The Case for Internal Controls, Reducing Fraud is Easier than You May Think

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The core of any organization's fraud-prevention program is strong internal controls. Yet too many nonprofits either fail to develop controls that address common risks or, if they establish controls, neglect to enforce them. Your nonprofit must do both if it wants to help prevent occupational theft and fraud perpetrated by outsiders.

Charities at Risk

According to the Association of Certified Fraud Examiners (ACFE), billing fraud, check tampering and expense reimbursement fraud are the three most common types of employee theft found in religious, charitable and social service organizations. But proper segregation of duties — for example, assigning account reconciliation and fund depositing to two different staff members — is a relatively easy and effective method of preventing such fraud.

For all types of organizations, such controls as strong management oversight, regular audits and confidential fraud hotlines are associated with decreases in financial losses. The ACFE has found that proactive data monitoring and analysis is the most effective means of limiting the duration and cost of fraud schemes — 50% shorter and 60% smaller than organizations that don't monitor data.

Getting Priorities Straight

Most nonprofits have at least a rudimentary set of controls, but employees bent on fraud can usually find gaps in the fence. For example, charities tend to devote the lion's share of their budgets to programming and can be stingy about allocating dollars to enforcing internal controls. This can be especially problematic when the "tone at the top" is lax and executive directors or board members indicate that preventing fraud is low on their priority list.

Nonprofit boards may also inadvertently enable fraud when they place too much trust in the executive director and fail to challenge that person's financial representations. Unlike for-profit companies, nonprofit boards may lack members with financial oversight experience, which means they may miss important warning signs that something is amiss. Trust is an Achilles' heel throughout many nonprofits. Organizations often regard their staff members as family and skip such important fraud-prevention measures as conducting background checks. In some cases, managers are allowed to override internal controls without recourse and volunteers are trusted to accept cash donations or keep the books without the oversight of a staff member — both very risky activities.

Send the Right Message

How nonprofits deal with perpetrators can also increase their fraud risk. A reputation for honesty and fiscal responsibility is any charity's bedrock. So it's not surprising that many organizations choose to quietly fire fraud perpetrators and sweep such incidents under the rug.

Unfortunately, such actions encourage fraud by telling potential thieves that the consequences of getting caught are relatively minor. And even if an incident is hushed up, it could fuel insidious rumors that do more reputational damage than publicly addressing the issue head-on would. It's better, therefore, to file a police report, consult an attorney and inform major stakeholders about the incident and what you're doing to prevent it from happening again.

Cover all Bases

Internal control policies should address both common fraud risks and those specific to your organization, its mission and constituents. To ensure you cover all the bases, work with knowledgeable advisors.

For more information on BPM's Nonprofit services, please visit our website or contact Daniel Figueredo at (415) 288-6284 or Shannon Silverman at (408) 961-6308.