



How Nonprofits Get In Trouble

When it comes to fraud at a nonprofit, most of us tend to think in terms of fraud committed *against* the organization (purchasing and disbursement schemes, cash receipt and accounts receivable scams, etc.).

But, intentionally or not, fraud is sometimes committed by the nonprofit organization. All it takes is one misleading statement to donors for your organization to find itself defending its good name against charges of fundraising fraud.

Whatever form it takes, fraud (or even an allegation of misconduct) can be devastating to a nonprofit, which depends on its unblemished reputation to raise funds and attract qualified board members and volunteers.

SAS 99 Turns Up The Heat

SAS 99 (officially, The American Institute of Certified Public Accountants Statement on Auditing Standards No. 99 "Consideration of Fraud in a Financial Statement Audit") casts an even more critical eye on fraud. Among other things, the standard re-emphasizes the role of nonprofit management and boards in preventing and detecting fraud. Under SAS 99, management's responsibilities for fraud prevention include:

- Setting the proper tone at the top by creating and maintaining a culture of honesty and ethics.
- Establishing and maintaining internal controls designed to prevent, deter and detect fraud.
- Adopting sound accounting policies.

SAS 99 also calls for auditors to exercise “professional skepticism” when auditing an organization’s financial statement. Under SAS 99, auditors are no longer allowed to “trust” a client just because it has never had an audit problem before. Among other things, auditors must “brainstorm” throughout the audit to critically evaluate how and where an organization’s financial statements might indicate or be susceptible to fraud (i.e., what would someone want to steal and how would they do it?).

Understanding The Fraud Triangle

SAS 99 also introduces the concept of the “fraud triangle,” which clearly identifies the three conditions that are typically present when fraud occurs:

- Incentive/Pressure
- Opportunity
- Rationalization

For example, a nonprofit employee with poor personal finances (e.g., huge credit card debts) might have the incentive/pressure to embezzle funds. Lax internal controls might provide the opportunity to dip into the till. And a relatively low salary and poor supervision might allow the employee to rationalize the misconduct (“They don’t pay me enough, and nobody seems to care what I do”). In addition to the elements found in the fraud triangle, the following situations also open the door to fraud:

- **Weak internal controls.** Any weakness in internal controls represents an opportunity for fraud to occur.
- **Collusion.** Collusion can overcome almost any control and thwart most generally accepted auditing procedures.
- **Lack of segregation.** The number one weakness in a system of internal controls is failure to segregate duties.

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Federal and state government impose extensive regulations on nonprofits — regulations that are easy to run afoul of via any of the following:

Financial reporting fraud — Overstating program expenses/understating fundraising and administrative expenses, charging unallowable costs to grants or inflating contributions.

Fundraising fraud — Making misleading statements to donors or noncompliance with restrictions.

Program reporting fraud — Misrepresenting program accomplishments or failing to comply with regulations.

Poor control of unsolicited donations — Failing to have controls in place so that unexpected funds (e.g., Tsunami relief) are not used fraudulently.

Tapping restricted funds — “Borrowing” restricted funds when cash flow is tight.

The Bottom Line

With sound financial controls in place, your organization should be able to not only detect fraud but also prevent it from ever happening in the first place. Bottom line: Establishing and maintaining these controls is management’s responsibility.

Uncover vulnerabilities in your systems and beef up your organization’s internal controls with help from our nonprofit accounting professionals.

Tips For Setting The Tone At The Top

SAS 99 re-emphasizes the role of nonprofit management and boards in preventing and detecting fraud. One way is to “set the tone at the top.” Here’s how:

- 1) Develop an organization-wide code of conduct.
- 2) Create and maintain a positive workplace environment.
- 3) Hire and promote individuals with high levels of integrity.
- 4) Identify and assess fraud risks and implement appropriate internal controls.
- 5) Take swift and decisive action against individuals who commit fraud.