

# Avoid Fraud With Effective Policies and Controls

By Terri McKnight, CPA

Over the past several years, nonprofits have been hit hard by the economic downturn. Due to declining membership and program revenues, associations have had to streamline operations to break even financially or minimize the impact of having to spend operational reserves. The last thing an association needs is unnecessary and unfortunate losses as a result of fraud.

Management can take these steps to limit its vulnerability to fraud:

**Perform a risk assessment to identify vulnerabilities.** Management should perform a risk assessment of where the association might be vulnerable to fraud. As part of that assessment, consider how the reputation of the association would be affected if fraud occurs. Misappropriation of an asset is disclosed in IRS Form 990, which is a public document, meaning there's no hiding such errors. Management should also review the insurance policies in place.

**Address the overall control environment.** In preventing fraud, the overall control environment is important to address. The control environment is set by management and those charged with governance. During staff meetings, management should remind all employees about the organization's policies on whistleblowing, conflict of interest, and ethics. Having a dialogue about the importance of ethical behavior sets a tone that fraudulent activities

will not be tolerated.

**Don't let reduced staffing levels affect controls.** An area significantly affected by the downturn is staffing. Associations have had to reduce staffing levels, cap salaries, or reduce benefits to help control costs. As an organization goes through the arduous task of reducing expenses, it is imperative that it does not lose the overall control environment that helps to protect its assets. As staffing levels decline, management still must maintain good internal controls and safeguarding of assets to ensure that it is protected from fraud, misuse, or abuse.

Segregation of duties in the finance department is also important in protecting assets. This may be difficult if the organization has had to reduce staff. To ensure segregation of duties between the initiation, authorization, and recording of transactions, the executive director and board treasurer may have to become involved. If accounting is outsourced, it is still management's responsibility to review and approve the work performed.

**Regularly reconcile accounts.** Asset and liability accounts should be reconciled monthly. All account reconciliation should be reviewed and approved by supervisory personnel.

**Maintain supporting documents.** Management must ensure that employees are following established internal control policies and procedures

concerning cash receipts and cash disbursements. Vendor selection is critical, and all expenses need to be supported by an invoice that is reviewed and approved by management. Credit-card purchases should be watched closely. Personal expenses charged to an organization's credit card should be prohibited, and employees who violate the policy should have their cards revoked. All credit-card transactions and expense reports should be reviewed and approved by the employee's immediate supervisor. A member of the board should review and approve the executive director's charges as an added control.

**Review IT department controls.**

It is important to review controls surrounding the IT department. Ensure computers and networks are secure.

Engage a qualified professional to review the IT environment to identify potential causes of any computer security breaches. Computers with access to social networks should not be used to conduct the organization's banking transactions. Control access to systems and change passwords regularly. Use dual control to initiate electronic banking transactions.

**If fraud has occurred, prosecute!**

These are just a few means to help protect an organization during these tumultuous times. If there is a breach and fraud has occurred, management should prosecute to the fullest extent of the law. If you do not, the perpetrator will abuse again with another nonprofit.



Terri McKnight

**COMPANY BIO**

Gelman, Rosenberg & Freedman, CPAs, serves more than 650 nonprofit organizations locally, nationally, and around the world, including member-based associations and other charitable institutions. This specialty comprises more than 70 percent of the firm's business. GRF provides auditing and tax preparation, Circular A-133 compliance, and outsourced accounting, among other services.

**Contact:**

Terri McKnight, CPA, Director, Audit Department  
Gelman, Rosenberg & Freedman, CPAs  
4550 Montgomery Avenue, Suite 650N  
Bethesda, MD 20814  
Phone: 301-951-9090  
Email: [tmcknight@grfcpa.com](mailto:tmcknight@grfcpa.com)  
[www.grfcpa.com](http://www.grfcpa.com)



**GELMAN, ROSENBERG & FREEDMAN**  
CERTIFIED PUBLIC ACCOUNTANTS