

Protecting Ohio's Families

Protecting the Integrity of Nonprofits

Ohio Attorney General Mike DeWine's office works to ensure that donations are used as they are intended. Learn strategies to prevent theft or misappropriation in your nonprofit organization.



Avoiding Theft in Your Nonprofit



MIKE DEWINE

OHIO ATTORNEY GENERAL

Dear Nonprofit Leader,

The single greatest asset of a nonprofit is arguably its reputation. When theft or misappropriation of assets is reported or even suggested, plummeting public confidence spreads beyond the affected organization and endangers future support for other nonprofits as well.

The Charitable Law Section of the Ohio Attorney General's Office ensures that donor dollars are used as intended and, at the same time, safeguards beneficiaries' interests.

This guide can help nonprofit leaders establish provisions to prevent embezzlement or misappropriation. If you become aware of questionable actions, please contact my office. Our Charitable Law Section will investigate suspected fraud, theft, or other activities that diminish or threaten the good work of nonprofits.

Thank you for your support and dedication as a nonprofit leader.

Very respectfully yours,

A handwritten signature in black ink that reads "Mike DeWine". The signature is written in a cursive, flowing style.

Mike DeWine

AVOIDING THEFT IN YOUR NONPROFIT

Nonprofits rely on the good-faith efforts of invaluable volunteers and sometimes paid staff members. Most people are honest and committed, but at times even longtime volunteers and employees can find themselves in situations that tempt them to steal from the organization.

Theft happens in large and small organizations, and often it involves individuals who are widely respected and valued within the organization. This sometimes occurs during times of economic difficulties for the individual, out of spite, for revenge, or even because of substance abuse issues. Often there is no rational explanation, other than perhaps greed. However, one thing is well-known: The number one contributing factor to theft is having access to the assets.

Unfortunately, valuable organizations — and, ultimately, those they serve — suffer when such incidents occur.

The Association of Certified Fraud Examiners estimates that a typical organization loses 5 percent of its annual revenues to fraudulent activity. If that figure is applied to Americans who contribute more than \$300 billion in charitable gifts annually, an estimated \$15 billion is lost each year.

DEVELOPING ANTITHEFT PROCEDURES

The adoption and ongoing review of written policies help protect the organization, board members, staff, and volunteers. All should find the development of such procedures a comfort, rather than a threat.

While it is impossible to guarantee the prevention of theft, nonprofits should take steps to reduce the likelihood of problems and ensure a quick response if they do arise. It is important that the focus be kept on the processes, not the people. Nonprofits should examine procedures based on objective standards about how to best protect the organization's interests.

Some board members rely solely on an annual audit to provide assurances that the organization is safe from fraud. But in truth, the audit process rarely uncovers fraud because its primary goal is to ensure that financial

statements provide an accurate fiscal picture. Fraud is most often uncovered through diligent oversight, whistleblowers, internal audits, or sheer luck.

Developing internal controls, audit processes, and written policies and procedures — and ensuring that they are being followed — are some of the most important duties of board members. In fact, failure to address these issues can constitute a breach of fiduciary duties, jeopardizing the organization's future and even risking personal liability to board members who recklessly and intentionally fail to act.

Lawyers, accountants, business leaders, and other community leaders often are willing to provide guidance on the creation of internal controls and board governance policies. Additionally, numerous books, resources, and training organizations can provide assistance if needed. Board members must take the time to analyze the specific needs and goals of the organization and work constantly to improve activities in these areas.

STEPS TO LIMIT EXPOSURE

An organization's size and complexity should be considered when assessing needs.

Here are some important actions nonprofit organizations should consider to limit their exposure to theft. Some focus on the importance of the separation of duties so that no single person has sole access to and control over collections, deposits, and the reporting of financial information — the root problem of theft in most instances. Other tips reinforce the importance of regular and effective oversight activities by the board or audit committee. It is the board's responsibility to ensure a system of checks and balances is in place.

There is no single foolproof formula to eliminate theft, but the surest recipe for disaster is to ignore the issue.

Require dual signatures

Requiring multiple signatures on checking and investment accounts for checks written above an established amount can provide some measure of control. The approved signatories should be individuals

who are independent of each other. In selecting approved signatories, avoid individuals who are family members, close friends, or related by supervisory structures.

Having blank checks signed in advance for the sake of convenience is a risk. Organizations also should investigate using safety checks that cannot easily be scanned or altered. For handwritten checks, gel pens are safer than ink pens. If your organization pays its bills electronically, consider granting online access to the accounts to someone not authorized to pay bills.

Reconcile bank statements

Someone who is not authorized to sign checks should reconcile all bank statements monthly. Each check should be compared against appropriate purchase orders and receipts to verify the expenditures were authorized and the goods or services were received. Arrangements also could be made to have the bank send multiple bank statements, one to the charity office and one to the home address of the board treasurer. This can reduce the risk that someone could tamper with bank statements to hide fraudulent activities.

Limit use of cash

Cash is particularly tempting, and the more organizations can limit the need to handle it, the better. However, this is not possible for many charitable organizations. Two people should count cash at events, and a third should deposit the funds in the bank. Counts should be recorded, verified, and reconciled. Ensuring cash deposits are routinely made rather than leaving money in the office is vital. Cash and checks should be safely locked up prior to deposit. If the group sells refreshments, for instance, consider having a ticketing system in which vendors don't handle cash, just tickets. This approach can help centralize the cash collection process.

Establish check-handling procedures

A common theft scheme in nonprofits is for volunteers or staff members to divert checks made out to the organization into other accounts that they open personally. While somewhat costly, using lockbox services in which donors mail checks to a lockbox at a bank, for instance, allows the checks to be processed automatically without going through volunteer or staff hands. Developing internal systems to monitor and track incoming

mail that might contain checks is an important consideration. Stamp incoming checks with “Deposit Only,” but don’t include bank account numbers. Some who receive canceled checks have been known to fraudulently make use of the bank account data.

And, it is important to ensure that there is a regular, segregated system for recording and depositing all checks received regularly. Checks should be safely locked away prior to prompt deposit.

Work from vendor lists

Some insider thieves submit phony invoices. To limit the success of this type of scam, organizations should consider making purchases only from an approved list of vendors. Before vendors can be added to the list, various verifications and research should be done to ensure that the business is legitimate. Consider including a “right-to-inquire” clause in the contract so that the vendor’s internal records can be inspected if fraud is suspected.

Develop payroll controls

Creating ghost employees is another scam that can divert a nonprofit’s funds. There should be coordination between the human resources and finance functions to ensure employees are taken off payroll when they leave. Only names of current employees should appear on the payroll. There should be limitations on who is authorized to add or eliminate names from payroll. Outsourcing this function to payroll processors can help eliminate this threat.

Establish expense reimbursement policies

The establishment of reimbursement policies is especially important, since this area is ripe for abuse. Pre-approval of expenses should be encouraged, and reimbursement requests must be accompanied by receipts and other forms of documentation. The issuance and use of corporate credit cards should be discouraged, as they often are a source of problems. If cards are permitted, they should be closely reviewed to ensure legitimacy and documentation by someone not authorized to use the cards. The board or one of its committees should regularly review the expenses of the executive director.

Match physical and recorded inventories

Many organizations lose resources through the loss of equipment and goods. Physical inventories should be taken regularly and matched against recorded inventories. These inventory efforts should include computers, cell phones, office equipment, and similar items.

Set and follow budgets

All organizations should have an annual budgeting process. While staff members often prepare the budget, the board must review, approve, and monitor it. Often a finance committee of the board is best positioned to do this. Budgets should encompass the entire organization as well as separate operating segments. At each board meeting, the board should review revenue and expenses and compare actual results to the projected budget levels. Some variations can be expected, but the board needs to understand the variations and develop plans to address problematic variations. Board members also should ensure that funds with restricted uses — grants, for instance — are used only for those purposes.

Employ competitive bidding

Board members face serious risks when they fail to exercise a duty of loyalty to the nonprofit. When charitable contracts are routinely sent to specific businesses, including those board members are involved with, consumers can legitimately question whether sound business decisions are being made that further the cause of the charity or the board members' personal interests. Conflict-of-interest policies are vital and can protect board members from possible criminal and civil action. And, competitively bidding out services and purchases above a certain threshold can reduce problems. It also is important to ensure that vendors aren't engaged in collusion and that insiders aren't seeking kickbacks.

Monitor grant administration

Many organizations can find themselves in trouble with government and private auditors over the improper use of grant funds and designated charitable gifts that can only be expended in ways the donor defines. In the area of grants, there often are specific requirements on allowable and unallowable costs, overhead expenses, procurement, and record-keeping. The board should ensure that all of the requirements are understood and followed.

Consider background and credit checks

Organizations may want to consider requiring criminal background and credit checks for staff and volunteers in a position to divert resources from the organization. Too many times, groups are victimized by a staff or board member who has engaged in theft at other organizations in the past. Through a partnership between the Ohio Attorney General's Office and the Ohio Bureau of Motor Vehicles, Ohio and FBI background checks are available through many BMV sites across the state. Locations are listed at www.OhioAttorneyGeneral.gov/WebCheck. Additional information is available through Ohio Attorney General Mike DeWine's Help Center at **800-282-0515**. Background checks also are available through local law enforcement agencies.

Require vacations and rotation of duties

Problems sometimes are not uncovered because the embezzler never takes a vacation or time off, and others are unable to get a full picture of what is going on with the finances. When vacations, mandatory work breaks, and rotation of duties are enforced, problems often can be discovered more quickly.

Change passwords, combinations, and locks

Volunteers and staff members come and go. Be certain to routinely change passwords on bank and financial accounts and change locks and combinations routinely so that people who leave the organization can no longer access valuable data.

Establish whistleblower policies

Boards should develop a whistleblower policy and ensure there are easy ways for staff and volunteers to report concerns about fiscal management issues.

Consider insurance coverage

Many nonprofits obtain insurance coverage to protect the organizations' board, staff, and volunteers from liability. This coverage will not protect board members who intentionally commit fraud or personally benefit from lax policies. And while coverage may not prevent theft, insurance carriers sometimes provide customers with ongoing training and tips on strengthening internal controls. If a loss does occur, the coverage may help the organization restore funds.

Assess internal controls

The board's audit committee should consider doing surprise visits or audits to check how well the processes and procedures are being followed. Checking for required documentation on check requests, testing the cash management policies, and examining payroll records can be helpful. There should be ongoing discussion and consideration of risk assessments to ensure policies address any gaps. The board also should ensure there is a document retention and destruction policy in place that protects the group's business records. This could become important should investigations occur later.

Recruit new audit committee members

Organizations can benefit from getting new and fresh perspectives on audit committees. This helps prevent or detect schemes that can extend for many years because there were never new individuals serving in an auditing role.

Look for warning signs

The board should be alert for warning signs of possible trouble:

- Concerns or questions expressed by people handling the collection of funds and financial reporting
- Changes in record-keeping methods
- Overall complexity of the operations
- Unwillingness to share financial information with interested parties
- Significant changes in revenue and/or expense levels compared to previous years
- Audit results
- Complaints
- Bounced checks
- Late or non-existent financial reports to the board
- Unpaid invoices
- Sudden, unexplained changes in lifestyles of employees or volunteers

Develop a fraud action plan

Boards should consider in advance how they will respond if problems arise. Sometimes the clear pronouncement of a policy favoring criminal prosecution for theft serves as a deterrent.

Avoiding Theft in Your Nonprofit

YOUR ANTITHEFT ACTION PLAN

Use this checklist to keep track of actions your organization has taken to help avoid embezzlement.

- Require dual signatures
- Reconcile bank statements
- Limit use of cash
- Establish check-handling procedures
- Work from vendor lists
- Develop payroll controls
- Establish expense reimbursement policies
- Match physical and recorded inventories
- Set and follow budgets
- Employ competitive bidding
- Monitor grant administration
- Consider background and credit checks
- Require vacations and rotation of duties
- Change passwords, combinations, and locks
- Establish whistleblower policies
- Consider insurance coverage
- Assess internal controls
- Recruit new audit committee members
- Know the warning signs
- Develop a fraud action plan



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