FIDUCIARY STEWARDSHIP

May 8, 2017
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
- External Audits, Reviews and Compilations
- Protecting your organization
  (ALA NHQ and Departments are all corporations, subject to corporate law and liability)
Over 1.6 million NFP entities and over 1 million 501c3 (charitable) Organizations (2015 data)

65% of 501c3 organizations have annual revenues < $25,000

Non-profit entities employ 11.4 million (10% of workforce)

Non-profit entities reported $1.74 Trillion revenues and $1.63 Trillion in total expenses (2013)

Association of Certified Fraud Examiners estimates that over 5% of revenues are lost to fraud – or $87 Billion

ALA Departments have had multiple fraud issues
  ◦ $Millions have been lost to fraudulent activities
  ◦ Only a few have been discovered
“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
- Members’ information
- Reputation
- Organizational Integrity
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
  - “Power” resides with the entity
  - “Authority” resides with the individual

- Even though the IRS “strongly encourages” annual audits, many NFP entities do not have their financial statements audited

- Too few resources are allocated to control systems and financial oversight

- 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

- Frauds often go unreported because of the fear of repercussion from donors and constituents

- Organizations do not maintain their accounting records permanently on electronic systems
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

  Under-recording expenses and costs

  Misreporting cost/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
  - Provide CEO with proper title, authority and responsibility
  - Create a formal succession plan for key management personnel
  - Governing body composition and tenure
  - Appropriate policies for rotation
  - Establish appropriate committees:
    - Executive
    - Finance: 5-year staggered terms
    - Audit: 3-year staggered terms
  - 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 and non PDPs
Best Practices related to safeguarding assets and establishing internal controls

- **AUDIT Committee**
  - Audit committee operates at arms-length and 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, but does not micro-manage
  - Requires expertise in auditing and compliance, not just accounting and finance
  - Members should be as “independent” of the organization as possible – not hold any other current leadership position
  - IRS looks very 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*
  - 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

- **Strongly advise purchasing:**
  - fidelity (theft) bond for individuals
  - fidelity (theft) insurance as part of general liability policies
  - Directors’ and Officers’ (D&O) insurance

- **Tools**
  - Use *Department Operations Guide and DEC101 tools* for information on controls and governance

- Invest excess cash in a prudent investment instrument
Protecting your organization

- **Annual Audits or Other Outside Assurance**
  - **Audit** – Amounts and disclosures are “audited”
  - **Review** – Amounts and disclosures are only “reviewed”
  - **Compilation** – Only amounts are presented – no disclosures or comfort
  - **Agreed-Upon Procedures (AUP)** – surgical procedures on critical areas of risk

  - Audit – highest Assurance (95%) – fee $5,000
  - Review – moderate assurance (50%) – fee $3,000
  - Compilation – lowest level of assurance (10%) – fee $1,500
  - AUP – targeted procedures – fee range from $700 to $2,000

- Independent CPA firm only

- Focus on cost/benefit
Protecting your organization

- **Annual Audits or Other Outside Assurance**
  - Annual *independent* audits are preferred
  - May rotate annual audits to every couple of years
  - Supplement off years with compilation and AUP

- CPA firm usually prepares Form 990 also

- Costs should be budgeted annually

- Discounts are usually provided for NFP entities
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.

Remember, the primary role of the NEC as the board of directors is to protect the organization’s reputation and ensure its financial health.