

# FRAUD PREVENTION AND FINANCIAL CONTROLS

University of Oregon  
Nonprofit Clinic



# OBJECTIVES

Understand what fraud might look like in nonprofits.

Understand why fraud prevention matters for nonprofits.

Understand financial controls.

Understand how to assess financial controls and fraud risk for nonprofits.

Understand the role of this assessment in alerting organizations to fraud risk.

# FRAUD IN NONPROFITS: ISSUES

Informality

Lack of Knowledge and Awareness

Undue Levels of Trust

Unwillingness to Discuss Fraud Risks

Complex Revenue Streams

Highly Susceptible to Negative Publicity

# SKIMMING

Taking a little (or a lot of) money for one's self

- Checking Fraud
- Grant Embezzlement
- Cash Skimming

# SKIMMING

## **Difficult to detect when:**

No receivable is recorded on the books

No tangible exchange of goods or services with the payer

Cash is used as payment (especially when the two circumstances above are present)

# PURCHASING FRAUD

**The most common (and easily perpetrated) fraud:**

Abuse of a corporate credit card for personal purchases

Expense reimbursement schemes

Exaggerating or fabricating mileage expenses

Writing organizational checks to pay personal bills

Shell company schemes

# FINANCIAL REPORTING FRAUD

**Typically designed to conceal problems that would otherwise be noticed on the balance sheet:**

Misclassifying expenses as program to minimize overhead

Inflating the value of donated goods and services

Grossing up certain fundraising activities (events)



# A FEW EXAMPLES

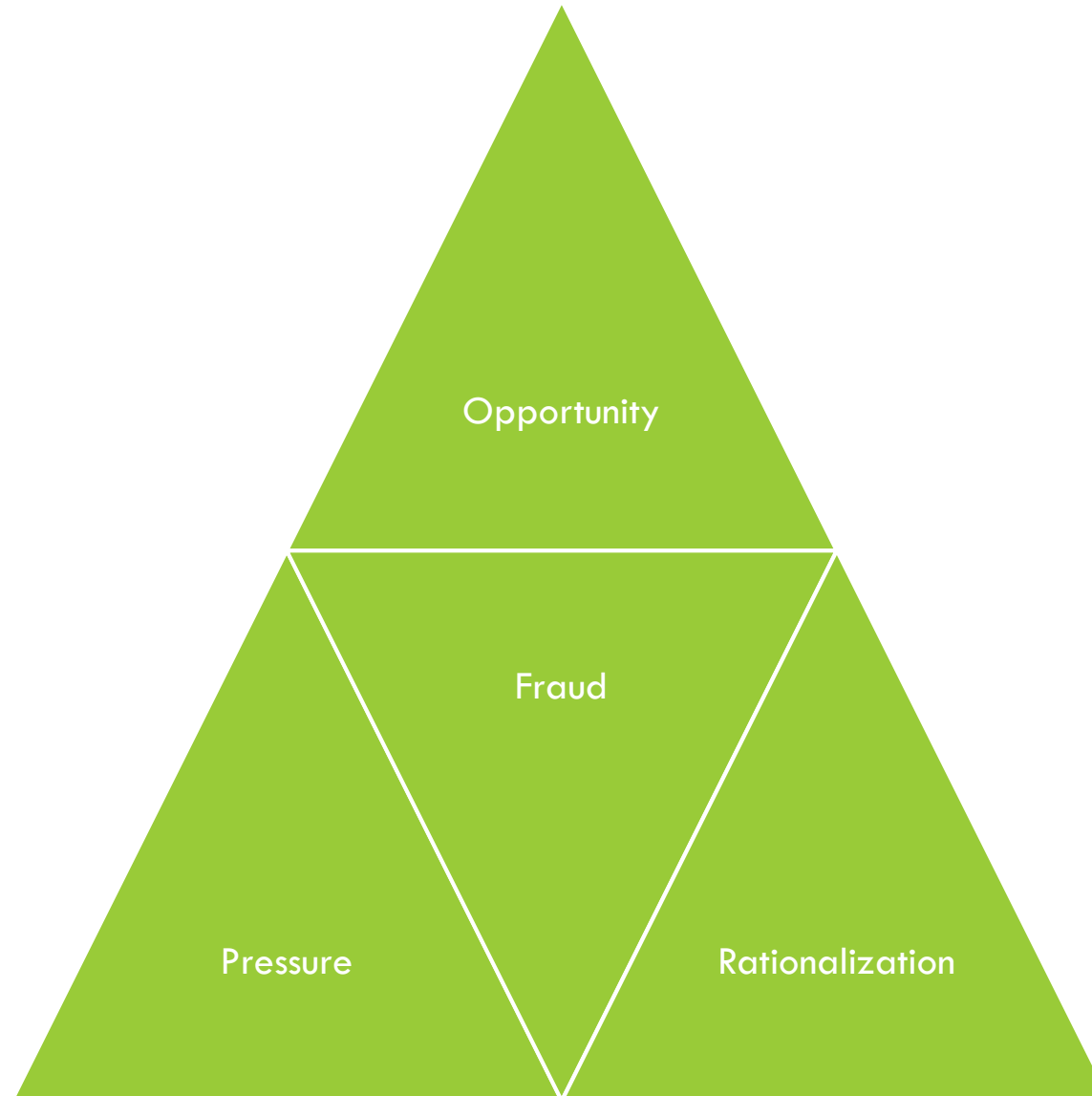
The Sweatpants Executive

The Great Escape

One for You, Two for Me



# FRAUD





# OPPORTUNITY

Indifferent Management

Ineffective Monitoring of Management (BOARD ROLE)

No Separation of Duties

Weak Internal Controls

# PRESSURE

Expensive Habits

Loss of Job in the Family

Excessive Debt

Never Takes a Vacation (may be hiding something!)

Unwillingness to Share Duties

Complaints About Pay, Autonomy or Authority



# RATIONALIZATION

Just Borrowing

They Owe Me

It's for the Good of the Organization

There's No Other Way



# FRAUD MATTERS

## **Consequences of Fraud in Nonprofits:**

Loss of Public Support

Closure

Litigation

Criminal Charges

Board Liability and Reputation

# FINANCIAL CONTROLS

*“Internal control is a process, effected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to **operations, reporting and compliance.**”*

*– COSO (Committee of Sponsoring Organizations of the Treadway Commission) Framework*



# THE FIVE COMPONENTS OF INTERNAL CONTROL

Control Environment

Risk Assessment

Control Activities

Information and Communication

Monitoring Activities

# CONTROL ENVIRONMENT

1. Commitment to integrity and ethical values
2. Independent board of directors oversees development and performance
3. Structures, reporting lines, authorities and responsibilities
4. Attract, develop, and retain staff
5. Individual accountability for internal control responsibilities



# RISK ASSESSMENT

6. Clearly specify organizational objectives
7. Identify and analyze risks
8. Consider potential for fraud
9. Identify and assess significant changes internal and external to the organization that may pose risk

# CONTROL ACTIVITIES

10. Select and develop control activities that mitigate risks
11. Select and develop general control over technology to support achievement of objectives
12. Deploy control activities with policies and procedures

# INFORMATION AND COMMUNICATION

13. Obtain and use relevant quality information
14. Internally communicate information
15. Communicate with external parties

# MONITORING ACTIVITIES

16. Select, develop and perform evaluations
17. Evaluate and communicate deficiencies to parties responsible for taking corrective action

# LIMITATIONS OF INTERNAL CONTROLS

Suitability of objectives

Human judgement and decision making is faulty and subject to bias

Errors and other human failures

Ability of management to override internal control

Ability of management or other personnel to circumvent controls through collusion

External events

# YOUR ROLE AS AN ASSESSOR

Start with this question:

“Do you undergo a GAAP (Generally Accepted Accounting Principals) compliant audit annually or on a regular basis?”

If YES: review their policies and look for gaps, but don't get in the weeds about it

# YOUR ROLE AS AN ASSESSOR

If NO:

Review their policies and procedures (if extant) and look for gaps

Ask questions to assess their awareness of risk

If awareness is low, ask further questions to address any symptoms of fraud potential

# YOUR ROLE AS AN ASSESSOR

## **Artisanal Question Tip:**

When you see a doctor because you're sick, the doctor doesn't ask you, "Do you have pneumonia?" Rather they ask you about your symptoms. Focus on symptoms, ask questions there.

To mix metaphors, you're a detective, not an interrogator.



# YOUR ROLE AS AN ASSESSOR

## **Corporate Lingo Pro Tip:**

Policies: **What** is expected by way of behavioral or performance standards.

Procedures: **How** to appropriately achieve the expected outcome defined in the policies.

# RESOURCES:

[“Nonprofit Fraud is a People Problem so Combat it with Governance.” Gerry Zack and Laurie De Armond, Nonprofit Quarterly, June 14, 2015](#)

[“Internal Control – Integrated Framework, Executive Summary.” COSO, May 2013](#)

[“How to Spot Financial Fraud in a Nonprofit: 2 Warning Signs.” Steve Mariotti, Huffington Post, August 15, 2014](#)

[“Violation of Trust: Fraud Risk in Nonprofit Organizations.” Jonathan T. Marks and Pete A. Ugo, Nonprofit Risk Management Center, August 2012](#)

[“Nonprofit Embezzlement: More Common and More Preventable Than You Think.” Jan Masaoka, Blue Avocado, November 14, 2008](#)