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Fraud Exposure and Your Non-Profit Organization – Part I
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Performing an internet search, it is apparent that fraud is happening everywhere and to all types of organizations, especially to non-profit organizations. An Executive Director at a local non-profit told me last week that he was alarmed at the examples of fraud they provided at a recent industry conference he attended. After returning from the conference, he sat down with his Director of Finance to discuss these examples and review what controls their organization has in place to prevent the same types of fraud. As an auditor, I am thrilled to hear that my clients are monitoring their internal controls and discussing fraud, which is something that is all too often overlooked.

With government funding cuts, decreased donor contributions and other issues that non-profits are facing, there are plenty of other seemingly higher priority matters to occupy your efforts instead of thinking about the types of fraud that could occur at your organization. However, this awareness is fundamental for non-profit leadership. Fraud cannot only result in theft or monetary loss; but it can also be a red-flag for donors, governmental funders, and community members. As a donor, would you choose to give money to an organization affected by fraud?

Three of the most prevalent methods of committing fraud are through improper trade disbursements, improper payroll transactions and disbursements, and misappropriation of cash receipts. In this article, we will briefly discuss some general concepts and controls that should be considered and implemented to help prevent fraud at your organization. Over the next few months, we will provide a series of articles in which we will consider concepts and controls related to preventing improper vendor/trade payable disbursements, improper payroll transactions and disbursements, and misappropriations of cash receipts.

General Controls

- *Internal Control Documentation* – When we meet with a new client, we ask what type of documentation they have for their internal controls. Far too often, the Director of Finance will say that there are controls in place but they have not been documented or were documented several years ago and not updated. While this may not be a priority at many organizations, having detailed documentation of significant transactional and financial reporting processes along with a strong policies and procedures manual helps to train new staff, provide documentation for staff when cross-training for positions (an important control to prevent fraud), and provide expectations for staff as to their responsibilities. It also provides management a method for reviewing controls in place and identifying conflicting duties.

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The documentation of your controls should be reviewed by your auditors as they gain an understanding of your internal controls and processes in place for daily transactions. During internal control walkthroughs, your auditor can assess whether these controls are being adhered to in practice. This documentation should assess each financial reporting area (trade disbursements, payroll, cash receipts, investment/debt transactions, financial reporting, etc.) and should include all activity from start to finish. Considerations include:

- Who initiates the transaction?
 - What source documentation is used as the basis for the transaction?
 - Who records the transaction in the general ledger?
 - Who reviews and approves the transaction and how is this evidenced?
 - What reporting is prepared as a result of the transaction?
 - Who reviews that reporting?
 - How is the general ledger account activity monitored and what is the frequency of that monitoring?
 - Who has access to the software sub-ledger modules and general ledger module?
 - Are there any conflicting duties – for example does the person initiating the transaction also have custody of the asset and access to the reporting?
- *Policies and Procedures Manual* – Upon completion of the internal control documentation, the policies and procedures manual should be updated to provide job descriptions for the individuals responsible for the accounting function. It is difficult to prepare a complete policies and procedures manual without the internal control documentation as a starting point. As mentioned above, this manual can be used for cross-training employees and reducing the opportunity for fraud at your organization. It is important that the internal control documentation and policies and procedures manual are reviewed and updated if there are changes in personnel or if roles are modified to ensure that the changes are not resulting in new issues related to segregation of duties.

Proper Oversight – Even the best policies and procedures manuals cannot provide for strong controls if there is a lack of proper oversight. This includes supervisory review of journal entries, reconciliations, and approval of internal financial reporting. In a small organization with limited staffing, there are monitoring controls that can be implemented to address segregation of duties which will be discussed in subsequent articles. The “tone at the top” is key to preventing fraud so that employees know that their work is being reviewed and that management has an awareness of how the controls are functioning. Related to this, proper training is important to provide for all new employees so they understand their roles and responsibilities.

- *Do Not Rely on your Auditor to Identify Fraud* – Having an audit is not an internal control. Auditors are not permitted to function as an element of internal control and do an audit. Numerous reports and studies have continued to support the fact that organizations cannot rely on their auditor to identify fraud. Audit procedures are not designed to identify fraud; rather they are designed to identify material misstatements in the financial reporting by considering internal control, or the lack thereof, that then helps the auditor plan the extent of auditing procedures. Thus, it is necessary for management to take the necessary steps to prevent fraud. Additionally, your Board should be involved with reviewing controls and understanding what risks exist at your organization.

Our next article of this series will address controls and considerations in preventing improper trade payable disbursements.

If you have any questions related to assessing your internal controls, please contact Bob Stillman or Jennifer Osburn at 614.221.1120.