

Nonprofits and Fraud



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It is a big problem

- ▶ More than 1.5 million nonprofit organizations in the United States, employing about 13 million individuals and generating an estimated \$1.4 trillion in revenue.
- ▶ Assuming an inflation rate of 3 percent and the Association of Certified Fraud Examiners' 2008 estimate that organizations lose 7 percent of annual revenue to fraud, the nonprofit sector is a victim of \$100 billion in estimated annual losses due to fraud.

Damage to the organization's reputation

- ▶ Negative publicity
 - ▶ Lower employee morale
 - ▶ Cost of litigation and investigation
 - ▶ Disruption to business operations
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- ▶ 7.3 percent of nonprofit organization, with a median loss of \$109,000 per incident.



More susceptible to fraud

- ▶ Nonprofits often place excessive control in their founder, executive director, or substantial contributor.
- ▶ Nonprofits often allocate limited resources to accounting, internal controls, and financial oversight.
- ▶ Nonprofits often have many volunteers working in the organization who are privy to confidential information.



More susceptible to fraud

- ▶ Nonprofits frequently have all-volunteer boards of directors, with little or no financial oversight expertise.
- ▶ Nonprofits typically have nonreciprocal transactions, such as charitable contributions, that are easier to steal than other sources of revenue where there is consideration exchanged.



More susceptible to fraud

- ▶ Nonprofits are highly susceptible to the effects of negative publicity and, therefore, are reluctant to report, or even discuss, fraud when it occurs.



Minimize the opportunity for fraud



Typical examples of fraud perpetrated against nonprofit organizations include the following:

Motives for Fraud

Financial Greed Living beyond means High personal debt Unexpected Financial needs	Vices Gambling Drugs Alcohol
Work-Related Job performance recognition Job dissatisfaction Fearing job loss Overlooked/Underpaid	Other Any pressures not fitting in Other motives




Rationalization

White -collar criminals have a strong sense of right and wrong and must rationalize their conduct.


Nonprofit Integrity Act of 2004

- ▶ Charitable Organizations Have 30 Days, Instead Of Six Months, To Register And File Articles Of Incorporation With The Attorney General's Registry Of Charitable Trusts [Government Code section 12585]
- ▶ Independent Audit of financial statement require for charities with gross revenues of \$2 million or more or \$500K of Government money
- ▶ Establishment and maintain audit committee for charities with gross revenues of \$2 million or more


Nonprofit Integrity Act of 2004

- ▶ The audit committee cannot include staff members, CEO, the treasurer or CFO. If an organization has a finance committee, members of that committee may serve on the audit committee, but cannot comprise 50 percent or more of the audit committee. The chairperson of the audit committee may not be a member of the finance committee.
 - ▶ The audited financial statements must be made available for inspection by the Attorney General and the public no later than nine months after the close of the fiscal year covered by the financial statement.
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Nonprofit Integrity Act of 2004

- ▶ Commercial fundraisers must notify attorney general before starting a solicitation campaign
 - ▶ Commercial fundraisers must have written contracts with the charitable organizations
 - ▶ Fundraising counsel must notify attorney general before starting solicitation campaign
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Nonprofit Integrity Act of 2004

- ▶ Ensure greater transparency and independence
 - ▶ Charitable organizations and commercial fundraisers for charitable purposes are prohibited from engaging in misrepresentation and certain other acts when soliciting donations
 - ▶ Commercial fundraisers must keep records of solicitation campaigns for at least 10 years.
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Internal Controls

- ▶ Need to be practical
 - ▶ Cost and time efficient
 - ▶ Mostly insert controls
 - ▶ Don't be asleep at the wheel
 - ▶ Be skeptical
 - ▶ Forced vacation times
 - ▶ Tone from the top
 - ▶ Segregation of duties
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Thank you!

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