NONPROFIT TRENDS

ADDRESSING THE ISSUE OF OCCUPATIONAL FRAUD AT YOUR NOT-FOR-PROFIT ORGANIZATION

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If asked, most of us can easily identify two certainties in life: death and taxes. However, for accountants and management teams, there is one more certainty: fraud. This article addresses some of the challenges faced by not-for-profits (NFPs) and organizations in general, on the issue of fraud and its potential impacts, and offers some advice on what to do about it. While the article's main focus is on one type of fraud – fraud perpetrated by employees or occupational fraud – many of the points and conclusions have broader applications.

NFPs are Unique

Not-for-profit entities may be especially exposed and vulnerable to fraud. There are different types of NFPs, but they usually share at least one factor: they are program-driven rather than bottom-line oriented. Many NFPs address their program-based objectives by, for example, emphasizing how they help the less-fortunate, reduce pollution or increase awareness about a specific health issue. After all, NFPs' ability to successfully communicate and promote their causes often makes the difference between receiving or losing donors' support. However, it is also critical for management teams to be attentive to other operational components, including financial and internal controls, particularly fraud prevention.

Fraud occurs in all types of organizations and has profound economic impacts. NFPs are extremely vulnerable to fraud due to their typical dependence on donors who don't want their contributions to go to waste. In today's world of 24/7 news, social media, and network interconnectivity, it is easier than ever for existing and potential donors to find out about NFPs' "blunders." Thus, any publicized issue of fraud and inappropriateness will negatively affect how donors see that organization managing its resources.

Fraud is Costly

A recent global study on occupational fraud, conducted by the American Institute of Certified Fraud Examiners (AICFE), found that a typical organization loses approximately 5% of revenue in any given year as a result of fraud. In addition to the direct monetary loss, other negative consequences of occupational fraud include:

- Decreased employee morale
- Lost productivity
- Replacement costs
- Investigation costs
- Potential governmental reviews/investigations
- Increased audit costs
- Increased insurance costs

The AICFE study examined how various industries are affected by different types of fraudulent cases. It uncovered that the most common occupational frauds within the not-for-profit industry include: billing schemes, check tampering and expense reimbursements. Approximately 15% of reported fraud cases involved health care, education, religious, charitable and social service companies.

Employee Red Flags

The study also found that most occupational fraudsters tended to be first-time offenders. However, this is partially because in over 40% of cases, the victim organization decided not to refer their fraud cases to law-enforcement. Although arriving at a precise profile of a fraudster is impossible, there are some typical employee red flags:

- Lifestyle changes: expensive cars, jewelry, homes, clothes, etc.
- Significant personal debt and credit problems
- Behavioral changes indicating possible drug, alcohol, gambling addiction, or fear of losing job
- High turnover, especially in areas vulnerable to fraud (such as bookkeeping)
- Refusal to take vacation or time-off/refusal to train other staff

There are also various work environment and organizational "red flags" that may indicate a higher likelihood of fraud:

- Executive management does not care about or reward good behavior
- Poor training and promotional opportunities
- Staff receiving poor feedback and lack of recognition for job performance
- Perceived inequities in the organization
- Low organizational loyalty or feelings of ownership
- Lack of clear organizational responsibilities/poor segregation of duties
- An organization paying more than the best price available to certain vendors/service providers
- Very specific requirements that tend to favor one bidder/service provider
- Projects that are broken into two contracts to circumvent review limits or approval authority

Fraud Prevention Starts from the Top

The AICFE study concluded that organizations that implemented internal controls experienced both quicker detection and lower fraud losses. Preparation is key, and the first step is to take fraud and security aspects seriously, starting from the top.

Management's view on fraud is crucial, and understanding potential exposures should be a team effort. For example, as the effectiveness of many anti-fraud tools depends on employees, the human resource department should be actively involved in the process, specifically with measures such as: employee background checks, anti-fraud training, employee exit interviews, review of compensation structure, and improving work environment. Other low-cost controls that are effective include:

- requiring mandatory vacations
- ensuring appropriate rotation of duties/cross-training
- establishing a tip hotline to confidentially report potential issues within an organization
- enforcing computer controls (along with the proper personnel limits)
- establishing checks and balances and independent verifications

To properly address the organization's unique needs, management should perform an enhanced fraud risk assessment specific to their operations. Entities that are prepared with active plans (both for fraud prevention and mitigation) in place and ready solutions are much more likely to prevent fraud, as well as survive any potential negative publicity.

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