A Fall From Grace

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Abstract

A visit with Mickey Mouse was one of the last things members of Small Town Church imagined their tithes would finance. However, that is exactly what happened when Grace Grifter, the church's secretary and bookkeeper, embezzled more than $100,000 over a four-year period. Fraud scourges all sectors of the economy, including nonprofit entities. In fact, it may even come as a surprise to learn that nonprofit organizations tend to be more susceptible to fraud, considering their altruistic missions. However, this increased susceptibility is often due to the trusting cultures and limited staff sizes typical of smaller nonprofits. Fraud detection and prevention help minimize and avoid loss of revenue and damage to an organization's reputation and employee morale. It also allows the organization to maintain focus on its mission. This article presents an example of how credit card fraud can occur in a small organization and the steps that can be taken to help mitigate any such future risks.

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A FALL FROM GRACE

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A visit with Mickey Mouse was one of the last things members of Small Town Church imagined their tithes would finance. However, that is exactly what happened when Grace Grifter, the church's secretary and bookkeeper, embezzled more than $100,000 over a four-year period.

Fraud scourges all sectors of the economy, including nonprofit entities. In fact, it may even come as a surprise to learn that nonprofit organizations tend to be more susceptible to fraud, considering their altruistic missions. However, this increased susceptibility is often due to the trusting cultures and limited staff sizes typical of smaller nonprofits. Fraud detection and prevention help minimize and avoid loss of revenue and damage to an organization's reputation and employee morale. It also allows the organization to maintain focus on its mission. This article presents an example of how credit card fraud can occur in a small organization and the steps that can be taken to help mitigate any such future risks.

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Grace and the church

Grace was a 67-year-old woman often described as "the sweetest old lady you'll ever meet." She had been active in Small Town Church for nearly 10 years, volunteering for church functions and singing in the choir. The church trusted Grace, who had worked part time helping the previous secretary/bookkeeper, Marge Robinson. Once Marge retired, Grace took over the position. But unlike Marge, Grace turned down offers of help, insisting she could handle the work herself.

At one of the church's monthly budget meetings, long-time budget committee member Clayton Stewart grew uneasy as he reviewed the church's cash numbers. Over the years, Clayton had observed that on average the church's monthly operating expenses accounted for approximately 80 to 90 percent of monthly tithes, with the parson's salary being the largest expense. However, this had not held true for the past two years, in which the monthly expenses seemed excessive. As a budget analyst for the federal government, Clayton told the other committee members he had a gut feeling something was not right — the numbers were not adding up. Although he wanted to suggest hiring an internal auditor, Clayton knew the church could not afford the salary and benefits necessary to attract a competent, qualified professional. Alternatively, Clayton suggested that the church outsource its internal auditing function and hire Diggs, Graves, and Berry, a small CPA firm that had performed non-auditing services for the church in the past.

Reverend Gable agreed, noting an internal audit would also benefit the church. Church members wanted to build a fellowship hall for hosting recreational activities, meetings, and meals. If planned properly, an internal audit could help identify any risks that may prevent the church from meeting its objectives by revealing the areas in which internal controls could be strengthened.

The internal audit

Diggs, Graves, and Berry had three offices and a total of about 50 to 70 employees. Of those, 15 to 20 were non-CPAs who held bookkeeping positions. Most of the firm's work was regional, within a 250-mile radius. The firm sent Ricky Goodman, who had four years of auditing experience, to perform the internal audit. Although Ricky had worked for Diggs, Graves, and Berry for a few years, he had not audited Small Town Church previously.

Ricky knew from experience that a typical internal audit investigation includes interviews and an analysis of documents, computers, and financial statements. When examining the church's accounting system for purchases on account, Ricky set out to verify that all of the church's purchases were recorded. If there were any errors or irregularities in the recording of accounts payable, Ricky hoped to find them by sampling disbursements and tracing the supporting documents to recorded transactions in the church's books. After determining the time frame on which to focus his investigation, Ricky compared the church's accounts payable balance, ratio of accounts payable to purchases, and ratio of accounts payable to total liabilities with the same metrics for the previous five years.

When reviewing the books, Ricky discovered a curious pattern — a check was voided every month. Among the church's expenses, he also found charges to a credit card in the church's name. Ricky thought it odd that a small church would have its own credit card and wondered if the church used it in place of keeping a petty cash fund. He wanted to ask the bookkeeper about this, but she had called in sick.

Upon further investigation, Ricky discovered expense receipts from Florida and Hawaii. The credit card receipts also showed charges from a car dealership, women's clothing stores, and a cell phone company. Could these charges be explained as church expenses? Perhaps church members took a religious conference trip to Florida and Hawaii, received new phone services, bought a new vehicle to transport members from various events, and purchased clothing to donate to those in need.

Ricky asked both Reverend Gable and the music director about the credit card charges. Reverend Gable said he was unfamiliar with the charges, claiming the church had never received any of the items on the receipts or visited either Florida or Hawaii. Although Reverend Gable was present at most church functions, Grace generally handled the financial side of administering these events. Ricky contacted the credit card company to request a copy of the most recent bill. Upon receipt of this bill, he discovered that the only named authorized user on the credit card was Grace.

When Grace returned to work the following day, Ricky and Reverend Gable asked about the credit card charges. At first, she claimed not to know what they were talking about; she denied knowledge of a church credit card and said she had never seen the charges before. Ricky told her some of the charges, such as the payments to a phone company, were made to accounts in her name. As the only person handling the church's records, Grace had the opportunity to create a church credit card without anyone else's knowledge. Faced with the receipts, Grace confessed to embezzling money from the church.

Grace said when she first started taking money from the church, she planned to pay it back. Then she believed she deserved the money — she had been through a lot throughout her 67 years. As an only child, Grace took on the medical costs that Medicare did not cover when her parents became ill 10 years

EXHIBIT 1 Recommended Internal Controls

Control	Type of Control
1. Establish a written credit card policy.	Preventive and Corrective
2. Determine which employees (by functional position) need a credit card, and limit the number of users.	Preventive and Corrective
3. Set credit limits on each card (total limit; daily, weekly, and monthly limits; etc.) and other restrictions.	Preventive
4. Require original supporting documents for each purchase — no copies.	Preventive
5. Do not allow personal expenses.	Preventive
6. Independent monitoring: • Examine credit card statements. • Compare expense amounts to prior periods and budget.	Detective
7. Train employees in appropriate credit card use.	Preventive
8. Perform annual credit checks on employees who use church credit cards.	Preventive
9. Limit board terms.	Preventive and Corrective
10. Maintain skepticism.	Preventive

ago. To deal with this added stress, Grace turned to shopping and traveling. Eventually, her lifestyle became more extravagant, and her monthly credit card payments became too burdensome after her husband's death two years ago. Although she had witnessed a significant increase in collections by the church over the past few years, the church denied her request for a raise. Grace felt resentful since she had been such a dedicated employee for many years. A religious woman and faithful member of the church, she volunteered and donated to charities. She was just taking what she believed was owed to her.

So Grace opened a credit card under the church's name. She alone checked the church's mail, and when the credit card bill was delivered, she would pay with one of the church's checks. Because she was the only one who handled the finances, it was easy for her to void that check each month without anyone noticing.

Ricky advised the church to take precautions when using a company credit card. While credit cards have become ubiquitous and can simplify business transactions, they can also increase the risk of misuse and theft. Small organizations with limited staff sizes, such as churches, face additional risks due to their inability to separate duties. Churches lack the financial checks and balances of other business organizations; a church finance committee consisting of volunteers may not provide the level of authority or skills needed for effective church fraud prevention. Additionally, segregating duties — keeping the books, paying bills, handling cash receipts, managing and issuing payroll, and reconciling bank accounts — may be difficult for a church with a small staff.

Basic internal controls for company credit cards

Ricky described these precautions as internal controls and provided suggestions for implementation specific to the church. Internal control procedures can prevent, detect, and correct fraud or errors. Preventive controls are preferable and act as an organization's first line of defense to help keep fraud from occurring. If preventive controls fail, the second line of defense is the use of detective controls, which help discover any discrepancies. Finally, if any fraud or errors do occur, an organization should have corrective controls in place to fix the problem and prevent it from reoccurring. It is important for an organization to have an appropriate mix of all three controls based on the individual risks of the organization.

The following are some internal controls Ricky recommended that Small Town Church implement. These basic controls (which are summarized in Exhibit 1) will help ensure that credit cards are used for legitimate purposes. Proper implementation of these controls will reduce future internal audit findings, improve efficiency of operations, and enhance the safeguarding of the church's assets.

Develop clear policies regarding church credit card expenditures. Clear policies should be outlined and understood by all employees authorized to handle church records/finances. This will help eliminate misunderstandings or misuse of the church credit card. Each person authorized to use the card should sign a statement agreeing to the terms of the church policy and acknowledge the consequences for failure to comply.

Control the issuance of cards. This includes the establishment of criteria for eligibility to receive a credit card. Only employees who need the credit card to carry out their official duties should be authorized to use them. In the event the church grows and has multiple employees who require travel or regular business expenses, additional credit cards may be issued. Credit checks (see item eight) should be performed on all authorized users.

The church credit card should have the same security and be treated with as much protection as a personal credit card. If fraud occurs, the church's credit card company should be immediately notified so that appropriate action can be taken to minimize any further misuse.

Set credit limits and not allow cash advances. Individual credit limits can be set based on expected monthly church business expenses of the employee.

Give receipts from credit card charges to the church. A credit card statement will not suffice as a receipt for IRS record-keeping requirements. If the person making a charge to the credit card does not provide a receipt, the treasurer should record that charge as taxable income to that person. All users of the church credit card should be aware of the importance of keeping receipts of credit card charges.

Never use the church credit card for personal expenses. Church policy should require that if any personal charges are made with the church credit card accidentally, the church should be reimbursed immediately for the exact amount. Otherwise, the amount will be deducted from the employee's paycheck.

The church credit card should be used only for church business, not for church members' or employees' convenience. The credit card should be used for items the church normally purchases, such as office supplies, special online orders, or fuel for church-owned vehicles. Furthermore, if the credit card is meant for such small purchases, a reasonable credit limit, such as $1,000, should be adopted. Alternatively, establishing a petty cash fund for these small purchases may be more appropriate than a credit card; this will minimize the risk of larger personal employee purchases. If church members pay ministry expenses using their personal money, a policy should require the employee to be reimbursed by the church for those purchases.

Credit card purchases should follow the church's purchase order system. Charging purchases to a church credit card may be more convenient than waiting for a check to be written, but credit card purchases should abide by the same purchase order approval process as all other church expenses. The business purpose of each purchase should be described.

Have credit card statements reviewed by an individual other than the employee using the credit card. The statements and original receipts should be reviewed to ensure all charges are related to church business. Additionally, monthly charge totals should be monitored in comparison to previous periods and budgeted expenses.

Bank statements and copies of cancelled checks should be reviewed by an individual outside the cash receipt and cash disbursement process. For a nominal fee, the chair of the finance committee or the pastor can have bank statements and copies of cancelled checks sent to his or her home. This independent review may partially compensate for the church's lack of segregation of duties. In this case, a reviewer might have noticed the monthly checks to the credit card company, and such amounts would have raised a red flag. Additionally, the reviewer should randomly select disbursements per the bank statement on a quarterly basis and require that support be provided for careful examination. This ongoing monitoring could detect and deter fraudulent activity.

Train employees in appropriate credit card use. This training should inform employees of the church's credit card policy. Additionally, employees should be required to annually document their job duties, including fiduciary and ethical responsibilities. This document should include a statement signed by the employee, acknowledging that the church does not permit employees to use the credit card for personal reasons. Such an annual process serves as a reminder to both the employees and the board about their responsibilities. In the event fraud is committed by an employee, this documentation can assist the organization in dealing with legal repercussions.

Perform initial and annual credit checks on those employees authorized to use the credit card. Employers may run credit checks for various reasons, such as the concern for employees who are financially strapped. These employees are often distracted at work by their financial woes and may even be tempted to steal. On the other hand, employees who responsibly manage their own personal finances are often viewed as better, more responsible workers.

Require that board terms not exceed three to four years. Mandatory rotation of board members, including finance committee members, would minimize the impact of fraudulent activities. This would forestall an event in which an employee might collude with a board member to commit fraud.

Have church's finance committee maintain a level of skepticism. Becoming too comfortable with a particular employee or existing policies and procedures may limit the committee's ability to identify risks or irregularities. The potential for fraud should not be taken lightly. Despite the altruistic nature of the church, it is still possible for fraud to be perpetrated by trusted employees or church members.

Justice over mercy

Although the church was reluctant to report Grace to the police because of the negative publicity, Ricky encouraged the church to do so for several reasons, such as increasing the church's ability to recover what was stolen and preventing Grace from repeating this behavior at another organization. As a result of her fraud scheme, Grace went from serving the Lord to serving time in jail. She was arrested on charges of grand theft and scheming to defraud. She is currently being held on $100,000 bail and has been ordered to pay $100,000 in restitution to the church.

Credit card abuse is only one of many employee fraud schemes that plague the nonprofit community. Other schemes include skimming cash and establishing fake vendors or ghost employees. Several of the control suggestions in this article can help prevent or detect some of these other methods of fraud as well. All organizations, no matter the size, should recognize the value of properly implemented internal controls and internal auditing functions.[1] ■

NOTES

[1] This article was based on an actual case. The names of the people, places, church, crimes, and punishment have been altered. For more information on basic internal controls for credit cards, see https://na.theiia.org.