

How to Safeguard Your Nonprofit against Fraud and Embezzlement: Best Practices, Common Pitfalls, and Practical Strategies

January 15, 2014

Venable LLP

Washington, DC

Moderator:

Jeffrey S. Tenenbaum, Esq., Venable LLP

Panelists:

William H. Devaney, Esq., Venable LLP

Joe Stephens, *The Washington Post*

Nidhi Rao, CPA, CFE, CFF, CIA, BDO USA LLP



Presentation





How to Safeguard Your Nonprofit against Fraud and Embezzlement: Best Practices, Common Pitfalls, and Practical Strategies

Wednesday, January 15, 2014, 12:30 p.m. – 2:00 p.m. ET

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Upcoming Venable Nonprofit Legal Events

February 19, 2014 - [Implementing a Bring-Your-Own-Device Policy: What Your Nonprofit Needs to Know](#)

March 20, 2014 - The OMB Super Circular: What the New Rules Mean for Nonprofit Recipients of Federal Awards (details coming soon)



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Agenda

- Recent Examples of Nonprofit Fraud and Embezzlement
- Why Does Employee Fraud Occur?
- Why Are Nonprofits Frequently the Victims of Fraud and Embezzlement?
- Effective Compliance Programs
- Controls Measures to Reduce the Risk of Fraud
- What to Do If an Issue Is Discovered?



Recent Examples of Nonprofit Fraud and Embezzlement

American Legacy Foundation

- In November 2013, Sen. Charles Grassley (R-Iowa), ranking member of the Senate Judiciary Committee, opened an investigation into the Washington, D.C.-based American Legacy Foundation, a nonprofit dedicated to educating the public about the dangers of smoking.
- The investigation was spurred by a *Washington Post* report that the Foundation had suffered an estimated \$3.4 million loss as a result of alleged embezzlement by a former IT specialist.
- According to the *Post* report, the executive – who was in charge of both ordering computer equipment and checking it in as being received – generated 255 invoices for computer equipment sold to the Foundation from 1999 to 2007, 75 percent of which were fraudulent.
- When a whistleblower came forward (after his concerns were ignored years earlier), the Foundation hired forensic examiners and notified the Board of Directors.
- The U.S. Attorney's Office told the *Post* that its investigation of the matter had been closed in February 2012, because the Foundation had taken more than three years to report the missing equipment and lacked reliable records.

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Vassar Brothers Medical Center

- In late October 2013, the *Post* reported that in 2011, the Vassar Brothers Medical Center in Poughkeepsie, New York reported a loss of \$8.6 million through the "theft" of certain medical devices.



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Project Genesis, Inc.

- On October 12, 2013, the former CFO of Project Genesis, a Connecticut nonprofit organization that serves people with disabilities, was sentenced to 33 months' imprisonment after embezzling more than \$348,000 from the organization over a three-year period.
- The former CFO stole the organization's funds by keeping terminated employees on the payroll and then transferring their salaries to his personal bank account.



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American Red Cross (NY Chapter)



- On February 27, 2013, the former financial director for a New York chapter of the American Red Cross was sentenced to two to seven years in prison for grand larceny.
- As signatory to the chapter's operating account, the former director obtained an ATM debit card in her name and linked to the chapter's account to make cash withdrawals, sometimes as often as every few days.
- The former director used the money to pay for clothing, her children's tuition, and other personal expenses, embezzling over \$274,000 between 2005 and 2009.
- The missing funds were uncovered by an audit.

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H.O.W. Foundation

- On November 8, 2012, the former executive director of the H.O.W. Foundation, a nonprofit alcohol and drug treatment center in Tulsa, Oklahoma, was sentenced to 15 months' imprisonment and ordered to pay over \$1.5 million in restitution for defrauding H.O.W. over the course of eight years.
- The former executive director wrote himself 213 unauthorized checks for a total of more than \$1.35 million and embezzled more than \$200,000 from a thrift store operated by the nonprofit.



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Global Fund to Fight AIDS, Tuberculosis and Malaria

- In 2012, the Global Fund to Fight Aids, Tuberculosis and Malaria, based in Geneva, Switzerland, reported to the federal government a misuse of funds or unsubstantiated spending of \$43 million by grant recipients in several countries.
- The Global Fund determined in a 2013 report that 1.9 percent of Global Fund grants were misspent, fraudulently misappropriated, or inadequately accounted for.



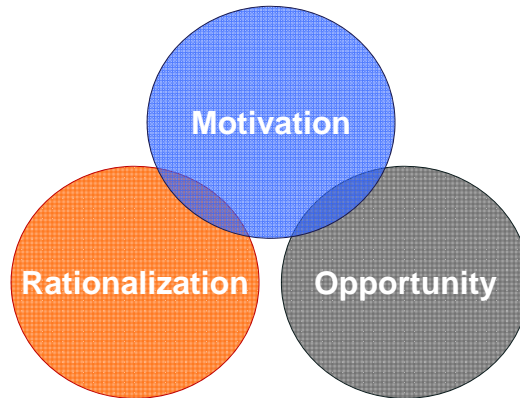
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Why Does Employee Fraud Occur?

Three Key Factors



Why Does Employee Fraud Occur?

■ Motivation

- Economic factors such as personal financial distress, substance abuse, gambling, overspending, or other similar addictive behaviors may provide motivation.

■ Rationalization

- The employee finds a way to rationalize the fraud.
- Such rationalizations can include perceived injustice in compensation as compared to their colleagues at for-profit enterprises, unhappiness over promotions, the idea that they are simply "borrowing" from the organization and fully intend to return the assets at a future date, or a belief that the organization doesn't really "need" the assets and won't even realize they are missing.

■ Opportunity

- The employee has sufficient access to assets and information that allows him or her to believe the fraud can be committed and also successfully concealed.



Why Are Nonprofits Frequently the Victims of Embezzlement?



Management and board members are often more trusting



Less stringent financial controls for nonprofits



A belief that audits will catch any fraud



Set the Tone at the Top



Effective Compliance Programs

- The best way to prevent embezzlement and to protect an organization given the nature of respondeat superior liability is a comprehensive and vigorous compliance program that must be more than a “mere paper program.”
- Any effective compliance program will:
 - Be tailored to the specific organization, such that the controls mitigate the risks inherent in that organization’s business and address any applicable government regulations and industry standards.
 - Include a written corporate code of ethics. The organization’s commitment to ethical behavior should be clearly and concisely communicated to the Board, management, and employees. This commitment to the code should be affirmed by all employees on a periodic and ongoing basis.



Effective Compliance Programs (cont'd.)

- Be owned by senior management. Management must be proactive. The Board must have ultimate oversight and control of the program.
- Provide for regular education and training for directors, management, employees, volunteers, and staff.
- Be regularly monitored and audited to ensure that it is working.
- Contain effective means to report violations and concerns, such as whistleblower hotlines or other anonymous reporting mechanisms.
- Provide for meaningful discipline for violation of the policy. A reputation for aggressively investigating fraud can have a strong deterrent effect while a reputation for ignoring possible fraud is an invitation to commit fraud.
- Require that appropriate steps are taken if a crime occurs.
- Address any control weaknesses uncovered.



Role of the Board

- Boards of Directors have a fiduciary duty to ensure:
 - Financial decisions are made soundly and legally;
 - Individual directors and management always put the organization's financial and business interests ahead of personal financial and business interests; and
 - The Board prudently manages the organization's assets in furtherance of the organization's stated purpose.
- Business Judgment Rule protects actions taken by board members, however those actions must be taken in good faith with that degree of diligence, care, and skill which ordinary prudent people would exercise under similar circumstances.

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Role of the Board (cont'd.)

- Satisfying these obligations requires hands-on oversight of management.
 - Review financial and other business records
 - Question management
 - Ensure the organization's policies, procedures, and mission are followed
- At least one board member should have relevant financial experience.
- At least some board members should not be current or former associates of management. Consider a seasoned lawyer as a board member, as well as members with nonprofit and sector expertise.

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Control Measures to Reduce the Risk of Fraud

Fraud Risk Assessments

- Purpose of a fraud risk assessment is to identify where fraud may occur within an organization and how it may be perpetrated.
- The Assessment Process:
 - Define fraud as it pertains to the organization's industry, culture, and tolerance for risk;
 - In collaboration with management and other appropriate employees, identify relevant fraud risks and scenarios;
 - Organize fraud brainstorming session for selected processes and/or departments;
 - Map fraud risks with their mitigating controls and identify control gaps;
 - Measure each fraud risk; and
 - Prioritize fraud risks.
- Conduct such assessments on a recurring basis. Risk level/tolerance may change.

Segregation of Duties

- One individual should not be responsible for an entire financial transaction.
 - Record; Reconcile; Custody of Assets; Authorization
- Money Coming In: No one person should be responsible for receiving, depositing, recording, and reconciling the receipt of funds.
- Money Going Out: No one person should be responsible for authorizing payments, disbursing funds, and reconciling bank statements.
- Require employees who hold financial positions to take vacation.
- Utilize compensating controls if the organization does not have enough staff on hand to segregate these duties.
 - A board director or officer could receive and review the bank and credit card statements.

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Double Signatures & Authorizations

- Multiple layers of approval will make it far more difficult for embezzlers to steal from your organization.
- For expenditures over a pre-determined amount, require two signatures on every check and two authorizations on every cash disbursement.
- Consider having an officer or director be the second signatory or provide authorization for smaller organizations.
- With credit cards, require prior written approval for costs estimated to exceed a certain amount.
- The person using the credit card cannot be the same person approving its use.
- Have a board member or officer review the credit card statements and expense reports of the Executive Director, CFO, CEO, etc.

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Require Backup Documentation

- All check and cash disbursements must be accompanied by an invoice showing that the payment is justified.
- If possible, the invoices or disbursement request should be authorized by a manager who will not be signing the check.
- Only pay from original invoices.



Never Pre-sign Checks

- Many nonprofits do this if the executive director is going on vacation.
- Keep blank checks and signature stamps locked up.



Purchasing and Fixed Asset Controls

■ Fair Bidding Process

- All contracts over a pre-determined financial threshold should be subject to at least three bids, and approved by a manager uninvolved in the transaction.
- Large contracts should be reviewed and voted on by the board.
- Extensive review of related-party transactions.

■ Fixed Asset Inventories

- Conduct a fixed asset inventory review at least once per year to ensure that no equipment (computers, printers, etc.) is missing.
- Record the serial numbers of the equipment and consider engraving an identifying mark on each item in case of theft.



Automated Controls

- Use system-generated reports to detect fraud when it occurs
- Provide ongoing monitoring and feedback mechanisms (e.g., system-generated e-mails notifying management of exceptions).
- Require physical access codes.
- Set system passwords.
- Use notification and alert services to alert the organization of possible debits to its accounts.
 - Positive pay exceptions notifications
 - Wire notifications (incoming/outgoing)
 - ACH Fraud Filter notifications
 - Balance threshold notifications



Conduct Background Checks

- Background checks on new employees and volunteers are important. Many organizations skip this basic step.
- The Association of Certified Fraud Examiners reports that 7 percent of embezzlers have been convicted of a previous crime.
- Background checks can reveal undisclosed criminal records and prior instances of fraud, allowing you to avoid a bad hire in the first place.
- They are also fairly inexpensive, and should be made a part of your hiring process.



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Mechanisms for Reporting and Investigating Fraud

- Explain what to do if employees/constituents perceive a fraud threat.
 - Whom to contact
 - How to contact
 - Anonymity
 - Evaluations of reports received
 - Incident responses
- Provide a means of anonymous communication.
- Employees must have a manner in which to contact a board member in the event something needs to be reported, and they do not feel comfortable reporting to management.
- Board members must be prepared to take these reports seriously, keep the reporting employee protected, and contact legal counsel.



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What to Do If an Issue Is Discovered?

What to Do If an Issue Is Discovered?

- Selection of Investigative Team
- Evidence Preservation
- Evidence Gathering
- Background Checks in an Investigation
- Interviews
- Reporting
- Remediation



Selection of Investigative Team

When selecting the investigative team consider the:

- Investigative team's relationship with the suspect or the whistleblower (the investigator should never be the suspect's supervisor)
- Investigative team's position within the organization
- Role of the suspect's supervisor in the investigative team
- Need for engaging external counsel, forensic accountants, and other investigative consultants
- Attorney-client privilege



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Evidence Preservation

- Preserve any potential evidence:
 - Pull back-up tapes
 - Preservation order
- Triage of potential evidence and target may include the following:
 - Placing the target on a leave of absence
 - Restricting his/her access to the organization's internal computer network and to its books and records
 - Organization should exercise caution and verify that these steps are taken in accordance with the company's policies and procedures/laws



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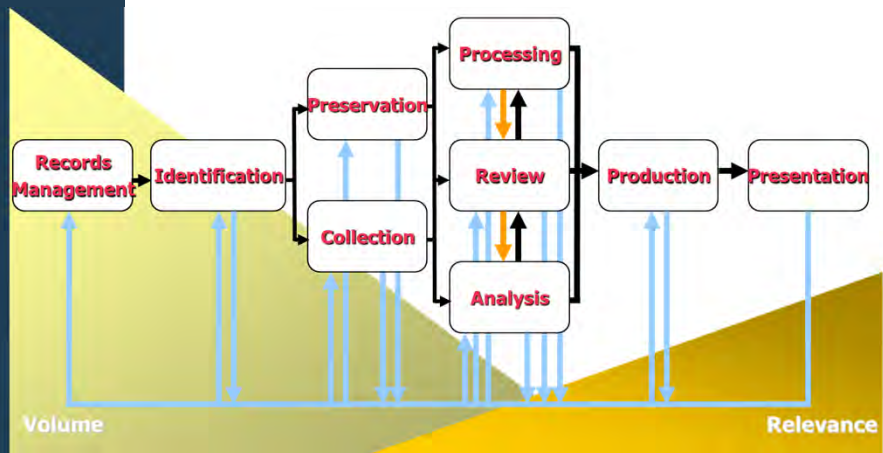
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Evidence Gathering

- Document chain of custody of documents and materials
- Electronic Evidence
 - Electronic Discovery Lifecycle - EDRM
- Background Checks
- Interviews



Evidence Gathering



Source: Socha Consulting and Kibbismid.com



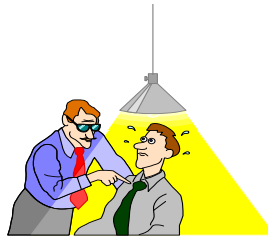
Background Check in an Investigation

- Conduct statewide criminal search as well as in the counties of residence/employment.
- Verify professional license and whether there has been any disciplinary history/sanctions by regulatory authorities.
- Conduct civil record, judgment, and lien searches in all jurisdictions linked to the subject.
- Use a combination of databases, plus free state record sites, as well as field investigators and sources.
- Don't limit a background check to an Internet search or to a compilation of raw data obtained from a search engine.
- Analyze the data in the context of the facts surrounding the fraud allegations being investigated.



Interviews

- Consider the timing of when the target is interviewed during the investigative process.
- Interviews are conducted by two investigators.
- Do not promise confidentiality “Upjohn Warnings.”
- Do not refuse to allow an employee to leave an interview.



Reporting

- Considerations can include the following:
 - Oral vs. Written/Privilege
 - Preparer
 - Distribution of the report
 - Facts, quantum, and circumstances
 - Should not contain recommendations for disciplinary actions or conclusions of guilt



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Remediation

- Root cause analysis
- Remediation of internal controls
- Need for new policies and procedures
- Training
- Disciplinary action



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Questions?

Jeffrey S. Tenenbaum, Esq.

jstenenbaum@Venable.com

t 202.344.8138

William H. Devaney, Esq.

whdevaney@Venable.com

t 410.244.7499

Joe Stephens

Joe.Stephens@washpost.com

t 202.334.6723

Nidhi Rao, CPA, CFE, CFF, CIA

NRao@bdo.com

t 301.634.4966

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Speaker Biographies





Jeffrey S. Tenenbaum

Partner

Washington, DC Office

T 202.344.8138 F 202.344.8300

jstenenbaum@Venable.com

AREAS OF PRACTICE

Tax and Wealth Planning
 Antitrust
 Political Law
 Business Transactions Tax
 Tax Controversies and Litigation
 Tax Policy
 Tax-Exempt Organizations
 Wealth Planning
 Regulatory

INDUSTRIES

Nonprofit Organizations and Associations
 Credit Counseling and Debt Services
 Financial Services
 Consumer Financial Protection Bureau Task Force

GOVERNMENT EXPERIENCE

Legislative Assistant, United States House of Representatives

BAR ADMISSIONS

District of Columbia

Jeffrey Tenenbaum chairs Venable's Nonprofit Organizations Practice Group. He is one of the nation's leading nonprofit attorneys, and also is an accomplished author, lecturer, and commentator on nonprofit legal matters. Based in the firm's Washington, DC office, Mr. Tenenbaum counsels his clients on the broad array of legal issues affecting charities, foundations, trade and professional associations, think tanks, advocacy groups, and other nonprofit organizations, and regularly represents clients before Congress, federal and state regulatory agencies, and in connection with governmental investigations, enforcement actions, litigation, and in dealing with the media. He also has served as an expert witness in several court cases on nonprofit legal issues.

Mr. Tenenbaum was the 2006 recipient of the American Bar Association's Outstanding Nonprofit Lawyer of the Year Award, and was an inaugural (2004) recipient of the *Washington Business Journal's* Top Washington Lawyers Award. He was one of only seven "Leading Lawyers" in the Not-for-Profit category in the prestigious 2012 *Legal 500* rankings, and one of only eight in the 2013 rankings. Mr. Tenenbaum was recognized in 2013 as a Top Rated Lawyer in Tax Law by *The American Lawyer* and *Corporate Counsel*. He was the 2004 recipient of The Center for Association Leadership's Chairman's Award, and the 1997 recipient of the Greater Washington Society of Association Executives' Chairman's Award. Mr. Tenenbaum was listed in the 2012-14 editions of *The Best Lawyers in America* for Non-Profit/Charities Law, and was named as one of Washington, DC's "Legal Elite" in 2011 by *SmartCEO Magazine*. He was a 2008-09 Fellow of the Bar Association of the District of Columbia and is AV Peer-Review Rated by *Martindale-Hubbell*. Mr. Tenenbaum started his career in the nonprofit community by serving as Legal Section manager at the American Society of Association Executives, following several years working on Capitol Hill as a legislative assistant.

REPRESENTATIVE CLIENTS

AARP
 Air Conditioning Contractors of America
 American Academy of Physician Assistants
 American Alliance of Museums
 American Association for the Advancement of Science
 American Bar Association
 American Bureau of Shipping
 American Cancer Society
 American College of Radiology
 American Institute of Architects
 American Society for Microbiology
 American Society for Training and Development
 American Society of Anesthesiologists
 American Society of Association Executives

EDUCATION

J.D., Catholic University of America, Columbus School of Law, 1996

B.A., Political Science, University of Pennsylvania, 1990

MEMBERSHIPS

American Society of Association Executives

California Society of Association Executives

New York Society of Association Executives

Association for Healthcare Philanthropy
Association of Corporate Counsel
Association of Private Sector Colleges and Universities
Automotive Aftermarket Industry Association
Biotechnology Industry Organization
Brookings Institution
Carbon War Room
The College Board
Council on CyberSecurity
Council on Foundations
CropLife America
Cruise Lines International Association
Design-Build Institute of America
Foundation for the Malcolm Baldrige National Quality Award
Gerontological Society of America
Goodwill Industries International
Graduate Management Admission Council
Homeownership Preservation Foundation
Human Rights Campaign
The Humane Society of the United States
Independent Insurance Agents and Brokers of America
Institute of International Education
International Association of Fire Chiefs
International Sleep Products Association
Jazz at Lincoln Center
LeadingAge
Lincoln Center for the Performing Arts
Lions Club International
Money Management International
National Association of Chain Drug Stores
National Association of College and University Attorneys
National Association of Music Merchants
National Athletic Trainers' Association
National Board of Medical Examiners
National Coalition for Cancer Survivorship
National Defense Industrial Association
National Fallen Firefighters Foundation
National Fish and Wildlife Foundation
National Hot Rod Association
National Propane Gas Association
National Quality Forum
National Retail Federation
National Student Clearinghouse
The Nature Conservancy
NeighborWorks America
Peterson Institute for International Economics
Professional Liability Underwriting Society
Project Management Institute
Public Health Accreditation Board
Public Relations Society of America
Recording Industry Association of America
Romance Writers of America
Trust for Architectural Easements
The Tyra Banks TZONE Foundation
United Nations High Commissioner for Refugees
Volunteers of America

HONORS

Recognized as "Leading Lawyer" in the 2012 and 2013 editions of *Legal 500*, Not-For-Profit

Listed in *The Best Lawyers in America* for Non-Profit/Charities Law, Washington, DC (Woodward/White, Inc.), 2012-14

Recognized as a Top Rated Lawyer in Taxation Law in *The American Lawyer* and

Corporate Counsel, 2013

Washington DC's Legal Elite, *SmartCEO Magazine*, 2011

Fellow, Bar Association of the District of Columbia, 2008-09

Recipient, American Bar Association Outstanding Nonprofit Lawyer of the Year Award, 2006

Recipient, *Washington Business Journal* Top Washington Lawyers Award, 2004

Recipient, The Center for Association Leadership Chairman's Award, 2004

Recipient, Greater Washington Society of Association Executives Chairman's Award, 1997

Legal Section Manager / Government Affairs Issues Analyst, American Society of Association Executives, 1993-95

AV® Peer-Review Rated by *Martindale-Hubbell*

Listed in *Who's Who in American Law* and *Who's Who in America*, 2005-present editions

ACTIVITIES

Mr. Tenenbaum is an active participant in the nonprofit community who currently serves on the Editorial Advisory Board of the American Society of Association Executives' *Association Law & Policy* legal journal, the Advisory Panel of Wiley/Jossey-Bass' *Nonprofit Business Advisor* newsletter, and the ASAE Public Policy Committee. He previously served as Chairman of the *AL&P* Editorial Advisory Board and has served on the ASAE Legal Section Council, the ASAE Association Management Company Accreditation Commission, the GWSAE Foundation Board of Trustees, the GWSAE Government and Public Affairs Advisory Council, the Federal City Club Foundation Board of Directors, and the Editorial Advisory Board of Aspen's *Nonprofit Tax & Financial Strategies* newsletter.

PUBLICATIONS

Mr. Tenenbaum is the author of the book, *Association Tax Compliance Guide*, now in its second edition, published by the American Society of Association Executives. He also is a contributor to numerous ASAE books, including *Professional Practices in Association Management*, *Association Law Compendium*, *The Power of Partnership*, *Essentials of the Profession Learning System*, *Generating and Managing Nondues Revenue in Associations*, and several Information Background Kits. In addition, he is a contributor to *Exposed: A Legal Field Guide for Nonprofit Executives*, published by the Nonprofit Risk Management Center. Mr. Tenenbaum is a frequent author on nonprofit legal topics, having written or co-written more than 500 articles.

SPEAKING ENGAGEMENTS

Mr. Tenenbaum is a frequent lecturer on nonprofit legal topics, having delivered over 500 speaking presentations. He served on the faculty of the ASAE Virtual Law School, and is a regular commentator on nonprofit legal issues for *NBC News*, *The New York Times*, *The Wall Street Journal*, *The Washington Post*, *Los Angeles Times*, *The Washington Times*, *The Baltimore Sun*, *ESPN.com*, *Washington Business Journal*, *Legal Times*, *Association Trends*, *CEO Update*, *Forbes Magazine*, *The Chronicle of Philanthropy*, *The NonProfit Times* and other periodicals. He also has been interviewed on nonprofit legal topics on Fox 5 television's (Washington, DC) morning news program, Voice of America Business Radio, Nonprofit Spark Radio, and The Inner Loop Radio.



William H. Devaney

Partner

New York, NY Office

T 212.983.8204 F 212.307.5598

whdevaney@Venable.com

AREAS OF PRACTICE

Foreign Corrupt Practices Act and Anti-Corruption

Investigations and White Collar Defense

Corporate Governance and Investigations

Commercial Litigation

Congressional Investigations

Class Action Defense

Litigation

Securities Enforcement and Compliance

Antitrust

International Dispute Resolution

International Trade and Customs

Internal Investigations

Brand Protection

Anti-Money Laundering

INDUSTRIES

Credit Counseling and Debt Services

Green Businesses

GOVERNMENT EXPERIENCE

Assistant United States Attorney, United States Department of

William (Widge) Devaney is co-chair of Venable's Foreign Corrupt Practices Act (FCPA) and Anti-Corruption Group.

Mr. Devaney's practice includes white-collar criminal defense in federal and state proceedings, SEC enforcement investigations and actions, complex civil litigation, civil RICO, defending individuals and corporations in multi-national investigations, including FCPA and export control, as well as conducting national and international internal investigations on behalf of corporate management, audit committees and special committees of boards of directors.

Mr. Devaney has significant jury trial and appellate experience, as well as significant experience leading investigations.

Mr. Devaney was an Assistant United States Attorney in the District of New Jersey, where he was most recently a member of the Securities Fraud Unit. As a federal prosecutor, Mr. Devaney investigated and prosecuted numerous cases involving securities fraud, bank fraud, mail and wire fraud, tax evasion, money laundering, terrorism, government program fraud, computer trespass, and export violations. Prior to joining the Department of Justice, Mr. Devaney practiced white-collar criminal defense and complex civil litigation, representing clients in federal and state criminal investigations, SEC and CFTC investigations, as well as attorney disciplinary proceedings.

SIGNIFICANT MATTERS

Mr. Devaney's recent matters have included the defense of corporations and individuals in areas such as the FCPA, export control and economic sanctions, antitrust, tax evasion, insider trading, accounting fraud, Medicare/Medicaid fraud, visa fraud, and mail and wire fraud, civil RICO, securities litigation and consumer fraud actions by state attorneys general. Mr. Devaney has also recently conducted several national and multi-national internal investigations for companies in the insurance, chemical, software, retail, and logistics industries.

HONORS

Recognized in *Super Lawyers Business Edition* in the Criminal Defense: White Collar category, New York, 2013

Selected for inclusion in *New York Metro Super Lawyers* in the Criminal Defense: White Collar category, 2011-2013

ACTIVITIES

Mr. Devaney is co-chair of the American Bar Association White Collar Crime Section Sub-Committee on Transnational Crimes. He is a member of the Association of the Bar

Justice, District of New Jersey

BAR ADMISSIONS

New York

COURT ADMISSIONS

U.S. District Court for the Eastern District of New York

U.S. District Court for the Southern District of New York

U.S. Court of Appeals for the Second Circuit

EDUCATION

LL.M., Cambridge University, 1995

J.D., Georgetown University Law Center, 1991

A.B., *cum laude*, Georgetown University, 1988

JUDICIAL CLERKSHIPS

Honorable Oliver Gasch, U.S. District Court for the District of Columbia

of the City of New York, (where he sits on the Criminal Advocacy Committee and previously sat on the Council for Criminal Justice), the Federal Bar Council and the National Association of Criminal Defense Lawyers. Mr. Devaney is also a member of the Criminal Justice Act panel for the U.S. District Court for the Southern District of New York.

PUBLICATIONS

Mr. Devaney has been the author of publications involving such topics as the FCPA and corporate compliance programs. Mr. Devaney also appears often in the print media commenting on current criminal matters.

SPEAKING ENGAGEMENTS

Mr. Devaney has recently lectured on reverse mergers, trends in SEC and Department of Justice enforcement and responding to attorney general civil investigations.

While with the Department of Justice, Mr. Devaney lectured extensively on the Patriot Act. He has also lectured on corporate criminal liability and served as a faculty member at the National Advocacy Center.

The Washington Post

Joe Stephens



Joe Stephens is a reporter for The Washington Post. An Ohio native, he spent a decade as an investigative projects reporter at The Kansas City Star before joining The Washington Post in 1999, where he specializes in in-depth enterprise reporting. Stephens is a three-time winner of the George Polk Award and, with colleagues, has on three occasions been a jury-nominated finalist for the Pulitzer Prize. Topics on which he has written extensively include the presidential race, political corruption, the war against terrorism, Afghan reconstruction, the federal judiciary and drug experiments conducted on children in the Third World. Stephens was a 2012 Ferris Professor of Journalism at Princeton University.

Stephens was a Pulitzer finalist in the investigative category for a review of the practices of the Nature Conservancy, the world's largest environmental organization. He was a finalist for national reporting for an investigation into secret CIA prisons and abuse of prisoners at Abu Ghraib, Iraq. He also contributed to a body of work on terrorism that won the staff of the Washington Post a finalist nomination for the Pulitzer Prize for Public Service.

Stephens won a George Polk Award for foreign reporting for articles revealing failures in the U.S. effort to rebuild Afghanistan. He won a Polk Award for legal reporting for stories that uncovered numerous financial conflicts in the federal judiciary, focusing in particular on judges who owned stock in companies appearing in their courtrooms. He won a Polk award for political reporting for his articles showing that casino companies had secretly promised to pay millions of dollars to elected officials and their supporters.

Stephens also has won awards from the Overseas Press Club, the Gerald Loeb Foundation, the Society of Professional Journalists, the Scripps Howard Foundation, Investigative Reporters & Editors, and the Annie E. Casey Foundation.

Stephens has lectured and conducted journalism training across the U.S. and abroad, and has appeared often on television news programs in the U.S. and Europe.

Biography



Nidhi Rao, CPA, CFE, CFF, CIA BDO Consulting Director

EXPERIENCE SUMMARY

Nidhi Rao is a Director in the Greater Washington D.C. office of BDO Consulting. She is a Certified Public Accountant and a Certified Fraud Examiner with more than 15 years of experience in the areas of forensic accounting, fraud investigations, litigation consulting, and internal control reviews. She has experience providing services to organizations in the not-for-profit, government contracting, hospitality, retail, and media industries.

Having significant forensic accounting and internal controls evaluation experience, she has led numerous investigations involving matters related to employee misconduct, embezzlement, misappropriation of funds, bribery, self-dealing, kickbacks, ponzi schemes, fraudulent financial reporting, and whistleblower complaints. Ms. Rao has also prepared and evaluated fidelity bond claims under employee dishonesty insurance coverage and has conducted fraud risk assessments and implemented policies and procedures to address fraud risks.

Ms. Rao has been published in several national publications and has presented at various conferences on such topics as internal investigations, fraud prevention, fraud risk assessments, corporate governance and the Foreign Corrupt Practices Act.

PROFESSIONAL AFFILIATIONS

American Bar Association - Associate Member
American Institute of Certified Public Accountants
Asian Pacific American Bar Association - D.C. Chapter
Association of Certified Fraud Examiners
South Asian Bar Association - Member of New York and D.C. Chapters
Women's White Collar Defense Group of Washington DC

EDUCATION

B.B.A., Accounting, University of Texas at Arlington

nrao@bdo.com
Direct: 301-634-4966
Mobile: 917-691-7892

7101 Wisconsin Avenue
Suite 800
Bethesda, MD 20814

Tel: 301-654-4900
Fax: 301-654-3567
www.bdoconsulting.com

Additional Information



Articles

November 2013

Preventing Fraud and Embezzlement in Your Nonprofit Organization

An abbreviated version of this article was published in Nonprofit Quarterly on December 4, 2013.

AUTHORS

William H. Devaney
Doreen S. Martin
Nicholas M. Buell
Jeffrey S. Tenenbaum

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On October 26, 2013, the *Washington Post* reported that from 2008 to 2012, more than 1,000 nonprofit organizations disclosed hundreds of millions in losses attributed to theft, fraud, embezzlement, and other unauthorized uses of funds and organizational assets. According to a study cited by the *Post*, nonprofits and religious organizations suffer one-sixth of all major embezzlements, second only to the financial services industry.

While the numbers are shocking, this trend will not surprise those in the nonprofit world, who have long known that nonprofits are highly susceptible to fraud and embezzlement. Nonprofits are generally established for beneficial purposes and assume that their employees, especially senior management, share the organization's philanthropic mission. As such, nonprofits tend to be more trusting of their employees and have less stringent financial controls than their for-profit counterparts. Thus, they fall prey to embezzlement and other forms of employee fraud at an alarming rate. By way of recent example, as reported by the *Washington Post*:

- From 1999 to 2007, the American Legacy Foundation, a nonprofit dedicated to educating the public about the dangers of smoking, suffered an estimated \$3.4 million loss as a result of alleged embezzlement by a former employee.
- In 2012, the Global Fund to Fight Aids, Tuberculosis and Malaria reported to the federal government a misuse of funds or unsubstantiated spending of \$43 million.
- In 2011, the Vassar Brothers Medical Center in Poughkeepsie, New York reported a loss of \$8.6 million through the "theft" of certain medical devices.

In addition to those incidents reported by the *Washington Post*, a few other recent examples include:

- On February 27, 2013, a former financial director for a New York chapter of the American Red Cross was sentenced to two to seven years in prison for grand larceny. The former director embezzled over \$274,000 between 2005 and 2009, using the money to pay for clothing, her children's tuition, and other personal expenses.
- On November 8, 2012, the former executive director of the H.O.W. Foundation, a nonprofit alcohol and drug treatment center in Tulsa, Oklahoma, was sentenced to 15 months' imprisonment and ordered to pay over \$1.5 million in restitution for defrauding H.O.W. over the course of eight years. The former executive director wrote himself 213 unauthorized checks for a total of more than \$1.35 million and embezzled more than \$200,000 from a thrift store operated by the nonprofit.
- On October 12, 2013, the former CFO of Project Genesis, a Connecticut nonprofit organization that serves adults and children with disabilities, was sentenced to 33 months' imprisonment after embezzling more than \$348,000 from the organization over a three-year period. The former CFO stole the organization's funds by keeping terminated employees on the payroll and then transferring their salaries to his personal bank account.

While external audits are necessary and helpful in ensuring that financial controls and fraud prevention measures are being followed and are effective, the standard audit is not designed and should not be relied upon to detect fraud. The Association of Certified Fraud Examiners reports that less than 4% of frauds are discovered as a result of an audit of external financial statements by an independent accounting firm.

Many nonprofits had previously elected to handle instances of fraud or embezzlement quietly in order to avoid unwanted attention and embarrassment. That is no longer an option. In 2008, the Internal Revenue Service implemented additional regulations designed to enable the public to more easily evaluate how

effectively larger nonprofits manage their money. Tax-exempt organizations whose gross receipts are greater than or equal to \$200,000, or whose assets are greater than or equal to \$500,000, are subject to additional disclosure requirements on their IRS Form 990 concerning embezzlement or theft. Specifically, these organizations are now required to publicly disclose any embezzlement or theft that exceeds \$250,000, 5% of the organization's gross receipts, or 5% of its total assets.

Additionally, in light of the disturbing numbers reported by the *Washington Post*, both Congress and numerous state attorneys general have pledged to launch investigations. This will inevitably lead to even greater scrutiny.

This newly found focus on fraud and embezzlement strikes at the heart of an organization's ability to raise funds and affect its mission. As one nonprofit official quoted by the *Washington Post* explained, "[p]eople give their money and expect integrity. And when the integrity goes out the window, it just hurts everybody. It hurts the community, it hurts the organization, everything. It's just tragic."

Nonprofits are not defenseless, however, and there are several proactive steps organizations can and should take immediately (if they are not doing so already) to prevent and detect employee fraud and embezzlement:

Double Signatures, Authorizations and Back-up Documentation

Multiple layers of approval will make it far more difficult for embezzlers to steal from the organization. For expenditures over a predetermined amount, require two signatories on every check and two different signatories on every authorization or payment. Where the professional staff of a nonprofit is too small to effectively implement a double signatory/authorization policy, consider having a (volunteer) officer or director be the second signatory. Similarly, all check requests and requests for cash disbursements should be accompanied by an invoice or other document showing that the payment or disbursement is appropriate. Never pre-sign checks. With credit cards, require prior written approval, again from two individuals, for costs estimated to exceed a certain amount. Require back-up documentation demonstrating the *bona fides* of the expense. And again, the person using the card should not be the same person authorizing its use.

Segregation of Duties

Hand-in-hand with multiple authorizations goes the segregation of duties. At a minimum, different employees should be responsible for authorizing payments, disbursing funds, and reconciling bank statements and reviewing credit card statements. If the nonprofit does not have enough professional staff to effectively segregate duties, a (volunteer) officer or director should be tasked with reconciling the bank statements and reviewing credit card statements. Because embezzlement also can occur when funds are coming into an organization, no single individual should be responsible for receiving, depositing, recording, and reconciling the receipt of funds. By the same token, all contracts should be approved by a manager uninvolved and personally uninterested in the transaction and, wherever possible, larger contracts should be the product of competitive and transparent bidding.

Fixed Asset Inventories

At least annually, the organization should perform a fixed asset inventory to ensure that no equipment or other goods are missing.

Automated Controls

Use electronic notifications to alert more than one senior member of the organization of bank account activity, balance thresholds, positive pay exceptions, and wire notifications.

Background Checks

Background checks on new employees and volunteer leaders can unearth things such as undisclosed criminal records, prior instances of fraud, and heavy debt loads that can make it more likely that an employee or volunteer leader might succumb to fraud. The Association of Certified Fraud Examiners reports that 6% of embezzlers have been convicted of a previous fraud-related offense.

Audits and Board-Level Oversight

The control measures discussed above only work if someone is checking. In addition to management, who should be ensuring that the measures discussed above are followed, nonprofits also should undertake regular external audits to ensure that these measures are effective. Organizations should establish audit committees on their boards of directors, containing at least one person familiar with finance and accounting, who would serve as the primary monitor of these anti-fraud measures. In lieu of an audit committee, smaller nonprofit organizations should consider putting a CPA or other financially knowledgeable person on the board of directors to serve a similar function.

Encourage Whistleblowers

While nonprofits should encourage the reporting of suspected wrongdoing to management or a designated board member, employees must have a means of anonymous communication if they do not feel comfortable reporting to their supervisor or management. Employees may not report theft or mismanagement if they believe that their job is in jeopardy. The board of directors must ensure that these reports are taken seriously, that the reporting employee is protected, and that outside legal counsel is brought in as appropriate.

Strong Compliance Program

The best way to prevent fraud and embezzlement and to protect nonprofits is a comprehensive and vigorous compliance program that must be more than a "mere paper program." An effective compliance program must be tailored to the specific organization, include a written code of ethics, be effectively implemented through periodic training, have real consequences for violations of the policy, have an effective reporting mechanism, and be periodically audited to ensure its effectiveness.

Self-Audits

Bringing in outside expertise – such as CPAs experienced in conducting fraud audits (different from the standard annual financial statement audit) and attorneys experienced in evaluating and enhancing internal controls as well as training staff on best practices – can be a critical tool in both identifying fraud and embezzlement that may be occurring and in shoring up weak controls and other process deficiencies that may make the organization more susceptible to theft.

While there will always be instances where a determined thief manages to beat an organization's controls, the steps suggested above will go a long way toward deterring and preventing embezzlement and other types of fraud at nonprofit organizations.

* * * * *

For more information, please contact William Devaney at whdevaney@Venable.com, Doreen Martin at dsmartin@Venable.com, Nicholas Buell at nmbuell@Venable.com, or Jeffrey Tenenbaum at jstenenbaum@Venable.com.

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Inside the hidden world of thefts, scams and phantom purchases at the nation's nonprofits



The American Legacy Foundation's headquarters in Northwest Washington (Linda Davidson/The Washington Post)

WRITTEN BY

Joe Stephens

Mary Pat Flaherty

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E-mail the writers ↗

For 14 years, the American Legacy Foundation has managed hundreds of millions of dollars drawn from a government settlement with big tobacco companies, priding itself on funding vital health research and telling the unadorned truth about the deadly effects of smoking.

Yet the [foundation](#), located just blocks from the White House, was restrained when asked on a federal disclosure form whether it had experienced an embezzlement or other "diversion" of its assets.

Legacy officials typed "yes" on Page 6 of their 2011 form and provided a six-line explanation 32 pages later, disclosing that they "became aware" of a diversion "in excess of \$250,000 committed by a former employee." They wrote that the

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Millions missing, little explanation

Published: Oct. 26, 2013

A Washington Post analysis identified more than 1,000 nonprofit organizations that have reported a “significant diversion” of assets since 2008, when a question about such losses first began being phased in on federal Form 990 disclosure reports. While some diversions involve legal exchanges, most are attributed to theft or embezzlement, sometimes leading to the loss of tens of millions of dollars to a single organization. Filing instructions direct organizations to explain what happened on Schedule O, usually located toward the end of the form. But The Post’s study found many organizations provide few or no details.

How nonprofits report diversions

[See examples »](#)



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Organization	Type	City	State	Revenue	Tax Year	Note
Trustees of Columbia University in The City of New York	Educational Organization Educational Institutions and Related Activities	New York	N.Y.	\$4,709,967,872	2011	
Global Fund To Fight Aids Tuberculosis and Malaria	Charitable Organization Medical Research	Switzerland		\$4,271,261,633	2011	
New York University	Educational Organization Educational Institutions and Related Activities	New York	N.Y.	\$2,970,318,554	2009	

The complete database can be accessed via wapo.st/diversionsdatabase.



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Posted on [November 18, 2013](#) by [Tim Mohr](#) and [Nidhi Rao](#)

Confront Fraud Head On: 5 Crucial Insights to Consider When Conducting an Internal Investigation

A recent [Washington Post](#) story provides a stern reminder that employee misconduct is an unfortunate reality in the nonprofit sector. As in industries traditionally more prone to fraud, individual offenders can often be left unnoticed by organizations, leading to violations and subsequent financial penalties for the nonprofit. The best approach for dealing with fraud, therefore, is to have in place sound protocols for internal investigations. Confronting potential instances of fraud with a delineated plan allows organizations to avoid common pitfalls that can undermine the investigative process. Recognizing these pitfalls is an important first step. Before beginning an investigation, read up on the following five blunders and our suggestions on how to avoid them:

1. **Investigative Bias** - When a manager initially assesses the situation, their first step is to assign a leader to the investigation and clearly determine to whom the details of the project will be accessible. To minimize biases and ensure sound judgment in all matters, managers should consider whether the leader is far enough removed from the circumstances to provide unbiased judgment. Does the candidate's relationship with the suspect provide them with sufficiently impartial discernment? Does the candidate's job title provide them with the resources necessary for obtaining all relevant information?
2. **No Suspect Isolation** - Depending on the seriousness of the fraud allegations under investigation, your organization should consider limiting or cutting off entirely the suspect's access to possible evidence. The idea here is to safeguard evidence as

best as possible. What are some best practices? To start, place the suspect on a leave of absence during the investigation and prohibit their access to your organization's books, records and internal computer networks.

3. **Evidence Slip-Ups** - Handle all evidence with caution; you don't want the lynchpin of your investigation to be considered invalid by the court. How can you best protect your evidence's integrity? Consider the following four steps:
 - A. Understand your organization's privacy policy to make sure the investigative team is collecting all materials appropriately.
 - B. Weigh the option of issuing a document preservation order.
 - C. Have the team document how, when and where exactly it obtained, handled and transported all evidence.
 - D. Ensure the investigator understands best practices for electronic data collection.
4. **Reliance on Background Checks** - These checks are limited in scope and effectiveness. Not only do they tend to miss critical details about the suspect's lifestyle and litigation history, but it's also difficult to take their findings and contextualize them within the investigation.
5. **Timing Gaffes** - Interviews can be crucial to securing actionable, insightful information for investigations. Before interviewing the suspect, though, make sure that the team has collected and reviewed all available information. This way, investigators will bring to the table richer, more pressing questions for the suspect that incorporate hard facts. Always interview suspects with multiple people present, as well, as it will provide witnesses and a reliable way to document findings.

Stay tuned to this blog for more information on best practices for reporting nonprofit fraud to the IRS.

Tim Mohr is a principal with BDO Consulting, where he leads the Investigative Due Diligence practice, and can be reached at tmohr@bdo.com. Nidhi Rao is a director at BDO Consulting, and can be reached at nrao@bdo.com.

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Material discussed in this blog is meant to provide general information and should not be acted upon without first obtaining professional advice appropriately tailored to your individual circumstances.



SIGNIFICANT DIVERSION OF ASSETS

By Laura Kalick, JD, LL.M



Recent reports regarding the significant diversion of assets by nonprofit organizations has caused federal and state officials to launch investigations as to what this actually means. The revised Form 990 Part VI, Section A (Governing Body and Management) line 5 asks: Did the organization become aware during the year of a significant diversion of the organization's assets? The instructions to Form 990 expound upon how the question should be answered. As you may be aware, the Governing Body and Management section was very controversial when added to the Form 990 during its revision. Segments of the public argued that only questions authorized by the statute should be reported on the form. The Internal Revenue Service (IRS) responded saying that a well-governed organization was more likely to be tax-compliant and, therefore, in order to insure that taxes are properly collected, they had the authority to ask the questions. Many in the nonprofit sector agreed that the transparency provided by the new form allowed the public to gain information that was necessary, especially in the case of a donor who was considering making a gift to a charity.

In April 2012 the IRS announced the results of a study it had done to see if a well-governed organization was more likely to be tax-compliant and stated they had found

that the greatest correlation between "good governance" practices and tax compliance was where the board of directors was significantly involved in setting compensation and also where organizations had procedures in place for the proper use of charitable assets. At the same meeting, the IRS announced a new audit program whereby the IRS would audit organizations that had indicated there had been a significant diversion of assets. The IRS looked at:

The tax filings and publicly available information on the 285 organizations that reported a significant diversion of assets in 2009 and that initial research found "roughly \$170 million in significant diversions was identified" and 82 cases resulted in civil or criminal charges against the responsible party. These are charges that were brought by the organizations involved, or by local authorities, who were outraged by the activity. They are not IRS charges. Forty-seven individuals were incarcerated or served probation for the diversion of the assets. Again, this did not arise from IRS actions. In nine cases restitution was paid in full; in 11 cases there was partial restitution.

See http://www.irs.gov/pub/irs-tege/georgetown_04192011.pdf for more details.

Here are the details of what is supposed to be reported. "Significant" means the gross value of all diversions (not taking into account restitution, insurance or similar recoveries) discovered during the organization's tax year to the extent they exceed the lesser of:

- (1) 5 percent of the organization's gross receipts for its tax year,
- (2) 5 percent of the organization's total assets as of the end of its tax year, or
- (3) \$250,000.

If the organization became aware of the diversion during the tax year, even though the diversion occurred in another year, the diversion is supposed to be reported. The organization is supposed to report on Schedule O the nature of the diversion, the amounts of property involved, corrective actions taken to address the matter and other pertinent circumstances.

A diversion of assets includes theft, embezzlement or any unauthorized use of the organization's assets and can involve any person, whether or not an officer, director, key employee or independent contractor. So it could also include a grantee diverting grant funds or an investment advisor. Diversions of assets do not include transactions at fair market value. For example, if an exempt organization sets up a taxable subsidiary and takes back the stock or enters into a partnership agreement where the exempt organization gets a quid pro quo interest, these are not a diversion of assets to be reported.

The IRS instructions to Form 990 note that, "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)." So this means that if it is found that a Disqualified Person, i.e., someone who can substantially influence the organization, diverts assets for his/her own behalf, in addition to any other adverse actions that could result, that person could be subject to a 25 percent tax on the excess amount and a 200 percent tax if the transaction is not corrected by returning it with interest.

For more information, contact Laura Kalick, national director, Nonprofit Tax Consulting, at lkalick@bdo.com.