The Simple Truth – About Fraud!

According to the latest "Report to the Nations on Occupational Fraud and Abuse, 2012 Global Fraud Study", by the Association of Certified Fraud Examiners, not-for-profit organizations continue to make up over 10 percent of the frequency of frauds committed. This has remained constant since the last report but the disturbing fact is that the methods in which frauds are committed could have been prevented (or at least better detected) with some simple controls.

Of the 54 religious, charitable and social service-related fraud cases, the following statistical breakdown was revealed:

51.9 percent – Instances of fraud by billing
33.3 percent – Instances of fraud by check tampering
31.5 percent – Instances of fraud by expense reimbursements

In addition, the report disclosed the following facts:

- Occupational fraud is more likely to be detected by tip from a fellow employee than by any other method.
- The median loss of occupational fraud cases for not-for–profit organizations was $100,000 but more than a fifth of the cases (for all entity types) amounted to at least $1 million.
- Frauds lasted a median of 18 months before being detected.
- Asset misappropriation was by far the most common type of occupation fraud, comprising 87 percent of cases.
- 77 percent of all frauds were committed by people working in one of six departments: accounting, operations, sales, executive/upper management, customer service and purchasing.
- Organizations with less than 100 employees were more likely to be the victim of fraud.

The report also reflected that the lack of strong internal controls contributed to over one third of the fraud cases analyzed. So the obvious solution to a major part of this problem is for all not-for-profit organizations to maintain a strong system of internal controls.

Internal controls are policies and procedures that protect the assets of an organization, create reliable financial reporting, promote compliance with laws and regulations, and achieve effective and efficient operations. These systems relate to accounting and reporting, and to the organization's internal and external communication processes. Internal controls typically include procedures for:

- Handling funds received and expended by the organization.
- Preparing appropriate and timely financial reporting to board members and officers.
- Conducting the annual audit of the organization's financial statements.
- Evaluating staff and programs.
- Maintaining inventory records of real and personal property and their whereabouts.
- Implementing personnel and conflicts of interest policies.

Effective controls are often simple, common sense approaches and do not require an elaborate process to implement. What is necessary is diligence in their design and execution. Also, the operation of the controls must be closely monitored to be certain there is compliance with the rules as established. We offer the following examples as strong concepts and practices to establish an effective internal control environment:

General Entity-Level Controls – Prepare an annual income and expense budget and periodic reports at least quarterly and preferably monthly. Actual receipts and expenditures should be compared to the budget with timely explanations of any variance.

Information Technology General Controls – Access to computer systems, inputting and changing electronic data maintained by the organization should be controlled. Preserving electronic records and ensuring data compatibility when systems change and creating an appropriate records retention policy are part of this process.

Segregation of Duties – Writing and signing checks or vouchers as well as receiving, recording, securing and depositing cash and other receipts should require the involvement of multiple people. Procedures should ensure that no single individual is responsible for receiving, recording and depositing funds, or writing and signing checks. These types of checks and balances are critical to reduce the opportunity for embezzlement. For example, the same person should not be responsible for handling cash receipts and preparing the bank reconciliations.

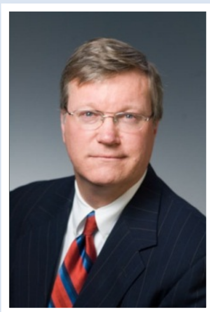
Sarbanes-Oxley Act – All not-for-profit organizations should establish a confidential and anonymous mechanism to encourage employees to report any inappropriateness within the entity's financial management. At the same time, organizations should develop procedures for handling employee complaints so that no punishment or repercussion to whistleblowers is permitted.

Revenue – Procedures to ensure that grants and contributions received are properly recorded. Grant reporting, as required as a condition of any grant, are completed and any restrictions on the use of such funds are appropriately followed.

Purchasing & Accounts Payable – Procedures require the requisition, authorization, verification, recording and monitoring of all expenditures, including payment of invoices, petty cash and any other expenditures. In addition, such procedures should ensure that no single individual is permitted to request, authorize, verify and record expenditures. Also, established procedures for approving contracts to which the organization is a party, including securing competitive bids from vendors are in place.

In conclusion, not-for-profit executives need to realize that they are not exempt from the reality that their organizations could well become the victim of fraud. However, a diligent web of processes and procedures sets the tone for a strong system of internal controls. Properly developed and executed, this can provide a tremendous deterrent or, at a minimum, bring potential fraud to light sooner rather than later.

About the Author



Bert Swain, Partner, Rockville, Maryland

Bert has over 30 years of experience serving the audit and accounting needs of clients across a wide range of industries. Bert plans and directs accounting and auditing engagements for the firm's not-for-profit clients, including single audits of federal and state grants and contracts (OMB Circular A-133). He has also written and lectured in the area of not-for-profit organizations, including his most recent publication, "A CPA's Guide to Management Letter Comments" published by CCH Incorporated.

Contact Bert: bert.swain@dhgllp.com | 240.403.3710

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