NONPROFIT UPDATE

Do Audits Detect Fraud?

While independent audits serve an important purpose and may prevent potential fraud, audits rarely detect fraud. Even when an organization conducts an independent audit or review of its financial statements, the auditors do not guarantee that the organization is free from fraud. Independent audits only provide reasonable assurance that the financial statements are free of material misstatement.

Most frauds are discovered as a result of a tip. Best practices to uncover fraud include educating your employees and raising awareness about fraud by inviting the organization's Directors and Officers, liability insurance carrier, bank, or even local law enforcement to make a presentation at a staff or board meeting. Consider the following steps that can help raise awareness about fraud among staff and board:

1. Strive to foster a culture that encourages employees to speak openly, without fear of retaliation. Investing in a tip hotline increases your chance of discovering fraud and may reduce the ultimate exposure. Organizations with tip hotlines detected fraud 50% faster than those organizations without tip hotlines.
2. Adopt a whistleblower policy and ensure that employees and board members are aware of the policy and understand the use of it is confidential.
3. Clarify how and to whom employees should raise concerns about financial mismanagement or other improper conduct. These guidelines should be spelled out in the employee manual and discussed during board orientation.
4. Build awareness as to what types of actions constitute fraud and demonstrate the cost of fraud to the organization including lost revenues, negative publicity, job loss, and a decrease in productivity and morale.
5. Communicate a zero tolerance policy for fraud. Ask employees to sign a written Code of Conduct that outlines expectations and specifies that the consequence of engaging in fraudulent behavior is termination of employment.
6. Identify the role of board members for responding to or investigating allegations of fraud.
7. Decide in advance that the nonprofit will pursue criminal charges against an employee who engages in fraud.

While an independent audit may not uncover fraud, strong internal controls can help reduce the risk of theft and embezzlement. Internal controls sound daunting, but there are numerous very practical steps every nonprofit can take including determining that policies are in place and are followed consistently.