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### Recommended Actions in Response to the Incident of Fraud in a New Hampshire Nonprofit

In New Hampshire, oversight of nonprofit activities falls under the jurisdiction of the New Hampshire Department of Justice's Charitable Trust Unit. State law and judicial decisions impose upon directors the fiduciary duties of care and loyalty regarding the corporations they serve. A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. These guiding principles should be exercised as a nonprofit determines its response to an incidence of fraud.

**Fraud Investigation Oversight** – Oversight of a fraud investigation should be under the direct purview of the board. The board may choose to establish a small sub-committee or select an individual to conduct the inquiry. This person(s) should be at least one layer removed from the incident. If the nonprofit's CEO is directly involved or is the immediate supervisor of an employee involved in the fraud, it is advisable that he or she not direct inquiries related to the fraud. The CEO can certainly be called upon to provide information to the investigative body (e.g. copies of relevant insurance policies, copies of cancelled checks); however, all analytical or inquiry-based functions are best conducted by someone else.

In determining whether or not the inquiry should be lead internally or referred to outside counsel, the board should evaluate the following considerations to ensure that the matter is handled fairly, impartially, and competently:

- Whether anyone on the board has enough investigative skill and experience to lead an inquiry;
- The likelihood that employees with first-hand knowledge of the alleged fraud or embezzlement will be honest and forthright with board members;
- The relative scale of the suspected misconduct;
- The board members' relationship and personal history with the subject (the investigator should never be the subject's supervisor);
- Whether the nonprofit's insurance policy will cover the costs of the internal investigation;
- Whether it may be important to rely on the attorney-client privilege to protect from subsequent disclosure to private third parties or the government in the event of a future investigation or litigation; and
- If insurance coverage is not available, the availability of other nonprofit resources to pay for outside investigative expertise.

Answering some of these relevant questions may require the use of legal counsel and or other experts, such as a forensic accountant.

**Determine regulatory reporting requirements** - Nonprofits cannot choose to handle instances of fraud or embezzlement quietly. In 2008, the Internal Revenue Service implemented additional regulations designed to enable the public to more easily evaluate how effectively larger nonprofits manage their money. Tax-exempt organizations with gross receipts greater than or equal to \$200,000, or whose assets are greater than or equal to \$500,000, must report "any unauthorized conversion or use of the organization's assets other than for the organization's authorized purposes, including but not limited to embezzlement or theft." Specifically, these

organizations are now required to publicly disclose any embezzlement or theft that exceeds \$250,000, 5% of the organization's gross receipts, or 5% of its total assets.

Whether or not a nonprofit is required to report the embezzlement is based on the type of Form 990 it files. If a nonprofit organization files a Form 990EZ, it may not need to report a material diversion of assets, however, it is still required to report excess benefit transactions, which includes acts of embezzlement. There can be severe penalties applied against a nonprofit and possibly the members of its board in instances of excess benefit transactions. Nonprofits should consult with a certified public accountant or legal counsel to determine what its reporting requirements will be.

**Determine the extent of the fraud** – It may not always be clear what the full extent of fraud was perpetrated until an investigation is conducted. Long-term employees who commit fraud may have been embezzling for a span of years; such investigations of fraud will likely require expertise beyond the scope of a nonprofit Board or staff. As noted above, the nonprofit board may have an obligation to accurately report instances of fraud to the IRS. Additionally, the nonprofit board has a fiduciary obligation to attempt to recover embezzled assets and may be expected to explain the efforts it took to do so to regulatory authorities, such as the IRS. To do that, the nonprofit must determine the full extent of the fraud.

**Create a clear and accurate record** – A clear, detailed, and accurate record of the events surrounding an instance of fraud should be written. Both the board and staff should detail the incident and their respective roles in its discovery and response. All communications with an employee(s) involved with the incident should be documented. Such records may be needed in response to criminal or regulatory investigations, and defamation lawsuits.

**Disclosure to the Public and or Donors** – A nonprofit's Form 990 is a public document. Whether or not this incident ever makes the press, there will be a public record that documents something occurred. A nonprofit that relies on the goodwill, trust, and generosity of the public must take this into consideration. Incidents of embezzlement and how they are managed call a nonprofits reputation and the reputation of its management and board into question.

Nonprofits should create a communications plan. A spokesperson should be identified and a message that assures key stakeholders of its plans to recover the assets stolen and the steps it will take to prevent such a crime from recurring again. Such communications should be made verbally, not in writing.

You may be surprised to hear your donors and partners have their own experiences to share; this is not an uncommon occurrence. You may find resources available, in the form of expertise or financial support, if you reach out and demonstrate the center has control of the situation and has a clear plan to move forward.

The specific contents of any public disclosure must be carefully considered, however, because a public accusation linking a specific employee to an act of fraud, if proven false, could lead to a defamation action.

Nonprofit staff should only be informed on a need-to-know basis.

Although specific details of a criminal case may not be available to a nonprofit, the investigative committee can ask the police and/or the Attorney General's office questions about the process around such a case that may assist you in understanding the risks of public disclosure of the embezzlement.

**Determine the extent of your insurance coverage** – Speak to your insurance agent about recovering the financial losses but also whether or not there is coverage that will support the costs associated with hiring outside experts, such as an accountant or legal counsel.

**Consider all recovery options** – Considering the fiduciary responsibilities of a nonprofit board, it is important that it consider all recovery options. Beyond exploring all options available through center insurance policies, this should include the possibility of pursuing a civil suit or establishing a repayment plan with the perpetrator. Knowing the extent of the embezzlement will help a nonprofit determine the best course.