

FALL
2011

Nonprofit Observer

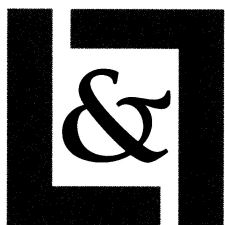


Is your nonprofit vulnerable to fraud?

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Is your nonprofit vulnerable to fraud?

This summer, an Idaho woman was sentenced to prison for embezzling \$1.3 million from the nonprofit drug and alcohol treatment organization where she had worked as a bookkeeper, a New York man pled guilty to siphoning more than \$200,000 from three separate veterans organizations, and the treasurer of a North Carolina performing arts group was found guilty of embezzling \$300,000 from the nonprofit.

These represent only a snapshot of the many financial crimes committed against nonprofits by their employees and volunteers in 2011. Nonprofits experience lower rates of occupational fraud than their corporate counterparts, but that's cold comfort to the organizations that fall victim. Address your vulnerabilities before fraud happens to you.

THE PERILS OF TRUST

Many nonprofits are staffed by people who believe strongly in their mission, which contributes to a culture of trust. Unfortunately, such trust makes nonprofits vulnerable to certain types of fraud. For example, if you don't supervise staffers who accept cash donations, you make it easy for them to skim (keep a donation for themselves without recording its existence

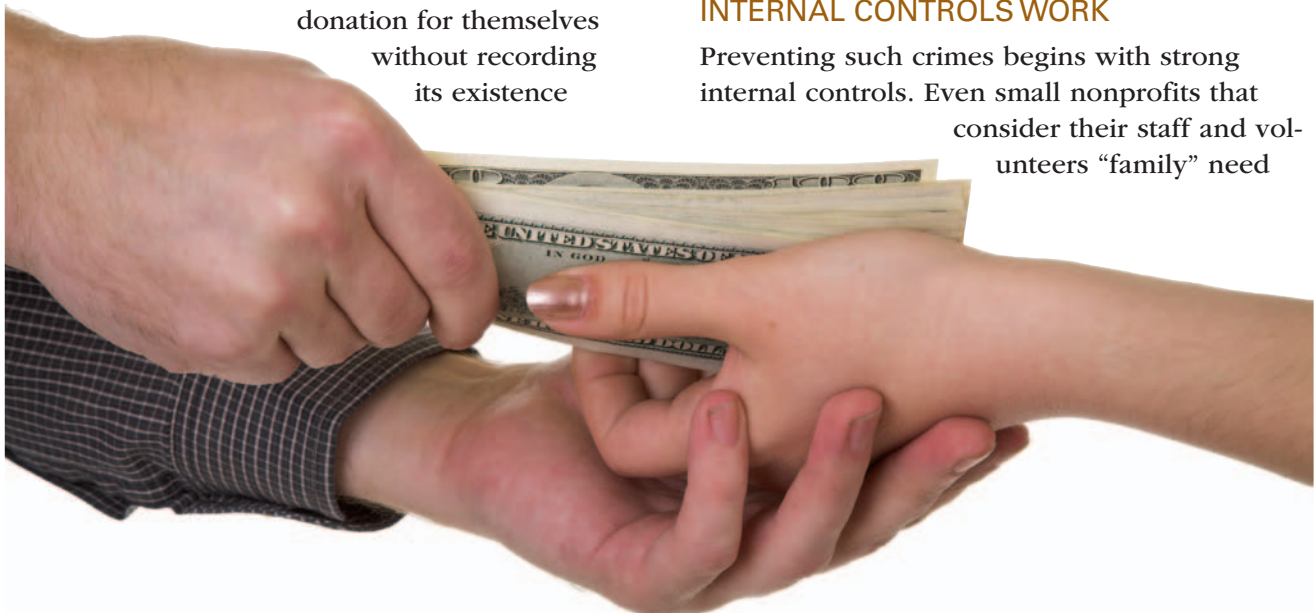
in the books). Skimming is even more likely to occur if you fail to perform background checks on new employees and volunteers who'll be handling money.

To reduce opportunities for any one person to steal, multiple employees should be involved in processing payables.

Billing schemes are also common. Staffers might invent and submit invoices on behalf of fictitious vendors or collude with actual vendors who are willing to submit false or inflated invoices. If your nonprofit has only a small staff, with one person handling most accounting duties, you may also be vulnerable to ghost payroll schemes and expense account fraud, among other scams.

INTERNAL CONTROLS WORK

Preventing such crimes begins with strong internal controls. Even small nonprofits that consider their staff and volunteers "family" need



Special rules for special events

Many nonprofits depend on money raised during a big annual gala or other special event. But because crowded and chaotic fundraisers where cash changes hands are fertile grounds for thieves, you need to take precautions.

To ensure the money raised at your fundraiser actually makes it to the bank, discourage supporters from making cash payments. As much as possible, presell or preregister event participants to limit access to cash on the day of the event. And if you do accept cash, double-check the money raised with prenumbered tickets that must be accounted for at the end of your event.

Also, try to assign cash-related duties to paid employees or board members. If you need to use volunteers, make sure they're closely supervised at all times.



to establish and follow procedures that limit access to funds.

Possibly the most important of these is the segregation of duties. To reduce opportunities for any one person to steal, multiple employees should be involved in processing payables. For example, every incoming invoice should be reviewed by the staffer who instigated it to confirm the amount and that the goods or services were received, and a different employee should be responsible for writing the check. For large expenditures, require the approval of more than one person.

Similar guidelines apply to receivables. The staffer who deposits checks shouldn't also open your monthly bank statement. And the employee who opens mailed donations needs to be different from the person who makes book-keeping entries and deposits checks.

And don't forget to protect electronic records that include financial data on donors, vendors, employees and others. Give employees access only to the information and programs required for their job responsibilities. All sensitive information should be password-protected, and users should be *required* to change their passwords periodically.

WHAT'S MY MOTIVATION?

Of course, opportunity alone doesn't lead to fraud — motivation also is required. In economically challenging times, even a staffer who normally is honest may be tempted to steal. And because nonprofit employees tend to earn less than their for-profit counterparts, guilty employees may use their lower salaries to justify fraud to themselves.

Be on the lookout for staff members whose financial fortunes seem to change overnight. An accounting department employee may have an inheritance to thank for his new car or lottery winnings for her expensive jewelry, but it pays to investigate. Also be suspicious of employees who avoid taking vacations or even single sick days. They may be concerned that someone will find fraud in their absence.

FOLLOW UP WITH AUDITS

Recognizing the potential for fraud and establishing controls to prevent it is only the beginning. You also need to conduct periodic audits. Your auditor can help identify weaknesses and ways to fix them so that your organization doesn't become the victim in another sad story about a defrauded charity. ✱

ERM: How to adopt this effective risk management tool

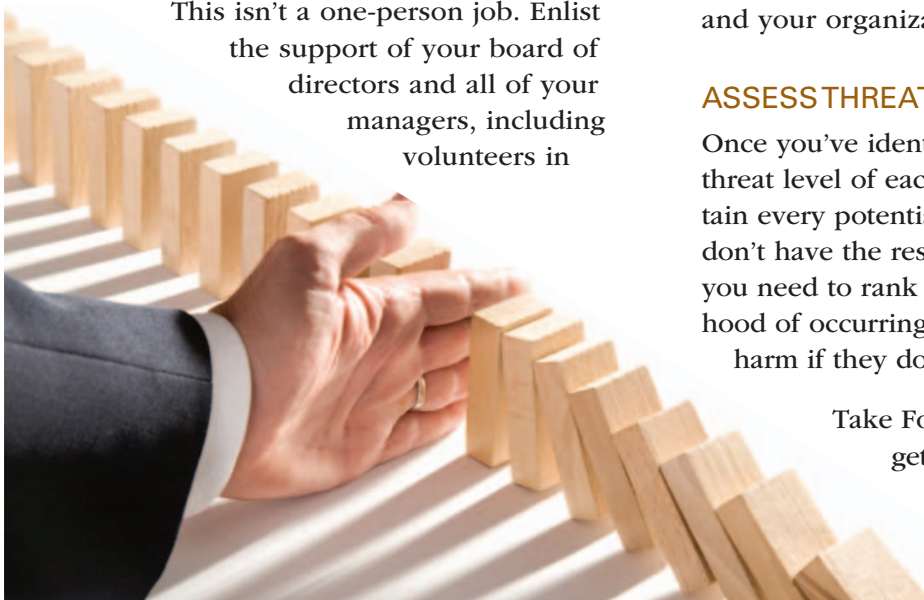
In recent years, many nonprofits have adopted business practices previously found only in for-profit companies. Greater regulatory oversight, tighter budgets, and increased scrutiny by donors and charity watchdog groups all mean that nonprofits are implementing new fiscal and risk management practices.

Enterprise risk management (ERM) is one of the best. The system seeks to contain risk on an integrated, organizationwide level. So instead of focusing on department- or project-level risks, it regards risk as an interrelated whole. Although ERM isn't foolproof, it has generally been effective in the corporate world and, implemented carefully, can be just as useful to nonprofits.

MAKE A LIST

How much and what types of risk require your attention depends on your organization's size, mission, staffing, governance and stakeholders, among other factors. ERM offers general strategies to deal with a variety of needs. But to implement an effective program, you should identify your nonprofit's specific risks.

This isn't a one-person job. Enlist the support of your board of directors and all of your managers, including volunteers in



positions of authority, and ask them to help you make a comprehensive list of risks. These might include:

- ◆ Budget shortfalls due to inadequate funding,
- ◆ Investment portfolio volatility,
- ◆ Fraud, including information technology vulnerabilities,
- ◆ Inadequate insurance coverage,
- ◆ Reporting errors,
- ◆ Activities that might threaten your exempt status, such as political advocacy,
- ◆ Failure to plan for succession, and
- ◆ Failure to plan for emergencies such as fires, natural disasters and terrorist attacks.

Every nonprofit is different, so you're likely to have items on your list that are specific to your organization. For example, if your mission involves children, failure to appropriately screen the backgrounds of the adults who work with them could put those children — and your organization — at significant risk.

ASSESS THREATS

Once you've identified risks, determine the threat level of each. Ideally, you'd like to contain every potential threat, but you probably don't have the resources to do so. Therefore, you need to rank them based on 1) their likelihood of occurring, and 2) the significance of the harm if they do occur.

Take Form 990 errors. It's easy to forget to proofread IRS forms and, as a result, submit them with typos. What's the worst that can happen if you make an

innocent mistake? The IRS might ask you to refile the forms. On the other hand, a Level 5 hurricane is much less likely to occur, but it could be the end of your nonprofit if you don't have an action plan and adequate insurance coverage.

CONSIDER CAPACITY

Next, clarify your organization's capacity for risk. For-profit companies grow market share via potentially risky strategies such as introducing new products, so their ERM programs tend to focus on *optimizing* risk. Nonprofits generally have to be more circumspect — regardless of the potential rewards.

Say, for example, that your general operating budget is tight but that you're allowed to use 5% of your endowment annually to fund new initiatives. You'd like to open a new facility, which would involve remodeling the building, buying furniture and hiring new staff, along with other, unanticipated expenses.

ERM would call for projecting and analyzing worst case scenarios, including how they could affect your organization's other programs. So before acting on your plan, you'd gather information from employees, your board and outside consultants such as general contractors, interior designers and financial professionals. Your contractor, for example, could provide you with high and low estimates for the job, so you could avoid budget surprises.

Then you'd outline detailed responses for containing each worst case scenario and assign

someone in your organization to be in charge of acting on them. "Ownership" is important — without it, staffers might let critical items slip through the cracks.

INTEGRATE YOUR PLAN

To integrate ERM into your nonprofit's culture, start at the staff level. Employees will be more open to your ERM system if it fits seamlessly into daily operations and takes into account how they do their jobs. In contrast, top-down directives, particularly when their purpose isn't properly understood, can alienate staff and create unnecessary work.

Specialized software can help you integrate ERM into your organization. Whatever package you choose, train employees on how to use it and ask for their feedback about customizations that can make for a better user experience. Also, continual monitoring of your system's risk metrics is essential. Most software packages come with digital dashboards that keep risk-related information accessible on your computer's desktop.

DO IT RIGHT

ERM can provide nonprofits with major rewards, but the systems can be difficult and time-consuming to implement. Consider bringing in experts who've worked successfully with nonprofits to help you. The last thing you want is to put an ERM system into place only to find that it's full of blind spots and other dangerous flaws. *

Give your board members a break — and your nonprofit a boost

If your nonprofit's board is like most, its members lead very busy lives. They may not get to every board meeting or perhaps are able to attend meetings only via teleconference.

It's essential, therefore, to organize periodic board retreats that bring everyone together in a relaxed setting. But good planning is necessary for a retreat to be successful.



BEST PRACTICES

Board retreats enable participants to get past the mundane topics of regular board meetings and delve deeply into specific issues. To take advantage of this opportunity and avoid wasting time and money, consider taking the following steps:

1. Get participant buy-in. Don't spring a fully planned retreat on your board without first vetting the idea and making sure everyone agrees to the merit of the session and its overarching goal. Otherwise, attendance may suffer or board members may show up but not be fully engaged.

2. Choose the time and place carefully. Once the board agrees to a retreat, you can turn your thoughts to logistics, which will vary depending on the outcomes you need to achieve. A half-day in a local coffee shop may be ideal if the board needs to brainstorm creative, new fundraising options. Broader agendas or confidential topics will require more time and privacy — perhaps several days at an offsite location.

The further you can get board members away from their regular work responsibilities, even if only mentally, the better. That may mean banning mobile phones, pagers and other electronic devices from working sessions.

3. Create a detailed agenda. Every retreat needs a well-planned agenda. The best way

to set the agenda is to start at the end. What outcome do you want to come away with at the close of the retreat? If, for example, you want to end the meeting with a five-year strategic plan, your agenda might start off with time to review the history of your organization and competitive research from other organizations. From there, build in time to brainstorm where your donors, beneficiaries, members and other important constituencies may be in five years.

And make sure you include adequate breaks and time for informal social interaction, such as a nice dinner.

This will not only keep your board members focused, but also give them a small reward for their efforts.

4. Make a postretreat plan. Some of the most important work will happen after the retreat. That's why you need to recap all decisions and commitments and make a plan to put your hard work into action before the board scatters.

The further you can get board members away from their regular work responsibilities, even if only mentally, the better.

Follow up by sending the board members a written summary of retreat discussions and add action items to future board meeting agendas based on those plans. This will help ensure your retreat outcomes remain a priority.

FOCUSED AND ENGAGED

Your board is your organization's lifeblood. You can't afford to have unfocused, disengaged members. A thoughtfully planned retreat can be just the ticket to rejuvenate them and find solutions for some of your nonprofit's critical issues. ✱

Giving USA survey

Donors increasing support of nonprofits

The past few years have been tough for nonprofits as individual donor dollars dwindled, corporations curtailed their giving programs, state and federal funds dried up and foundations tightened their funding criteria.

Although the U.S. economy isn't out of the woods yet, the philanthropic picture is improving. According to *Giving USA 2011: The Annual Report on Philanthropy*, Americans donated \$291 billion to charity in 2010, a 3.8% (2.1% adjusted for inflation) improvement over 2008 and 2009, when giving fell a combined 13%.

KEY STATS

The report, prepared by Giving USA Foundation and The Center on Philanthropy at Indiana University, made several important findings that can help organizations set fiscal objectives and target their fundraising efforts:

- ◆ Foundation giving remained steady and individual giving rose modestly in 2010, but corporate donations increased by 10.6% and charitable bequests increased by 18.8%.
- ◆ The biggest beneficiary of increased giving was the international charity sector, where donations rose 15.3%, at least partly due to the January 2010 earthquake in Haiti.
- ◆ Donations to foundations and education, health, public society benefit, and arts, culture and humanities organizations increased, while giving to individuals and religious, human services, and environment and animal nonprofits remained steady.
- ◆ As it has for the past half century, religion received the largest share of donations (35%), following by education (14%).

These modest improvements are consistent with previous postrecession recovery periods. However, *Giving USA* suggests that the severity of the economic downturn may affect how quickly charitable giving returns to prerecession levels. Generally, gross domestic product (GDP) is the economic indicator that most closely correlates with the amount Americans donate to charity.

CONNECT WITH DONORS

Nonprofits still face plenty of fiscal challenges. But you should take heart in the fact that individuals and groups continue to make giving a priority, even when they're uncertain about their own financial futures.

Donor outreach, therefore, is critical as never before. Supporters want to know their dollars are making a difference, so be sure to provide them with detailed and specific results — in your newsletter, on your website, at events and during group and one-on-one meetings. Use



both numbers and narratives (such as case studies and testimonials) to communicate how donor funds are helping your organization achieve your mission.

SAY "THANK YOU"

Many people are making financial sacrifices to continue supporting their favorite charities. You don't want your donors to think you're taking them for granted, so be sure to thank them at every opportunity. *