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Nonprofit News

Strategic Nonprofit Alliance Partnership
Working Together To Build Stronger Communities

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Working Together To Build Strong Communities

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Fraud: It Can Ruin Your Day

Incidents of fraud are found in every type of industry, including nonprofit organizations, and have been perpetrated by all levels of employees and management. No company is inherently safe from fraud. The Association of Certified Fraud Examiners' 2004 Report to the Nation on Occupational Fraud and Abuse reported the following information on fraud.

The loss for nonprofit organizations is far more significant and longer lasting than any actual monetary loss. Nonprofit organizations typically suffer damage to reputation, loss of public trust, and alienation of donors.

Sector	Sector Percentage of Total Loss of Reported Fraud	Median Loss ($ Per Organization)
Nonpublic Companies	41.8 %	$123,000
Public Companies	30.3 %	$100,000
Government	15.8 %	$ 37,500
Nonprofit Organizations	12.2 %	$100,000

When fraud is exposed, nonprofit organizations typically suffer losses consisting of damage to reputation, loss of public trust, and alienation of donors.

Who Commits Fraud?

Research into the characteristics of fraud perpetrators has shown that they share more demographic characteristics, such as sex, age, religion, and education level, with the general population than with other criminals. They look and act like your average employee.

Why Do They Commit Fraud?

Typically, three conditions are present when fraud occurs; these include:

- *Incentive/Pressure.* Exists when an individual has a reason to commit fraud.
- *Opportunity.* Occurs when circumstances exist that allow an individual to believe the opportunity to commit and conceal fraud is present.
- *AttitudelRationalization.* Exists when an individual has the ability to rationalize committing a fraudulent act.

What Can We Do To Avoid Fraud?

It is management's responsibility to establish and implement internal control processes and procedures that will reduce or eliminate the opportunity to commit fraud. This article focuses on the steps that can be taken to reduce the opportunity for an employee to commit fraud.

The opportunity to commit fraud can arise when an employee is trusted too much or when internal controls are weak or nonexistent. Examples of specific internal controls include:

- **Financial and operating performance reviews.** Comparisons of current financial reports to budgets, prior year information or operating data can uncover significant differences from expected results.

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- **Independent checks.** Independent checks test another employee's work through such procedures as computer validation procedures, reconciliations or job rotation.
- **Separation of duties.** This is one of the most effective controls to prevent or detect misappropriation of assets. Areas lacking separation of duties often provide opportunity for theft. Whenever possible, incompatible duties should be performed by different employees.
- **Access and authorization controls.** Controls are designed to ensure that only appropriate employees can authorize transactions or access the organization's assets, documents and records.

When designing an internal control system or strengthening an existing control system, a series of steps can be followed. The basic steps generally include:

Step 1: Review the organizational level components of internal control and identify weak or nonexistent controls. The organizational level components include the control environment, risk assessment, communication, and monitoring.

Step 2: Identify assets susceptible to theft and risks that may result in fraudulent financial reporting. The first step in identifying fraud exposure is to identify which assets held by the organization are susceptible to misappropriation. Assets generally susceptible to misappropriation include cash, inventory, assets easily converted into cash, and readily marketable small equipment or fixed assets. The risk of significant fraudulent financial reporting occurring is often related to management's incentives and pressures, although characteristics such as organization size, complexity and funding sources can also have an influence.

Step 3: Review the organization's systems and procedures relating to the vulnerable areas and identify weak or missing systems and procedures. Once vulnerable areas have been identified, the next step is to review the organization's systems and procedures relating to these areas. Focus on how transactions are approved, initiated, recorded, processed and reported.

Step 4: Develop controls to reduce the risk of theft and fraudulent financial reporting in the vulnerable areas. The controls you develop can be either preventive or detective. Preventive controls are designed to keep fraud from occurring. Some examples of preventive controls include locking up the blank check stock, having someone independent of accounts receivable open the mail and prepare the deposit slip, using pre-numbered sales receipts and using a capital budget for fixed asset purchases.

Detective controls are designed to detect fraud soon after it has occurred. Some examples include having an independent employee reconcile the checking accounts within a reasonable period of time, having an independent employee review the accounts payable master list periodically to ensure only valid vendors have been added and conducting periodic surprise inventory counts.

The bottom line is an increase of checks and balances reduces the opportunity for fraud to occur. Nonprofit organizations should take care in order to avoid the irreparable and long lasting damage that the organization would suffer if fraud occurred.

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