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Work Product – Confidential
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Preventing Fraud

PREVENTING FRAUD

<David and Nina are sitting behind a desk>

< conversationally >

David: Hi, I'm David.

Nina: And I'm Nina.

David: Welcome to the Charitable Trusts Unit of the New Hampshire Department of Justice. Today we're going to talk about preventing fraud.

Nina: Yes, everyone loves to hear about preventing fraud, but nobody wants to be a victim.

David: And any charity, large or small, stands a good chance to be a victim of fraud.

Nina: Actually, David, often smaller charities, like sports leagues, have a higher risk of being victims of fraud because their boards of directors have not adopted internal controls.

David: So, before we go any further, what is fraud?

Nina: Fraud is cheating another person or entity through falsehood or deception.

Embezzlement, a type of fraud, occurs when a person takes money that has been entrusted to him or her and makes it their own..

David: Stealing. You're talking about stealing from a charity.

Nina: Exactly. Embezzlement is the most common type of fraud in the charitable world, but our recommendations today apply to all types of fraud.

David: So, Nina, if you were to give one piece of advice for preventing fraud, what would it be?

Nina: The most important thing is to have a board of directors that understands its responsibilities to safeguard the charitable assets under its control. Also, knowing that fraud can happen to any organization, and that every board has a fiduciary duty to be proactive in preventing fraud.

David: Fiduciary duty?

Nina: Don't worry; we're not going into that here. Just know that you have a legal duty to act in the best interest of the organization and act carefully with the organization's assets. The directors should not do things that are completely irresponsible, like signing blank checks. For further information, please see our video on Fiduciary Duties.

David: Ok, so the board has a fiduciary duty to act in the interest of the organization.

How should board members go about fulfilling that duty?

Nina: Well, since the board is responsible for choosing the person who has control of the money, they should be vigilant and aggressive in executing that duty. They also should monitor the person they choose. There are three factors that are indicative of the

likelihood of fraud in an organization:

<Screen out to Credit screen of factors – The FRAUD TRIANGLE>

Nina: The three factors are the person's integrity, the opportunity to commit fraud, and the pressure on the person.

<Direct shot of David>

David: So what should a board do?

<Direct shot of Nina, controls listing appears by side of head>

Nina: To reduce fraud, the board should first do its best to pick someone with integrity who isn't likely to commit fraud. Second, try to reduce the opportunities to commit fraud through internal controls.

<Fade to screen listing of cases of fraud and embezzlement, fly in style, news clippings>

Nina: (continuing, voiceover) You can't always tell who will commit fraud – many of the offenders our unit has dealt with in its decades of experience were respected individuals with no record. We've seen people in law enforcement, accountants, and other professionals commit fraud. Even though they were people the groups thought they could trust, they embezzled. Oversight of the individual is key. We have a phrase in the office: Trust, but verify.

<Direct shot back on team>

David: Before we get to oversight, the board has to select the person who will have control over the money. What should board members think about in selecting this person? Should a little league team's board be running background checks before someone becomes treasurer? That seems pretty extreme.

Nina: The key thing for the board to know is that they, the board members, are responsible for choosing the person who has possession of the charity's money.

David: So what should a board do if not a background check?

Nina: Every board should ask the person about himself or herself. If the he or she has been convicted of a felony; find out more. If the person embezzled from another charity, then hiring them to control your money could be a breach of your fiduciary duties.

Believe it or not, our unit has seen people do this over the years.

David: So the board members have a duty to protect the charity's assets, and they go about doing that through oversight of the person with possession of the money. So what are they actually doing as oversight?

Nina: Oversight actions verify the work of the person who has possession of the money. Since the board has a legal right to the bank records as well as check images, the person who is entrusted with the check writing powers should be able to produce reconciled bank statements within 24 hours. When the board makes a request and the person responds with questions like "What, you don't trust me?" and gets defensive, then you may have something to be worried about.

(Zoom to motion listing of oversight IC's)

Nina: (1) The treasurer should attend all board meetings and should give monthly reports on the financial position of the organization. (2) The board should review budgets and

watch the spending of the treasurer. (3) Finally, the bank statements should be mailed to a person other than the treasurer. A great way to do that is to have a P.O. box with only two people having control of the box.

(Text of list: (1) Treasurer should attend meetings and report monthly (2) Review Budgets (3) bank statements mailed to P.O. Box not the treasurer

(Back in on team)

David: Those controls sound like they're focused on how the treasurer does their job.

What else should the board be concerned with?

Nina: Another major source of fraud relates to cash. If someone steals money before it is deposited, then there's no paper trail or budget to track. Cash internal controls are especially important for organizations that handle a significant amount of cash, like a sports league. An example of weak cash controls would be where one person volunteers to be both the treasurer and handle concession money.

David: So what would be proper internal controls for cash?

(Zoom out to motion listing of IC's for CASH)

Nina: For cash, there are three main forms of oversight that an organization should have.

First, the person who has the power to write checks should never be the person who makes deposits. Second, there should usually be two people counting cash after an event and making deposits. Third, you should have a paper trail from an event to the bank, with signatures, verifying how much money was given to each person en route to the bank.

<Text of graphic: 1. Person writing checks should not make deposits. 2. Two people counting cash and making deposits. 3. Paper trail from event to bank>

<Camera back on Nina and David>

Nina: Those are the most important things for the handling of cash, but if someone wants more tips, the Charitable Trust Unit has an entire article on fraud prevention with tips that can be found on our website.

<Sub link to mike's Fraud Article doj.nh.gov/publications/pdf/preventing_fraud.pdf>

David: So after the board has selected someone, and has oversight of the treasurer and internal controls for how cash is handled, is there anything else the organization should be doing?

Nina: Yes. The last place that a lot of fraud occurs is with fraudulent expenses. While the treasurer may be giving out accurate and limited checks, the amounts of reimbursement should be only for the items for the organization, not personal expenses.

And a treasurer should never sign blank checks.

David: So what should the treasurer be looking for there?

<Screen fade to black for motion listing of check IC's>

Nina (voiceover): Expense fraud is either done by employees or by outside organizations faking or increasing bills. Before paying a bill, the treasurer should at a minimum see the invoice of the amount of the bill. For employee reimbursements, the treasurer should examine the receipt before paying the full amount to ensure it's only for business expenses. Finally, whenever possible the treasurer should verify invoices and bills through physical inspection to make sure everything is in order.

<Text of graphic: 1. See invoice before paying a bill. 2. See the person's receipt before reimbursing for expenses. 3. Verify the items bought, if possible.

<Fade screen back to the team>

David: Actually checking to see if the items were delivered, when possible.

Nina: Exactly.

David: So with the board watching over the treasurer, and all cash being verified before being deposited at the bank, and the treasurer watching over expenses, will doing all of that prevent fraud?

Nina: The reality is that if someone really wants to commit fraud, it can be extremely difficult to detect. Internal controls don't guarantee fraud prevention, but will help to create an environment where it's much less likely to happen.

David: Well, that's a lot of things for a charity to do. Thanks again for going into all that detail Nina.

Nina: Thanks for listening.

David: Are there any other resources for our watchers?

Nina (Holds up ROTN 2008): The Association of Certified Fraud Examiners issues a report every two years on fraud prevalence in the US in all organizations. It has detailed analysis on various fraud prevention techniques and their effectiveness.

<Sub link to 2008 report acfe.com/documents/2008-rttn.pdf >

Nina (holds up Preventing Fraud in Nonprofit Orgs): And this book, Preventing Fraud in Nonprofit Organizations, is specific to the nonprofit sector and outlines all the ways that individuals commit fraud within nonprofits and internal controls to prevent them.

<Sub link to “Preventing Fraud in Nonprofit Organizations, Edward McMillan, CPA
CAE>

Nina: And our watchers can always contact our office for even more resources to prevent fraud.

David: And that about wraps it up here at the Charitable Trusts Unit. We hope you enjoyed our discussion on fraud and learned some ideas to implement.