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Charities and Embezzlement

08.09.16 | Linda J. Rosenthal, JD

The City of New York is host to many of the finest cultural productions in the world, but the cost of these events is out of reach for many people. The Healing Arts Initiative, a 501(c)(3) charity, fills that void for hundreds of thousands of the city's poor, elderly, and disabled. But on May 6, 2016, a scandal enveloped this fine organization. An official had embezzled over $750,000 and, to cover up this fraud, had arranged a lye attack on the Healing Arts Initiative's executive director.

This type of insider theft, though, is not limited to large- and medium-sized organizations.

In early 2014, a similar drama played out in Clinton Township outside of Detroit. This time, it was the Clinton Valley Little League that was robbed – of $300,000. The embezzler was an unlikely criminal; the elementary school's library clerk who was active in her church. She was "like everyone's grandma in town." As a volunteer, she handled the cash and was able to misappropriate small amounts over the six years that she had handled the money.

'The whole township was broken up by it,' one observer said. 'It was a nightmare." [The perpetrator] kept no books for the league finances over the six years of her tenure. During that time, her personal money and the league's were commingled. She pleaded guilty and was sentenced to five years' probation and restitution, "but the incident has left the town traumatized and divided."

"The [Clinton Valley Little League case] is hardly rare in the increasingly prosperous world of American youth sports, from which millions of dollars have been stolen in what public officials and nonprofit watchdogs say is a mounting swarm of corruption cases."

Embezzlement in nonprofit organizations is often easier than in for-profit businesses because people in charities are more trusting and ascribe good intentions to their fellow trustees and executives.

"...[T]he person committing fraud is often described as the last one anyone would suspect...."

According to another observer: "Just like commercial businesses, non-profit organizations are susceptible to fraud. In fact, they are actually more vulnerable. There are a number of reasons that non-profit organizations are more vulnerable to fraud. Some of the issues include lack of significant oversight, limited administrative staff, ad hoc board membership, and a tendency for misplaced trust."

Precisely because of that trust, the fallout from such insider theft is devastating: "When oversight is lax, so much more is lost beyond stolen cash."

When Embezzlement Occurs

The California Attorney General has advice that applies to this state's charities, and which is instructive as well for 501(c)(3)s around the nation.

In the "Guide for Charities," the following hypothetical question is posed: "Q. We just learned that an employee embezzled substantial funds from our charity." What can we do about it?"

The Attorney General's answer is clear and direct: "1. Upon learning that an employee has embezzled funds from the charity, the directors have a legal duty to take reasonable steps to try to recover the funds and to refer the matter to the local District Attorney for possible criminal prosecution."

In addition, the "directors may have to hire a private attorney to file a civil suit for restitution against the employee. Directors must evaluate whether the prospect of recovery outweighs the probable costs of suit."

Moreover, the "loss to charity should be reported on the Form RRF-1 filed with the Attorney General, with an attached explanation of the action taken by the directors to recover the loss." Specifically that Form RRF-1 includes this question: "2. During this reporting period, was there any theft, embezzlement, diversion or misuse of the organization's charitable property or funds?"

Conclusion

Of course, "an ounce of prevention is worth a pound of cure." Even the smallest nonprofit should have basic internal financial controls and procedures in place.

— Linda J. Rosenthal, J.D., FPLG Information & Research Director