PREVENTING FRAUD IN NONPROFIT ORGANIZATIONS

Nonprofits lose $40 billion annually to fraud and embezzlement. And it's not just small nonprofits that are vulnerable – although they tend to suffer the largest losses – but nonprofits of all sizes and with a wide range of missions.

Altogether, nonprofits accounted for 14% of all occupational fraud cases. The majority of these thefts involve cash in the form of payroll or check disbursements. Clearly, many nonprofits are not doing enough to protect themselves against fraud. And, while there is no foolproof model for preventing all fraud, organizations can deter it by strengthening three major areas: board governance, risk management and internal controls.

BOARD GOVERNANCE Many nonprofits face significant hurdles in providing strong board oversight. Most rely on volunteer board members who often lack sufficient training. In addition, turnover on nonprofit boards tends to be high. However, nonprofit boards have a responsibility for assuring that the nonprofit's resources are protected so its mission can be fulfilled. Among the oversight duties that boards must take responsibility for are:

- Setting the appropriate "tone": Board members should assure that internal controls are in place and *implemented*. If the Board and senior management emphasize and adhere to internal financial controls, it will create an appropriate culture of control.
- Scheduled reviews: On at least a yearly basis, the board should review internal controls. Are they working? Does each procedure still make sense? Are procedures too onerous? Are modifications required?
- Segregation of duties: No single person – whether employee or volunteer – should be responsible for the entire payable or receivable process. Although it may be difficult to separate duties in a small organization, it is a critical step in preventing fraud.

RISK MANAGEMENT Nonprofits, whether they are associations, religious organizations, philanthropies, social services, etc., enjoy a large measure of the public's trust. Many rely on donor goodwill for survival, and small charities in particular operate on very tight budgets. Consequently, an incidence of fraud within the organization can be devastating to their mission and their reputation.

The most common form of fraud in a nonprofit, accounting for half of all cases, is billing false or inflated invoices. Other areas to watch are payroll fraud, expense reimbursement, stolen or altered checks and undocumented refunds or payments (the most expensive form of fraud). Managing these and other risks should be everyone's responsibility – board members, management, employees and volunteers.

INTERNAL CONTROLS Nearly half (49%) of nonprofit fraud detection comes from employee tips. Another 25% is detected via an internal audit, while 13% is detected by external audit. More than 10%

are detected by accident! The most significant contributor in fraud cases is lack of internal controls, followed by lack of appropriate management oversight and override of existing controls.

Effective internal controls will govern two high risk areas for fraud: expenditures and receipts. Clearly, the day-to-day handling of cash or access to checks or credit cards presents the greatest temptation and opportunity for fraud, and nonprofits must be vigilant about enforcing anti-fraud procedures. Some specific suggestions for preventative internal controls nonprofits should consider include:

- Expenditures
  - Establish authority levels and documentation requirements for placing orders and approving payments
  - Check invoices against orders
  - Implement a formal expense reimbursement policy that includes requiring reimbursements by check or direct deposit
  - Establish rules for using the organization's credit card; i.e. , restrict retailers where the card can be used, require copies of statements be sent directly to the finance team, establish spending limits.
  - Protect checkbooks by keeping them in a secure place, promptly record payments, obtain documentation before paying for goods and services, reconcile bank statements when the statements are received.
- Receipts
  - Record incoming cash and checks and reconcile against deposit slips and bank statements
  - Protect receipts received via mail by holding in a secure place as they're received. Don't delay opening mail or recording and banking receipts.
  - Control banking procedures by requiring incoming cash and checks be immediately recorded and deposited.

ABOUT SUSAN JONES Please contact Susan R. Jones, Principal, and leader of Miller Cooper's Nonprofit Services Group at 847-527-1149 or SJones@MillerCooper.com

Susan Jones joined Miller Cooper from a national accounting firm in which she had more than 20 years experience serving a broad range of nonprofit, private and public audit clients. In addition to handling the accounting and audit needs of her nonprofit clients, she consults with them regarding planning and various organizational matters, and shares best practices from working with a variety of organizations.

Ms. Jones received a Bachelor of Science in Accounting from the University of Illinois-Champaign/Urbana. She also received a Master of Business Administration from DePaul University: Kellstadt Graduate School of Business. Ms. Jones is a member of the Illinois CPA Society and its Not For Profit Committee and the Association Forum.