The webcast will start at 1:00 p.m. Eastern

- Visit capincrouse.com/nonprofit-fraud-risks to access these materials from today's webcast:
  - Handout
  - Recording

- To receive CPE credit, you must respond to the polling questions.

- If you qualify for CPE credit, a certificate will be emailed to you within the next few weeks.

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Navigating Current Nonprofit Fraud Risks

Nathan Salsbery, Partner and Executive Vice President
Ken Tan, Partner
Joan O'Dowd, Senior Accountant
5.21.24

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Session Objectives

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

- Understand the anatomy of fraud and its financial impact on an organization

- Identify the traits of a fraudster

- Describe real case studies of fraud

- Review current nonprofit fraud risks

- Explain prevention methods your nonprofit can apply to help decrease the risk of fraud

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Polling Question 1

Do you want CPE credit?

- Yes

- No

Fraud Triangle

Opportunity

Rationalization

Incentive
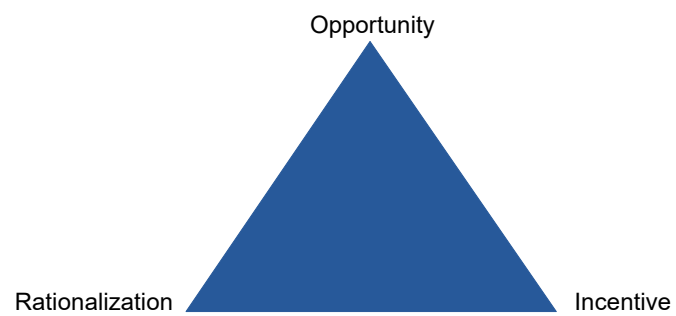
What is fraud?

- An intentional deception made against an individual or organization for personal gain

- **A violation of trust**

Anatomy of Nonprofit Fraud

- Cost?

- Schemes?

- Who? Why?

- How can you protect your nonprofit?

- Conclusions and recommendations

Understanding the Cost of Fraud

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Thoughts to Consider

- In a recent Church Law & Tax survey of 700 church leaders:
  - Nearly **1 in 3** respondents said their church had suffered some form of financial misconduct
  - Half of the fraud incidents occurred within the last 10 years
- No organization is immune to the risk of fraud

Organization Type – Frequency

- Nonprofit organizations account for 10% of all fraud reported

- 21% of fraud cases occurred within organizations of 100 or fewer employees, with a median loss of $141,000

- $85,000 median loss in fraud cases at religious, charitable, or social services organizations

Source: *Occupational Fraud 2024: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

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Additional Thoughts to Consider

- Church fraud estimates:
  - Global fraud for Christian organizations is expected to hit $86 billion in 2024
    - Churches gave $73 billion to global missions in 2023
    - Church crime grows an average of 6% a year
  - Gordon-Conwell's Status of Global Christianity (2024)
    - Giving to Christian causes = $1.3 trillion
    - Ecclesiastical crime = $86 billion (6.7% of total giving)

Sources: World Christianity 2024: Fragmentation and Unity, *International Bulletin of Mission Research*, 48(1), 43-54;
Status of Global Christianity, 2024, Gordon-Conwell Theological Seminary

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Median Loss Due to Fraud

- $76,000 in nonprofits

- $150,000 in government agencies

- $150,000 in private companies

- $150,000 in public companies

- As a percentage of total cash reserves, nonprofit losses are much higher and more damaging than those of public companies

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Collusion Makes a Big Difference

Number of Perpetrators	Median Loss	Duration
One	$75,000	12 months
Two	$135,000	12 months
Three or more	$329,000	14 months

54% of fraud cases in the 2024 ACFE report involved two or more perpetrators.

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Understanding How Fraud is Committed

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Types of Fraud Committed

Larcen...
Check Tam...
False Refunds
Mischaracterized Expenses
Personal Purchases
Payroll Schemes
...ements
Receivables
Billing Schemes
Refunds
Unrecorded
...ctitiou... ...penses
Write-Off Schemes
Asset Requisitions and Transfe...
Schemes
Understated
Unconcealed
Forged Endorsen...
...arcen...

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Asset Misappropriation: Most Prevalent Fraud Scheme

Scheme	Percent of Cases	Median Loss
Billing	22%	$100,000
Noncash	22%	$66,000
Expense reimbursements	13%	$50,000
Check and payment tampering	11%	$155,000
Cash on hand	11%	$50,000
Skimming	10%	$43,000
Cash larceny	10%	$50,000
Payroll	10%	$50,000
Register disbursements	3%	$50,000

Source: *Occupational Fraud 2024: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

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Polling Question 2
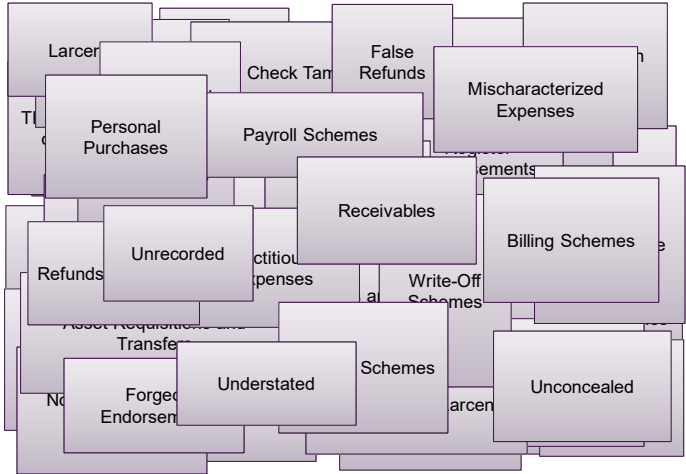
I believe the following about occupational fraud:

- My organization will never be a victim.

- It's possible that it could occur in my organization.

- Everyone in my organization is capable of perpetrating it.

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Knowing the Profile of a Fraudster

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Perpetrator Profiles

Most Common

- 74% of fraudsters were male

- 69% were 31 – 50 years old

- 87% were never previously charged or convicted of fraud

- The longer the perpetrator has worked for an organization, the more costly their fraud

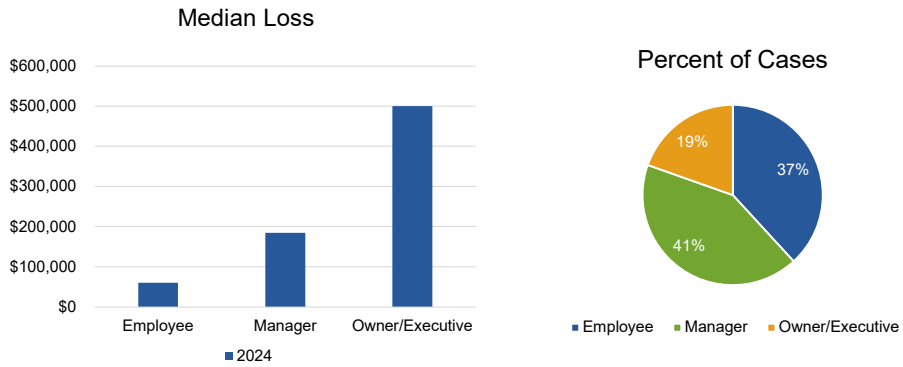## Most Costly

- Male – median loss of $158,000

- Age 60+ – median loss of $675,000

- Owner/executive – median loss of $500,000

Source: *Occupational Fraud 2024: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

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Employment Level of Perpetrator

Median Loss

Employment Level	2024
Employee	~$60,000
Manager	~$185,000
Owner/Executive	$500,000

■2024

Percent of Cases

- Employee: 37%
- Manager: 41%
- Owner/Executive: 19%

■Employee ■Manager ■Owner/Executive

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Primary Internal Control Weaknesses

Weakness	2024
Lack of internal controls	32%
Override of existing controls	19%
Lack of management review	18%
Incompetence in oversight	9%
Poor tone at the top	8%
Lack of independent checks	5%
Other	4%
Lack of employee fraud education	3%
Lack of clear lines of authority	1%
Lack of reporting mechanism	1%

■2024

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Top Behavioral Red Flags Displayed by Perpetrators

Behavioral Red Flag	Percentage
Living beyond means	39%
Financial difficulties	27%
Unusually close association with vendor	20%
No behavorial red flags	16%
Control issues	13%
Irritability, suspicousness, defensiveness	12%
"Wheeler dealer" attitude	12%
Bullying or intimidation	11%
Divorce/family problems	10%
Complained about inadequate pay	8%
Addiction problems	7%
Excessive pressure from within org.	7%
Refusal to take vacations	6%

84% of fraudsters displayed at least one behavioral red flag.

Living beyond their means has been the most common red flag since 2008.

Source: *Occupational Fraud 2024: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)
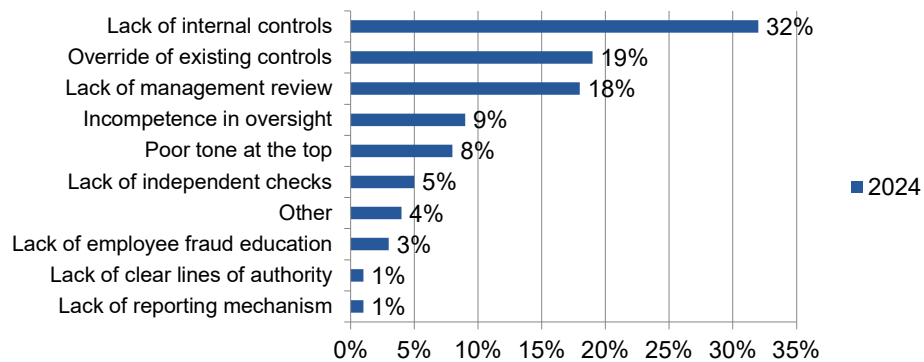
23

Polling Question 3
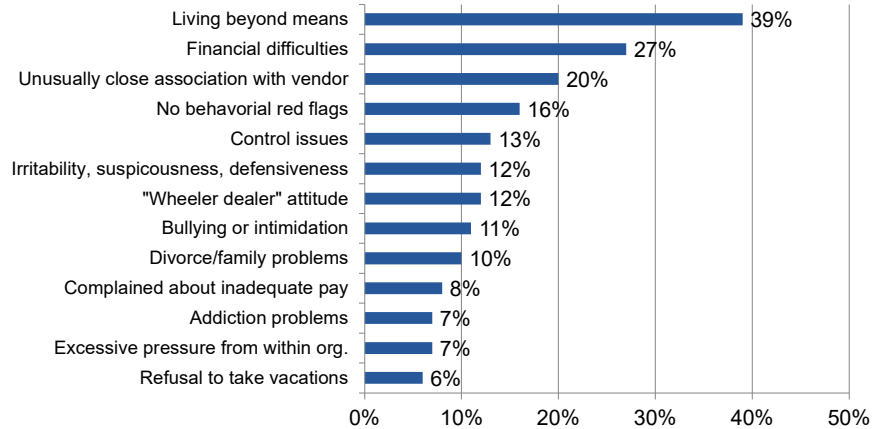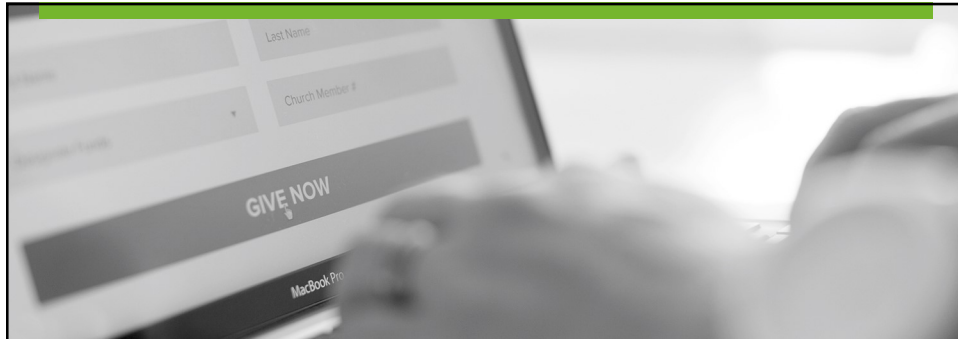
Are you aware of a fraud incident that happened at a church or other nonprofit in your community?

- Yes

- No

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Nonprofit Fraud Case Studies

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Former Georgia man sought for $30 million Christian ministry fraud scheme, authorities say

AL.com, August 2, 2023

Police: Over $470K embezzled from Dallas, NC church since 2018

WBTV.com, December 18, 2023

Memphis pastors among 10 indicted in COVID-19 relief fraud schemes, officials say

fox13memphis.com, October 11, 2023

Former Virginia Beach church accountant gets 5 years for embezzling

The Virginian-Pilot, October 25, 2023

West central Minnesota sisters jailed, ordered to pay $100,000 to church, township

West Central Tribune, October 27, 2023

Priest at North Strabane church accused of stealing more than $117K

The Observer-Reporter, December 1, 2023

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Case Study – HR Director

- **Incentive** = Lavish lifestyle

- **Opportunity** =

  - Lack of timely bank reconciliations

  - Unsecured check stock

  - Management override

  - Methods:

    - Ghost employees/terminated employees

    - Insurance premium payments to personal account

    - Related-party vendors

- **Rationalization** = No one will notice

Incentive/Pressure — FRAUD RISK — Opportunity — Attitude/Rationalization
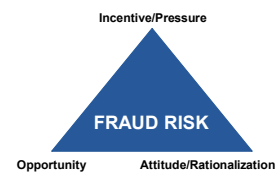
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Case Study – Church Finance Administrator

- **Incentive** = Personal gain

- **Opportunity** =

  - Lack of segregation of duties

  - Methods:
    - Unauthorized cash disbursements
    - Checks payable to self or cash
    - Diverting of incoming funds to personal bank accounts

- **Rationalization** = Will pay back the money

Incentive/Pressure

FRAUD RISK

Opportunity   Attitude/Rationalization

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Case Study – Executive Director

- **Incentive** = Personal benefit

- **Opportunity** =

  - Inadequate board monitoring

  - Inadequate internal review process

  - Methods:
    - Unauthorized cash disbursements
    - Unauthorized credit card charges
    - Expense reimbursements with no business purpose documentation

- **Rationalization** = None provided

Incentive/Pressure

FRAUD RISK

Opportunity   Attitude/Rationalization

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Case Study – International Mission Organization

- **Incentive** = Sale/leaseback of building in foreign field location

- **Opportunity** =
  - Distance and limited onsite monitoring
  - Methods:
    - Collusion with a local attorney knowledgeable in local real estate transactions

- **Rationalization** = Building will be used just the same

Opportunity

FRAUD RISK

Rationalization   Incentive

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Understanding Current Nonprofit Risks

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Top Nonprofit Cyber Fraud Risks to Consider

- Cyber Fraud
  - Social Engineering
  - Ransomware

- Internal Fraud
  - Corruption
  - Asset Misappropriation
  - Payroll Fraud

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Cyber Fraud: Social Engineering

- The art of manipulating people to give up confidential information

- Targeting individuals who are susceptible to give sensitive information such as:
  - Passwords
  - Bank information
  - Computer access

- Easy to exploit the natural inclination to trust
  - Easier to fool someone to provide a password than to try to hack it

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Types of Social Engineering

- **Phishing – Sending emails acting as a reputable company/individual to persuade the recipient to reveal personal information**

  - Email from a trusted friend

    - Contains a link or a download of an attachment

  - Email from a trusted source

    - Financial institutions

    - Notification of a breach and to "verify information"

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Phishing (continued)

- Emails with compelling story or pretext

  - Posing as your boss or coworker

  - Urgent request for help

  - Donation to charitable fundraiser

  - Notification that you have won a grant or large donation and asking you to verify information by clicking on the link provided

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Ransomware

- Malware that employs encryption to hold a victim's information for ransom

- Encrypts an organization's database to restrict access
  - A ransom is demanded to provided access

- Usually distributed through spam or targeted attacks

- Never a guarantee that the recovered data is not compromised

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Internal Fraud – Asset Misappropriation

- Occurs when people who are entrusted to manage the assets of an organization steal from it

- Typically cash or cash equivalents are stolen
  - Fake invoicing
  - Skimming
  - False expense reimbursements

- Common in nonprofit fraud due to recurring theme: Lack of segregation of duties

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Internal Fraud – Corruption

- Dishonest behavior by those in positions of power

  - Executive directors and leadership
  - Committee/elders
  - Those in a decision-making capacity

- Abusing one's influence and power for personal benefit

- Conflicts of interest and lack of disclosure

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Internal Fraud – Payroll Fraud

- Phantom employee

  - Employee terminated, but supervisor continues to submit hours and obtains terminated employee's checks
  - Fake employee added to register

- Payroll manipulation

  - Person with access to payroll register updates their rates or the rates of others without supervision

- Lack of oversight and review

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Polling Question 4

Have you or a colleague encountered one of these fraud trends in the past year or two?
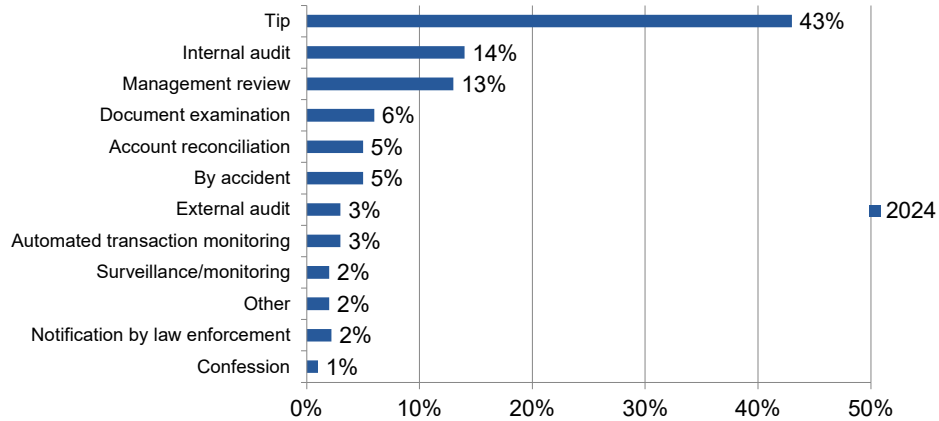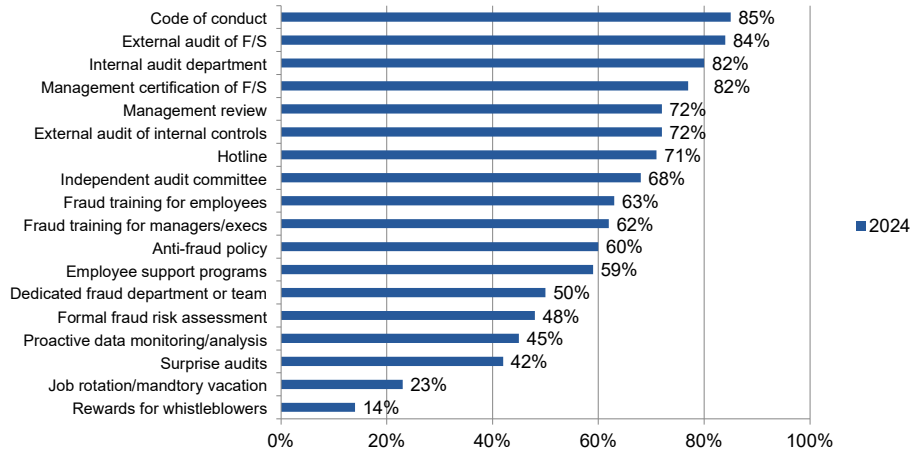
- Yes

- No

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Fraud Prevention

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Percent of Cases Detected by Method

Method	2024
Tip	43%
Internal audit	14%
Management review	13%
Document examination	6%
Account reconciliation	5%
By accident	5%
External audit	3%
Automated transaction monitoring	3%
Surveillance/monitoring	2%
Other	2%
Notification by law enforcement	2%
Confession	1%

Source: *Occupational Fraud 2024: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

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Anti-Fraud Controls Used

Control	2024
Code of conduct	85%
External audit of F/S	84%
Internal audit department	82%
Management certification of F/S	82%
Management review	72%
External audit of internal controls	72%
Hotline	71%
Independent audit committee	68%
Fraud training for employees	63%
Fraud training for managers/execs	62%
Anti-fraud policy	60%
Employee support programs	59%
Dedicated fraud department or team	50%
Formal fraud risk assessment	48%
Proactive data monitoring/analysis	45%
Surprise audits	42%
Job rotation/mandtory vacation	23%
Rewards for whistleblowers	14%

Source: *Occupational Fraud 2024: A Report to the Nations*, Association of Certified Fraud Examiners, Inc. (ACFE)

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Protecting Your Nonprofit

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Knowledge is Power!

- Educate nonprofit leaders and staff about risks and prevention

- Focus on controls

- Use technology as a tool

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Educating Nonprofit Leaders and Staff

- Teach nonprofit leaders and staff about the risks of fraud and what to be mindful of

- Regularly test staff and leaders to keep awareness heightened

- Encourage a culture of fraud awareness among staff

- Adopt, and rigorously implement, a zero-tolerance policy toward employee fraud

- Develop and implement a clear response plan in case fraud is discovered

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Focus on Controls

- Implement clear segregation of duties
  - Consider outsourcing some areas

- Implement a Whistleblower Policy

- Regularly perform bank and account reconciliations

- Clearly define review and authorization levels for payments

- Trust but verify

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Technology as Your Tool

- Restrict and closely monitor access to sensitive information and systems

- Adjust email spam filters

- Secure computing and technology devices
  - Anti-virus software
  - Firewalls
  - Email filters
  - Update operating systems regularly

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Additional Tips to Consider

- Consider automating processes (cash receipts and cash disbursements)
- Use expense management systems to monitor spending
- Outsource back-office processes (Accounting, HR, etc.)
- Supplement support through committee and nonprofit donors
  - Don't sacrifice controls for convenience
- Always perform due diligence in hiring
  - Background checks
  - References
- Set regular touchpoints with staff
  - Identify red flags
  - Beneficial for mental and social health

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Conclusions and Recommendations

- DO implement an anonymous tip line and whistleblower policy
- DO review credit card statements, canceled checks, and bank reconciliations
- DO implement fraud training
- DO increase the perception of detection
- DON'T rely upon your external audit
- DON'T use trust as an internal control
- DO assess your organization's vulnerability to fraud capincrouse.com/fraud-questionnaire
- DO understand your fiduciary responsibility perlmanandperlman.com/embezzlement-board-liability

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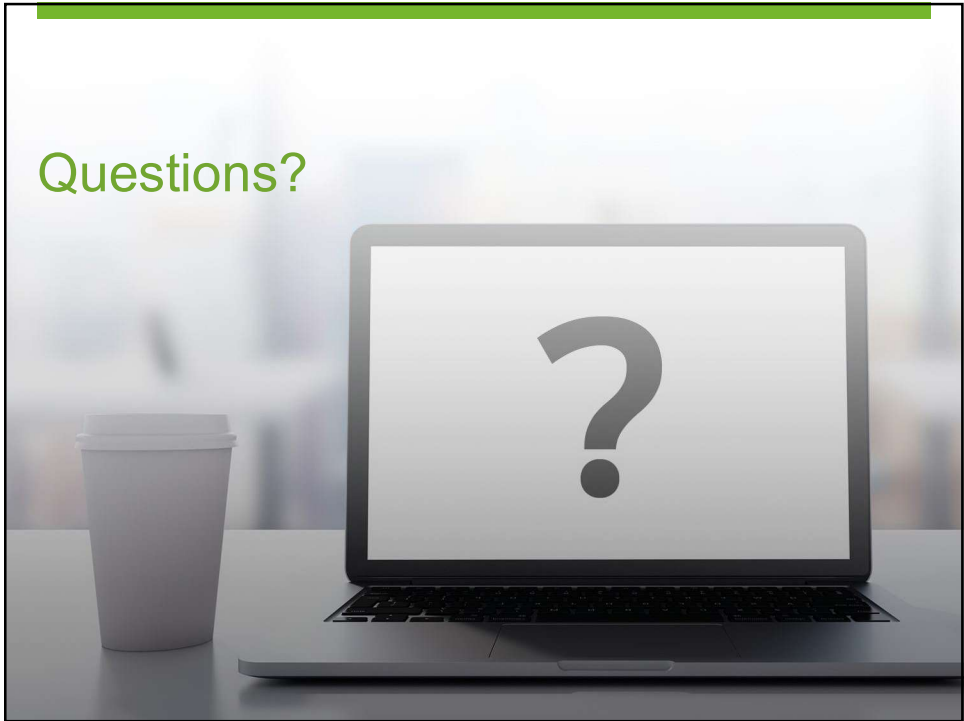## Resources to Help Protect Your Organization

CapinCrouse offers experienced insight and informative resources to help you reduce the risk of fraud and respond effectively if it occurs.

Scan the QR code or visit capincrouse.com/fraud-resources to learn more and access free resources.

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Questions?

Thank you.

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