



Minimizing Fraud in the Nonprofit Grant Process

For



The Chapin Foundation

ACCT 631 Fraud Examination-Dr. Karen Maguire-Spring 2016

Who Are We?

**Graduate students in the
Master of Accountancy Program and
Master of Business Administration at
Coastal Carolina University
Dr. Maguire's ACCT 631 Fraud Examination Class**

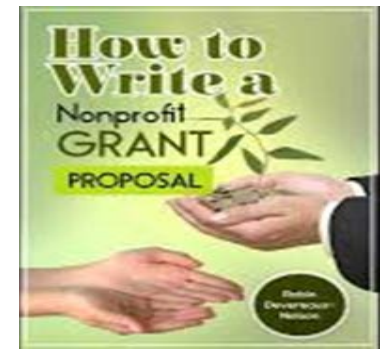


Why Are We Here?

To address concerns and standardization procedures in order to minimize fraud throughout the grant process.

Our Goals Are:

- to help NPOs increase grant funding
- to minimize fraud
- to minimize reputational risk
- to help you build additional capacity
- to achieve best practices



Who is Interested or May Find This Useful?

DONEES-Nonprofit Organizations

DONORS-Individual Contributors

SERVICE RECIPIENTS

GRANTMAKERS

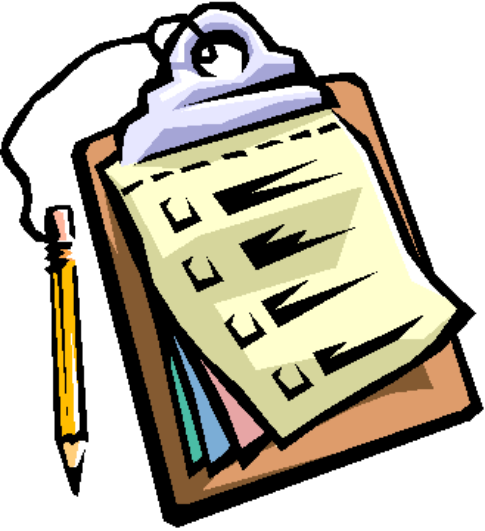
STATE GOVERNMENTS

IRS/OMB

CREDITORS



What Is Our Main Agenda?



- To provide an overview of the Grant Process and details in regards to the Three Phases of the Grant Process
- To provide fraud examples and ways to detect and minimize fraud in each of the three phases
- To provide you methods to accomplish best practices which should help you to increase operational efficiencies, minimize operational risk and build additional capacity.

Statistics

- The majority of charitable contributions received by national NPOs are between \$1MM and \$3MM
- The majority of charitable contributions received by South Carolina NPOs are for amounts less than \$50K



How Do Grants Help?

The Grant Process is a way that corporations, foundations or governmental entities fund ideas and projects to provide various public services.



How Do Grants Help?

Grants can support capacity building, critical recovery initiatives, innovative research, and a litany of other programs.



How Do Grants Help?

The Grant Process can be a means to incorporate best practices for accounting, auditing, and governance.

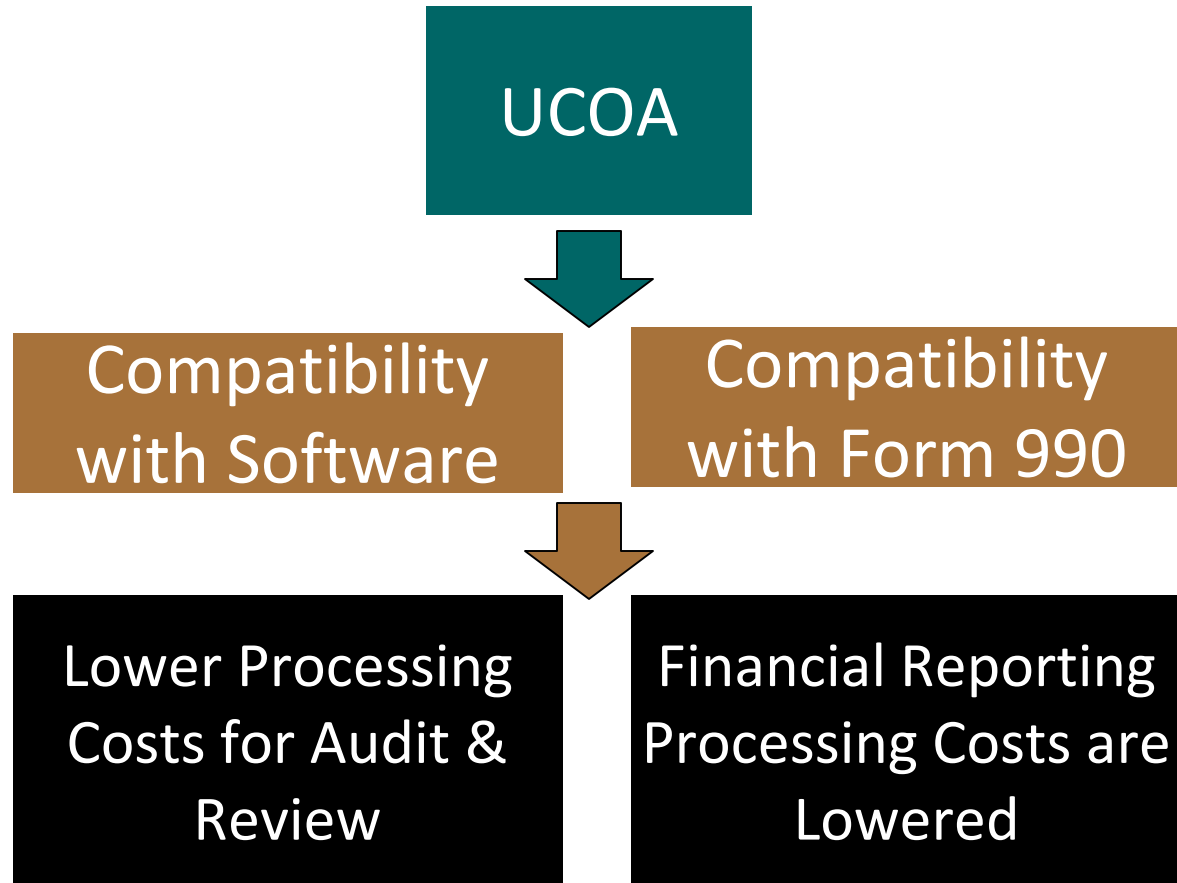


Unified Chart of Accounts

- A chart of accounts freely available on the National Center for Charitable Statistics website.
- Designed so that nonprofits can quickly and reliably translate their financial statements into the categories required by the
 - IRS Form 990,
 - Federal Office of Management and Budget,
 - Generally Accepted Accounting Principles,
 - The United Way,
 - and other standard reporting formats.

UCOA seeks to promote uniform accounting practices throughout the nonprofit sector.

Unified Chart of Accounts



Attributes of UCOA

- **Main attributes**
 - Transparency – Clear view of how dollars are invested
 - Uniformity – Same principles, standards, or rules used from district to district for consistency
 - Accountability – Rules for reporting data aligned to goals and objectives
 - Comparability – Methods and content allow NPOs to compare financial information

THE SLIDE

- An Example of using UCOA across NPO financial reporting formats

	BLS Rate Per Hour	Total Tracked Hours	Volunteer Value	Purchase Services	UCOA*	GAAP	OMB Matching	990 - No Audit**	990 - Audit***
Skilled	\$100	1,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000	\$100,000
Unskilled	\$10	2,000	\$20,000	\$20,000	\$20,000	-	\$20,000	\$20,000	\$20,000
Amount reportable on NPO Financial Statements				\$120,000	\$120,000	\$100,000	\$120,000	0	\$100,000

*Skilled - Donated Professional Services - GAAP

Unskilled - Donated Other Services - Non-GAAP

**Both reported on line 82b of Form 990 for informational purposes only

***\$100,000 reported in Part IV of Form 990 - Reconciliation of GAAP-IRS

\$20,000 reported on line 82b of Form 990 for informational purposes only

Usefulness of UCOA

- Knowing how much to request from funding sources
- Break down of income
- Mirror Form 990 and GAAP requirements

Statistics

The ACFE estimates that organizations lose roughly 5% of their annual revenue due to fraud. The median loss is \$150K, but more than 23% of cases involved fraud losses of more than \$1MM.



Fraud Fantasy -VS- Reality



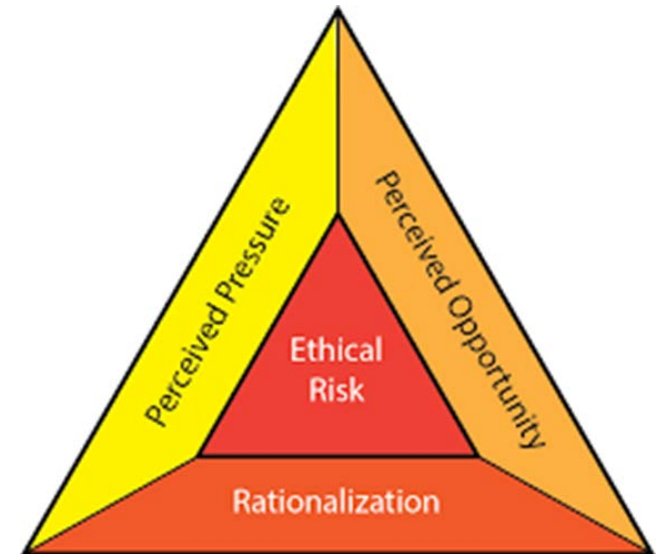
OR



Minimizing Fraud

There are three elements present in every fraud which are commonly known as the fraud triangle

- **Perceived Opportunity**
- **Perceived Pressure**
- **Rationalization**



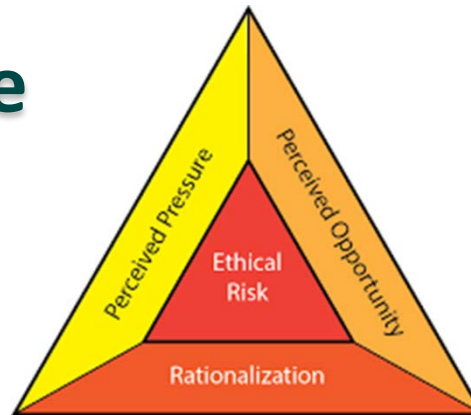
Fraud Triangle

Perceived Opportunity

- A perceived or actual opportunity to commit fraud
- A belief that no one will notice

Perceived Pressure

- Personal debt
- Costly addictions such as gambling
- Unforeseen expenses



Rationalization

- I'll pay it back
- Other people are doing it
- They don't pay me enough

Who is Responsible for Fighting Fraud?

Donees bear primary responsibility for prevention and detection of misconduct.

Federal agencies have ultimate oversight authority for Federally funded research.

While all frauds can damage funding and reputations, of particular concern are those that include using the mail or electronic communications to perpetuate the fraudulent activities.



Reputational Risk



Maintaining reputation is vital to the survival of the organization and it has to be approached in a strategic and well-planned way. Example of potential problems include:

**Poor scores on sites like Charity Navigator,
Inadequate or missing information on GuideStar,
Unhappy donors who take to complaining on Social Media,
Special event gone awry**

All these bring reputation risk to even the most well regarded organization.

The Grant Process

The specific actions along the grant lifecycle are typically grouped into three main phases:

- **The Application Phase**
- **The Implementation Phase**
- **The Reporting Phase**



The Application Phase



What is it?

**How do I
apply?**

Before You Apply

Questions about program objectives/using funds

- Will you use funds to provide direct services?
- Do you need help building the capacity of your organization and/or others to serve your target population?
- Will you be starting a new program or expanding an existing one?
- Will your grant request fund a collaborative effort or a single agency?

Before You Apply

- **Considering these questions will help you clarify your goals, narrow your search for assistance, and determine the type of program and funding for which you will be eligible.**



Application

The pre-award phase represents the beginning of the grant lifecycle, which includes

- Announcing opportunities
- Submitting applications
- Reviewing applications

Following are explanations of what generally occurs during the pre-award phase.



Application

Registering to Apply

Registering to apply for grants on Grants.gov includes several steps and types of registration, including DUNS, SAM.gov, and Grants.gov accounts.



Application

Completing Your Application

Major components of the planning process includes developing your ideas, conducting research, writing your proposal, and completing your application.



Application

Some grant programs require applicants to submit audit reports and financial statements to determine applicants' financial viability.



Required Attachments



- **Proof of Nonprofit status**
 - **List of Boards of Directors**
 - **Audits and Financial Statements**
 - **Application Forms**
-
- **Required Certifications**
 - **Letters of Support**
 - **Partnership Agreement and assurances with original signatures**

Application

Potential Grant Fraud

- Falsification of Data
- Fabrication
- Plagiarism
- Forgery
- Unsolicited Application Offers
- Commission-Based Fees
- Corruption
- Mail Fraud
- Wire Fraud



Falsification, Fabrication, and Plagiarism

Falsification is the practice of omitting or altering materials, equipment, data, or processes in such a way that the results are no longer accurately reflected in the project records.



Falsification, Fabrication, and Plagiarism

Fabrication is the practice of inventing data or results and recording and/or reporting them in the project records.



Falsification, Fabrication, and Plagiarism

Plagiarism - using or representing the work of others as your own work constitutes plagiarism, even if committed unintentionally.



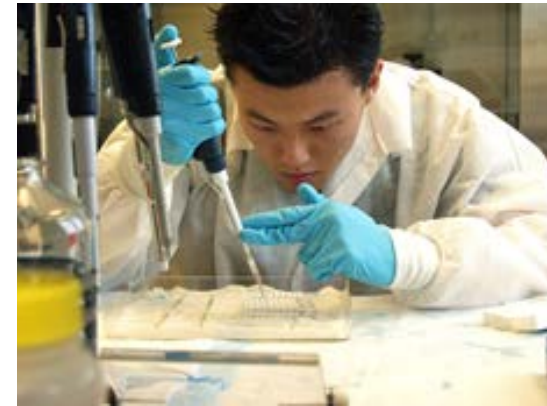
Example of Fraud

Iowa State University

Laboratory manager spiked samples of rabbit blood with human antibodies to make an experimental HIV vaccine appear to be a breakthrough in AIDS research.

Fraudster received more than \$7MM in NIH funding.

Detected by another lab that uncovered irregularities, fraudster sentenced to four and a half years in prison and required to pay money back.



Detection of Falsification and Fabrication

Proactive Fraud Auditing

The only way to detect falsification and fabrication of data is to have someone do the groundwork and do some fact checking.



Detection of Plagiarism

Federal agencies and independent organizations use plagiarism detection software to analyze thousands of grant applications.

The screenshot displays the Viper plagiarism detection software interface. The title bar reads "Viper - Finished". The main window has a red header with the Viper logo (version 1.2.01) and the slogan "Biting hard on plagiarism". Below the header, there are buttons for "Save All Reports" and "Start New Search". A status bar indicates "All searches are finished, 12 documents found." The main content area shows a search path: "C:\Users\bart\Documents\An academic essay is not.doc". Below this, a table lists search results with columns for URL, Full PR, Filtered PR, and Side-By-Side. The table contains five rows of results with varying percentages. Below the table, there are two text panes. The left pane shows a snippet of text from the document being searched, and the right pane shows a snippet from a source website. Both panes have red highlighting indicating matches between the document and the source.

URL	Full PR	Filtered PR	Side-By-Side
<input type="checkbox"/> http://www.englishessays.org.uk/how-to-write-academic...	9%	4%	Compare
<input type="checkbox"/> http://www.latrobe.edu.au/theses/writing.html	6%	3%	Compare
<input type="checkbox"/> http://onlineeducationalwriting.wordpress.com/	10%	3%	Compare
<input type="checkbox"/> http://www-science.mgmt.waikato.ac.nz/Orange+Book+Part...	3%	1%	Compare
<input type="checkbox"/> http://onlineeducationalwriting.wordpress.com/2008/07/1...	5%	3%	Compare

Prevention of Falsification, Fabrication, and Plagiarism

Prevention techniques may include:

- Employ detection software and screen all grant applications beforehand.
- Highlighting the importance of citing your sources of where you acquired the information.
- Enforcing harsher penalties.



Forgery

1. A crime that involves making to altering a writing with the attempt to defraud another person or entity.
2. The production of fake art or others works that a person claims are genuine fabricating.
3. The act of devising, fabricating, or counterfeiting a document or other object.



Potential Forged Documents

This includes, but is not limited to:

- **Government issued identification**
- **Deeds**
- **Conveyances**
- **Checks**
- **Stock certificates**
- **Patents**
- **Wills**
- **Prescriptions**
- **Other medical documents**



Example of Fraud

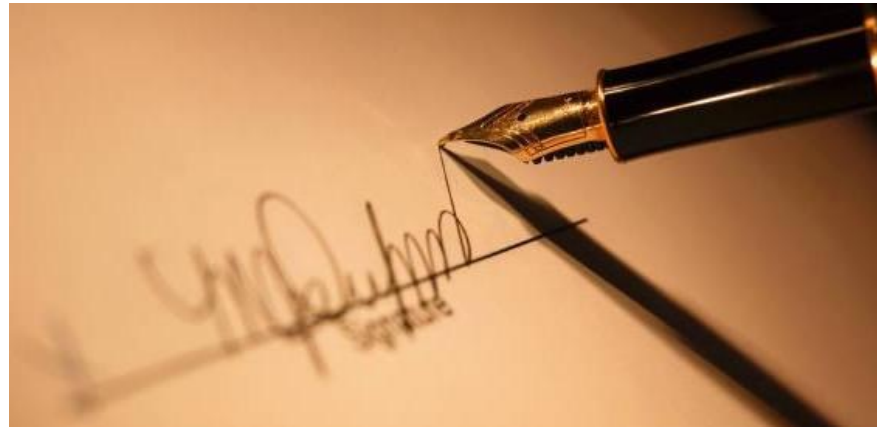
Grant writer for a community coalition seeking funding under the 21st Century Community Learning Center Program was found guilty of forgery, mail fraud, and making false statements after a local school district found that memos of understanding had been altered and district signatures had been forged.

Coalition had to return entire \$35MM grant.



Detection of Forgery

Detection can be done by contacting the supposed signer and asking him or her if they signed the document in question.



Detection may require a highly skilled individual who is an expert in the art of forensic document examination.

Prevention of Forgery

Prevention techniques may include:

- **Developing a complex signature.**
- **Practicing your signature so it is consistent.**
- **Signing rapidly so your signature is less legible.**
- **Requiring a public notary to attest to signatures on grant applications.**



Unsolicited Application Offers

An unsolicited offer will be received in the mail, electronic or paper that is not from an established professional organization.



Detection of Unsolicited Applications

Unsolicited application offers could well be an early warning of potential problems. Professional Grant Writing Associations, such as Association of Fundraising Professionals and the American Grant Writers Association have never been known to solicit grant offers to those who seek them.



Prevention of Unsolicited Applications



The key here is to never entertain these offers, as this is where the fraud begins. It's best to just hit that ignore button!

Commission-Based Fees

Professional ethics for Certified Grant Writers require a flat rate and the rate must be agreed upon before receiving the funding.



Detection of Commission Based Fees

If a grant writing organization discloses that they will work for a percentage of the funding amount, they have violated industry ethics, and should not be employed.



Prevention of Commission Based Fees

The grant seeking organization should request the disclosure of payment policies before giving the grant writer any important information such as bank accounts.



Corruption

Types of Corruption

- **Conflict of Interest – Official exploits fiduciary duty for his/her own benefit**
- **Bribery – Transfer of value to influence a decision**
- **Illegal Gratuities – Transfer of value to reward a decision**
- **Extortion – Threat made to influence a decision favorable to extortionist**



Example of Fraud

Speaker of the New York State Assembly convicted of multiple types of corruption.

During 20 year tenure as Speaker accepted more than \$4MM in bribes and kickbacks.

He steered business to doctors, law firms, and real estate developers, and helped them win favorable legislation. He then received a portion of the fees funneled through law firm.

Example of Fraud

These firms took advantage of NY loophole that allows LLCs to be legally defined as an individual. Firms created multiple LLCs and donated maximum allowed per “person” to Speaker’s campaign fund.

His defense strategy was that conflicts of interest were inherent and legal part of government work.

Prosecutor countered that Speaker’s actions were not for the people of NY, they were for the Speaker.

Detection

Red Flags Include:



- One person having control over disbursements with no oversight
- Grant projects funded by more than one grant may indicate fraud, particularly if the funds come from more than one federal or state jurisdiction
- Grant funds drawn down well before end of year

Detection

Red Flags Include:



- Consistent use of same vendors
- Vendor's insistence to deal with a specific representative
- Personal intervention to get certain vendors paid
- Referral of certain vendors to perform work
- Payments for personal expenditures

Prevention

- **Conflict of interest is avoided if employee discloses relationship with potential for conflict**
- **Written conflict of interest policy (Form 990 question)**
- **Code of conduct signed by all employees, becomes legal tool if necessary**



Mail Fraud

Using the mail in order to execute a scheme or specific fraudulent act in an attempt to defraud.

The material sent through mail does not need to be fraudulent, only needs to be part of a larger scheme to defraud.

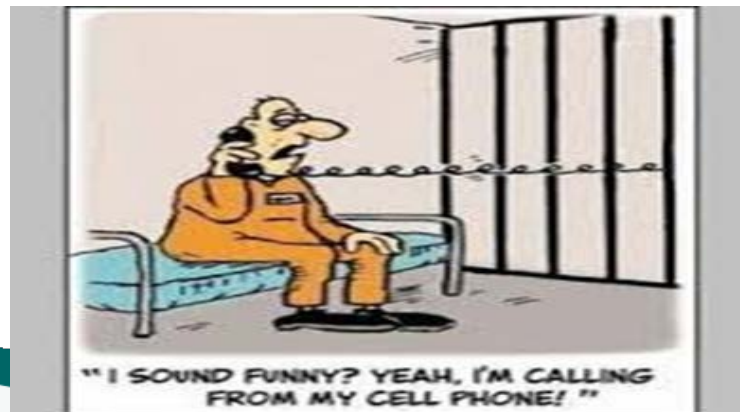


Day 276: After sending out that message in a bottle stating my location, I've been bombarded with junk mail."

Wire Fraud

Wire fraud is the same as mail fraud except it requires use of an interstate telephone call or electronic communication.

The communication itself need not be fraudulent if it is part of or in furtherance of a larger scheme.



Mail/Wire Fraud Penalties

Each mailing, phone call, or email across state lines in furtherance of fraud is separate count.

For each count, convicted offender can serve up to 20 years in federal prison. If disaster relief funds or financial institutions are victim organizations, term per offense increases to up to 30 years.

For each count, convicted offender can be fined up to \$250,000. If disaster relief funds or financial institutions are victims, fines can be up to \$1MM per offense.

UCOA in Application Phase

NPO can determine whether or not they are able to effectively use grant funds to achieve mission as they assemble consistent reports for grant application.

NPO and/or Grantmakers may detect or prevent previously unknown falsified data, conflicts of interest, or corruption.

Grantmakers can evaluate applicants on “apples to apples,” basis.

Grantmakers can make better allocation decisions when reviewing applicant NPOs in standard format.

IMPLEMENTATION



The Implementation Phase

Implementation

This stage begins when the grant is funded, and concludes on the project completion date listed in the grant submission.

Fraud in this phase occurs when funds received are used for a purpose other than intended.



Implementation

Some of the most common fraud scenarios include:

- **Misappropriation of funds for personal purposes**
- **Commingling grant funds with other funds**
- **Submitting false or altered documents when requesting reimbursement from the funding source**



Implementation

Potential Grant Frauds

- **Theft of Cash – larceny, skimming, petty cash**
- **Fraudulent Disbursements – billing, expense reimbursement, payroll schemes**
- **Noncash Frauds – supplies, inventory, information, securities frauds**



Example of Fraud

Payroll manager worked for hospital with 5,000 people.

When employee was terminated, fraudster falsified severance and vacation pay then replace employee bank account number with his own. Fraudster embezzled \$480,000.

Fraudster believed terminated employees are not around to complain about incorrect payroll numbers.

He failed to anticipate payments would be reflected in terminated employees' W-2 forms. Fraudster caught when former employee contacted hospital about too much compensation.



Example of Fraud

Effect of Bernie Madoff's securities fraud on NPOs

Yeshiva University -- \$106MM

Upstate NY Engineers Health Fund -- \$39MM

NYU -- \$26MM



Detection

- **Unique activities when sort transactions by employee**
- **Invoices for vague services**
- **Multiple invoices for amounts just below approval threshold**
- **Sequential SSNs in payroll**
- **Recorded \neq Actual amounts**
- **Reported \neq Predicted results**



Prevention

- **Mandatory vacations with employee rotation**
- **Well-defined reimbursement policy**
- **Periodic physical disbursement of payroll checks**
- **Segregation of custody, authorization, recording duties**
- **Inform employees about proactive fraud auditing**



UCOA in Implementation Phase

NPO can track performance throughout grant process, compare actual results to predicted results.

NPO and/or Grantmakers can detect changes over time that may signal fraud.

Grantmakers can increase efficiency of interim grant review process, and provide timely advice to NPO grantees that helps them achieve goals.



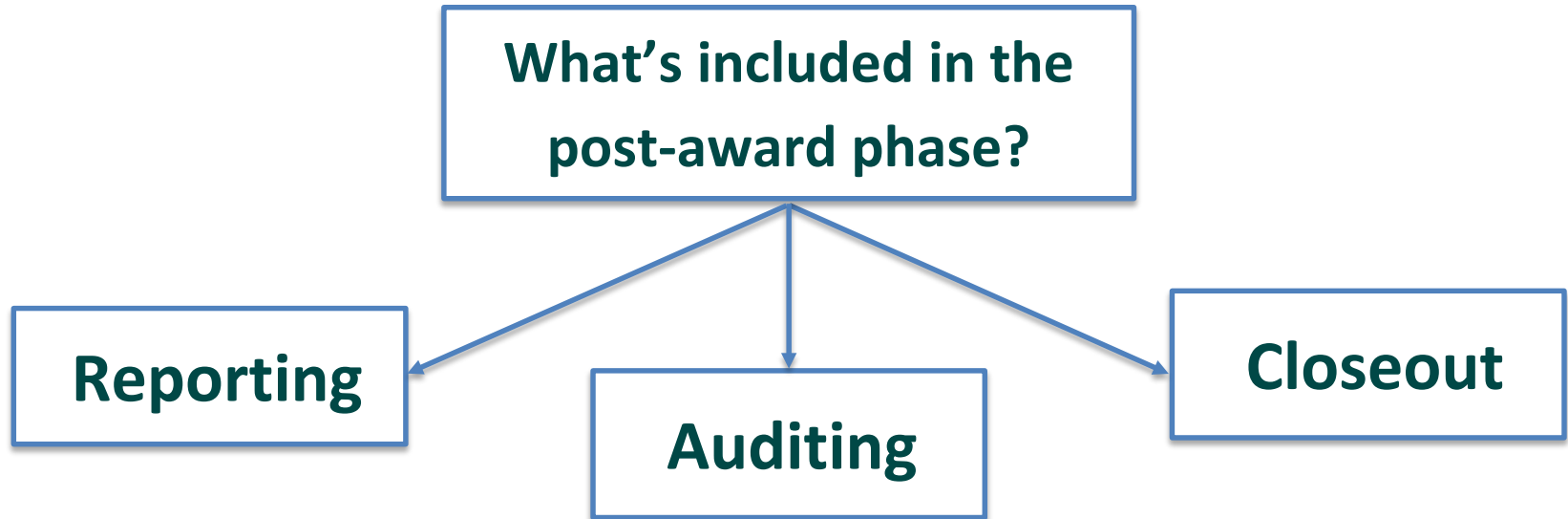
The Reporting Phase

Fraud In The Reporting Phase



- The Reporting Phase is unique in that the frauds present here are more the results of fraud committed in previous phases.
- A small fraud in previous phases may result in severe consequences in this phase.

Grant Reporting



Reporting

- **Specific reporting requirements, schedules, and systems can vary for each grant.**
- **Awarding agency typically has a grants management officer and program officer designated to each grant for the life of the grant.**
- **Law requires information about entities and organizations receiving federal funds be disclosed to the public via a central website, USASpending.gov.**



Auditing

Federal grants are audited by the Government Accountability Office (GAO), Office of Inspector General (OIG), and various federal departments when applicable.

These agencies monitor and analyze policies, expenditures, performance, and activities of grantees.



Closeout

Grant process ends here.

Must submit final financial and programmatic reports within 90 days after grant expires.

Ensures compliance.



Fraud In The Reporting Phase

Frauds in previous phases that can affect reporting phase

- Misappropriation of funds for personal use
- Commingling grant funds with other funds
- Submitting false or altered documentation when requesting reimbursement from the funding source
- Violation of organizational conflict of interest standards that are a condition of the grant
- Failure to comply with record keeping accounting requirements



Example of Fraud

Charity director in Beaver Falls, PA found guilty of filing false tax return, subject to fine of \$500K, up to 23 years in prison, or both.

Over 4 year period director spent \$91K on personal expenses, only gave \$10K to intended recipients.

Harsh penalties a result of failing to report fraudulently obtained money on individual tax return as income.



Detection



IRS Forms

- Required information
- Form 990-N
- Standard Form 425

Financial Statements and Reports

- Secretary of State
 - Annual Financial Reports
 - Division of Public Charities reports
- Other documents:
- False Grant
 - Reimbursement Requests

Accounting Records

- Recording of expenditures and payments
- Adjusting journal entries, improper revenue recognition, and overstatement of assets.
- Cost/Price Analysis

IRS 990-N Form

- 2 Did the organization undertake any significant program services during the year which were not listed on the prior Form 990 or 990-EZ? Yes No
If "Yes," describe these new services on Schedule O.
- 3 Did the organization cease conducting, or make significant changes in how it conducts, any program services? Yes No
If "Yes," describe these changes on Schedule O.
- 4 Describe the exempt purpose achievements for each of the organization's three largest program services by expenses. Section 501(c)(3) and 501(c)(4) organizations and section 4947(a)(1) trusts are required to report the amount of grants and allocations to others, the total expenses, and revenue, if any, for each program service reported.

4a (Code: _____) (Expenses \$ _____ including grants of \$ _____) (Revenue \$ _____)



Narrative and financial information on the three largest (by amount spent on them) activities to carry out the mission. Here you can see what the nonprofit considers most important as well as begin evaluating it: Do the programs support the mission as stated in line 1? Are the program descriptions concrete, or are they merely vague generalizations? Did the nonprofit provide all of the data required?

IRS 990-N Form

Did the organization become aware of a significant diversion of the organization's assets?

A diversion is considered significant if it exceeds \$250K or 5% of the organization's receipts or assets.

For many groups, this box is the place to report embezzlement and fraud.

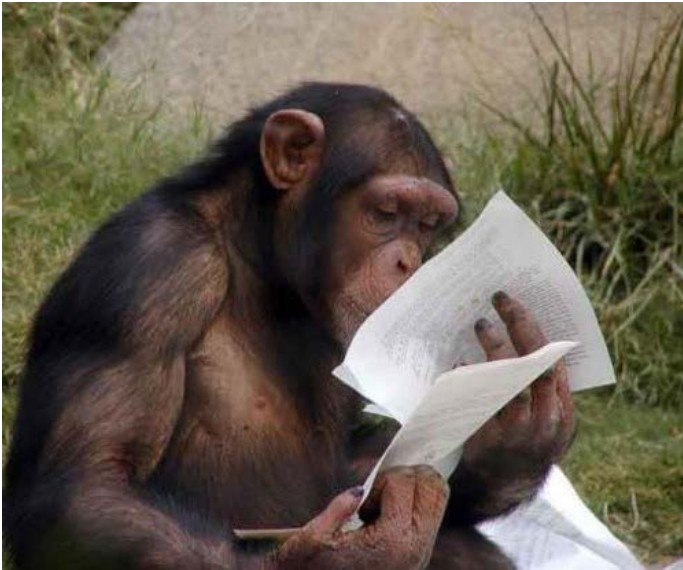
10 **Form 990 (2012)** **2012** Page **6**

Part VI Governance, Management, and Disclosure For each "Yes" response to lines 2 through 7b below, and for a "No" response to line 8a, 8b, or 10b below, describe the circumstances, processes, or changes in Schedule O. See instructions. Check if Schedule O contains a response to any question in this Part VI X

Section A. Governing Body and Management

	Yes	No
1a Enter the number of voting members of the governing body at the end of the tax year 1a		
If there are material differences in voting rights among members of the governing body, or if the governing body delegated broad authority to an executive committee or similar committee, explain in Schedule O.		
b Enter the number of voting members included in line 1a, above, who are independent 1b		
2 Did any officer, director, trustee, or key employee have a family relationship or a business relationship with any other officer, director, trustee, or key employee? 2		
3 Did the organization delegate control over management duties customarily performed by or under the direct supervision of officers, directors, or trustees, or key employees to a management company or other person? 3		
4 Did the organization make any significant changes to its governing documents since the prior Form 990 was filed? 4		
5 Did the organization become aware during the year of a significant diversion of the organization's assets? 5	X	
6 Did the organization have members or stockholders? 6		
7a Did the organization have members, stockholders, or other persons who had the power to elect or appoint one or more members of the governing body? 7a		

What Do You Need To Submit?



**Grant recipients
must submit Federal
financial reports &
narrative progress
reports**

What To Report?

Narrative Progress Reports



Progress reports include the grantees' accomplishments towards the goal of the project, plans for the next year of the project, personnel who have worked on the project, delays and plans to resolve them, etc.

What To Report?

Grant recipients may need to file financial reports with the IRS, OMB, GAAP, The United Way, Grantmakers, and other external stakeholders.



What Should I Do?



Failure to submit reports on a timely basis will result in delayed payments or denial of eligibility for future grants.

If failure to report includes IRS forms, penalties can be assessed.

Records and reports should be kept by the grant recipient for a minimum of three years from the date of the original grant distribution.

Auditing

**AUDIT
ME!**

Single Audit Act of 1984 – ensures that organizations receiving substantial federal funds use the funds in compliance with the federal government’s funding requirement.

Uniform Guidance went into effect for the 2015 tax year.

Auditing

If NPO expends more than \$750K in federal awards in a given fiscal year then Single Audit required.

Single Audit covers the entire scope of NPO's financial operations, including presentation of financial statements, evaluation of internal controls, and compliance with applicable regulations.

Subpart F Audit does same, but imposes additional training and certification requirements on auditors.



UCOA in Reporting Phase

NPO will require less billable hours – and hence a lower price – to complete an audit with consistent accounting data across all formats.

NPO with audit can reflect its increased capacity and eligibility for larger grants.

NPO and Grantmakers can decrease time needed to complete final reporting process.

Grantmakers can compare grantees' results more efficiently and generate timely feedback on what methods lead to best outcomes.

Recommendations

Best Practices



Recommendations

To minimize the potential for fraud:

- **Adopt UCOA;**
- **Follow best practices for accounting, auditing, and governance; and**
- **Apply detection and prevention activities discussed in this report.**



Recommendations

- Accurate reporting, internal and external auditing, monitoring expenditures can be applied to NPO as a whole, not just to detect specific frauds.
- Grant certifications as a condition of receiving grant.
- Increased training of grant recipients and awarding agencies.
- Improved communications among stakeholders.





Conclusions

Conclusions

Following recommendations for detection, prevention, and best practices, nonprofit grant seekers, grant recipients, and grantmakers can work to:

- Increase grant funding;
- Minimize fraud;
- Minimize reputational risk;
- Build additional capacity; and
- Achieve best practices.



Conclusions

Dr. Maguire's classes will continue conducting research for South Carolina NPOs that will:

- **Help NPOs work from their Form 990 to**
- **Follow UCOA to**
- **Work with an accounting system that is compatible with standard nonprofit financial reporting formats to**
- **Enable proper reporting to**
- **Prepare for an audit or review with**
- **Lower processing costs of the audit or review.**

Conclusions

By strengthening the financial knowledge and practices of South Carolina NPOs:

- **Donors will have more confidence;**
- **NPOs will have the ability to obtain the funding needed to reach their goals;**
- **Efficiency in “back-room operations” will increase effectiveness in “front-room operations;”**
- **NPOs can build capacity; and**
- **Continue to provide charitable services to our communities.**

Conclusions

These projects provide a mutual benefit to both Coastal Carolina University and the South Carolina Nonprofit Community.

Q & A

Questions?

Contact Information

For additional comments or questions, please contact:

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