Non-Profit Collaborative
How to Protect your Non-Profit from Fraud and Embezzlement

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Disclaimer

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Today’s Agenda

- What is Fraud?
- Internal Threats
- External Threats
- Prevent
- Identify
- Recover
- Conclusion
What is Fraud?

Fraud - Wrongful or criminal deception intended to result in financial or personal gain
2,690 real cases of occupational fraud
from 125 countries in 23 industry categories

$7 BILLION+ in total losses
$130,000 median loss per case
22% of cases caused losses of $1 million+

Median duration of a fraud scheme: 16 months

Corruption was the most common scheme in every global region

Small businesses lost almost twice as much per scheme to fraud

$104,000 median loss for 100+ employees
$200,000 median loss for <100 employees
Current Statistics

• Internal Control weaknesses were responsible for nearly 50% of cases.
• Over 40% of all cases were detected by a tip (more than twice the rate of any other detection method).
• For non-profits, the median loss is $75,000 and is 9% of the total fraud ($7 billion) reported.
• If fraud is caused by an individual, the median loss is $74,000, if two people commit the fraud together, the loss increased to $150,000, and if three or more people work together, the loss increased to $339,000.
• Most common fraud schemes for non-profits include billings, corruption, expense reimbursements, cash, and payroll.

*Statistics from the ACFE’s Report to the Nations
Impact of Fraud

- Financial Losses
- Reputational Impact
  - Loss of Trust of a Funder
- Lower Employee Morale
- Potential lawsuits
  - Personal liability or jail time
- Closing of Non Profit
# Types of Fraud

<table>
<thead>
<tr>
<th>Internal</th>
<th>External</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Payable/Purchasing</td>
<td>Check Fraud and Petty Cash</td>
</tr>
<tr>
<td>Financial Statement Fraud</td>
<td>Corporate Account Takeover</td>
</tr>
<tr>
<td>Bribery/Corruption/Kickbacks</td>
<td>Debit Card/Credit Card Fraud</td>
</tr>
<tr>
<td>Expense Reimbursements</td>
<td>Third parties</td>
</tr>
<tr>
<td>Business Assets for Personal Use</td>
<td>Fictitious employees</td>
</tr>
</tbody>
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Why Do They Do It?

HEALTHCARE
- Financial: 64%
- Fun: 23%
- Grudge: 13%

PUBLIC ADMINISTRATION
- Espionage: 64%
- Financial: 20%
- Fun: 16%
Internal Threats

- Our people and providing the opportunity and motivation
- Poor physical controls
  - Data Centers
  - Negotiable Instruments
  - Access After Hours
  - Alarms
- Granting too much access to confidential information
  - Financial Data (Insider Trading)
  - Unlimited Authorization/User Access Rights
  - Customer and Employee Data
  - Information Databases
  - Trade Secrets
Internal Threats

- Social Engineering
- Lack of monitoring
  - Reconciliations of Bank and General Ledger Accts.
    - Unusual amounts
    - Stale dated items
  - User activity
    - Access attempts
    - Hours of access
    - What are they getting into?
- Financial transactions
- Unusual variances
- Expense growth
- Cash transactions
DATA MONITORING/ANALYSIS and SURPRISE AUDITS were correlated with the largest reductions in fraud loss and duration

- 52% LOWER LOSSES
- 58% FASTER DETECTION

Yet only 37% of victim organizations implemented these controls

85% of fraudsters displayed at least one behavioral red flag of fraud

51% LOWER LOSSES
54% FASTER DETECTION

Fraudsters who had been with their company longer stole twice as much

- More than 5 years' tenure: $200,000 median loss
- Less than 5 years' tenure: $100,000 median loss

Over the past 10 years, occupational fraud referrals to prosecution declined 16%

Top reason for non-referrals was fear of bad publicity - 16%

Only 4% of perpetrators had a prior fraud conviction

A majority of the victims recovered nothing
Why Do They Do It?

- Undefined roles and responsibilities
  - Create job descriptions
- Improper tone from the top
  - Create core values and Code of Ethics
- Collaboration amongst employees
  - Circumvention of controls
- Loss of customer data or a data breach
  - Third party access
  - Training and awareness
  - Incident response
Why Do They Do It?

• Lack of understanding of technology
  • System configuration
  • Software limitations
  • Electronic security needs
  • Virus and malware detection
  • Patching
  • Penetration and vulnerability testing
• Convenience is our greatest threat
External Threats

• Relationships with third parties
  • Risk rate your vendors
  • What standards should they comply with?
  • Read the fine print in contracts
  • Conduct a Google search of the vendor
  • Perform background checks
  • Collect data
  • Review information security programs
External Threats

• Pressure to commit fraud
  • Spouse and family
  • Financial commitments
  • Addictions: drugs, gambling, etc.
• Copy cats that see an opportunity
• Complexities of doing business
  • Understand what data you collect
  • Where is data stored?
  • Who has access to the data?
  • How long is it retained?
External Threats

• Loss of a third party
• Loss of utility services, internet, etc.
• Electronic threats
  • Viruses and sleepers
  • Malware
  • Skimming devices
  • Denial of service attacks
External Threats

- Customer threats
  - Identity theft
  - Corporate account takeover
  - Stolen cards and checks
  - Social engineering
  - Improperly identifying a customer
- The Internet and Social Media
  - The internet of things
  - This is where it all begins.....
Preventing Fraud

• Establish written policies and procedures
• Rotate roles periodically
• Authorization limits
  • Contracts
  • Wages
  • Credit Cards (who has access to #?)
  • Check signing authority
  • Loans
  • Accounts Payable; vendors and invoices
  • Wires, ach, and any electronic money transfers

[Checkmark and Cross symbols]
Protecting Electronic Data

• Protect and dispose of physical and electronic files properly
• Properly install new technologies and communication channels (wifi and remote access)
• Check security standards and don’t use factory defaults
• Periodically have your system tested; penetration and vulnerability
• Know your third parties and what they do with data
• Business continuity and disaster recovery
• Have an Incident Response Program
Employee/Volunteer Focus

Personnel Controls:
• Observe employee behaviors
• Test knowledge and review policies
• Perform due diligence when hiring new employees or temporary workers
  • Background check
  • Credit check
  • Check references
THE RED FLAGS OF FRAUD

Understanding and recognizing the behavioral red flags displayed by fraud perpetrators can help organizations detect fraud and mitigate losses.

85% of cases: Fraudsters displayed at least one behavioral red flag.
50% of cases: They exhibited multiple red flags.

These 6 behavioral red flags have been the most common in every one of our studies dating back to 2008, with a remarkably consistent distribution.

- Living beyond means
- Financial difficulties
- Unusually close association with vendor/customer
- Control issues, unwillingness to share duties
- Divorce/family problems
- "Wheeler-dealer" attitude
Red flags varied by perpetrator’s position:

- **Owner/Executive**
  - Unusually close association with vendor/customer: 24%
  - Control issues, unwillingness to share duties: 21%
  - “Wheeler-dealer” attitude: 22%
  - Irritability, suspiciousness, or defensiveness: 18%
  - Complained about inadequate pay: 4%

- **Employee**
  - Financial difficulties: 16%
  - Control issues, unwillingness to share duties: 8%
  - “Wheeler-dealer” attitude: 9%
  - Irritability, suspiciousness, or defensiveness: 10%
  - Financial difficulties: 35%

Red flags varied by perpetrator’s gender:

- **Female**
  - Financial difficulties: 39%
  - Divorce/family problems: 20%
  - Instability in life circumstances: 6%

- **Male**
  - Financial difficulties: 24%
  - Unusually close association with vendor/customer: 11%
  - “Wheeler-dealer” attitude: 16%
  - Excessive pressure from within the organization: 8%
  - Instability in life circumstances: 2%
Preventing Fraud

Establish strong policies and procedures:
- Conduct new employee orientation
- Implement a Whistleblower Policy
  - A way to report suspected activity
  - Anonymous method
  - No retaliation
- Establish a Code of Ethics
  - Conflicts of interest
  - Gifting policy
  - Expected behaviors and values
- Create record retention guidelines
- Have an employee handbook
  - Accountability
  - Document a process for violating the rules
Protecting Data

• Utilize complex passwords
• Provide user access based on job responsibilities
• Implement patches and upgrades
• Truncate account numbers and personal information
• Don’t store credit card data
• Back up programs and data regularly
• Apply patches when released
• Look for end of life or unsupported systems
• Perform network scans
• Review firewall configuration
Preventing Fraud

• Physical Controls
  • Negotiable instruments
  • Cash and records
  • Dual controls
• Physical security
  • Alarms
  • Access Controls
  • Video surveillance
<table>
<thead>
<tr>
<th>Anti-Fraud Control</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Anti-fraud policy</td>
<td>54%</td>
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<tr>
<td>Fraud training for employees</td>
<td>53%</td>
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<tr>
<td>Fraud training for managers/executives</td>
<td>52%</td>
</tr>
<tr>
<td>Dedicated fraud department, function, or team</td>
<td>41%</td>
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<td>Formal fraud risk assessments</td>
<td>41%</td>
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<tr>
<td>Surprise audits</td>
<td>41%</td>
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<tr>
<td>Proactive data monitoring/analysis</td>
<td>37%</td>
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<tr>
<td>Job rotation/mandatory vacation</td>
<td>37%</td>
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<tr>
<td>Rewards for whistleblowers</td>
<td>19%</td>
</tr>
<tr>
<td>Code of conduct</td>
<td>80%</td>
</tr>
<tr>
<td>External audit of financial statements</td>
<td>80%</td>
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<tr>
<td>Internal audit department</td>
<td>73%</td>
</tr>
<tr>
<td>Management certification of financial statements</td>
<td>72%</td>
</tr>
<tr>
<td>External audit of internal controls over financial reporting</td>
<td>67%</td>
</tr>
<tr>
<td>Management review</td>
<td>66%</td>
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<tr>
<td>Hotline</td>
<td>63%</td>
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<tr>
<td>Independent audit committee</td>
<td>61%</td>
</tr>
<tr>
<td>Employee support programs</td>
<td>54%</td>
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Identifying Fraud

Financial Controls:
- Conduct annual reviews or audits of financial records
  - Compilations, reviews and audits
- Regularly conduct account reconciliations
  - Review stale activity
  - Segregation of duties
  - Delivery of bank statements
- Review budget-to-actual projections
  - Identify unusual fluctuations and variances
Observations:

- Employees that take vacation or never take vacation
  - > 5 years tenure = $200,000 while < 5 years = $100,000
- Phone Calls or mail for unrelated people or businesses sent to your non-profit
- Access logs
- Management reviews
- New vendors set up for accounts payable
Insurance as a Control

Insurance is not a control, but it can save your entity

- Directors and Officers Insurance
- Employment practices policy (payroll)
- Bond or General Liability policy
  - Actions of employees
- Interruption of Services or Cyber insurance
- Property insurance
- Review your deductibles
- Assess your coverage periodically
Recover from a Fraud

• Notify the appropriate agencies (law enforcement, Attorney General, Consumer Affairs, etc.)
• Notify your insurance agency, financial institutions, and CPA firm.
• Remediation of computer equipment
  • Change passwords
  • Change accounts
  • Change user name
  • Restore from backups
• Retain documentation;
The Devil is in the Details
• Fraud is everywhere
• Establish a system of checks and balances
• Monitor activity
• Protect your physical environment
• Review and understand financial results
• Know where your data is, and who has access to it
• Understand and utilize technology
• Review relationships with third parties
• Know your employees
• Educate your employees
• Be observant and practice professional skepticism
References

- Federal Bureau of Investigation - [https://www.fbi.gov/investigate/cyber](https://www.fbi.gov/investigate/cyber)
Questions?

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