was not influenced in any way by the individual providing us with the data. The collection of the raw data (that is, unprocessed computer data) provided us with this assurance.⁸ Additionally, by analyzing raw data we could look at information that is not readily visible or known to exist by its user.

We have not concluded our assessment of the Prism system. We do, however we expect this to be completed no later than March 10, 2006, and will report to you immediately.

Recommendation: We recommend further evaluation of the Prism system, its use, and implementation of controls in the system. We also recommend continued review of Community Services processes and procedures. We will provide detailed transaction information to the Internal Audit Department as well as the Deputy Superintendent.

Reconciliation of Prism and Oracle Data

We have reviewed WCPSS' process for regular reconciliation of data from the two systems. In our opinion, given the audit limitations with Prism the reconciliation process is an effective solution.

Recommendation: We recommend that the Accounting Department continue to work to improve the reconciliation process with Community Services. Once we have completed our assessment of the Prism system we will provide all additional recommendations we develop.

CHILD NUTRITION SERVICES

Child Nutrition Services ("CNS") provides breakfast and lunch programs at school locations. The child nutrition program is self-supporting. Each cafeteria is decentralized and functions with limited staff.

⁸ To use a culinary analogy, data that has been processed by the computer is sometimes referred to as "cooked data."

Win SNAP

Win SNAP, a food service point of sale and inventory system, is used by each cafeteria. This system is used to manage prepaid student accounts and detailed point of sale and inventory transactions.

Detailed transaction data (current fiscal year only) from Win SNAP is maintained at the school level. Previous years' transaction data is maintained on storage media at the central CNS office. Summaries of daily transaction data are downloaded from the cafeterias by the central CNS office each day. Win SNAP is not integrated with WCPSS' financial system, Oracle.

Cafeteria Accounting

With the limited cafeteria staff many of the following functions are completed by one person at a school, creating a lack of segregation of duties.

Payment Options

- Prepayment via online, phone, or automatic bank draft to the student account. These payments are handled by an outside agency and remitted to WCPSS by funds transfer.
- Prepayment via check submitted by the student to the cafeteria. Payments are recorded on a handwritten log and applied at a later time to the student account. No receipt is issued to the student.
- Cash payment at the time of purchase.

In addition, students at the middle and high school levels can make cash purchases from vending machines.

Daily Sales Reconciliation

At the end of each meal service period the cashier (who could be the cafeteria manager) is responsible for reconciliation and reporting of his or her cash drawer:

- The cash drawer receipts must be reconciled in the presence of another employee.
- Prepayment money must be reconciled to the handwritten log of prepayments, in the presence of another employee.
- Cafeteria vending receipts are collected and recorded.

- Once all cash receipts have been counted, the deposit slip is prepared and taken to the bank by the cafeteria manager or his or her designee.
- Bank deposits are made daily.
- Validated deposit slip is sent to the CNS accounting specialist in the central accounting office.
- The CNS accounting specialist records monthly entries in Oracle.

Inventory

The purchasing department handles all formal, sealed bids for CNS. Supplies and commodity foods are ordered from the CNS warehouse. All other food is delivered to the school directly from the vendor. The cafeteria manager's order is reviewed by CNS central staff and delivery is coordinated with the vendor. Inventory is delivered directly to the cafeteria and checked in by the cafeteria manager. The invoice is sent to CNS' accounting technician. Physical inventory is conducted by the cafeteria manager once a month.

Cafeteria vending machines are stocked by the cafeteria staff daily. Money for cafeteria vending purchases is collected daily and included with the daily cafeteria bank deposit.

Findings and Recommendations

Win SNAP

Because Win SNAP is not integrated with Oracle we requested detailed transaction data from the current school year for all schools. Our analysis included various analytical techniques to check for anomalies.

We have completed our analysis of the data and have found several areas which should continue to be monitored by WCPSS. We are in the process of compiling this information to present to the Board and the Deputy Superintendent.

Recommendations:

1. We recommend that detailed analysis of transaction information for each school as well as comparative analysis between schools be developed and monitored regularly. We believe this analysis should be overseen by either the fiscal administrator for CNS or the Internal Audit department. Such an analysis could be automated by ACL or another similar data mining tool (as discussed in the Internal Audit Function section on page 17). Monitoring the fluctuations of key factors over time will increase the likelihood of detection of fraudulent activity.

2. We recommend that CNS consider implementing Web SMARTT. Web SMARTT is a web-based software solution that provides real-time communication between CNS' central office and school sites. This would allow review of detailed data by individuals outside the school cafeterias.
3. We recommend that all schools implement the exception report that has been developed by Win SNAP and is maintained for regular review and analysis by the central CNS office. Currently, in the schools where the report has been implemented, it prints at the school level and is maintained by the Cafeteria Manager.

Lack of Segregation of Duties

This is discussed in detail on page 30.

MAINTENANCE AND OPERATIONS

The Maintenance and Operations Department's work order system, MAXIMO, is designed to enable management to monitor the efficiency and effectiveness of that department. MAXIMO was originally implemented in 2001. MAXIMO remains only partially implemented and is only minimally integrated with Oracle. Currently, Oracle "supplies" MAXIMO with the following data as it relates to the MAXIMO inventory module:

- Vendors
- Chart of Accounts – Auxiliary Services accounts only
- Inventory items
- Inventory item balances

Inventory items and inventory item balances refer to materials that are in the maintenance warehouse managed by the Purchasing Department. Despite this integration, materials are still input manually into MAXIMO.

Findings and Recommendations

MAXIMO

We requested data from the work order module to conduct data mining techniques. We also conducted compliance testing to determine if material costs were consistently input for each work order.

Currently, MAXIMO is used primarily for work order tracking and preventive maintenance management. It appears to be an efficient scheduling tool for these purposes. However, we noted that material cost is not consistently input. As a result, it

is our opinion that current application of the MAXIMO system does not permit meaningful analysis of work order costs.

Materials and supplies inventory

We understand that physical counts of materials and supplies are not conducted for inventory maintained in storerooms or on trucks away from the Maintenance and Operations central office.

Because little meaningful analysis can be conducted of work order cost, combined with a failure to conduct inventory counts, the vulnerability to fraudulent activity is increased within the Maintenance and Operations department.

Recommendations

1. We recommend that MAXIMO be fully implemented and integrated with Oracle. The output from MAXIMO will only be as good as the data that is input. Full integration of MAXIMO with Oracle will improve the quality of data input to MAXIMO. The manual input of material cost data is cumbersome and potentially unreliable. Furthermore, reliance upon work order costs generated from the current application of MAXIMO could allow a fraudulent scheme to go undetected.
2. Due to weaknesses in the MAXIMO system we recommend that an alternative solution for tracking work order cost be explored.
3. We recommend conducting periodic physical inventory of materials and supplies.

FRAUD PREVENTION AND DETECTION

While previous sections of our report address specific areas of concern, this section is devoted to a focus on the broader concepts of internal control. Discussed here are areas we believe in the long run will require minimum resources to improve current controls and will address the intolerance of fraudulent activity. Additionally, we believe these concepts aid tremendously in the prevention and detection of fraud.

STRENGTHENING INTERNAL CONTROL

Internal control plays an important role in fraud prevention. Although a system of weak internal controls does not mean that fraud exists, such a system does, however, foster an environment for fraud to succeed. Conversely, a system of strong internal controls does not preclude fraud from occurring, such a system does, however help deter fraud and reduce the costs of any frauds that may occur.

SEGREGATION OF DUTIES

The performance of incompatible duties provides an individual the opportunity to commit a fraud and to conceal it. For that reason, incompatible duties should be performed by different employees. For example, the responsibility for authorization, recording and custody of assets should be assigned to different people in the organization. These duties are incompatible because someone could commit fraud and conceal it.

Segregation of duties can pose difficulties in areas where there is a limited staff. We found this to be the case with schools and school cafeterias, where too few employees are available to allow proper segregation of duties in many cases. In those cases direct oversight by the principal is one alternative to provide the necessary control. Additionally, in those areas where it is difficult to add controls without compromising operational efficiency, analytical review and audit techniques such as data mining should be performed by the internal audit department.

Findings and Recommendations

Schools

1. Fixed assets - One employee is responsible for both maintaining and counting the fixed asset inventory.

Recommendation: We recommend that someone independent of the employee maintaining the inventory list be responsible to conduct the annual count of assets. One option for the annual count of fixed assets would be to have an employee of one school count the assets of a different school. A compensating control activity could include random and unannounced counts by an individual independent of each school.

We noted during our compliance testing that some of the schools were using asset tags to track their inventories. Asset tags are an excellent tool for asset tracking. Although WCPSS does not utilize an asset tracking system, it is our understanding that the schools noted in our testing had taken it upon themselves to use Athena – a cataloging system used in libraries – in our opinion an ingenious suggestion for all schools and departments.

2. Banking – The bookkeeper (sometimes referred to as the treasurer) conducts multiple incompatible duties including:
 - Preparation of deposits
 - Recording deposits
 - Delivery of deposit to the bank
 - Reconciliation of the bank statement

- Preparation of deposit analysis reports

Recommendation: We recommend segregation of duties to the extent possible. Compensating control activities include:

- Receipt of the monthly bank statement at the central administrative office rather than the school. For this activity to be effective, the statement must be opened and randomly reviewed prior to delivery and reconciliation at the school.
- Random review of the canceled checks by the Fund 6 accounting specialist upon receipt of the bank reconciliation. Canceled checks should be reviewed for completeness. Signatures should also be reviewed.

Additionally, we recommend monitoring account activity through analytical review, by comparing deposit activity between schools. Such an analysis could be automated by a data mining tool similar to ACL (as discussed in the Internal Audit Function section).

3. Before and After School Care – The site coordinator (or the designee) performs several incompatible duties:

- Collection and recording of payments received via Collector’s Daily Report – two signatures are required, the collector’s and the depositor’s. The depositor is the school bookkeeper who is already conducting multiple incompatible tasks (see above).
- Maintenance of the class roster – a duplicate class roster is maintained by the teacher in each class. Class rosters include records of attendance and payment.
- Reconciliation of the Collector’s Daily Report and class roster. Reconciliation is completed on the 20th Day Reconciliation Form. The reconciliation form is maintained by the site coordinator.

Funds are recorded in a receipt book and turned into the school bookkeeper, who deposits the funds into the school working fund.

Additionally, it is our understanding that reconciliations are not completed consistently between schools.

Recommendation: In our opinion not only are duties incompatible, but controls are very weak within this area. We recommend segregation of duties to the greatest extent possible and oversight by the principal. Reconciliations should be maintained and reviewed by someone independent of the program staff. Additionally, we

recommend monitoring attendance and deposit activity between schools.

School Cafeterias

1. Vending – Controls over the vending function are extremely loose. We noted the following incompatible duties:

- Purchasing of merchandise
- Receipt of merchandise
- Physical inventory
- Stocking vending machines
- Removal of cash from the vending machine
- Preparation of deposits
- Delivery of deposit to the bank

Recommendation: We recommend segregation of duties to the extent possible. Compensating control activities include analytical review by comparing vending activity between schools. Key comparative factors include purchases, food cost, revenues and deposit activity. Monitoring the fluctuations of these factors over time will increase the likelihood of detection of fraudulent activity. Such an analysis could be automated by a data mining tool similar to ACL (as discussed in the Internal Audit Function section).

INDEPENDENT CHECKS

Independent checks test another employee's work. They include controls to assure the accuracy and completeness of the accounting records. Independent checks can be accomplished in many ways, such as:

- Second check (re-performance)
- Computer validation
- Employee vacation or rotation
- Audits
- Data mining techniques

Independent checks often serve as acceptable compensating controls when segregation of duties is compromised.

Accounting

Accounts payable technicians are cross trained; however, their positions are not rotated.

Recommendation: We recommend that positions be rotated on an annual basis. We were told the primary reason for not rotating these positions is to allow each accounts payable technician to foster a relationship with the vendors for whom they are responsible for payment processing. While such a relationship can be advantageous, such a relationship can prove detrimental. In our opinion, the benefits of job rotation far outweigh any advantage of a relationship between WCPSS personnel and vendors. Recall that the discovery of the fraud in the Transportation Department was a result of job rotation.

ADDITIONAL DETECTION DEVICE

VENDOR AUDIT CLAUSE

Reserving the right to audit a suspicious vendor provides a valuable discovery tool. The vendor audit clause should be included on the back of purchase orders and included with every contract.

Finding and Recommendation

WCPSS does not have a standard procedure for requesting the right to audit a vendor. Although such a clause is occasionally included with contracts there is no such clause included with purchase orders.

Recommendation: We recommend that WCPSS include a vendor audit clause on the back of all purchase orders and include it in every contract. We recommend that you consult with legal counsel for effective wording.

THE WCPSS STANCE ON FRAUD - INCREASING THE PERCEPTION OF DETECTION

The perception of detection is an important deterrent to fraud. That means putting employees and management on notice that WCPSS will investigate and report all incidences of fraud. Such a perception is an effective fraud prevention method. Increasing the perception of detection can be accomplished by multiple means:

EMPLOYEE EDUCATION

Educating management and employees about fraud not only increases awareness but also the likelihood that employees will become additional eyes and ears for the organization. Educational efforts should be positive and non-accusatory with an emphasis that fraud, waste and abuse eventually costs everyone. Fraud education should be a part of both employee orientation and later training programs.

Findings and Recommendations

Various methods have been used to provide fraud awareness to employees:

- The Director of Accounting has provided fraud awareness training for numerous departments, employees and managers.
- Articles in various WCPSS newsletters.
- Annual letter from the Superintendent to all employees, included with paychecks. The letter emphasizes the importance of accountability and WCPSS' zero tolerance of fraudulent activity.
- New employee orientation.

Recommendation: We recommend that WCPSS continually and consistently educate its employees about fraud, emphasizing that fraud, waste and abuse is an expense the schools cannot afford. This education should occur at meetings or other training programs where employees can discuss fraud prevention among themselves. Additional training programs such as online courses should be provided so that fraud training can be provided on an as-needed basis.

FRAUD HOTLINE

In its *2004 Report to the Nation*, the Association of Certified Fraud Examiners reported that tips are the number one method for reporting fraud. In fact, the Association of Certified Fraud Examiners found that ***organizations with hotlines typically cut their fraud losses in half***. The ultimate goal of a fraud hotline is to give employees, suppliers, and other stakeholders a confidential means to report their concerns about illegal or unethical behavior. To maximize usage, and likewise effectiveness, the fraud hotline should be promoted with educational materials directed to everyone associated with the organization, including employees, vendors and the public. In our opinion the most effective hotlines offer 24-hour, 365-day access to a skilled interviewer.

Findings and Recommendations

WCPSS has a fraud hotline that is maintained by its internal audit department. Hotline calls go directly to a voicemail box which is available 24 hours a day. The fraud hotline is advertised via a flyer available on the WCPSS intranet and posted conspicuously in departments.

Recommendations: We recommend that the fraud hotline be outsourced to an external third party to increase anonymity and confidence by callers.⁹ It is our experience that if employees realize they are calling an internal number they may decide not to call, for fear their identities will be traced. Additionally, two-way conversations (especially those that are conducted by a skilled interviewer) allow for immediate clarification of unclear or incomplete statements. Such clarity may be lost in a one-sided voicemail. The availability of the fraud hotline should be made known to other stakeholders, such as vendors and the public.

CONFLICT OF INTEREST STATEMENT

A conflict of interest occurs when an employee, manager, or executive has an undisclosed economic or personal interest in a transaction that adversely affects the organization.¹⁰ The most common situations that could give rise to a conflict of interest include accepting gifts from suppliers, employment by another organization, ownership of a significant part of a company or business, and close or family relationships with suppliers. The potential for conflict of interest increases for WCPSS employees who make decisions in their jobs that would allow them to give preference or favor to a vendor in exchange for anything of personal benefit to themselves, family or friends. A policy requiring employees to complete an annual disclosure statement is an excellent prevention tool.

Findings and Recommendations

The WCPSS Employee Handbook is provided to each employee annually. Employees must acknowledge that they have received a copy of the handbook. The handbook provides selective and general coverage of school system policies and procedures with the caveat that employees are responsible for compliance with the full text of the Board's policies.¹¹ Although the handbook contains selections from the WCPSS Code of Ethics and Standards of Conduct, the section on conflicts of interest is not included in the handbook.¹²

Additionally, WCPSS requires each new vendor to complete a Vendor Information Form.¹³ Included on the form is a conflict of interest question asking if any owners of the company are related to any WCPSS employee. If the answer is yes, the owner's name, WCPSS employee name, position and relationship is required.

Recommendations: We recommend a separate conflict of interest disclosure be completed by every employee annually. The disclosure should include open-ended questions regarding significant ownership of a business, close or family relations with outside suppliers, or gifts received. The advantage of having a separate conflict of

⁹ EthicsLine is the fraud hotline recommended by the Association of Certified Fraud Examiners.

¹⁰ Association of Certified Fraud Examiners, Fraud Examiners' Manual, Revised 2nd Edition. ACFE, 1996.

¹¹ 2005-2006 Wake County Public School System Employee Handbook

¹² Board Policy 2305.1, 3005.1, 4005.1

¹³ Form 1808A/1820A

interest disclosure statement is to allow the employee to actively acknowledge both his or her responsibility and WCPSS' stance on fraud.

CLOSING

We commend the Board on its efforts to renew the confidence of students, parents, staff and associates of Wake County Schools by sending the message that fraud, waste, or abuse will not be tolerated. Furthermore, we appreciate the cooperation we received from WCPSS' staff during our assessment.

In our opinion, especially considering the additional control procedures implemented in the last 18 months, WCPSS' internal controls are operating effectively. We do not, however, believe that current procedures alone are sufficient to adequately reduce the risk of future improprieties. For this reason, it is critical that WCPSS implement a proactive audit approach and a risk based audit program to sufficiently manage its risk of vulnerability to fraud, waste and abuse.