Sobel & Co.’s Nonprofit and Social Services Group presents

Your Organization is Vulnerable: The Facts About Nonprofits and Fraud
“If you are above average intelligence - and if you have mastered the use of high intelligence to solve problems and achieve goals - it is the premise of this book that you are at risk (of perpetrating a fraud) because of the strength of your cognitive equipment.”

From the Headlines

• Former American Cancer Society employee arrested on embezzlement charges
• Oxnard woman admits to embezzling from Ventura nonprofit
• Former New York Red Cross financial director sentenced for stealing more than $274,000 from the humanitarian organization
• Missing church funds leads to embezzlement arrest
• Former Nonprofit Executive Charged With Health Care Fraud
Nonprofit Statistics

- 1,424,918 tax-exempt organizations, including:
  - 956,738 public charities
  - 97,435 private foundations
  - 370,745 other types of nonprofit organizations, including chambers of commerce, fraternal organizations and civic leagues.

(Source: NCCS Business Master File 07/2013)

- In 2010, nonprofits accounted for **9.2% of all wages and salaries** paid in the United States.
  (Source: The Nonprofit Almanac, 2012)

- Nonprofit Share of **GDP was 5.5%** in 2012.
  (Source: The Nonprofit Almanac, 2012)
Makeup of Nonprofits

- In the United States nonprofit organizations employ 11 million people.

- An additional 110 million people volunteer.

- The majority of volunteers are between 40 and 60 years of age, followed closely by college age individuals.
Nonprofits in New Jersey - New York

- 42,285 registered nonprofit organizations in New Jersey
- 99,763 registered nonprofit organizations in New York
- Combined annual revenue over $217 Billion

(National Center for Charitable Statistics 2010)
Why Are Nonprofits Frequently the Victims of Embezzlement?

- Management and board members are often more trusting
- Less stringent internal controls
- A belief that audits will detect fraud
Why Are Nonprofits Frequently the Victims of Fraud?

Contributing factors include:

• In many cases, the person committing the fraud is someone you know and trust
• Lack of transparency
• Weaker internal controls
• Lack of business and financial expertise
• Reliance on volunteer boards
• Excessive control by founder, executive director, major contributors
• Lack of resources for financial management
Primary Internal Control Weakness

- Lack of Internal Controls: 35.5% (2012), 37.8% (2010)
- Override of Existing Internal Controls: 19.4% (2012), 19.2% (2010)
- Poor Tone at the Top: 9.1% (2012), 8.4% (2010)
- Lack of Competent Personnel in Oversight Roles: 7.3% (2012), 6.9% (2010)
- Lack of Independent Checks/Audits: 3.3% (2012), 5.6% (2010)
- Lack of Employee Fraud Education: 2.5% (2012), 1.9% (2010)
- Other*: 2.2% (2012)
- Lack of Clear Lines of Authority: 1.8% (2012), 1.8% (2010)
- Lack of Reporting Mechanism: 0.3% (2012), 0.6% (2010)
Cost of Fraud

• Typical organization loses about 5% of annual revenues to fraud
  ➢ Equivalent to $3.5 trillion annually, worldwide

• The median time a fraud scheme goes undetected is 18 months (Financial Statement Fraud is 27 months)

• Small and nonprofit businesses suffer disproportionate losses
Culprits

- Male (65%) – Female (35%)
- 54% between 31-45 years of age
- College educated
- Never charged with or convicted of a crime
Top Ways Fraud is Detected

- Tip (43.3 %)
- Management review (14.6%)
- Internal audit (14.4%)
- By accident (7.0%)
- Account reconciliation (4.8%)
- Document examination (4.1%)
- External audit (3.3%)
Case Results

• Reported to Law Enforcement (65.2%)
  - Bad Publicity
  - Internal Discipline
  - Private Settlement
  - Too Costly

• Civil Suit (22.5%)

• No monetary recovery (48.7%)
Common Reasons Fraud is not Reported

- Reputational risk
- Fear of the legal system
- Concern about personal safety
- Compassion
Sutherland Theories

• Edwin H. Sutherland (1883 – 1950) coined term *white collar crime* in a speech to the American Sociological Society in 1939

• “a crime committed by a person of respectability and high social status in the course of his occupation”

• Implied trust
Prior to Sutherland, many believed that criminal behavior was genetic.

- Theory of differential association
- Learning process included techniques, attitudes, rationalization, and motives
- Corporate culture (Tone at the Top)
- Term “White Collar Crime” has evolved
Cressey Theories

- Donald R. Cressey (1919 – 1987)
  *Other People’s Money: A Study in the Social Psychology of Embezzlement*

- Trust violators

- “Trusted persons become trusted violators”
Pressures

- Financial
- Personal habit
- Work related
Opportunities

• Level of trust

• Weak internal controls
Rationalization

Need to justify behavior

- “I am only borrowing the money”
- “Nobody will get hurt”
- “It’s only temporary”
- “Booking early is the norm”
- “The company owes me”
Motivation for Fraud

- Living beyond means
- An overwhelming desire for personal gain
- High personal debt
- A close association with customers, donors, vendors, volunteers, and constituents (recipient of service)
- Feeling pay was not commensurate with responsibility

- A wheeler-dealer attitude
- Strong challenge to beat the system
- Excessive gambling habits
- Substance abuse
- Undue family or peer pressure
Types of Losses

• Asset Misappropriation (Employee fraud, all levels from most junior to senior)

• Fraudulent Statements (Management fraud)

• Corruption
# Schemes and Number of Cases

## Religious, Charitable or Social Services

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Number of Cases</th>
<th>Percent of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Billing</td>
<td>28</td>
<td>51.9%</td>
</tr>
<tr>
<td>Check Tampering</td>
<td>18</td>
<td>33.3%</td>
</tr>
<tr>
<td>Expense Reimbursements</td>
<td>17</td>
<td>31.5%</td>
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<tr>
<td>Skimming</td>
<td>12</td>
<td>22.2%</td>
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<tr>
<td>Corruption</td>
<td>12</td>
<td>22.2%</td>
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<tr>
<td>Cash Larceny</td>
<td>11</td>
<td>20.4%</td>
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<tr>
<td>Payroll</td>
<td>8</td>
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<tr>
<td>Cash on Hand</td>
<td>7</td>
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<td>Non-Cash</td>
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<td>Register Disbursements</td>
<td>3</td>
<td>5.6%</td>
</tr>
<tr>
<td>Financial Statement Fraud</td>
<td>3</td>
<td>5.6%</td>
</tr>
</tbody>
</table>
Billing

Any scheme in which a person causes his or her employer to issue a payment by submitting invoices for fictitious goods or services, inflated invoices or invoices for personal purchases.
Check Tampering

Any scheme in which a person steals his or her employer’s funds by intercepting, forging or altering a check drawn on one of the organization’s bank accounts.
Expense Reimbursements

Any scheme in which an employee makes a claim for reimbursement of fictitious or inflated business expenses.
The Board and Senior Management

• Ensure the organization has adopted adequate anti-fraud policies and procedures
• Taken steps to identify fraud risks
• Follow-up on reports of fraud to include
  ➢ Investigation
  ➢ Recommendations
  ➢ Consistency

It’s up to **YOU** to set
Organizational Culture and
Tone at the Top
What Can We Suggest Today?

- Management culture
  - Code of ethics
  - Fraud policy
  - Establish a way for an employee to report fraud such as a hotline

- Review of insurance policies
  - D&O
  - Employee Dishonesty
  - Bonding

- Enhanced Human Resource policies
  - Background checks on new employees
  - Employee manuals
What Can We Suggest Today? (cont.)

- Never let one employee have total responsibility for the books, collection of funds, writing the checks and the reconciliation of records
  - Have monthly statements sent directly to the board
  - Safeguard of checks and other financial documents – in a safe, not a locked desk
  - Restrictive endorsements

- Foster a strong relationship with the banks – positive pay / two signatures / cancelled checks

- Vacation policy and job rotation
What Can We Suggest Today? (cont.)

- Conduct anti-fraud training
- Communication with your auditors
- Communication with legal counsel
- A fraud vulnerability evaluation
Questions?

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