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## How Religious Organizations Can Defend Against Fraud

June 20, 2018

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- A professional services firm with three distinct business lines
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  - Outsourcing
  - Audit, Tax, and Consulting
- More than 5,400 employees
- Offices coast to coast
- Serving over 6,000 nonprofits



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# Speaker Introductions

- Managing Principal, Southwest Region
- More than 30 years experience



**Ernie  
Cooper**

JD, CPA,  
CFF, CFE,

# Learning Objectives

At the end of this session, you will be able to:

- Discuss why fraud is committed and who is committing the fraud
- Describe fraud trends impacting nonprofit religious organizations
- Explain the potential impact of fraud on your organization
- Identify internal controls that could address gaps in risk assessments and prevent fraud



# Fraud Trends Impacting Nonprofit Religious Organizations



# Introduction

In today's environment, nonprofit religious organizations have many of the same challenges as the for-profit world and you must be concerned about:

- fraud from **external sources**, including cybercriminals and
- fraud from **internal sources**, including trusted employees



# Fraud Trends from External Sources, including Cybercriminals

# External Fraud Trends Impacting Religious Organizations

## Business Email Compromise (BEC) Schemes

- This is the number one threat in today's 2018 environment!
- The use of deception to manipulate individuals into divulging confidential information!
- Can cause you to wire funds to unauthorized third parties!

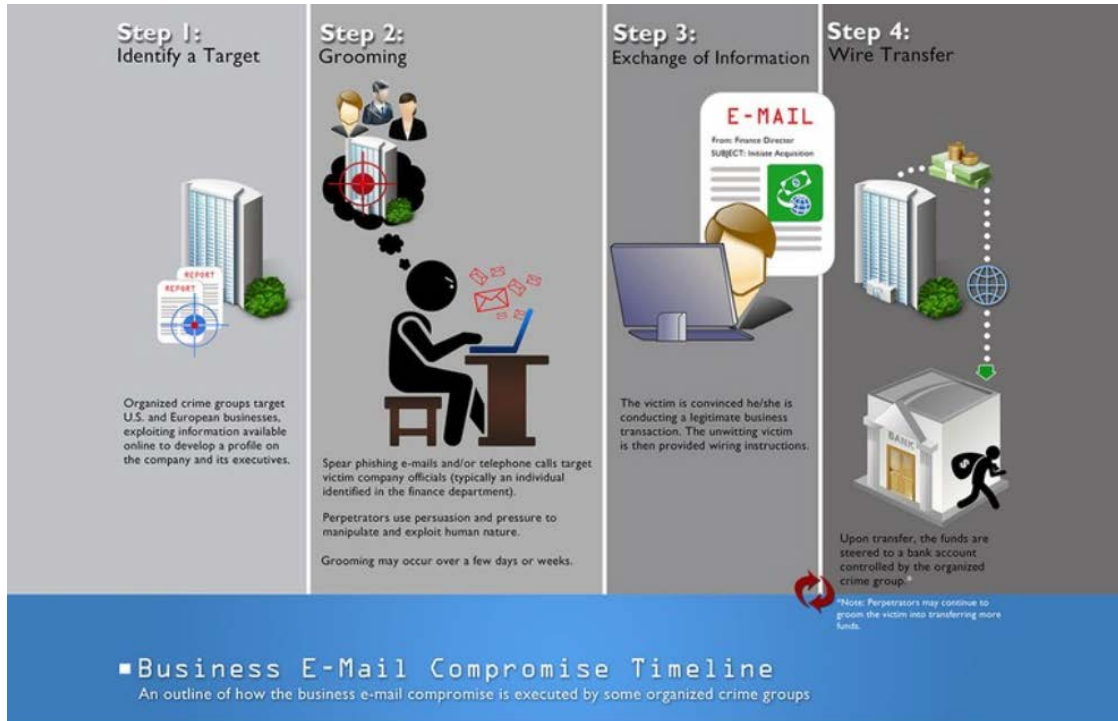


## Scammers and Schemes

- Fraudulent schemes perpetrated by a dishonest individual, group, or criminal enterprises in an attempt to obtain money by trick, deceit, or false pretenses

## Hackers and Malware (CLA Cyber Security Webinar)

# Business Email Compromise



# Scammers and Schemers

- Ruse disguised as a Charity Contribution  
- \$4,500 scam
- Fake email from Cybercriminal  
purporting to be from church official -  
\$7,600 scam
- Church scammed on Craigslist
- Scams against your congregation –  
especially elderly



# Tips to Minimize External Fraud Sources

- An anti-fraud oversight group must be established to address both external and internal fraud
- Ensure you have a current robust Cybersecurity Program in place and it is tested!
- Ensure all computer and electronic access to your organization's network is immediately disabled when employees/volunteers leave
- Ensure regular fraud training is provided to all employees, staff and volunteers



# Fraud Trends from Internal Sources, including Trusted Employees

# Why Is Fraud being Committed?



# The Fraud Triangle



Understanding the Fraud Triangle is Critical to:

- Minimize the risk of Abuse
- Minimize the risk of Fraud
- Develop strong internal controls

# The Fraud Triangle

## *Pressure*

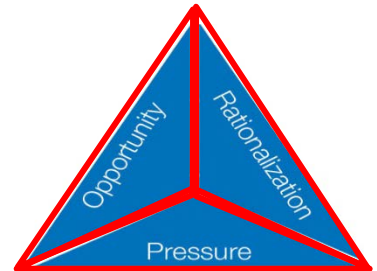
- Serious problem (financial) that requires immediate attention and cannot be resolved by ordinary financial resources

## *Opportunity*

- Aware that financial problems can be solved by stealing from organization

## *Rationalization*

- Mindset that fraudulent action undertaken is justified



# Who is Committing Fraud?

# Who is Committing Fraud?

**ANYBODY**

is capable of committing

**FRAUD**

## Religious Organization Examples

- Pastors
- Treasurer and assistant treasurer – husband and wife
- Controller
- Business manager
- Office manager, facilities manager and a volunteer - collusion

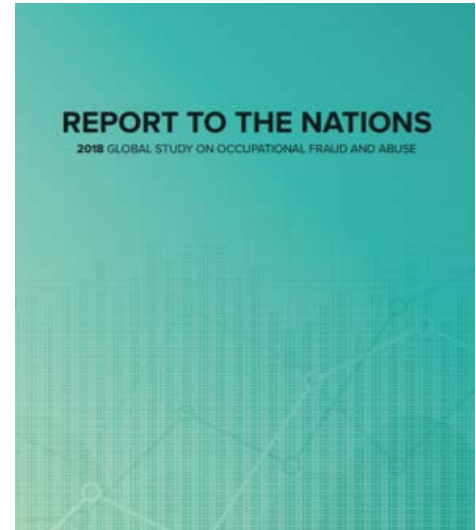
# Association of Certified Fraud Examiners (ACFE)

- World's largest anti-fraud organization and premier provider of **anti-fraud training and education**
- Reducing occupational fraud worldwide and **inspiring public confidence** in the integrity and objectivity of/within the profession
- Provides Certified Fraud Examiner (CFE) credential
  - Requires meeting professional, educational and ethical standards and passing rigorous exam on the four major disciplines that comprise the fraud examination body of knowledge: Fraud Prevention and Deterrence, Financial Transactions and Fraud Schemes, Investigation, and Law
- Headquartered in Austin, TX
- 80,000+ members



# ACFE Report to the Nations 2018

- Report to the Nations on Occupational Fraud and Abuse, 2018 Global Fraud Study
- Bi-Annual Report
- Analysis of 2,690 cases of occupational fraud across 125 countries in 23 industries
- Results based on 2017 Global Fraud Survey opened to 41,788 CFEs about their largest fraud case investigation completed between January 2016 and October 2017
- First ACFE Report to the Nations was issued in 1996



<http://www.acfe.com/report-to-the-nations/2018/>



# Loss to Organizations

Typical  
organizations lose  
5% of revenue in a  
given year as a  
result of fraud

(Occupational Fraud: The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets)

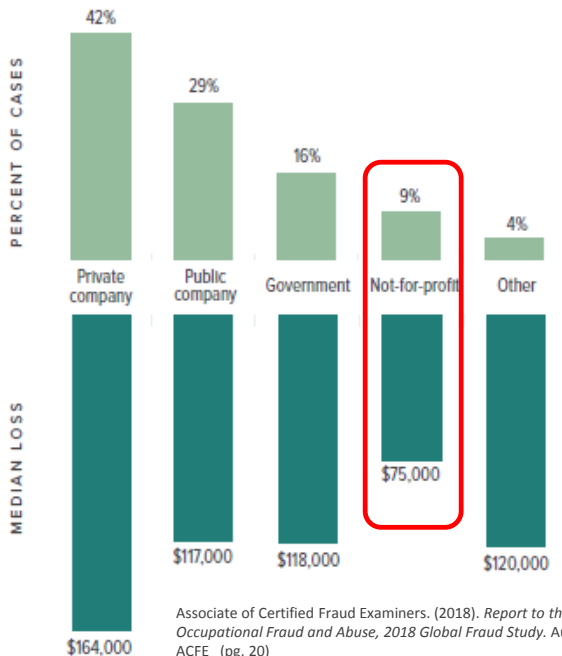
- Asset Misappropriation
  - 89% of Cases
  - \$114,000 Median Loss
- Corruption
  - 38% of Cases
  - \$250,000 Median Loss
- Financial Statement Fraud
  - 10% of Cases
  - \$800,000 Median Loss



# Fraud Exists in Every Industry and Organization Type

9% of occupational fraud cases involved nonprofit entities

FIG. 12 What types of organizations are victimized by occupational fraud?



Associate of Certified Fraud Examiners. (2018). *Report to the Nations on Occupational Fraud and Abuse, 2018 Global Fraud Study*. Austin, TX: ACFE (pg. 20)

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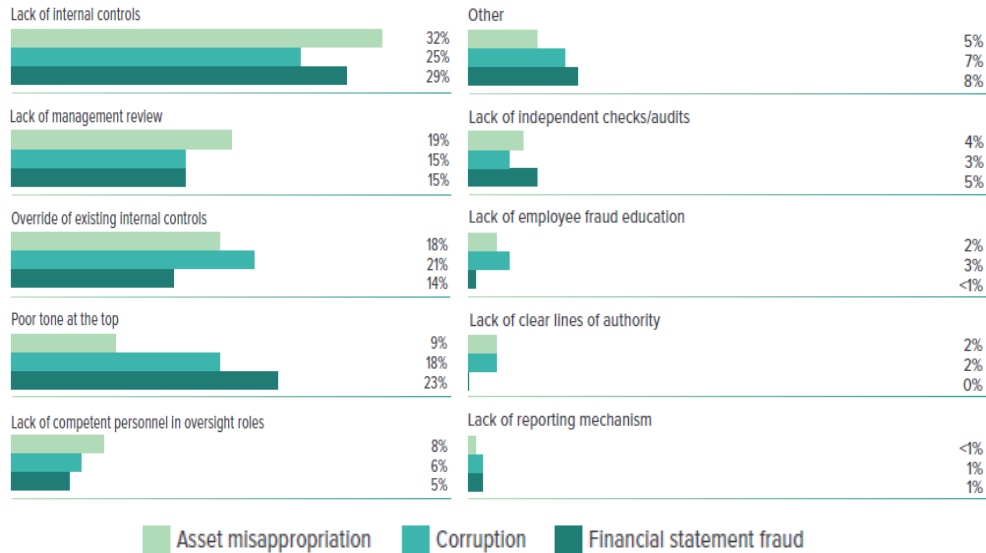


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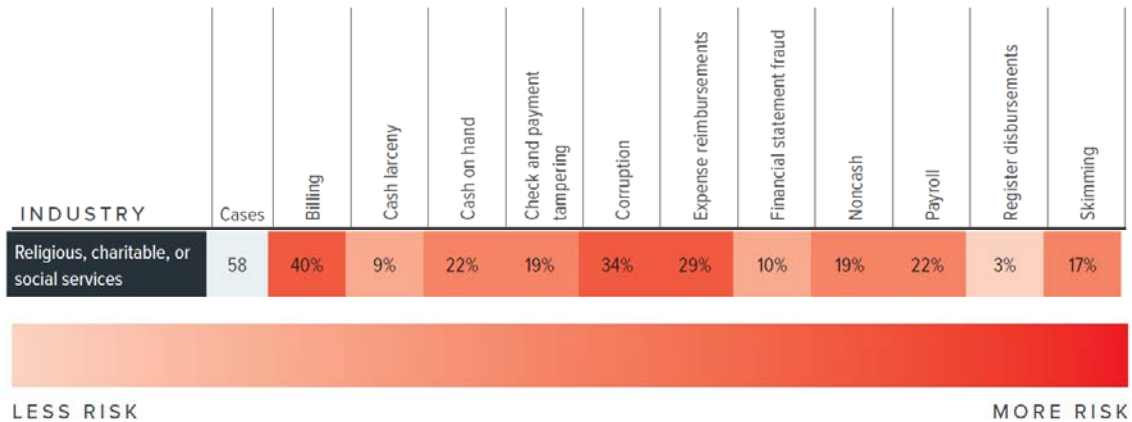
# Prominent Organizational Weakness: Lack of Internal Controls

FIG. 23 How do internal control weaknesses vary by scheme type?

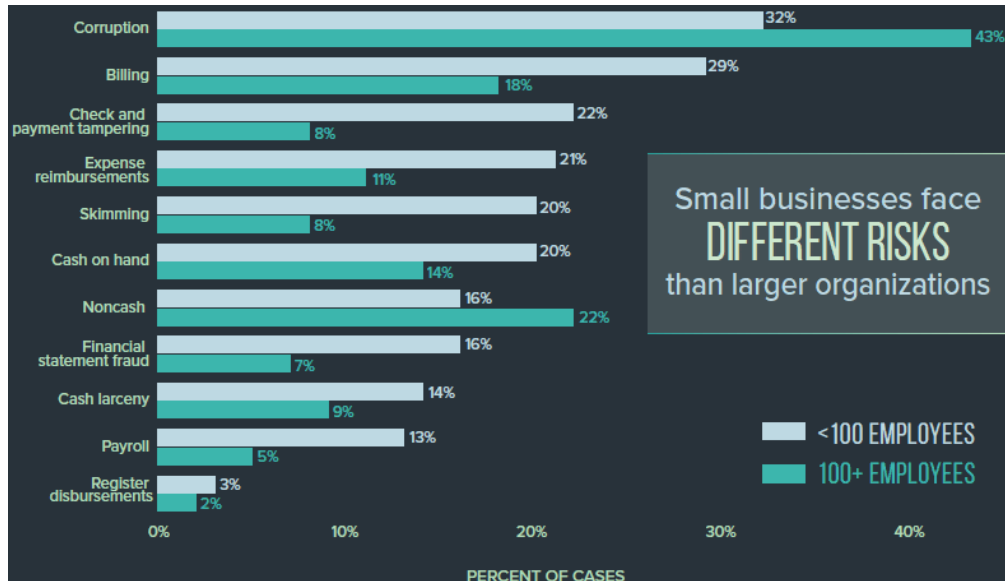


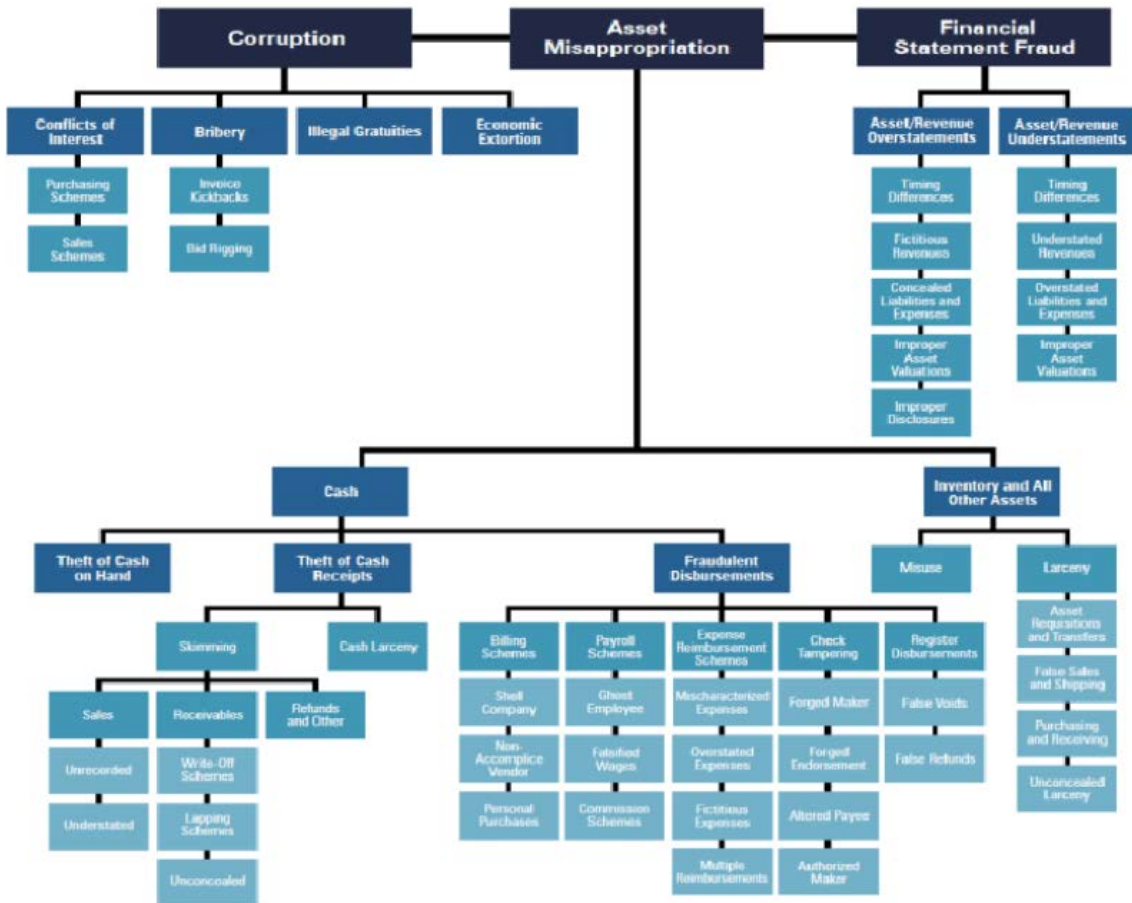
# Most Common Fraud Schemes (by Industry)

FIG. 16 What are the most common occupational fraud schemes in various industries?



# Risks Evolve and Change as an Organization Grows

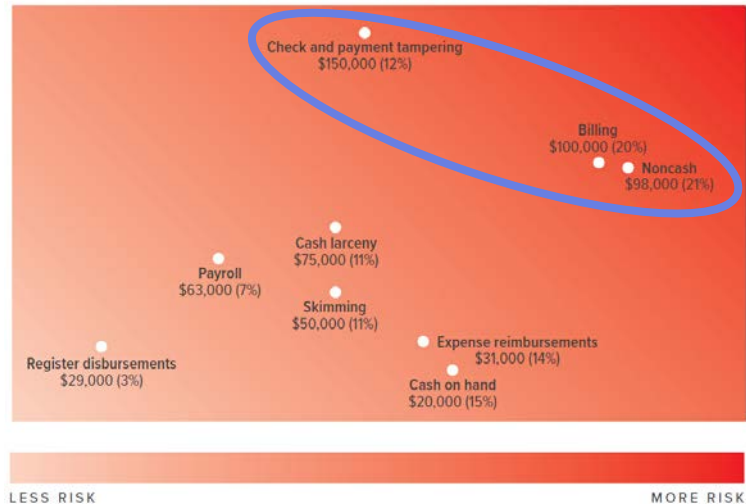




# Misappropriation of Assets

Billing schemes and check tampering present the greatest risk to organizations

FIG. 6 What asset misappropriation schemes present the greatest risk?



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# Origin – Accounting Department

FIG. 29 What are the most common occupational fraud schemes in high-risk departments?

| INDUSTRY                   | Cases | Billing | Cash larceny | Cash on hand | Check and payment tampering | Corruption | Expense reimbursements | Financial statement fraud | Noncash | Payroll | Register disbursements | Skimming |
|----------------------------|-------|---------|--------------|--------------|-----------------------------|------------|------------------------|---------------------------|---------|---------|------------------------|----------|
| Accounting                 | 290   | 29%     | 14%          | 17%          | 30%                         | 23%        | 12%                    | 13%                       | 7%      | 14%     | 2%                     | 19%      |
| Operations                 | 266   | 15%     | 8%           | 15%          | 8%                          | 36%        | 11%                    | 4%                        | 20%     | 5%      | 2%                     | 11%      |
| Executive/upper management | 223   | 35%     | 14%          | 16%          | 15%                         | 62%        | 29%                    | 30%                       | 20%     | 12%     | 3%                     | 9%       |
| Sales                      | 216   | 10%     | 12%          | 12%          | 6%                          | 34%        | 13%                    | 6%                        | 25%     | 2%      | 5%                     | 14%      |
| Customer service           | 155   | 5%      | 16%          | 31%          | 8%                          | 19%        | 4%                     | 1%                        | 15%     | 3%      | 5%                     | 14%      |
| Administrative support     | 147   | 33%     | 7%           | 21%          | 14%                         | 26%        | 22%                    | 8%                        | 19%     | 13%     | 3%                     | 14%      |
| Finance                    | 110   | 17%     | 15%          | 21%          | 16%                         | 37%        | 13%                    | 16%                       | 15%     | 6%      | 2%                     | 10%      |
| Purchasing                 | 94    | 18%     | 5%           | 6%           | 5%                          | 77%        | 10%                    | 3%                        | 31%     | 3%      | 2%                     | 4%       |



# Financial Statement Impact – Material or Not Material?

- Majority of occupational fraud is not material to the financial statements
  - Perception of auditor's responsibility to detect all forms of fraud
    - ◇ Immaterial transactions rarely examined by auditors (not cost-effective)
  - When detected, a question often arises: "Why didn't my auditor discover this?"
    - ◇ Need to be thorough
    - ◇ Need to be skeptical



# How are fraud schemes initially detected?

FIG. 9 How is occupational fraud initially detected?

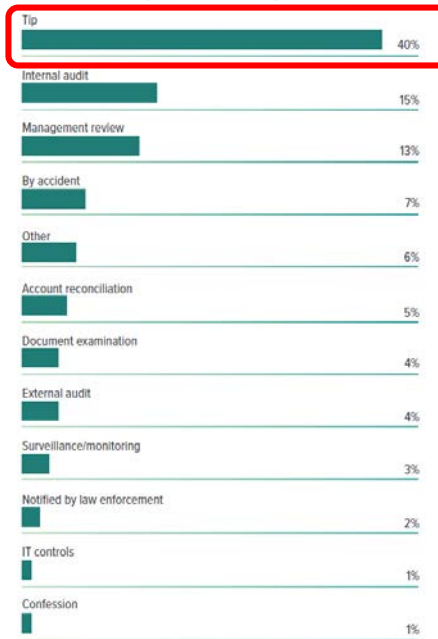


FIG. 10 Who reports occupational fraud?





# Impact of Fraud on Your Organization

# How Fraud is Impacting Your Organization

- Loss of money
- Loss of reputation
- Loss of vendors
- Overdraft charges & other finance fees
- Loss of trust
- Public outcry
- Loss of willing job applicants/volunteers
- Lawsuits
- Decrease in membership
- Revocation of non-profit status (usually in rare and egregious instances)



# Internal Controls That Address Gaps in Risk Assessments and Prevent Fraud

# Organization's Responsibility to Prevent/Detect Fraud

- Some of the most common internal control weaknesses that contribute to occupational fraud are:

- Lack of Internal Controls (30%)
- Override of Existing Controls (19%)
- Lack of Management Review (18%)
- Poor Tone at the Top (10%)
- Lack of Competent Personnel in Oversight Roles (8%)
- Other (6%)
- Lack of Independent Checks/Audits (4%)**
- Lack of Employee Fraud Education (2%)
- Lack of Clear Lines of Authority (2%)
- Lack of Reporting Mechanism (<1%)



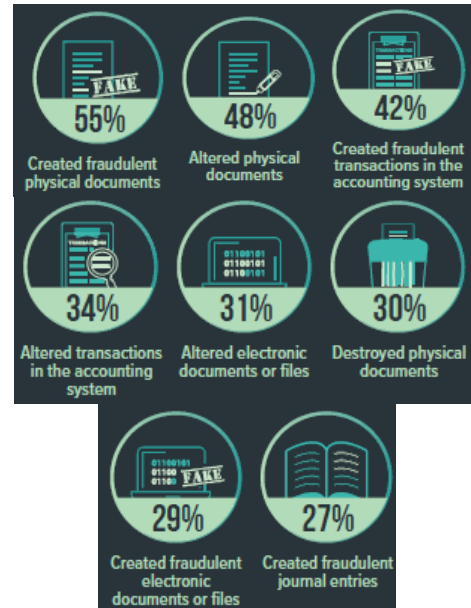
# Organization's Responsibility to Prevent/Detect Fraud

- Auditors are often the primary line of defense against fraud, but...
  - Only 4% of occupational frauds occur as a result of the organization having insufficient independent audits and other independent checks (fraud is much more likely to be detected internally)
  - Most frauds committed are immaterial to financial statements (meaning auditors are much less likely to uncover it)
  - IF auditors uncover the fraud, it is already too late to prevent losses.
    - ◇ Proactive monitoring for fraud is always the best way to prevent significant losses



# Preventing & Detecting Fraud - Concealment

- Fraudsters are often clever enough to at least attempt **concealment** of their misdeeds
- Concealment becomes **more difficult the longer the scheme continues**
- Losses increase by **orders of magnitude** with each passing year



# Preventing & Detecting Fraud - Concealment

- Only 3% of cases did not involve any attempts at concealment
  - Note: All of these unconcealed cases were committed by owners/executives
- Most popular methods of concealment are:
  - 80% relied on alteration of existing evidence (changing dates, check/invoice numbers, remittance information, etc.) to conceal misdeeds
  - 80% relied on creation of fraudulent evidence (generating fake bills/invoices, vendors, employees, customers, etc.)



# Preventing and Detecting Fraud: Crafting Effective Internal Controls (IC)

- Simple but effective controls:
  - Pre-numbered documents (invoices, receipts, admission tickets, etc.)
  - Cash lockboxes
  - Reconciliations
  - Documentation/“Paper Trail” (including digital recordkeeping)
  - Surprise audits
  - Passwords and User Rights
  - Written Policies
  - **Separation of duties**





# Preventing and Detecting Fraud: Crafting Effective Internal Controls (IC)

- Separation of Duties
  - In a perfect IC system, no single person would perform more than one of the following tasks:
    - ◇ Authorize a transaction
    - ◇ Record a transaction
    - ◇ Maintain custody of the financial instrument (cash, checks, etc.)
    - ◇ Perform month-end account reconciliations
  - Perfect IC systems usually not cost-effective
  - Balance cost vs effectiveness



# Preventing and Detecting Fraud: Crafting Effective Internal Controls (IC)

## Internal Control Framework Model:

C - Control Activities

R - Risk Assessment Activities

I - Information and Communication

M - Monitoring of Performance Metrics

E - Environment (Corporate Culture  
and Philosophy) Laws and Ordinances

\*\*\*The **internal control framework** comprises the building blocks of internal control:

1. Safeguard Assets
2. Carry Out Management Directives
3. Monitors performance
4. Ensures Compliance with Applicable Laws and Ordinances



# Preventing & Detecting Fraud: Crafting Effective Internal Controls (IC)

## New Vendor Due Diligence

- Public searches for vendor credentials/licenses
- Assign vendor number
- Maintain a vendor master file
- Periodic review of master file (is anyone not authorized making changes, any temporary vendor numbers)
- Verify any changes to vendor banking/mailing information requested via email (pick up the phone and call)



# Summary

# Summary

- Fraud is very costly to organizations... if left undetected, this cost increases exponentially over time
  - Financial (ex. misappropriation and other loss, increased costs, penalties)
  - Nonfinancial (ex. public perception, employee morale, customer trust)
- Fraud occurs in all industries – including religious organizations!
- Understand the fraud triangle
- Anybody can commit fraud
- Maintain professional skepticism – You are very vulnerable!
- Materiality
  - Majority of fraud is not material to financial statements, HOWEVER
  - Need to be aware of fraud risks
  - Repeated instances of fraud can, and often do, add up to create significant material losses for an organization





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**Questions?**


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