

Fraud and Its Warning Signs

“You understand how we do business in this city, don’t you?” asked the executive director. “Do you understand our culture?” Unfortunately, we did, which gave us cause for alarm.

Our client’s executive director was responding to our questions about a grant check that, according to the award letter from the funding foundation, had been previously mailed, but of which we could find no trace in their accounting records or on any bank statement. “I deposited the check in a special account I keep for our restricted funds,” the director helpfully explained. He declined to show us the bank statement and, when we insisted, he decided our services were no longer needed.

In our accounting practice, we work almost exclusively with nonprofit organizations. I am pleased to say that almost all our clients are wonderful organizations working hard to achieve their missions. Yet, where there’s money, there could be fraud. We typically uncover several instances of it every year.

There are common misconceptions about fraud detection: that the nonprofit sector is so moral and impoverished that no one would think of defrauding an organization. Or that the clues jump off the page and should be easy to detect. In fact, people committing fraud typically expend a great deal of energy concealing their activities. We often joke that if fraudsters were to put the same amount of effort into doing their jobs, they would be outstanding employees. Detection often relies on an experienced accountant picking up on what is probably a very subtle clue, an item so obscure that it may have eluded management, the board, and the auditors for months and possibly years.

Presented in this article are actual examples of fraud that we have come across in our work. Perhaps some of the warning signs are present in your organization. Names and certain identifying information and details have been changed to protect confidentiality.

Concealing information

We will not work for an organization that conceals financial information from us. Accordingly, in the situation above, had our client not let us go, we would have resigned. But were they committing fraud? We were prevented from staying long enough to find out, though we have our suspicions. Within our firm, we refer to these situations as “near fraud” since we cannot say for a fact that fraud has been committed. Clearly, though, hiding information is a serious warning sign.

Recently a client of ours hired a new office manager who was given a variety of bookkeeping responsibilities. Part of our job was to come in each month and reconcile bank statements and perform various other controllership functions. Very early on a pattern with the office manager started to emerge. She was very unorganized with invoices, deposits slips, etc., and had accounting documents strewn all over her desk, which made it impossible for anyone else to find anything. Nothing reached us on a timely basis. Bank statements, deposit slips, credit card deposits, credit card statements, and even timesheets were often delayed 2-3 months. She kept her own extensive worksheets and databases and

didn't want to fully utilize the organization's accounting software. She made herself the sole contact with PayPal, credit card companies and other vendors. She convinced the executive director that she had special relationships with these people and that having anyone else intrude on these relationships would be a detriment to the organization. You could not question the office manager or even criticize her in a constructive manner because she would take it personally and cause a fuss.

How many of these behaviors have you encountered in your organization? These efforts at concealment are warning signs and potential risks, though none is proof of fraud.

The proof ultimately came when it was learned that she had applied for a new company credit card and charged over \$10,000 of personal expenses to it. The existence of the credit card came to light only when the office manager was out of work one day and someone else opened the mail.

Insurance scams

We were working with an organization for about two years when we noticed an unusually large increase in their insurance premiums. We asked the executive director about this and, since he had no explanation, we decided, with his permission, to call their insurance broker. The broker, who seemed surprised we were asking, said it was due to insurance claims at the organization over the past year. Now we were the ones who were surprised because neither we, nor the executive director, were aware of any claims. We pursued details of the claims with the insurance broker such as who filed the claims, when, for what amounts, and for what reason. The scheme began to unfold.

The office manager had set up a separate bank account in the name of the organization. She then filed several false claims for work on the building, such as for supposed damage done to the building during a storm. When the insurance was paid, she deposited the money in an account that only she knew about. It later turned out that she had a very close family member at the insurance agency who colluded with her. This scheme apparently had been going on for some time and, had it not been for our noticing what seemed to us to be an unusual increase in their premiums, might never have been caught.

Just one check

We were preparing 1099's for a new client. Among all the disbursements for the year, our accountant noticed one check, from the early part of the year, made payable to a former chief financial officer of the organization. Though our accountant had never met this CFO, he recognized the name. Wondering why the CFO had issued himself a check, our accountant decided to look further into this. Thus began the unraveling of a scheme perpetrated over several years in which the CFO had stolen several hundred thousand dollars. He wrote checks to himself, covered his tracks by changing the payee (i.e. himself) in the accounting records, and then doctoring the bank statements. Had it not been for our staff member noticing this one check, recognizing the payee and deciding to investigate, the whole scheme would have gone undetected.

In our experience when warning signs are evident, most often there is no fraud just bad work habits, poor procedures, and internal controls. But in that occasional situation, it is typically something subtle which gives it away.