



Published Date – January 13, 2014

Analysis

Part I: Nonprofits, Grantees Must Remain Vigilant About Fraud

BDO Offers Multiple Insights for Protecting Against Fraud and Embezzlement

By: Karen Norris

Nonprofits and other grantees generally understand that improper payments, fraud, waste and abuse can occur at every phase of the grant cycle, and in fact, throughout standard business practices. Being watchful is a shared responsibility among grantees, program offices, grants offices and general oversight offices.

BDO, a financial consulting firm with offices throughout the U.S. and worldwide, presented a December webinar moderated by Laurie De Armond, a partner in BDO's Nonprofit & Education industry group, about the cascading impacts of fraud. Presenters Tim Mohr, a principal with BDO Consulting, Mike Sorrells, BDO's national director of nonprofit tax services, and Randal Simonetti, a reputation and crisis management consultant, highlighted key issues relating to fraud that can often challenge nonprofits and other recipients, with damage extending well beyond the initial act. "Poor public perception and reputational risk can outweigh the monetary loss," warned Mohr.

In addition to the financial loss suffered from fraudulent acts, bad press can adversely impact public and employee perception, and cause any grantor to designate the recipient as high risk. Mohr underscored, "Support from donors, grantors and other public sources will most likely suffer due to a damaged reputation."

What Is Fraud?

The terms fraud, waste and abuse are often linked in discussion, as are improper payments. Fraud is an intentional act, an unlawful acquisition of benefits (money and services) by committing wrongful acts affecting government programs and business operations. Waste can be intentional or unintentional, a careless expenditure or mismanagement of resources. Abuse is the excessive or improper use of resources, including position and authority, and improper payments can be simple mistakes—the wrong amount to the wrong person or payments made without documentation. While all of these create challenges, the act of fraud is particularly harmful.

Federal Grants Compliance Expert

For more information on Thompson's Federal Grants Compliance Expert | Complete Suite, [click here](#). A free 14-day trial to our grants development and grants management digital research libraries also are available [here](#) and [here](#), respectively.

Two-Way Street

Fraud can be committed against nonprofit organizations and other recipients; however, nonprofits and other recipients can also commit fraud.

Fraud schemes committed against recipients include: skimming assets, theft of donated merchandise or procured materials, submission of fictitious expenditures or invoices, fictitious vendors, ghost employees or overstatement of hours worked.

“Look at how easy it is for a person to create a vendor or employee,” hypothesized Mohr. “At what point is there a trigger for someone to come back and question?”

Fraud schemes that can be committed by nonprofit organizations include:

- questionable fundraising practices such as charging fundraising costs to programs;
- misrepresenting the portion of donations that will be used for programs;
- failure to comply with donor-imposed restrictions; and
- using or selling donor data under false pretenses.

These actions also could apply to other recipients if partner contributions or matching funds are included in a grant program.

Additional fraudulent acts involving any grant recipient include failing to disclose related-party transactions (hiring a brother-in-law, for example), intentional misclassification of match, intentional misclassification of expenses, failing to correctly value receivables or inventory, and failing to correctly report obligations.

Steps to Reduce Fraud

“You can never completely prevent fraud, but you can reduce the exposure and likelihood of it,” said Mohr. “You can detect and deter.” Mohr suggested recipients evaluate reporting areas that may be susceptible to misstatement, internal controls, screening processes, audit procedures, travel and other employee expenses, risk assessments and personnel who could possibly manipulate the financials. “Trust, but verify,” Mohr advocated.

Mohr described the benefits of a fraud hotline to help detect and deter fraud. He recommended establishing a hotline with a toll-free number that allows for anonymity. A process should be developed to handle calls received on the hotline. He also recommended advertising the hotline to employees, but, “Define the purpose,” he coached. “It’s not a ‘I didn’t get a raise’ complaint line.”

Diversion of Assets

Sorrells discussed the 2009 results from Internal Revenue Service audits of 285 organizations that found “roughly \$170 million in diversions.”

Diversion of assets, according to Sorrells, includes any unauthorized conversion or use of the organization’s assets other than for authorized purposes, including embezzlement or theft and misuse of grant funds.

“Sports teams, parent teacher associations and other small groups have fraud,” said Sorrells. “It’s not just the large groups.” As federal and state officials increase scrutiny over the expenditure of grant funds, Sorrells expected increased investigations.

Crisis Management

A fraudulent act can create a crisis, and consistent with the advice provided by Mohr, Simonetti advocated, “Protecting your reputation is not a luxury; it is the key to sustainability.” Reviewing national statistics, Simonetti shared, “40 percent of organizations that experience a serious crisis never reopen, while 25 percent of those that reopen, fail within one year.”

“Do not leave your reputation to chance,” Simonetti said, and recommended that organizations prepare a crisis management plan. With planning, an organization would be better able to manage the associated impacts of fraud beyond the immediate financial loss. “The goal,” Simonetti said, “is to keep the duration of media exposure short and the frequency of media appearances low.”

BDO

BDO is the brand name for BDO USA, LLP, a U.S. professional services firm providing

assurance, tax, financial advisory and consulting services for more than 100 years. The firm serves clients through 49 offices and more than 400 independent alliance firm locations nationwide. As an independent Member Firm of BDO International Limited, BDO serves multinational clients through a global network of 1,264 offices in 144 countries.

BDO will be presenting Part II of the series January 15 in association with the law firm of Venable, LLC.

For More Information

For more information about BDO, visit www.bdo.com.

For more information about Venable, go to www.Venable.com/nonprofits.

Local/State Funding Report

The previous story was excerpted from the *The Local/State Funding Report*. *The Local/State Funding Report* is published under the Grants Compliance Expert subscription service by Thompson Information Services, 4340 East West Highway – Suite 300, Bethesda, MD 20814. For subscription service, call 800-677-3789. For editorial email karen.norris@thompson.com. This information is designed to be accurate and authoritative, but the publisher is not rendering legal, accounting or other professional services. If legal or other expert advice is desired, retain the services on an appropriate professional.

Managing Editor: Karen Norris

<http://grants.complianceexpert.com>

Copyright ©2014 Thompson Information Services