



FRAUD – COULD IT HAPPEN TO MY NONPROFIT?



October 10, 2024

TRY TO AVOID THIS TYPE OF HEADLINE:

CEO of Utah County-based nonprofit faces 32 felonies for alleged fraud

Alleged misconduct includes false representations to donors and using organization's funds for personal use including homes, cars, trips, etc.

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FRAUD TRIANGLE

The Fraud Triangle

Rationalization

- “I don’t get paid what I’m worth”
- “Everyone else is doing it”
- “If they don’t know I’m doing it, they deserve to lose the money”
- “I intended to pay it back”
- “Nobody will miss the money”

Opportunity

Internal controls:

- None in place
- Not enforced
- Not monitored
- Not effective

No segregation of duties

Too much trust

Poor “tone at the top”

Pressure / Motivation

External Pressure / Motivation:

- Debt, greed
- Lifestyle needs
- Life pressures

Internal Pressure / Motivation:

- Pressure to perform
- Too much work

FRAUD EXAMPLES

Washington, D.C. charity fraud

A nonprofit lost \$500,000 when it was discovered that its former chief financial officer wrote fraudulent checks to herself and forged her supervisor's signature on them. Her crime was uncovered when she resigned from her position and the new CFO discovered the missing checks.



Embezzlement of nonprofit that supports children & families

The director of political affairs embezzled over \$60,000 from this nonprofit that supports children and families. The employee made 83 personal transactions using the nonprofit's credit card.



Educational nonprofit payroll scheme

An employee used a payroll scheme to pay herself extra using the payroll system over a period of time. She ended up stealing \$xxx,xxxx.



Skimming cash from a small retail operation

An employee started skimming cash from the daily cash receipts and then replacing them with the next day's receipts. The intent was to eventually "pay back" the funds, but the scheme quickly got out of hand.



A family affair

Bob and Bill, brothers, owned a farm equipment business. After their wives retired from helping with the bookkeeping, they hired James, Bob's son, to handle all the bookkeeping duties which included accounts payable, receivables, payroll, account & bank reconciliations, check signing ability and company credit card. James soon got married and began a family. He quickly realized that it was getting harder to maintain the lifestyle he wanted and so it began.....

- Company credit card for personal purchases which gradually increased in size & frequency.
- Paid himself excessive overtime and for not taking vacation time even though he did.
- Writing checks to himself
- New personal credit card at same bank as business



COMMON TYPES OF FRAUD IN SMALL NONPROFITS

Common Types of Fraud

1 Skimming Schemes

2 Purchasing Schemes

3 Payroll Schemes



Skimming Schemes

- The intercepting of incoming funds intended for an organization. It is referred to as “off-book” because the money is stolen prior to it ever being deposited or recorded.
- Collecting cash at a fundraiser and not turning in all of the cash received.
- Depositing checks or directing credit card receipts to a different bank account in the name of the organization.
- Soliciting contributions and not passing them along to the organization.
- Outright theft of cash or assets.



Purchasing Schemes

- Abuse of organization credit or debit card for personal purchases.
- Expense reimbursements – misrepresenting personal expenses as business expenses.
- Writing organizational checks to pay personal bills.
- Shell companies – an entity formed solely for fraudulent purposes. Fake invoices are created and paid.
- Kickback arrangements – collude with a company to provide them business if they agree to pay a kickback.
- Pay-and-return – overpay legitimate vendors and then embezzle the overpayment when returned.



Payroll Schemes

- Paying more than one's salary, inflating overtime, unearned bonuses, or unauthorized holiday or vacation pay.
- Ghost employees – setting up a fake employee to receive wages.
- Embezzling withholding – earmarking the money for something but directing it somewhere else.
- Exploiting sick leave or jury duty

FRAUD RISK FACTORS



Organizational Factors

Weak internal controls: Many nonprofits do not have internal controls in place to help detect or prevent fraudulent activity.

Lack of oversight: Insufficient oversight from governing boards and management can provide opportunity for fraud.

Concentrated power: When few individuals have excessive control over the organization's finances, it increases the risk of fraud.

Complex financial transactions: These can be difficult to understand and monitor and make them more susceptible to fraud.



Financial Factors

Cash-intensive operations: Organizations that handle large amounts of cash are at a higher risk of theft.

Lack of financial reporting: Insufficient financial reporting can make it difficult to detect fraudulent activity.

Pressure to meet financial goals: Pressure to achieve unrealistic financial targets can lead to unethical behavior.

Employee Factors

Disgruntled employees: Employees who are dissatisfied with their jobs or feel unfairly treated may be more likely to commit fraud.

Lack of employee training: Inadequate training on fraud prevention and detection can increase the risk.

Lack of segregation of duties: When employees have too much control over financial transactions, it increases the risk of fraud.

FRAUD WARNING SIGNS

INDIVIDUAL SIGNS

Unexplained changes in lifestyle: Sudden changes in spending habits, vacations, or possessions.

Avoidance of supervision: Reluctance to work under supervision or share information.

Secretiveness: Being overly secretive about work or financial matters.

Defensive behavior: Becoming defensive when questioned about work or financial matters.

Vacation time: The employee is never taking any vacation time. Preventing other employees from finding what is going on.

Organizational Signs

Unusual financial ratios: Significant fluctuations in ratios or abnormally consistent financial ratios.

Budget to actuals: Actual expense amounts for multiple accounts being exactly inline with the budgeted amounts.

Unusual adjustments: A lot of adjustments being made at the last minute that significantly impact results.

Inflated revenues: Significant revenues in a year where such revenues were not expected.

Lack of transparency: Limited disclosure of financial information or resistance to inquiries.

Aggressive accounting practices: Using aggressive accounting methods to inflate profits or hide losses. Or multiple changes to accounting policies.

FINANCIAL STATEMENT LEVEL FRAUD

PREVENTING FRAUD



Employee Awareness

Ethics training: Provide employees with training on ethical behavior and the consequences of theft.

Fraud prevention awareness: Educate employees about common fraud schemes and how to report suspicious activity.

Incentive programs: Implement reward programs for employees who report fraud or misconduct. Provide an avenue to report such items (whistle blower hotline).



Controls Over Cash Receipts

- ✓ Divide responsibilities: Ensure that no single person has complete control over cash handling, recording, and reconciliation.

Separate cash handling and accounting: Assign different individuals to handle cash and record transactions.
- ✓ Regular rotation of duties:

Periodically rotate employees among different tasks to reduce the risk of collusion.

Cash Receipts

Daily cash counts: Require employees to count cash at the end of each shift and reconcile it with the register tape.

Regular reviews of financial records: Regularly review financial statements and reports for inconsistencies or unusual activity. Include review of AR aging.

Limit access to cash: Restrict access to cash drawers and safes to authorized personnel.



Controls over Cash Disbursements



Divide responsibilities: Ensure that no single person has complete control over the entire disbursement process.

Separate authorization, payment, and recording: Assign different individuals to authorize payments, make payments, and record transactions.



Cash Disbursements

Require supporting documentation: For each disbursement, require supporting documents such as invoices, purchase orders, and receiving reports.

Number and sequence documents: Assign a unique number to each document to track its progress and prevent duplicates.

Review for accuracy: Carefully review supporting documents for accuracy and completeness before authorizing payments.

Cash Disbursements

Establish clear approval limits:
Define specific approval limits for different levels of management.

Obtain necessary approvals: Ensure that all payments are authorized by the appropriate level of management.

Document approvals: Maintain a record of all approvals for future reference.



Compensating Controls

Reconcile bank statements:
Regularly reconcile bank statements with the general ledger to identify any discrepancies. A review should be performed over the bank reconciliation.

Monthly or quarterly review:
Management and the board should be performing a monthly or quarterly review of the organization's financial statements.



Controls that Don't Work



Reliance on Outside Parties



Two Signatures on every check

- Banks don't look at signatures on checks

Annual financial statement audit

- An audit isn't designed to detect 100% of fraudulent activity

Travel Expenses

Questions to consider in developing policy:

- What travel expenses are eligible for reimbursement (what types of expenses and for what purposes)?
- Are there standard reimbursement rates for travel (i.e. mileage rates, per diem rates, maximum lodging rates)?
- Is there a pre-approval process for travel outside of the local area?

Questions to consider in developing procedures:

- Who authorizes travel requests? Who authorizes travel requests for THAT person?
- What documentation needs to be maintained?

TRAVEL POLICY

EXPENSE REIMBURSEMENT

According to a report by the Association of Certified Fraud Examiners, 14 percent of all asset misappropriation schemes were from expense reimbursement. That percentage, however, increases to 25 percent for religious, charitable, or social services organizations. Although general expense reimbursement policies and procedures with related training are good anti-fraud controls, many organizations do not have a written travel policy in place. Even when they do, those organizations might not review it annually or train staff accordingly.

Employee Expenses

Questions to consider in developing policy:

- For what types of expenses can employees be reimbursed?
- What is the deadline for submission?
- Is there a dollar amount limit?
- Is pre-authorization required?

Questions to consider in developing procedures:

- What forms are used to request reimbursement and when are they submitted? How are late submissions handled?
- Who authorizes reimbursement requests? Who authorizes reimbursement requests for THAT person?
- How are reimbursement requests processed and distributed?

EMPLOYEE REIMBURSEMENTS





QUESTIONS?



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WE ARE HERE TO HELP!

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