FRAUD & YOUR ORGANIZATION - YOU DON'T HAVE TO BE A VICTIM

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According to the Association of Certified Fraud Examiners, typical businesses — including nonprofits — lose from 5 percent to 6 percent of annual revenue to occupational fraud.

To prevent fraud, industries have adopted their own controls. The financial services industry, for example, uses security codes and photos on credit cards.

Why should nonprofits be any different? In fact, the relative impact of fraud on a nonprofit can be substantially higher than on a for-profit business. Why? Reputation.

Successful nonprofits create a bond of trust with their supporters — a bond that can be quickly broken by the slightest sign of fraud.

Consider United Way of America. The organization lost one-third of its income after "irregularities" involving upper management came to light. It took three years for the organization to return to its previous level of income.

YOU ARE SUSCEPTIBLE

By their nature, nonprofits are vulnerable to fraud. First, there are no "owners" watching over money.

Plus, nonprofits are typically not staffed by people well-versed in fraud prevention. Turnover can be high and employee count low, making it even more challenging to properly segregate duties.

Additionally, board members may lack the skills to properly review financial statements, cash flow and internal controls.

WHAT TYPES OF FRAUD OCCUR?

Nonprofit boards often have trouble accepting the idea that someone would steal from a charitable organization. But no matter what the industry, employees do steal. Fraud expert John J. Hall estimates that 95 percent of employees will commit fraud given the right circumstances.

The classic perpetrator is the "trusted employee," a dedicated and faithful long-term staff member. Often, this person is given access to pre-signed checks and a signature stamp for the obligatory second signature. This employee may also keep the books, balance the checkbook and receive the bank statements, creating ample opportunity for wrongdoing.

WHAT YOU CAN DO

Take practical steps to protect your organization from fraudulent activity.

Start at the top. In addition to a strong executive committee that meets regularly, nonprofit organizations should have an active finance committee. This committee would be responsible for understanding the organization's exposure to theft or loss, considering safeguards to reduce and mitigate risk, and monitoring cash flow, accounts receivable and accounts payable.

Hire smart. Ask potential employees to sign a consent form authorizing that all references and records may be checked, and then check them! These investigations typically look into authenticity of degrees as well as public records of criminal and credit problems. Because everyone in the organization has an opportunity to steal, your organization must know as much as possible about every staff member — from

those working in the finance department to volunteers and even the maintenance staff.

Recruit strategically. Seek board members with a financial background who can offer practical financial advice. These are the people most likely to recognize the warning signs of fraud.

Set expectations. Establish a formal code of ethics or conduct that clearly spells out what is acceptable behavior and conveys that theft of organizational assets will be fully prosecuted.

Create a reporting mechanism. Identify a board member to whom staff can report suspected improprieties. Or create an anonymous reporting process and open it to customers and suppliers as well.

Insure against it. It's the board's responsibility to make sure the organization has the appropriate level of fraud loss coverage. Employee dishonesty coverage (also called fidelity insurance or bonding) is a good place to begin. Make sure all employees are bonded, as well as volunteers who sign checks, transfer funds or otherwise have access to assets. Typically, this type of insurance is not expensive and makes sense for all but the smallest of organizations.

THE GOLDEN RULE OF INTERNAL CONTROLS

The best way to ensure effective internal controls is to separate incompatible functions. Consider this the golden rule of fraud prevention.

This means no single individual should have custody of assets (money, inventory, etc.) and responsibility for maintaining the related records.

At the very least, segregate the duties of handling and reconciling funds. Make one person in charge of approving disbursements and a different person responsible for physically receiving and distributing funds. A third person should receive and reconcile bank statements.

INTERNAL CONTROL: TOP 5 TIPS

Have bank statements and cancelled checks sent directly to your treasurer or a designated board for review.

Require supporting documentation for all invoices/bills — and ensure that the documentation is appropriately filed.

Insist on timely financial statements each month (and review them thoroughly). Promptly investigate any delays in financial reporting.

Do not accept just a statement of activities (equivalent to a profit and loss statement), or just a statement of position (equivalent to a balance sheet in the business world). You need both. There is a relationship between these financial statements. If receivables, prepaid expenses, accounts payable or accrued expenses are misstated or overlooked, your statement of activities will be affected as well.

Request next year's budget before the fiscal year begins. Investigate any deviation between current year results and the proposed budget.