

IDENTIFYING THE RISK OF FRAUD IN NOT-FOR-PROFIT ORGANIZATIONS

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Not-for-Profit organizations and their auditors are gearing up to implement SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*, which is effective for years beginning on or after December 15, 2002. Although not required for September 30 and December 31, 2003 year-ends, early implementation is encouraged.

Although SAS No. 99 makes significant changes in the procedures auditors are required to perform in their audits, it is actually an extension of SAS No. 1, *Codification of Auditing Standards and Procedures*, AU sec. 110.02 dealing with the responsibilities and functions of the independent auditor. SAS No. 1 states, in part:

The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud.

The public, including client management and other stakeholders of those entities, however, isn't always knowledgeable about auditing standards. For the most part, they are more likely to believe that SAS No. 99 was adopted as a direct response to fraudulent activity recently in the press such as that at Enron and HealthSouth. In

fact the Auditing Standards Board began studying the effectiveness of SAS 82 one year after it was issued.¹ Auditors have expressed concern that the new standard will increase the expectation gap between what the public believes auditors should do (i.e. "find fraud") and what SAS No. 1 and SAS No. 99 actually require. The expectation gap may be more pronounced for auditors dealing with smaller clients, particularly not-for-profit organizations.

Audits of not-for-profit organizations may be considered by some to have a relatively low risk of fraud since profit is not a motive and not-for-profits lack investors. However, this is not the case. In its 2002 survey, the Association of Certified Fraud Examiners asked 663 certified fraud examiners to answer questions about the frauds they encountered.² Although the survey did not provide results specifically about not-for-profit organizations, some of its findings have application to not-for-profits, especially the finding that organizations with 1-99 employees were more likely to have losses due to fraud (39%) than those with 100-999 employees (20.1%),

¹ Beasley, M. 2003. SAS 99: A New Look at Auditor Detection of Fraud. *Journal of Forensic Accounting* 4(1):1-20.

² Association of Certified Fraud Examiners. 2002. *Report to the Nation on Occupational Fraud and Abuse*. ACFE, Austin, TX.

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