

## **Minimizing financial fraud**

### *It's easier than you might think*

When the Ethics Resource Center (ERC), a nonprofit, nonpartisan organization that researches ethics in organizations worldwide, talked to employees in nonprofits, they uncovered some very good news: Nonprofits “exhibit stronger ethical cultures” than government entities or corporations, and their employees are more likely to report misconduct.

But the ERC also reports bad news: Illegal and inappropriate conduct is increasing within nonprofits, boards are taking less responsibility for setting the ethical tone of organizations and financial fraud is still more prevalent in nonprofits than in the for-profit business world or government. How can you increase the good news and reduce the bad from your nonprofit?

### **The process solution**

Your first line of defense against financial fraud is establishing sound accounting processes that provide appropriate internal controls. At its most basic, this means you must divide and conquer. Several employees should be involved in processing donations and other incoming funds. For example, the person opening mailed donations should be different from the person responsible for making bookkeeping entries and depositing checks. By separating duties, you reduce opportunities for cash to disappear without at least one employee’s knowledge. Another way to prevent missing money is to use receipts with preprinted tracking numbers so that all of them can be accounted for.

Also establish and enforce guidelines for incurring expenses so that money is spent appropriately and within pre-existing parameters. Every incoming invoice should be reviewed by the person who instigated it, to confirm that the goods or services being billed for were actually received. Again, it’s important to separate payment duties. The person authorizing a purchase shouldn’t be the one who also writes the check. And multiple signatures should be required on large expenditures.

Occasionally auditing your processes will help ensure your employees are following set guidelines and that no gaping loopholes exist. Your CPA can help you study internal practices and identify areas where additional structure might be required and how to implement it.

## **The people solution**

It's possible to curb fraudulent behavior before it even walks in the door. Carefully screen applicants for positions that involve access to and control over cash, donor records, and other sensitive materials. Background checks are a must, as is calling all applicant-provided references and previous employers. Anyone you plan to entrust with financial information needs to be thoroughly vetted.

You can also use behavioral interviewing techniques when screening applicants. A typical behavioral technique is to ask questions that require applicants to tell you how they have handled or would handle certain scenarios. For example, you might ask a job candidate, "Tell me about your process for handling accounts receivable" or "What would you do if you thought accounting records were being kept inaccurately?"

Finally, supervise all employees appropriately. No one should ever be in a position to make decisions or take actions without accountability.

## **The prosecution and publicity solutions**

If, despite your best efforts, your organization becomes victim of fraud perpetrated by an employee, don't sweep it under the rug. Pursue all applicable employment consequences and potential criminal charges.

According to the Association of Certified Fraud Examiners, many nonprofit groups are reluctant to fire or prosecute employees involved in theft, fearing it will generate bad publicity. That's the wrong attitude to have. Although you could experience some negative fallout, it's far more important to reassure your audiences that your nonprofit responds to fraud swiftly and appropriately. You're more likely to be judged by your reaction to the situation than its occurrence, so show that you're working to preserve the organization's integrity.

Plus, when you take action against someone who's committing financial fraud (or any other kind of inappropriate behavior) it sends an unmistakable message to employees that misconduct won't be tolerated. That kind of internal publicity can be a powerful deterrent. What's more, it reinforces the ethical culture you want to instill.

## **A multifaceted solution**

Financial fraud takes many shapes, so it stands to reason that your defenses against it should be multifaceted as well. Put the right controls in place, build a culture with zero tolerance for fraud and take corrective action when your organization experiences a breach, and you'll be more likely to avoid becoming a statistic.