Greater Knoxville SCORE Chapter
412 North Cedar Bluff Road, Suite 450 Knoxville, Tennessee 37923 · Phone: (865) 692-0716

Fraud Prevention Basics For Small Nonprofits

How Would the Publicity of Fraud Impact Your Organization?

Why Are Nonprofits So at Risk of Embezzlement?

- Management and board members are often too trusting
- Financial controls for nonprofits are often not as rigid as those of for-profit organizations
- A belief that audits will catch any occurrences of fraud

Why Do Employees Commit Fraud?

Motivation

- Personal financial issues, substance abuse, gambling, overspending, or other similar behaviors may provide motivation
- The current economic environment may be increasing the incidence of fraud

Opportunity

- The employee has sufficient access to assets and control of information that allows him or her to believe the fraud can be not only committed, but also concealed

Rationalization

- The employee finds a way to justify or rationalize the fraud (examples include unhappiness over compensation/promotions, thinking that they are simply "taking out a loan" which they fully intend to pay back, or a belief that the asset is not needed or won't be missed)

About Audits

- External auditors can provide advice on financial controls and fraud prevention measures; ask for their guidance and a review of your financial controls
- The standard audit, however, is not designed and should not be relied upon to detect fraud
- The Association of Certified Fraud Examiners reports that less than 10% of frauds are discovered as a result of an audit
- Auditors do not have an absolute responsibility for the detection of fraud

Build a Strong Compliance Program

Be aware of *respondeat superior* (the employer is responsible for the actions of employees) liability. The best way to prevent fraud is to have a well designed compliance program which is more than a "paper program."

An effective fraud prevention program will:

- Incorporate applicable government regulations and industry standards *plus* address the risks inherent in the nonprofit's business processes
- Have a corporate code of ethics. It should be clearly and concisely communicated to the board, management and employees. This commitment to the code should be affirmed by all employees on a periodic and ongoing basis. The leadership of the organization must demonstrate an ongoing commitment to ethical behavior. They are the *owners*.
- Include regular education and training for directors, management, employees and volunteers
- Be regularly monitored and audited to ensure that it is working and address any identified weaknesses
- Include whistleblower procedures or other anonymous reporting mechanisms
- Respond with meaningful discipline for violation of the policy. Having a reputation for ignoring possible fraud is an invitation to commit fraud.

Preventing Fraud by Example

Managers, directors and officers should be "role models" of ethical behavior by setting a good example for fair and honest business practices.

The Fiduciary Duties of a Board of Directors are to Ensure that:

- Financial decisions are reviewed in detail on a regular basis to assure that they are being made soundly and follow the bylaws and processes of the organization
- Individual directors and managers put the organization's financial and business interests ahead of personal interests
- The board prudently manages the organization's assets in furtherance of the organization's mission and strategic plan
- It practices hands-on oversight of management, including detailed periodic reviews of financial and other business documents and records
- Board membership includes having those with relevant financial expertise

Best Practices to Consider

Double Signatures and Authorizations

- Require two signatures on every check and two authorizations on every cash disbursement. Be careful if a minimum threshold is set for a review. Do spot checks of expenditures below the minimum.
- Consider having an officer or director be the second signatory or provide authorization in smaller organizations
- Minimize the use of credit cards. Reimburse rather than use credit cards. If you do use credit cards, be extra careful. Tightly control their use and have two independent reviews of each expenditure.
- Have two board members or officers review the credit card statements and expense reports of the Executive Director, CFO, CEO, etc.

Require Backup Documentation

- All check and cash disbursements must be accompanied by an original invoice or documentation showing that the payment is justified

Protect Your Checks

- Never pre-sign checks
- Keep blank checks and signature stamps locked up

Segregation of Duties

- Incoming Money – At least two individuals should be responsible for receiving, counting, recording and depositing the receipt of funds
- Outgoing Money – Two or more individuals should be responsible for each transaction authorizing payments or disbursement of funds and for reconciling bank statements
- Have employees, who handle finances, switch duties for 2 – 4 weeks to permit transactions to clear in their absence

Conduct Background Checks

- Background checks on new employees and volunteers should be a requirement
- They are a small investment and should be made a part of your hiring process

Stewardship of Fixed Assets

- Maintain a fixed asset inventory. Review at least once per year to ensure that no equipment is missing.
- Record the serial numbers of equipment and each should have an identifying mark. Photograph if appropriate.
- Ensure that the level security for facilities and information is adequate

Purchasing Practices

- All significant or ongoing financial commitments should be subject to at least three quotes, and approved by a manager uninvolved in the transaction
- The larger ones should be reviewed and voted on by the board

Audits and Board Level Oversight

- Regular audits are critical to help prevent fraud
- The board should fully review the results with the auditor. Solicit their improvement suggestions.
- Carry fidelity insurance for employees in sensitive positions

Openness and Transparency

- If employees recognize that their financial activities will be open and transparent to others, fraud will be less likely
- Utilize technology to electronically share financial transaction information with selected managers and board members

Example: There is a local non-profit, with more than $1 million in annual expenses, that has 3 board members review electronic copies of every expenditure monthly. This is in addition to double signatures and approvals, plus review by the treasurer.

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