



This article presents general guidelines for Ohio nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.

Nonprofits: How to Enhance Your Internal Controls

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As with every type of organization, nonprofits are at risk of falling victim to costly acts of fraud and tend to have some common characteristics that can make them particularly susceptible to such schemes. In this article, we will review factors that make nonprofits vulnerable to fraud as well as steps and suggested controls you should consider putting in place to mitigate fraud.

Environment

Nonprofits tend to operate in a culture of trust and rapport, and that's one reason that they're attractive targets for fraud perpetrators. Organizations are often founded by a handful of passionate and idealistic volunteers and develop over time into a team with tighter relationships than typically seen in many for-profit businesses. As a result, the board may not feel the need for antifraud controls, or they find it hard to ask tough questions when confronted with possible signs of fraud.

Similarly, many nonprofits place significant control in the hands of a limited number of people – for example, the founder, CEO, or executive director. This is a risk even in an organization with some internal controls because these powerful individuals can simply override the controls, with lower-level staff too intimidated to intervene.

These aren't the only factors that make nonprofits so vulnerable to fraud. High turnover among staff, volunteers and board members, as well as limited resources, also may contribute. A newer significant risk is the new environment of cyber security and remote working.

Suggested Controls

Internal controls in the form of strong policies, procedures and governance are a must for every nonprofit, regardless of size. Controls can help deter and detect fraud and remove perception of the opportunity.

Perhaps the most critical control is *segregation of duties*. A single employee should never be responsible for all the steps in any accounting process – for example, collecting, recording, reconciling and depositing cash receipts. Segregating duties can be a challenge for smaller nonprofits. But, at the very least, the duties of handling and reconciling funds should involve more than one individual. If a nonprofit lacks the manpower, consider including board members or outside advisors to segregate duties.

Governance plays a role in deterring and detecting fraud, too. The board of directors must perform proper oversight by, for example, naming qualified individuals to independent finance and audit committees. It also



should set an antifraud tone by developing – and enforcing – policies on matters such as conflicts of interest and the treatment of whistleblowers.

The Association of Certified Fraud Examiners has consistently found that tips are the most common (and low-cost) detection method for occupational fraud. It's best if tips are reported to the board or one of its committees, rather than management. The organization should make an anonymous fraud hotline available to employees, volunteers, vendors, and clients.

Finally, you'll need to formally educate your employees about fraud. You should provide training on the organization's antifraud policies, red flags that could signal fraud and how the hotline works. Yearly cyber security and technology training has become extremely important in this new era of technology advances. Board members and volunteers with financial responsibilities should receive training, as well.

An Ounce of Prevention ...

You can't prevent all fraud – no organization can. But you can reduce the risk of substantial fraud losses by recognizing your vulnerabilities and taking appropriate steps to mitigate them and to investigate thoroughly when fraud is suspected. Choosing to ignore fraud risks and hope for the best may result in suffering both financial and reputational damage. It is also important for the board of directors to not only understand their role as a board member, but to understand the nonprofit and the safeguards that it applies.

About the Author

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