PROTECTING YOUR NONPROFIT ORGANIZATION FROM FRAUD AND EMBEZZLEMENT

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INSIGHTS FROM LATEST FORENSIC FINDINGS

Agenda

I. Fraud in the Headlines

II. Fraud and Nonprofit Organization

III. Types of Fraud in Nonprofit Organizations

IV. Steps to Reduce Exposure to Fraud

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Fraud in the Headlines

Former Detroit Public Schools Accountant, Teacher Indicted on Fraud and Money Laundering Charges

pepsi refresh project

Pepsi Refresh, the online fund-raising contest with a $20M giveaway for charitable causes and nonprofit groups, received complaints that its results are being manipulated

Nakami Chi Group Ministries International

Valley con man Edward Purvis sentenced to five years in January 2009 for operating a Ponzi scheme

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Fraud in the Headlines

October 2013 - Former managers allegedly engaged in "pattern of self-dealing"

No jail for officials who stole redevelopment money

April 2012 - Oakland charter school accused of fraud may close

Fraud and Nonprofit Organization

Effect of Fraud

- Financial damage
- Reputational damage
- Support from donors, grantors, and other public sources will most likely suffer due to a damaged reputation

Fraud and Nonprofit Organizations

Contributory Factors

- Atmosphere of trust
- Significant control by Founder / Executive Director of the organization
- Limited resources
- Difficulty in verifying certain revenue streams
- Large amounts of incoming cash flow from various sources
- Weaker internal controls
- High staff turnover
- Lack of business and financial expertise
- Reliance on volunteer boards,
- Lack of Audit Committee training / financial understanding

Fraud and Nonprofit Organizations

Types of Fraud

- Misstatement of Contributions / Revenue
- Expense misreporting
- Related party transactions
- Employee Embezzlement
- Travel and Entertainment

Frauds Committed Against Nonprofit Organizations

Asset Misappropriation Schemes

Revenue and cash receipts schemes

- Skimming
- Theft of donated merchandise

Purchasing, cash disbursement, and expense reporting schemes

- Credit card abuse
- Submission of Fictitious Expenditures
- Fictitious Vendors

Payroll schemes

- Ghost Employees
- Overstatement of hours worked

Frauds Committed By Nonprofit Organizations

Fraudulent fundraising practices

- Charging fund-raising costs to programs to improve expense ratios
- Misrepresenting the portion of donations that will be used in charitable programs
- Failure to comply with donor-imposed restrictions pertaining to the use of a gift
- Using or selling donor data collected under false pretenses

Frauds Committed By Nonprofit Organizations

Fraudulent financial reporting

- Failing to disclose significant related party transactions
- Failing to disclose noncompliance with debt requirements
- Misclassifying restricted donations to mislead donors or charity watchdogs
- Holding records open beyond the period end in order to inflate revenues
- Misclassifying expenses to mislead donors regarding the funds used for programs
- Failing to correctly value receivables, inventory, donated assets, and liabilities under split-interest or gift annuity obligations
- Failing to report trade payables in the correct period to understate expenses
- Failing to correctly report obligations for deferred compensation or retirement benefits

Steps to Reduce Exposure to Fraud

Questions to consider

- What financial reporting areas are susceptible to misstatement?
- What operational areas are susceptible to misappropriation of assets?
- What are the areas of recurring disagreement or problems?
- Who is in the position to be able to defraud the organization or manipulate the financials?
- Are internal controls adequate?
- Are there any weaknesses in the internal control system that can be exploited?

Steps to Reduce Exposure to Fraud

Questions to consider

- How could a perpetrator override or circumvent controls?
- What could a perpetrator do to conceal the fraud?
- Were the allocations appropriately modified for changes in activity at the organization?
- Do all reported assets actually exist?
- Is there a mechanism to raise issues anonymously?
- Is a process in place to screen new vendors and employees?
- How are related parties identified?

Steps to Reduce Exposure to Fraud

- Remain alert to red flags of fraud, changes in life-style of management
- Consider periodically reviewing management travel and other expenses
- Inquire about and review new employment agreements or other significant contracts entered into during the year
- Add audit procedures to add an element of unpredictability
- Consider risk of management over-ride
- Ask about the organization’s fraud risk assessment process
- Incorporate fraud questions in process discussions or day-to-day conversations with client personnel

Steps to Reduce Exposure to Fraud

Trust but Verify

SIGNIFICANT DIVERSION OF ASSETS: 990 REPORTING

Significant Diversion of Assets:
990 Reporting

Form 990, Part VI, Section A (Governing Body and Management) line 5:

- Did the organization become aware during the year of a significant diversion of the organization's assets?
- "Significant"--gross value of all diversions (not taking into account restitution, insurance, or similar recoveries) discovered during the organization's tax year exceeds the lesser of:
- (1) 5% of the organization's gross receipts for its tax year,
- (2) 5% of the organization's total assets as of the end of its tax year, or

  (3) $250,000.
- IRS auditing 285 organizations that reported a significant diversion of assets in 2009 and initially found "Roughly $170 million in diversions".

Significant Diversion of Assets:
990 Reporting

- If yes, explain on Schedule O:
  - Nature of diversion
  - Amounts or property involved
  - Corrective actions taken to address the matter, and
  - Pertinent circumstances
- *Diversion of assets* includes any unauthorized conversion or use of the organization's assets other than for the organization's authorized purposes, including but not limited to embezzlement or theft (e.g., misuse of grant funds by grantee)
- Report diversions by the organization's **officers**, **directors**, **trustees**, **employees**, **volunteers**, **independent contractors**, grantees (diverting grant funds), <u>or any other person</u>, even if not associated with the organization other than by the diversion.

Significant Diversions

- Federal and state officials including New York, Hawaii, Maryland, DC have launched multiple investigations into groups that reported losses to authorities.
- Three ranking senators and a House committee chairman said they were distressed about new revelations regarding what are known as "significant diversions" of assets. Regulators in seven states and the District also said they moved this week to scrutinize how well nonprofits are safeguarding charitable funds meant to serve their communities.
- Republican Sen. Charles E. Grassley (Iowa), ranking member of the Judiciary Committee, opened an investigation into legal issues related to the diversions.

Diversions-Inurement and Excess Benefit Transactions

- A diversion of assets does not include an authorized transfer of assets for FMV consideration, such as to a joint venture or for-profit subsidiary in exchange for an interest in the joint venture or subsidiary.
- A diversion of assets can in some cases be inurement of the organization's net earnings.
- In the case of section 501(c)(3), 501(c)(4), and 501(c)(29) organizations, it also can be an excess benefit transaction taxable under section 4958 and reportable on Schedule L (Form 990 or 990-EZ), if the party is a “disqualified person” with regards to the organization (generally an insider or person with significant influence)

MANAGING YOUR REPUTATION WHEN IT COUNTS

- Protecting your reputation is not a luxury; it is the key to sustainability
- A serious crisis can occur at any moment
- If managed ineffectively, it can become a reputation nightmare

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Each year, over 70,000 serious crises and disasters occur worldwide

It is highly probable that a crisis will impact your organization in the future

Over 40% of organizations that experience a serious crisis never re-open while 25% of those that reopen, fail within one year

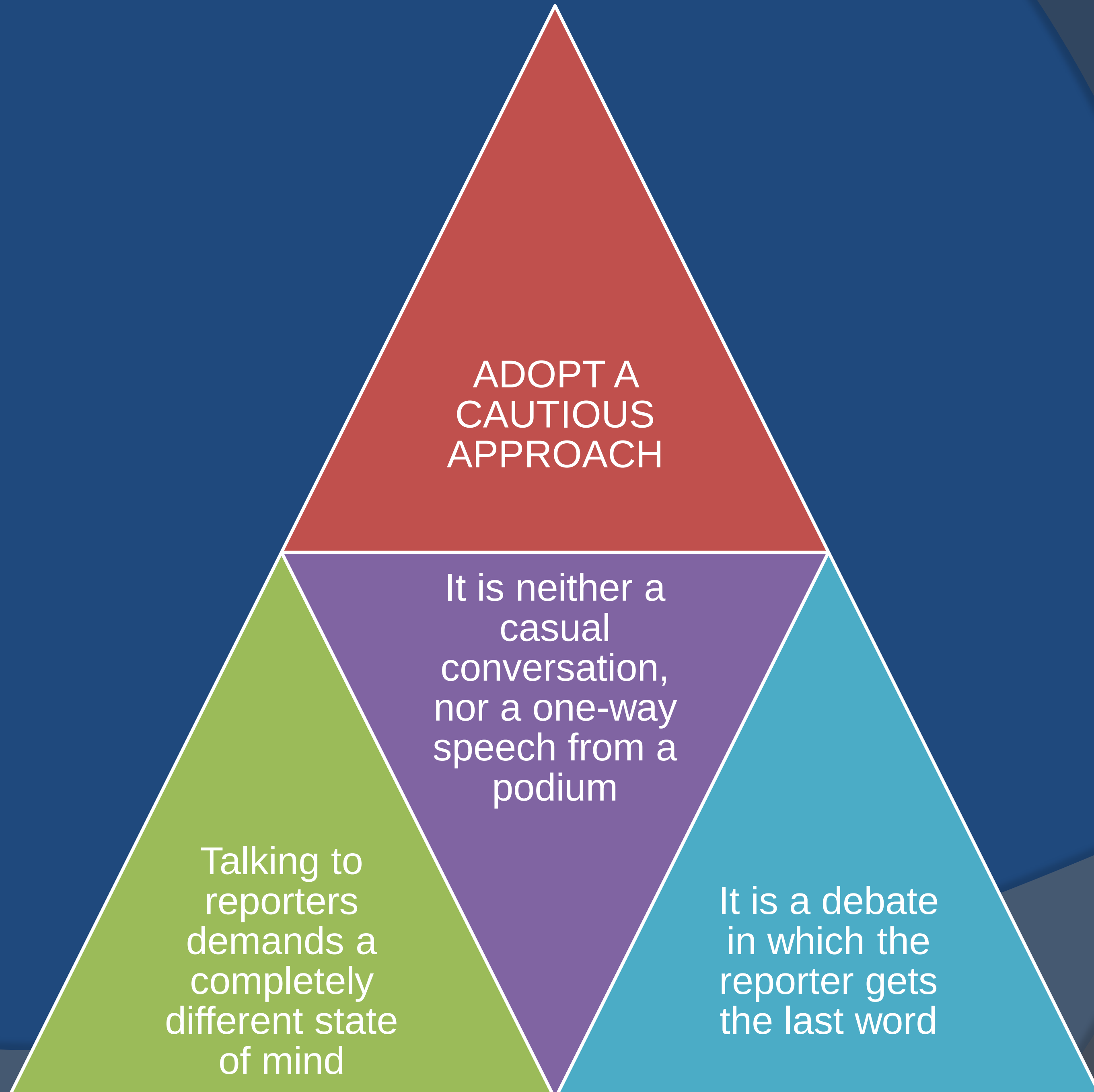
While some crisis situations cannot be anticipated, all crises share a common set of elements

If these conditions are ignored, the reputation of the company and its leadership can be severely impacted

To insure your protection, a comprehensive Crisis Management plan is recommended

Do not leave your reputation to chance


Reputation & Crisis Management Planning
15-year evaluation *Ethics Hotline
Hierarchy of protection
Crisis management strategy
Advanced media management training
Coaching: *Interpersonal *Conflict *Negotiations
On-camera simulations
Media monitoring service
Real-time on-site crisis support


ADOPT A CAUTIOUS APPROACH
It is neither a casual conversation, nor a one-way speech from a podium
Talking to reporters demands a completely different state of mind
It is a debate in which the reporter gets the last word

Understanding News Media Platforms, Ratings and Measurements

Setting the Stage for Success

Scoping the Interview

Creating a Positive First and Last Impression

Psychological Barriers

How to Speak to the Camera

Anticipating the Classic Questions

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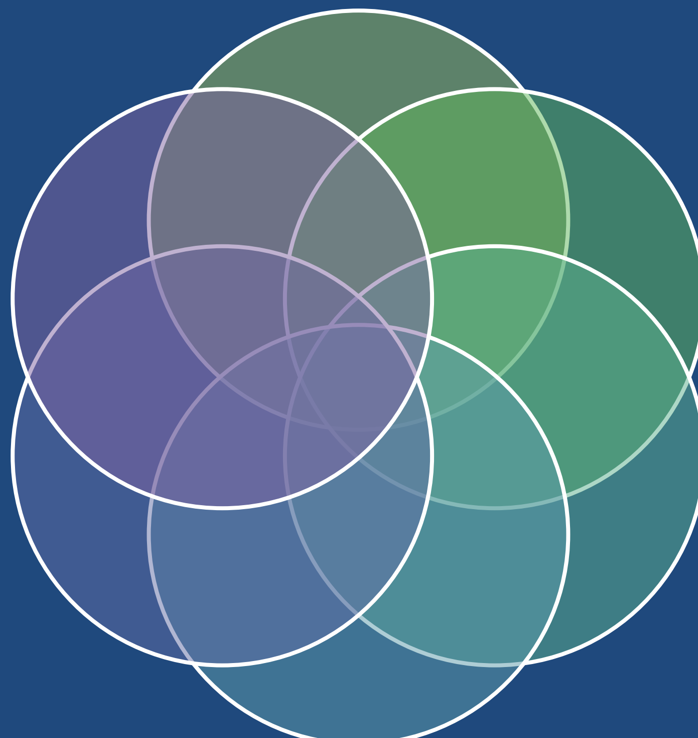
Creating the Appropriate Image

Negotiating with the Media

Managing the Press Conference



Assessing the Consequences of Speaking, “Off the Record”

Managing the Ambush Interview

Avoiding a Secondary Crisis

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Ignition Crisis Action Model:

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The goal is to keep the duration short and the frequency low.

THANK YOU

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