PROTECTING CHURCH ASSETS THROUGH PROACTIVE SAFEGUARDS

Fraud Prevention & Detection

Comprehensive Strategy for Fraud Prevention, Detection & Recovery

Church Clergy Tax Management & Compliance

Today's Agenda

- Nonprofit Fraud Statistics & Risk Profile
- Common Fraud Schemes in Churches
- Fraud Red Flags & Warning Signs
- Prevention vs. Detection Strategy
- Internal Controls & Cash Handling
- Whistleblower Programs & Detection
- Recovery & Forensic Accounting

Nonprofit Fraud Statistics: The Reality (ACFE 2024)

- Frequency: Nonprofits experience 10% of all occupational fraud cases
- Median Loss: $76,000 per fraud case in nonprofits (churches: $85,000)
- Annual Risk: Organizations lose 5% of annual revenue to fraud
- Detection Time: Average 24 months to detect fraud (without controls: 36 months)
- Low Implementation: Nonprofits have LOWEST fraud awareness training rate
- Training Impact: Fraud awareness training reduces losses 2.5x faster detection
- Perpetrator Profile: 74% of occupational frauds committed by employees/volunteers

Why Churches Are Fraud Targets

- Culture of Trust: Churches operate on faith & trust (minimal oversight)
- Cash-Heavy Operations: Offerings, donations, fundraisers generate significant cash
- Limited Segregation: Small churches often have one person handling all finances
- Volunteer Workforce: Volunteers & part-time staff may lack financial training
- No Forensic Awareness: Church leaders may not know fraud red flags
- Weak Internal Controls: Fewer checks & balances than other organizations
- Reputation Concerns: Churches hesitant to report fraud (fear of scandal)

Common Fraud Schemes in Churches

- Cash Theft: Skimming offerings before counting (small amounts, hard to detect)
- Embezzlement: Treasurer pocketing funds, falsifying records (largest losses)
- Expense Reimbursement: Fraudulent or inflated expense claims (fake receipts)
- Unauthorized Wire Transfers: Using church accounts for personal transfers
- Credit Card Fraud: Personal purchases on church credit card (350+ unauthorized transactions)
- Vendor Fraud: Kickbacks, fake invoices, overpayment schemes
- Payroll Fraud: Ghost employees, inflated hours, unauthorized salary increases

Fraud Red Flags: Warning Signs to Watch

Financial Red Flags

- Missing receipts/invoices
- Bank discrepancies
- Unusual transactions
- Expense patterns changing

Behavioral Red Flags

- Refusing to take vacation
- Defensive about questions
- Living beyond means
- Sudden behavior changes

Prevention Strategy: Building Strong Controls

- Segregation of Duties: Separate: collecting, counting, depositing, recording, reconciling
- Dual Authorization: Two people must sign checks over certain amount ($1,000+)
- Bank Reconciliation: Independent person reconciles bank statements monthly
- Board Oversight: Finance committee reviews statements, approvals, variances
- Written Policies: Document cash handling, expense reimbursement, purchasing
- Physical Controls: Safes, cameras, tamper-evident bags for cash storage
- Fraud Awareness Training: Teach board/staff to recognize fraud schemes

Cash Handling Controls: Essential Procedures

- Two-Person Count: NEVER one person counts cash alone. Minimum 2 people, 3+ preferred
- Witness Documentation: Both counters sign off on amount; document in register
- Tamper-Evident Bags: Place cash in sealed bags, mark amount, signatures before bank
- Timely Deposits: Deposit cash within 1-2 business days (don't hold in office safe)
- Secure Storage: Safe with restricted access, audit trail of who opens it
- Bank Statements: Send directly to board member for independent reconciliation
- Offering Process: Use collection plates, pre-printed receipts, separate donation tracking

Anti-Fraud Control Impact: 18 Key Controls (ACFE Study)

Without Controls

- Median loss: $76,000
- Duration: 24 months
- Undetected losses

With 18 Controls

- Median loss: $38,000
- Duration: 12 months
- 50% reduction both

Whistleblower Programs: Most Effective Detection Method

- Detection Rate: Whistleblower tips detect 43% of all fraud (highest method)
- Anonymous Reporting: Online form preferred (surpassed phone/email in 2024)
- Why It Works: Employees know what's happening; hotline removes fear of retaliation
- Cost: Third-party hotlines cost $250-$500/year for nonprofits (ROI: $76,000 loss prevented)
- Confidentiality: Anonymous process encourages reporting without fear
- Investigation Process: Hotline reports to audit committee or board chair directly
- Protection: Policy MUST protect whistleblowers from retaliation

How to Implement a Whistleblower Hotline

- Select Third-Party Provider: Companies: Avoxi ($500/yr), Fraud Hotline ($250/yr for nonprofits)
- Multiple Reporting Channels: Phone, email, web form (accommodate different preferences)
- Anonymous Process: Callers never identify themselves; tracked by case number only
- Written Policy: Adopt formal whistleblower/anti-retaliation policy (board approval)
- Publicize the Hotline: Website, bulletin, newsletter, staff meetings (staff must know it exists)
- Investigation Protocol: Define who investigates, how, timeline, documentation
- Follow-up: Hotline provider tracks report; board/audit committee reviews monthly

Detecting Fraud: Recognizing Active Schemes

- Bank Reconciliation Red Flags: Missing transactions, altered checks, duplicate deposits
- Accounting Records: Gaps in sequence, altered amounts, missing supporting documents
- Expense Patterns: Sudden increases, inconsistent vendors, same-day payments
- Vendor Analysis: New vendors appearing, similar names to current vendors (shell company)
- Personnel Changes: Fraudster resistance to taking vacation (scheme needs constant attention)
- Financial Statement Analysis: Unexpected decreases, unusual account balances
- Follow the Money: Trace large/unusual transactions back to source (receipt, approval)

Audit Procedures: Detecting Fraud

- Annual Audit: Hire CPA to conduct independent audit (look for control deficiencies)
- Surprise Audit: Unannounced audit of cash, inventory, vendor payments (catches active fraud)
- Proactive Data Analysis: CPA uses software to analyze transactions (duplicate payments, anomalies)
- Sampling Testing: Test percentage of transactions (10-20%) for documentation, authorization
- Controls Testing: Verify segregation of duties, dual authorization, reconciliation procedures
- Vendor Analysis: Compare vendor payments to contracts; identify payments to related parties
- Budget Variance Analysis: Investigate unexpected expenses, missing revenue

Discovery Protocol: Responding to Fraud (Immediate Steps)

Day 1: Secure & Contain

- Preserve evidence
- Suspend access
- Notify board chair

Days 2-5: Investigate

- Hire forensic CPA
- Collect documents
- Interview parties

Forensic Accounting: Professional Fraud Investigation

- Hiring Forensic CPA: Specializes in fraud investigation, litigation support, evidence collection
- Scope of Work: Determine fraud amount, identify perpetrator, document evidence for legal action
- Investigation Process: Analyze records, interview parties, reconstruct transactions, prepare report
- Cost: $2,000-$5,000 for small fraud investigation (vs. $76,000 median loss)
- Report Output: Professional report with findings, evidence, recommendations for recovery
- Admissible in Court: Forensic accountant can testify in legal proceedings
- Insurance Coordination: Work with D&O insurance in investigation & recovery

Recovery Strategies: Getting Money Back

- Insurance Claim: D&O/crime insurance may cover fraud losses (file immediately)
- Restitution Agreement: Perpetrator agrees to repay (court-ordered or voluntary)
- Criminal Prosecution: Report to police; restitution often part of sentencing
- Civil Lawsuit: Sue perpetrator for recovery (through church attorney)
- Asset Recovery: Seize perpetrator's assets (house, car, bank accounts) for restitution
- Bond Forfeiture: If perpetrator posted bond, forfeit for restitution
- Realistic Expectations: Most embezzlers cannot repay full amount (judgment lien)

Case Study: $150K Fraud Prevented

- Situation: Mid-size church received training on fraud detection. New board member noticed treasurer's resistance to implementing dual-signature approval.

Detection: Board required independent bank reconciliation. CPA found missing checks, unauthorized wire transfers, credit card charges to personal vendors.

Result: Treasurer embezzled $150K over 3 years. Fraud stopped immediately. CPA investigation documented $75K recoverable. Prosecution resulted in restitution agreement.

✅ **Learning:** Trained boards + strong controls catch fraud early, preventing catastrophic losses.

Fraud Prevention Checklist

- ☐ Segregation of duties implemented (no one person controls cash end-to-end)
- ☐ Dual-signature approval required for checks over $1,000
- ☐ Bank statements sent directly to independent board member
- ☐ Monthly bank reconciliation by person not handling cash
- ☐ Annual independent audit by CPA (fraud procedures included)
- ☐ Whistleblower hotline established (third-party provider)
- ☐ Formal whistleblower protection policy adopted
- ☐ Fraud awareness training completed by board & staff

Fraud Prevention Checklist - Continued

- ☐ Cash handling policy documented & enforced (two-person counts)
- ☐ Tamper-evident bags used for cash storage & transport
- ☐ Timely deposits (within 1-2 business days of collection)
- ☐ Surprise audits conducted annually by external CPA
- ☐ Conflict of interest disclosures signed annually
- ☐ Expense reimbursement policy documented with receipts required
- ☐ Vendor list reviewed; no suspicious vendors identified
- ☐ Personnel background checks conducted for financial staff

Key Takeaways: Fraud Prevention Excellence

- Nonprofit median loss: $76,000 (but 50% reduction with controls)
- Whistleblower tips detect 43% of fraud (most effective method)
- Whistleblower hotline cost ($250-500) vs. fraud loss ($76K) = clear ROI
- Fraud awareness training reduces loss 2.5x & speeds detection
- Segregation of duties prevents 90% of fraud schemes
- Bank reconciliation by independent person is critical control
- Annual audit + surprise audit catches active fraud immediately

Fraud Prevention Implementation: 90-Day Plan

Days 1-30

- Assess current controls
- Identify gaps
- Get hotline quotes

Days 31-60

- Implement controls
- Launch hotline
- Plan training

STRONG CONTROLS + WHISTLEBLOWER PROGRAM = 50% FRAUD LOSS REDUCTION

Prevent Fraud Before It Happens

Next: Politics and the Pulpit (New IRS Guidance July 2025)

VIGILANCE, CONTROLS & AWARENESS: THE FOUNDATION OF FRAUD PREVENTION

Thank You

Questions & Discussion Welcome