AASLH

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# HISTORY NEWS

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## The Many Voices of a Historic House

## The Museum as Center for Social Innovation

## Opportunities in the Aftermath of Disaster

# Embezzlement:

By Max A. van Balgooy

Ever walk out of a shopping mall and can't find your car? There's that odd feeling of panic as you're wondering if it was stolen mixed with anticipation that you'll find it around the next corner. That's how I felt when I learned in 2011 as a member of AASLH's Council that our finance director had embezzled nearly $750,000. For more than thirty-five years, AASLH has been an important part of my professional life, so I took the news hard. The Council meetings that followed were a confusion of anger, anticipation, dread, disappointment, frustration, and surrender until 2013 when the Nashville Criminal Court convicted Risa Woodward of theft, forgery, identify theft, and credit card fraud and ordered restitution of $712,975.87, one year of jail, and nine years of probation.

I had hoped her conviction would put this ordeal behind me, but it returns with every heart-wrenching story of embezzlement I encounter at a history museum, historical society, or historic site:

- Historic Dumfries *($11,000 stolen by president)*
- Centerville Recreation and Historical Association *($14,000 stolen by treasurer)*
- Southington Historical Society *($30,000 stolen by president)*
- Chapel Hill Historical Society *($50,000 stolen by treasurer)*
- Fitzwilliam Historical Society *($58,000 stolen by treasurer)*
- Nebraska State Historical Society *($70,000 stolen by chief financial officer)*
- Museum of Idaho *($82,000 stolen by manager of business affairs)*
- Chaffey Communities Cultural Center *($85,000 stolen by the treasurer)*
- Old Prison Museums *($136,000 stolen by director of operations)*
- Lewis County Historical Museum *(more than $137,000 stolen by executive director)*
- Alabama Museum Association *($41,000)* and Carnegie Visual Arts Center *($98,000) by the same person, who was respectively serving as the treasurer and executive director*
- Historic Concordia Cemetery *($154,000 stolen by the treasurer)*
- Preble County Historical Society *($289,000 stolen by the executive director)*
- Brooklyn Museum *($600,000 stolen by payroll manager)*
- American Association for State and Local History *(nearly $750,000 stolen by finance manager and her husband)*
- Fruitlands Museum *($1 million stolen by chief operating officer)*
- Mark Twain House *($1 million stolen by the controller)*
- Independence Seaport Museum *($1.5 million stolen by the president)*
- Texas Highway Patrol Museum *($9 million stolen by board and staff)*

**It's not a matter of *if* but *when* it will happen to you.**

There are probably many more, but I suspect they've kept their stories secret out of embarrassment (but search for "embezzlement" at the *Chronicle of Philanthropy* to see how widespread it is in the nonprofit world). Indeed, the Association for Certified Fraud Examiners (ACFE) in its *2016 Global Fraud Study* showed that fraud resulted in more than $6 billion in total losses at an average of nearly $3 million per case for businesses around the world. Also:

- The typical organization loses 5 percent of its revenues to fraud each year. (It's not a matter of *if* but *when* it will happen to you.)
- Frauds last an average of eighteen months before being detected, and losses rose the longer the schemes continued. (The faster you act, the smaller your losses.)
- While banking and financial services are the most commonly victimized industries, fraud is a greater threat to small businesses (which includes small nonprofit organizations) because they suffer the largest proportional losses.

It's the last point that affects the field of state and local history the most, and the Centerville Recreation and Historical Association in California provides a useful example of a typical situation. First, it's not the amount stolen that matters; it's the proportion of assets. In 2010, the treasurer stole $14,209 that had been collected over the years from membership dues, donations, and fundrais-

# Is it Our Dirty Little Secret?

ing events. This is a small amount compared to the other cases mentioned in this article; however, it left them with only $300 in the bank. The case also highlights that nonprofit organizations are incredibly vulnerable targets. The Centerville Recreation and Historical Association, like many nonprofit organizations, relies heavily on trusting its volunteers, and its treasurer was a retired local resident who had a thirty-year career as an IRS agent. The theft was discovered by accident. When the treasurer became too ill to continue, the financial records were turned over to another volunteer. She discovered that the former treasurer stole money by depositing cash and checks into unauthorized accounts at another bank, then withdrawing funds for personal use using a debit card. Last, because embezzlement is not considered a serious crime, seeking restitution takes determination. The treasurer ultimately pleaded no contest to grand theft and only had to return the stolen funds and be placed on probation for two years. He received no fine or jail time.[1]

It can be a depressing situation, but state and local history organizations can reduce losses and recover more quickly if boards and staff are better informed about the techniques used by criminals and adopt practices that provide obstacles and create transparency. Embezzlement (also called accounting fraud and asset misappropriation) is an intentional act to steal money while deceiving others, not an error that is unintentional. It can be a single, one-time act. It doesn't have to be part of a grand plan or conspiracy. Financial fraud can take many forms, but the most common are:

- **Tampering with bills, checks, and accounts.** A person causes the organization to issue a payment by submitting fake invoices, inflated invoices, or invoices for personal purchases; alters a check issued by the organization by changing the name of the recipient or amount; or opening unauthorized bank or credit card accounts. This is the most frequently used technique for stealing money inside the organization.
- **Expense reimbursements.** A staff or board member requests reimbursements for false or inflated business expenses, or opens unauthorized credit card accounts with a business. Fake invoices or receipts are common techniques, but increasingly criminals present a legitimate credit card statement from an office supply or hardware store, but the expenses are not closely scrutinized to identify personal or unauthorized purchases.
- **Skimming.** Any scheme where cash is stolen from an organization before it is recorded on the books or records, for example, taking money from a donation box.
- **Financial statement fraud.** A person presents fake or altered financial reports or bank statements. It's the least common technique; however, it causes the greatest losses.
- **Non-cash theft.** Occurs when an employee steals collections, inventory, or office supplies for personal use or sale or steals or misuses confidential donor, member, or customer financial information.
- **Personal relationships.** Embezzlers use personal relationships to build trust, intimidate critics, or create misdirection. Nonprofit organizations are incredibly vulnerable in these situations because we rely heavily on volunteers and colleagues to keep our museums and sites open to the public. The most egregious case is the Texas Highway Patrol Museum, which deceived a trusting public into believing it was a charitable organization affiliated with the Texas Highway Patrol. By the time the Attorney General closed the museum in 2012, it had spent $9 million collected from donations on travel, entertainment, and meals for staff and board members and on exorbitant vet bills for Lou, the office cat.[2]

## Common Embezzlement Patterns

Embezzlement often involves a senior staff member or executive board member, frequently the treasurer or chief financial officer, who has access to the organization's assets (money or collections). In its standards, the Public Company Accounting Oversight Board recognizes that, "Management has a unique ability to perpetrate fraud because it frequently is in a position to directly or indirectly manipulate accounting records and present fraudulent financial information."[3]

As they say in the novels, it is a crime of opportunity. The motive, however, is rarely because the thieves are hungry, need medicine, or face bankruptcy. The perpetrator at the Independence Seaport Museum, for example, earned a salary of $300,000 annually and the museum provided his house. Most embezzlers believe they deserve the money (feeling underpaid and unappreciated), it's "free" (comes from donations), or it won't be missed (because the museum has an endowment) and use their fingered cash to make car repairs and home improvements, buy clothes and electronics, and obtain season tickets or a second home.[4]

Fraud also often involves a person who's been on staff a long time and has developed a high level of trust, so no one asks questions. Unfortunately, the longer a perpetrator has worked for an organization, the greater the losses tend to be. The Tucson Museum of Art discovered that it had allowed itself to become overly "trusting of this employee" because she had worked at the museum for eighteen years and "was doing her job well."[5]

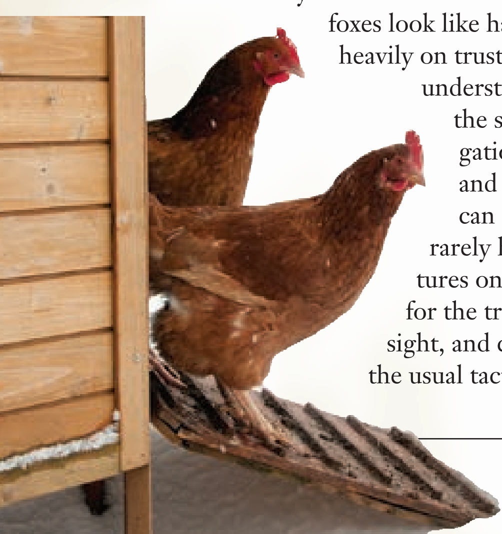
These schemes can be complex, and sorting them out can be difficult for you and the police. You may know something is missing, but it can be hard to find because it can involve fraudulent credit cards, hidden financial accounts, falsified reports, or clever money laundering. At the Mark Twain House, the embezzler "submitted false information via the Internet to the organization's payroll management vendor to receive additional pay that she was not entitled to. The money was deposited directly to her personal bank account as payroll advances. She then adjusted the general ledger to hide the advances by classifying the amounts as payments to other accounts, including maintenance and utilities."[6]

Fortunately, many times red flags signal fraudulent behavior. These include: living beyond his or her means; an unusually close association with vendors, volunteers, staff, or board members; an unwillingness to take vacations; persistently late financial reports; and excessive control issues, such as being openly hostile, uncooperative, or aloof when questioned about finances. When fraud is discovered, expect that the extent of losses is much greater than initially estimated, to spend years completing investigations before the perpetrator is brought to court, and to hire a forensic accountant or fraud examiner for complex situations.

Organizations may have financial controls and policies in place, but they're either not followed or inadequate to guard against embezzlement. At the Tucson Museum of Art, they believed they were "doing everything right with our internal systems, including having full financial audits conducted every year with an independent firm specializing in nonprofits." Despite these safeguards, nearly $1 million was siphoned off over five years.[7]

## Keeping an Eye on the Chickens in the Henhouse

At nonprofit organizations or small businesses, it's often a serious challenge to defend against embezzlement, and you can feel as vulnerable as a henhouse (and the foxes look like harmless chickens). We rely heavily on trust among a small staff and rarely understand finances. Even if we follow the standard tactics—such as segregation of duties, requiring receipts, and two signatures on checks—we can easily become victims. Banks rarely have the time to verify signatures on checks, online banking allows for the transfer of funds with little oversight, and corporate thieves are wise to the usual tactics. But we shouldn't give up hope; we just need to recognize that we have to update our thinking. Here are a few suggestions:



### Don't Assume an Independent Audit Will Catch Fraud

It's still a good idea to conduct an external audit, but catching fraud is not its primary intent. Audits provide an "opinion as to whether the financial statements are fairly stated and comply in all material respects with Generally Accepted Accounting Principles." *They are not designed to catch fraud.* Indeed, the ACFE estimates that external audits detected less than 5 percent of the frauds. Auditors are expected to "exercise professional skepticism," but it can be hard to recognize a financial crime. For example, an auditor will have difficulties catching someone selling office supplies on eBay for personal gain or submitting falsified invoices

## AASLH's Experience with Fraud

**By John R. Dichtl, President & CEO**

During the past five years, thanks to committed volunteers, staff, and members, AASLH emerged from a withering financial crisis and is stronger and wiser today. While the depths of the fraud that had been perpetrated were unfolding, however, things looked grim.

In late summer 2011 AASLH staff, including a new finance manager, discovered alarming financial irregularities between the cash balance in the organization's bank account and its general ledger. The treasurer and CEO immediately informed the AASLH Executive Committee, several days before that year's Annual Meeting, and then the full Council when it gathered at the meeting in Richmond, Virginia. During the Business Meeting of the conference, the chair of Council informed the membership. Priority attention was given to continuing communication that would be as transparent as possible to the Council, members, and friends and supporters of the organization and to ensuring uninterrupted delivery of service. The messages were clear: "We have had a problem. We are addressing it. We continue to do the work of AASLH. We will come through this and be even stronger than before."

Meanwhile, local law enforcement authorities had been notified, while the Council, treasurer, CEO, and staff took steps to secure the organization's financial situation. They had locked down credit cards, changed access to bank accounts, researched all open accounts, changed all passwords, and changed physical locks in the office. They also began the time-consuming process of supporting an intensive criminal investigation. AASLH soon hired forensic accountants to pinpoint the means and amount of the loss and legal counsel to pursue recompense. The criminal investigation of Risa Woodward, AASLH's former financial manager, and her husband James Woodward concluded in March 2012 when the Davidson County (TN) District Attorney's office charged them with nine counts of fraud against AASLH totaling nearly three-quarters of a million dollars.

AASLH's former financial manager had been employed at AASLH since 1991 and stepped down in August 2011,

**Risa and James Woodward pled guilty, received sentences, and are required to pay restitution to AASLH.**

shortly before the fraud was discovered by her replacement. In an elaborate scheme employing credit card fraud, identity theft, and falsification of documents and reports, someone the organization trusted had looted operating, restricted, and endowed funds systematically, in many transactions, over several years. This staff member also opened credit cards in the CEO's name using her social security number. The fraud was devastating and personal.

In March 2013, Woodward pled guilty to six felonies including theft, fraudulent use of credit cards, identity theft, and forgery. She received a ten-year sentence for her crimes, and served one year of incarceration at a correctional facility and nine years of probation under Community Corrections. Her husband also pled guilty to four felony counts of fraudulent use of credit cards. He received a ten-year suspended sentence with ten years of supervised probation. The couple was required to make restitution to AASLH; each pays a predefined dollar amount a month until the restitution is paid in full.

In response to the fraud, the AASLH leadership took several additional steps from 2011 to 2013. AASLH's new finance director worked with the CEO to sharpen the organization's financial management through additional controls and training. The treasurer and Finance Committee revised the organization's Financial Policies and Procedures manual to ensure secure internal control, developed check points to be sure it is followed, and vetted it with CPAs, auditors, and the office of the Inspector General of the National Endowment for the Humanities. In June 2014, AASLH Council officially adopted the new manual. The new procedures:

- Strengthened the controls in place for staff use of credit cards and the review of credit card statements
- Created additional internal controls governing the AASLH investment accounts
- Made sure multiple staff and key board members review financial reports on a monthly basis and report to Council regularly on financial matters
- Added experienced CFOs from large member organizations to serve on the Audit Committee and Investment Committee
- Simplified reporting documents presented to AASLH Council to allow for more thorough review

While toughening several accountability systems and sets of internal controls, AASLH also sought to reassure donors, and with the help of key members began to rebuild its endowment that the embezzlement had diminished. Through careful investing and deliberately generating operating budget surpluses over the past few years, the corpus of the endowment (total donor-restricted contributions over the years) has been fully restored to $1,512,334.

There can be no restitution for the immense harm to the AASLH's reputation; the emotional toll on the organization's staff, Council, and volunteers; nor the countless hours of work over the years to respond to the fraud and recoup losses, but it feels good and assuring to know that AASLH is in a strong position today.

Although there are aspects of the experience that staff and Council members are not at liberty to discuss, we are trying to share what we have learned. For example, at the 2013 and 2016 AASLH Annual Meetings, AASLH presented sessions on strengthening history organizations against financial malfeasance: "Financial and Mission Questions Boards Should Ask and Staff Should Answer," and "After the Financial Crime: Putting the Pieces Back Together." In addition, the AASLH Professional Standards and Ethics Committee is developing a Technical Leaflet on the subject, and AASLH is reviewing its Financial Policies and Procedures Manual for any necessary updates. We want to share the document as an example to others and realize that AASLH's experience holds important lessons for the field. ◉

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for travel expenses. What an audit should do is "review the financial reporting processes and internal accounting controls to assure that the company's systems are appropriately designed and operating effectively."[8]

In other words, auditors can identify weaknesses in financial management processes and suggest ways to improve. All board members and senior staff should carefully read the auditor's Management Letter to learn of any weaknesses or deficiencies (not to be confused with the Management Representation Letter or Independent Auditors' Report, which is typically a one-page cover letter) and review the notes to the financial statements. If they raise a red flag, ignore them at your peril. If embezzlement later occurs, you'll have a lot of explaining to do.

When choosing an accountant, find one who has sufficient experience with nonprofits to understand standard systems and processes, is trained to identify common weaknesses and deceptive practices, and can provide relevant and feasible recommendations based on your organization's capacity. Auditors should be independent and neutral so that their relationships with board members and staff do not compromise their willingness to critique management or disclose unprofessional practices (that's one of the major reasons to change auditors every three to five years). If your accountants are taking your executive director out to lunch or a round of golf, find another firm. You might want to provide a copy of this article to your accountant to be sure they're reviewing your procedures and policies along with your numbers.

### Most Frauds Are Detected by Tips

Nearly 40 percent of fraud is uncovered by a tip—far exceeding audits, management review, or discovery by the police. Kentucky's Auditor of Public Accounts was so concerned about the extent of fraud in nonprofit organizations that she issued guidelines that boards should "establish an independent process to receive, analyze, investigate, and resolve concerns related to the organization including anonymous concerns." Large companies typically have whistle-blower policies and hotlines to report fraud, but what about small organizations? Travis Wilson, a certified public accountant and a nonprofit auditor for more than a decade, started Fraud Hotline, LLC to fill the breach by providing small businesses and nonprofit organizations both an affordable voicemail system that transcribes messages and a twenty-four-hour secure online reporting system that forwards messages to three people designated by the organization (plus they'll review the message to be sure it isn't reported to the suspected person). Most tips come from employees, but a significant number come from customers, members, and vendors, so if you use a hotline, publicize its availability broadly. Although hotlines are primarily for reporting suspected fraud, they can also be used to anonymously report drug abuse, conflicts of interest, sexual harassment, and other inappropriate behavior.[9]

### Adopt New and Different Policies

Organizations that implement policies such as mandatory vacation, random internal audits, background checks, fraud training, and an independent audit committee double their chances of catching fraud (see facing page). Collusion, or instances when two or more people coordinate their fraudulent activities, surprisingly occurs about 40 percent of the time, but the harm is significantly greater because their combined efforts can override many anti-fraud controls, such as the two-signature requirement for payments, and the losses are typically more than twice as large. Therefore, you may need to institute policies that anyone with financial responsibilities cannot be related to other staff, volunteers, board members, or vendors unless additional precautions are in place (for example, their signatures cannot be combined on checks) and that gifts and discounts from vendors and businesses to staff and board members must be declared or be limited to a low dollar amount, such as $25.

You can implement procedures that give the perception of review. Small organizations, for example, could adopt a policy that all bills are handled in a two-step process, such as being mailed directly to the board president, who will then forward them to the treasurer, or that the bank sends two copies of your monthly statement: one to the board president and the second to the treasurer (you want originals, not copies made in-house, which can be easily forged).

### Computers and Credit Cards

Figure out the new world of credit cards, computerized bookkeeping, and online banking. Several embezzlement cases involved the use of credit and debit cards, but often they're the only way to conduct business so they can't be eliminated without difficulties. We need to go beyond the usual policy that "company credit cards cannot be used for personal expenses" and look at having unique cards for every user (rather than loaning the one card to anyone who needs it), establishing credit limits, subscribing to alerts, restricting cash advances, and reviewing monthly statements with their receipts. See if your computer bookkeeping program creates audit trails, leaving digital fingerprints that record changes to entries. (Quicken does not; QuickBooks does if turned on.) Use email alerts with online banking systems to notify you of transactions. Change passwords regularly and keep them private. The American Institute of Certified Public Accountants is developing standards for automated auditing, and in a few years we should expect online auditing services that review electronic accounting records to find errors or suspicious entries.

### Identity Theft Can Happen to People and Organizations

Identity theft is not just about someone using your existing credit cards without your authorization, but using your personal information to obtain new accounts. For example, an employee can open a business account without your knowledge at a hardware store to buy supplies for his own home or if he has access to your personal information, can get a credit card in your name (at the Fruitlands Museum, the fraud was conducted with fourteen credit cards using the names of three coworkers!). Obtaining a credit report annually can reveal if anyone has taken a credit card out in your name. Since embezzlement is an inside job and you will know the perpetrator, the nonprofit Identity Theft Resource Center offers a free fact sheet suggesting what to do if you know the imposter and when to involve the police.[10]

### Get a Better Handle on Your Finances

The two failings I see most often with nonprofit boards:

- Most directors and board members do little more than look at the bottom line. If it's a big positive number, it's assumed everything is okay.
- Elect an accountant as the organization's treasurer to excuse the rest of the board from examining the financial statements. If an accountant says it's okay, it must be okay. Review the list of victims again and note how frequently the treasurer is the culprit.

Sorry, but if you're a senior staff member or a trustee of a nonprofit organization, you're responsible for the finances. You shouldn't be distracted by a lovely financial report presented by a friendly face. You don't need to know the difference between debits and credits, but you should be willing and able to explain the organization's financial reports to your members and supporters. At the most basic level, compare the balance sheet to the bank and investment statements to be sure the figures match (use originals, not copies, which can be easily forged). We have to get away from flip statements like, "We made a lot of money on our last event" to more thoughtful ones like, "Compared to the last three years, this event earned signifi-

**Nearly 40 percent of fraud is uncovered** ***by a tip.***

cantly more revenue; however, why do we continue to run a deficit?" or "I'm concerned about the cost of vendors. Do we have a written policy on obtaining bids?" or "Why did maintenance increase so much?"

This requires two steps: first, understanding the typical financial report and second, recognizing when something is unusual. It's the same approach historians use when facing an old document or photograph for the first time: what would I expect to find and what is a surprise?

Accessible books like *Financial Intelligence, Revised Edition* by Karen Berman and Joe Knight or a college-level class in financial management are great places to start. Perhaps several local nonprofits could coordinate annual training on finances with a Certified Public Accountant for their boards and staff—this isn't an issue just for history organizations. To develop robust policies and procedures to guard against fraud, review *Executive Roadmap to Fraud Prevention and Internal Control* by Martin Biegelman and Joel Bartow or "Recommendations for Public and Nonprofit Boards" by Crit Luallen, the Auditor of Public Accounts for the Commonwealth of Kentucky. You may also need to rethink your financial management structure to better address audit and financial management responsibilities (those who check the accounting for accuracy shouldn't be the same people who do the accounting).

### What's the Difference? Audit Committee vs. Finance Committee

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| **Audit Committee** | ***The audit committee*** is authorized to consider matters related to (a) the financial statements of the organization and other official financial information provided to the public;<br>(b) the systems of internal controls, including overseeing compliance by management with applicable policies and procedures and risk management (e.g., for organizations that are part of a national network, annually reviewing whether the organization meets the re-chartering requirements of its national organization);<br>and (c) the annual independent audit process, including the recommended engagement of and receiving of all reports from the independent certified public accountants. The audit committee shall have such other authority and perform such other duties as may be delegated to it by the board. |
| **Shared Responsibilities** | ***The finance committee*** ensures that budgets and financial statements are prepared; ***the audit committee*** has oversight for ensuring that reports are received, monitored, and disseminated appropriately.<br>***The finance committee*** monitors financial transactions; ***the audit committee*** makes sure things are done according to policy and with adequate controls.<br>***The finance committee*** provides guidance about what can be done; ***the audit committee*** ensures that independent oversight occurs. |
| **Finance Committee** | ***The finance committee*** shall oversee the preparation of the annual budget and financial statements.<br>***The finance committee*** shall oversee the administration, collection, and disbursement of the financial resources of the organization.<br>***The finance committee*** shall advise the board with respect to making significant financial decisions. |

Courtesy of the Nonprofit Risk Management Center

## Talk About It

Embezzlement is embarrassing, but it is occurring far too frequently and threatens the future of our state and local history organizations. The feeling of betrayal can leave board members, staff, and supporters angry at the criminal and each other for years. Betrayal can also provoke feelings of denial and dismissal. When two board members at the Lewis County Historical Museum attempted to figure out how their $460,000 endowment disappeared, the *Chronicle* reported, "They were rebuffed by some on the executive board and at one point were told to 'get over it.'"[11]

Encountering financial fraud puts everyone in a tough position, but I don't recommend quietly addressing the crime without involving the police, swallowing the loss and urging others to "move on," or declaring the embezzlement too small to worry about. When we take that approach, we allow the criminal to pursue other victims, which could include our colleagues and friends. Let's learn from each other so we can outsmart, outthink, and outlast the criminals, especially if they are working among us. We've got to stop this dirty little secret. ◉

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