

## **An Internal Control Listing- For Nonprofit Organizations**

### **Organizational Controls:**

- Duties should be segregated (**to the extent possible**).
- One person should not be in control of all of the major accounting responsibilities.
  - *Example:* the person having custody of the assets should be different from the one handling the record keeping.
  - *Example:* the person preparing the bank reconciliation should be different from the one keeping the books and controlling cash.
  - *Example:* the person signing the checks should be different from the one keeping the books and controlling cash.
- The Board of Directors of your organization should regularly receive and review periodic (monthly) financial reports, and discussions regarding financial matters should be documented in the minutes.

### **Financial Controls:**

- Comparisons of budgeted and actual revenues and expenditures are made in periodic (monthly) financial reports.
- Compare results with actual year-to-date results from the same period in the prior year.
- Checks received should be restrictively endorsed upon receipt.
- Checks received should be deposited the same day they are received and a receipt log should be maintained.
- Checks paid should have accompanying documentation when reviewed and signed.
- Invoices should be approved and signed off on (or initialed) before payment.
- Only original invoices should be paid to avoid duplication of payment.
- Each invoice should be marked "paid" when the check is prepared.
- Have fidelity bond coverage.

### **Processes and Procedures Controls:**

- Two signatures should be required for large checks.
  - *Example:* amounts paid over \$1,000 may require a second signature, such as by the Executive Director and Treasurer of the Board. This is one way of having internal controls for expenditures when the staff of the organization is small.
- Use pre-numbered documents such as invoices and checks for easier tracking.
- All journal entries should be reviewed and approved.
- Policies should be communicated throughout the staff and Board of Directors.
- Train staff on the importance of accounting controls.

### **Documentation Controls:**

- Supporting documentation such as deeds for buildings and loan agreements should exist for transactions.
- Internal control policies and procedures should be documented in an accounting policies and procedures manual or similar document. This practice saves significant time when the auditor comes in to perform the external financial audit.
- Have procedures in place to periodically check to see that all transactions are recorded in the proper account(s) as well as in the proper amount.
- Have a conflict of interest or ethics statement in place.

### **Security Controls:**

- Assets should be safeguarded (e.g., proper security should be used).
- Authorized levels of staffing and budgeting should exist.
- Use appropriate levels of computer security for staff, such as one or two-level passwords for entry into the accounting system, and change them regularly.

# Fraud Schemes

<p><b><u>Cash Theft Schemes:</u></b></p> <ul style="list-style-type: none"> <li>• Cash skimming</li> <li>• Unrecorded sales</li> <li>• Theft of checks</li> <li>• Check tampering</li> <li>• Forged endorsements / signatures</li> <li>• Cash register schemes</li> <li>• Fraudulent bank reconciliations</li> <li>• Deposit lapping</li> <li>• Altered payees</li> <li>• Converting stolen checks</li> <li>• Altering receipts</li> <li>• Altering cash counts</li> <li>• Altering deposits</li> <li>• False accounts</li> <li>• Voided transactions</li> </ul>	<p><b><u>Accounts Receivable Schemes:</u></b></p> <ul style="list-style-type: none"> <li>• Lapping</li> <li>• False credits</li> <li>• False discounts</li> <li>• Unauthorized write-offs</li> <li>• Collection agency schemes</li> <li>• Unauthorized credit card refunds</li> <li>• Collusion with customers</li> <li>• Skimming</li> <li>• Forcing balances</li> <li>• Debiting fictitious accounts</li> <li>• Stolen statements</li> </ul>
<p><b><u>Billing Schemes:</u></b></p> <ul style="list-style-type: none"> <li>• Setting up “shell” companies</li> <li>• Fraudulent invoicing</li> <li>• Collusion with vendors</li> <li>• Pass-through schemes</li> <li>• Overbilling</li> <li>• Kickbacks</li> <li>• Diverting business for personal use</li> <li>• Pay-and-return schemes</li> <li>• False purchase orders</li> <li>• Returning merchandise for cash</li> </ul>	<p><b><u>Accounts Payable Schemes</u></b></p> <ul style="list-style-type: none"> <li>• Kickbacks</li> <li>• False or inflated vendor invoices</li> <li>• Improper purchasing</li> <li>• Duplicate payment schemes</li> <li>• Theft or misappropriation of payments</li> <li>• Contract or bidding fraud</li> <li>• Ghost vendors</li> </ul>
<p><b><u>Fixed Asset Schemes:</u></b></p> <ul style="list-style-type: none"> <li>• Theft</li> <li>• Conversion for personal use</li> <li>• Manipulation and concealment</li> </ul>	<p><b><u>Computer Schemes:</u></b></p> <ul style="list-style-type: none"> <li>• Entering false transactions</li> <li>• Bogus file maintenance transactions</li> <li>• Failure to enter data</li> <li>• Altering data</li> <li>• Manipulation of accounts</li> </ul>
<p><b><u>Expense Account Schemes:</u></b></p> <ul style="list-style-type: none"> <li>• Overstated reimbursement requests</li> <li>• Altered supporting documentation</li> <li>• Fictitious receipts</li> <li>• Multiple reimbursements</li> <li>• Claiming expenses paid by others</li> </ul>	<p><b><u>Financial Reporting Schemes</u></b></p> <ul style="list-style-type: none"> <li>• Understated liabilities</li> <li>• Recording fictitious assets</li> <li>• Sham transactions</li> <li>• Improper revenue recognition</li> <li>• Overstated accounts receivable</li> <li>• Overly complex transactions</li> </ul>

## **FRAUD CASE STUDY: Slush Funds Association**

### ***Facts:***

Here's how a kiting scheme worked in Slush Funds Association, a nonprofit organization:

- **Day 1** - Slush Funds Association receives cash receipts totaling \$20,000. The Finance Department enters the deposit accurately in the accounting records. The dishonest accountant, Paul, however, does NOT take the deposit to the bank on the following business day; instead, he pockets the \$20,000 in cash. There's no one else that handles cash and Accounts Receivable, other than Paul.
- **Day 2**- Slush Funds Association receives cash receipts totaling \$25,000. Once again, the dishonest accountant, Paul, pockets the \$25,000. Now he has \$45,000!
- **Day 3**- Slush Funds Association receives cash receipts totaling \$22,000. The dishonest accountant, Paul, uses \$20,000 out of the third day's receipts to cover the \$20,000 deposit for the first day. He keeps the \$2,000 as his "slush fund" to balance subsequent deposits.
- **Day 4**- Slush Funds Association receives cash receipts totaling \$23,000. The dishonest accountant, Paul, applies this total, plus \$2,000 from the slush fund, to cover the second day's deposit of \$25,000.
- **At the end of the month**, Paul pockets the total receipts from the last two business days of the month. This time, he records these receipts as "deposits in transit" on the bank reconciliation.
- Paul also prepares the monthly financials for Slush Funds Association. The financial statements have been misstated by kiting deposits (by covering them with subsequent deposits) and showing the last two days' receipts as outstanding (deposits-in transit) items. At this point, the dishonest accountant, Paul, has pocketed four days' worth of receipts.
- This system of kiting of receipts and phantom deposits in transit is very difficult to detect ... it is extremely difficult to reconstruct, particularly if done over a long period of time.

### **Questions for you:**

- 1) How could this have been prevented?**
- 2) How could they have caught this sooner?**