



NOT-FOR-PROFIT

# FRAUD SURVEY 2016

# INTRODUCTION

We are pleased to present the sixth BDO Not-for-Profit Survey, covering 12 years of trends in fraud, in the sector.

The 2016 survey revealed two significant concerns. The first was a gap in the perception of fraud amongst Not-for Profit organisations. Most respondents identified fraud as a significant problem for the sector overall, however, few believed it was a significant problem for their own organisation.

The second major concern was that the overall awareness of fraud as an issue seems to have reduced since the previous survey in 2014.

These findings perhaps explain why respondents also reported a low level of recent or planned fraud prevention activities. Many also reported a level of uncertainty about the potential impact of fraud on their organisation and the likelihood of it becoming a greater issue in the future.

The survey results may indicate a level of complacency amongst Not-for-Profits that 'it won't happen to us.' That complacency means they may not be doing enough to actively prevent fraud and protect themselves against potential threats.

This report focuses predominantly on fraud prevention within Not-For-Profits. The report identifies what measures survey respondents currently have in place, the strengths and weaknesses of current approaches and potential gaps and issues that may need to be addressed. We hope you find it useful.

The impact of fraud can be immense, particularly for smaller organisations who have minimal cash reserves. It is the smaller organisations which make up the majority of Not-for-Profits. In the worst cases, fraud can threaten their continued existence. At BDO, we are committed to helping Not-for-Profits understand these risks and how to put measures in place to mitigate them.

As always, we would like to thank the people who made this survey possible – the 739 survey respondents. We appreciate their willingness to take part and share their views and experiences.

**Bernard Lamusse**  
Leader, Not-for-Profit  
BDO New Zealand

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# OVERVIEW



**52%**

of respondents saw fraud as a problem for the sector overall



**9%**

of respondents saw fraud as a problem for their organisation



**43%**

of respondents saw fraud prevention as important



**29%**

of respondents had a risk management framework in place



**89%**

of respondents felt the likelihood of fraud having occurred in their organisation but not been detected was low



**84%**

of respondents felt the likelihood of fraud becoming a greater issue for their organisation in the future was low or very low



**34%**

of respondents conducted background checks on employees

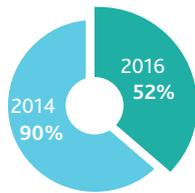
# PERCEPTIONS OF FRAUD

## WHAT IS THE PROBLEM

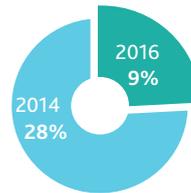
As in previous surveys, most respondents felt fraud was a problem for the sector. Also in line with previous surveys, most respondents also felt fraud was much less of a problem for their own organisation. However, when compared with the last survey in 2014, respondents to this year's survey reported a significantly lower overall awareness of fraud as a problem, for both their organisation and the sector as a whole.

### Perception of fraud as a problem: 2016 vs 2014

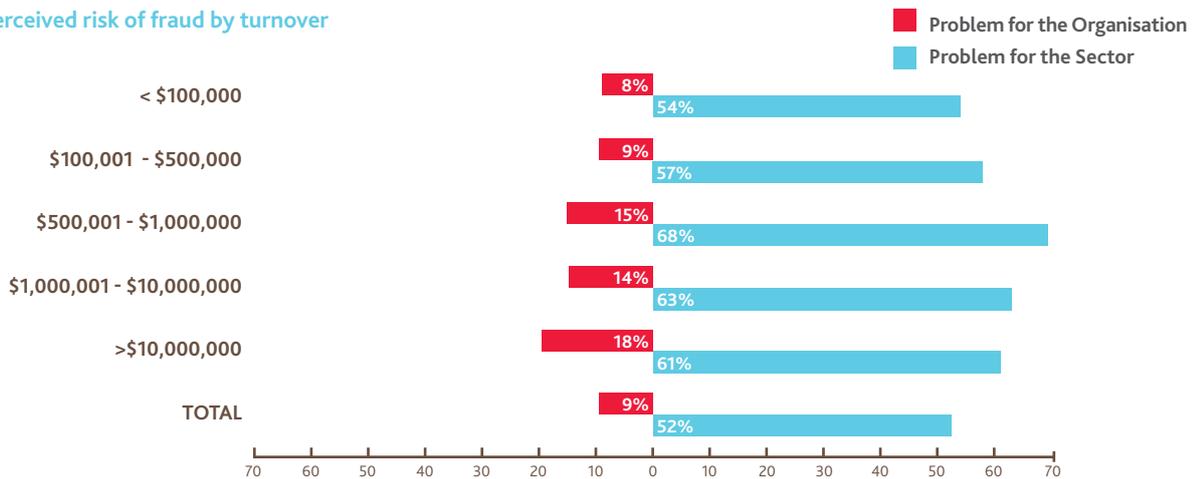
Respondents saw fraud as a problem for the sector



Respondents saw fraud as a problem for their organisation



### Perceived risk of fraud by turnover



The survey reveals a strong belief amongst Not-for-Profits that fraud is something that happens to other organisations – but not to theirs. This is further underlined by the response to other survey questions:



Likelihood of fraud occurring in an organisation



Likelihood of fraud occurring in an organisation but not being detected



Likelihood of fraud occurring in an organisation but not reported



Possibility of money laundering occurring

## WHERE IS THE PROBLEM

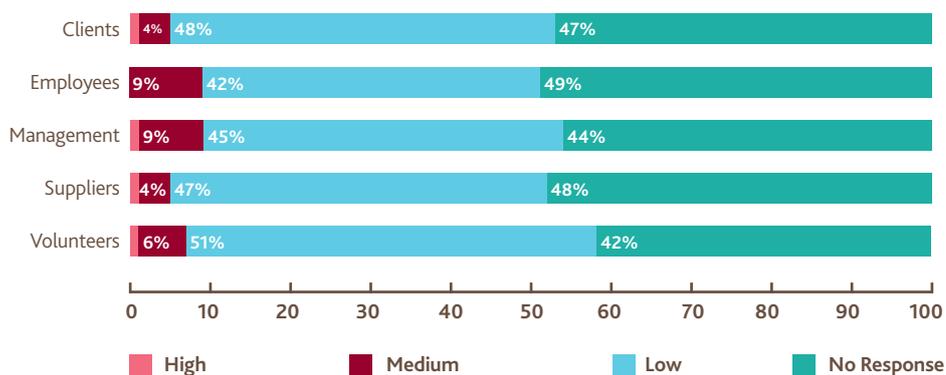
In this year's survey respondents from across the spectrum of the Not-For-Profit sector believed it was a problem for the sector as a whole. However respondents in the Development & Housing, International and Health industry categories perceived fraud as a greater problem for their organisation than respondents in other categories. In the 2014 survey respondents from the Social Services category were the most likely to perceive fraud as a problem for their organisation, followed by the Health and International categories

### Perception of fraud by category

INDUSTRY CATEGORY	2016 SURVEY		2014 SURVEY	
	PROBLEM FOR THE ORGANISATION	PROBLEM FOR THE SECTOR	PROBLEM FOR THE ORGANISATION	PROBLEM FOR THE SECTOR
Social Services	12.00%	53.00%	39.00%	89.00%
Health	15.00%	51.00%	33.00%	93.00%
International	18.00%	45.00%	33.00%	100.00%
Other	6.00%	53.00%	31.00%	100.00%
Business & Professional Associations, Unions	0.00%	40.00%	28.00%	88.00%
Culture & Recreation	7.00%	50.00%	25.00%	90.00%
Education & Research	10.00%	52.00%	24.00%	81.00%
Development & Housing	21.00%	63.00%	21.00%	71.00%
Environment	4.00%	48.00%	20.00%	93.00%
Religion	9.00%	53.00%	14.00%	91.00%
Law, Advocacy & Politics	0.00%	60.00%	14.00%	100.00%

Employees, management, suppliers, volunteers and clients were rated almost equally unlikely to commit fraud.

### Likelihood of stakeholders committing fraud





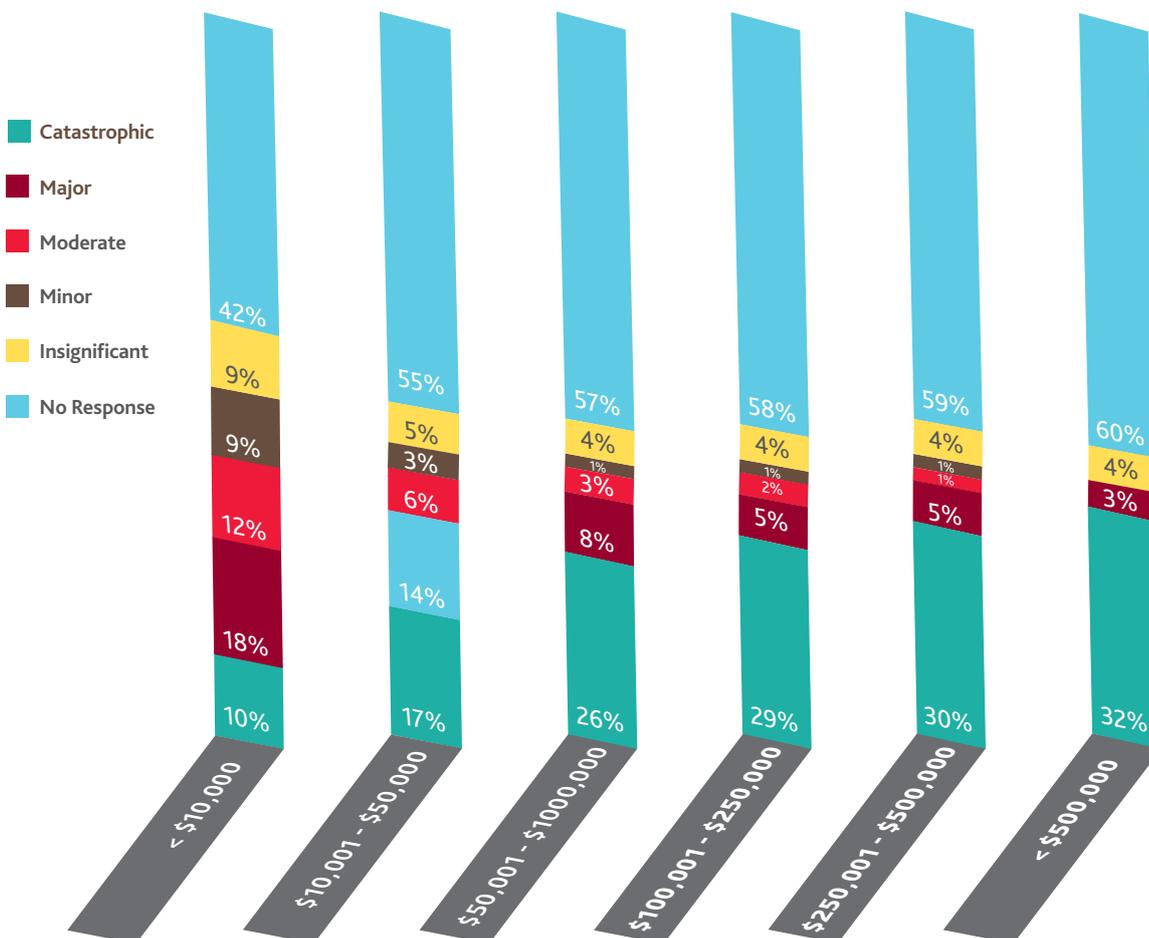
## HOW BIG IS THE PROBLEM

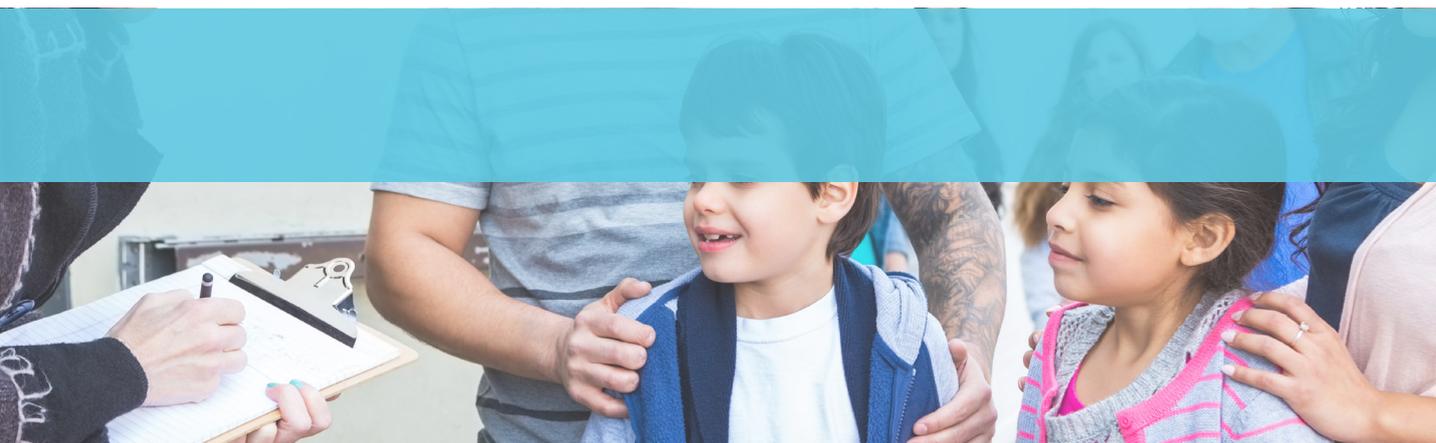
Many respondents felt that the potential impact of fraud occurring in their organisation was significant, even catastrophic – and the larger the fraud, the bigger the impact.

It's interesting to note however, that a high percentage (60%) of respondents did not answer this question, perhaps indicating a lack of awareness of the potential impact fraud can have on Not-for-Profits.

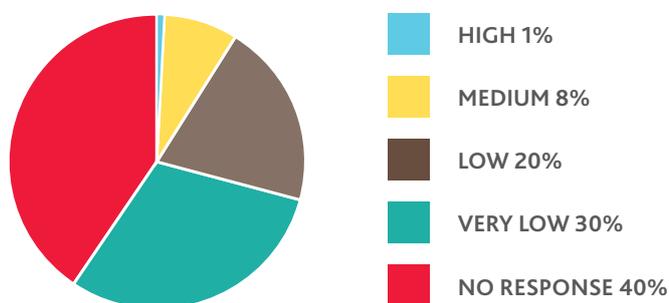
As in the 2014 survey, respondents generally don't expect things to get worse. 84% of respondents rated the likelihood of fraud becoming a greater issue for their organisation in the future as low or very low.

### Impact of fraud: Perceived impact of fraud





### Rating of fraud being greater problem in the future



### How well understood is the problem?

While many respondents understand the potential impact of fraud, and generally agree that it is a problem within the sector they operate in, the majority believe that it is not a significant problem for their own organisation. The reason for this perception is not that fraud does not occur, but rather because they believe they have strong fraud prevention and detection processes in place.

Respondents who believed fraud was not a problem in their organisation cited a range of reasons:

- 69% said they employed trustworthy staff/volunteers
- 66% said their organisation had a good culture
- 55% said their external auditor has not discovered any cases of fraud
- 49% said their organisation had an internal audit function who should find any fraud if it was happening
- 49% said their organisation had strict internal controls
- 19% said their organisation had a fraud control policy in place which was adhered to
- 16% cited other reasons

Many Not-for-Profit organisations do have robust and effective fraud prevention and detection mechanisms in place. However, the general perception that fraud is not a problem for their organisation, either now or in the future, inevitably creates the risk of complacency.

Fraud is not something that can be addressed once and then ignored. Nor is it something that stands still – new and ever more clever forms of fraud are evolving, often taking advantage of new technology. Organisations cannot control what fraudsters do, but they can ensure they provide fraudsters as little opportunity as possible to succeed.

By their nature, Not-For-Profits are set up to benefit the greater good, which can make them even more unwilling to accept that fraud could be occurring in their organisation. But that unwillingness can make the eventual impact of fraud, if it does occur, even more damaging. It is incumbent upon Not-For-Profits to continue to review and improve their fraud prevention and detection strategies, to avoid that potential becoming reality.

29% of respondents said their organisation had a Risk Management framework in place (compared with 55% in 2014). Risk Management frameworks were prevalent in respondents with higher turnovers.

# RISK MANAGEMENT

43% of survey respondents saw fraud prevention as important. This section of the report looks at what they are doing within their own organisations.

## Risk Management Framework by turnover

TURNOVER	PERCENTAGE OF RESPONDENTS WITH RISK MANAGEMENT FRAMEWORKS
Under \$100,000	15%
\$100,000 - \$500,000	36%
\$500,001 - \$1,000,000	47%
\$1,000,001 - \$10,000,000	55%
Over \$10,000,000	84%

Of those who had Risk Management frameworks in place, a range of elements had been implemented:

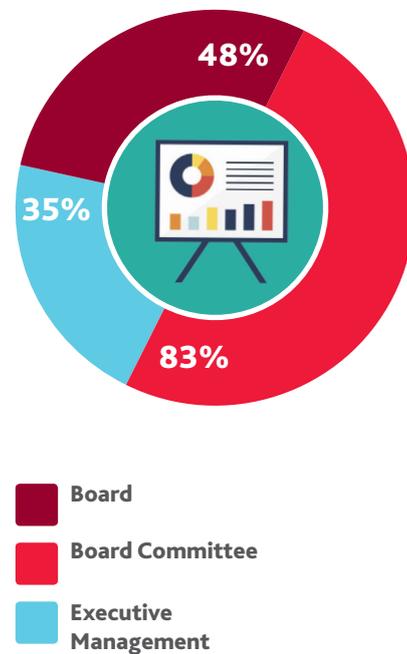




**Primary risk categories identified by those organisations were:**

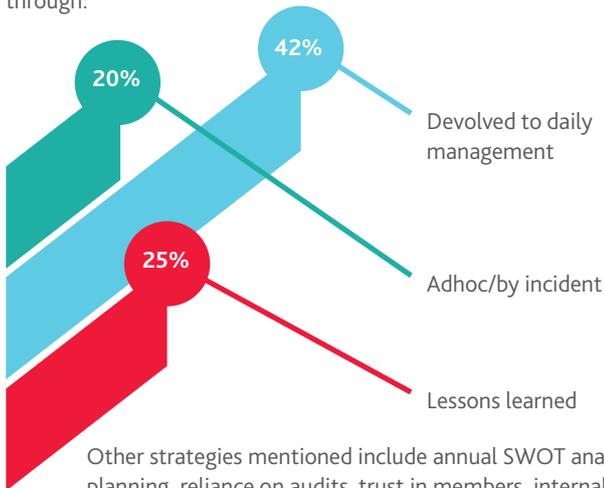


**The relevant governance forums were:**

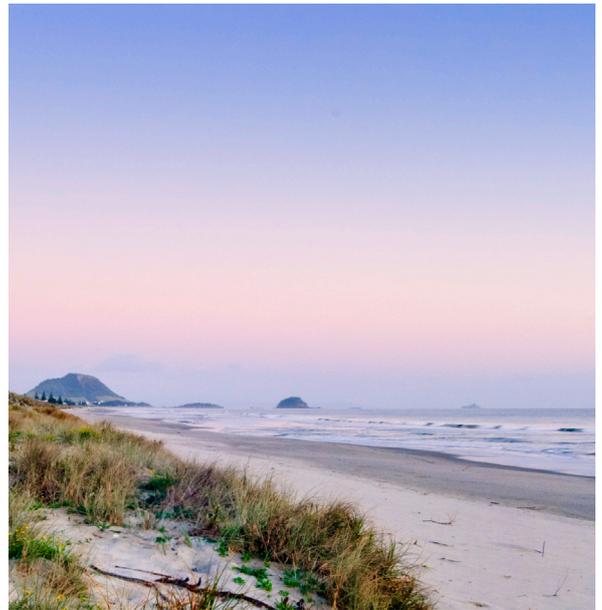


The primary role with responsibility for the risk management framework was the CEO (27%), Chief Operating Officer COO (6%), Company Secretary (4%), and Risk Officer (4%). Other roles identified included the Quality Assurance Leader, General Manager, Board, and Chairperson.

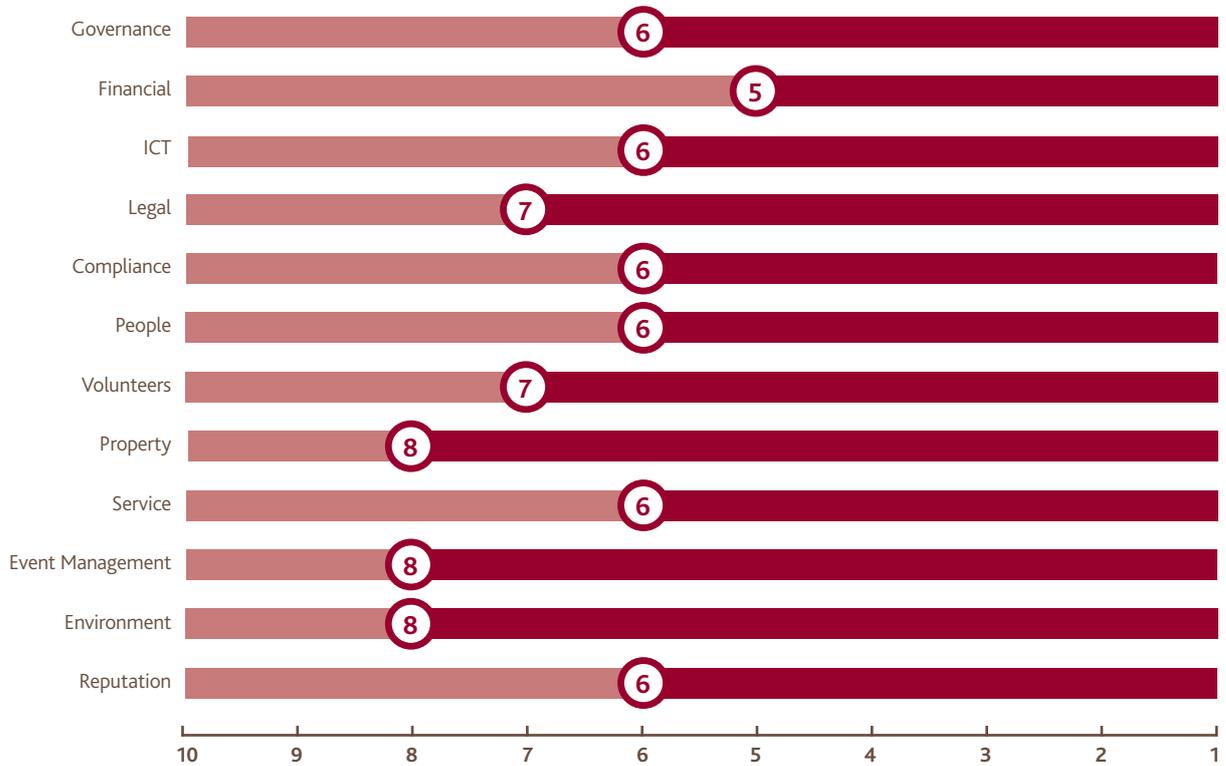
Those organisations who did not have formal Risk Management frameworks in place identified, assessed, managed and reported on risks through:



Other strategies mentioned include annual SWOT analysis and planning, reliance on audits, trust in members, internal controls, and Board involvement.



All respondents were asked to rate risks for their organisation. Average ratings (1 being the highest risk) were:



38% of respondents rated their risk management activities as adequate and effective, quite adequate and effective or highly adequate and very effective. 30% rated their risk management activities as either inadequate and ineffective or not so adequate and effective, with 32% not responding to this question.

# FRAUD PREVENTION

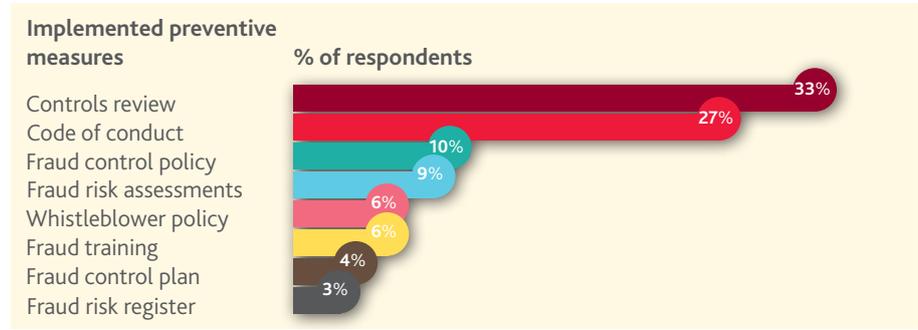
Respondents rated Top Management / Board support, ethical organisation culture, strong internal controls, external audits and internal audits as the most important factors influencing the risk of fraud.

Ranking of importance by respondents

Primary factors reducing the risk of fraud

- 1 Top management/ Board support
- 2 Ethical organisational culture
- 3 Strong internal controls
- 4 External audits
- 5 Internal audits
- 6 Strong fraud control policy
- 7 Fraud risk assessments
- 8 Prosecution of offenders
- 9 Whistleblower hotline

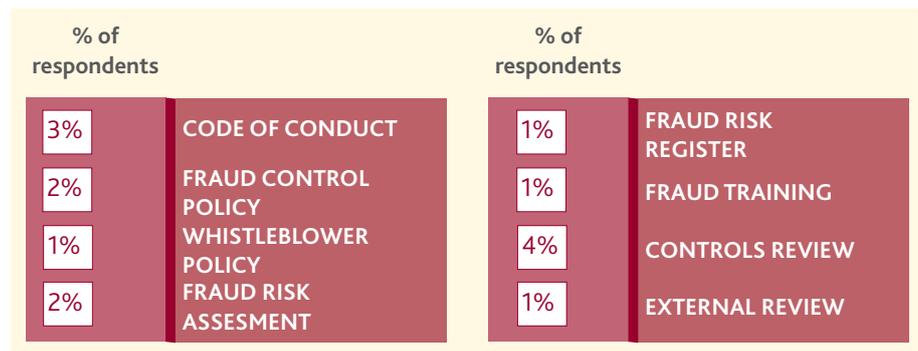
Respondents had implemented a range of fraud prevention measures:



Perhaps worryingly, not many respondents have implemented new measures in the last 2 years (Fraud prevention measures implemented - last 2 years):



A further cause of concern was that not many planned to implement new measures either: (New fraud prevention measures planned)



## Are Not-For-Profits doing enough?

A significant number of respondents said the impact of fraud if it occurred in their organisation would be catastrophic. However, the survey raised some questions about how well Not-For-Profits are prepared for such an occurrence.

While respondents felt fraud protection was important, only 10% had implemented a Fraud control policy while only 9% had implemented fraud risk assessments and only 6% had conducted fraud training. All of these are important in helping employees understand importance of and tolerance to fraud.

Only 6% had a whistleblower policy in place. However whistleblowers are an increasingly common method of detecting fraud, particularly in larger organisations. Surveys show that 47% of large public and private organisations had some form of whistleblower policy in place.

It is interesting to note that the survey revealed a significant dependence emphasis on external audits in detecting fraud. However, external audit procedures are not designed to detect fraud. It's important to remember that the ultimate responsibility for assessing, identifying and managing fraud remains with governance and management.

While 69% said employing trustworthy staff & volunteers was a reason why fraud was not a problem in their organisation, only 34% conducted background checks of employees. 30% conducted background checks of volunteers. There is perhaps a tendency within Not-For-Profits to believe that people who are attracted to work in their organisation are motivated by altruistic reasons; however fraud is a feature in every sector. Another reason for performing background checks is that in our experience, fraudsters can often be repeat offenders. Talking to previous employers will help prevent those people from harming your organisation.

Another cause for concern is the low number of new fraud prevention and detection measures, either in the last two years or planned for the future. This may reflect a sense of complacency amongst respondents. As we have already noted, fraud and fraudsters do not stand still - fraud prevention and detection requires ongoing vigilance and focus.



WAIKATO DIOCESAN  
School for Girls

## A CAUTIONARY TALE

### Learning the lessons of fraud

Waikato Diocesan School for Girls is a special character Anglican school based in Hamilton. The buildings are owned by the Proprietors Board. Between May and September 2015 the commercial manager at the Proprietors Board stole an excess of \$800,000 from the organisation. This was done whilst major building works were being undertaken.

### The fraud took the following forms:

- Fictitious construction company invoices were created through Photoshop and put through the system.
- Personal expenses were booked to the organisation's credit card.
- Requests were made for cheques to be signed urgently – these were used for personal expenses which were booked down as organisation expenses.

Concerningly, after the event had been publicised in the media it emerged that the person was also being investigated by their former employer for substantial irregularities.

### Lessons learnt

There were a number of key lessons learnt by the organisation:

- Have a good protected disclosures policy (whistle blowers policy). This fraud was partly discovered through the concerns of a staff member.
- Ensure that credit cards are approved by someone senior to the person whose name the card is in. In the case of the CEO, their card should be approved by the chairperson.
- Trust your management, but always question whether they have too much control.
- Check with suppliers by phone if they have changed their bank account details.
- All bank account details should be authorised by someone other than the person initiating the change.
- Check references with previous employers regarding reasons for a person leaving that employment.

### A happy ending

The Proprietors Board were very fortunate to have a proactive principal and a strong board who immediately on discovering the fraud took the right action in terms of employment, and more importantly in terms of identifying where the money had gone and obtaining freezing orders over various assets. The result of this is that the entire fraud amount was able to be recovered from the fraudster. This is a rare exception to the rule.

# REDUCING RISK AN EXTERNAL PERSPECTIVE

To help Not-For-Profits manage the risk of fraud more effectively, we asked two BDO partners with particular expertise in this area for their views



**Andrew Sloman**

*Andrew is a partner in BDO's Auckland office and specialises in helping organisations understand and manage their risks.*

The first step for any organisation in managing their fraud risks is to understand exactly what their risks are – and that's often not as simple or easy as it sounds.

The 2016 survey shows that around 30% of respondents have a Risk Management framework in place - which means 70% don't. And of those that do, it's likely to be a whole of business framework. When it comes to addressing fraud risk specifically, the survey also shows that only 3% have a documented fraud risk profile in place. Having this in place is key because without it, organisations may not understand the full breadth of fraud risks they are facing.

For example, as Not-for-Profits increasingly look for new ways to broaden their revenue stream, they may be exposing themselves to new risks as well. One new avenue for many Not-for-Profits is the establishment of online portals for credit card donations, to make giving simple and easy for donors. However, these are often targeted by criminals using them to test stolen credit card numbers, by making small donations. The result for Not-for-Profits who have been caught out by this fraud is considerable time, effort and cost in refunding the donations - not to mention the reputational cost.

Many Not-for-Profits are also seeking to outsource fundraising to third party organisations. However, that does not reduce the onus to retain control and oversight of the process. They should have processes and mitigations in place to ensure that all funds raised by

the third party are passed on completely and not siphoned.

The challenge for Not-for-Profits, of course, is that they are often under-resourced, particularly when it comes to administrative functions. The focus, understandably, is on ensuring that as much money as possible is spent on the delivery of services and achieving the objectives the organisation was set up to achieve. There is considerable pressure from both people working in the organisation, and from donors, to ensure money is not 'wasted' on things that are not seen to contribute to those objectives.

As the survey reveals, though, the impact of fraud on Not-For-Profits can be enormous. There is always a delicate trade-off between delivering front-line services and protecting their ability to continue to deliver those services. However, fraud risk management is becoming increasingly important. Funders, for example, are increasingly asking Not-for-Profits to demonstrate that they have adequate frameworks and controls in place to ensure all funds are used for the purpose they are intended.

The starting point for any risk management strategy is an understanding of your organisation's risk profile, as this will drive the controls you need to have in place. It's also important to regularly review this – for example, any discussion of new revenue opportunities should be accompanied by a review of the potential fraud risks that come with it.



## Bernard Lamusse

*Bernard Lamusse is a partner in BDO's Hamilton office and is BDO's National Spokesperson on the Not-For-Profit sector.*

Fraud is a major issue for Not-For-Profits, both in New Zealand and overseas. In the 2016 Global Fraud Study by the Association of Certified Fraud Examiners, for example, 10% of fraud cases were Not-For-Profit fraud. Given that Not-For-Profits tend to understate fraud, the incidence may be higher.

The impact of fraud on Not-For-Profits can be huge in financial terms. But even if it is not, the ramifications of fraud can be immense.

Most Not-For-Profits in New Zealand are relatively small organisations, with less than 10 paid employees. When one of them is found to have committed fraud, it can destroy the character and culture of the organisation. It can also destroy trust amongst supporters and donors, making it much more difficult to raise funds in the future. In many ways, fraud can destroy the very fibre of an organisation.

In my experience, the culture of Not-For-Profits can make it more difficult for them to establish fraud risk management processes. However, it is increasingly important that they do so. Here are some of the key measures organisations can take to help prevent fraud.

1. Segregation of duties: requiring more than one person to complete key tasks; for example, dual signatories for cheques or dual PINs for online banking.
2. Creating and monitoring key management reports – for example, comparing budget against actual expenditure and identifying 'spikes' in expenditure or large invoices will help identify potential fraud early.
3. Do the unexpected – for example, counting petty cash or reviewing credit card statements can prevent fraudsters taking advantage of established patterns of business and help stop fraud before it happens.
4. Establish a 'Whistleblower' policy – while respondents ranked this as the least important factor in preventing fraud and only a small number had implemented this, providing staff and volunteers with clear and confidential mechanisms to raise

concerns is an increasingly common and effective response.

5. Control your assets – establishing processes like regular stocktakes, setting different access levels linked to staff roles and responsibilities, and having adequate physical security systems all help prevent fraud.
6. Report any cases of fraud – too often fraud is swept under the carpet to protect the organisation's reputation – which can lead to repeat offences.
7. Know your people – Only 34% of respondents conducted background checks on employees. Given that fraudsters are often repeat offenders, reference and background checks should be undertaken for potential employees and volunteers.

Protecting against cybercrime: With the increased use of technology in all aspects of Not-For-Profits' day-to-day activities, electronic fraud is increasingly common. Simple measures to help prevent cyber crime include:

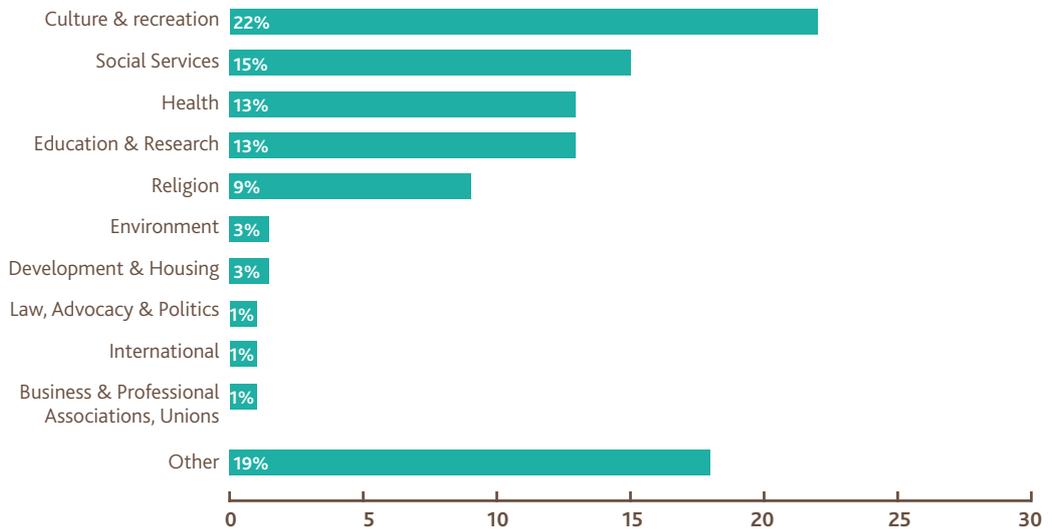
- Security software – ensure you install firewalls, anti-virus and anti-malware software and keep them up to date. You should also download and install security patches for operating systems and key applications immediately.
- Mobile devices – ensure that any mobile devices such as phones and ipads are also protected with passwords and security software.
- Passwords – insist employees choose strong passwords, change them regularly and never share passwords.
- Back-ups – ensure you have a process for backing up and retrieving your data.
- Use spam filters to block out as much spam as possible coming into your organisation.
- Education – provide information and training for your staff and volunteers on staying safe online. Ensure they are aware of and can recognise the main types of fraud, and know what to do if they are suspicious

# APPENDIX

This year's survey received 739 responses, compared with 436 in 2014. The majority (82%) were from New Zealand.

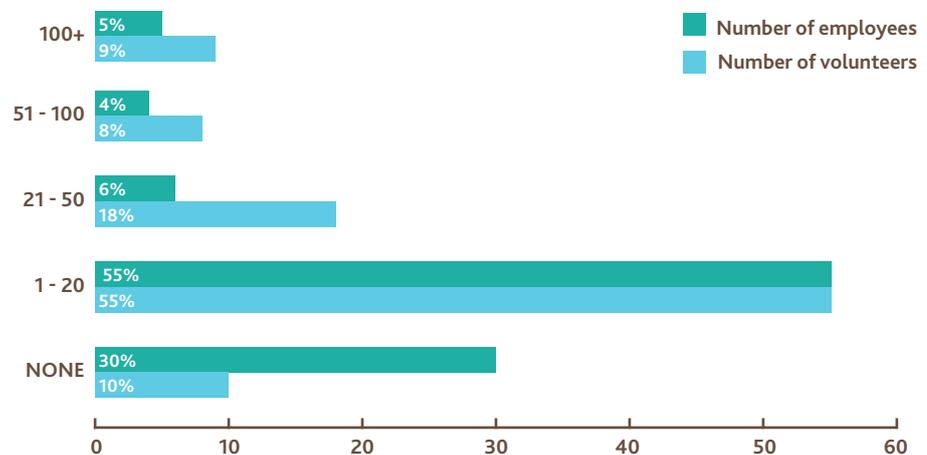
Respondents were from across all Not-For-Profit categories:

## Categories respondents operate in



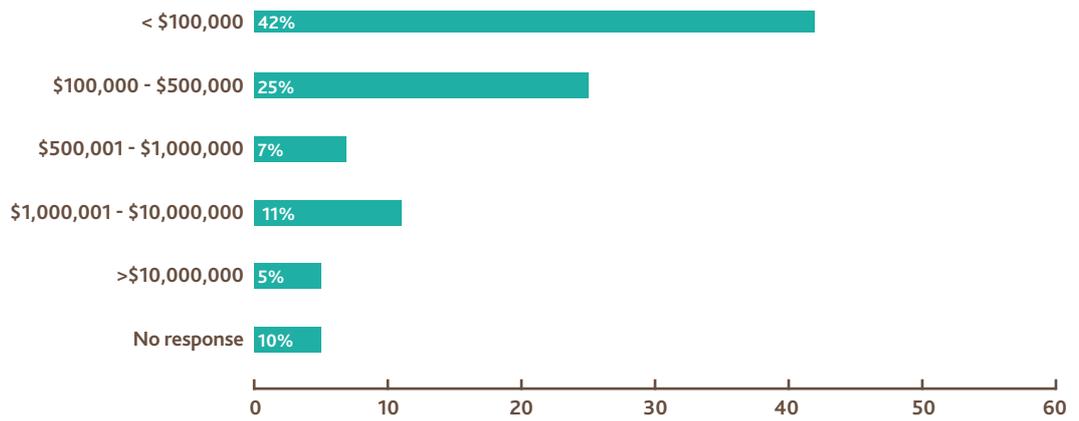
## Respondents by employees and volunteers

Half of respondent organisations had less than twenty paid employees. The majority had less than twenty volunteers.



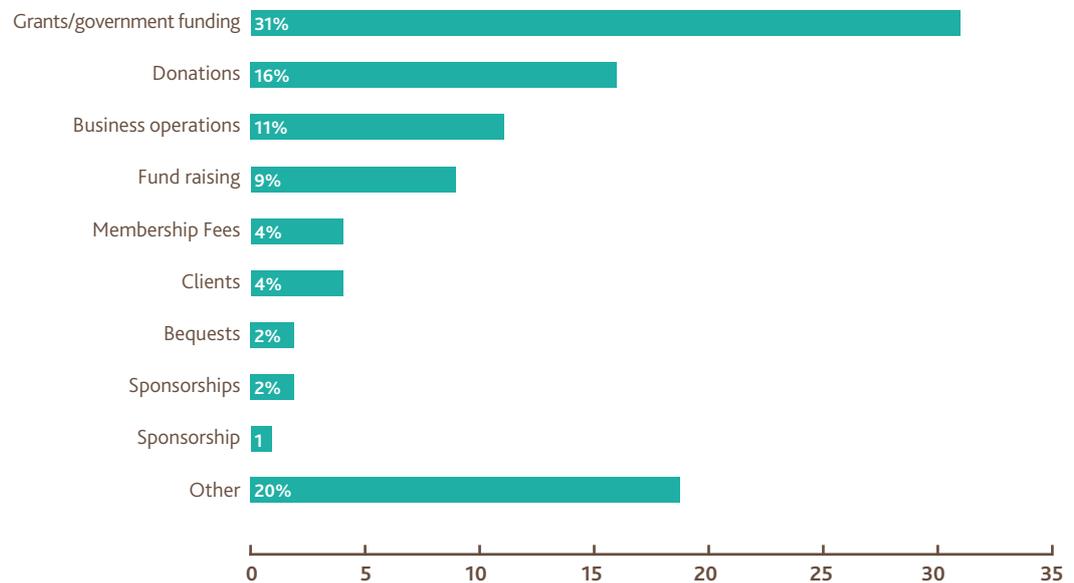


### Respondents by turnover



### Respondents by source of funding

Respondents received their funding from a wide range of sources.





Left to right, Billie Stanley, Louise Werder-Bridgeman, Matt Coulter

## Raising Awareness

To thank participants in this year's survey for their time, we entered all respondents into a draw for an iPad. The winner was Louise Werder-Bridgeman of Palmerston North, who is the Treasurer for Soroptimist International New Zealand Central.

As well as the iPad, however, Louise also gained a new-found awareness of the risks organisations like hers face. "I'd never thought about fraud in charities before doing the survey," said Louise. "But it's really opened my eyes to the significant risks, especially now with online transactions. It got me thinking about the urgent need to drag charities into the 21st century.

"I think for many small charities who operate with volunteers on a shoestring budget, the task of identifying risks and developing policies is just too overwhelming. But when you're dealing with money you've worked very hard to raise from the public it's critical to have a hard and fast manual outlining how that money is protected."

## Thanks

Final thanks to all those who responded.



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