

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

**Your Organization is Vulnerable:
The Facts About
Nonprofits and Fraud**



Why Smart People Do Dumb Things

“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.”

Feinberg and Tarrant – Why Smart People Do Dumb Things (New York: Simon & Schuster, 1995)

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?

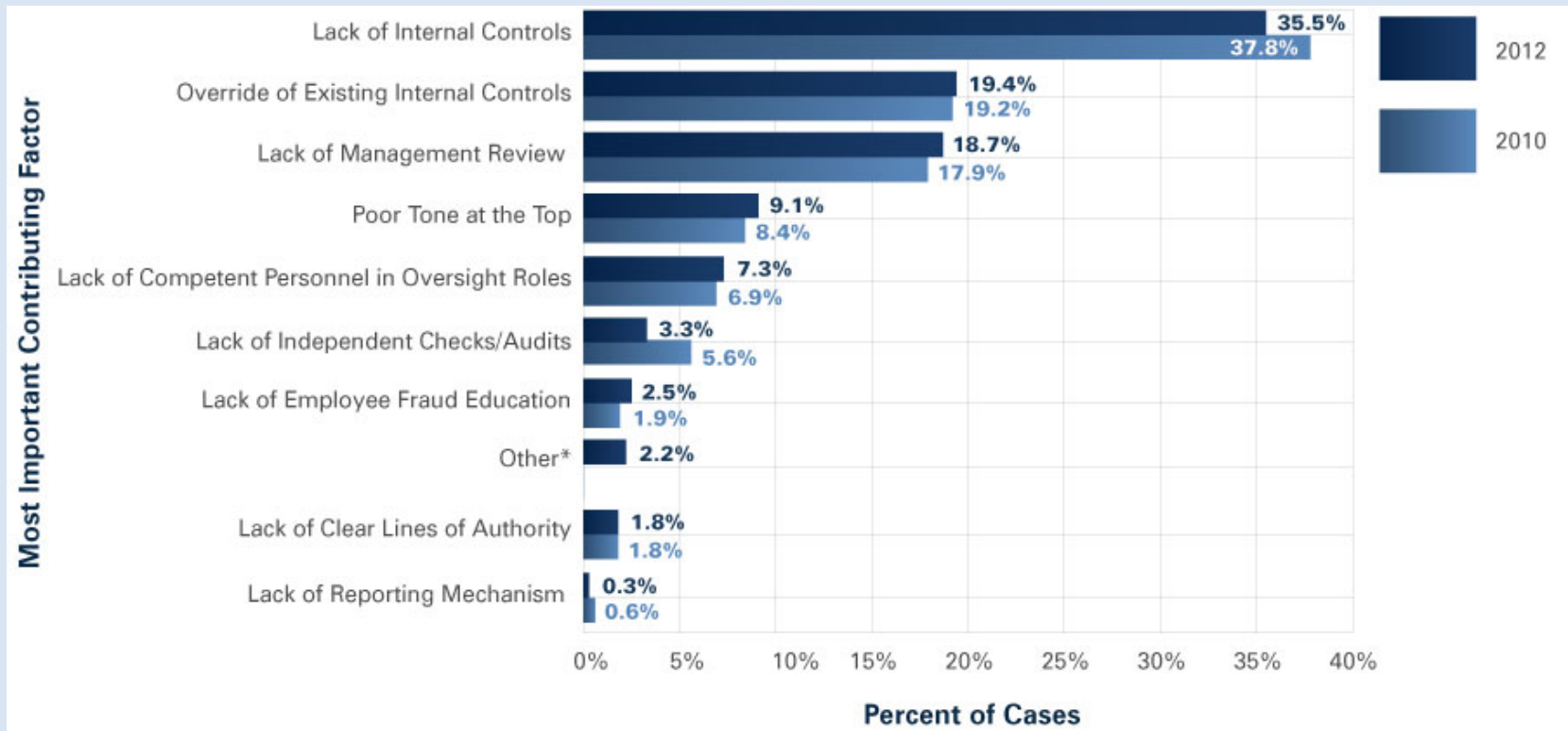
- Management and board members are often more trusting
- Less stringent internal controls
- A belief that audits will detect fraud

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



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

Sutherland Theories

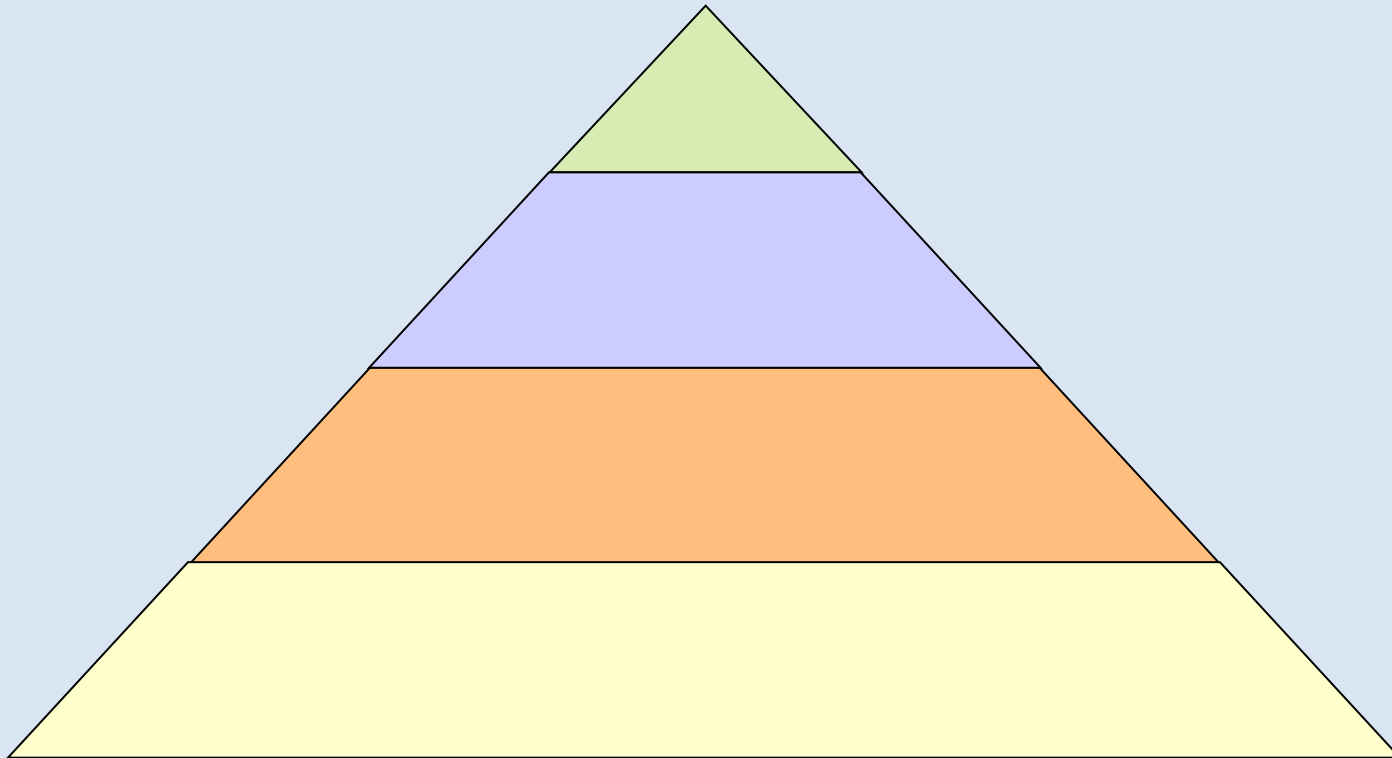
- Prior to Sutherland many believed that criminal behavior was genetic
- Theory of differential association
- Learning process included techniques, attitudes, rationalization and motives
- Corporate culture (Tone at the Top)
- Term “***White Collar Crime***” has evolved

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”

Cressey Theories

Opportunity



Pressure

Rationalization

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 54 Cases

Scheme	Number of Cases	Percent of Cases
Billing	28	51.9%
Check Tampering	18	33.3%
Expense Reimbursements	17	31.5%
Skimming	12	22.2%
Corruption	12	22.2%
Cash Larceny	11	20.4%
Payroll	8	14.8%
Cash on Hand	7	13.0%
Non-Cash	6	11.1%
Register Disbursements	3	5.6%
Financial Statement Fraud	3	5.6%

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?



Darryl S. Neier

Partner in Charge

Forensic Accounting and Litigation Services Group

973-994-9494 Ext.184

Darryl.Neier@sobel-cpa.com

Sobel & Co., LLC