Do you smell a rat?

Dealing the risk of fraud in your school, ***Wendy Collins***

If you were asked whether your school was at serious risk of fraud, chances are you would say, rather defensively, "no, definitely not". It's easy to place your school on a pedestal, ignoring statistics and warning signs, and assuming that fraud would never happen to your school, on your watch.

It is an unfortunately common misplacement of trust, to assume that your school would never be the victim of fraud. Accounting firm, BDO's 2014 Not-for-Profit Fraud Survey remarkably revealed that whilst 90 per cent of respondents believed that fraud is a problem for the NFP sector, only 28 per cent thought it to be a problem for their own organisation.

Trent Dean, Risk Management Expert, warns that despite having a 'values-based school' or high calibre 'trustworthy' staff, "it is likely that you do have some form of fraud or corruption happening in your organisation: you just don't know about it yet. More often than not, some of your staff will be either involved, or at least, aware of its existence". (Better Boards Australia, 2014)

Still not convinced? Here are some of the more notable recent reports of fraud in schools:

- A school Bursar sentenced to 18 months' jail for stealing more than $250,000 from an independent college
- A senior college official accused of falsifying school loans
- A company director of a non-government school sentenced to 4 1/2 years imprisonment for fraud, relating to receiving funding to which the school was not entitled, based on falsified records
- A school official faking millions of dollars' worth of building invoices
- A former principal pleading guilty to two counts of defrauding the Queensland and Federal governments in enrolment funding.

If similar fraud should happen to your school, your name and your school's name will be splashed across the headlines of the national newspapers. That is the sort of publicity you and your school certainly would hope to avoid. A key finding in the BDO survey was that 54 per cent of respondents did not report fraud to the police because of concerns about the possible damaging impact to the organisation's reputation. Such avoidance of negative publicity from reputational damage, may inadvertently increase the potential risk of fraud. In fact, of the respondents who experienced fraud, 70 per cent had suffered fraud previously, indicating that they had not learnt from the lesson, nor responded appropriately.

The most common types of fraud, as reported by the BDO survey are as follows:-

- Cash theft (30%)
- Payroll fraud (54% of total value of largest frauds)
- On-line payment fraud
- False invoicing
- Kickbacks/bribery/fraudulent personal benefits
- Financial statement fraud.

Personal financial pressure is reportedly the main reason given as the motivation for committing frauds. Aspirational lifestyle factors, greed, and gambling-associated fraud are also cited as common reasons for corruption.

It is disconcerting to note that, according to BDO, 30 per cent of the largest fraud incidents reported involved collusion. Of these, 31 per cent involved a board member. The impact of collusion is that it increases the average time it takes to detect a fraud – to 665 days, according to another international accounting firm's study (KPMG's 2012 Fraud, Bribery and Corruption Survey).

Although most fraud is committed by non-management employees, a real concern is the growing incidence of fraud committed by senior executives and directors. Many independent schools are now governed by Boards of Directors. Boards in Australia have a responsibility to foster a culture of compliance with Australian law. Under the Criminal Code, a company can be convicted of Commonwealth criminal offences if it is established that the company "had a culture that directed or encouraged, tolerated, or led to non-compliance, or failed to maintain a culture that required compliance with relevant legislation." (KPMG 2014, p. 31)

KPMG's survey found that major frauds occur due to deficiencies in internal controls and governance frameworks/risk management. "Although it is impossible to totally control human behaviour, empirical data shows that having good risk management programs and a whistleblower policy in place can increase the likelihood that irregular behaviour by employees will be detected earlier." (KPMG, 2014, p.7)

Findings also support the view that internal controls and tip offs have been the most successful ways of discovering fraud. KPMG suggests an effective fraud and misconduct risk management approach is one that focuses on three objectives, as shown in the diagram below. "Establishing policies, programs and controls designed to reduce the risk of fraud and misconduct from occurring (prevention), detecting it when it occurs (detection), and taking appropriate corrective action to remedy the harm caused by integrity breakdowns (response)". (KPMG, 2104, p.11)

KPMG 2014 Fraud Risk Management

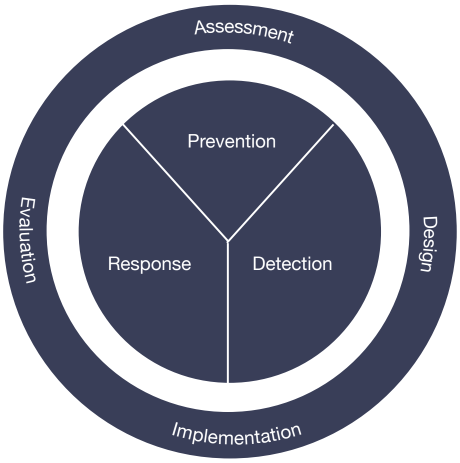
Here are some specific suggestions you could put in place in your school, by applying the three-part approach outlined in the pie chart.

Prevention

- Lead by example. Just as teachers set the tone in the classroom, school leaders and board members set the tone for the whole school, and should establish a culture of ethical and responsible business practices
- Conduct a fraud risk assessment. You should consider hiring an external consultant to assist you in identifying the potential 'blind spots', which could be overlooked if you self-assess
- Have strong internal controls, such as segregation of key financial duties, and appropriate delegations and lines of authority regarding financial reporting and recording
- Have a clear Code of Conduct and make sure that it is communicated to staff in your professional development and training activities
- Employment contracts should set out expectations regarding ethical behaviour and consequences of misconduct
- Conduct employee and third-party due diligence. For example, perform adequate background and reference checks of prospective staff.

Detection

- Provide mechanisms for employees seeking advice and reporting misconduct. Establish hotlines for whistle-blowers, which allow for anonymity and confidentiality, when reporting suspicions of fraud. Prohibit retaliation against employees who act in good faith
- Conduct audits, both internally and from independent external auditors; ensure ongoing monitoring of internal controls; undertake forensic data analysis. Audits could particularly focus on payroll processes and reporting, leave entitlements recording and usage, credit card statements, mobile phone usage, property and equipment usage, handling of cash and petty cash (especially for fetes, fundraising, tuckshops, donations and levies).



Response

- Be prepared to investigate any information provided which indicates the possibility of fraud
- Enforce sanctions consistent with the seriousness of the offence (e.g. warning system, suspension, termination and police enquiries) and apply discipline, regardless of job level, tenure or job function
- Hold managers accountable for misconduct of subordinates, when they knew or should have known that fraud or misconduct might be occurring
- Encourage disclosure. Ensure transparency in reporting to management, the board, auditors and regulators, and police if appropriate
- Remedial action – initiate legal proceedings to recover money or property.

David Williams, Director of a forensic accounting firm in Brisbane, suggests that "if it is well known that an organisation has a zero tolerance policy and the police will be involved in even the smallest of matters, then the potential perpetrator will be less likely to take the risk of being caught and prosecuted". (*Business News Australia*, July 2014)

Don't wait until you smell a rat before you take action. Ethical organisational culture and strong internal controls are primary factors in reducing fraud risk. However, if you do smell a rat, do something about it. Don't simply remove the evidence, extend grace and hope the problem will go away. Take decisive action. Determine how the fraud occurred and respond in a way that will reduce the chance of its reoccurrence.

Further reading

BDO Not-for-Profit Fraud Survey 2014 http://www.bdo.com.au/__data/assets/pdf_file/0010/155359/BDO-Not-For-Profit-Fraud-Survey2014.pdf [accessed September 18, 2015]

Dean, T 2014 "Not for Profit, Not for Fraud", Better Boards Australasia, http://betterboards.net/goverance/not-for-fraud/ [accessed September 19, 2015]

KPMG Forensic 2014 Fraud Risk Management, Developing a Strategy for Prevention, Detection and Response, May, https://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Documents/fraud-risk-management-strategy-prevention-detection-response-v2.pdf [accessed September, 19, 2015]

KPMG Forensic - A Survey of Fraud Bribery and Corruption in Australia and New Zealand, 2012. https://www.kpmg.com/AU/en/IssuesAndInsights/ArticlesPublications/Fraud-Survey/Documents/fraud-bribery-corruption-survey-2012v2.pdf [accessed September 18, 2015]

Williams D, 2014, Preventing Fraud, "Business News Australia" http://www.business newsaus.com.au/articles/preventing-fraud.html [accessed September 19, 2015]

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