Internal fraud at charities
Time for a summer clear out!

In the current economic climate, internal fraud is a rapidly growing concern for all organisations – and charities are not exempt. How confident are you in your charity’s ability to effectively mitigate the risk of and counter internal fraud?

In this document, the Forensic Investigations and Compliance team at Mazars give a whistle-stop tour of the theory of fraud, its potential impacts, and key countermeasures.

We have also produced a document with recommended anti-internal-fraud activities to complete – split into easy wins to complete in the next month, and longer term initiatives to complete within the next year.

The Fraud Triangle

The traditional ‘Fraud Triangle’ model of fraud is a useful tool for understanding why acts of fraud are committed. It suggests that there are three main factors that contribute to a fraud being committed:
Motivation to commit fraud

Today, the UK faces a severe cost of living crisis. In such an environment, individuals have higher motivation to commit fraud and may perceive difficult financial circumstances a ready-made justification for their actions.

Particularly for those who have already spotted an opportunity – for example, individuals with access to and control of the finance systems or cash deposits of charitable organisations – challenging individual circumstances can create the ‘right moment’ to seize an opportunity and, can render normally trustworthy people capable of doing bad things. However, the ‘right moment’ can come about in other ways; a long-serving and previously ethical employee can use their perception of their own record of good behaviour and work record as a mental crutch with which to justify small-time fraudulent behaviour – therefore considering themselves ‘deserving’ of the proceeds of the fraud.

During economic downturns, charities may not possess the financial flexibility to increase salaries in-line with inflation and, may rely more heavily on volunteers, or the goodwill of employees to continue working without a salary increase. Without clear communication from management and decision-makers, charity employees and volunteers can become disillusioned – especially where there is high inequality in salaries. As a result, disengaged employees or volunteers who have committed fraud are likely to believe that they were, to some degree, ‘owed’ what they have stolen.

Countering internal fraud

In challenging times such as these it is imperative that charities consider refreshing their procedures and taking steps to ensure that they have sufficient internal controls in place to prevent and, identify potentially fraudulent activity.

Step 1 – Code of conduct

The first step in preventing internal fraud is to develop a strong culture of integrity and honesty within the organisation. A durable culture of integrity requires full buy-in from everyone working at the charity – codes of conduct that do not extend to trustees and volunteers will be less effective than those that do. Organisations must raise awareness of the consequences of non-compliance – this should be communicated at all levels.

Step 2 – Robust internal controls

Next, charities must have strong internal controls and a clear understanding of their effectiveness. They cannot rely on trust and the goodwill of those involved, whether as employees or volunteers. Wherever possible, financial approvals should be reviewed separately by two members of staff, to reduce autonomy. If resources allow or if a charity is of the requisite size, an external audit can provide a comprehensive understanding of internal controls and their effectiveness. Auditors can identify ongoing control weaknesses and processes that do not comply with best practice or the organisation’s specific policies. However, it is important to remember that an audit focuses on an organisation’s

Case study

John Public – ex-employee who is still an authorised signatory

The situation

John Public was an employee of a horse sanctuary in the Southwest of England until July 2022, when he was forced to step away from the role to care for a family member. At the horse sanctuary, he had been partially responsible for fundraising and helped with payments as part of his general finance role.

In early January 2023, John received a text to his personal phone regarding a bank approval – the text indicated that he was still a designated signatory.

Recently, a trustee of the horse sanctuary highlighted an urgent, unforeseen need for additional medical supplies for the horses and asked whether this might fit the budget. On re-evaluating the budget against the sanctuary’s cashflow, a member of the finance team identified that several unusual small payments had been made in the past two months, and upon review, they were authorised by John Public.

Why did this happen?

- The charity did not consider John Public’s access to finances when he stepped away from his role, and did not have a process to effectively deal with off-boarding employees.
- The charity did not regularly check and update its list of designated signatories.
- The charity implicitly trusted John Public’s moral character.

How could this have been prevented?

- Having a robust off-boarding process in place, ensuring access to all company systems and finances is disabled as soon as an employee leaves.
- Complete regular checks of designated signatories, ensuring they’re up to date with new joiners and those who have left.

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processes and procedures and how these might leave gaps for a fraudster to operate – auditors do not directly search for all possible instances of fraud. More specialised projects can also benefit charities, including targeted internal audit engagements.

**Step 3 – Simple fraud detection mechanisms**

Whilst fraud prevention is critical, fraud identification is no less so. Charities should consider the benefits of implementing specialised technologies such as data analytics and artificial intelligence to identify patterns of suspicious behaviour – however, these means of detection may be cost-prohibitive, or unnecessarily complex for a charity with simple operations. Effective fraud detection can come about through simple review activities, such as spot checking bank statements, expenses, or invoice listings for validity, as well as a strong anti-fraud culture empowering individuals to step forward and voice any concerns.

Finally, charities should consider the benefits of engaging forensic investigators in situations where a fraud has been identified or a whistleblower has raised a possible concern.

Organisations in the private, public and third sector regularly instruct Mazars to investigate possible fraud events, leveraging technology and proven methodologies to understand the nature of a fraud, quantifying any losses, identifying areas of weakness that may have left the organisation vulnerable, and providing actionable recommendations to strengthen the organisation. Mazars also provides proactive preventative work, such as fraud health checks and fraud training sessions tailored to an organisation’s specific risks.

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**Case study**

Jane Public – finance team member, who collaborates with her brother to pay fake invoices

**The situation**

Jane Public is an administrative assistant for a charity that provides free meals to homeless individuals in the Northwest of England. The meals are prepared on-site in large batches and then transported to various locations throughout the region. One of Jane’s key responsibilities is to approve supplier invoices and make payments for these.

Recently, Jane was passed over for a more senior administrative role – which included a higher salary – in favour of an external candidate. Over the holiday period, she expressed her frustration to her brother, Josh. Josh could not believe that Jane was not selected for the role she seemed the perfect candidate for – he felt that she should at least deserve something more for the long hours she had put in over the past year.

Jane made a copy of an invoice from the charity’s supplier UK Food Co. and sent it to her brother, who was able to edit it and use it as a template.

Four months later, the finance lead discovered that the charity was £60,000 over budget on food supplies. A closer look indicated that these payments were made in response to UK Food Co. invoices received, however from a different email address to that normally used. They were also paid out to an unfamiliar bank account. The finance lead called UK Food Co., who confirmed that it had never issued the invoices in question.

**Why did this happen?**

- Jane was able to both approve and pay invoices in her position – a lack of segregation of duties.
- Private supplier information was shared beyond the organisation.

**How could this have been prevented?**

- More frequent/consistent checks of accounts payable.
- Clear splitting of duties between approval and payment for all invoices.
- Sensitive communication with Jane on the reasons that she was not promoted, explaining her value to the organisation.
- Robust IT usage policies, including clear consequences of non-compliance.
### The situation

Jackie was a trustee of an environmental charity for a number of years and was often required to travel across the country for various business development opportunities. The charity’s policies stated that employees are allowed reasonable expenses for their travel, food and drink when conducting relevant work.

In May 2023, the financial director noticed expenses worth £20,000 from 2022 that do not reconcile. Jackie has since moved to a similar role at a different charity abroad.

A closer look revealed that Jackie had been serially submitting expenses for personal trips alongside those for work purposes. These fraudulent expenses had been approved by the two financial controllers at the charity, even though many were not accompanied by any commentary regarding business rationale.

### Why did this happen?

- Approvals process is ineffective – the business purpose of expenses are not properly checked and Jackie has realised and exploited this.
- No regular reconciliation of individuals’ expense claims or limits on the totals checks of the expenses that have been put through.

### How could this have been prevented?

- Initial expense approval for employees from line managers instead, who have a better understanding of actual travel necessary for the activity, with finance review before payment.
- A manager in the finance team to complete a more frequent review of total expenses paid.