

Prevent fraud by looking in all the right places

There is an over-reliance by churches on an external audit in detecting fraud.



In a Peanuts episode, Charlie Brown feverishly searches for a quarter he has dropped in the dark. Standing under a porch light, Lucy offers some sage advice; “Why don’t you look over here where there is more light?” This cartoon, dredged up from childhood memory, brings to my mind the approach many churches take in fraud prevention.

Despite evidence to the contrary, they continue to look for fraud weaknesses in the wrong places, or at least in using the wrong methods. They do this by often utilizing methods that are the most expensive while at the same time being the least effective, the most notable example of this is over-reliance on the external audit.

The Association of Certified Fraud Examiners (ACFE) says that more than 50 percent of small organizations rely *solely* on the external audit for fraud prevention. However, the ACFE also reports that only a paltry 4.6 percent of reported fraud cases were discovered as a result of an external audit. The verdict? Many churches spend far too much money for far too little results – especially in light of the fact that several less expensive but much more effective methods are available.

Take a tip

For years the ACFE has reported that anonymous tips are by far the most common method of fraud detection. This held true in their 2010 Report to the Nations with more than 40 percent of reported frauds being detected as

a result of anonymous tips. This rate of discovery is almost three times as large as any other detection method.

However, despite these facts churches seldom implement a fraud reporting system. These systems enable employees, vendors, and volunteers to anonymously report observed fraud or other misconduct. A fraud reporting system can be very inexpensive and can consist solely of a web-based portal. Of course, in the church environment, such a step must be taken with sensitivity and grace.

I mentioned that too many organizations rely solely on an external audit for fraud prevention. The ACFE statistics point out that a much higher success rate exists for those who take matters in their own hands, doing some of the work themselves, rather than farming fraud prevention out to the auditors.

Two other relatively low cost techniques have been proven to be quite effective.

Management review and internal audit steps accounted for more than 30 percent of detected fraud reported to the ACFE. By using volunteers and involving board members, churches can easily implement these two steps

while spending few dollars.

It would seem management review would be a rather easy task, but surprisingly is seldom utilized by churches other than in a cursory manner. This is evidenced by the ACFE findings that fewer than 50 percent of all organizations conduct intensive reviews.

What would a management review involve? At least annually, the church (through its finance committee, elders, board members, etc.) should take a half day in which to brainstorm the accounting and management systems the church is utilizing. A beginning point would be to flow chart or outline the church’s cash flow systems, paying close attention to the controls, processes, accounts and transactions involved.

The purpose of this review is to identify potential weaknesses in the system, such as lack of dual controls in areas involving cash management. When fraud portals are discovered, corrective actions can be taken quickly before any damage is done.

An internal audit takes the management review one step further. The management review identifies potential weaknesses in the church’s management processes. The internal audit >>



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“We understand we are stewards of this ministry”

“We understand we are stewards of this ministry. As a result we joined the ECFA very early in our history and we strive to maintain their highest standards.”

Gary Kendall, Lead Pastor
Indian Creek Community Church

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Verne Hargrave book

IMPLEMENT A FRAUD, WASTE AND ABUSE REPORTING SYSTEM

Go to the Website of the Arlington Independent School District in Texas and prominent on its opening page is a link to "Report Fraud, Waste and Abuse." The district has instituted a reporting system to safeguard its assets and ensure that funds are spent according to board policy and the annual budget. [www.aisd.net]

Wish that churches were doing the same, says Verne Hargrave, a CPA and certified fraud examiner. The school district provides "an avenue for reporting suspected financial fraud, waste and abuse" and to do so anonymously. A form is provided that can be submitted directly to the Internal Auditor for review and investigation.

The reporting system is intended for theft of district assets of property or money, misuse of district assets, conflicts of interest, and waste and abuse of district resources. A touchy subject for churches, no doubt, but the frequent cases of fraud — often three or four incidents reported a month in the media — suggest that the problem for churches is near epidemic. —**RK**

allows a church to test its processes during the year, rather than waiting for the external auditors to do their work after the year has ended.

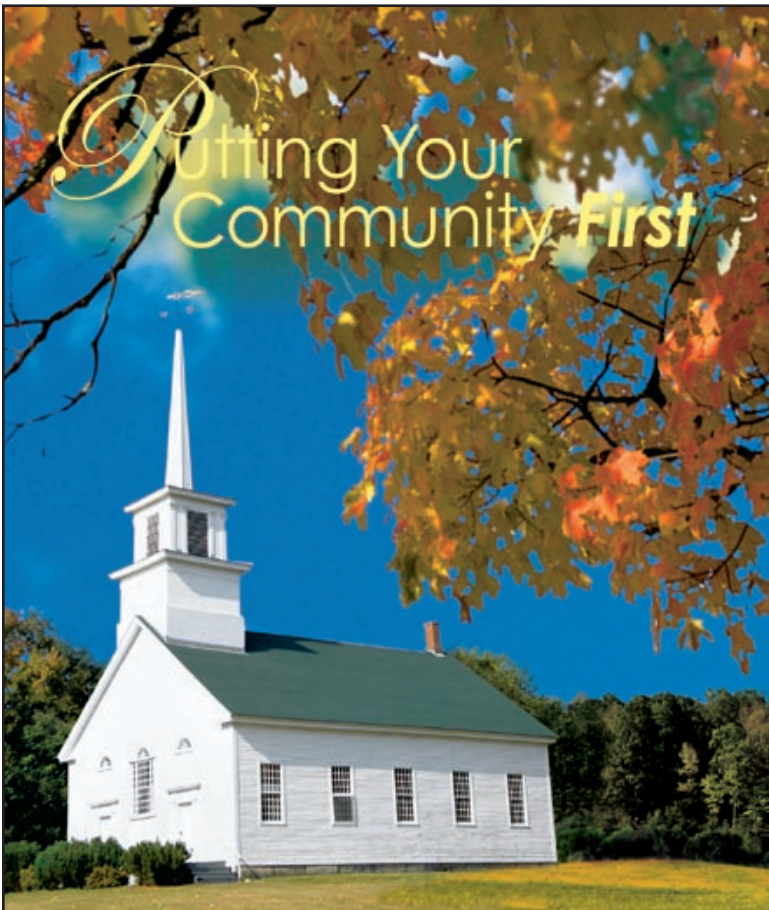
Volunteers can test the process by analyzing a sample of the church offerings by reviewing teller sheets, tracing amounts to the church general ledger and bank statements. On the cash disbursements side, one useful tool is to export the cash disbursement register to an Excel

worksheet. Once in the worksheet, the data can be sorted by dates, amounts and vendors. It is an easy process to then scour the worksheet looking for anomalies. A sample of questionable disbursements can then be traced to the underlying vendor invoices to assess propriety.

In contrast to Lucy, thieves do not like light. When churches take steps to shine a light on their accounting and management processes, potential fraudsters will

usually move on to darker venues. CE

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