



Thomas F. Blaney



Eliot Green

By Thomas F Blaney and Eliot Green

Fighting Fraud

A watchful board can stop a crime before it happens

A disgruntled employee in your nonprofit never seems to take vacation time. She's sloppy with her recordkeeping and procrastinates when pressed to show documents. When transaction files disappear, she's quick to blame a computer problem. Maybe she's telling the truth. Or maybe you've stumbled on to the warning signs of fraud.

Nowadays, it seems that the news is constantly bringing us revelations of embezzlement or misappropriation of assets at some corporation. These situations can come in various forms, from the omission of assets on a balance sheet to an act of fraud or theft by an employee. Nonprofit organizations aren't immune from fraud. The community has faced its share of embezzlement cases. These illegal acts can be as devastating to nonprofits as they are to corporations — maybe more so since they tarnish a nonprofit's all-important reputation. They can mortally wound a nonprofit's fundraising activities as well as its ability to attract and maintain qualified board members.

The majority of fraudulent transactions start small. In the accounting department, they often begin with pocketing petty cash or check-signing schemes. Most "fraudsters" become more comfortable as they commit more illegal acts. They begin to think they will never be caught. As time goes by, the frequency and magnitude of the fraud usually increases until the individual is caught or leaves the organization.

It's not always easy to spot fraud. But board members have a fiduciary responsibility to oversee the implementation of policies and procedures to protect and insulate their organization from fraud. They must also investigate any allegations against their nonprofit. A watchful board member can head off legal troubles by being aware of the "warning" signs of fraud.

Examples would include a disgruntled employee living above his means; an employee who never takes a vacation, possibly out of fear that she will be discovered while she is away; an employee

who, when confronted over irregularities, procrastinates with information or blames it on technical failures, like computers; unusual variances on monthly financial statements; and vendor addresses that are post office boxes.

In order to avoid potential embarrassments from embezzlements, there are certain policies and procedures all nonprofit organizations should have in place. These should include

- ◆ All checks should be signed by a board officer. If this is not practicable, then the treasurer could review the monthly check register.
- ◆ Checks should never be made payable to cash.
- ◆ On a test basis, a board member or a member of the finance or audit committee should review an unopened monthly bank statement and accompanying cancelled checks. Once or twice a year, this same individual should distribute the payroll checks.
- ◆ Petty cash should be kept to a minimum.
- ◆ Competitive bids should be received for capital projects; the submission of these bids should be in a sealed envelope opened in the presence of two management employees
- ◆ A board member should physically inspect work connected with major capital projects.
- ◆ Any change orders for major capital projects should be approved by a board member (preferably the president or treasurer).
- ◆ All employees should be required to take their vacations.
- ◆ The president or treasurer should review the executive director's expenses.
- ◆ Any write-offs should be approved in writing by the treasurer.
- ◆ The board, finance committee, or audit committee should meet annually with the auditors and address recommendations contained in their management letter.
- ◆ The organization should have directors' and officers' liability insurance as well as adequate employee dishonesty insurance.

Board members or executive directors who suspect fraud should notify their legal counsel immediately. No accusations should be made to a "suspect" until an investigation is completed.

Even after a fraud is discovered, some nonprofits don't go public with the information. They worry that negative publicity could ruin their organization. The employee is usually terminated and rarely is legal action taken. But this response may actually encourage fraud. Other employees might believe they have a free hand to take liberties. Also a leak to the public may well occur.

In addition to having clear policies and safe-guards, a prudent board will also be forthcoming with legal information. Fighting fraud is bad enough. Battling charges of a board cover-up can be disastrous.

Thomas F. Blaney is a partner with the accounting firm of Conroy, Smith & Co. He is also a certified fraud examiner. Eliot Green is a partner in the Corporate Department and Non-Profit Practice Group in its New York office.

Resources:

Preventing Fraud: How To Safeguard Your Organization by Andrew Lang and Tammy Ricciardella. BoardSource, 2001.

Leaving Nothing to Chance: Achieving Board Accountability through Risk Management by Melanie Herman and Leslie White. BoardSource, 1998.