



Fraud Risk Management: What “Non-Profit Organizations” Should Know

Presented by Mike McCormack, BA, CFI
MNP Investigative and Forensic Services

Presentation Agenda

Why are we here?

To communicate:

- Why fraud/misconduct is an issue for not-for-profits
- What fraud is and who commits it
- What you need to know and ask about managing fraud risk in the NPO
- Your governance responsibilities



Understanding the Challenge



“I don’t appreciate you questioning my integrity. Especially since I’ve skipped town and can’t be there to defend it.”

Fraud Statistics

Highlights of the Association of Certified Fraud Examiners 2018 *Report to the Nations:*

- Fraud is extremely costly: on average, 5% of annual gross revenues are lost to fraud
- Fraud schemes went on an average of 18 months before detection
- The most common fraud types are billing schemes and corruption
- Anti-fraud programs and controls have a measurable impact on an organization's exposure to fraud
- The median loss in the **not-for-profit sector** is **\$100,000**
- Most frauds involved behavioural red flags of perpetrators living beyond their means or experiencing financial difficulty

What is Fraud and Misconduct?

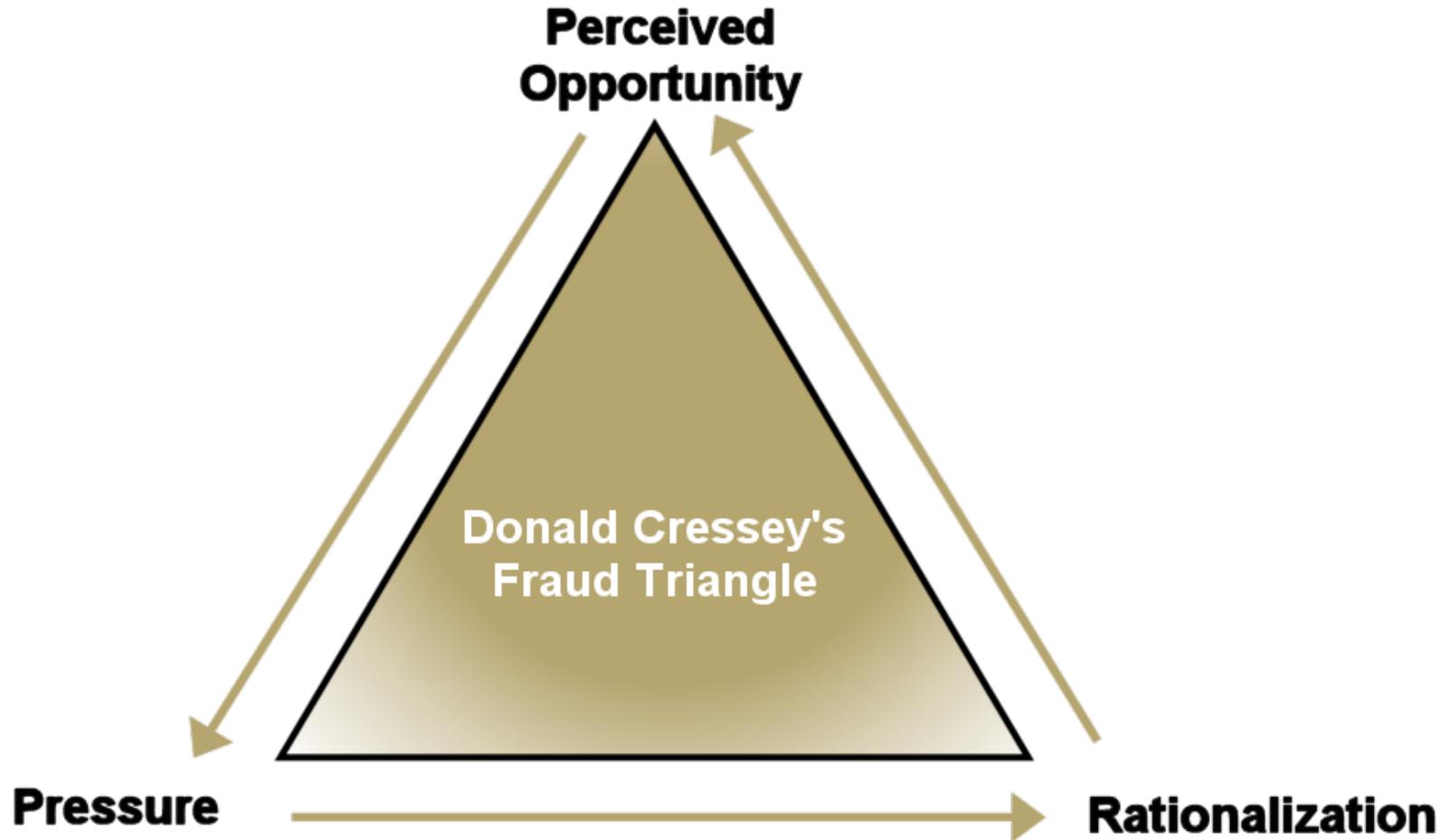
Fraud is deliberate **deceit** which is planned and executed to **deprive** an individual of property, money or any other valuable security. Fraud is committed with **intent** and includes actions of misrepresentations and/or acts of omission.

Theft is the illegal taking of another person's property without the person's freely given consent.

Fraud and **Theft** are not the same thing.

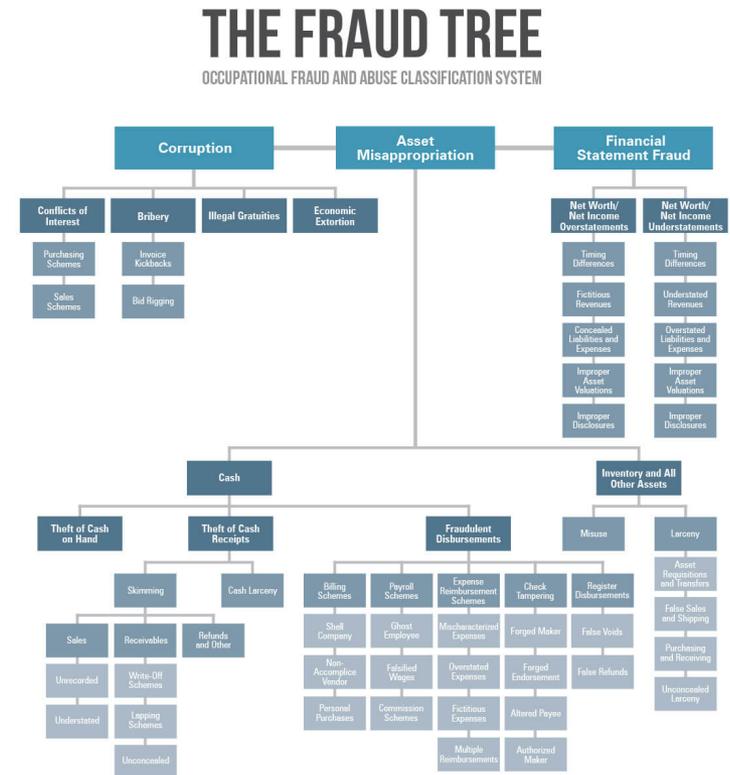
Misconduct is any act contrary to the best interests of the organization.

Fraud Theory



Types of Fraud and Misconduct

- Theft or division of inventories and capital assets
- Donation fraud
- Program, grant, or benefit fraud
- Bribery and corruption
- Bid-rigging and kickbacks
- Violation of privacy and data breaches
- Expense account fraud
- Bogus accounts payable schemes
- Payroll fraud



Why

- Lack of segregation of duties
- NPOs are generally smaller and require a strong ED who will have more control over financial matters
- Can happen anywhere to any organization
- General lack of oversight



What is Fraud Risk Management?

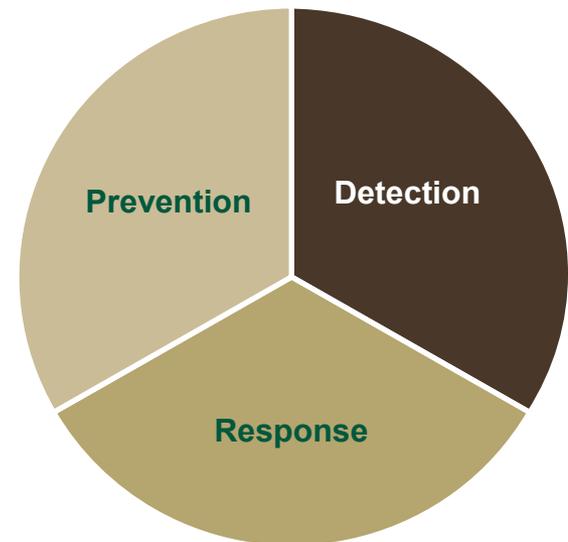
Effective anti-fraud programs provide an organization with tools to manage risk in a manner consistent with its stewardship requirements as well as its business needs.



Fraud Risk Management

Anti-Fraud Programs and Controls are focused on:

- **Prevention:** controls designed to reduce the risk of fraud and misconduct from occurring in the first place
- **Detection:** controls designed to discover fraud and misconduct when it occurs
- **Response:** controls designed to take corrective action and remedy the harm caused by fraud or misconduct



Fraud Prevention

Prevention includes:

- Performing the Risk Assessment
- Code of Conduct and “Tone at the Top”
- Documentation of Policies
- Application of Transaction-Level Controls
- Fraud Awareness Training
- Human Resource Procedures
- Delegation of Authority Limits
- Assigned Responsibility for Anti-Fraud Program



Prevention: “Tone at the Top”

- Foundation for all other components of internal control and fraud risk management
- Management sets the tone of an organization and influences the control consciousness of its people
- Through words and actions management creates & maintains culture of honesty & ethics, especially with respect to accounting functions and financial reporting

Prevention: Code of Conduct

- Code of Conduct – comprehensive, effectively communicated and understood throughout the organization
- Explicit guidance of expectations
- Makes it clear that violations will not be tolerated and remedial action will be taken
- Employees acknowledge compliance on an annual basis



Prevention: HR Policies

- Policies exist which promote recruiting & promoting competent & trustworthy people
- Volunteers and employees are pre-screened and monitored
- Employees are made aware of their responsibilities and management's expectations
- Performance Management and training or other programs are in place to ensure appropriate skills
- Integrity and ethical values are criteria in performance appraisals



Prevention Questions for NPO

Management and the Board should ask the following questions regarding preventative controls:

- Have we performed a fraud risk assessment?
- Are our HR policies and Code of Conduct defined and documented?
- Have we defined and documented transaction-level controls?
- How do we delegate financial authorities?
- Do we have an appropriate tone from the top?
- Do we have fraud awareness training for staff and volunteers?
- Who has responsibility for the anti-fraud program, and how often will they provide reporting to the Board?

Fraud Detection

Fraud Detection includes:

- Testing process and transaction controls to ensure they are working
- Solicitation of feedback via ethics reporting line or other means
- Employee feedback solicitation
- Employee periodic training and testing
- Periodic internal and external audit



Detection: Mechanism to Report

- Studies show that a significant portion of fraud is identified as a result of informants or ethics line complaints
- Controls should exist to report violations of company policies, including the Code of Conduct/Ethics, suspected fraud and misconduct and to ensure violations are investigated and documented
- Mechanisms should allow for confidential and anonymous reporting, by both internal and external parties



Detection: Monitoring

- Effective monitoring of controls provides insight into potential control weaknesses that may allow fraud to occur and go undetected.
- Effective monitoring consists of:
 - Ongoing monitoring by process owners to assess whether internal controls over financial reporting are operating effectively
 - Separate and periodic evaluation of internal controls over financial reporting by individuals independent of the process
 - Tracking and reporting of deficiencies to control owners, management and the Board on a timely basis

Detection: Controls Testing

- Controls testing involves ensuring that process and transaction controls as documented are actually occurring in practice
- It also includes:
 - Ensuring segregation of incompatible duties
 - Ensuring management review takes place
 - Verification that reconciliations occur
 - Ensuring financial authority limits are heeded
 - Reviewing database and other access controls
 - Review of HR policy application

Detection Questions for NPO

Management and the Board should ask the following questions regarding detective controls:

- How do we know our controls are working?
- How often do we test and report on our anti-fraud controls?
- Do we have a mechanism to receive complaints anonymously? Do we track complaints we receive?
- Do we take into account feedback from auditors in our anti-fraud program?
- Have we trained our employees?

Fraud Response

A structured fraud response plan provides those people within your organization who may receive reports of alleged fraud and misconduct with guidance on how to respond.

It addresses such matters as:

- Responsibility and protocol for investigations
- Need to consult with internal counsel
- Impact of Privacy Legislation on investigation
- When to involve outside parties
- Consideration of avenues of recovery
- Remediation of control weaknesses
- Reporting to the Board



Fraud Response Considerations

- Does the NPO have insurance that will cover a financial loss or costs of an investigation?
- Who should conduct the investigation?
- What impact will our decisions have on internal controls, company policies and procedures, and morale?
- Is the alleged misconduct culpable or non-culpable? (legal consideration)
- Will we require an external media communication strategy?
- What should the ED say to employees?

Fraud Response Considerations

- Does privacy law have an impact on the situation?
- What time and resources will be required to deal with this?
- Where is the evidence and how do we contain it?
- What if we need to obtain evidence from elsewhere?
- What to do if an employee is under suspicion

Response Questions for NPO

- What does Management do when there is a serious complaint?
- Do we have Critical incident response protocols in place?
- How does Management plan to mitigate further risk?
- How do Management plan to investigate?
- How are results reported to the Board?
- What is the Board's responsibility related to the results of an investigation?



Summary

Board of Directors should ensure that its own governance practices set the tone for fraud risk management.

The Board needs to make sure that the CEO and Administration have a plan to manage the risk of fraud, and it includes elements of prevention, detection, and response, as well as periodic reporting at a Governance level.

Management should, through enquiry and periodic review of reports, have a level of comfort that the fraud risk management program is well-designed, fully implemented, and periodically tested and re-assessed for effectiveness.

Fraud risk cannot be completely eliminated in any organization – but it can be significantly mitigated.

Questions & Answers



Thank you



**Michael McCormack,
BA, CFI**

📞 780.733.8673

✉ Michael.McCormack@MNP.ca