An Institutional Response to Fraud, Scandal, and Embarrassment – The Dallas Independent School District Procurement Card Case

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Procurement cards (Pcards) can be a valuable tool in reducing accounts payable transactions; however, if used inappropriately or not monitored properly they can lead to fraud and abuse. At the Dallas Independent School District (DISD), employees used Pcards to make millions of dollars of purchases which violated district purchasing policy and state procurement laws. In response to findings of fraud and abuse, the Pcard system was terminated and a new department, the Office of Professional Responsibility (OPR), was created. The OPR was charged with the responsibility to prevent and detect fraud, waste, abuse and to increase accountability in the DISD.

INTRODUCTION

The Dallas Independent School District (DISD) is the 12th largest school district in the nation, with an enrollment of more than 157,000 students and more than 20,000 employees. The district budget for the 2009-10 year is in excess of $1.48 billion (DISD, n.d.a). In the last 25 years, the district has had a number of scandals, both financial and non-financial in nature. However, the recent procurement credit card (Pcard) scandal proved to be so embarrassing for the district that it led to significant changes in the way the district upholds stewardship of public funds.

On July 2, 2006, the *Dallas Morning News* began a series of reports on the abuse of the Pcard system where reporters examined a database containing 150,080 district credit card purchases made between January 2004 and March 2006 (Dallas Morning News, 2006). While most of the $41.5 million in purchases appeared to be proper, it was obvious that there were significant problems in the operation of the credit card system. The newspaper reported that millions of dollars in purchases violated district purchasing policy and state procurement laws. Also, a large number of purchases appeared to have no connection to the educational function of the school district – educating children. Amongst the transactions were 7,088 purchases totaling $1,220,747 at restaurants; 1,581 purchases totaling $600,391 at clothing, cosmetic and jewelry stores; 1,765 purchases totaling $479,295 on trinkets and rewards; and 1,045 purchases totaling $245,520 on amusements such as theme parks, movies and roller skating (Fischer, et al., 2006).

The district began the Pcard program in 1999 with a small pilot program to test its viability, according to the Final Report (Coggins, et al., n.d.). After about six months the district felt the pilot program was successful and rolled it out into a district-wide program. The intention behind the program was valid. Its aim was to reduce the costs and time involved in processing small, frequent purchases of supplies for the district. The Quality Control Office (QCO) was responsible for managing and administering the program. This office was directed by Sherri Brokaw who had an accounting degree and 18 years experience prior to joining DISD. For the first three years there were only two people involved in managing and administering the Pcard program. Later, three people performed this function. One of these employees was initially a teacher with the district, but in 1999 was hired as a "Pcard specialist." Another started as a temporary employee and later became a permanent employee in the Quality Control Office. A fourth employee, who was employed after the departure of one of the three above, was hired as a "Quality Control Specialist" but had no noted background in the field (Coggins, et al.).

Pcard use became widespread, with almost 1,400 employees using over 3,100 cards. Pcards became the preferred way to make purchases. Five years after the program started, employees made 66,400 Pcard purchases a year, totaling nearly $20 million (Fischer & Hobbs, 2007). This was nearly five times the number using traditional purchase orders. Employees were instructed in the Procurement Card Manual that Pcards were "for district purchases only." Card holders were required to sign Procurement Cardholder Agreement Forms which stated "I understand that under no circumstances will I use the procurement card to make personal purchases, either for others or myself" (Coggins, et al., n.d., p. 10). Employees were required by law to keep their receipts for purchases. Supervisors were supposed to review each purchase and sign off on monthly summary reports.

The Quality Control Office had a number of responsibilities with regard to the Pcard program – to act as a liaison to the bank, performing the monthly accounting tasks necessary to reconcile Pcard purchases to the bank and the district's general ledger, to provide customer service relating to the Pcard, to receive and process Pcard applications, to train employees on the proper use of the Pcard, and to process budget transfer requests whereby employees requested increases to their cards' spending limits. The QCO received hundreds of these requests each month. Sherri Brokaw said they were overwhelmed by the work load and only looked for improper Pcard purchases after all their other duties were completed. While each employee received a monthly statement for their individual Pcard, they were not required to pay the bill. The district received a bill for all Pcard purchases and paid it with one check of approximately $1.5 million monthly (Fischer, et al., n.d.).

Early in the Pcard program the district's auditors reported that program oversight was lax. In their opinion it was not feasible to monitor even a representative sample of Pcard purchases with the current staffing level (Fischer, et al., n.d.). The auditors suggested strengthening the district's controls over the program with oversight going to the purchasing department. They also suggested that receipts be examined using the same methodology used by auditors. However, few of the auditors' suggestions were implemented.

The operation of the Pcard program was controlled by a Procurement Card Manual. The 2003 version of this manual contained a number of rules and regulations, including:

1. A requirement for each Pcard holder to maintain an original receipt for each transaction and a procurement card log.
2. A requirement to maintain Pcard security with only the named card holder using the card.
3. A $1,000 purchase limit for non-price agreement vendors. Such purchases were limited to a single card transaction of $1,000 and the splitting of purchases to bypass the $1,000 limit was prohibited. Purchases from price agreement vendors were allowed up to $24,999.
4. Gift card purchases were allowed in nominal denominations but receipts were required for both the purchase of the card and the redemption of the card.
5. Notification that Pcard purchases should not be charged state sales tax and given a copy of DISD's tax exempt certificate.
6. A requirement to identify and register controllable assets. This applied to most equipment purchased at a cost of $500 or more.
7. A requirement that each Pcard holder reconcile his/her Pcard statement to his/her Pcard log on a monthly basis and send his/her approval of the charges to the Quality Control Office.

8. A listing of categories of non-permissible purchases. Personal or fraudulent purchases were forbidden in addition to a number of specified categories. The forbidden categories included lodging, travel, training and registration fees, entertainment, all alcoholic beverages, pagers, and cellular phones (Coggins, et al., n.d.).

The Final Report indicates that in June 2005, a revised and updated Pcard manual was issued. It was very similar to the 2003 manual, but was a little more specific regarding some requirements. The noticeable difference was that it completely prohibited the purchase of gift cards for any reason.

DISD had appointed a new superintendent, Dr. Michael Hinojosa, on April 28, 2005. He had been in his position a little more than a year when the abuse of the Pcard system became public knowledge. On July 11, 2006, Dr. Hinojosa terminated the Pcard program. In response to the growing scandal, on July 18, 2006, the district appointed outside investigators to scrutinize and report on the operation of the system. The lead investigator, now a private lawyer, had in the past been responsible for prosecuting district employees on fraud charges. Faced with looking at over 250,000 transactions totaling more than $71 million from a 42 month period, the investigators used five criteria to focus their investigation to find the worst abusers (Coggins, et al., n.d.). They looked at the following criteria: top 100 spenders; high volume of gift card purchases; high volume of department store purchases; Pcard holders who were subject to parallel investigation; and Pcard holders who were identified by other employees.

The Final Report took 10 months to prepare and was presented to the trustees of DISD on May 10, 2007. The report noted that many Pcard users maintained good records and appeared to use the Pcard responsibly. However, the investigation found widespread and systemic problems in the Pcard system with regard to both the structure/administration of the Pcard program and the transactions of individual Pcard holders (Coggins, et al., n.d.). With regard to the first problem, the breakdowns in the structure/administration of the Pcard program, the investigation found that there were substantial failures at each level, namely:

1. Failure to monitor/reconcile one's own Pcard purchases.
2. Breakdown in Pcard monitoring by direct supervisors.
3. Lack of supervision of Pcard purchases by the Quality Control Office.
4. Failure to heed warning signs regarding the supervision of Pcard transactions.

With regard to the second problem, the systemic issues in the Pcard transactions of Pcard holders, the investigation found a number of serious failures, namely:

1. Failure to maintain original receipts for Pcard transactions.
2. Failure to maintain itemized receipts for Pcard transactions.
3. Failure to maintain gift card documentation.
4. Systemic issues with the payment of sales tax on Pcard transactions.
5. Systemic violations of the $1,000 limit on Pcard purchases with a) single transactions in excess of $1,000 and b) structured transactions in excess of $1,000.
6. The breach of Pcard security with persons other than the card holder using the card.
7. Pcard expenditures which may violate federal funding guidelines with respect to a) food expenditures which may not meet Texas Education Agency (TEA) guidelines and b) the purchase of "incentives" for students, staff, parents, teachers, and volunteers.

The Final Report listed a number of internal controls which the DISD could implement to enhance its ability to efficiently track and utilize its funds. These were:

1. Sales tax audit and training.
2. Federal funds audit and training on TEA regulations for federal expenditures.
3. Implementation of district-wide training on bidding regulations.
4. Implementation of guidelines to control food expenditures.
5. Implementation of guidelines to regulate "incentive" expenditures.
6. A controllable asset audit.

The outside investigation cost $1 million and only focused on 200 employees for reasons of cost and time. Following the investigation, 86 employees were disciplined. Fifteen termination letters were sent out, although two recipients were retained, but demoted. A total of 48 employees were put on probation, 10 demoted and 9 had their contracts shortened, with the possibility of nonrenewal. Two area superintendents and 38 principals were recommended for discipline along with school office managers, teachers, central office officials, and a counselor. Subsequently, the district reported about 15 current and former employees with the "most egregious" spending to the IRS for using their old district credit cards to gain "unauthorized income."

Due to the illegal activity revealed regarding employee use of Pcards, the FBI became involved. Two secretaries were convicted and imprisoned due to their use of their Pcard for personal spending. Gloria Orapello pled guilty to felony theft. Because she helped in the investigation her sentence was reduced to one year in federal prison. She said she misused her Pcard when she realized that no one was watching her. She turned some property over to DISD and was ordered to pay $100,000 in restitution. Marsha Ollison was convicted on three counts of theft from an organization receiving federal funds and sentenced to 18 months in federal prison and ordered to pay $64,000 in restitution (U.S. Department of Justice, 2007). Her explanation for her actions was that "it just got easy." Sherri Brokaw was not retained by the DISD.

The Pcard scandal only strengthened public criticism of the DISD and how it managed its funds. In response to this, Dr. Hinojosa created a new department, the Office of Professional Responsibility (OPR), with a responsibility to prevent fraud, waste, and abuse in the DISD. This new department would have a public face with information about it prominently displayed on the DISD website. The intention was to make this new effort to prevent fraud very visible and accessible to all. The OPR states its mission as being:

> Our mission is to promote integrity in the Dallas Independent School District by conducting ethics training, internal investigations, and districtwide operational reviews, in order to detect and prevent fraud, waste, and abuse plus identifying opportunities for improving efficiency and effectiveness throughout the district. (Dallas Independent School District, n.d. b).

In forming the new department, the DISD sought to overcome what many had viewed as significant weaknesses in the monitoring of the Pcard system. One was the issue of competence. There was a clear intent to hire staff for the new department who had significant experience in the area of fraud prevention and ethics investigations. The second was the size of the workforce. Both internal and external auditors had stated that it was not possible to monitor the Pcard program at the previous staffing level. The creation of the new department and the hiring of a large enough staff to properly carry out its function was recognition by the DISD that it costs money to adequately enforce internal controls, but that this is still cheaper than bearing the cost of widespread fraud.

Currently the department has a staff of ten. Initially the objective was to have at least twelve. However, the department was a victim of cutbacks, like all other departments, in the reduction in force cuts necessitated by the district's budget problems in 2008. Under the position guidelines, the Executive Director is required to have knowledge and experience in the areas of accounting and auditing; investigative techniques; criminal law, civil law, rules of evidence and expert witness matters; and management of a professional staff.

The Executive Director, Donald R. Smith, Jr. has more than 25 years experience as a criminal investigator with the IRS's Criminal Investigation Division as well as relevant experience in the private sector. He is a CPA and a CFE. Other staff members have equally impressive backgrounds, including:

- The Director of Investigations with 27 years in law enforcement comprising 22 years as a federal agent investigating white collar crimes, financial fraud and money laundering, and 5 years as a police investigator. He is also a CFE.

- An employee with more than 30 years of federal investigative experience with 15 years as a special agent with the Air Force Office of Special Investigations and 16 years with the DOD Office of the Inspector General investigating public corruption and major procurement fraud.
- An employee with 26 years as an IRS special agent.
- An inspector who was an Air Intelligence Officer in the Navy then a FBI special agent and had IRS Criminal Investigation Division experience working cases involving tax evasion, bankruptcy fraud, bank fraud and money laundering followed by time as an enforcement advisor working overseas for the US Government. He is also a CFE.
- An inspector who worked 24 years with the IRS with 4 years as an auditor and 20 years as a Special Agent in the Criminal Investigation Division. He is also a CFE.
- An investigator who is an accountant with school district experience. He is also a CFE.

To reflect the increased focus on fraud prevention and the hiring of experienced professionals in this field, the district is paying market based salaries. The top salary is $137,917 followed by $122,004 and $97,072 with four others above $80,000 (Texas Tribune, n.d.). The office is subdivided into three groups: the Office of Investigations, the Office of Compliance, and the Office of Ethics and Integrity.

The Executive Director has wide-ranging authority in fulfilling the department's mission. This includes the right to investigate any employee of the district and to have full, free and unrestricted access to all district records. He is able to take testimony and compel the production of any material relevant to an investigation and temporarily assign, with the Superintendent's approval, any district staff member with special skills to achieve the mission of the department. To back up and enforce the work of the department, he is authorized to share any information relating to possible criminal acts with all appropriate law enforcement agencies.

One of the complaints leveled at the new system is that the Executive Director reports directly to the Superintendent. While this guarantees the director access to the top administrator in the district, there has been concern expressed that this gives the superintendent too much power, and that a better system would be having the director report directly to the school board, just as the head of internal auditing in a corporation would report directly to the board of directors. Some of those who argue the new system gives the superintendent too much power use the following case as proof. The district has been sued for retaliation by a former middle school principal who claims that Dr. Hinojosa abused his power by using the OPR to try and protect himself against rumors relating to his personal life. The principal was accused of starting a rumor that the superintendent was having an inappropriate relationship with a teacher. The principal was investigated by the OPR which filed a 64 page report which concluded that the rumor was false and that she had lied when she said she had only told two people about the rumor (Shipp, 2008). The OPR held that she had told four district employees and she was demoted to assistant principal of an elementary school.

The OPR main webpage contains details of how to contact them in a number of different ways. They display their physical address, their telephone number and their mailing address. They provide a web link to a page allowing for a "Confidential and Anonymous Report of Ethics Concerns Regarding the Dallas Independent School District." They also display the 800 number for the 24-hour Dallas ISD Fraud Hotline which is bilingual and confidential. There is a link for frequently asked questions, one for more information about the mission of the OPR, and another on the principles of public service. A further feature, and an important one, is a link detailing whistleblower protections for those contacting the office (Dallas Independent School District, n.d.b).

The Publications link on the OPR web site provides a copy of the *DISD Handbook of Ethics and Integrity*, a brochure entitled *Doing the Right Thing,* and links to all OPR newsletters. The newsletter, *Integrity Insights*, is sent out regularly and contains notes from the Executive Director, information on ethics generally, details of DISD policy, and statistics of the workload of the OPR.

The creation of the OPR was a forceful response to the Pcard scandal. The DISD has committed the resources and funding to effectively combat fraud within the district. As with any enforcement activity, there will always be criticism regarding particular techniques and investigations. However, there is no doubt that the response of the district is genuine and stands a much better chance of succeeding in its objective of responsibly controlling and spending the public monies with which it is entrusted.

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