

## Protecting Your Organization from Operational Fraud: Deterrence Methods

by Cindy Bergvall, CPA

*"Treasurer and his wife take \$72,000 from local athletic group"*

*"Manager spends \$70,000 of government's money on personal expenses"*

*"Trusted employee used \$200,000 of company funds"*

Headlines like these appear in the local paper almost once a month. For every reported story, there are an estimated five to ten thefts that go unreported. The employer does not want the publicity, they don't want the hassle of dealing with the crime, or they believe it was adequately taken care of within the organization.

There is no question that occupational fraud occurs more frequently than we would like to acknowledge. Organizations want to say "that wouldn't happen here." But statistics actually show is that the typical fraudster is a long-term trusted employee--either in management or accounting.

The fact of the matter is that organizations must take steps to protect themselves.

Every two years the Association of Certified Fraud Examiners (ACFE) puts out a study that examines the number of frauds in the US and what can be done to curtail this type of theft.

The 2006 ACFE Report to the Nation on Occupational Fraud and Abuse identifies the following measures to reduce the size of the fraud loss:

- √ deter fraud
- √ detect fraud sooner.

The most effective measure to deter fraud is to provide an anonymous hotline for employees to report suspected fraudulent activity. Fraud is more likely to be discovered by an anonymous tip than by an internal audit or an external audit. Usually the tip comes from an employee but in some cases it can come from an outside vendor or a bank.

Third party services provide a confidential hotline for employees to report their suspicions. The mere existence of a hotline can serve as a deterrent as employees realize that such activity could be reported easily and anonymously.

The next three measures rank second in similar effectiveness:

- √ internal audits
- √ surprise audits
- √ fraud awareness training for all employees

Even if an organization is not large enough to have an internal audit department, there are things that they can do to periodically conduct

a surprise audit or "check" of certain areas.

The last measure, the external audit is not as effective as the other methods. This is ironic as most organizations place the most faith in this type of audit to detect or deter fraud. It is important to remember that the purpose of an external audit is to express an opinion on the fair presentation of the financial statements, not to detect fraud.

The internal controls of the organization also play a key role in avoiding fraud to begin with.

### Internal Controls-Your Best Weapon against Fraud

The general rule of thumb is to make sure to have at least two people involved in every transaction. The more people that are involved, the less likely that fraud will occur. Think of this example: John issues a purchase order for a computer. Barbara approves the purchase order. Jane opens the invoices from the vendor and sends them to John for approval. John initials that he received the computer. Jane inputs the invoices and prints the checks. Bill and Bob sign the check which requires two signatures. Rick reconciles the bank statement. Six people are involved.

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You may think-we don't even have six employees-this won't work for us. If you only have one employee in the organization and that person orders supplies, inputs invoices, and prints the checks, you'll need to get your Board involved. The Board (or Finance Committee) will need to see the check register each month. A Board member's signature could be required on the checks with a second member's signature for checks over a certain amount. Another Board member should periodically review the bank reconciliation. One person cannot have the full financial responsibility of the organization on their shoulders.

In designing internal controls for your organization you need to remember the statistics; most fraud occurs at the management level and the accounting level. The size of the loss increases with the level of the position, so the higher up within the organization the fraud occurs, the larger the amount of the fraud. Also, the typical fraudster tends to be a long term trusted employee. Your internal controls need to apply to everyone from the executive director on down. There needs to be procedures for the work of upper level staff to be checked and even spot checked by surprise audits.

### **What to look for: Occupational Fraud in all shapes and sizes**

Occupational fraud will generally fall into one of three categories. The most common is the misappropriation of assets. Someone directly takes money from an organization. The next is where someone structures something to indirectly benefit them-either by taking bribes or a conflict of interest. Lastly, occupational fraud can occur when the financial statements are misrepresented.

The misappropriation of assets can occur through the receipt cycle or the disbursement cycle and can involve cash or non cash transactions. It is important to note that when someone is taking money from their employer, they may go about it in several different ways.

In the receipt cycle, someone may take cash even before it is recorded on the books or they may divert customer payments to their own bank account and adjust the customers account with a credit.

Fraud involving disbursements tends to be more common. Someone can create a fake vendor with fake invoices and have the organization issue checks for products or services that were never received. They can purchase personal items from real vendors.

This is often seen when a person makes personal expenses on the company credit card. They can submit fake expense reports for mileage, meals, or hotel stays. They might make company checks out to themselves or sign over vendor refund checks to themselves. Payroll can be misdirected by submitting extra hours for hourly workers or setting up a fake employee. Bank transfers can be wired to personal accounts. Money from cash registers can be taken by voiding a sale and removing the cash.

Non cash losses occur when someone takes inventory or equipment. Nonprofits need to be especially careful in this area. Employees should not be allowed to even borrow equipment or supplies. These items were purchased with donor or grant money and care needs to be taken that they aren't used for personal benefits.

Indirect benefits can often be deterred by conflict of interest policies. Vendor selection for purchases over certain amounts should be competitive and the process should be carefully structured so that one vendor does not have unfair advantages. While frequent and repeat business with a vendor is usually just a good vendor relationship, you need to pay attention to these transactions and make sure that there aren't any behind the scenes relationships that are encouraging the business.

The process to deter fraud is time consuming. Identifying the risks noted above, setting up internal controls to address the risks, educating employees about how to spot fraud, and creating an environment where employees can easily and confidentially report fraud takes time and needs to be continually monitored. However the alternative-a front page headline or the time spent dealing with it internally makes the effort well worth it.

### **fraudreportonline.com**

Bee, Bergvall & Co. is pleased to announce a new service, **fraudreportonline.com**, an online reporting service that allows your employees to anonymously report suspected fraud within your organization.

For as little as \$99/yr. employees can log on to the website and complete a confidential fraud activity report. This report is then reported back to the organization.

Visit [www.fraudreportonline.com](http://www.fraudreportonline.com) or call Cindy Bergvall, CPA at 215-343-2727 for more information about this low cost subscription service.

# Know What's Covered Under Directors & Officers (D&O) Liability Insurance

By Ron Martin, Martin Kueny Insurance

**Directors and Officers Liability insurance**, or D&O, covers corporate activities. Because a corporation is legally a person, as are the directors and officers who direct it, D&O serves to protect each from liability associated with various actions and inactions.

But what happens when corporate interests differ from those of these individuals? In short, the coverage is not the same. An **indemnity policy** protects the corporation, while a **D&O policy** covers the individual acts of directors and officers. The two types of policies can work hand-in-hand to provide complementary coverage. They can also work apart.

## *No Criminal Act Coverage*

D&O policies do not cover criminal acts and are primarily for civil remedies, mainly damages. First and foremost, D&O policies represent the interests of the shareholders, as a group, and other corporate constituencies in directing the business and affairs of the corporation within the law.

D&O policies offer individual directors and officers the protection they need from personal liability and financial loss stemming from wrongful acts committed while acting as a corporate officer or director. Most policies also cover the liability of the corporate entity itself when the liability is from a claim involving the company's purchase or sale of securities.

## *Who's At Risk?*

Keep in mind, all companies — those that employ one or more individuals, work with customers, clients, or even competitors — are at risk. Any perceived violation leaves both the directors and officers of the company, as well as the corporate entity itself, at risk for lawsuit and in need of applicable coverage to adequately protect the business as well as the directors and officers involved.

## **Other Coverage to Consider**

*Employment Practices Liability* (EPL) can provide additional coverage, acting like an Excess policy in an employment situation, and can also involve claims by and against management. Enhanced coverage on a standard D&O might cover EPL, but should be verified with your insurance agent.

Actions including wrongful termination or demotion, breach of contract or agreement, negligent evaluation of an employee's performance, refusal to hire or promote someone, workplace harassment, failure to follow the company's personnel manual and more, can fall under EPL.

Insurance experts advise protecting yourself and your business with indemnity or D&O coverage and suggest you understand exactly what your policy covers. Remember, if your D&O policy does not cover EPL, you should consider purchasing EPL coverage, or have it written into your D&O policy.

For more information on D&O insurance, or questions regarding this article, please contact: **Ron Martin CIC, CISR** Martin Kueny Insurance Solutions 215-918-1002 x16; 267-200-0695 Fax or e-mail: [rmartin@martinonline.com](mailto:rmartin@martinonline.com)

## **2008 NONPROFIT MANAGEMENT TRAINING SEMINAR SERIES**

The Bucks County Center for Nonprofit Management is pleased to bring you the following seminars. All programs will be held at the Pennsylvania Biotechnology Center of Bucks County, 3805 Old Easton Rd. Doylestown, PA. Registration begins at 8:30 and programs end at 12:00pm. Cost is \$35 per seminar. A limited number of scholarships are available. To register, contact Liz Vibber, 215-343-2727 or [lvibber@bbco-cpa.com](mailto:lvibber@bbco-cpa.com). Brochures will be mailed in April.

### **SPRING 2008**

5/07/2008--The Redesigned Form 990

5/22/2008--Grant Seeking\*

6/19/2008--Starting a Development Program\*

### **FALL 2008**

9/18/2008--Board Development\*

10/16/2008--Individual & Major Gifts\*

11/13/2008--Annual Giving\*

\* Association of Fundraising Professionals *Essentials of Fundraising* seminar.

# **BBCo Community Bulletin Board**

We are pleased to accept your submissions of jobs and special announcements. E-mail directly to: Liz Vibber, lvibber@bbco-cpa.com.

**The Bucks County Assoc. for the Blind and Visually Impaired**, Newtown, Pa., has an opening for a full time Director. Requirements are a BA/ BS degree, MS preferred. At least 5 years experience in administration. Work in a handicapped, low vision or medical rehabilitation environment desired. Questions, resume and salary required should be e-mailed to Wooliest@aol.com and buckdj1@verizon.net. No phone calls.

Heather Gee, CFRE, CAP Vice President for Development Services of the **Philadelphia Foundation**, has been recently appointed the board of the International Association of Advisors in Philanthropy.

**Volunteer consultant wanted:** A small animal rescue is looking for someone with knowledge of buildings, property and local regulations that can assist us with locating a shelter for our abandoned and stray animals. We are looking for the resource to offer advice on buy/lease options, suggestions on types of structures to examine, suggestions on local regulations to consider and direction on where to find these properties. We anticipate this would demand 40 hours of effort over the next three to nine months. Please send questions or comments to pablo@cattalesinc.org

**Delaware Valley Society of Association Executives** has hired Denise Downing of Downing & Neff of Mt. Laurel, NJ as Executive Director and appointed Mike Taylor, ED of National Demolition Association as President. Also, DVSAE Association Leadership Day is scheduled for Friday, May 16<sup>th</sup> at the Cieara Building next to 30<sup>th</sup> Street Station in the city and will deal with Planning for Associations in the 21<sup>st</sup> Century.

**Twilight Wish Foundation** is pleased to announce new appointments to their board of directors. Catherine Scott Asplen, of Chalfont, PA, has been elected chairman of the board and takes over the helm from founder Cass Forkin, who is now President of the Board. Catherine Fishman, of Newtown, PA, has been elected Treasurer of the Board and Tammy Whittaker, of Horsham, PA, has been elected Corporate Secretary.

**Big Brothers Big Sisters of Bucks County** has two part-time positions. One Enrollment and Match position and one match support position. The Enrollment and Match position involves interviewing and assessing children and volunteers and making matches. The match support position involves coaching volunteers and children through issues within their match. Please email resume to Susan Bartels at bartels@bbbsbc.org if interested.

**Martin Kueny Insurance Solutions** of Warrington, PA , in conjunction with Philadelphia Insurance Company, has developed a comprehensive insurance program for the Animal Welfare Federation of New Jersey. With over 700 members, MKIS looks forward to assisting these shelters and rescue groups continue their important work by protecting their operations at reduced costs. Martin Kueny Insurance Solutions offers the same program in the State of Pennsylvania. Also, congratulations to **Mish Ganssle** who won a 2008 Lehigh Valley SUITS award.

**Joni and Friends Greater Philadelphia** On March 15, 2008 our new location will be 121 E Chestnut Street, 2nd floor, Ste 1, Souderton PA 18964. PO Box 64085 in Souderton for mail.

Spring, 2008

**BUCKS COUNTY CENTER FOR NONPROFIT MANAGEMENT**  
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