



Agenda

- Group Check
- What is Fraud?
- Examples of Fraud
- What do we need to know?
- What we can do to reduce Fraud?
- Questions and Discussion



Group Check: How many state associations have

- no professional staff?
- Less than 1?
- 1 to 3?
- Over 3?
- Outsource some or all administrative functions?



Rename presentation: Checks and Balances:

Why Associations Need to Be Vigilant!



Miriam-Webster's *Dictionary of Law*

 Fraud: any act, expression, omission, or concealment calculated to deceive another to his or her disadvantage



The American Dictionary of the English Language

 Fraud: A deception deliberately practiced in order to secure unfair or unlawful gain; a piece of trickery; a swindle; a cheat; one who assumes a false pose; an imposter; a sham



Microsoft Thesaurus

 Fraud: deception, scam, con, scheme, swindle, racket, hoax, smoke and mirrors



Misconduct and Dishonesty includes but is not limited to:

- theft or other misappropriation of assets
- misstatements and other irregularities in company records
- Wrongdoing
- forgery or other alteration of documents misapplication of funds or assets
- impropriety with respect to reporting financial transactions destruction or disappearance of records or assets



A language has many words to describe that which is commonly found

- The Intuits have over 150 words for snow, but few for "car"
- Think how many words are in the English language to describe fraud.











The Not-for-Profit Sector as a Target of Fraud

- \$665 billion in revenue
- 9% of all workers are employed within the sector (nearly 12M people)
- 65 M volunteers



Volunteer Boards

- May bring a significant amount of valuable experience to the organization, but often have limited financial backgrounds
- Results in reliance on the executive director, controller or accounting supervisor to make the board aware of any financial concerns



Why Small Organizations are Especially Vulnerable to Fraud

- The person responsible for collecting and disbursing funds is also the individual who provides the financial reports
- Many small organizations raise much of their funds in cash. Cash is more easily misappropriated than checks



Financial Restraints

- It can be very difficult to adequately segregate incompatible financial functions, such as purchasing and payments
- supervision and monitoring activities are often limited



Not-for-Profit Culture

 The culture in a not-for-profit is one of trust

"It won't come up...."

The Carrot Seed, Ruth Krauss





Not-for-Profit Culture, cont.

 This trusting environment is what a dishonest employee exploits



In a 2006 study of occupational fraud cases

 13.9% of all frauds occurred in the not-for-profit sector



Not-for-Profit Fraud Losses

- Not-for-profits have the second highest median loss (\$100,000 per fraud occurrence) of the organizations studied
- 45.8% of the frauds occurred in organizations with fewer than 100 employees, with a median loss of \$98,000.

Report to the Nation on Occupational Fraud and Abuse
Association of Certified Fraud Examiners



Duration of Fraud Schemes

- Median length of time before discovery = 18 months
- More than 13% lasted 5 years or more
- Only 3.4 % detected within one month



The Impact of Fraud may include:

- the actual financial loss incurred
- cost of investigation
- Cost of Litigation
- damage to the reputation of organization and employees



Impact of Fraud, cont.

- loss of customers
- damaged relationships with contractors and suppliers
- damaged employee morale
- loss of employees
- negative publicity

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Fear of Negative Publicity

- Charities have a strong motivation to keep stories involving theft, embezzlement, and mismanagement of charitable funds off the front pages
- Fear of effecting future contributions and grants..



Group Check: How many state associations have experienced a fraud?

- How many organizations think you may be vulnerable for a fraud?
- How many state associations are "pretty sure" a fraud cannot occur in their organizations?
- How many are certain you are "fraud-proof"?



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Salvation Army

 The onetime financial manager for the charity's Newark office was sentenced to 37 months in prison for stealing \$385,000 from the Salvation Army

Newark Star-Ledger, November 7, 2006.



Orange County Arts Center Embezzler Sentenced

- An employee of the Orange County Performing Arts Center was sentenced to 10 years in prison for embezzling \$1.85 million
- The scheme was perpetrated over a five-year period, with the bulk of the proceeds being used to finance the employee's gambling activities.

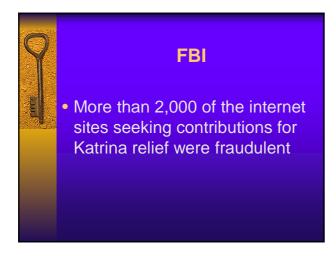
LA Times, Mar. 28, 2006.



Red Cross Quietly Settles Case of a \$120,000 Theft

- The Connecticut chapter of the American Red Cross settled for less than half the money stolen
- Payment from its insurance company
- Rather than pursue the full amount through litigation
- Wanted to avoid the bad publicity that would come with litigation.

April 28, 2006









Asset Misappropriation

- the most common form of not-for-profit fraud (97%); 95% in cash
 - Skimming stolen before it is recorded
 - Larceny stolen after it is recorded
 - Fraudulent disbursements entity pays an expense it does not owe



ASHA Mailroom

- Skimming taking checks from envelopes, changing the payee name
 - Mailroom Temps



ASHA Travel Disbursements

- Larceny stolen after it was disbursed
 - Accommodated a staffer's expressed financial need
 - Allowed exception to travel documentation policy



Credit Card and Expense Reimbursement

- Fraudulent disbursements
 - Affiliated entity
 - Submitted reimbursement requests (with receipts) for amounts already charged to corporate credit card
 - Charged personal items to corporate credit card



And those are just a few of the ways of fraud.....

"Let me count the additional [sic] ways..."

Elizabeth Barrett Browning

#1 Cause of Fraud in Not-for-Profits: Fraudulent Billing Billing schemes (submitting or altering an invoice) causing a check to be written • fictitious vendor • collusion with a dishonest vendor • Payroll - overstated hours or ghost employees









Financial Statements

- A not-for-profit's financial performance and status are captured in 3 primary statements:
 - Statement of Activity (Income Statement)
 - Statement of Financial Position (Balance Sheet)
 - Statement of Cash Flows



Income Statement:

- measures financial performance (over a period of time)
 - Revenue
 - Expense
 - Net Income (loss)



Income Statement: Revenue

- Earned as a result of providing goods or services
 - Examples: Dues, Convention registration
- Also, Investment Income



Income Statement: Expense

- Incurred as a result of consuming goods or using services
 - Examples: Personnel, Travel, Supplies, Services, Rent, and Utilities



Income Statement: Net Income (loss)

- + Revenue
- Expense
- = Net Income (loss)



Balance Sheet: Financial Position

- At a point in time
- Assets
- Liabilities
- Net Assets



Balance Sheet: Assets

- Something of value owned by or owed to the entity
- Provides future benefit to the entity
- Examples:
 - Cash, Accounts Receivable, Prepaid expenses, Investments, Land, Building, and Equipment



Balance Sheet: Liabilities

- Obligations of the entity
- A promise to pay in the future
 - Examples: Accounts Payable, Mortgage Payable
- or, a promise to provide goods or services in the future
 - Examples: Deferred Dues, Deferred Subscription Revenue



Balance Sheet: Net Assets

- + Assets
- Liabilities
- = Net Assets,
 aka "Net Worth"

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Financial Statement Misstatement (Fraud)

- overstating revenue (largest losses)
- understating liabilities or expenses
- recognizing revenue or expense in the wrong period
- reporting assets at more or less than the actual value
- failing to disclose significant information



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Corruption

The wrongful use of influence in a business transaction to procure benefits for one's self or others at the expense of one's employer.

- Bribes cash is paid to aid in the fraud
- Rewards improper gifts given/received after the fraud
- Extortion asset obtained by force of the threat of force
- Conflicts of Interest one party to the transaction is not independent



United Way of America

William Aramony

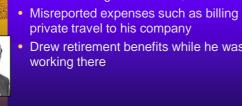


- · Scandal involving fraud, embezzlement, sexual affairs, and executive arrogance
- Unrelated for-profit subsidiaries established to be run by his son (related party)



United Way of the National Capital Area

- Former CEO Oral Suer
- Defrauded organization of \$1.6 M
- private travel to his company
- Drew retirement benefits while he was still working there



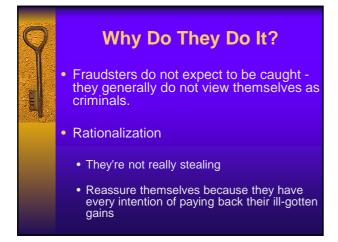
United Way of the National Capital Area • The charity initially denied the questionable practices and ousted employees and board members who pushed for an investigation

United Way of the National Capital Area • Impact of Negative Publicity

Who is a fraudster? Larger not-for-profit employee frauds are correlated with collusion (multiple perpetrators), higher salaries, age, longer tenure, educational level >25% of frauds committed by managers; 8.6% executives Median fraud case resulted in loss of <\$50K, committed by a female with no criminal record, who earned less than \$50k per year, had worked for the org at least 3 years.

Why Do They Do It? • "Honesty pays, but it don't seem to pay enough to suit a lot of people." Kin Hubbard

Why Do They Do IT? • GONE Theory • Greed • Opportunity • Need • Expectation of not being caught





Why Do They Do IT?

- Financial problems, possibly due to marriage breakdown or heavy debt load
- Delusions of grandeur
- An inflated ego
- A craving for success
- A compulsion, such as gambling or substance abuse problems.



Why Do They Do It?

- In some instances they convince themselves that they deserve, and are in fact justified in taking, whatever they can get their hands on
- An unrealized promotion, a salary level below current market rates or expectations, or feelings of being unappreciated may create a fertile environment for this sort of reasoning.



CAUTION! Warning Signs

- Material related-party transactions
- High turnover in key accounting positions
- Inadequate segregation of duties
- Personal financial difficulty of management and/or staff

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• Management's reluctance to provide periodic financial reports, clear explanations • Reluctance to take vacations • Living beyond one's means • Sudden mood swings or personality changes • Inability to keep up with regular work responsibilities





Control Environment (tone at the top)

- Information and communication
- Training
- Conflict of interest policy
- Code of ethics policy
- Whistle blowing policy
- Fraud Policy
- Prohibition on personal loans to board members and not-for-profit executives



Risk Assessment

- Management fraud/Management override of controls
- Fidelity Bond (insurance)
 - covered organizations recovered about 57% of their losses



Control Activities - Deterrents

- Competence of personnel
- clearly defined roles and responsibilities
- Execution in accordance with authorization



Most Important Organizational Characteristics Where Loss Was Suffered

- Lack of proper procedures for authorization of transactions.
- lack of enforcement of clear lines of authority

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Controls, cont.

- Segregation of duties
- Background checks on new financial personnel
- Background checks on those with responsibility/authority for purchasing or receiving assets



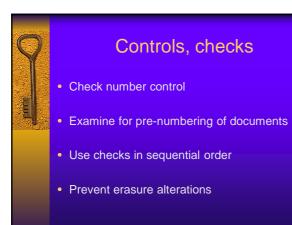
Controls, cont.

- Control over receipts consider lockbox
- Endorsement stamps spelling out full name of organization
- Outsource payroll



Controls, checks

- Proper and adequate documentation for disbursements
- Ensure that original documentation is made void
 - to prevent against duplicate payments
- Check stock control





Controls, cont.

- Prompt bank reconciliation by other than AR or AP
- Physical safeguards
- Mandatory vacation policies
- Internal and/or Annual independent audits (admittedly impractical for small orgs)



Compensating Controls

- Cross training
- Checks signed by officer
- Positive Pay



Compensating Controls, cont.

- Bank statements sent to officer and opened promptly (also deterrent)
- Bank reconciliations performed promptly



Compensating Controls, cont.

- Budgets and Budget analysis
 - if we didn't meet expectations, why not?



Response

- internal investigation protocols
- enforcement and accountability
- remedial action protocols
 - no action more and higher fraud



Fiduciary Responsibilities

Fiduciaries have discretionary authority over another's money, property, or other assets, and a legal duty to act in a manner that benefits the other person, or organization.

Kilpatrick Stockton LLP



Fiduciary Responsibility of Board Members

- Monitoring
- What financial statements to ask for
 - · What do the statements mean?
 - · Financial analysis
 - Ratio analysis



Group Check Revisited

- How many organizations think you may be vulnerable for a fraud?
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