

Embezzlement: Is it Our Dirty Little Secret?

by Max A. van Balgooy

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In the last few years, I've encountered a surprising number of cases of embezzlement—the internal theft of assets—at many of the non-profit organizations where I've worked or been on the board. The experience not only undermines the trust among colleagues and friends, but also threatens the survival of an organization that may be skirting the edge of bankruptcy and now has a smaller bank account and a diminished reputation. Given how frequently I've encountered it, I did a quick search about embezzlement at museums and historic sites in the last five years and discovered nearly a dozen heart-wrenching stories:

- American Association for State and Local History (finance manager and her husband accused of stealing more than \$730,000)
- Bellevue Arts Museum (\$300,000 stolen by the chief financial officer)
- Carnegie Visual Arts Center (\$98,000) and Alabama Museum Association (\$41,000) by the same person, who was respectively serving as the executive director and treasurer
- Chaffey Communities Cultural Center (\$85,000 stolen by the treasurer)
- Fruitlands Museum (\$1 million stolen by chief operating officer)
- Guggenheim Museum Bilbao (\$775,000 stolen by the financial officer)
- Independence Seaport Museum

(\$1.5 million stolen by the president)

- Mark Twain House (\$1 million stolen by the controller)
- Olympic Museum (\$1.8 million stolen by museum store manager)
- Tucson Museum of Art (\$1 million stolen by the bookkeeper)

There are probably many more, but I suspect they've kept their stories secret out of embarrassment (but search for "embezzlement" at the Chronicle of Philanthropy to see how widespread it is in the non-profit world). Indeed, the Association for Certified Fraud Examiners (ACFE) in its 2012 Global Fraud Study showed that in businesses around the world:

- The typical organization loses 5% of its revenues to fraud each year.
- Frauds last an average of 18 months before being detected.
- While banking and financial services are the most commonly victimized industries, fraud is a greater threat to small businesses (which includes small non-profit organizations) because they suffer the largest median losses.

Embezzlement (also called accounting fraud and asset misappropriation) can take many forms, but the most common are:

- Billing, in which a person causes the employer to issue a payment

The typical organization loses 5% of its revenues to fraud each year. —2012 Global Fraud Study

by submitting invoices for fictitious goods or services, inflated invoices, or invoices for personal purchases.

- Skimming, which is any scheme where cash is stolen from an organization before it is recorded on the books or records. For example, taking money from a donation box.
- Expense reimbursements, when an employee requests reimbursements for false or inflated business expenses.
- Non-cash theft, which occurs when an employee steals collections, inventory or offices supplies for personal use; or steals or misuses confidential donor, member, or customer financial information.

There are also some common patterns in embezzlement:

It often involves a **senior staff member**, frequently the treasurer or chief financial officer, who has access to the organization's assets (money or collections). As they say in the crime novels, they have "opportunity" but the motive isn't necessarily because they're hungry or need medicine. The perpetrator at the Independence Seaport Museum earned a salary of \$300,000 annually and the museum provided his house (Shiffman, 2007). Typically embezzlers believe they deserve the money (e.g., feel underpaid and unappreciated), it's "free" (i.e., donations), or it won't be missed (e.g., the museum has an endowment).

It often involves a person who's been on

staff a long time and has developed a high level of trust, so no one asks questions.

Unfortunately, the longer a perpetrator has worked for an organization, the higher fraud losses tend to be (ACFE, 2012). At the Tucson Museum of Art, they discovered that they allowed themselves to become overly "trusting of this employee" because she had worked at the museum for 18 years and "was doing her job well" (Kornman, 2009).

Embezzlement **schemes can be complex**

and sorting them out can be difficult. You may know something is missing, but it can be hard to find because it can involve fraudulent credit cards, hidden financial accounts, falsified reports, or clever money laundering. At the Mark Twain House, the embezzler "submitted false information via the Internet to the organization's payroll management vendor to receive additional pay that she was not entitled to. The money was deposited directly to her personal bank account as payroll advances. She then adjusted the general ledger to hide the advances by classifying the amounts as payments to other accounts, including maintenance and utilities" (Goode, 2011). Fortunately, many times there are red flags that signal fraudulent behavior, such as living beyond his or her means; an unusually close association with vendors, volunteers, or staff; an unwillingness to take vacations; persistently late financial reports; and excessive control issues, such as being openly hostile, uncooperative, or aloof when questioned about finances.

Organizations may have **financial controls and policies in place** but they're either **not followed or inadequate** to guard against embezzlement. At the Tucson Museum

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(continued from page 71)

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of Art, they believed they were, “doing everything right with our internal systems, including having full financial audits conducted every year with an independent firm specializing in nonprofits” (Kornman, 2009). And yet, more than \$1 million was siphoned off over five years.

Keeping an Eye on the Fox in the Henhouse

At non-profit organizations or small businesses, it's often a serious challenge to defend against embezzlement, and you can feel as vulnerable as a henhouse with the fox inside. We rely heavily on trust among a small staff and rarely understand finances. Even if we follow the standard tactics, such as segregation of duties, requiring receipts, and two signatures on checks, we may still become victims. Banks rarely have the time to verify signatures on checks, online banking allows for the transfer of funds with little oversight, and the embezzlers are wise to the usual tactics. But we shouldn't give up hope; we just need to recognize that we have to update our thinking. Here are a few suggestions:

1. Don't assume an independent audit will catch fraud. It's still a good idea to conduct an external audit, but catching fraud is not its primary intent. These audits provide an “opinion as to whether the financial statements are fairly stated and comply in all material respects with Generally Accepted Accounting Principles”—it's not designed to catch fraud (Johnson, 2010). Indeed, external audits detected less than 5% of the frauds (ACFE, 2012). Auditors are expected to “exercise professional skepticism,” but if the embezzled funds are properly recorded, it's hard to smoke them out

(AICPA, 2002). For example, an auditor will have difficulties catching someone selling office supplies on eBay for personal gain or submitting falsified invoices for travel expenses. What an audit can do is “review the financial reporting processes and internal accounting controls to assure that the company's systems are appropriately designed and operating effectively” (U. S. Securities and Exchange Commission, 2002). In other words, they can identify weaknesses in your financial management and tell you how to improve. If you get this advice, ignore it at your peril. If embezzlement later occurs, you'll have a lot of explaining to do.

2. Most frauds are detected by tips. More than 40% of fraud is uncovered by a tip—far exceeding audits, management review, or discovery by the police (ACFE, 2012). Kentucky's Auditor of Public Accounts was so concerned about the extent of fraud in non-profit organizations that she issued guidelines that boards should, “establish an independent process to receive, analyze, investigate, and resolve concerns related to the organization including anonymous concerns” (Luallen, 2010 p. 2). Large companies typically have whistle-blower policies and hotlines to report fraud, but what about small organizations? Travis Wilson, a certified public accountant and a nonprofit auditor for more than a decade started Fraud Hotline, LLC (FraudHL.com) to fill the breach by providing small businesses and non-profit organizations both an affordable voice mail system that transcribes messages and a 24-hour secure web-based reporting system that forwards messages to three people designated by the organization (plus they'll review the message to be sure it isn't reported to the

What's The Difference?
Audit Committee vs. Finance Committee

AUDIT COMMITTEE	SHARED RESPONSIBILITIES	FINANCE COMMITTEE
<p>The audit committee is authorized to consider matters related to (a) the financial statements of the organization and other official financial information provided to the public;</p> <p>(b) the systems of internal controls, including overseeing compliance by management with applicable policies and procedures and risk management (e.g., for organizations that are part of a national network, annually reviewing whether the organization meets the re-chartering requirements of its national organization);</p> <p>and (c) the annual independent audit process, including the recommended engagement of and receiving of all reports from the independent certified public accountants. The audit committee shall have such other authority and perform such other duties as may be delegated to it by the board.</p>	<p>The finance committee ensures that budgets and financial statements are prepared; the audit committee has oversight for ensuring that reports are received, monitored, and disseminated appropriately.</p> <p>The finance committee monitors financial transactions; the audit committee makes sure things are done according to policy and with adequate controls.</p> <p>The finance committee provides guidance about what can be done; the audit committee ensures that independent oversight occurs.</p>	<p>The finance committee shall oversee the preparation of the annual budget and financial statements.</p> <p>The finance committee shall oversee the administration, collection, and disbursement of the financial resources of the organization.</p> <p>The finance committee shall advise the board with respect to making significant financial decisions.</p>

Figure 1. Audit Committee vs. Finance Committee Comparison. Courtesy of the Nonprofit Risk Management Center.

suspected person). Most tips come from employees, but a significant number come from customers, members, and vendors, so if you use a hotline, publicize its availability broadly. Although hotlines are primarily for reporting suspected fraud, they can also be used to anonymously report conflicts of interest, sexual harassment, and other inappropriate behavior.

3. Adopt new and different policies.

Organizations that implement policies such as mandatory vacation, surprise internal audits, fraud training, and an independent audit committee (see Figure 1) double their chances of catching fraud (ACFE, 2012). Collusion or instances when two or more people coordinate their fraudulent activities surprisingly occurs about 40% of the time, but the harm is significantly greater because their combined efforts can override many anti-fraud controls, such as the two-signature requirement for payments, and the losses are typically more than twice as large. Therefore, you may need to institute policies stating that anyone with financial responsibilities cannot be related to other staff, volunteers, board members, or vendors unless additional precautions are in place (for example, their signatures cannot be combined on checks). Finally, you can implement procedures that give the perception of review, for example a rule that all bills must be mailed directly to the board treasurer, who will then forward them to the bookkeeper.

4. Figure out the new world of credit cards, computerized bookkeeping, and online banking. Several embezzlement cases involved the use of credit cards, but often they're the only way to conduct business

so they can't be eliminated without difficulties. We need to go beyond the usual policy that, "company credit cards cannot be used for personal expenses" and look at having unique cards for every user (rather than loaning the one card to anyone who needs it), establishing credit limits, subscribing to alerts, restricting cash advances, and reviewing monthly statements with their receipts. See if your computer bookkeeping program creates audit trails, leaving "digital fingerprints" that record changes to entries (QuickBooks does, Quicken does not). Use email alerts with online banking systems to notify you of transactions. Change passwords regularly and keep them private. New companies, such as AuditMyBooks.com, have sprung up to address this growing issue for small businesses by providing automated reviews of electronic accounting records to check for errors or suspicious entries.

5. Identity theft can happen to people and organizations. Identity theft is not just about someone using your existing

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Embezzlement is embarrassing, but it is occurring far too frequently and threatens the future of our cultural institutions.

(continued from page 73)

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credit cards without your authorization, but using your personal information to obtain new accounts. For example, an employee can open a business account without your knowledge at a hardware store to buy supplies for his own home or if he or she has access to your personal information, can get a credit card in your name (at the Fruitlands Museum, the fraud was conducted with 14 credit cards using the names of three co-workers! (Nugent, 2008)). Obtaining a credit report annually can reveal if anyone has taken a credit card out in your name. Since embezzlement is an inside job, and you will know the perpetrator, the non-profit Identity Theft Resource Center has a fact sheet addressing what to do if you personally know the imposter.

6. Get a better handle on your finances. The two failings I see most often with non-profit boards:

- Most directors and board members do little more than look at the bottom line. If it's a big positive number, it's assumed everything is okay.
- Elect an accountant as the organization's treasurer to excuse the rest of the board from examining the financial statements (whew!). If an accountant says it's okay, it must be okay.

Sorry, but if you're a senior staff member

or a trustee of a non-profit organization, you really need to be able to analyze financial reports on your own. You don't need to know the difference between debits and credits. You need to evaluate the information in the reports. We have to get away from flip statements like, "we made a lot of money on our last event" to more thoughtful ones like, "compared to the last three years, this event earned significantly more revenue; however, we continue to run a deficit." Books like *Financial Intelligence* (Berman and Knight, 2006), free booklets such as *Preventing Fraud* (Lang and Ricciardella, 2001), or a college-level class in financial management are great places to start. It may be useful that several local non-profits coordinate annual training on finances for their boards and staff. You may also need to rethink your financial management structure to better address audit and finance responsibilities.

7. Talk about it. Embezzlement is embarrassing, but it is occurring far too frequently and threatens the future of our cultural institutions. Let's learn from each other so we can outsmart, outthink, and outlast the criminals, especially if they are working among us. We've got to stop this dirty little secret.

This article is an updated and expanded version of a post by Max van Balgooy on his blog, EngagingPlaces.net, on February 19, 2012. A longer version adapted to history museums will also appear in History News. The Editor. ✨