

FIDUCIARY STEWARDSHIP

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What we will cover:

- ▶ Definitions of Fiduciary and Stewardship
- ▶ Fraud in the Non-profit Segment
- ▶ Why is fraud so prevalent and controls so lacking in non-profit entities?
- ▶ Common types of frauds in Non-profit organizations
- ▶ Best practices relating to safeguarding assets and establishing internal controls
- ▶ Protecting your organization

(ALA NHQ, Departments are each a corporation, subject to corporate law and liability)



Fiduciary Stewardship

- ▶ “**Fiduciary**” applies to a duty all non-profit leaders (members of Governing Body and Management) have to the organization.
- ▶ In the law, and in practice, a fiduciary duty represents the highest standard of care and includes:
 - Trust
 - Loyalty
 - Dedication
- ▶ “**Stewardship**” applies to the acceptance or assignment of responsibility to *shepherd* and *safeguard* the valuables of others.
- ▶ “Valuables” in a Non-profit entity include:
 - Name, Brand and Goodwill (Emblem)
 - Assets – tangible and intangible
 - Reputation



Fraud in the Non-Profit Sector

- ▶ Over 2.3 million NFP entities and over 1 million 501c3 (charitable) Organizations
- ▶ 87% of 501c3 organizations have annual revenues < \$25,000
- ▶ Non-profit entities generate employ 14 million and generate \$1.5 Trillion in revenues
- ▶ Private donations to c3 organizations in 2012 = \$323 Billion
- ▶ Association of Certified Fraud Examiners estimates that over 5% of revenues are lost to fraud – or \$75 Billion
- ▶ *Accordingly, 23% of Non-profit revenues are lost to fraud!*



Other Effects of Fraud on the Non-profit Sector

- ▶ Damages the reputation of the entity and taints the entire industry
- ▶ Creates long-lasting negative publicity
- ▶ Lowers employee morale
- ▶ Depletes human and economic resources in investigation and litigation
- ▶ Disrupts business operations – diverts focus
- ▶ Creates a negative image in the minds of regulators, donors and watchdog organizations

Why is Fraud so prevalent and controls so lacking?

- ▶ Control and power are often concentrated in either one individual or a small group of individuals who too often lack expertise in financial or business management
- ▶ Too few resources are allocated to control systems and financial oversight
- ▶ Too often employees are paid less than for-profit employees
- ▶ Volunteers provide substantial assistance but are not always subject to the same controls as paid employees
- ▶ All-volunteer governing bodies too often lack governance experience, rotate too often, and sometimes have questionable motives
- ▶ Insufficient funds and expertise are spent on internal controls
- ▶ Frauds often go unreported because of the fear of repercussion from donors and constituents



Common Types of Frauds in Non-profit Organizations

▶ Frauds against the organization

- **Skimming** – cash is stolen before recorded in books
- **Credit card abuse** – organization cards are used for personal use or donor card information is stolen
- **Fictitious vendors** are set up and paid
- **Conflicts of Interest** – Board members or executives have hidden financial interests in vendors
- **Payroll schemes** – continued payments to terminated employees, overstatement of hours, fictitious reimbursement of expenses and negative payroll deductions
- **Sub-recipient fraud**



Common Types of Frauds in Non-profit Organizations

▶ FRAUDS Committed by the Organization

Deceptive Fundraising Practices – Misrepresentation of the extent of a charitable donation or the value of the donation

Failure to comply with legal requirements of designated pledges and contributions, and over-recording pledges

Under-recording expenses and costs

Misreporting cost/s expenses related to fundraising events

Misreporting allocation of expenses as to Program, General/Administrative and Fundraising

Reporting misleading or inaccurate information on government and tax forms

Misreporting to donor organizations



Best Practices related to safeguarding of assets and establishing internal controls

▶ GOVERNANCE

- Understand difference between governance and management
- Governing body composition and tenure
- Appropriate policies for rotation
- Establish appropriate committees:
 - Executive
 - Finance
 - Audit
- Continuous training and education



Best Practices related to safeguarding assets and establishing internal controls

▶ FINANCE COMMITTEE

- Finance Committee is accountable to the Governing Board
- Ensures that internal and financial reporting controls are appropriate
- Oversees the Investment and Spending policies for Investments and establishes policies and procedures for Cash Management
- Reviews budget prepared by Management and votes on the budget proposal
- Presents budget to governing board for adoption – not Convention
- Reviews, approves and communicates monthly financial statements and comments on variances from budget
- Often includes non-board members



Best Practices related to safeguarding assets and establishing internal controls

▶ AUDIT Committee

- Audit committee is accountable to the Governing Board
- Is responsible for ongoing Risk Assessment and Whistleblower resolution
- Focuses efforts on internal controls, compliance matters and monitoring
- Works alongside the Finance Committee in financial reporting and compliance matters
- Requires expertise in auditing and compliance, not just accounting and finance
- Can be as few as 3 members and in very small organizations, there may actually be only one qualified member
- Members should be as “independent” of the organization as possible –not hold any other current leadership position
- IRS looks favorably on organizations with an audit committee



Protecting your organization

▶ Internal Controls

- Segregation of duties (no one person can complete a receipt, disbursement or payroll cycle)
 - *Secretary and Treasurer cannot be the same person and have the responsibilities of both officer positions*
 - Progress is being made – more have hired bookkeepers and segregated duties
- Independent reconciliation of bank account monthly
- Independent review of expense reports and credit card statements
- Deposits made independent of recording of receipts
- Use automated/integrated bookkeeping system (e.g. QuickBooks)



Protecting your organization

- **Budgetary controls**
 - The most effective controls in a small organization
 - Only useful if budget is prepared using zero-based budgeting
 - Must measure results each month compared to budget – with commentary
 - Management and/or finance committee should prepare
- **Perform background checks on all personnel responsible for handling or approving financial transactions**
- **Strongly advise purchasing a fidelity bond or fidelity insurance in addition to D&O and general liability policies**
- **Check insurance policy for theft coverage**

Invest excess cash in a prudent investment instrument



Protecting your organization

- **Annual Audit**

- Insist on having annual *independent* audits performed
- Do not settle for compilations or reviews
- Cost should be budgeted annually

- **Tools**

- Use *Department Operations Guide* for information on controls and governance
 - Available today for discounted price
 - Can go to ALA website and download
- Use free tools from internet research



Final Comments

- ▶ *Each member of the organization's leadership has a FIDUCIARY DUTY to be good STEWARDS of the Organization's assets.*
- ▶ The constituency to which you owe these duties is broad, including ALA members, donors – past and present, government agencies, employees, other ALA organizations that use the ALA Emblem, and those women and men who have served our country and who will serve our country in the future
- ▶ Your Fiduciary Duty and responsibility for Stewardship is not an option – *it is a legal, ethical and moral responsibility*

