Nonprofits and Embezzlement

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- Types of fraud
- Who commits fraud?
- Failure to prosecute
- Minimizing the risk
- Examples of costly embezzlement cases

All organizations are subject to fraud. However, according to "The 2011 Marquet International Report on Embezzlement," nonprofits, ranging from small charities to large nonprofit institutions, (not including religious organizations), are the third most frequently victimized industry sector. Only financial institutions (ranked 1st) and healthcare entities (ranked 2nd) were more frequently fleeced. This may not be an accurate reflection of the severity of this issue, since nonprofits have a reputation for not reporting fraud incidents in an effort to avoid negative publicity.

The nonprofit sector, known for serving the public good, is more susceptible to fraud than many for-profit enterprises. This can be attributed to the unusual level of trust afforded to employees, founders, executive directors, or substantial contributors, along with weak financial controls. Their boards of directors may consist of volunteers who have little financial expertise. Finally, nonprofits deal primarily with charitable contributions, which are non-reciprocal transactions that are difficult to track.

The National Center of Charitable Statistics reports that as of September 2011, there were 1,574,674 tax-exempt organizations operating in the United States. This large group is comprised of:

– 100,337 private foundations
– 514,639 other types of nonprofit organizations, including chambers of commerce, fraternal organizations and civic leagues
– 959,698 public charities

In 2009, nonprofit organizations provided 5.5% of the nation's entire gross domestic product (GDP), or US$ 75b worth of output. There were 13.5m individuals employed in this sector, or approximately 10% of the country's workforce. Considering the total worth of the sector, the number of people employed within it, and the hesitancy for upper management to report wrong-doing, abundant opportunities are present for those who may be tempted to steal funds.

According to Marquet's review of 473 major cases across industries, secular nonprofit losses due to misappropriation of financial assets by employees totaled nearly US$ 24.7m (7% of gross losses) with an average loss of US$ 425,000. Combined with religious organizations, the group incurred the second highest gross losses, at US$ 31.6m.

In the first six months of 2011 at least five embezzlement cases, each with a value of US$ 1m or more, were reported by nonprofit organizations. The fact that such high-value cases are not the norm, though, may be little comfort to their insurers and risk managers.

The embezzlement issue is concerning for a number of reasons. The damage, while significant, is not only financial. The nonprofits reputation, donor relations, future growth and fundraising can all be negatively impacted by a single fraud incident.

Anecdotal evidence strongly suggests that economic factors such as poor economic times may increase the frequency of fraud. However, it is not the only factor. In fact, employees often begin their schemes in good economic times when it is easier to hide their infractions from an otherwise more vigilant management. Schemes tend to operate for a significant period of time. The average embezzlement scheme lasts nearly five years. According to Marquet, most embezzlers are motivated by a desire for a more lavish lifestyle rather than by financial problems.

Types of fraud

In a 2010 Marquet Report, "Nonprofits at Risk for Fraud and Embezzlement," the most common types of embezzlement consist of the following schemes, in order of frequency:

- Forging checks payable to cash, oneself and/or to personal vendors
- Pocketing cash receipts meant for deposit into institutional accounts
- Issuing extra paychecks and/or bonus checks through payroll to oneself
- Submitting fraudulent expense reports for reimbursement
- Submitting fraudulent invoices from phony or legitimate vendors
- Abusing institutional credit card accounts for personal use
- Electronic transfers of institutional funds to personal accounts and/or vendors
- Pilfering institutional equipment and/or inventory

Who commits fraud?

In “The Impact of Fraud on the Nonprofit and Social Services Sector,” accounting firm Sobel & Co. found that women earning less than US$ 50,000 and with less than three years tenure at an organization were the most likely to embezzle. Management-level individuals who work in accounting or in executive positions commit 25% of all nonprofit fraud.

Failure to prosecute

Once a person commits fraud and is caught, many nonprofits choose not to prosecute the employee. This is particularly common among religious organizations. There are several reasons why a nonprofit may conceal an incident. First, there is a fear of legal action in situations where the nonprofits may be threatened with civil and criminal action by an offender. For example, someone caught pilfering funds may threaten to sue for defamation, false arrest, violation of privacy, or wrongful termination. Second, as workplace violence continues to rise, employers are wary of prosecuting thieves who threaten personnel with bodily injury. Finally, the issue of compassion plays a role in a nonprofits failure to prosecute. Very often, the organization’s leader may find it difficult to take action after reviewing the circumstances facing the embezzler. In some cases, the embezzler may claim he stole funds because he needed to care for a sick child or older relative, and they are remorseful. In order to impose the appropriate penalties, the organization should focus on the action rather than the circumstances surrounding the action.

The failure to impose penalties has serious ramifications. The leaders, in their failure to prosecute the offender, set a precedent. They actively create an environment that encourages rather than deters fraud. They may lose respect and credibility among other employees who previously looked to them for direction. If the leaders fail to do the right thing, why would other employees do so?

The failure to prosecute could also lead to additional issues for the nonprofit. Executives and board members in charge of nonprofits have a fiduciary duty to protect their nonprofits’ assets. Failure to prosecute can lead to “breach of duty” claims against the managers who neglected to take action.

Minimizing the risk

There are three important measures for organizations to have in place to minimize the risk of embezzlement. First, there needs to be extensive policies and procedures in place to prevent opportunities. These procedures include but are not limited to:

– Establish hiring procedures that include background checks
– Require independent directors
– Create an audit committee
– Hire an independent auditor who has significant knowledge about nonprofit accounting
– Conduct background checks for all employees with access to cash
– Purchase insurance/bonding for employees with access to cash
– Require that all bank statements are sent directly to the organization’s account
– Record and lock up all checks and endorsement stamps
– Endorse all checks immediately – “for deposit only”
– Alternate mail opening responsibilities

– Separate duties – the person opening the checks should not have signing authority or deposit responsibilities
– Divide financial recordkeeping – develop a conflict of interest policy, including annual written reporting by board members and officers
– Review all internal controls periodically to ensure that they can detect fraud
– Perform and document an annual risk assessment of financial statement fraud
– Establish a records retention policy to maintain records
– Establish a policy to deal with anyone caught committing fraud against the organization
– Require all employees to take vacation – beware of office employees who refuse to stay away from work more than one or two days

Second, every organization needs to implement measures to detect fraud as quickly as possible. This includes:

– Establish a confidential method of reporting the suspected fraudulent behavior
– Develop and document a whistle-blower policy
– Train each employee and volunteer about the harmful effects fraud has on the organization and the procedures to follow when fraud is committed
– Conduct routine checks of state charities' websites for the names of individuals previously convicted of nonprofit fraud

Finally, the organization should maintain adequate employee crime or dishonesty insurance coverage. Organizations need to evaluate their exposure and determine what the appropriate policy limits should be. The policy should also cover the cost of the investigation. This is critical, since the investigation can easily cost tens of thousands of dollars or more. Furthermore, the insurance program should cover unique exposures faced by nonprofits that operate in multiple countries.

Examples of recent costly embezzlement cases

Date	Description
January 2012	Anita Collins, 67, of the Bronx, New York, was charged with embezzling more than US$ 1m from the Catholic Archdiocese of New York, where she had been employed as bookkeeper within its Department of Education Finance Office.
February 2012	Reuben Bynum, 61 of West Bloomfield Township, Michigan, was charged with embezzling approximately US$ 650,000 from the Trinity Missionary Baptist Church.
March 2012	Retired National Guard Colonel James Eugene Burnes, 66, embezzled nearly US$ 2.8m from the Arizona Department of Emergency and Military Affairs, a nonprofit where he had served as resource manager.
March 2012	Anita Guzzard, 42, was charged with embezzling more than US$ 900,000 over a six year period, from the Archdiocese of Philadelphia where she had been employed as the chief financial officer.
March 2012	Risa Lynn Woodward and her husband, James Calvin Woodward of Hendersonville, Tennessee were indicted for embezzling more than US$ 730,000 from the American Association for State and Local History. Risa was the finance director of the organization.
September 2011	Barbara Jo Ericsson a.k.a. Barbara Jo Fulton, 56, of Olympia, Washington was sentenced to 24 months in prison and five years of supervised release for embezzling US$ 451,909 from the Washington State Superior Court Judges Association (SCJA). For seven years, the former bookkeeper forged 136 checks to pay her credit card bills, support her husband's business and give money to her son.
June 2011	Eun Tae Lee, 50, of Fairfax, Virginia, was sentenced to 1 year in jail and ordered to pay restitution for embezzling more than US$ 700,000 from Seed International Inc., a missionary company sponsored by the Korean Central Presbyterian Church for which he had served as Chief Administrative Officer.
June 2011	Connie A. Stills, 56, of Middleton, Idaho was sentenced to 41 months in prison for embezzling US$ 1.3m from the Port of Hope Centers Inc., a nonprofit drug and alcohol treatment center, where she was employed as a bookkeeper.
May 2011	Louanne Aponte, 52, of Austin, Texas, was sentenced to 25 years in prison for embezzling more than US$ 1m from Family Connections, a child care services nonprofit, for which she had served as executive director. She also took funds from the Texas Association of Child Care Resource and Referral Agencies and the Hyde Park Christian Church, where she had served as treasurer, according to prosecutors. Louanne Aponte, formerly known as Louanne Shetter, was twice convicted on embezzlement charges in the 1980s.
May 2011	Vincent Paul Reed Jr., 58, of Shapleigh, Maine was charged was embezzling about US$ 1.25m from the Massachusetts Grand Lodge of Masons where he served as treasurer.

Examples of recent costly embezzlement cases (cont)

Date	Description
February 2011	Alan Jonas, 63, formerly of New Britain, Connecticut, was charged with first degree larceny for allegedly embezzling nearly US$ 400,000 from the First Baptist Church in Southington, Connecticut where he had served as head of its finance committee. Jonas, a CPA by training, was in prison at the time for embezzling US$ 38,000 from Chorale Connecticut, a nonprofit he served as treasurer as well as another US$ 70,000 from an elderly woman suffering from Alzheimer's disease. Jonas was also previously convicted in 1999 of embezzling US$ 22,000 from Middlesex Hospital, where he had served as chief financial officer.
January 2011	Hugh Michael Robie, 48, of Bowie, Maryland, was sentenced to one year in prison for his role in an embezzlement scheme that bilked approximately US$ 1.7m out of the American Board of Opticianry and the National Contact Lens Examiners, where he served as executive director. Hugh conspired with Carletta Stewart, 45, of Fredericksburg, Maryland, the group's chief financial officer and legal officer. The scheme spanned a six-year period.
January 2011	Ronald E. Partee, 45, of St. Louis, Missouri, pleaded guilty to charges of embezzling more than US$ 1m from MERS/Goodwill Industries, where he served as an assistant vice president in the human resources department and had specific fiduciary duties.
January 2011	Marcia Jackson, 51, of Florissant, Missouri, was sentenced to seven years in prison for embezzling more than US$ 650,000 from Show-Me Institute, a local non-profit think-tank, where she was employed as an office manager.

Sources: various news articles - see sources.

Exposure Checklist

Does the organization require independent directors?

Are audits conducted routinely by an independent auditor with non-profit expertise?

Are there internal controls in place to detect fraud? Are these controls reviewed periodically?

Is there a conflict of interest policy in place that requires board members and officers to file annual written reports?

Does the organization have a documented whistleblower policy in place that includes a confidential method of reporting suspected fraudulent behavior?

Do hiring procedures include background checks and routine review of state charity websites to identify individuals previously convicted of nonprofit fraud?

Are all employees required to take consecutive days of vacation per year?

Is routine training conducted for all employees and volunteers about the harmful effects of fraud and the organizations sanctions against such acts?

Is there adequate separation of duties within the organization to prevent one person from having control over the cash flow?

Is there a policy in place that requires all checks to be recorded and stored with endorsement stamps under secure conditions?

Is there adequate insurance/bonding coverage for each employee who has access to cash?

Client survey: response requested

Your feedback on this report is appreciated.

By completing this short questionnaire, we can continue to provide you with pertinent information, which will assist you in meeting your strategic business initiatives.

Please click here for the questionnaire:

http://www.munichreamerica.com/client_research_survey.htm

Purpose of study
The purpose of this report is to provide an overview of nonprofits and embezzlement issues including statistics, mitigation measures and case summaries.

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