



.....  
**Fraud Exposure and Your Non-Profit Organization – Part II**  
.....

In our first article, we discussed the general internal control environment, including documenting and assessing the internal controls at your organization. Next, we want to look at specific financial reporting areas – vendor/trade payable cash disbursements, cash receipts, and payroll disbursements. This article will focus on the vendor/trade payable cash disbursements.

Your organization may have cash disbursements for different activities, including monthly recurring transactions such as utilities or rent, payments for services such as legal or accounting fees, and purchases of materials or supplies. These expenses occur at different times during the year, should require certain levels of approval depending on the type of expense, and should all be monitored for the controls surrounding these transactions. Some key considerations are included below.

**Vendor/Trade Payable Cash Disbursements**

- *Segregation of Duties* – This is probably the most important control that should be in place. As a reminder, the three areas of focus related to segregation of duties are 1) access to modify records or source documents, 2) authorization or custody of assets, and 3) reporting to those monitoring the Organization.

One person should not:

- 1) authorize invoices for payment,
- 2) process disbursements,
- 3) control access to blank check stock,
- 4) be an authorized check signer,
- 5) post transactions to the general ledger,
- 6) perform the bank reconciliation, and
- 7) prepare all financial reporting.

In order to not create an *opportunity* for a potential defalcation, these roles need to be split among more than one employee.

When suggesting improvements for internal controls for our clients, we often hear that the organization is too small or does not have enough employees to have appropriate segregation of duties. If you do have limited staffing, you will need to identify and implement appropriate controls.

It is important to consider the type of organization you are and the strengths of your leadership team. In some cases, your Executive Director may not want to perform much of a financial monitoring control or provide for the appropriate checks, thus it may be necessary to involve a board member such as the Treasurer or the Board Chairman. At smaller organizations, we often see a Business Office Manager or Accounting Manager having access to the check stock, preparation of the bank reconciliation, and responsibility for the financial reporting. If there is no review of the unopened bank statement or no monitoring of check stock, there is opportunity for fraud.

For smaller organizations, a few simple controls that are the responsibility of the Executive Director or a Board Member can provide for appropriate segregation of duties. For example, if you have an accounting clerk performing most duties, the Executive Director could:

- 1) review and sign all disbursements,
- 2) receive the unopened bank statement directly (with printed check images or cleared checks) to review for any unusual transactions or forged signatures,
- 3) keep a log of checks used to monitor any gaps in check sequence,
- 4) access the online bank activity and reviewing transactional activity monthly, if not more often.

These simple controls which do not take much time for the Executive Director would provide an additional layer of controls and function as a preventative control.

If you have more employees involved in this process, a tiered system of review may work better for your organization. For example, trade disbursements under a certain threshold could only require the accounting manager approval, the next level could require the approval of the Chief Financial Officer, and then higher amounts could require signatures of the Executive Director (live or check stamp) or even a Board Member.

- *Review of Purchase Orders and Support for Payment* – Using purchase orders is a strong control. This can be used to document that the purchase was approved prior to being ordered. If there was a bid process utilized, the purchase order can document that the bids were compared for the most efficient use of the organization's money.

Additional controls related to purchasing include:

- 1) Original invoices should be used for payment to make sure that the payment is only processed once.
  - 2) Matching the purchase order and invoice to ensure no duplicate payments occur.
  - 3) The invoice should be stamped as "paid" when done so and copies of invoices received should be noted as such so that it is evident that it is a copy.
- *Setup of New Vendors* – If the accounts payable clerk is authorized to set up vendors within your accounting system, consider creating a control that requires approval from a second employee. The second employee should be responsible for verifying the company exists, considering whether there is only a PO Box and not a physical address, and reviewing the legitimacy of the relationship with the vendor. Many fraud schemes are perpetrated with the accounts payable clerk creating a fictitious vendor and submitting fraudulent invoices for payments to those vendors.
  - *Electronic Fund Transfers* – An often overlooked area is the internal controls around electronic transactions. These should be considered when assessing the internal controls around physical or live checks. Similar to those controls, the person who can log into the bank account and either create a vendor or process an electronic payment can have other duties within the process, but the Executive Director or a Board Member should perform the appropriate supervisory review so that there are sufficient mitigating controls in place to prevent inappropriate payments. This is related to our prior comment about the Executive Director accessing and reviewing the online transactional activity on a regular basis.
  - *Other* – Consider positive pay for your organization. Using this system, your finance department provides a check register to the bank and the bank only allows those included checks to clear and post to the account. This could prevent a duplicate check or your check images being used for unauthorized disbursements not run through the payables system.

Our next article of this series will address controls and considerations in processing, recording, and collection of cash receipts, including trade receivable cash receipts and contributions.

If you are not confident with your segregation of duties, we can help you assess this. Please contact Bob Stillman or Jennifer Osburn at 614.221.1120.