

Association of Corporate Counsel, Nonprofit Organizations Committee: Legal Quick Hit
**Preventing Embezzlement and Fraud at Nonprofits:
What You Can Do To Protect Your Organization**

August 9, 2011 | 3:00 PM ET



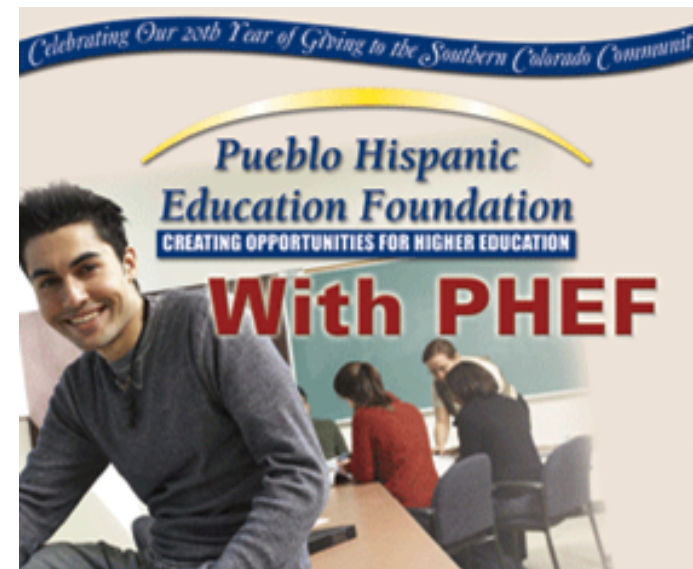
RECENT EXAMPLES OF NONPROFIT EMBEZZLEMENT





New Day Products & Resources



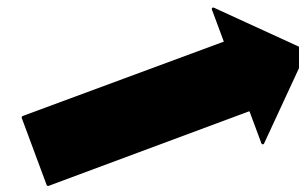


Why Does Employee Fraud Occur?

Three Key Factors



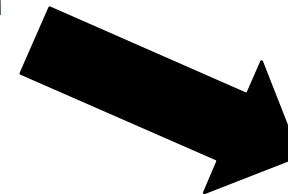
Why Are Nonprofits Frequently the Victims of Embezzlement?



Management and board members are often more trusting



Less stringent financial controls for nonprofits



A belief that audits will catch any fraud



Strong Compliance Program

- n 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.”
- n Any effective compliance program will:
 - Ø 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.
 - Ø Include a 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.
 - Ø Be owned by senior management. Management must be proactive. The Board must have ultimate oversight and control of the program.
 - Ø Provide for regular education and training for directors, management, employees, volunteers and staff.



Strong Compliance Program

- Ø Be regularly monitored and audited to ensure that it is working.
- Ø Contain effective means to report violations and concerns, such as whistleblower hotlines or other anonymous reporting mechanisms.
- Ø 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.
- Ø Require that appropriate steps are taken if a crime occurs.
- Ø Address any control weaknesses uncovered.

Company
Handbook

Your organization's
compliance policy
outlined here

2010



Preventing Embezzlement

Set the tone at the top



Role of the Board



- n **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
 - The Board prudently manages the organization's assets in furtherance of the organization's stated purpose
- n **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.**
- n **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
- n **At least one board member should have relevant financial experience.**
- n **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.**



Control Measures to Consider #1

Double Signatures & Authorizations

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



Control Measures to Consider #2

Require Backup Documentation

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



Control Measures to Consider #3

Never Pre-sign Checks

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



Control Measures to Consider #4

Segregation of Duties

- n One individual should not be responsible for an entire financial transaction.
- n Money Coming In: No single individual should be responsible for receiving, depositing, recording and reconciling the receipt of funds.
- n Money Going Out: No one person should be responsible for authorizing payments, disbursing funds, and reconciling bank statements.
- n If the organization does not have enough staff on hand to segregate these duties, a board director or officer should reconcile the bank and credit card statements.
- n Require employees who hold financial positions to take an uninterrupted vacation for two weeks – do not let them work from vacation – This permits transactions to clear properly in their absence. If you have an employee who refuses to go on vacation – that could signal a problem.



Control Measures to Consider #5

Conduct Background Checks

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



Control Measures to Consider #6, #7, #8

6.

Fair Bidding Process

- All contracts 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.

7.

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.

8.

Audits and Board Level Oversight

- Regular audits will not catch every instance of fraud. However, they are critical to prevent fraud, and there should be board level review, if not oversight, of the audit.



Control Measures to Consider #9

Encourage Whistleblowers

- n Provide a means of anonymous communication.
- n Employees may not report theft or mismanagement if they believe their job is in jeopardy.
- n 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.
- n Board members must be prepared to take these reports seriously, keep the reporting employee protected and contact legal counsel.



QUESTIONS?



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