

## **Corporate Governance Update**

### **New Study Emphasizes Board Oversight to Protect Against Asset Misappropriation**

By Michael W. Peregrine, McDermott Will & Emery

Nonprofit boards, and their audit and compliance committees, should take note of a newly released, important study of financial fraud committed *against* (as opposed to "by or on behalf of") charitable organizations. The basic theme of the article is that the incidence of such fraud has dramatically increased. The study, "An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents"<sup>1</sup> (Study), concentrates on the following key points:

**Victims and Perpetrators of Fraud.** The Study offers interesting observations about the types of occupational fraud against nonprofits (*e.g.*, the largest frauds typically involve collusion by higher compensated employees with longer tenure) and the typical perpetrators of such fraud (*e.g.*, employees, managers, or executives of the organization).

**Type of Fraud.** Asset misappropriation constitutes the vast majority of reported frauds against nonprofits, with cash being the most common type of misappropriated asset. Fraudulent disbursements constitute the largest percentage of misappropriated cash: payment of inflated invoices, payroll fraud, expense reimbursement fraud, check tampering, and fraudulent register disbursement. Conflicts of interest and fraudulent financial statements are also forms of financial fraud found in the nonprofit sector.

**Discovery of Fraud.** The study cites several potential sources for discovery of fraud by the nonprofit organization: internal controls, internal and external audits, internal anonymous fraud hotlines, vendor tips and, to a considerably lesser degree, customer/constituent tips.

**Preventative Measures.** Among the loss prevention measures recommended by the study are: (i) enhanced board/audit committee oversight; (ii) use of insurance and surety bonds; (iii) stronger internal controls and audit practices; (iv) facilitating the ability of employees, vendors, and constituents to report financial fraud; and (v) increased board/employee education about the potential for, and related cost of, financial fraud committed against nonprofit, charitable organizations.

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The results of the Study should be of great interest to board members of all types of nonprofit organizations. The incidence of financial fraud perpetrated against nonprofits appears to be at a significant level. This is causing charity regulators (*e.g.*, the IRS and state attorneys general) to take greater notice, and to be more attentive not only to individual occurrences of fraud but also to measures taken by the nonprofit organization to identify the fraud, and to prevent its occurrence. (*See, e.g.*, Part VI, Section A-5 of the new IRS Form 990, asking whether the organization became aware during the year of a material diversion of assets.) Indeed, in a recent newspaper account, one of the Study's authors observed that the failure of nonprofits to punish those who steal from the organization was a major cause of fraud in the sector.<sup>2</sup>

This Study provides a useful signal to nonprofit boards, and their audit and compliance committees, of the need to direct appropriate attention to the effectiveness of internal procedures to protect against financial fraud committed *against* (instead of by, for or on behalf of) the nonprofit organization.

<sup>1</sup>Janet Greenlee, Mary Fischer, Teresa Gordon, Elizabeth Keating, "[An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents](#)," *Nonprofit and Voluntary Sector Quarterly*, Vol. 36, No. 4., December 2007.

<sup>2</sup>Stephanie Strom, "Report Sketches Crime Costing Billions: Theft From Charities"; *The New York Times*, March 29, 2008.