How could you let your bookkeeper steal from you?

Three internal controls you can implement today to prevent internal fraud

By: Kieron Mitchell, MBA and consultant with CICS

Perhaps the last question you'd want to hear from your board is, "How could you let your bookkeeper steal from you?" Chances are the answer would be, "Our organization lacked proper internal controls."

It is estimated that about 5–7% of nonprofit donations, tens of billions of dollars, will be lost as a result of stealing. Most of the stealing is done by the accounting department and upper management, and lack of internal controls is what usually allows the fraud to occur.[1] Once you are doing the "basic blocking and tackling" of financial control,[2] the next logical step is to implement the three simple internal controls discussed below.

The issue is not just the money that might be stolen, it's about maintaining donor trust in your organization. As a member of the executive team of a church or nonprofit, you have been given the responsibility to use your organization's resources wisely. Your donors assume that you will protect the assets they have entrusted to you. If it comes to light that you have allowed fraud, donations could fall like a rock.

So what can you do today to lower the risk of fraud significantly? The following controls are low-cost and easy to implement.

1. Don't let the bookkeeper do everything (segregate duties):

    If two people have to collude in order to defraud the organization, fraud risk is greatly reduced, and the dollar amount of successful fraud drops dramatically.

    A bookkeeper can defraud, but the largest fraud by dollar amount is due to the Executive Director. Once a month **a board member, preferably the treasurer, should "drill down" into some larger expenses, and some smaller, random expenses**. Keep asking questions and asking for documentation until you are convinced that the expense is legitimate.

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[1] Report to the Nation on Occupational Fraud and Abuse, 2012, The Association of Certified Fraud Examiners.

[2] Balancing your checkbook, reporting financial results on a regular basis, and only paying bills if they are properly authorized, for example.

In one of the nonprofits I directed the finances for, I instituted the practice in which a board member was to review and sign off on the credit card statements of the Executive Director.

If you receive a significant amount of cash in the mail, then **two people should open it**.

2. Break the fraud system:

A long-running system of fraud takes a lot of WORK to keep up. Bank statements need to be intercepted and modified, cancelled checks destroyed, vendor payments manipulated and, in general, the paper trail leading back to the fraudster needs to be changed so that he isn't caught. He can't afford to have someone else handling his paperwork.[3]

By **requiring a five-day-in-a-row vacation,** or, better yet, ten days, it makes it difficult to keep up the system of fraud. Something is likely to come to light during the vacation such as a call from a vendor who hasn't been paid in awhile (even though the books show everything is up-to-date), or a donor whose cancelled check looks like it might have been deposited in the wrong account "accidentally."

3. Set a good example (the "tone at the top"):

Children learn how to behave from watching what their parents do. Telling your child that it's wrong to steal while you are in the middle of downloading a bootleg DVD does little to deter them. Similarly, if the boss is willing to fudge an expense report, you better believe that the employees will feel more comfortable cutting ethical corners.

Upper management's emphasis on ethical behavior, and consistent modeling thereof, is the most important factor in keeping fraud from happening because it creates a culture of behavior and expectations. It is also the hardest of the three suggestions to define concretely because it is, by its nature, a cloud of behaviors. In addition to being a good role model, upper management needs to do things as subtle as frowning in staff meetings when someone suggests using a "loophole," to instituting the concrete policy of sending an email each year to everyone in the

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[3] Embezzlement: *How it works and how to prevent it*, Tax & Business letter, p. 3, Fall 2013, Yount and Company LLC.

organization encouraging them to make known anything questionable they have witnessed.[4]

You can put these controls in place today because they are low-cost and easy to implement. There are a number of other important financial controls that take more effort but are very important. One in particular worth mentioning is having a budget and reviewing it quarterly, if not more often. Comparing actual expenses to budgeted expenses makes it much more difficult to steal from an organization.

General Citations, additional reading: “Preventing Embezzlement and Fraud in Nonprofit Organizations,” The New York State Society of CPAs Not-for-Profit Organizations Committee, May 4, 2011, William H. Devaney, Jeffrey S. Tenenbaum.

About the author: With an MBA and almost twenty years of relevant experience, Kieron Mitchell provides full-service outsourced bookkeeping to churches and nonprofits anywhere in the U.S. (when he isn’t playing chauffeur to one of his teenage daughters). He would love to hear about your organization’s needs and challenges, and can be reached by going to www.cics.us.

[4] The most common way fraud is discovered is from an inside “tip,” so if you don’t already have a whistle-blower policy in place, ECFA-accredited organizations can find a good template by searching for “whistleblower” at www.ecfa.org. This has the added benefit of improving your IRS information return, the Form 990, since it implies having such a policy is best practice.