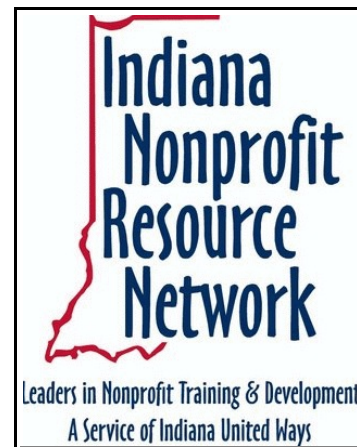


Safe Passage for Nonprofits

Reduce Risk
Increase Confidence
Manage Compliance



September 12, 2011

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Safe Passage for Nonprofits

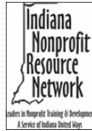
Reduce Risk – Increase Confidence – Manage Compliance

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* The standard disclaimer applies – the author is an attorney, but not YOUR attorney. Any information presented in the workshop materials are yours to use, but at YOUR OWN RISK. The author recommends that you (a) review any forms carefully and modify them to suit your particular circumstances and (b) have your attorney review the materials before implementation, to be sure that they are legally appropriate for your organization.

SAFE PASSAGE FOR NONPROFITS:
KEEPING YOUR NONPROFIT ON THE RIGHT PATH



Reduce Risk
Increase Confidence
Manage Compliance

September 12, 2011

Sponsored by:
Indiana Nonprofit Resource Network
DeKalb County Community Foundation

Presenter:
Miriam Robeson,
Attorney

WHY ARE WE HERE?

- Starting with 2010, the IRS has increased scrutiny of nonprofits with an aggressive program to revoke nonprofit status for out-of-compliance nonprofits
- Economy has decreased available funds for nonprofit budgets, but increased criticism of nonprofit
- Increase in media attention on unscrupulous nonprofits and nonprofit directors/officers
- It's easier to PREVENT problems with nonprofit status – after problems become public, it may be too late to fix

Information Level –Intermediate
Assumes some familiarity with basics of nonprofits

WHY ARE WE HERE – PART 2
THE HORROR STORIES AND BAD PRESS

- Investigation of Fiesta, Sugar, and Orange Bowl games for abuse of nonprofit status and “extravagant compensation”
- Medical Association of Atlanta ED pleads guilty to embezzling more than \$300,000
- Nonprofit Status of 30 credit counseling organizations revoked for failure to achieve a nonprofit purpose and for excessive executive compensation
- Close to Home** – Fort Wayne – Garrett woman embezzles > \$30K from St. Joseph Catholic Church

**WHY WE ARE HERE – PART 3
THE IRS**

- IRS increases nonprofit oversight
 - Employment Taxes
 - Executive Compensation
 - Activist Agenda
 - Compliance (Tax forms)
- Since 2008, the IRS has added more than 100 employees to the Exempt Organizations Section
- As of June, 2011, the IRS has “automatically revoked” the nonprofit status of more than 275,000 nonprofits

SAFE PASSAGE FOR NONPROFITS

- Compliance
- Accountability
- Transparency
- Risk Management
- Danger Zones



COMPLIANCE

- Government and other technical requirements

COMPLIANCE – STATE REQUIREMENTS

Annual
Business
Entity
Report

- Indiana Secretary of State
- We exist!
- Failure to file – Administrative Dissolution
 - Must file Application for Reinstatement
 - Clearance Letter from State Department of Revenue
- Catch up on delinquent reports
- Time-consuming, tedious, and easy to make errors
- Can cause trouble with IRS nonprofit status
- Check out your standing at the IN SOS website

COMPLIANCE – STATE REQUIREMENTS

Entity
Annual
Report

- Indiana State Board of Accounts
- Form E-1
- Not to be confused with the IN SOS Annual Business Entity Report
- Required for ALL nonprofits that receive State grant funds – even if through another entity.
- May be required if you received federal funds
- Determines whether your nonprofit must have an audit
- For some nonprofits – this is a new requirement

COMPLIANCE – STATE REQUIREMENTS

Annual
NP 20

- Indiana Department of Revenue
- We Exist! Also attach IRS 990EZ or 990, if filed
- Failure to file – possible tax assessment – possible audit

COMPLIANCE - FEDERAL

IRS – 990 Form

<\$50,000 – 990 N

- Change in thresh hold effective for tax years ending in 2010
- On-line ONLY
- Due 5 + 15 after end of fiscal year
- NO extensions of time!

>\$50,000 – 990 EZ / 990

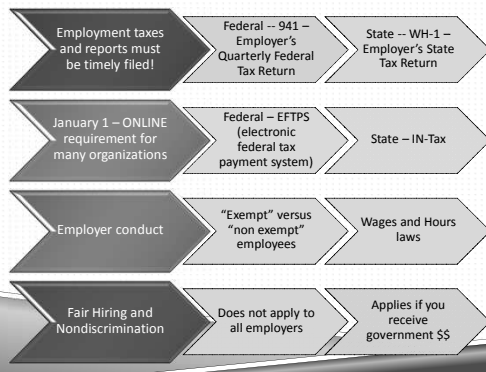
- Due 5 + 15
- 6 month automatic extension of time
- For most nonprofits – 990 EZ
 - Minimal property or real estate
 - Normal gross receipts < \$200,000

Failure to file – *automatic* revocation of §501(c)(3) status

COMPLIANCE – IRS IS YOUR NONPROFIT “ON THE LIST?”

- **IRS Publication 78** – Cumulative List of Nonprofit Organizations approved by the IRS
- <http://www.irs.gov/charities/article/0,,id=96136,00.html>
- Go to IRS website and search “Publication 78”
- Incorporation as a State (Indiana) nonprofit does not equal IRS nonprofit - 501(c)(3) - Status

COMPLIANCE - EMPLOYMENT



COMPLIANCE - UBIT

UBIT – Unrelated Business Income Tax

- (A) Trade or business
- (B) regularly carried on
- (C) not "substantially related" to exempt purpose

Examples:

- Apartment rental income
- Charity gaming income

If UBIT constitutes "substantial portion" of income, nonprofit can lose exempt status!

ACCOUNTABILITY

The Buck Stops with the Board

Board reports to

- Donors
- Government
- Sponsors
- Grantors

Are you Good Stewards of the resources the public entrusts in your care?

ACCOUNTABILITY - FINANCIAL

- Financial Policies
- Financial Controls
- Monitor appropriate use of nonprofit funds
- Audit - review

ACCOUNTABILITY -
FINANCIAL GOVERNANCE POLICIES

- Policies for –
 - Handling Money
 - Recording Money
 - Reporting Money

ACCOUNTABILITY - GOVERNANCE

- Conflict of Interest
- Ethical Standards

ACCOUNTABILITY - CONFLICTS OF INTEREST



Watch Appearance of Impropriety!

ACCOUNTABILITY - PERSONAL BENEFIT

A Nonprofit
CANNOT
distribute funds to
members, officers
or directors

ACCOUNTABILITY - ETHICS

When are your actions...

Legal?

Illegal?

Question-
able?

Un-
ethical?

NONPROFIT ETHICAL ISSUES - EXAMPLES

- Improper donor acknowledgements
 - Donations of time are not tax-deductible
- Donor "influence-buying"
- Improper arrangements with donors
 - Failing to include both spouses in joint gift paperwork
- Staff/ED/Board/Volunteer accepting gifts from donors
- Failing to take responsibility ("Not My Fault")

Only 10% of the public
believes that charities are ethical

- Failure to properly account and restrict use of donor-specified donations (illegal and unethical!)
 - Capital contributions used for operational expenses
 - “Borrowing” from restricted funds
- Purchases from Board-member business without proper disclosure (the copy shop example)
- Failure to consult professionals for assistance, when needed (lawyer – accountant)
- Improper oversight of spending (financial control policies) - Indianapolis Humane Society

MORE EXAMPLES – ETHICS

TRANSPARENCY – CREDIBILITY TO PUBLIC
Regularly provide information to the Public

Required disclosures

- Tax returns
- Organizational Documents
 - Articles of Incorporation
 - Bylaws
- Funds used for lobbying
- Application for Exempt Status

Recommended disclosures

- Annual report
- Basic Financial Statement
- Report of Activities
- Mission/Vision

RISK MANAGEMENT FOR NONPROFITS

▶ Best Practices to Prevent Financial Crisis

- ▶ Identify Risk
- ▶ Rank Risk
- ▶ Identify Policies to manage risk
- ▶ Implement protections
- ▶ Implement procedures in event of crisis





RISK MANAGEMENT - PEOPLE

- ▶ Poor economy has resulted in an increase in criminal conduct against nonprofits
- ▶ Embezzlement by employees
- ▶ Embezzlement by officers
- ▶ Fraud from “outsiders”
- ▶ Phrase of the Day – “Trust But Verify”

NONPROFITS AND FRAUD

WHAT TO DO WHEN IT HAPPENS TO YOU!

Fraud Alert!

If you suspect fraud – act immediately!

- Lock-down data
- Start a formal audit process with outside auditor
- Change procedures and rotate staff responsibilities

If you verify fraud

- All of the above, PLUS
- Confront the perpetrator (employee, officer, outside contractor)
- Copy and compile evidence in a separate, protected and confidential file
- Contact the police, if appropriate

See - Handouts

PR FOR NONPROFITS

PUBLIC RELATIONS DURING FRAUD CRISIS

If Fraud or embezzlement finds your Nonprofit.

- How the public hears about and perceives the incident can drastically affect the nonprofit's ability to move beyond the event.

DO NOT HIDE or Minimize the seriousness of the event

- If you are contacted by the press, answer! - if you don't get your story out, no one will, and speculation will replace facts

Have a plan of action for response

- If employee: suspension, termination
- If board member: resignation, removal
- Note appearance of impropriety is enough to take action for a board member, but more evidence is needed to take action against an employee

PREVENTING FRAUD

Have and use financial control policies

Know who handles the money

Remove temptation

Review financial information

- ALSO - have independent review of finances

Be aware that it can happen to your nonprofit!

OTHER DANGER ZONES

Lobbying – political activity

Charity Gaming

Abuse of Nonprofit Status

DANGER ZONE - LOBBYING

CANNOT DO

- Endorse political candidate
- Spend more than 5% of annual budget on lobbying activities
- Directly lobby legislators

CAN DO

- Hold Candidate forum
- Educate the public on the issues important to the nonprofit
- Encourage like-minded supporters to contact their legislators

DANGER ZONE – CHARITY GAMING

Rule 1 - Gambling is illegal in the State of Indiana

Rule 2 – Charity Gaming is allowed, but regulated

WHAT IS “CHARITY GAMING?”

Games of chance -- “Pay to Play”

- Raffles
- 50-50 Raffles
- Program “sticker” prizes
- Bingo
- Casino Night

Door prizes for Cost-Admission Event

NOT Charity Gaming – NOT Regulated:

- Games of SKILL – Guess the pennies, shoot the basket
- Silent Auction

DANGER ZONE - ABUSE OF STATUS

Abuse of Status

Improper Conduct
Excessive Executive Compensation

“Private Inurement”

- Excessive compensation
- Unreasonable Rental Agreements
- Unreasonable lending agreements
- Unreasonable sales transaction

Consequences

IRS Consequences – \$\$

- Fines to Nonprofit
- Fines to Board of Directors
- Fines to Staff
- PERSONAL LIABILITY FOR ALL!

IRS Consequences –
Revocation of Nonprofit Status

HAS YOUR STATUS BEEN REVOKED?

Google: “recent IRS revocations”

<http://www.irs.gov/charities/charitable/article/0,,id=141466,00.html>

Comprehensive List of
“Automatic Revocations”
(organized by state)

<http://www.irs.gov/charities/article/0,,id=240099,00.html>

WHAT IF YOU LOSE NONPROFIT STATUS?

If your organization loses nonprofit status, you are NOW a taxable corporation

File 1120 Corporate Return

Pay Income Tax (Federal and State)

Donations NOT tax-deductible to donor

Loss of eligibility for MOST grants, including pending grants

HOW CAN YOU RECOVER NP STATUS?

- Loss of Status **cannot** be reversed or appealed
- Must go through re-application for tax exempt status
 - *May include request for retroactive reinstatement to avoid taxes for "interim period"*
 - Requires payment of user fee (\$400 or \$850)
 - Small nonprofits *might* be allowed to pay \$100 user fee
 - Must write "Automatically Revoked" on application
- If exemptions do not apply, **must** provide complete packet of information for re-application

FOR MORE INFORMATION

- IRS.gov – Exempt Organizations
 - Publication 557 – Tax Exempt Status Info
 - Publication 78 – Approved nonprofit list
- Indiana Charity Gaming Commission
- Indiana Secretary of State
- Indiana Department of Revenue
- Guidestar.org
- Charity Navigator

SAFE PASSAGE FOR NONPROFITS

- Compliance
- Accountability
- Transparency
- Risk Management
- Danger Zones



Any Questions?

THANK YOU FOR YOUR ATTENTION!

Miriam Robeson, Attorney
Today's materials are available on Miriam's
Website:

<http://blog.lawlatte.com/index.php/upcoming-workshops/>



Nonprofit Financial Control Policy

The Board desires to set a tone of accountability for managing finances. This policy establishes controls for handling receipts and disbursements, including notation of what transactions require Board approval.

1. Check-Signing Authority. The board chair, treasurer, chief executive, and one senior staff member other than the director of finance, as designated by the chief executive, are authorized to sign checks.
 - a. One Signature Authorized. Checks up to \$250 require one signature.
 - b. Two Signatures Required. Checks over \$250 require the signature of two of the following: the board chair, treasurer, chief executive, or other senior staff member as designated above.
 - c. Board Approval Required. Board Pre-approval for expenses in excess of \$1000 is required.
 - d. Self-signing Checks Prohibited. No one may sign a check payable to oneself, either as a sole or a secondary signature.
2. Accounting and Cash Management Security.
 - a. Counting Cash. For all fund raising activity or receipts of cash from events, two people will count the cash, together.
 - b. Deposits. All cash and checks will be processed immediately; if deposits cannot be made in a timely manner, checks and cash will be locked in a secure location.
 - c. Computer Controls. Computers will be password-protected and kept in a secure location. Laptops will be stored in a secure location when not in use.
 - d. Reconciling Accounts. All accounts will be reconciled monthly.
3. Cash Disbursements. Cash Disbursements are discouraged; however, an authorized check signer will make disbursements only upon review and approval of the transaction, including review of proper supporting documentation, such as a purchase order and evidence of the receipts of the goods and services.
4. Collection of Funds and Deposits. Ideally, the person that writes checks does not make deposits. For all deposits, careful record funds must be made, including fund account deposited to, purpose of deposit, donor (or payor), and amount. Copies of all checks are encouraged. If possible, deposits should be verified and initialed by another staff or Board member.
5. Board and Staff Fiduciary Duty. It is the duty of any Board and Staff member who has authority to sign check to verify that there are sufficient funds available for payment of the checks before affixing his or her signature.
6. Board Approval Required for all Credit and Borrowing Transactions. Board approval must be obtained for all applications of credit and loans. At least two signatures, at least one of which must be a Board Member, are required to obligation Acme for any loan or extension of credit.
7. Credit Cards and ACH Payments prohibited. Except for payroll and as otherwise specifically approved by the Board, use of company credit cards or ACH payment of expenses is prohibited.
8. Annual Audit or Review. The Board will conduct an annual audit or review of the financial accounts. If a third-party audit is not feasible, at least one Board Member, other than the Treasurer, will review all income and expenses, bank statements, and account balances for the year. A report will be made to the Board of any findings

10 Financial Priorities for Nonprofit Boards

Proper financial management is more than an easy “Top-10” list. However, adopting basic philosophies with respect to how financial management is governed will make compliance with financial policies more natural, and financial failures more recognizable (sooner, rather than later).

1. **Remember the Mission** – The mission must be a top priority. This is especially true for financial policy, budgeting, allocation of resources, and (when necessary) budget cutbacks.
2. **Remember loyalty to constituents, organization and donors** – All financial decisions should serve constituents, be true to the organization, respect the wishes of donors and requirements of granting organizations.
3. **Be an engaged Board Member** – The day of the “honor board” is gone. Board Members are selected for the talents they bring “to the table.” If you cannot commit to regular meetings and regular participation in the life of the organization, you should respectfully resign and make room for an active replacement.
4. **Develop basic financial literacy** – Understand basic terms, be able to find “income” and “expense” information and know how to ask questions about financial performance of programs. While financial genius is not required, ALL Board Members should have some basic understanding of the financial picture of the Nonprofit.
5. **Establish and USE Financial Controls** – Assume mismanagement or fraud CAN happen to your nonprofit. Financial controls protect both the people handling the money and the organization. A high level of oversight and control fosters a high level of public confidence and less opportunity for mismanagement or fraud.
6. **Insist on regular financial reports and accurate record-keeping** – By definition, nonprofits are a “public trust” held to a higher standard of care than a “for-profit” business. Regular reports and accurate record-keeping, including balancing the checkbook register, comparing current financial information with current budgets and previous years’ activities, are vital to the fiscal health of the nonprofit.
7. **Be a model of ethical behavior** – Nonprofits are held to a higher standard of ethics than other organizations. The mere appearance of a Board Member conflict of interest or self-dealing stance can ruin a nonprofit’s credibility. Act appropriately and document all financial decisions in meeting minutes.
8. **Obtain professional advice when needed** – Legal and Financial professionals are wise investments, help prevent financial crisis and provide options if financial crisis is approaching (or in progress).
9. **Pay Applicable Taxes** – The IRS and your State Department of Revenue are the worst creditors you can have. Failure to timely file required paperwork and pay taxes (particularly employment and sales taxes) can be a costly mistake. Engage professionals to help you implement procedures that prevent tax failures.
10. **Regularly review and assess the financial situation** – Conditions change quickly. Financial plans should be reviewed regularly to be sure that they are being implemented and are still helpful and relevant. Periodically ask a (qualified) tax or legal professional to review your policies against current industry practices. Compare notes with other like nonprofits to see if they have better procedures that you adapt for your use.

Save-The-World Nonprofit Conflict of Interest Policy

Section 1. General. The Board and Staff of STW NonProfit shall administer the affairs of STW NonProfit honestly and economically and exercise their best care, skill, and judgment for the benefit of the STW NonProfit. The Officers shall exercise the utmost good faith in all transactions relating to their duties for the STW NonProfit. In their dealings with and on behalf of STW NonProfit, they are held to a strict rule of honest and fair dealings. They shall not use their position, or knowledge gained therefrom, so that a conflict might arise between the STW NonProfit interest and that of the individual or an organization affiliated with the individual.

Section 2. Disclosure of Potential Conflict. Any officer, Director or Staff member of STW NonProfit shall have a duty to disclose any potential conflict of interest by virtue of business or charitable affiliation.

Section 3. Conflict of Interest Defined. A conflict of interest, or potential conflict of interest, or appearance of conflict of interest, occurs when an officer, Director, or Staff member of STW NonProfit is in a position to exert influence, in dealings with or on behalf of STW NonProfit, which would give preference to any other business or charitable organization with whom the officer, Director, or Staff member is affiliated, by virtue of employment with, membership in, ownership of, appointment to or election to said business or charitable organization.

Section 3. Waiver of Conflict. Whenever a conflict of interest arises, or the appearance of a conflict of interest, such director or officer with the conflict who is present at the meeting of the Board of Directors or of a committee of the Board, shall disclose in good faith the material facts as to such interest, or financial interest, or appearance of conflict of interest, and any action of the Corporation to approve activity in which a conflict of interest, or appearance of conflict of interest, exists, shall be approved by a majority of the disinterested directors.

Conflict of Interest – Board Member Affirmation and Disclosure Statement

My answers to this disclosure form are correctly stated to the best of my knowledge and belief. Should a possible conflict of interest arise in my responsibilities to the Corporation, I recognize that I have the obligation to notify, based on my position, the appropriate designated individual (President of the Board and/or the Board of Trustees), and to abstain from any participation in the matter unless and until the Corporation can determine whether a conflict exists and how that conflict shall be resolved. If any relevant changes occur in my affiliations, duties, or financial circumstances, I recognize that I have a continuing obligation to file an amended "Conflict of Interest Disclosure Form" with the appropriate designated office.

I understand that the information on this form is solely for use by the Corporation and is considered confidential information. Release of this information within the Corporation will be on a need-to-know basis only. Release to external parties will be only when required by law and/or federal regulations.

Signature

Date

Please complete the following questions, and submit this form to the Board President.

1. Are you or a member of your immediate family an officer, director, trustee, partner (general or limited), employee or regularly retained consultant of any company, firm or organization that presently has business dealings with the Corporation or which might reasonably be expected to have business dealings with the Corporation in the coming year?

_____Yes _____No

If yes, please list the name of the company, firm or organization, the position held, and the nature of the business which is currently being conducted with the Corporation or which may reasonably be expected to be conducted with the Corporation in the coming year:

2. Do you or does any member of your immediate family have a financial interest, direct or indirect, in a company, firm or organization which currently has business dealings with the Corporation or which may reasonably be expected to have such business dealings with the Corporation in the coming year?

_____Yes _____No

If yes, please list the name of the company, firm or organization, the nature of the interest and the name of the person holding the interest, and the nature of the business which is currently being conducted with the University or which may reasonably be expected to be conducted with the Corporation in the coming year:

3. Do you or does any member of your immediate family have a financial or personal interest in an entity in which the Corporation has a financial or other vested interest?

_____Yes _____No

If yes, please provide details below:

4. Have you or an immediate family member accepted gifts, gratuities, lodging, dining, or entertainment that might reasonably appear to influence your judgment or actions concerning the business of the Corporation?

_____Yes _____No

If yes, please provide details below:

5. Do you have any other interest or role in a firm or organization, where that interest or relationship might reasonably be expected to create an impression or suspicion among the public having knowledge of your acts that you engaged in conduct in violation of your trust as a trustee, officer, faculty or staff member?

_____Yes _____No

If yes, please provide details below:

Please add additional pages as needed.

If any material changes to the responses provided on the annual disclosure form occur before the next form is due, the trustee, officer or employee is required to update the information on this form in writing, and submit the update to the Board President.

Acme Nonprofit Risk Management Policy

Acme Nonprofit is committed to protecting its human, financial, tangible, real estate, and goodwill assets and resources through the practice of effective risk management.

Acme's board and management are dedicated to safeguarding the safety and dignity of its paid and volunteer staff, its clients, and anyone who has contact with the organization. To this end, the board will ensure that the organization has a risk management plan for the organization that is reviewed and updated on an annual basis.

1. Policy Overview. Financial resources of Acme are the responsibility of the board of directors. The board will:
 - a. Have a clear plan for acquisition of financial resources to pay for the programs and services provided by Acme
 - b. Provide guidelines for management and allocation of financial resources which will produce optimum benefit for those we serve.
 - c. Monitor and evaluate the financial plans and guidelines of Acme to ensure the financial integrity of Acme
2. Budget. An annual operating budget will be prepared by the executive director and presented to the board for approval at least 60 days prior to the beginning of the next fiscal year. The budget will reflect the cost of carrying out the programs and services of Acme for the next fiscal year. This budget will also reflect the anticipated revenues of Acme.
3. Budget Review and Implementation. The budget will be viewed by the board as the financial plan for Acme, and approval of the budget by the board will be authority for the executive director to manage Acme's finances according to the plan without seeking further approval of the board. However, the executive will keep the board well informed of the ongoing status of the financial plan, and will not make expenditures outside of the budget plan without seeking board approval to amend the budget. Amendments to the budget will be presented to the board for approval for any of the following reasons:
 - a. Acme enters into compacts or contracts that were not included in the approved budget.
 - b. Management proposes a major expenditure that was not included in the approved budget.
 - c. Significant unanticipated revenues are received or cost overruns occur
4. Capital Reserves. A working capital reserve sufficient to keep Acme operating for at least a 60-day period will be maintained at all times.
5. Accounting Systems. The accounting system used by Acme will utilize generally accepted accounting practices (GAAP) that are required and/or recommended by regulatory or lending agencies and the Acme auditor.

10 Ways to Catch Fraud (and Mistakes) from Outside the Nonprofit

Fraud and error can occur both within and without an organization. Your employees and board may be completely trustworthy, but fall prey to a number of scams that are now more frequently targeting nonprofit because of the general trusting nature that is part of nonprofit culture. Here are some tips to help you catch outside fraud (or mistakes) before it affects your bottom line:

1. **Verify all packing slips and receipts.** When orders are delivered, (or at the check-out counter, if purchases are made in-store) double-check packing lists and receipts against orders to be sure that you have received all you were billed for, and haven't been double-billed for an order.

2. **Verify all invoices**
 - a. **(part 1 - error)**. Before writing the check, be sure that you haven't already paid a bill. Because of the economy and increased need for immediate cash flow, many vendors are accelerating their payment cycle, and you might get a "reminder invoice" close in time to receipt of the original invoice.

 - b. **(part 2 - fraud)**. Make sure you have actually received the product for which you have an invoice. There have been recurrences of an old fraud scheme to bill a customer for a product that was never ordered and never received, on the theory that the accounting department will routinely pay any bill that looks "legitimate."

3. **Never place orders with cold-callers.** No matter how great of a "deal" a cold-call sales person might have, NEVER place an order with an unfamiliar vendor that calls you. This, too, is an older scam that has been resurrected as a result of the poor economy.

4. **Use Bids for Larger Purchases and Service Contracts.** Get a second (or third) quote or bid for larger purchases, such as HVAC improvements and repairs, computer and network purchases and installation work, and office improvements. Check references for new contractors, such as outsourced payroll and benefits services, building repair and services, HVAC contractors and custodial services.

5. **Watch Outsourced Services.** Monitor third-party payroll and accounting services to be sure that the work is accurate and timely, including required government reports. If you use a third-party fund-raising service, be especially vigilant of over-reporting and hidden fees.

6. **Use Conservative and Rated Investment Services.** For nonprofits lucky enough to have endowment funds, investments, and reserves, place these funds with reputable and rated investment firms. Ask a board member familiar with banking and investment practices to review the investment statements to be sure that the investments are appropriate for a nonprofit (nonprofits are held to a “prudent investor” standard of care, and prohibited from making risky or speculative investments).

7. **Closely monitor cash events.** Have at least two vetted volunteers monitor cash receipts at events where cash plays a large part of the revenue (gate receipts, cash sales or products at an event, silent auction payments). Insist on taking your time to calculate amounts due and in counting money. It is very easy to scam cash when there is a crowd of people competing for the person “running the till” at a cash-intensive event.

8. **Pursue bad checks.** It is tempting to “let go” bad checks because of the hassle involved - especially when a small amount is involved. Knowingly writing bad checks is a criminal offense, and can be costly to the nonprofit in bank fees. Have a system and policy to pursue repayment of bad checks, and (if necessary) keep a list of and enforce “cash only” customers.

9. **Verify Credentials.** Verify credentials of any professional services you partner with or hire. Many times, a quick “Google” search will confirm (or not) credentials claimed by a new acquaintance/potential project partner. Watch for suspicious “blanks” in someone’s history or credentials, or credentials that seem “too good to be true.” Ask for and check references.

10. **Secure the Premises.** Have a practice of locking all doors when the nonprofit business is closed and organize your office space for secure and monitored access during the day. Is the door visible from the office so someone can monitor public traffic? Are valuables (cash, computers, supplies) secured from public access during business hours? Is someone ALWAYS in the office during business hours or when the office is accessible to the public?
 - a. Apply a philosophy of security to any public event sponsored by the Nonprofit to extend physical security practices to event sites.
 - b. Don’t forget to secure computers from outside invasion. Be sure the software monitoring, virus and spyware is up-to-date and activated. Safeguard and use passwords for computer access, and backup regularly.

15 Ways to Minimize Employee Fraud

Financial Controls to Minimize Employee Fraud

1. Perform a background check on all new hires. The Board should have a policy of performing a criminal background check (called “Limited Criminal History Check”) on all new hires. Require the candidate to provide references and CALL the references (and listen “between the lines” to what is said) Don’t get pressured by the need to fill a vacancy or by the candidate’s self-disclosed “other options.” Check before you hire.
 - a. Are Credit-checks legal? Do they work? A new trend in employee background checks is to also conduct a credit check. This can verify whether a candidate pays bills on time, and can be helpful in verifying previous addresses and employment. This information can provide clues about a candidate’s level of responsibility. You must obtain the candidate’s permission before on a separate consent form prior to running the check.
 - b. If you decide to NOT hire a candidate based upon credit check results, you MUST inform the candidate of the reason and provide a copy of the adverse credit report, including the contact information for the credit reporting agency that provided the report. You must also keep the results of the credit check confidential (regardless of the results).
2. Require two signatures on checks. Depending on your corporate structure, you can limit the two-signature requirement to checks above a certain threshold (for example, \$250 or \$500), or require two signatures on ALL checks.
3. NEVER pre-sign checks. This is not only a “bad idea,” but compromises the nonprofit’s financial integrity. What would the public say if they knew that you allowed pre-signed checks?
4. Do not allow one person control over all accounting functions. This is also called “separation of duties,” and provides both an actual and psychological barrier to fraud. Examples:
 - a. The person that writes the checks does not sign the checks.
 - b. The person that makes the deposits does not count the cash.
 - c. The person that opens the mail does not count the deposits
 - d. Two people count cash receipts (particularly for events that generate a lot of cash)
 - e. The person that reconciles the check book with the bank does not handle the money
 - f. Cross-train employees to cover for vacations and illnesses
5. Consolidate Checking Accounts. Talk to your banker about consolidating checking accounts. Usually, computer programs are very good about segregating project funds, so if you don’t have a need (or supervising agency requirement) for separate bank accounts, consider consolidating the accounts. If you must have more than one account, use the same bank and make sure the banking staff knows you and your organization. This will discourage “phantom accounts,” which can be used by employees for skimming.

6. Eliminate petty cash. These days, there is very little requirement for cash, and petty cash can often be overlooked and easily “skimmed,” since it fosters a more lack accounting.
7. Have an outside auditor review the books. At least annually for most nonprofits, and more often for larger nonprofits or nonprofits that have a significant amount of government money (either tax dollars or grant funds), an outside party should take a look at the books.
8. Use a computer program to enter all financial activity. Even very small nonprofits can afford some of the “consumer-based” accounting packages that are both inexpensive and easy to use. Computer data that is regularly reconciled with company documents and bank statements can quickly show discrepancies and omissions that may lead to discovery of fraud.
9. Use Budgets. Consistent use of budgets and comparison of cash flow to budget expectations can reveal unexpected expenses or discrepancies in expected income
10. Look for Ways to Improve. Encourage employees to suggest improvements to the financial system.

Corporate and Procedural Controls to Minimize Employee Fraud

11. Watch Employee Hours and Overtime. Verify employee hours, particularly overtime hours, to be sure that there is not “padding.” This is also true for compensatory time (Comp Time) – inflated Comp Time is the same as padding paid hours.
12. Watch Corporate Stock and Inventory, Including Supplies. In today’s economy, employers are recording an increase in theft of office supplies and corporate inventory. Even larger items, such as computers and cameras have been reported stolen by employees. Note if office supplies seem to be depleting more rapidly than expected, or if sales revenue does not match inventory sold.
13. Watch Expense Accounts. Require receipts for all reimbursements (including board reimbursements) and do not allow anyone to approve his or her own expense reports. Verify requests for reimbursement (Does mileage match approved destinations? Were purchases approved? Is there a “cap” for reimbursement of meals?)
14. Verify Credit Card Charges. It can be “too easy” for employees to purchase items using the company credit card. Over the past several years, there have been several stories of executive staff using nonprofit credit cards personal purchases, particularly when the credit card statements are not closely reviewed and receipts matched with charges, and when the executive is the one that processes the credit card statements
15. Routinely Review Bank Statements. Appoint someone outside of the financial routine to review bank statements. Many banks include check images and deposit slip images with the bank statements, which can be a quick way to review and verify checks and catch patterns of improper payments, overpayments and duplicate payments (whether deliberate or mistaken).

BONUS TIP: Set the tone at the top: promote high ethics and create a code of conduct and conflict of interest policies that reflect your culture and encourage ethical behavior at all levels.

Safe Passage for Nonprofits Bibliography and Further Reading

Boards Can't Just Abandon an Insolvent Nonprofit

Janet Kleinfelter, The Watchdog, Chronicle of Philanthropy, January 19, 2011

<http://philanthropy.com/blogs/watchdog/boards-cant-just-abandon-an-insolvent-nonprofit/24376>

Deceiving Donors and Putting Victims at Risk: a Recipe for Trouble

Bob Carlson, The Watchdog, Chronicle of Philanthropy, January 28, 2011

<http://philanthropy.com/blogs/watchdog/deceiving-donors-and-putting-victims-at-risk-a-recipe-for-trouble/24391>

Embezzlement Happens. It's What Charities Do Next That Matters

Bob Carlson, The Watchdog, Chronicle of Philanthropy, January 12, 2011

<http://philanthropy.com/blogs/watchdog/embezzlement-happens-its-what-charities-do-next-that-matters/24359>

Five Internal Controls for the Very Small Nonprofit

Carl Ho, Board Café, Finance and Strategy, January 6, 2010

<http://www.blueavocado.org/node/485>

Nonprofit Embezzlement: More Common and More Preventable Than You Think

Staff Report, Board Café, November 15, 2008

<http://www.blueavocado.org/content/nonprofit-embezzlement-more-common-and-more-preventable-you-think>

Nonprofits Face Internal Threats

Staff Report, Philanthropy Today, Chronicle of Philanthropy, April 22, 2011

<http://philanthropy.com/blogs/philanthropytoday/nonprofits-face-internal-thefts/34536>

NPR Debacle Raises Questions for All Noprofits

Doug White, Opinion, The Chronicle of Philanthropy, March 16, 2011

<http://philanthropy.com/article/article-content/126773/>

Our Executive Director is Embezzling

Vernon Waldren, Board Café, Finance and Strategy, December 23, 2009

<http://www.blueavocado.org/content/our-executive-director-embezzling>

Transparency Can Keep a Nonprofit Out of Trouble

Bob Carlson, The Watchdog, Chronicle of Philanthropy, March 4, 2011

<http://philanthropy.com/blogs/watchdog/transparency-can-keep-a-nonprofit-out-of-trouble/24415>

Treasurer's of All-Volunteer Organizations – Eight Key Responsibilities

Dennis Walsh, Board Café, Finance and Strategy, February 12, 2010

<http://www.blueavocado.org/node/498>

Two Questions NPR's Board Should Ask

Rick Moyers, Against the Grain, Chronicle of Philanthropy, March 14, 2011

<http://philanthropy.com/blogs/against-the-grain/two-questions-nprs-board-should-ask/27636>

Tip: Put the name of the article in your favorite browser search to find the article, rather than trying to type the long URL.

NOTE: All articles cited above were available online as of the date of this compilation

Safe Passage for Nonprofits Where to Go for Government Compliance

Indiana Secretary of State

Annual Business Entity Report – Check your status and file your report online

Search: indiana secretary of state business entity report

URL: <http://www.in.gov/sos/business/2436.htm>

Indiana State Board of Accounts

Entity Annual Report – For nonprofits that receive state funding

Search: entity annual report e-1

URL: <http://www.in.gov/sboa/3104.htm>

Indiana Department of Revenue

Nonprofit Organization's Annual Report – Financial reporting to Indiana

Search: indiana nonprofit np20

URL: <http://www.in.gov/dor/3506.htm>

IRS – 990N

For nonprofits with gross receipts from all sources <\$50,000

Search: irs 990n

URL: <http://www.irs.gov/charities/article/0,,id=169250,00.html>

IRS – 990 EZ or 990

For nonprofits with gross receipts from all sources >\$50,000

Search: irs 990

URL: <http://www.irs.gov/pub/irs-pdf/f990.pdf>

NOTE: This is a PDF fill-able form version of the 990 for your information only. The presenter *strongly* recommends that you hire the services of a qualified professional to complete and file the 990EZ or 990 for your nonprofit. Some nonprofit professionals consider in-house preparation of a 990 EZ or 990 to be a breach of a nonprofit's fiduciary duty.

IRS Publication 78

Cumulative list of *approved* nonprofit organizations

Search: Publication 78

URL: <http://www.irs.gov/charities/article/0,,id=96136,00.html>

IRS Recent Revocations of §501(c)(3) status

List of nonprofits that have had their status *revoked* - organized by alphabetical links

Search: recent revocation charity

URL: <http://www.irs.gov/charities/charitable/article/0,,id=141466,00.html>

Case Study

Acme Nonprofit is a medium-sized nonprofit with a paid Executive Director and paid staff. Operations include community activities, daycare, and human services. Volunteer Board of Directors meets monthly with ED to review finances, event reports, and programs.

Although Acme has a mission of providing services at low or no-cost, the staff has become extremely delinquent in collecting assessed fees for services, and has been “waiving” fees without scrutiny or approval. Also, donations and grants have been falling off, so cash flow is starting to reach a critical stage.

ED begins to “cover up” shortages in cash flow, and becomes lax in supervision of staff members. Donations collected during the day are stashed in the safe and forgotten - not deposited for several days (or even weeks). Bill payment becomes late or missed to the point that late charges are regularly assessed and Acme experiences several instances of phone and electric shut off. This causes interruption of services and additional expense in the form of reconnect fees. ED blames the bank or the utility for the interruption in service. ED actively hides cash flow issues by manufacturing book keeping reports for the Board to review and preparing checks for Board Member counter-signature, but which are never mailed.

Some of the Board Members become suspicious and confront the ED, who gives lame excuses. The Board begins to investigate complaints from constituents. Board hires a CPA firm to review the books, but the ED evades requests for access to the books for nearly three months before the Board insists that ED cooperate with the CPA. Board terminates ED for insubordination.

When the Board Members clean out the ED’s office, they are stunned to find piles of unopened mail from the IRS - all of which is asking for payment of employment taxes. Also in that drawer are several unopened (and unpaid) bills. Another drawer reveals a stack of signed checks for payment of bills that were never mailed.

After a thorough review of the books, the Board determines that payroll taxes have not been paid for 18 months, and other bills are several cycles delinquent. The Board borrows funds to catch up all accounts except IRS withholding liabilities. However, because the cash flow crises was allowed to progress unchecked, the Board has no choice but to discontinue certain services while attempting to regroup and rebuild cash flow. Of course, the financial troubles of Acme have become known in the community served by the Nonprofit, and this creates an additional burden of loss of good will and donation dollars.

A year later, and after much concerted effort, the financial records are in order, and Acme cash flow has improved, but is not yet “in the black.” IRS liabilities from the 18 month time period (including interest and penalties) are still owing, but all current (new) liabilities are paid. The Board continues to work toward developing cash flow through donation and fund raising programs, with an eye toward establishing the long-range financial stability of the organization.

The Board keeps a close eye on financial matters, these days, with regular review by the CPA firm, and all government reporting delegated to the CPA firm, for independent verification.

What bitter lessons did this Board learn?