

Charity Fraud: Often, It's "Inside the House"

11.16.21 | Linda J. Rosenthal, JD



For six years, a “partnership of charities, regulators, law enforcers and other not-for-profit stakeholders” around the globe have joined forces in an annual week-long campaign to spread the word about an urgent problem affecting the philanthropy community.

As in the past, this year’s Charity Fraud Awareness Week (October 18-22, 2021) focused on raising “awareness of fraud and cybercrime affecting organizations and to create a safe space for charities and their supporters to talk about fraud and share good practice.”

But days of awareness have to translate into action and vigilance all year long. See [Charity Fraud Awareness Push](#) (November 6, 2019).

Insider Fraud

In our post about the 2019 Charity Fraud Awareness Week, [we linked](#) to some 14 of our earlier articles about this critical concern facing nonprofits of all sizes. Many of them have focused on the unsettling but widespread problem of insider fraud and embezzlement.

Since then, we’ve written more on this important topic, including most recently in [Nonprofits: More “What Not to Do](#) (September 7, 2021), about an audacious embezzlement case right here in our San Diego backyard. Thankfully, it was so sloppily done that it was bound to be discovered eventually, as it was by two eagle-eyed staffers in the accounting department as well as separately by a county auditor. By then, though, there were already big financial losses by the organization and the government funders.

In his October 29, 2021, [Nonprofit Tweets of the Week](#) post, attorney Gene Takagi recommended an excellent resource on this point by Carr, Riggs & Ingram, CPAs and Advisors from their CRInsights series. See [The Not-for-Profit’s Guide to Fraud Prevention: A Tale of Two Organizations and How To Create Your Own Happily-Ever-After Story](#).

This 16-page downloadable PDF booklet of explanations, tips, and best-practices advice begins: It's an all-too-common moral of a story: The one we trust the most is the one who betrays us."

Tales and Advice

The Introduction explains that – often – these “violations of trust” in the nonprofit setting occur “due to a lack of resources or knowledge necessary to implement preventive or detective controls.”

The booklet begins with two fictional “tales” of the types of common fraud that strike the nonprofit sector each year. The first describes undetected insider fraud by a bookkeeper who took advantage of significant holes in the control system. The second explains how a successful whistleblower thwarted the embezzlement scheme of two high-level executives. These composite examples show “how a few preventive measures made all of the difference.” See also: “Internal Controls Can Save the Day” at page 3.

In the next section of the booklet, “6 Risks Specific to Non-Profits,” the authors blast the two most prevalent myths about insider fraud in nonprofit organizations. The first is that “it can’t happen here” because everyone here is honest and has been with us for years showing devotion to the mission. No, everyone isn’t (honest). The second is “if someone was stealing from us, we would have found it by now.” No, the success rate for embezzlers is uncomfortably high. The data show that at least 10 percent of frauds occur in nonprofit settings. These six particular practices and risks at nonprofit organizations that contribute to the ease with which fraudsters can make off with charitable funds are:

- Inadequate resources for financial reviews and safeguards
- Too much control in one person, especially in small organizations
- Volunteers with access to confidential information and who perform many financial functions
- All volunteer boards with insufficient oversight
- “Nonreciprocal transactions”: that is, donors receive little or nothing of value in exchange for contribution except for a receipt and often they give in cash which is easily divertible
- Effect of possible negative publicity: many fraud cases are not reported to authorities, most often because of “fear of negative publicity” including subsequent “hit to donations” that “could sink the organization.”

See also “Reducing the Risk of Fraud.” It’s important for an organization to begin its anti-fraud efforts by identifying the types of situations that could occur. Some of the most prevalent schemes are: (1) billing fraud; (2) “skimming”: diverting funds before they are recorded; (3) expense reimbursement fraud; (4) check tampering; (5) payroll manipulation, including “fraudulent timekeeping, fictional employees, and continued payment of terminated employees”; and (6) corruption, particularly including board members and high-level staff.

Fraud Risk Assessment

Next, in “Profile of a Fraudster,” the authors describe how uncovering fraud within an organization is “all the more difficult because the typical fraudster doesn’t look like a crook. In fact, it may be the

person you least suspect,” pointing to the wrongdoers in the two hypothetical tales at the beginning of *The Not-for-Profit’s Guide to Fraud Prevention: A Tale of Two Organizations and How To Create Your Own Happily-Ever-After Story.*

In “Key Questions to Determine Your Risk,” these experts explain how doing a “fraud risk assessment” is essential. The awareness by key organizational leaders of potential fraud situations and the “demographics” of perpetrators, as well as the necessary practice of asking and answering key questions “that can illuminate gaps in internal controls,” can go a long way in reducing the incidence of fraud.

The following section, “Implement Controls to Mitigate Risks,” is particularly important. There is invaluable advice about measures to take – and examples – in three key areas: prevention, detection, and correction. The booklet concludes with “Living Happily-Ever-After and Free of Fraud.”

Conclusion

According to estimates by the Association of Certified Fraud Examiners (ACFE), “all organizations lose, on average, about 5% of revenues to fraud every year.” But, with “anti-fraud controls,” there is a “significant” drop in cost and duration of these incidents.

Living happily-ever-after requires more than hope and trust. It demands constant vigilance and a willingness to face the hard truth that the nonprofit sector is not a fairy tale of unblemished goodness and altruism.

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