Best Practices to Mitigate Nonprofit Fraud

A McCann Investigations White Paper

ABSTRACT

Like any other organization, for profit or not, nonprofit organizations are prime targets for unscrupulous volunteers and employees to take advantage of and steal from. In some ways, nonprofit organizations are easier targets than their for-profit counterparts. Many nonprofit organizations rely on volunteers, who often are tasked with multiple positions, to ensure the donations and earnings are spent in-line with the organization's goals. This situation sets the stage for serious risk of embezzlement, as well as potential tax liability problems.

Best Practices to Mitigate Nonprofit Fraud

Nonprofit Organizations have a wonderful history in our country and are an integral part of the American (and the world's) social safety net. Studies suggest there are over 1.5 million not for profit charitable organizations in the United States and that Americans give these groups more than 300 billion dollars. One might think that because these groups are staffed mostly by volunteers who want to help their fellow man, the contributions collected would be safe from theft or misappropriation. Unfortunately, that's just not true. Like any other organization, for profit or not, nonprofit organizations are prime targets for unscrupulous volunteers and employees to take advantage of and steal from. In some ways, nonprofit organizations are easier targets than their for-profit counterparts.

Normal companies have one main goal in mind, and that is maximizing profit through maximum efficiency. These companies pay employees and outside auditors to guarantee their money is being spent effectively and efficiently. Conversely, many nonprofit organizations rely on volunteers, who often are tasked with multiple positions, to ensure the donations and earnings are spent in-line with the organization's goals. This situation sets the stage for serious risk of embezzlement, as well as potential tax liability problems. If nonprofit organizations would take several simple measures, that risk could be mostly eliminated. Below are some best practices for nonprofit organizations to follow to ensure the financial health of their organizations.

Written Policies

While many in the business world take having written policies for granted, many small and medium sized nonprofit organizations lack sufficient written policies to cover even the most basic of tasks. Without written policies, not only do members not know what expectations there are on fulfilling their responsibilities, but there is also the added problem of being unable to prove prior-notice when it comes to member separation, or civil and criminal processes. The most important of these policies would be those covering the collection, handling, and distribution of organizational funds.

Membership Screening

Most nonprofit organizations are understaffed due to the mostly volunteer status of its membership and officers. These groups are normally just happy to have enough people willing to be involved to staff all necessary positions. This situation often leads to individuals filling multiple positions with little to no ongoing oversight. To combat the potential risk of this situation, nonprofit organizations should require all members who come into contact with any contributions or distribution of funds to go through a thorough criminal and civil background checks. These background checks should be required to be rerun on an annual or semi-annual basis to ensure the integrity of their members or officers in sensitive positions.

Expenditure Oversight

Many nonprofit organizations require dual signatures for expenditures over a certain amount. While this can be an effective way to mitigate embezzlement, it doesn't guarantee the two people tasked with approving expenditures won't collude to misappropriate larger amounts. To decrease the risk of this, nonprofit organizations should require not only multiple signatures, but also a vote of the leadership to approve expenditures over a certain amount. The involvement of more people decreases the risk of collusion.

Approved Vendor List

Every nonprofit organization should have an approved vendor list, or list of companies with whom they often do business. Any expenditure of funds to anyone other than approved vendors should require a vote of the leadership team. There could also be an amount along with this requirement that should be kept under $50. Along with this, there should also be a policy against any vendor being associated with anyone on the membership team.

Bookkeeper Independence

Unlike most businesses that have multiple layers of oversight, most nonprofit organizations have a single paid bookkeeper that reports directly to the head of the organization. This situation sets up a serious risk of embezzlement by the head of an organization through intimidation of an often meagerly paid employee. To combat this, nonprofit organizations should require all bookkeeping and accounting to be done by outside contractors who report to the entire leadership team, and not just one or a few select people. Another important aspect of bookkeeper independence, is that the bookkeeper and/or accountant should have a direct conduit to the organization's parent organization (i.e. state leadership, regional leadership, national leadership).

Cash Receipt & Deposit Reconciliation

Most nonprofit organizations collect at least some of their funds in the form of cash. Because cash is relatively untraceable once it has been misappropriated, nonprofit organizations must take steps to reduce the risk of cash being stolen. The best way to account for cash is to require receipts to be generated on all cash transactions at the time of collection with a copy kept for the organization. These cash receipts should be used at the end of the day to reconcile with the actual cash on hand. All cash should be deposited into the bank no later than the next day with the deposit slip and daily reconciliation provided to the bookkeeper for proper accounting. When practical, the collection of cash should be limited to as few people as possible.

Financial Accountability to Membership

In regular companies, leadership has a responsibility to provide financial information to the board of directors and shareholders. For nonprofit organizations, the leadership team serves as the board of directors and the membership serves as the shareholders. The bookkeeper or accountant should be required to present a profit and loss statement to the membership at regular interval, preferably monthly. Along with the profit and loss statement, the bookkeeper or accountant should also provide a detailed bank statement to be viewed (and questioned) by membership at these meetings.

Annual External Audits

Just like in business, nonprofit organizations should require annual external audits of their financial records. This will not only provide another layer of oversight, but also assist in maintaining the integrity of the organization's tax status.

Term Limits on Leadership

Most fund misappropriations start out as small-time embezzlement and slowly snowball into much larger schemes involving multiple avenues of fraud. To combat this natural evolution of fraud, the members of the leadership team with account signature authority should have limits on their terms of service.

Punishment for Criminal Behavior

Many times when a nonprofit organization discovers minor misappropriations of funds by someone, there is a tendency to keep it secret from general membership or law enforcement. There are a myriad of reasons why this occurs, but in the end it only foments future criminality with no expectation of punishment. Studies have shown that the single largest deterrent to fraud is the expectation of being caught and punished. Therefore, every nonprofit organization should have a zero tolerance policy requiring dismissal and prosecution for any criminal breach of responsibility with the organizations funds.

Thorough Investigation of Misappropriations

Studies have shown that when a fraud is discovered, it is rarely the only fraud and the amount diverted is usually much higher than originally thought. Once a nonprofit organization suspects someone in their ranks is defrauding the organization it is imperative to conduct an independent investigation. A competent private investigation will ensure the totality of the methods and amount of the fraud are uncovered and documented.

A thorough private investigation can also ensure proper documentation for tax reporting of the fraud, as well as maximize the chances for a successful civil recovery of lost funds. Another important aspect of hiring of a private investigation firm is packaging for criminal prosecutions.

Financial related crimes are often very complex in that they consist of sometimes overwhelming documentation, and a multitude of possible aspects of fraud. There is also a very large ratio of financial related crimes to the amount of law enforcement resources allotted to investigate such crimes. Put simply there are too many fraudsters and not enough criminal investigators. Because of this, cases that are thoroughly investigated, documented, and packaged prior to criminal referral will maximize the chances that the case gets the attention it deserves and is successfully prosecuted.

While the above measures are most applicable to small to medium sized charities, it is also useful in larger charities with a widely dispersed franchise (i.e. Boy Scouts, American Legion, Masonic Lodges, etc). In the end, there is no way to 100% guarantee that someone won't take or use a nonprofit organization's money for their own personal gain. An organization can only minimize the risk, and then take steps to ensure quick discovery, thorough investigation, and successful civil & criminal prosecutions.