

The Lindsey Letter



Take Aim at Fraud

Fraud 101

Financial dishonesty, be it embezzlement or fraud, when found within a major corporation usually leads to page one coverage, but the mere hint or evidence of wrongdoing within a nonprofit can cause irreversible damage to its reputation and a speedy withdrawal of donor support.

The dictionary defines fraud as an intentional act or omission designed to deceive and resulting in the perpetrator achieving a gain or the victim suffering a loss. Five years ago the Association of Certified Fraud Examiners (ACFE), issued a report stating, "...the United States economy loses approximately six percent of its Gross Domestic Product to fraud each year, or approximately \$600 billion." In the intervening years, fraud has continued to rise and last year U.S. employers lost close to a trillion dollars to various types of malfeasance.

The fact is that anyone presented with the opportunity, and having a perceived "need" for extra cash, can succumb to the temptation to steal. And too often, they do. This happens with churches, government funded institutions, hospitals and charitable organizations.

In general fraud occurs in one of the following ways:

Asset misappropriation — Includes everything from stealing cash to the use of the nonprofit's "corporate" credit card for personal items.

Fraudulent statements — An employee accesses manual or computer records to falsify payroll information.

Bribery and corruption — An individual with purchasing authority urges a consultant to submit fictitious bills, or an unsupervised volunteer is responsible for counting cash receipts at a fundraiser.

From a financial and fiduciary standpoint, leadership must ask, and get satisfactory answers to the following two questions: How vulnerable is my nonprofit to the preceding three basic types of fraud? What proactive measures can be taken to reduce the opportunity for malfeasance?

A good starting point is to get guidance and assistance from your external auditors.

Be on the Lookout for Conditions That Can Lead to Fraud

- Ensure timely bank reconciliations and checks and balances on all transactions related to asset acquisition and payment.
- Look for cozy relationships between staff and suppliers.
- Learn how to spot "lapping receivables", i.e. crediting customer B's payment to customer A's account to conceal that customer A's payment has been stolen.
- Run vendor addresses through an edit check to see if any match each other and/or employee addresses.
- Review the vendor list in your accounting system twice a year.

Ethics and the Nonprofit Organization

Ethical lapses—Regardless of whether they are real or perceived, can quickly undermine the public trust for the entire nonprofit sector.

If a story appears about nonprofit shenanigans, a typical organizational response is to promise an investigation, create a code of ethics, develop

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training programs for all employees, and perhaps seek some sort of third party endorsement/certification as an ethical organization.

Several years ago, GuideStar [www.guidestar.org] publicly stated, “Unfortunately, nonprofits are run by people with the same range of ethical standards as the rest of society.” They went on to point out organizations as prestigious as the Nature Conservancy, the Red Cross, and the United Way found themselves in the crosshairs of the media, due to questionable practices.

It may be a cliché today, but Harry Truman had it right when he said, “The Buck Stops Here.” The leaders of any nonprofit, i.e. the executive director, his or her officers, and the board of directors must set the standard because a clear and enforced code of ethics allows a nonprofit to focus on its mission and do the good works it is set up to do.

GuideStar maintains a broad and deep database on the administrative, program, and fundraising expenses of almost two million IRS recognized nonprofits. In addition to publishing and publicizing a wide range of detailed information on the programs and finances of nonprofits, it offers detailed guidance on formulating effective policies.

Why There are no Accurate Statistics on Nonprofit Fraud

Many frauds perpetrated against non-profits, even when discovered are not reported or prosecuted for one of more of the following reasons:

- an organization fears the effects of negative publicity if they file report on insider theft
- a nonprofit may be threatened with civil and criminal action by an offender. For example,

someone caught stealing may threaten to sue for defamation, false arrest, violation of privacy, wrongful termination and more.

- as workplace violence takes up residence on our radar screens, employers are understandably wary of prosecuting thieves who threaten personnel with bodily injury; and
- a nonprofit organization’s leaders have a difficult time taking appropriate action because they have a sense of compassion for the circumstances facing the embezzler.

The downsides to not prosecuting insiders, include:

- setting a precedent that could lead to additional fraud;
- creating an environment that spurs rather than deters fraud;
- loss of credibility and respect for the organization among employees and others; and
- lack of access to a crime policy — some, but not all crime policies, require that the insured prosecute employees and volunteers who steal.

A Few Fascinating Fraud Facts

On average, an organization loses about 6% of its total annual revenue or approximately \$9 per day per employee to fraud and abuse.

Losses caused by managers are four times those caused by employees and median losses caused by executives are 16 times those of other employees.

The most costly abuses occur in organizations with less than 100 employees.

Source: Association of Certified Fraud Examiners

And now a few words from...


“Some rob you with a six gun, some with a fountain pen.” Woody Guthrie

“A thief believes everybody steals.” Edgar Watson Howe

“Fraud and falsehood only dread examination. Truth invites it.” Samuel Johnson

“Fraud is the ready minister of injustice.” Edmund Burke

“There are three things in the world that deserve no mercy, hypocrisy, fraud, and tyranny. Frederick W. Robertson

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