

FRAUD, WASTE AND MISMANAGEMENT

By: Elena M. Gallegos and Linda M. Trujillo

WG | **WALSH GALLEGOS**
TREVINO RUSSO & KYLE P.C.

500 Marquette Avenue NW, Suite 1310
Albuquerque, New Mexico 87102
Phone: 505-243-6864

BUDGET CYCLE



BUDGET DEVELOPMENT

SUPERINTENDENT AND BOARD ROLES RE: BUDGET

- ❑ The superintendent prepares the budget for review and approval by the board and PED.
- ❑ The finance subcommittee makes recommendations to the board regarding annual budget preparation and oversight.
- ❑ The board reviews and approves the annual school district budget.

**See NMSA 1978 § 22-5-4 (2005). Local school boards; powers; duties.*

**See NMSA 1978 § 22-5-14 (2003). Local superintendent; powers and duties.*

**See NMSA 1978 § 22-8-12.3 (2010). Local school board finance subcommittee; audit committee; membership; duties.*

**See also 6.29.1.9 NMAC. Procedural requirements.*

MAKING THE HARD DECISIONS – WHAT DRIVES THE PROCESS?

- ❑ The board reviews, approves and supports the district's EPSS and each school site-level EPSS.
 - ❑ “Educational plan for student success (EPSS)” is “the strategic plan written by all districts and schools to improve student performance.”
- ❑ The superintendent is the chief executive officer of the district.
- ❑ The board employs and evaluates the local superintendent.

**See 6.29.1.9 (A) NMAC. Procedural Requirements.*

**See also 6.29.1.7 (AN) NMAC. Definitions.*

**See also NMSA 1978 § 22-5-14 (2003). Local superintendent; powers and duties.*

MAKING THE HARD DECISIONS - PERSONNEL

- ❑ The superintendent employs, fixes the salaries of, assigns, terminates or discharges all employees of the school district.
- ❑ The board discharges or terminates licensed school personnel when a reduction in force (RIF) is required “as a result of decreased enrollment or a decrease or revision of educational programs or insufficient legislative appropriation or authorization being made by the state and/or federal government.”

**See NMSA 1978 § 22-5-14 (2003). Local superintendent; powers and duties.*

**See also 6.67.3 NMAC. Termination or Discharge of Licensed School Personnel when Reduction in Personnel is Required.*

REDUCTION IN FORCE (RIF)

- ❑ Requirements:
 - A. local school boards have a reduction in personnel policy in place and comply with those procedures;
 - B. the discharge or termination is made in accordance with the School Personnel Act (Chapter 22, Article 10A NMSA 1978), any applicable rules and regulations of the department and local board of education, and any applicable collective bargaining agreements; and
 - C. a local school board has considered placement of the licensed school employee in another position, and there is no other position for which that individual is qualified, consistent with the academic necessities of the district.

*6.67.3 NMAC. Termination or Discharge of Licensed School Personnel when Reduction in Personnel is Required.

WHAT HAPPENS IF THE BOARD FAILS TO SUBMIT A BUDGET?

- ❑ “If a local school board fails to submit a budget pursuant to this section, the department shall prepare the operating budget for the school district for the ensuing fiscal year.”
- ❑ “A local school board shall be considered as failing to submit a budget pursuant to this section if the budget submitted exceeds the total projected resources of the school district or if the budget submitted does not comply with the law or with rules and procedures of the department.”

*NMSA 1978, § 22-8-6 (D) (1999). Budgets; submission; failure to submit.

PREVENTING FRAUD AND WASTE THROUGH FINANCIAL OVERSIGHT

FINANCE SUBCOMMITTEE

- ❑ Each board shall appoint at least two members of the board as a finance subcommittee.

**See NMSA 1978 § 22-8-12.3 (2010). Local school board finance subcommittee; audit committee; membership; duties.*

ROLE OF FINANCE SUBCOMMITTEE

- ❑ The finance subcommittee shall:
 - (1) make recommendations to the local school board in the following areas:
 - (a) financial planning, including reviews of the school district's revenue and expenditure projections;
 - (b) review of financial statements and periodic monitoring of revenues and expenses;
 - (c) annual budget preparation and oversight; and
 - (d) procurement; and
 - (2) serve as an external monitoring committee on budget and other financial matters.

AUDIT COMMITTEE

Each board shall appoint an audit committee that consists of:

- ☐ Two board members;
- ☐ One volunteer member who is a parent of a student attending that school district; and
- ☐ One volunteer member who has experience in accounting or financial matters.

The superintendent and the district business manager serve as ex-officio members.

A local school board with more than five members may appoint more than two board members to its audit committee.

**See NMSA 1978 § 22-8-12.3 (2010). Local school board finance subcommittee; audit committee; membership; duties.*

**See also 6.29.1.9 NMAC. Procedural requirements.*

ROLE OF THE AUDIT COMMITTEE

- ❑ The audit committee shall:
 - (1) evaluate the request for proposal for annual financial audit services;
 - (2) recommend the selection of the financial auditor;
 - (3) attend the entrance and exit conferences for annual and special audits;
 - (4) meet with external financial auditors at least monthly after audit field work begins until the conclusion of the audit; ...

*NMSA 1978 § 22-8-12.3(D) (2010). Local school board finance subcommittee; audit committee; membership; duties.

ROLE OF THE AUDIT COMMITTEE

❑ The audit committee shall:

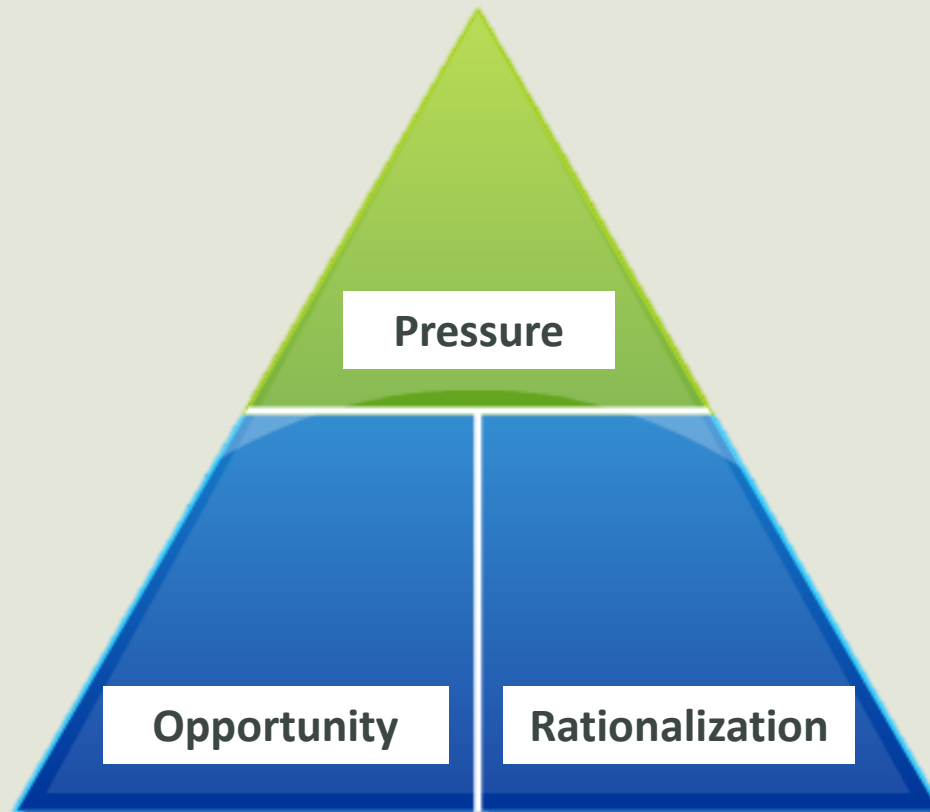
...

- (5) be accessible to the external financial auditors as requested to facilitate communication with the board and the superintendent;
- (6) track and report progress on the status of the most recent audit findings and advise the local school board on policy changes needed to address audit findings;
- (7) provide other advice and assistance as requested by the local school board; and
- (8) be subject to the same requirements regarding the confidentiality of audit information as those imposed upon the local school board by the Audit Act and rules of the state auditor.

WHAT IS AN AUDIT FINDING?

- ❑ “Generally and in the context of school district audits, an audit finding reflects a weakness in internal control or an instance of non-compliance with applicable laws and regulations.”
- ❑ A typical audit finding includes:
 - 1) a statement of the condition and the criteria used to define it;
 - 2) an explanation of the cause of the condition;
 - 3) a discussion of its results; and
 - 4) recommendations for improvement.

THE FRAUD TRIANGLE



Association of Certified Fraud Examiners, located at: <http://www.acfe.com/fraud-triangle.aspx>.

WHAT IS THE FRAUD TRIANGLE?

- ❑ “The fraud triangle is a model for explaining the factors that cause someone to commit occupational fraud: (1) perceived unshareable financial need; (2) perceived opportunity; and (3) rationalization.”

**Association of Certified Fraud Examiners, located at: <http://www.acfe.com/fraud-triangle.aspx>.*

THE CRIMINAL PROFILE

- ❑ “The vast majority of fraudsters are first-time offenders with no criminal past; they do not view themselves as criminals. They see themselves as ordinary, honest people who are caught in a bad set of circumstances. Consequently, the fraudster must justify the crime to himself in a way that makes it an acceptable or justifiable act.”

**Association of Certified Fraud Examiners, located at: <http://www.acfe.com/fraud-triangle.aspx>.*

WHAT ARE INTERNAL CONTROLS?

- ❑ “A process effected by those charged with governance, management, and other personnel designed to provide reasonable assurance about the achievement of the entities objectives.”

**Manual of Procedures for Public School Accounting and Budgeting Acronyms and A Glossary of Terms, located at:
<http://ped.state.nm.us/div/fin/school.budget/PSAB/Glossary%20&%20Laws%20Combo.pdf>.*

WHAT ARE THE DISTRICT'S INTERNAL CONTROL OBJECTIVES?

- ❑ The school district's objectives fall into separate but related categories:
 - ❑ safeguarding its assets;
 - ❑ checking the accuracy and reliability of its accounting data;
 - ❑ promoting operational efficiency; and
 - ❑ encouraging adherence to policies for accounting and financial controls.

**Manual of Procedures for Public School Accounting and Budgeting Acronyms and A Glossary of Terms, located at:
<http://ped.state.nm.us/div/fin/school.budget/PSAB/Glossary%20&%20Laws%20Combo.pdf>.*

PENALTIES

PENALTIES FOR MISUSE OF PUBLIC MONIES BY A PUBLIC OFFICER UNDER THE NM CONSTITUTION

- ❑ “Any public officer making any profit out of public money or using the same for any purpose not authorized by law, shall be deemed guilty of a felony and shall be punished as provided by law and shall be disqualified to hold public office...”

*Article VIII § 4 New Mexico Constitution

PENALTIES FOR VIOLATION OF THE SCHOOL FINANCE ACT BY ANY PERSON

- ❑ Violation of act; penalties:
 - A. Any person violating any provision of the Public School Finance Act is guilty of a petty misdemeanor.
 - B. Any person diverting or expending any public school money contrary to the approved budget is, in addition to being subject to any other civil or criminal action, liable along with his sureties to the state for the amount diverted or expended.
 - C. Any person diverting any public school funds from the purpose for which the funds were raised or acquired, or embezzling public school funds, shall be removed from office by the court imposing the criminal penalty. ... (continued)

PENALTIES FOR VIOLATION OF THE SCHOOL FINANCE ACT BY ANY PERSON

❑ Violation of act; penalties:

- D. Any person falsifying any record, account or report required to be kept or filed pursuant to the Public School Finance Act or knowingly using any money budgeted or appropriated for public school use or for any other purposes than that provided in the appropriation or budget is guilty of a petty misdemeanor and shall, in addition to all other civil or criminal penalties, forfeit his office or employment.
- E. Legal proceedings for violation of the Public School Finance Act shall be instituted by the state superintendent [secretary]...
(continued)

PENALTIES FOR VIOLATION OF THE SCHOOL FINANCE ACT BY ANY PERSON

☐ Violation of act; penalties

- F. “A certified school instructor or certified school administrator guilty of any of the violations provided by this section shall, upon conviction, have his certificate revoked by the state board [department].
- G. Nothing in this section shall be interpreted to prevent the enforcement of any provision of the Public School Finance Act by means of mandamus or injunction.”

NEW MEXICO SUPREME COURT ON PENALTIES AGAINST PUBLIC OFFICERS

- ❑ Quo Warranto action brought by private person challenging board members' title to office due to improper use of public monies.
- ❑ Alleged acts included purchase of round-trip airfare for member's wife; purchase of gas from member; payment to member and member's wife for work and services not performed.
- ❑ Supreme Court affirmed removal of two members.
- ❑ "Each sanction described by Art. VIII, § 4 is separate and distinct; disqualification is not dependent on a felony conviction."
- ❑ "One need not be found guilty of a felony to forfeit and be disqualified from office under the New Mexico Constitution and Section 22-8-42(D)."

**State ex rel. Martinez v. Padilla, 94 N.M. 431 (1980).*

GOVERNMENTAL CONDUCT ACT

- ❑ Senate Bill 432 from the 2011 Legislative Session broadened the scope of the Governmental Conduct Act to extend to school boards and district employees and the way they do business with entities in which they may have a private interest.
- ❑ The Governmental Conduct Act is located at NMSA 1978 § 10-16-2 (2007) et seq.
- ❑ The NM Attorney General's *Governmental Conduct Act Compliance Guide* is available on-line: <http://www.nmag.gov/publications.aspx>.
- ❑ "Full disclosure of real or potential conflicts of interest shall be a guiding principle for determining appropriate conduct. At all times, reasonable efforts shall be made to avoid undue influence and abuse of office in public service." NMSA 1978 § 10-16-3(C).

GOVERNMENTAL CONDUCT ACT

- ❑ “Unless a public officer or employee has disclosed the public officer's or employee's substantial interest through public notice and unless a contract is awarded pursuant to a competitive process, a local government agency shall not enter into a contract with a public officer or employee of that local government agency, with the family of the public officer or employee or with a business in which the public officer or employee or the family of the public officer or employee has a substantial interest.”

*NMSA 1978 § 10-16-3(C) (2011). Ethical principles of public service; certain official acts prohibited; penalty.

GOVERNMENTAL CONDUCT ACT

- ❑ “‘Substantial interest’ means an ownership interest that is greater than twenty percent.”
- ❑ “‘Contract’ means an agreement or transaction having a value of more than one thousand dollars (\$1,000) with a state or local government agency...”

*NMSA 1978 § § 10-16-2(C) and (L) (2011). Definitions.

GOVERNMENTAL CONDUCT ACT

- ❑ “[I]t is unlawful for a public officer or employee to take an official act for the primary purpose of directly enhancing the public officer’s or employee’s financial interest or financial position.”

*NMSA 1978 § 10-16-4(A) (2011). Official act for personal financial interest prohibited; disqualification from official act; providing a penalty.

- ❑ Financial interest is “an interest held by an individual or individual’s family that is: (1) an ownership interest in business or property; or (2) any employment or prospective employment for which negotiations have already begun.”

*NMSA 1978 § 10-16-2(F) (2011). Definitions.

GOVERNMENTAL CONDUCT ACT (PENALTIES)

- ❑ Criminal penalties: “Unless specified otherwise in the Governmental Conduct Act, any person who knowingly and willfully violates any of the provisions of that act is guilty of a misdemeanor and shall be punished by a fine of not more than one thousand dollars (\$1,000) or by imprisonment for not more than one year or both. Nothing in the Governmental Conduct Act shall preclude criminal prosecution for bribery or other provisions of law set forth in the constitution of New Mexico or by statute.”
- ❑ Civil penalties: “May include a permanent or temporary injunction, a restraining order or any other appropriate order, including an order for a civil penalty of two hundred and fifty dollars (\$250) for each violation not to exceed five thousand dollars (\$5,000).”

* NMSA 1978 § 10-16-17 (1993). Criminal penalties.

*NMSA 1978 § 10-16-18(B) (1995). Enforcement; civil penalties.

STANDARDS OF PROFESSIONAL CONDUCT OF LICENSED EDUCATOR

- ❑ Standards of Professional Conduct include:
 - ❑ “shall not accept any gratuity, gift, meal, discount, entertainment, hospitality, loan, forbearance, favor, or other item having monetary value whose market value exceeds \$100, excluding approved educational awards, honoraria, plaques, trophies, and prizes.”
 - ❑ “shall avoid conduct connected with official duties that is unfair, improper, illegal or gives the appearance of being improper or illegal.”

*6.60.9.9 (C)(8) and (C)(9) NMAC.

REQUIRED REPORTING OF ETHICAL MISCONDUCT BY LICENSED SCHOOL EMPLOYEE

- ❑ Background checks; known convictions; alleged ethical misconduct; reporting required; limited immunity; penalty for failure to report:
 - A. As used in this section, 'ethical misconduct' means unacceptable behavior or conduct engaged in by a licensed school employee...
 - F. A local superintendent, charter school administrator or director of a regional education cooperative or their respective designees shall investigate all allegations of ethical misconduct about any licensed school employee who resigns, is being discharged or terminated or otherwise leaves employment after an allegation has been made... (continued)

REQUIRED REPORTING OF ETHICAL MISCONDUCT BY LICENSED SCHOOL EMPLOYEE

- ❑ Background checks; known convictions; alleged ethical misconduct; reporting required; limited immunity; penalty for failure to report:
 - F. ... If the investigation results in a finding of wrongdoing, the local superintendent, charter school administrator or director of a regional education cooperative shall report the identity of the licensed school employee and attendant circumstances of the ethical misconduct on a standardized form to the department and the licensed school employee within thirty days following the separation from employment. Copies of that form shall not be maintained in public school, school district or regional education cooperative records... (continued)

REQUIRED REPORTING OF ETHICAL MISCONDUCT BY LICENSED SCHOOL EMPLOYEE

- ❑ Background checks; known convictions; alleged ethical misconduct; reporting required; limited immunity; penalty for failure to report:
 - F. ... No agreement between a departing licensed school employee and the local school board, school district, charter school or regional education cooperative shall diminish or eliminate the responsibility of investigating and reporting the alleged ethical misconduct, and any such agreement to the contrary is void...

FORMER PRINCIPAL ACCUSED OF STEALING SCHOOL FUNDS (SF NEW MEXICAN)

- ❑ New Mexico State Auditor has issued a warning to the Anonymous School District regarding its hiring of a woman convicted of tax fraud who is being investigated in connection with the theft of student activity money from an elementary school.
- ❑ Though the woman is not named in the auditor's letter to the schools, The New Mexican learned that Anonymous employee was the principal of Anonymous Elementary school when \$12,000 in student activity funds went missing in the 2013-2014 school year.

(continued on next slide)

FORMER PRINCIPAL ACCUSED OF STEALING SCHOOL FUNDS (SF NEW MEXICAN) CONTINUED

- ❑ The school district and the State Auditor's Office both allege the employee embezzled money. The employee was convicted of tax fraud in 2004.
- ❑ Anonymous school's interim Superintendent said employee has since resigned from the district.
- ❑ The State Auditor's Office said the district should consider financial reforms to prevent similar fraud.

WHAT INTERNAL CONTROLS WERE NOT FOLLOWED?

- ❑ “Data recorded by information and financial systems are periodically compared with physical assets and discrepancies are examined.”
- ❑ “Inventory levels of materials, supplies, and other assets are checked regularly: differences between assets recorded and actual amounts are corrected and the reasons for the discrepancies are resolved. The frequency of comparison is based on the vulnerability of the asset.”

**Manual of Procedures for Public School Accounting and Budgeting Tips, Tools and Resources – Exhibit 2-1, located at:*
<http://ped.state.nm.us/div/fin/school.budget/PSAB/Tips%20and%20Tools.pdf>.

POSSIBLE FRAUD AT TROUBLED CHARTER SCHOOL (LAS CRUCES SUN-NEWS)

- ❑ Fraudulent student enrollment and questionable travel reimbursements are just a few of the violations uncovered by a state investigation of Anonymous Academy, which led to the revocation of the school's charter by the Public Education Commission after only a year of operation.

WHAT INTERNAL CONTROLS WERE NOT FOLLOWED?

- ❑ “Appropriate organizational structure and supervision help provide oversight of internal control functions.”
- ❑ “Automated edits and checks as well as clerical activities are used to help control accuracy and completeness of transaction processing. Separation of duties and responsibilities is used to help deter fraud.”

**Manual of Procedures for Public School Accounting and Budgeting Tips, Tools and Resources – Exhibit 2-1, located at:*
<http://ped.state.nm.us/div/fin/school.budget/PSAB/Tips%20and%20Tools.pdf>.

AUDIT REVEALS 4 INSTANCES OF POSSIBLE FRAUD (KOAT 7 ALBUQUERQUE)

- ❑ An internal audit of Anonymous School District's activity funds has shed light on misspending and suspicion of check fraud.
- ❑ Of the 86 transactions audited, a couple stood out: the student activity fund at Anonymous High School and suspicion of check fraud at Anonymous Elementary.
- ❑ An investigation into the Anonymous Elementary fraud is underway by police.
- ❑ In that instance, a bookkeeper noticed a \$4 check issued to a parent for the refund of a lost library book that had been located. It was turned into a \$1,500 check that was cashed, but not by the parent.

AUDIT REVEALS 4 INSTANCES OF POSSIBLE FRAUD (KOAT 7 ALBUQUERQUE)

- ❑ In the instance of the Anonymous High activity fund, more than \$19,000 raised by the student body was used to pay for a trip to send seven students and four adults to attend the presidential inauguration in Washington, D.C., in 2013.
- ❑ “When you're talking just strict activity funds though it's obvious that not all the procedures are being followed and things are falling through the cracks and at the end of the day the school takes the hit for those mistakes,” said Audit Committee Member.

AUDIT REVEALS 4 INSTANCES OF POSSIBLE FRAUD (KOAT 7 ALBUQUERQUE)

- ❑ Another report had to do with the Anonymous High School cheer coach and her handling of club money. The internal audit found what was happening could be considered fraud, waste or abuse, but before they could question the coach, she resigned.
- ❑ “As far as I'm concerned, there's no question that we need to be looking at how we are monitoring our accounts at each school,”...
- ❑ An audit of Anonymous Middle School choir program was requested by leadership because of the large amount of funds being raised by students. That audit found everything was above board.

WHAT INTERNAL CONTROLS WERE NOT FOLLOWED?

- ❑ “Operating reports are integrated or reconciled with financial and budgetary reporting system data and used to manage operation on an ongoing basis, and management is aware of inaccuracies or exceptions that could indicate internal control problems.”
- ❑ “Program directors and other operating personnel are required to sign-off on the accuracy of their program's financial statements and are held accountable if errors are discovered.”

**Manual of Procedures for Public School Accounting and Budgeting Tips, Tools and Resources – Exhibit 2-1, located at:*
<http://ped.state.nm.us/div/fin/school.budget/PSAB/Tips%20and%20Tools.pdf>.

PUBLIC VS. PRIVATE MONIES (BOOSTER CLUBS)

- ❑ “As used in the Public School Finance Act... ‘public money’ or ‘public funds’ means all money from public or private sources received by a school district or state-chartered charter school or officer or employee of a school district or state-chartered charter school for public use.”

*NMSA 1978 § 22-8-2(L) (2009). Definitions

REPORTING REQUIREMENTS FOR BOOSTER CLUBS

- ❑ For purposes of Title IX: “Beginning August 31, 2012 and each year thereafter no later than August 31st, the following data shall be submitted to the department in a format required by the department ... an accounting of the funding sources that are used to support the school’s athletics programs and to which teams those funds are allocated funding sources include ... fund raising or booster clubs.”

*6.13.4.8 (D)(2)(a)(iii) NMAC.

CONSIDER THE FOLLOWING INTERNAL CONTROLS FOR BOOSTER CLUBS

- ❑ The NMAA does not provide guidance on Booster Clubs; districts may want to use guidance published by the University Interscholastic League (UIL) when developing internal controls. Examples:
 - ❑ The superintendent or a designee who does not coach or direct a [NMAA] contest has approval authority over booster clubs and should be invited to all meetings. All meetings should be open to the public.
 - ❑ Booster clubs do not have authority to direct the duties of a school district employee.
 - ❑ Individuals who actively coach or direct a [NMAA] activity should serve in an advisory capacity to the booster club and should not have control or signature authority over booster club funds, including petty cash or miscellaneous discretionary funds.
 - ❑ Coaches wish-lists should have received prior approval from school administration before submission to boosters.

THE ROLE OF THE WHISTLEBLOWER

☐ Internal Controls:

- ☐ Meetings with employees are used to provide management with feedback on whether internal control is effective.
- ☐ Relevant issues, information, and feedback concerning internal control raised at training, seminars, planning sessions, and other meetings are captured and used by management to address problems or strengthen internal control structure.
- ☐ District encourages employees to identify internal control weaknesses and report them to the next supervisory level.

**Manual of Procedures for Public School Accounting and Budgeting Tips, Tools and Resources – Exhibit 2-1, located at: <http://ped.state.nm.us/div/fin/school.budget/PSAB/Tips%20and%20Tools.pdf>.*

NM WHISTLEBLOWER PROTECTION ACT

- ❑ A public employer shall not take any retaliatory action against a public employee because the public employee:
 - A. communicates to the public employer or a third party information about an action or a failure to act that the public employee believes in good faith constitutes an unlawful or improper act;
 - B. provides information to, or testifies before, a public body as part of an investigation, hearing or inquiry into an unlawful or improper act; or
 - C. objects to or refuses to participate in an activity, policy or practice that constitutes an unlawful or improper act.

*NMSA 1978 §10-16C-3 (2010). Public employer retaliatory action prohibited.

NM WHISTLEBLOWER PROTECTION ACT

- ❑ “Retaliatory action” for purposes of the Whistleblower Protection Act means “taking any discriminatory or adverse employment action against a public employee in the terms and conditions of public employment.”

*NMSA 1978 § 10-18-2(D) (2010). Definitions.

CONTACT

Elena M. Gallegos

Linda M. Trujillo

Walsh Gallegos Treviño Russo & Kyle P.C.

500 Marquette Avenue NW, Suite 1310

Albuquerque, New Mexico, 87102

Phone: 505-243-6864

Fax: 505-843-9318

Email: egallegos@wabsa.com

ltrujillo@wabsa.com

Web: www.WalshGallegos.com

The information in this presentation was prepared by Walsh Gallegos Treviño Russo & Kyle P.C. It is intended to be used for general information only and is not to be considered specific legal advice. If specific legal advice is sought, consult an attorney.

