

## I. Executive Summary

### Introduction

VLS is pleased to deliver to the Subcommittee for the Clay Investigation (Subcommittee) the Phase II Report of Forensic Accounting Investigation (Report). This Report is prepared pursuant to the Phase II contract between Vicenti, Lloyd & Stutzman, LLP (“VLS”) and the West Contra Costa Unified School District (WCCUSD) executed on February 9, 2016. VLS’s work was performed under the direction of Kawahara Law, APC, acting as special outside legal counsel to the Subcommittee for the Clay Investigation.

The overall scope of work and approach was conducted utilizing standards in accordance with the American Institute of Certified Public Accountants (“AICPA”) *Statement on Standards for Consulting Services No. 1 (SSCS)* and the Code of Professional Standards of the Association of Certified Fraud Examiners (ACFE). In consulting engagements, the nature and scope of work is determined solely by the agreement between the practitioner (VLS) and the client (the District). This Report does not constitute an audit, compilation, or review, in accordance with standards of the AICPA, the objective of which would be the expression of an opinion on any specified elements, accounts, or items. Accordingly, VLS does not express such an opinion.

In accordance with these standards, no opinion is expressed by VLS regarding the legal guilt or innocence of any person, party, or organization.

### Background

**Phase I:** On October 7, 2015, the District Board of Education approved awarding a contract to VLS to provide the Subcommittee with:

- A fraud risk assessment of a District employee’s complaint that alleged acts of gross mismanagement, negligence and malfeasance in the District’s bond program to identify highest risks of waste or improper expenditure; and
- To provide guidance to the Board’s Subcommittee in providing a scope for a forensic accounting investigation and develop a scope of work for completion of the forensic accounting investigation of high priority items for approval by the Board’s Subcommittee.

VLS performed the services for Phase I from October 2015 through December 2015 under the direction of Kawahara Law, APC, acting as special outside legal counsel to the Subcommittee.

On January 7, 2016, VLS delivered to the Subcommittee a two-part deliverable as contracted for in Phase I. This consisted of the Bond Program Fraud Risk Assessment Matrix and a Proposed

Scope of Work for Phase II forensic accounting services. The Risk Assessment Matrix identified a Risk Score of High, Medium, or Low to the identified Risk Areas. These risk scores measured the risk of waste, improper expenditure, or fraud (financial irregularity) to the District based on the internal controls in place at or near the time of the allegations by the complainant(s).

The Proposed Scope of Work for Phase II included sixteen areas identified for testing of the internal controls (TCs) which according to the District had been implemented since the time of the initial allegations and complaints.

The Proposed Scope of Work for Phase II also included performing appropriate forensic accounting investigation (FIs) for eleven specific work steps. The following criteria were used to determine which of the various historical transactions, allegations, and complaints were selected as FIs and were tested in Phase II:

- Allegations that called for a criminal, civil, or other potential legal opinion by VLS were not selected for testing, as VLS, by professional standards of the AICPA and the ACFE, is prohibited from rendering such opinions. For example, the allegation that a Board member received a kickback would require a criminal investigation and a legal proceeding. The allegation that a District employee was negligent in fulfilling his/her duties would also require a legal proceeding.
- Allegations were not chosen for Phase II FIs if, in VLS's professional judgment, the benefit to the District would be better served by testing the internal control processes associated with the risk of fraud. For example, an FI work step was not designed to investigate the allegation that the Board is not told if a project has sufficient budget for a contract; however, there was a TC work step designed to test the internal controls in this area.
- Allegations were taken into consideration when designing FI work steps when the allegation, if investigated, could result in the recovery of monies for expenditures paid by the District that it may not have been obligated to pay.
- Allegations deemed to be related to significant management functions of the District Bond Program were taken into consideration for designing FI work steps.
- Consideration was given to the overall potential cost of investigating any allegations where the allegation would be better served by addressing it through a test of the related internal controls.

**Phase II:** On January 20, 2016, the District Board of Education approved the proposal, which had been presented to the Subcommittee on January 7, 2016, for VLS to perform the Phase II

forensic accounting services related to the Bond Program review. The contract between the District and VLS was executed on February 9, 2016, with a total cost of \$725,224. VLS did not request any increases to this original amount.

The contract called for the Phase II Preliminary Report to be delivered to the Subcommittee approximately seven months from the date of the signed engagement letter, which was August 31, 2016, then modified to September 9, 2016, at the request of VLS.

### **Scope of Services for Phase II**

The approved scope of work for Phase II included:

- 1) *To assign a New Risk Score to the Risk Assessment Matrix based on VLS's analysis of the results of the sixteen "Test of Controls" (TC).*

The New Risk Score measures the level of risk to the District for waste, improper expenditure, or fraud (financial irregularity) related to the Bond Program expenditures based on the results of testing the internal controls. These are the internal controls that the District currently has in place and are directly related to the allegations and systemic risk areas as specified in the Risk Assessment Matrix Phase II.

If a New Risk Score is identified as a High risk, this indicates that the internal control(s) in place to minimize fraud, waste, or abuse for that particular allegation or concern are either not implemented or the internal control(s) has been implemented, but testing revealed that the internal control(s) is not functioning adequately. Therefore, a High likelihood exists that 1) the District may be at risk for waste, improper expenditure or fraud (financial irregularity) related to the Bond Program expenditures, 2) the dollar impact would be significant, and 3) the impact on public perception/trust would be significant.

- 2) *To perform the appropriate testing for each of the sixteen TC work steps. Then, based on VLS's analysis and the results of the work performed, assign the New Risk Score. If the New Risk Score identified is a Medium or High risk, report any recommendations for the District to consider implementing in order to lower the New Risk Score to a Low risk.*

During Phase II, the testing for the TCs generally involved a two-part process. The first part included understanding and documenting processes and procedures currently used. It also included verifying the internal controls in place for those processes and procedures being tested by the specific TCs. VLS then identified the significant internal controls that had been implemented and were being relied upon by the District to reduce the risk for waste, improper expenditure, or fraud (financial irregularity) related to the Bond Program expenditures. Once the significant internal controls were fully

identified, the populations of transactions related to those controls were identified, and samples were selected for testing.<sup>1</sup>

The second part of our testing involved obtaining and reviewing the supporting documentation for the samples selected to verify that the significant controls identified were in place and were being followed.

Based on a review and assessment of the results of testing, VLS assigned a New Risk Score and made specific recommendations for the District to consider implementing in order to lower the New Risk Score to a Low risk. VLS provided the TC recommendations to the District, in advance of this report, for their response. Other than some minor clarifications, the District was in agreement with VLS's recommendations and looks forward to implementing VLS's recommendations.

For each of the TCs, VLS documented the results of the work performed in the specific "Results of Testing" section for each of the sixteen TCs. The "Results of Testing" sections include the following:

- The specific work step.
- The results of the work VLS performed in testing the specific work step. This includes, where applicable, analyses and steps performed and other information relevant to the testing of the TC.
- The New Risk Score for the most significant internal control risk area impacted by the TC.
- The specific recommendations for the District to implement based on the analysis of work performed and conclusions reached for each TC work step.
- The District's response to VLS's recommendations.
- VLS's assessment of the response by the District.

- 3) *To conduct the appropriate forensic accounting investigation for the eleven specific FIs.* Then based on the results of work performed and conclusions reached for each FI, VLS made specific recommendations for the District to consider implementing for the purpose of improving the overall efficiencies and effectiveness in the management and operation of the District Bond Program, and lowering the New Risk Score where applicable.

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<sup>1</sup> In accordance with AICPA professional standards, VLS used a combination of random sampling and judgmental sampling in order to select the samples for testing in the Test of Controls section. A random sample is used so every unit in the population has an equal chance of being selected, while a judgmental sample relies on the auditor's professional judgment, meant to focus and confirm a condition that is reasonably thought to exist.

The work performed in Phase II for the FIs involved interviews, document gathering, analysis and examination, data analytics, and computer forensics and email review.

VLS provided the FI recommendations to the District, in advance of this report, for their response. Other than minor clarifications, the District was in agreement with VLS's recommendations and looks forward to implementing VLS's recommendations.

For each of the specific FIs, VLS documented the results of the work performed in the specific "Results of Testing" section. The "Results of Testing" sections include the following:

- The specific FI work step.
- The results of the work performed in testing the specific work step. This includes, where applicable, the analyses and steps performed, any scope limitations, and other information relevant to the testing of the FI section.
- Conclusions based on the results of the testing.
- Recommendations made for the District to implement.
- The District's response to VLS's recommendations.
- VLS's assessment of the response by the District.

### **Highlights of Work Performed**

VLS performed the work for Phase II from February 2016 through September 2016 under the direction of Kawahara Law, APC, acting as special outside legal counsel to the Subcommittee. In addition to extensive review, analysis, documenting work performed, and drafting of the Report, highlights of work performed include:

- Interviews of twenty-three individuals, including a combination of District employees, CBOC members, District vendors and contractors, and Board members.
- Numerous documents were obtained directly from the District and from third-party sources. These documents were specifically relevant to both the TC and the FI areas' scope of work. A "secure portal" protocol was utilized with the District to ensure that all documents, records, and information received were transferred securely and were appropriately maintained in accordance with legal, investigative, and/or consulting standards for this project. Throughout Phase II, the District was fully cooperative in working with VLS. Letters requesting documents and records from vendors were drafted by VLS and, in coordination with the District, were submitted directly to the vendors.
- Computer forensic procedures were performed that allowed VLS to obtain electronic information (emails, electronically created files, etc.). The results of the computer

forensic analysis were reviewed by VLS to identify information and evidence relevant to this investigation.

- A fraud hotline phone number and website link were established for the District to publish so that individuals with relevant information or knowledge regarding fraud, waste, or abuse within the District’s Bond Program had a means to contact VLS directly. This hotline was in existence for the duration of Phase II. Anonymous callers did contact the hotline during Phase II.
- Monthly status reports for the Subcommittee were provided to legal counsel throughout Phase II. The status reports included: investigative and testing steps completed or in progress, all work to be performed for the following month, project obstacles, and a summary of hours and costs to date. Subsequent to June, status updates were provided to legal counsel via phone conference calls. This medium was used to communicate status updates as the majority of fieldwork had been completed and VLS focused on concluding the test of controls assessments, and forensic accounting investigation testing. Also during the course of our work in Phase II, VLS communicated directly with legal counsel as appropriate.
- VLS attended a meeting with the Subcommittee for the Clay Investigation on 5/23/2016.

### **Highlights of Scope Limitations and Impact on Work Performed**

For purposes of this engagement, the meaning of scope limitation and impact on work performed is defined as follows:

- Scope Limitation: VLS did not receive documents requested from the District, vendors, or other third parties.
- Impact on Work Performed: Whether VLS was able to reach a conclusion of the work step by performing alternative and/or sufficient testing and investigation.

### **Scope Limitations and Impact on Work Performed:**

- 1) District: The District was able to provide all the documents and records requested by VLS; therefore, there was no scope limitation from the District.<sup>2</sup>

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<sup>2</sup> There were limited documents available related to work step (G) in FI (7) due to the time period of the contract and project reviewed; however, this did not prevent VLS from reaching a conclusion on that work step.

- 2) Vendors (Other than SGI): VLS sent a letter requesting certain information and documents related to the work the vendors performed for the District, contributions made to District affiliated organizations, and gifts purchased on behalf of District employees and/or Board members. Of all the vendors where documents were requested, all but three vendors provided the documents requested by VLS. However, even with this scope limitation VLS was able to reach a conclusion on the applicable work step.<sup>3</sup>
- 3) SGI: SGI did not provide all the records requested by VLS, which resulted in VLS being unable to reach a conclusion for certain work steps in FI (3) Work Step. SGI retained legal counsel subsequent to VLS's request of documents. At such time, Mr. Kawahara, legal counsel to the Subcommittee for the Clay Investigation, was advised and VLS worked under the direction of Mr. Kawahara in communication with SGI from May 2016 through August 2016.

The sections that VLS was unable to conclude as a result of SGI's refusal to comply with VLS's requests were the following:

- Sections for which payroll registers, and time keeping records were requested:
  - FI (3) section (C) work step - *Conduct appropriate investigative steps to determine if SGI was paid inappropriately for sick and vacation time and if SGI billed the District for hours not worked by SGI employee*
  - FI (3) section (F) work step - *Conduct appropriate investigative steps to determine if sufficient supporting documentation was provided with invoices submitted by SGI to the District*
- Section for which VLS requested samples of SGI employee resumes and degrees if applicable:
  - FI (3) section (E) work step - *Conduct appropriate investigative steps to determine if SGI employees possess the appropriate qualifications as stated in the terms specified in the SGI contract with the District.*

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<sup>3</sup> Four vendors contacted by VLS retained legal counsel. Three of these vendors ultimately provided VLS with the records requested. One of these vendors did not provide VLS with the records requested. Additionally, two other vendors failed to provide VLS with the records requested. One of these vendors indicated they needed additional time. The other vendor never acknowledged or responded to VLS's request.

Finally, in addition to FI (3), SGI failed to provide VLS with documents and interviews of SGI personnel as requested by VLS for FI (1). Although VLS was allowed to interview SGI personnel for TC related work, VLS was not allowed to interview SGI personnel for FI related work. Additionally, SGI did not provide VLS with documents and financial information concerning any contributions made to organizations and any payments made by SGI for gifts or meals and entertainment to District Board members and District staff.

The failure of SGI to provide these requested documents and interviews of SGI personnel resulted in a scope limitation of the work VLS was able to perform for this work step. However, VLS was able to perform alternate and/or sufficient testing and investigative procedures to complete our work for FI (1) Work Step.



Highlights of the New Risk Scores Assigned to the Final Risk Assessment Matrix Phase II

The final Risk Assessment Matrix Phase II (Phase II Matrix) is located in Section II B. Included below is a chart that summarizes key information from the Phase II Matrix. This chart depicts the original Risk Scores from the Risk Assessment Matrix Phase I (Phase I Matrix) and the New Risk Scores assigned in Phase II. The last column of this chart identifies the number of recommendations to lower the New Risk Score for the applicable Risk Area.<sup>4</sup>

Risk Area	Score Level	Phase I Original Risk Score	Phase II New Risk Score	Number of Recommendations to Lower Risk Score
Conflict of Interest	High	8	0	6
	Medium	0	7	
	Low	0	1	
Compliance with Legal Requirements and Board Policies	High	3	1	9
	Medium	2	4	
	Low	1	1	
Budgeting Practices	High	6	5	15
	Medium	1	2	
	Low	1	1	
Vendor Contract Administration	High	7	2	13
	Medium	6	10	
	Low	3	4	
Billings and Performance of Outside Construction Manager	High	2	0	5
	Medium	5	7	
	Low	0	0	
Change Order Approval and Accounting Practices	High	4	0	10
	Medium	3	7	
	Low	0	0	
Project Accounting Systems - Munis	High	3	2	6
	Medium	3	4	
	Low	0	0	
Project Accounting Systems - Primavera	High	0	0	4
	Medium	3	3	
	Low	0	0	
Financial Reporting	High	3	0	10
	Medium	1	4	
	Low	0	0	
<b>TOTAL</b>	High	<b>36</b>	<b>10</b>	<b>78</b>
	Medium	<b>24</b>	<b>48</b>	
	Low	<b>5</b>	<b>7</b>	

<sup>4</sup> This includes all 75 TC recommendations and three FI recommendations that were deemed by VLS to be applicable to certain risk areas to assist in lowering the New Risk Score.

#### Key observations of the New Risk Scores:

- There has been a significant decrease in the number of High risk areas from Phase I. In Phase I, there were a total of 36 High risk area categories. For Phase II, the number decreased to 10. This result indicates that, overall, the District has significantly improved in addressing the High risk areas identified in Phase I. However, the District still needs to continue to address these High risk areas and implement the specific recommendations to lower the New Risk Score.
- VLS's assessment determined the majority of the High risk areas that decreased were assigned a New Risk Score of Medium. This indicates that the District still needs to continue to address these Medium risk areas and implement the specific recommendations to lower the New Risk Score.
- The one risk area category that remains High is "Budgeting Practices." There are five High risk areas. This is a decrease of just one from Phase I. The District has considerable work in this area to address lowering the risk scores. VLS has made 15 specific recommendations for the District to consider implementing to lower the New Risk Score in the "Budgeting Practices" area. VLS recommends that addressing the "Budgeting Practices" risk area category and the implementation of the related specific recommendations be a high priority of the District.
- VLS has made 78 specific recommendations for the District to consider implementing to lower the New Risk Score. The specific recommendations are located in Section II C. The last column of the final Risk Assessment Matrix Phase II, located in Section II B, identifies the specific recommendation(s) for each risk area.
- The District has already been provided these recommendations, and the District looks forward to implementing VLS's recommendations. In addition, VLS strongly encourages that a strict **"Recommendations Implementation Task Force"** be established so accountability measures are put in place by the District to ensure these recommendations are implemented. Considerable time, effort, costs, and resources have been invested by the District and the community for both Phase I and Phase II engagements. The District should ensure this momentum and attention continues. The **"Recommendations Implementation Task Force"** is a proven tool to ensure progress toward a Low risk environment continues.

#### High Level Summary of FIs and Recommendations

VLS has made 33 recommendations for the District based on the conclusions and results of work performed for the eleven FIs. These recommendations are for the District to consider

implementing as they are designed for the purpose of addressing any concerns noted in the conclusions from the work performed in the FIs, lowering the New Risk Score where applicable, and improving the overall efficiencies and effectiveness in the management and operation of the District Bond Program. Included below is a chart that indicates the number of recommendations by Risk Area.

Risk Area	Number of Recommendations Identified in the Forensic Investigation Testing
Conflict of Interest	5
Compliance with Legal Requirements and Board Policies	11
Budgeting Practices	4
Vendor Contract Administration	11
Billings and Performance of Outside Construction Manager	0
Change Order Approval and Accounting Practices	2
Project Accounting Systems - Munis	0
Project Accounting Systems - Primavera	0
Financial Reporting	0
<b>TOTAL</b>	<b>33</b>

The District has already been provided these FI recommendations, and the District looks forward to implementing VLS's recommendations. As noted for the previous 78 recommendations, VLS strongly encourages that these recommendations be addressed through the **"Recommendations Implementation Task Force"** suggested by VLS.

Included in the 33 FI recommendations are recommendations specific to the District's legal counsel, which relate to the following two categories:

- VLS recommends that the District's legal counsel provide guidance and counsel to the Subcommittee on Clay Investigation and the Board to determine whether this report should be referred to appropriate law enforcement agencies for appropriate action. See recommendation FI1-4.
- VLS recommends that the District consult with legal counsel to determine whether further course of action is appropriate in certain areas. For example, the failure of SGI to provide requested documents and allow interviews of SGI personnel resulted in a scope limitation of the work VLS was able to perform. Therefore, SGI may have been in breach of the Right to Audit Clause of the contract between the District and SGI by failing to provide VLS access to requested documents after reasonable notice was provided. See recommendations FI1-5, FI3-6, FI3-7, FI3-8, FI10-1 and FI10-2.

#### Closing Statement

In addition to assigning New Risk Scores to the Phase II Matrix, making 78 specific recommendations to lower New Risk Scores, and making 33 recommendations resulting from the work of the FI testing, VLS also makes the following four recommendations for the overall operational and administrative efficiencies of the Bond Program:

- The District should ensure that an effective FRAUD REPORTING MECHANISM is in place for reporting known or potential wrongdoing impacting the District Bond Program.
- The District should ensure ongoing FRAUD and ETHICS TRAINING is provided to all employees of the District, especially those associated with the Bond Program.
- The District should evaluate the adequacy of resources assigned to the INTERNAL AUDIT DEPARTMENT for review of the Bond Program.
- VLS strongly encourages the establishment of the **"Recommendations Implementation Task Force"** so accountability measures are put in place by the District to ensure all recommendations for work completed in Phase II are adequately assessed and implemented.