Can Your Organization Afford to Lose $100,000? Safeguards Every Nonprofit Needs to Implement

Are you making any of these common mistakes?

By Tanya Ferreiro

We've all read the stories about nonprofits victimized by fraud. According to the Association of Certified Fraud Examiners' *Report to the Nation on Occupational Fraud & Abuse* (www.acfe.org), nearly 14% of fraud cases take place in nonprofit organizations, with a median loss of $100,000. The top five most common types of fraud committed against nonprofits are:

- corruption (accepting or paying a bribe, or being involved in a transaction with an undisclosed conflict of interest)
- billing schemes (billing the organization for non-existent services, or submitting invoices for payment of personal purchases)
- fraudulent expense reimbursement claims
- check tampering (taking and using blank checks or stealing a legitimate outgoing vendor check)
- skimming (accepting a donation or other payment and not recording it).

Your budget should serve as a monitor for your organization's activities.

Nonprofit World • Volume 30, Number 3, May/June 2012.
Published by the Society for Nonprofit Organizations
P.O. Box 510354, Livonia, Michigan 48151
734-451-3582 • www.snpo.org

How Can You Protect Your Organization?

Budgeting is an important internal control. If your budgeting process stops after developing and approving a budget, you've missed a simple opportunity for oversight. One purpose of a budget is to project income and expenses for the coming year, but your budget should also serve as a monitor for your organization's activities. Periodically, a manager or board member should review the expected cash receipts and disbursements against the actuals. A finance committee serves this purpose in many organizations. In some cases a shortfall might indicate overly optimistic planning. In others it could indicate fraud.

Ask questions like, "Why, halfway through the year, have we received no major gifts against a budget of $300,000?" A fraudster might have solicited—and pocketed—a large contribution.

Ask, "If this program was supposed to be completely funded through a grant, why are expenses exceeding income?" Perhaps inappropriate expenses are being hidden within the program.

Ask, "Why did the event we budgeted at $10,000 in expense and $20,000 in revenue barely break even?" Perhaps expenses were artificially inflated by a billing scheme diverting funds to a fictitious supplier. Or maybe ticket revenue from the event was skimmed by a ticket-seller.

Nonprofits lose a median of $100,000 to fraud.

Segregation of duties is a classic technique to protect an organization. Simply put, segregation means assigning someone to keep an eye on the person responsible for receiving or disbursing cash.

- If the same person is responsible for cash receipts and deposits, there's no control in place to assure that a check doesn't vanish before getting to the bank. A cash receipts log should be created and maintained by someone independent of the accounts receivable bookkeeping.
- In the case of cash disbursements, the person who signs the checks should be independent of the initiator or approver of purchases. This can seem daunting in a small, lean operation, but it's

Special events pose a perfect opportunity for the fraudster.

one of the most effective protection tactics.

- Bank statements should be received and opened by someone (a manager or board member) who's not responsible for cash receipts or disbursements, before being routed to accounting for reconciliation. The reconciliation should then be reviewed by someone in management or at the board level.

Approval procedures can deter fraud, and can be implemented without adding additional staff. For example, many organizations require checks over a certain amount ($2,500 or $5,000) to be signed by two approvers, at least one a board member. Certainly non-cash disbursements can easily be controlled with passwords, authorization limits, and even bank verification of transactions over a certain limit. Make sure that the person verifying for the bank isn't the same individual initiating the transaction.

Special events pose a perfect opportunity for the fraudster. There's generally a lot of cash involved, often many volunteers, and sometimes merchandise for an auction. The excitement and commotion of an event can draw attention away from fraudulent activities.

As you do your planning, make sure to establish a budget for the event. Later, take care to investigate any variances from that budget. For ticketed events, use pre-numbered tickets, and keep track of the series each ticket-seller has been issued. Account for all tickets sold and unsold. Make sure that cash receipts on the day of the event are counted by at least two people, no more than one of them a volunteer.

As far as auction materials, keep close track of the donated property. Inventory should be monitored by someone not responsible for the physical control of the materials. Control who has the right to bid, to make sure that insiders aren't manipulating the auction. When a bid is accepted, make sure you have procedures in place for properly collecting and accounting for the payment before releasing the merchandise. In one common fraud scheme relating to auction merchandise, a bidder takes the property the night of the auction without paying, and an insider writes off the receivable.

Expense report falsification is a popular fraud, representing nearly 20% of the fraud cases studied in the ACFE report, with a median loss of $25,000. Make sure written procedures are in place for expense reimbursements, including a clear definition of expenses that qualify. Consider a time limit (one month, perhaps) on requests for reimbursement. Use a standard form, and require receipts for all expenses. Require approval from an appropriate member of management or the board, possibly dictated by the amount.

Two other measures, mandated for public companies by the Sar-

continued on page 20

Anti-fraud training for all staff sets the proper tone.

continued from page 19

banes-Oxley Act, should be part of every nonprofit's armor against theft. The first is known as "tone at the top." Management needs to set the tone for ethical, honest operations—not just putting procedures in place but talking about the reasons behind them. Anti-fraud training for all staff sets the proper tone. Follow the procedures (filling out standard expense reports, for example) and your staff will follow your lead.

Second, make sure employees have a direct line of communication with top management and with someone on the board. An employee observing misconduct within the chain of command can't be expected to report it through the same chain. But, according to the ACFE report, the most common method of fraud detection wasn't through an auditor's observation or even by the types of controls we've outlined above—it was from a tip. Establishing a hotline for whistleblowers makes it easier for those observing potential misdeeds to report them without fearing retribution.

Are inappropriate expenses being hidden within the program?

It's a pretty good bet that your organization can't afford to lose $100,000 to fraud, not to mention the damage to your credibility which would follow. Putting stronger controls in place, setting the right tone, and establishing a reporting mechanism can go a long way toward protecting you. ■

Tanya Ferreiro, CPA (tferreiro@kaufmanrossin.com) leads the nonprofit audit practice for Kaufman, Rossin & Co., one of the top accounting firms in the Southeast.

Resources (available at www.snpo.org/members)

- **Fraud: How to Prevent It in Your Organization** (Vol. 26, No. 3)
- **Navigating Tough Conflict of Interest Situations** (Vol. 27, No. 1)
- **Risk Management: How to Protect Your Assets** (Vol. 26, No. 1)
- **The Sarbanes-Oxley Act & Nonprofits: But I Thought That Didn't Apply to Us** (Vol. 22, No. 5)