*Article*

# Fraud and Corruption in U.S. Nonprofit Entities: A Summary of Press Reports 2008-2011

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**Deborah S. Archambeault[1], Sarah Webber[1], and Janet Greenlee[1]**

**Abstract**

The charitable sector is vulnerable to fraud losses, with these losses negatively impacting the organization's reputation, future funding, and ability to advance its mission. Research on nonprofit fraud is relatively scarce, due mainly to limited availability of data. We create a database that summarizes and describes basic facts (nature and timing of fraud, description of organization, magnitude of loss, and perpetrators) for 115 incidents of detected fraud occurring in U.S. nonprofit organizations. We find a disproportionately high incidence of nonprofit fraud in the Health and Human Services National Taxonomy of Exempt Entities Groups, a high percentage of females committing misappropriation frauds, and that the organizational role of the perpetrator is related to the size of the fraud loss. We also investigate whether organizations detecting a nonprofit fraud report this information, as required, on Internal Revenue Service Form 990, and find that many organizations do not comply.

**Keywords**

nonprofit fraud, nonprofit, fraud, IRS 990, asset diversion

## Introduction

Fraud continues to exact a high cost on businesses and nonprofit organizations. The Association of Certified Fraud Examiners (ACFE) estimates in its most recent fraud study, covering for-profit and nonprofit organizations, that the typical organization

[1]University of Dayton, OH, USA

**Corresponding Author:**
Sarah Webber, Assistant Professor of Accounting, University of Dayton, 300 College Park, Dayton, OH 45469-2242, USA.
Email: swebber1@udayton.edu

loses 5% of its revenues to fraud each year (ACFE, 2014), with asset misappropriations (e.g., theft, misuse, and fraudulent disbursements) being the most frequent type of fraud, while financial statement frauds (FSF; for example, improper valuation, improper disclosure) are the most costly to the organization (ACFE, 2014). That estimate does not incorporate investigative costs, reputational loss, and other indirect costs, nor does it incorporate the impact of undetected or unreported frauds that are an inherent challenge of any fraud study.

The nonprofit sector is particularly sensitive to the negative effects of fraud. In terms of fraud exposure, many nonprofits lack sophisticated internal controls, such as those required of publicly traded companies by the Sarbanes-Oxley Act of 2002 (SOX; Spillan & Ziemnowicz, 2011), that can be helpful in preventing and detecting fraud. Since nonprofits are often small organizations with very limited resources, even a minimal dollar loss can have a significant effect on the organization and its ability to carry out its mission. In addition, the negative reputational effects of a scandal involving a nonprofit organization can negatively impact future contributions (Petrovits, Shakespeare, & Shih, 2011; Prakash & Gugerty, 2010). A better understanding of fraud in the nonprofit sector is necessary to develop strategies to curb fraud. While the ACFE data provide a helpful point of reference on fraud, generalizability to nonprofits is limited because the data presented are survey-based aggregations of information from the nonprofit and for-profit sectors, with only about 11% of the fraud cases included in the study involving nonprofits (ACFE, 2014). A better understanding of frauds in the nonprofit sector is needed, leading to our first research question:

**Research Question 1:** What do frauds in the nonprofit sector look like (i.e., nature and timing of the fraud, description of the organization, magnitude of the loss, perpetrators)?

We address this question through the development and analysis of a nonprofit fraud database.

Potential donors are increasingly proactive in researching nonprofit organizations before making donations, and the growing use of charity rating services (e.g., charitywatch.org, BBB.org, charitynavigator.org) has increased the visibility of "bad" nonprofits. Although each rating service uses different metrics, Charity Watch explicitly considers disclosures of material diversion of assets in its rankings. Recent changes to Internal Revenue Service (IRS) Form 990 demonstrate a heightened interest in information about nonprofit governance and the incidence of material asset diversions occurring in nonprofit organizations. However, this information is helpful to users only if it is reported faithfully. Research suggests that in some contexts, nonprofits misreport information on their Form 990s (Jones & Roberts, 2006; Krishnan, Yetman, & Yetman, 2006), raising a question about the reliability of the required asset diversion reporting. This leads to our second research question:

**Research Question 2:** Do nonprofit organizations experiencing material asset diversions comply with the IRS Form 990 reporting requirements?

We address this question through the inspection of IRS 990s filed by the organizations in our nonprofit fraud database.

While fraud in nonprofit organizations is not a new phenomenon, the research on this issue remains largely anecdotal, with the scarcity of comprehensive data being a significant deterrent to the study of this important issue. Because an inherent challenge of studying and quantifying fraud is the fact that undetected and unreported frauds are not reflected in the available data, it is particularly important to make use of the limited information that is available. This study makes several important contributions to a better understanding of nonprofit fraud. First, we develop a database of recent nonprofit frauds by summarizing cases of U.S. nonprofit fraud and corruption reported via press reports from 2008 to 2011. Using press reports as the means of identifying fraud cases has a significant benefit over using surveys, as press reports are more likely to be representative of the broader population of detected frauds.[1] From this database of 115 detected frauds, we present key descriptive information about the frauds (e.g., nature and timing, description of the organization, magnitude of the loss, perpetrators), and test related hypotheses. We supplement the available information in the news stories with information from Form 990 filings to provide a more comprehensive description of the organizations involved. Finally, this study is the first to provide evidence about organizational compliance with the Form 990 reporting requirement regarding asset diversions.

## Fraud, Fraud Literature, and Hypothesis Development

### *Fraud*

While fraud against an organization can be perpetrated by individuals within or outside the organization, the ACFE's (2014) *Report to the Nations* studies internal fraud, which they refer to as occupational fraud. The report defines occupational fraud as "the use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets" (ACFE, 2014, p. 6). The report further classifies occupational fraud into three components: asset misappropriation (e.g., theft of cash, fraudulent disbursements, misuse of assets), corruption (e.g., bribery, conflicts of interest), and FSF (e.g., misstatement of assets, misstatement of revenues, improper valuations, improper disclosures). While each type of fraud is possible in any organization, nonprofits are particularly susceptible to asset misappropriation, as these organizations often lack basic controls that would help to prevent or detect this type of activity.[2]

A widely accepted model for explaining why fraud occurs is the fraud triangle, based on Cressey's (1953) model of factors that cause a person to violate trust. The three elements of the fraud triangle, as described by the ACFE (n.d.), are pressure (financial need that motivates the behavior), opportunity (access to a method of committing the fraud), and rationalization (justification of the behavior). While organizations cannot generally control the pressure and rationalization factors, they can minimize the opportunity factor by ensuring adequate controls and oversight within

the organization. Because fraud generally involves attempts to conceal the act, it is often difficult to detect. As a result, many frauds go undetected, and even in detected frauds, the actual amount of loss may not be known (ACFE, 2014, p. 8). Despite these inherent limitations, there have been attempts to describe and quantify the fraud problem.

## Fraud Data

Empirical research on fraud in the for-profit sector is well developed, aided by the availability of centrally compiled U.S. Securities and Exchange Commission (SEC) Accounting and Auditing Enforcement Release (AAER) data on one type of fraud—fraudulent financial reporting (FFR; e.g., Lennox & Pittman, 2010 and Perols, 2011 represent two recent examples, although this data source has been used consistently since the 1990s). In comparison, research on nonprofit fraud has been limited by a lack of readily available, centrally compiled data, leading researchers to rely on survey data, or to undertake exploratory studies that identify fraud cases during a specified period.

In 1996, the ACFE issued its first report on occupational fraud and abuse in the United States. The information for this report was obtained from survey responses submitted by Certified Fraud Examiners (CFEs) who had investigated fraud cases.[3] Starting in 2002, the ACFE began issuing a biennial version of this survey-based report, with the most recent version (ACFE, 2014) reporting U.S. and global frauds. While the majority of the fraud cases incorporated in the study's statistics occurred in for-profit organizations, 11% of the cases involve nonprofits (ACFE, 2014). As the ACFE data come directly from the CFEs who investigated the cases, inclusion of a nonprofit organization in the database suggests that the organization involved was large enough, and had sufficient resources, to hire a CFE, and hence the ACFE data on nonprofits may be biased toward larger or more affluent nonprofits.

Two studies have used a portion of the ACFE's data specific to nonprofits as the basis for investigating characteristics of the nonprofit organizations involved.[4] Greenlee, Fischer, Gordon, and Keating (2007) use 2004 ACFE survey data to describe 58 victim organizations, the perpetrators, and the types of frauds committed, and present bivariate analysis of key fraud variables. Holtfreter (2008) provides basic descriptive statistics and regression analysis to study 128 frauds, the offenders, the victim organizations, and the type of offense, using ACFE survey data from 1997 to 1998 and 2001 to 2002.

A few studies gather their own sample of fraud incidents from news reports, and provide basic case information, but little in the way of summary or descriptive statistics. Gibelman and Gelman's (2001) exploratory study documents fraud reported in 10 U.S. and 13 international health and human services NGOs from 1998 to 2000. In a similar study focused on faith-based groups, Gibelman and Gelman (2002) identify 23 cases of financial misconduct appearing in print media from 1995 to 2001. Fremont-Smith and Kosaras (2003) use newspaper reports published between 1995 and 2002 to document cases of civil and criminal wrongdoing by fiduciaries (officers or directors)

of 152 nonprofit charitable organizations. In a follow-up study, Fremont-Smith (2004) documents cases involving criminal wrongdoing by employees of 32 charitable organizations reported in newspapers in 2003.

## Nonprofit Fraud Literature

Despite the data limitations discussed above, past research provides helpful insights into the nature of nonprofit frauds (type of wrongdoing, timing, duration, and size of loss), the victim organizations (size and age), and the perpetrators (gender, age, position within the organization). This information guides our identification of variables to be examined in the current exploratory study. We also draw on this literature to develop testable hypotheses.

*Sectors affected.* Fremont-Smith and Kosaras (2003) note a high preponderance of human service agencies in their sample. However, it is not evident whether this is in proportion to the relative number of those organizations existing in the nonprofit sector, or whether these types of organizations experience a disproportionate occurrence, detection, or public reporting of fraud. Differences in any one of these factors could contribute to disproportionate findings. For example, it is possible that the nature of the work done or the strength of prevention controls in some sectors make a fraud more or less likely to occur, while differences in the incidence of detection would be driven by differences in the strength of detection controls. We seek to determine whether the distribution of fraud across nonprofit organization types (National Taxonomy of Exempt Entities [NTEE] Major Groups) is proportionate to the distribution of those groups within the nonprofit sector, and present the following hypothesis in null form:

> **Hypothesis 1:** The distribution of frauds across NTEE major groups is proportionate to the distribution of organizations across NTEE major groups.

*Perpetrator gender and organizational role.* Women comprise about 47% of the U.S. labor force (U.S. Department of Labor, 2010), and a significant majority of the nonprofit workforce, with recent estimates placing this statistic at or above 70% (Faulk, Edwards, Lewis, & McGinnis, 2012; White House Project, 2009). The ACFE's (2014) most recent report found that only 33% of the frauds in their sample (nonprofit and for-profit combined) were perpetrated by women. While these findings might suggest that women are less prone to fraud than men, these observed differences may be related to factors other than innate differences in the ethicality of the sexes.

An employee's position within an organization affects his or her opportunities to perpetrate a fraud. Holtfreter (2005) notes that those in managerial or executive positions in for-profit organizations might have access to greater opportunities, and might be more "trusted," whereas lower level employees' access to fraud opportunities are more likely to be restricted (p. 356). Holtfreter also finds that asset misappropriation frauds (typically committed by lower ranking employees) are more likely to

be perpetrated by women, whereas FFR (typically committed at higher levels in the organization) is more likely to be perpetrated by men. This "glass ceiling" phenomenon is consistent with the ACFE (2014) finding that women commit a larger portion of asset misappropriation frauds, while men commit a larger portion of FFR and corruption frauds. Steffensmeier, Schwartz, and Roche (2013) find in their study of high level white-collar crime in the for-profit sector that women are less likely than men to be involved in fraud conspiracy groups, and when they are involved, they tend to play minor roles. We offer the following hypotheses that consider the role of these varied factors in the nonprofit sector:

**Hypothesis 2a:** In the nonprofit sector, the gender of the perpetrator is related to the incidence of fraud.
**Hypothesis 2b:** In the nonprofit sector, the gender of the perpetrator is related to the type of fraud committed, with women more likely to commit lower level (misappropriation) fraud, and less likely to commit higher level (conspiracy and FSF) fraud.
**Hypothesis 3:** In the nonprofit sector, lower level (nonexecutive) employees are more likely to commit misappropriation fraud.

*Size of fraud loss.* Holtfreter's (2008) study provides a review of the impact of perpetrator characteristics on fraud in the for-profit and nonprofit settings. While prior literature indicates larger losses perpetrated by males, Holtfreter's results indicate smaller losses by males and suggest that the interaction of organization characteristics, such as the presence of internal controls, may affect this relationship. She also notes that prior studies suggest that workplace position increases fraud losses, with level of education, access to finances, and organizational reliance on the individual cited as three plausible explanations. Her findings on organizational role, however, did not find this to be a significant factor explaining fraud losses in nonprofit organizations. We seek to gain a better understanding of the factors affecting the size of the losses reported in our sample by examining gender and organizational position.

**Hypothesis 4a:** In the nonprofit sector, perpetrator gender has an impact on the size of the fraud loss.
**Hypothesis 4b:** In the nonprofit sector, perpetrator position within the organization has an impact on the size of the fraud loss.

## Revised IRS Form 990 Reporting Requirements

Beginning in 2008, as the result of a major revision to IRS Form 990, filers are required to answer a series of "Governance, Management, and Disclosure" questions in Part VI of the return. The IRS instituted this revision as a means of requiring nonprofits to provide more information about their governance policies, with many of the items in these required disclosures motivated by the 1933 and 1934 SEC Acts and the SOX (Yetman & Yetman, 2012). The Part VI reporting requirements apply only to filers of

the long Form 990, while Forms 990PF and 990EZ do not contain these questions. Of particular interest in the current study is Question 5, which asks whether the organization became "aware during the year of a material diversion of the organization's assets" and requires disclosure of any such incident on Schedule O (IRS, 2008b). The IRS emphasized the importance of the use of Schedule O to provide nonprofits an opportunity to supplement and explain any "material diversion of assets" in a narrative form including the nature of the diversion, amounts or property involved, corrective actions taken to address the matter, and pertinent circumstances (IRS, 2008a).

The 2008 Form 990 instructions define a diversion of assets as "any unauthorized conversion or use of the organization's assets other than for the organization's authorized purposes, including but not limited to embezzlement or theft" (IRS, 2008b). A diversion is considered material if the gross dollar amount exceeds the lesser of US$250,000 or 5% of the organization's gross receipts or 5% of the organization's total assets (IRS, 2008b).

A few aspects of the IRS guidance on this disclosure are unclear. The instructions designate that the materiality test should use "gross receipts" in the calculation, even though that line item does not appear on the return. The instructions specify that the materiality calculation should be done for "the tax year," but do not specify whether to use information from the year of the diversion or the year of its discovery. Updated instructions in 2010 failed to address these issues, but did replace the term *material* with the term *significant*. In summary, even for the best intentioned filer, the lack of clear guidance makes the rate of compliance with these provisions questionable, and as a result, we expect to see less than full compliance with this requirement. In addition, a *Washington Post* analysis of Form 990 filings from 2008 to 2012 finds that while more than 1,000 nonprofit organizations reported a significant diversion of assets in Part VI of their return, these organizations routinely omitted important details from the Schedule O disclosure (Stephens & Flaherty, 2013), further suggesting that there will be a significant degree of noncompliance in our data. Because we have no basis for predicting rates of compliance, we do not offer a formal hypothesis.

To determine compliance with this disclosure requirement, we reviewed Form 990 filings subsequent to the discovery of a fraud. A significant body of literature examines whether nonprofit organizations report information accurately on the Form 990, with the focus primarily on the reporting of expense information (Jones & Roberts, 2006; Krishnan et al., 2006). Yetman and Yetman (2012) use governance information available in the Form 990 to examine the determinants of charitable expense reporting accuracy. To build upon the literature on the accuracy of 990 reporting, we examine a new aspect of compliance. Ours is the first study to investigate the accuracy of compliance with the material diversion of assets disclosure requirement for a sample of organizations with detected frauds.

## Data Collection and Sample Development

We performed a search of the LexisNexis All News Database during the period January 1, 2008 through December 31, 2011, to identify news stories published about fraud or

corruption in nonprofit entities.[5] As of October 2012, this database included 5,900 international and U.S. news outlets written in the English language. We immediately eliminated duplicate occurrences of the same news story. News stories reporting frauds by the same perpetrator at multiple organizations were split and counted as separate stories. Our initial search yielded 427 distinct news stories about nonprofit frauds. We eliminated cases involving non-U.S. organizations, as they do not file the Form 990. We also eliminated stories that did not contain sufficient details about the organization, the perpetrator, or the time period of the incident. When we found subsequent stories about a case that had already been identified in our sample, we added the additional information provided in the subsequent story. Finally, we eliminated stories that otherwise did not meet our criteria (e.g., stories that contained individual actors unrelated to a nonprofit).

As shown in Table 1, our initial sample consisted of 219 unique stories of fraud involving nonprofit organizations. We refined this sample by eliminating 1 case where the alleged perpetrator was subsequently acquitted. As our focus in this study is on describing the nonprofit organizations in which a fraud was perpetrated, we eliminated 29 cases where the nonprofit organization was victimized by an outsider, but was not actually involved in perpetrating the fraud (e.g., an investment advisor swindled the organization). Two cases of an organization-level fraud with no individual perpetrators cited in the story were also eliminated, leaving an initial sample of 187 nonprofit organizations.[6] Four cases where the fraud could not be quantified in dollars (e.g., theft of information rather than assets; dollar amount of fraud not disclosed) were eliminated. Finally, because of the importance of Form 990 as a source of descriptive information about the organizations, we eliminated cases for which we could not locate necessary Form 990 filings during the sample period. These procedures yielded a final sample of 115 frauds involving nonprofit organizations.

The news stories identified in our search were the primary sources of information about each incident. We supplemented this information by performing Internet searches using key information from the news story to obtain more detailed and updated information. Form 990 filings, which provide information about the nonprofit entities and the perpetrators, were obtained from Foundation Center's 990 Finder or from the Guidestar database. Data were coded by two researchers independently, with any resulting differences in coding reconciled.

## Analysis and Key Findings

### *Nature, Timing, and Duration*

Each case was analyzed to determine the type of wrongdoing that occurred. First, each incident was classified into one of two general groups. Group 1 includes incidents where the nonprofit organization victimized the public, while Group 2 includes incidents where an individual within a nonprofit organization victimized the organization. Within these groups, each case was further classified into specific categories, as shown in Table 2. Many cases involve more than one type of wrongdoing, so we assigned up

**Table 1.** Sample Development.

| | |
|---|---|
| News stories generated from initial search | 427 |
| Less: | |
| Stories involving a non-U.S. organization | (49) |
| Stories with insufficient information (e.g., name of entity, name of perpetrator, years) | (36) |
| Subsequent stories about a case previously identified | (73) |
| Stories about individual actions not affiliated with a nonprofit organization (e.g., individuals posing as a nonprofit) | (26) |
| Stories that otherwise did not meet the sample criteria | (24) |
| | *219* |
| Less: | |
| Cases where the perpetrator was acquitted or charges dismissed | (1) |
| Organizations victimized by an outsider | (29) |
| Organization-level fraud with no individuals cited | (2) |
| Number of organizations in initial sample | *187* |
| Less: | |
| Organizations with no IRS Form 990 filings found | (41) |
| Organizations with no IRS Form 990 for first fraud year | (27) |
| Fraud not quantified in dollars (e.g., not disclosed; identity theft) | (4) |
| Number of organizations included in final analysis | *115* |

*Note.* IRS = Internal Revenue Service.

to two codes to describe the primary type(s) of wrongdoing that occurred. In general, Group 2 activities are mainly "wide access" activities, such as misappropriation, that could be conducted at any level within the organization. Group 1 activities, in contrast, include primarily "limited access" activities (e.g., improperly claiming government funds, filing false documents) that would not typically be accessible by rank and file employees.[7] For the remainder of this study, we use Group 1 as a rough proxy for frauds that are analogous to the ACFE's corruption and financial statement fraud categories, and Group 2 as a rough proxy for frauds that are analogous to the ACFE's asset misappropriation category.

Table 2, Panel A, presents a description of the types of wrongdoing found in our sample. While news stories that focus on incidents of nonprofit organizations victimizing the public (Group 1) often attract significant media attention, we find that these incidents constitute less than a quarter of the published frauds in our sample. In instances where the organization victimized the public, the most common types of wrongdoing are defrauding contributors (e.g., using funds for other than the intended purpose) and improperly claiming loans, grants, or government funds. The second category of wrongdoing (Group 2), where an insider victimized a nonprofit organization, constitutes more than 75% of our sample, with check and credit card schemes being the most common theft from the organization.

**Table 2.** Nature, Timing, and Duration ($n$ = 115).

Panel A: Nature of Wrongdoing as Described in News Releases.

| Description | Number of incidents | Percentage of sample |
|---|---|---|
| Group 1: Nonprofit victimizes the public | 27 | 23.5 |
| Defrauding contributors (e.g., using funds for other than intended purpose) | 20 | |
| Corruption (e.g., money laundering, bid rigging) | 3 | |
| Filing false documents (e.g., government reports, tax returns) | 4 | |
| Improper billing for services | 3 | |
| Improperly claimed loans, grants or government funds | 9 | |
| Theft of assets from residents/clients of the nonprofit | 4 | |
| Group 2: Insiders victimize the nonprofit | 88 | 76.5 |
| Theft of cash or deposits | 12 | |
| Check or credit card schemes | 59 | |
| Theft of assets through other means | 40 | |
| | | 100 |

*Note.* As many cases contained more than one type of wrongdoing, totals in the number of incidents column exceed the total within each grouping.

Panel B: Year of Earliest Newspaper Report Published During Sample Period.

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize the nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|
| Year | Number of reports | Percentage of cases | Number of reports | Percentage of cases | Number of reports | Percentage of cases |
| 2008 | 3 | 11.1 | 15 | 17.1 | 18 | 15.7 |
| 2009 | 5 | 18.5 | 23 | 26.1 | 28 | 24.4 |
| 2010 | 9 | 33.3 | 28 | 31.8 | 37 | 32.1 |
| 2011 | 10 | 37.1 | 22 | 25.0 | 32 | 27.8 |
| Total | 27 | 100 | 88 | 100 | 115 | 100 |

Panel C: Year Incident Began.

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|
| Year | Number of incidents | Percentage of cases | Number of incidents | Percentage of cases | Number of incidents | Percentage of cases |
| Prior to 2004 | 15 | 55.6 | 16 | 18.2 | 31 | 27.0 |
| 2004-2005 | 7 | 25.9 | 30 | 34.1 | 37 | 32.2 |
| 2006-2007 | 4 | 14.8 | 24 | 27.2 | 28 | 24.3 |
| 2008-2009 | 1 | 3.7 | 16 | 18.2 | 17 | 14.8 |
| 2010-2011 | 0 | 0 | 2 | 2.3 | 2 | 1.7 |
| Total | 27 | 100 | 88 | 100 | 115 | 100 |

*(continued)*

**Table 2. (continued)**

Panel D: Duration of Activity.

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|
| Duration | Number of incidents | Percentage of cases | Number of incidents | Percentage of cases | Number of incidents | Percentage of cases |
| 1 year or less | 1 | 3.7 | 23 | 26.1 | 24 | 20.9 |
| >1 to 3 years | 11 | 40.8 | 31 | 35.3 | 42 | 36.5 |
| >3 to 5 years | 9 | 33.3 | 23 | 26.1 | 32 | 27.8 |
| >5 years | 6 | 22.2 | 11 | 12.5 | 17 | 14.8 |
| Total | 27 | 100 | 88 | 100 | 115 | 100 |
| Median | 4.0 years | | 2.5 years | | 3.0 years | |
| Average | 3.97 years | | 2.75 years | | 3.04 years | |

Table 2, Panel B, shows that the distribution of newspaper reports across the four sample years is fairly uniform. As shown in Panel C, the 2004-2005 time frame is the most common (32% of cases) for fraud origination in our sample. Not surprisingly, only 2% of the reported sample frauds start in the most recent (2010-2011) time frame, as it is likely that many frauds beginning during that time frame had not yet been discovered or reported.

It is difficult to determine precisely the duration of the fraud activity, as the details in many news stories often report only the year, but not the exact date, when the fraud activity began or ended. In cases where specific information about the duration was not given, we approximated the duration using the information available.[8] Table 2, Panel D, reports the estimated fraud duration, with the median duration in our sample being 3 years. In comparison, the ACFE reports a median duration of 24 months for all frauds (for-profit and nonprofit organizations combined) included in their sample (ACFE, 2008[9]). Frauds involving an insider victimizing the nonprofit organization (Group 2) last a median of 2.5 years, in contrast to the 4-year median duration of frauds in which the nonprofit organization victimizes the public (Group 1).

## *Organizations Involved*

To better understand the types of nonprofit organizations involved, we describe our sample in terms of 501(c) status and NTEE Major Group categories. As reported in Table 3, Panel A, all but four of the organizations are 501(c)(3) organizations, allowing them to be further classified into 1 of 10 NTEE Major Groups. Human Services organizations (NTEE Major Group V) are the largest group, representing 39% of our sample. To determine whether the NTEE Major Groups are represented in our sample in proportion to the relative size of each Major Group within the nonprofit sector, we perform a chi-square goodness of fit test.[10] We find, contrary to Hypothesis 1, that our

**Table 3.** Description of Organizations Involved.

Panel A: Nature of Organization ($n$ = 115).

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | | NTEE Actual distribution of 501(c)(3) Organizations[a] |
|---|---|---|---|---|---|---|---|
| | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | Percentage of population |
| 501(c)(3) Organizations: (by NTEE major group) | | | | | | | |
| I. Arts, culture, and humanities | 2 | 7.4 | 5 | 6.0 | 7 | 6.3 | 7.67 |
| II. Education | 3 | 11.1 | 10 | 11.9 | 13 | 11.7 | 13.40 |
| III. Environment and animals | 0 | 0 | 2 | 2.4 | 2 | 1.8 | 3.41[b] |
| IV. Health | 3 | 11.1 | 18 | 21.4 | 21 | 18.9 | 6.27 |
| V. Human services | 10 | 37.1 | 33 | 39.3 | 43 | 38.8 | 24.83 |
| VI. International, foreign affairs | 0 | 0 | 3 | 3.5 | 3 | 2.7 | 1.17[b] |
| VII. Public, societal benefit | 6 | 22.2 | 10 | 11.9 | 16 | 14.4 | 23.50 |
| VIII. Religion related | 3 | 11.1 | 2 | 2.4 | 5 | 4.5 | 13.77 |
| IX. Mutual/membership benefit | 0 | 0 | 1 | 1.2 | 1 | 0.9 | 5.63 |
| X. Unknown, unclassified | 0 | 0 | 0 | 0 | 0 | 0.0 | 0.35[b] |
| Total 501(c)(3) organizations | 27 | 100 | 84 | 100 | 111 | 100 | 100 |
| Non-501(c)(3) organizations[c] | 0 | | 4 | | 4 | | |
| Total fraud sample | 27 | | 88 | | 115 | | |

*Note.* Hypothesis 1: $\chi^2(df)$: 52.747 (7)***. NTEE = National Taxonomy Of Exempt Entities.

[a]Twelve-year average (2000-2011) from National Center for Charitable Statistics.

[b]For chi-square goodness of fit testing, the three smallest groups were aggregated to avoid expected cell counts less than 5.

[c]Includes one 501(c)(4), one 501(c)(5), one 501(c)(6), and one 501(c)(8) organization.

***$p < .001$, two-tailed.

**Table 3. (continued)**

Panel B: Size of Organization.

| | Group 1: Nonprofit victimizes the public | | | | Group 2: Insiders victimize nonprofit | | | | Aggregated: Group 1 and Group 2 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total assets | | Total revenues | | Total assets | | Total revenues | | Total assets | | Total revenues | |
| Size measure reported on Form 990 | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases |
| Negative or 0 | 1 | 3.7 | 1 | 3.8 | 3 | 3.4 | 1 | 1.1 | 4 | 3.5 | 2 | 1.8 |
| US$1-US$100,000 | 7 | 25.9 | 5 | 18.5 | 16 | 18.2 | 14 | 15.9 | 23 | 20.0 | 19 | 16.5 |
| US$100,001-US$250,000 | 6 | 22.2 | 4 | 14.8 | 10 | 11.4 | 8 | 9.1 | 16 | 13.9 | 12 | 10.4 |
| US$250,001-US$500,000 | 1 | 3.7 | 4 | 14.8 | 13 | 14.7 | 11 | 12.5 | 14 | 12.2 | 15 | 13.0 |
| US$500,001-US$1,000,000 | 1 | 3.7 | 5 | 18.5 | 4 | 4.5 | 16 | 18.2 | 5 | 4.3 | 21 | 18.3 |
| US$1,000,001-US$10,000,000 | 7 | 25.9 | 4 | 14.8 | 27 | 30.7 | 25 | 28.4 | 34 | 29.6 | 29 | 25.2 |
| US$10,000,001-US$25,000,000 | 3 | 11.2 | 2 | 7.4 | 5 | 5.7 | 6 | 6.8 | 8 | 6.9 | 8 | 7.0 |
| >US$25,000,000 | 1 | 3.7 | 2 | 7.4 | 10 | 11.4 | 7 | 8.0 | 11 | 9.6 | 9 | 7.8 |
| Total | 27 | 100 | 27 | 100 | 88 | 100 | 88 | 100 | 115 | 100 | 115 | 100 |
| Less: Organizations reporting negative or zero | (1) | | (1) | | (3) | | (1) | | (4) | | (2) | |
| Total organizations with positive reported values | 26 | | 26 | | 85 | | 87 | | 111 | | 113 | |
| Minimum | 6,041 | | 11,278 | | 398 | | 20,160 | | 398 | | 11,278 | |
| Median | 260,202 | | 562,073 | | 959,222 | | 794,927 | | 716,904 | | 719,653 | |
| Maximum | 68,082,151 | | 84,859,114 | | 559,454,847 | | 552,400,978 | | 559,454,847 | | 552,400,978 | |
| Average | 5,558,481 | | 5,983,547 | | 21,875,876 | | 23,744,209 | | 18,053,784 | | 19,657,685 | |

*(continued)*

**Table 3. (continued)**

Panel C: Age of Organization at Inception of Fraud ($n$ = 115).

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|
| | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases |
| Less than 1 year | 3 | 11.1 | 3 | 3.4 | 6 | 5.2 |
| 1-4 years | 8 | 29.7 | 5 | 5.7 | 13 | 11.3 |
| 5-10 years | 6 | 22.2 | 20 | 22.7 | 26 | 22.6 |
| 11-15 years | 3 | 11.1 | 13 | 14.8 | 16 | 13.9 |
| 16-25 years | 2 | 7.4 | 16 | 18.2 | 18 | 15.7 |
| 26-50 years | 4 | 14.8 | 20 | 22.7 | 24 | 20.9 |
| >50 years | 1 | 3.7 | 11 | 12.5 | 12 | 10.4 |
| Total | 27 | 100 | 88 | 100 | 115 | 100 |
| Minimum age (years) | 0 | | 0 | | 0 | |
| Median age (years) | 7.0 | | 19.0 | | 14.0 | |
| Maximum age (years) | 55.0 | | 123.0 | | 123.0 | |
| Average age (years) | 13.2 | | 24.7 | | 22.0 | |

Panel D: Pearson Correlations for Selected Variables ($n$ = 115).

| | | X1 | X2 | X3 | X4 | X5 | X6 | X7 |
|---|---|---|---|---|---|---|---|---|
| X1 | Fraud loss dollars (natural log) | — | | | | | | |
| X2 | Organization size-total assets (natural log) | .344** | — | | | | | |
| X3 | Organization size-total revenue (natural log) | .331** | .848** | — | | | | |
| X4 | Organization age | .140 | .524** | .553** | — | | | |
| X5 | Perpetrator gender | −.015 | .023 | .098 | .185* | — | | |
| X6 | Perpetrator position in organization | .246** | .321** | .314** | .089 | .022 | — | |
| X7 | Perpetrator age | .160 | .016 | .026 | −.027 | −.182 | −.159 | — |

*Significant at the .05 level, two-tailed.
**Significant at the .01 level, two-tailed.

fraud sample does not follow the expected distribution ($\chi^2(df) = 52.747$ (7), $p < .001$). The incidence of fraud in some NTEE Groups is disproportionate to the size of the Group, with Health (Group IV) and Human Services (Group V) organizations having disproportionately high incidences of fraud, consistent with the findings of Fremont-Smith and Kosaras (2003), while Public, Societal Benefit (Group VII), and Religion Related (Group VIII) organizations have disproportionately low incidences of fraud. Further review of the data by fraud Group indicates that the disproportionately low result for Public, Societal Benefit (Group VII), and Religion Related (Group VIII) organizations appears to be driven by Group 2 (insiders victimizing the organization), where the observed percentages are less than half of expectations.[11]

We also describe our sample in terms of the size of the organization involved, using information obtained from the Form 990 filed for the first fraud year. Table 3, Panel B, reports organization size measured in terms of total assets and total annual revenue.[12] We exclude from this analysis all organizations that reported zero or negative total assets or total revenue. The average organization has approximately US$18 million (median US$717,000) of total assets in the first fraud year, and approximately US$19.6 million (median US$720,000) of annual revenues in the first fraud year. The Group 2 organizations are notably larger than the Group 1 organizations, both in terms of median assets and median revenues.

We determine the organization's age at the inception of the fraud by reference to disclosures in Form 990 filings, Secretaries of States' websites, and Guidestar.org. As reported in Table 3, Panel C, the 115 organizations in our sample were on average 22 years old when the fraud began, with a median age of 14 years. The Group 2 organizations are notably older than the Group 1 organizations, suggesting that nonprofits that victimize the public are less established. Combined with the size differences noted between Group 1 and Group 2 above, this suggests that the public should exercise care when dealing with upstart (newer, smaller) nonprofits, as frauds that victimize the public tend to occur or to be detected in those organizations more frequently in our sample.

Table 3, Panel D, provides correlations for the organizational size variables and other variables of interest. These correlations indicate that the size of the organization has a positive and significant relation to the age of the organization (i.e., the older the organization, the larger it is). Both organizational size measures are positively and significantly related to the size of the fraud loss suffered by the organization. The significant positive correlation between perpetrator position and fraud loss dollars is more fully analyzed in the "Perpetrators" section.

## *Losses*

Table 4, Panel A, describes the magnitude of the loss resulting from the fraud. Losses in our sample range from US$1,000 to US$6,000,000, with a median loss of US$125,000. This is similar to the ACFE's reported US$175,000 median loss for all organizations (ACFE, 2008), and their reported US$108,000 median loss for nonprofit organizations (ACFE, 2008). The smallest median and average losses were experienced in Group 2 cases.[13] The total amount lost to fraud in the sample is more than US$50 million.

**Table 4.** Magnitude of Loss.

Panel A: Size of Loss in Dollars ($n$ = 115).

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|
| Loss | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample |
| Less than US$10,000 | 0 | 0 | 9 | 10.2 | 9 | 7.8 |
| US$10,001-US$49,999 | 3 | 11.1 | 12 | 13.6 | 15 | 13.1 |
| US$50,000-US$99,999 | 2 | 7.4 | 18 | 20.5 | 20 | 17.4 |
| US$100,000-US$499,999 | 12 | 44.5 | 33 | 37.5 | 45 | 39.1 |
| US$500,000-US$999,999 | 3 | 11.1 | 9 | 10.2 | 12 | 10.4 |
| US$1,000,000 or more | 7 | 25.9 | 7 | 8.0 | 14 | 12.2 |
| Total | 27 | 100 | 88 | 100 | 115 | 100 |
| Minimum | 26,722 | | 1,000 | | 1,000 | |
| Median | 249,000 | | 110,851 | | 125,000 | |
| Maximum | 6,000,000 | | 3,900,000 | | 6,000,000 | |
| Average | 843,493 | | 316,771 | | 440,437 | |
| Total loss in sample ($) | 22,774,322 | | 27,875,889 | | 50,650,211 | |

*(continued)*

**Table 4. (continued)**

Panel B: Size of Loss Scaled by Organization Size.

| Loss scaled by | Group 1: Nonprofit victimizes the public | | | | Group 2: Insiders victimize nonprofit | | | | Aggregated: Group 1 and Group 2 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Percentage of assets | | Percentage of revenue | | Percentage of assets | | Percentage of revenue | | Percentage of assets | | Percentage of revenue | |
| | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample |
| Less than 1% | 1 | 3.9 | 3 | 11.5 | 13 | 15.3 | 15 | 17.2 | 14 | 12.6 | 18 | 15.9 |
| 1%- 4.99% | 3 | 11.5 | 1 | 3.9 | 16 | 18.8 | 15 | 17.2 | 19 | 17.1 | 16 | 14.2 |
| 5%-9.99% | 4 | 15.3 | 1 | 3.9 | 6 | 7.1 | 6 | 6.9 | 10 | 9.0 | 7 | 6.2 |
| 10%-24.99% | 1 | 3.9 | 1 | 3.9 | 14 | 16.5 | 15 | 17.2 | 15 | 13.5 | 16 | 14.2 |
| 25%-49.99% | 2 | 7.7 | 7 | 26.9 | 12 | 14.1 | 19 | 21.8 | 14 | 12.6 | 26 | 23.0 |
| 50%-74.99% | 2 | 7.7 | 2 | 7.6 | 3 | 3.5 | 3 | 3.5 | 5 | 4.5 | 5 | 4.4 |
| 75%-99.99% | 2 | 7.7 | 1 | 3.9 | 4 | 4.7 | 3 | 3.5 | 6 | 5.4 | 4 | 3.5 |
| 100% or more | 11 | 42.3 | 10 | 38.4 | 17 | 20.0 | 11 | 12.7 | 28 | 25.3 | 21 | 18.6 |
| Total | 26 | 100 | 26 | 100 | 85 | 100 | 87 | 100 | 111 | 100 | 113 | 100 |
| Minimum | 0.15% | | 0.12% | | 0.02% | | 0.01% | | 0.02% | | 0.01% | |
| Median | 74.99% | | 53.44% | | 16.55% | | 16.38% | | 21.83% | | 24.39% | |
| Maximum | 3,299.68% | | 1,330.02% | | 13,671.86% | | 3,129.40% | | 13,671.86% | | 3,129.40% | |
| Average | 463.79% | | 171.85% | | 280.72% | | 72.62% | | 323.60% | | 95.45% | |

To give some context to these fraud losses, we report the losses relative to the size of the organization in Table 4, Panel B. While both metrics are affected by some extreme observations (e.g., organizations reporting very large assets or revenues in the first fraud year), overall, the observed frauds are material to the organizations affected. The median fraud losses experienced by nonprofits (Group 2) amount to 16% of the organizations' total assets, and 16% of the organizations' annual revenues, while on average, these organizations lost 2.8 times their total assets, or almost 73% of their annual revenue, to fraud.

## *Perpetrators*

In cases involving multiple perpetrators, we identify a primary perpetrator and focus our analysis on that individual. As indicated in Table 5, Panel A, the average age of the primary perpetrator at the onset of the fraud is 44.7 years. The perpetrators in Group 1 are older than their Group 2 counterparts, which is consistent with the notion that limited access frauds (corruption and FSF) are committed by those who are senior in their organizations.

Almost 57% of the primary perpetrators in our sample are women, which is significantly higher than the ACFE's statistic of 42% (ACFE, 2008) and is more in line with Greenlee et al.'s (2007) finding of 71% specific to nonprofits. Chi-square testing indicates that while these gender differences are not statistically significant for the aggregated frauds (Hypothesis 2a not supported), the higher incidence of female fraudsters in Group 2 frauds is statistically significant at the .05 level, $\chi^2(df) = 5.500$ (1), providing partial support for Hypothesis 2b. In other words, women in our sample are more likely than men to commit a misappropriation fraud against their organization. The lower incidence of women than men in Group 1 frauds, while consistent with our expectation, is not statistically significant, $\chi^2(df) = 1.815$ (1).

As shown in Table 5, Panel B, operational and financial executives (e.g., President, CEO, Executive Director, Treasurer, CFO) are the primary perpetrators in 60% of the cases, while accounting employees and other employees are the primary perpetrators in 16% and 18% of the cases, respectively. Cross-tabulation analysis of Executives/Non-Executives versus Group 1/Group 2 fraud indicates a significant relationship at the .05 level, Pearson $\chi^2(df) = 6.049$ (1), between the perpetrator's role in the organization and the type of fraud committed. In our sample, Executives are involved in a higher than expected proportion of Group 1 (corruption, FSF) frauds, while Nonexecutives are involved in a higher than expected proportion of Group 2 (misappropriation) frauds, supporting Hypothesis 3, and consistent with Holtfreter's (2005) insights about organizational role and opportunities to commit fraud in the for-profit sector.

Table 5, Panel C, continues the analysis of the fraud perpetrator by examining how gender and organizational role affect the size of the fraud loss. On average, men are responsible for higher dollar fraud losses than women. Interestingly, Nonexecutives steal less, on average, than Executives, and this holds true for men, women, and the aggregated sample. Results of a two-way ANOVA, with gender and organizational

**Table 5.** Primary Perpetrators.

Panel A: Gender and Age of Primary Perpetrator ($n$ = 115).

| | | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|---|
| Average age at inception of fraud activity | Male | 51.6 | | Male | 44.5 | Male | 47.0 |
| | Female | 46.3 | | Female | 42.4 | Female | 43.0 |
| | Overall | 49.6 | | Overall | 43.2 | Overall | 44.7 |
| | | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample | No. of organizations | Percentage of sample |
| Male | | 17 | 63.0 | 33 | 37.5 | 50 | 43.5 |
| Female | | 10 | 37.0 | 55 | 62.5 | 65 | 56.5 |
| Total | | 27 | 100 | 88 | 100 | 115 | 100 |
| Hypotheses 2a & 2b: $\chi^2(df)$ | | 1.815 (1) | | 5.500 (1)* | | 1.957 (1) | |

*Significant at the .05 level.

Panel B: Primary Perpetrator's Role in the Organization ($n$ = 108).

| | | Group 1: Nonprofit victimizes the public | | | | Group 2: Insiders victimize nonprofit | | | | Aggregated: Group 1 and Group 2 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Cat. | | No. of organizations | Percentage of cases | No. of Male | No. of Female | No. of organizations | Percentage of cases | No. of Male | No. of Female | No. of organizations | Percentage of cases | No. of Male | No. of Female |
| A | Operational or financial executive (e.g., President, CEO, Exec. Director, Treasurer, CFO) | 19 | 70.4 | 12 | 7 | 50 | 56.8 | 23 | 27 | 69 | 60.0 | 35 | 34 |

*(continued)*

**Table 5. (continued)**

| Cat. | | Group 1: Nonprofit victimizes the public | | | | Group 2: Insiders victimize nonprofit | | | | Aggregated: Group 1 and Group 2 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | No. of organizations | Percentage of cases | No. of Male | No. of Female | No. of organizations | Percentage of cases | No. of Male | No. of Female | No. of organizations | Percentage of cases | No. of Male | No. of Female |
| B | Accounting or finance employee (e.g., Bookkeeper, Controller) | 1 | 3.7 | 0 | 1 | 17 | 19.3 | 2 | 15 | 18 | 15.7 | 2 | 16 |
| C | Other employee | 2 | 7.4 | 0 | 2 | 19 | 21.6 | 7 | 12 | 21 | 18.3 | 7 | 14 |
| D | Other[a] | 5 | 18.5 | 5 | 0 | 2 | 2.3 | 1 | 1 | 7 | 6.0 | 6 | 1 |
| | Total cases | 27 | 100% | 17 | 10 | 88 | 100% | 33 | 55 | 115 | 100% | 50 | 65 |
| | Less: Other | (5) | | (5) | (0) | (2) | | (1) | (1) | (7) | | (6) | (1) |
| | Total perpetrators analyzed | 22 | | 12 | 10 | 86 | | 32 | 54 | 108 | | 44 | 64 |

[a]This "other" category includes 2 trustees or board members who did not have any of the above roles, 3 individuals who signed the 990 but had no other organizational role specified, and 2 founders with no other organizational role evident. This nonhomogeneous group was excluded from the analysis below, for a remaining sample size of 108.

Primary Perpetrator's Role in the Organization ($n$ = 108).

| Cross-tabulation: Executive vs. Nonexecutive | | | Group 1 | Group 2 | Aggregated |
|---|---|---|---|---|---|
| | Executive | Count | 19 | 50 | 69 |
| | (Category A) | Expected | 14.1 | 54.9 | 69 |
| | Nonexecutive | Count | 3 | 36 | 39 |
| | (Category B + C) | Expected | 7.9 | 31.1 | 39 |
| | Total | Count | 22 | 86 | 108 |
| | | Expected | 22 | 86 | 108 |
| Hypothesis 3: | Pearson $\chi^2(df)$: | 6.049 (1)* | | | |

*Significant at the .05 level (two-sided).

**Table 5. (continued)**

Panel C: Impact of Perpetrator's Gender and Organizational Role on Fraud Loss ($n$ = 108).

| Gender | Organizational role | Average fraud loss | | *SD* | |
|---|---|---|---|---|---|
| | | $[a] | Ln $ | Ln $ | *n* |
| Male | Executive | 476,697 | 11.4926 | 1.88447 | 35 |
| | Nonexecutive | 606,304 | 12.4266 | 1.56326 | 9 |
| | Total | 503,207 | 11.6837 | 1.84603 | 44 |
| Female | Executive | 238,168 | 11.4436 | 1.49824 | 34 |
| | Nonexecutive | 361,384 | 12.1227 | 1.20945 | 30 |
| | Total | 295,926 | 11.7619 | 1.40208 | 64 |
| Aggregated | Executive | 359,161 | 11.4684 | 1.69280 | 69 |
| | Nonexecutive | 417,904 | 12.1928 | 1.28360 | 39 |
| | Total | 380,374 | 11.7300 | 1.59011 | 108 |

Summary of two-way ANOVA results

Dependent variable: Fraud loss (natural log)

| Hypothesis | Source | *df* | *Mean Square* | *F* |
|---|---|---|---|---|
| H4a | Gender | 1 | 0.616 | 0.249 |
| H4b | Organizational role | 1 | 12.855 | 5.206* |
| | Gender × Organizational Role | 1 | 0.321 | 0.130 |
| | Error | 104 | 2.469 | |

[a]Fraud Loss in dollars is a helpful metric for showing the practical significance of the differences between groups. All analyses reported use the natural log transformation of Fraud Loss. $R^2$ = .051 (adjusted $R^2$ = .023); ANOVA = analysis of variance.
*Significant at the .05 level.

role as factors and fraud loss (natural log) as the dependent variable, show that organizational role is the only significant factor in this model ($p = .025$). This result supports Hypothesis 4b (impact of perpetrator's role in the organization), but does not support Hypothesis 4a (impact of gender) related to the size of the fraud loss.

### *Disclosure of the Incident on Form 990*

Determining whether asset diversion disclosures were made is a complicated process, given the difficulty of pinpointing an exact date when the disclosure should have been made.[14] Therefore, we use a range approach, whereby we construct a range of time during which the incident most likely should have been reported, and search all available 990s for disclosure within the range.[15] Our objective is to determine whether there was any disclosure, rather than to test for perfectly timed compliance.

We find (Table 6, Panel A) the fraud incident disclosed in the 990s of 24 organizations, or 21% of the sample, with 21 of those disclosures appearing in the designated area of Part VI, and 20 of those 21 organizations making a corresponding disclosure of information on Schedule O.[16] Only 6 of the 20 organizations that reported on Schedule O provided complete and accurate disclosure, consistent with the *Washington Post* findings of inaccurate and incomplete diversion disclosures (Stephens & Flaherty, 2013). We reviewed the circumstances surrounding the other 91 fraud cases to determine whether a disclosure should have been made on the 990, and found that 12 organizations (10% of the sample) did not disclose, even though based on the time frame of the fraud and its discovery, and the type of fraud and dollar amount, a disclosure should have been made.

Table 6, Panel B, provides more details about these 12 cases of undisclosed material diversions. The size of the unreported diversions ranges from very small (US$14,000) to very large (US$1,300,000), with both small and large organizations failing to comply. All 12 organizations utilized a paid preparer to complete their 990 return, suggesting that tax preparers may have struggled with the application of this new requirement.

## Discussion and Implications

As the analysis presented in this study shows, nonprofit fraud continues to be a significant and costly issue. In our sample, which reflects only those frauds that were detected and publicized, the total fraud losses exceed US$50 million, with US$27.9 million of that amount lost by nonprofit organizations (Group 2), while the public was victimized to the tune of US$22.8 million (Group 1). The typical (median) Group 1 fraud case occurred in an organization that was 7 years old, was perpetrated by a male executive, age 51, who victimized the public over the course of 4 years, for a total of US$249,000. The typical (median) Group 2 fraud case occurred in an organization that was 19 years old, was perpetrated by a female executive, age 42, who victimized her organization over the course of 2.5 years, resulting in a loss of US$110,000.

**Table 6.** Compliance With IRS Form 990 Asset Diversion Reporting.

Panel A: Disclosure of Material Asset Diversions ($n$ = 115).

| | Group 1: Nonprofit victimizes the public | | Group 2: Insiders victimize nonprofit | | Aggregated: Group 1 and Group 2 | |
|---|---|---|---|---|---|---|
| | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases | No. of organizations | Percentage of cases |
| Disclosure of incident was found in the organization's form 990: | | | | | | |
| In Part VI, Question 5 | 0 | 0 | 21 | 23.9 | 21 | 18.3 |
| Elsewhere | 0 | 0 | 3 | 3.4 | 3 | 2.6 |
| Disclosure of incident was not found in the organization's form 990 for the following reasons | | | | | | |
| Fraud did not meet IRS definition of "diversion of assets" | 9 | 33.3 | 0 | 0 | 9 | 7.8 |
| Fraud did not meet IRS definition of "material"[a] | 1 | 3.7 | 9 | 10.2 | 10 | 8.7 |
| Discovery of fraud predated 2008 | 9 | 33.3 | 21 | 23.8 | 30 | 26.1 |
| Short form (990EZ or 990PF) filed, so no disclosure required | 5 | 18.6 | 12 | 13.6 | 17 | 14.8 |
| Missing 990s-Unable to determine whether disclosed | 3 | 11.1 | 10 | 11.4 | 13 | 11.3 |
| Incident fits criteria for disclosure, but no disclosure made | 0 | 0 | 12 | 13.7 | 12 | 10.4 |
| Total | 27 | 100 | 88 | 100 | 115 | 100 |

*Note.* IRS = internal revenue service.
[a]The materiality for organizations reporting zero or negative assets or revenues in the fraud year could not be evaluated. Those organizations exit the sample.

Panel B: Incidents That Fit Criteria for Disclosure, but no Disclosure Found ($n$ = 12).

| Fraud loss | Fraud span | Fraud type | Size of organization in first fraud year (assets) | Size of organization in first fraud year (revenue) | NTEE major group | Perpetrator role | Perpetrator gender | Paid preparer signed 990 |
|---|---|---|---|---|---|---|---|---|
| US$530,000 | 2004-2008 | Theft of cash or deposits | US$647,594 | US$1,431,140 | V. Human services | Executive | Male | yes |
| 1,300,000 | 2002-2008 | Check or credit card scheme | 1,486,507 | 939,321 | I. Arts, culture, humanities | Executive | Female | yes |
| 941,000 | 2004-2008 | Check or credit card scheme | 3,957,948 | 7,033,218 | V. Human services | Accounting/finance employee | Female | yes |

*(continued)*

**Table 6. (continued)**

| Fraud loss | Fraud span | Fraud type | Size of organization in first fraud year (assets) | Size of organization in first fraud year (revenue) | NTEE major group | Perpetrator role | Perpetrator gender | Paid preparer signed 990 |
|---|---|---|---|---|---|---|---|---|
| 180,000 | 2004-2010 | Check or credit card scheme | 1,087,790 | 584,341 | VII. Public, societal benefit | Other employee | Female | yes |
| 150,000 | 2006-2009 | Check or credit card scheme | 259,030 | 525,372 | IV. Health | Executive | Male | yes |
| 233,606 | 2006-2009 | Check or credit card scheme | 113,740 | 174,589 | V. Human services | Executive | Male | yes |
| 225,079 | 2006-2010 | Check or credit card scheme | 207,078 | 626,797 | IV. Health | Accounting/ finance employee | Female | yes |
| 1,100,000 | 2003-2009 | Other misappropriation | 13,327,657 | 3,112,957 | VII. Public, societal benefit | Other employee | Male | yes |
| 290,000 | 2004-2008 | Check or credit card scheme | 311,002 | 365,510 | N/A 501(c)(6) | Executive | Female | yes |
| 783,489 | 2003-2008 | Check or credit card scheme | 9,118,467 | 1,783,325 | VIII. Religion related | Accounting/ finance employee | Male | yes |
| 14,000 | 2005-2008 | Check or credit card scheme | 64,140 | 142,870 | VII. Public, societal benefit | Executive | Female | yes |
| 109,702 | 2007-2008 | Other misappropriation | 260,358 | 794,927 | VII. Public, societal benefit | Other employee | Female | yes |

*Note.* NTEE = National Taxonomy of Exempt Entities.

Our analysis shows that contrary to Hypothesis 1, the incidence of detected fraud is not distributed proportionately across NTEE groups. We find disproportionately high instances in Health (NTEE Group IV) and Human Services (NTEE Group V) organizations, and disproportionately low instances in Public, Societal Benefit (NTEE Group VII), and Religion Related (NTEE Group VIII) organizations. What is unclear is what is causing these disproportionate findings. The frauds in our sample have three common factors: They occurred, they were detected, and they were reported. Differences in any one of these factors (e.g., strength of prevention controls, presence of effective detection controls, motivation to keep the information out of the press) could contribute to the disproportionate results found.

Our exploration of the effects of perpetrator gender and role has mixed results. Female fraudsters are more likely to commit an internal misappropriation (Group 2) fraud than their male counterparts, consistent with the prevalence of female employees in the nonprofit sector, and with the "glass ceiling" phenomenon observed in ACFE data. Nonexecutive employees are more likely to commit a Group 2 (misappropriation) fraud than a Group 1 (corruption and FSF) fraud, while Executives are more likely to commit a Group 1 (corruption and FSF) fraud than a Group 2 (misappropriation) fraud, suggesting that a fraudster's opportunity for perpetrating a fraud is defined largely by his or her position within the organization. Interestingly, we note that whereas few Nonexecutives commit a Group 1 (corruption and FSF level) fraud, the opposite is not true. Executives are clearly not immune to the attraction of the Group 2 (misappropriation) fraud, as 56% of those frauds are committed by Executives. These results highlight the importance of opportunity. Executives have the access and power that allows them to commit a fraud at any level in the organization, whereas Nonexecutives' limited power and authority confines their opportunities. Executives are also likely to possess an elevated level of trust from their organizations that would enable these activities to occur. The perpetrator's role within the organization is also a significant determinant of the size of the fraud loss. What is not clear is why Executives in our sample are responsible for smaller losses than Nonexecutives, as this conflicts with the ACFE's (2008) finding that Executives have median losses 5 times higher than managers and 11 times higher than employees. Finally, we reinforce that the results reported pertain to instances of fraud that were detected and publicized. It is not clear whether the gender and organizational role relationships discussed are driving the initial commission of the fraud, its likelihood of being detected, its likelihood of being publicized, or some combination of those factors.

One of the central contributions of this study is information on the level of compliance with the Form 990 diversion of assets disclosure requirement. Our analysis, while primarily exploratory, indicates that of the 36 organizations that met the criteria for disclosure and that had sufficient 990 information available for us to verify, 21 made the appropriate disclosure in Part VI, Question 5, but only 6 of those went on to make complete disclosure of the supporting information as required on Schedule O. Another 3 organizations recognized that some form of disclosure was appropriate, but failed to use the designated portion of the return. A total of 12 organizations failed to make any

disclosure of the material diversion in any portion of the return in any of the years surrounding the discovery. These disclosure failures may be the result of malfeasance, or of a lack of understanding of the reporting requirement.

## Implications for Nonprofit Organizations

The lack of internal controls in the nonprofit sector has been well-documented (Gallagher & Radcliffe, 2002; Greenlee et al., 2007). While the controls present in our sample are unknown, the types of frauds are similar to those noted in the previous literature that found internal controls were lacking. Improving internal controls is one approach to curbing the fraud problem, but the relative costs and benefits of implementing such controls are an important consideration. Many nonprofit organizations, despite not being subject to the SOX corporate governance requirements, have taken a cue from the for-profit sector, and have voluntarily adopted many SOX best practices related to internal controls (Iyer & Watkins, 2008).[17] Nezhina and Brudney (2012) note that nonprofits voluntarily implementing SOX-type provisions benefited from better controls and reduced fraud risk, but at the cost of higher audit fees and more administrative expenses.

Strong board oversight is an important aspect of internal control for nonprofit organizations. The board plays an important role in hiring and monitoring top-level executives. Our analysis shows that 60% of frauds occurred at the executive level, reinforcing the importance of strong board oversight and the presence of an audit committee that has been suggested in the previous nonprofit literature (Gallagher & Radcliffe, 2002; Greenlee et al., 2007). This literature also suggests that nonprofits can benefit from additional accounting-related controls and administrative controls, including employee background checks, separation of employee duties, developing a confidential fraud reporting process, and educating employees on the harm fraud may cause the organization.

In our sample (Table 2, Panel A), we find numerous misappropriation frauds that involved theft of cash and check or credit card schemes. These incidents could potentially be curbed with stronger controls over cash, and particularly over check processing. These controls are most likely to be effective for low level employees, but the ability of management to override controls makes the effectiveness of such controls questionable at higher levels of the organization. Over half of the misappropriations in our data were perpetrated by executives, reinforcing the importance of an actively engaged board as a critical oversight mechanism.

## Implications for Regulators

Whereas the financial activities of public for-profit organizations are heavily regulated by the SEC, the regulatory structure surrounding nonprofits is very different. The IRS grants tax-exempt status to nonprofit organizations and provides a limited amount of monitoring, but it is the state attorney generals who are largely responsible for oversight and enforcement (Neely, 2011).

At the federal level, improvements to the tax reporting requirements of governance disclosures for nonprofits are a good first step that needs some refinement. The diversion of assets (Question 5) disclosures should apply to all filers, not just those who file the long Form 990. As many of the frauds in our data were perpetrated by small organizations, it is important for organizations of all sizes to be held accountable for providing this information. We found organizations switching between filing the Form 990 and Form 990EZ, highlighting that the differential in reporting requirements leads to reduced transparency. In our data, we find numerous cases of failure to report, or inaccurate reporting of asset diversions. The instructions for reporting a diversion could benefit from additional clarification, which would increase the likelihood that well-intentioned filers will provide the information more accurately.

### *Implications for Future Research*

A limitation inherent in any fraud study is that the analysis is restricted to only those frauds that have been discovered. Our constructed database was further limited by the population of newspapers included in the LexisNexis database, the search terms used, and the time period that was searched. Despite those limitations, our press report–based study benefits from its ability to capture a sample that is fairly representative of the population of detected frauds, in contrast to the bias introduced by survey-based studies. However, a drawback of the press report–based study is that the amount of available information about each underlying fraud case is somewhat limited. To obtain a better understanding of other organizational factors that may have contributed to or allowed the fraud to occur, it would be helpful to do a more in-depth analysis of a few individual cases for which additional information is available. Spillan and Ziemnowicz (2011) provide this type of analysis for five specific fraud cases provided by the New York State Commission on Quality Care for the Mentally Disabled, and a similar approach would be suitable for our data set. In addition, a longitudinal study of what happens to the organizations post discovery of a fraud could provide helpful insights into the organizations' subsequent survival, changes to internal controls, incidence of repeat offenses, and level of donations.

The present study provides insight into Form 990 asset diversion reporting in our sample of frauds. Analysis using a more inclusive database, such as the *Washington Post*'s database of reported diversions, would allow for a more comprehensive analysis of compliance with the diversion disclosure requirement. Leveraging the database would allow for a more thorough analysis and understanding of the entire population of organizations that report a material diversion.

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## Notes

1. "Fraud Data" section discusses the extant survey-based and press report–based studies.
2. The financial statement frauds (FSF) aspect in the nonprofit setting would correspond mainly with Form 990 and similar filings in the nonprofit sector.
3. In addition to providing details about a sample fraud case that they had investigated, the respondents also provided their own estimates of the size and extent of fraud occurring within organizations generally.
4. The report issued by the Association of Certified Fraud Examiners (ACFE) does not include detailed information about individual fraud cases. However, the researchers requested additional supporting data from the ACFE.
5. The key words and operators searched were as follows: (nonprofit OR non-profit OR non profit OR notforprofit OR not-for-profit OR not for profit OR charit* OR charitable) AND (fraud* OR theft OR scandal OR embezzle* OR corruption). Because compliance with the revised 990 reporting requirements was a primary objective, we began our sample period in 2008, the first year of this requirement. Ending the sample period in 2011 allows time for the review of 990s filed subsequent to the incident.
6. In both cases, the news story identified a fraud within the organization, but did not specifically identify any individuals who were involved.
7. The distinction between "wide access" and "limited access" fraud describes the degree of opportunity to engage in the activity. We acknowledge that high-level executives may engage in both types of frauds, as they typically have access to all aspects of the organization's operations. In contrast, lower level employees are generally limited to "wide access" frauds, as, for example, they typically lack access to financial reporting mechanisms that would allow them to file false reports on behalf of the organization.
8. In cases where specific beginning and/or ending dates were not available, we calculated the duration as ending year minus beginning year. For cases where all of the activity occurred within a single year, but specific dates were not available, we estimated the duration as 0.5 of a year.
9. The ACFE's 2008 report included occupational frauds investigated between January 2006 and February 2008. This time frame best aligns with the fraud activity occurring in our sample fraud period. All ACFE comparisons made in this section of the paper use the ACFE's 2008 report data.
10. The expected values for our test are derived from National Center for Charitable Statistics data. We calculated a 12-year average (2000-2011, which covers the majority of our sample fraud period) based on the actual counts of 501(c)(3) organizations in each National Taxonomy of Exempt Entities (NTEE) Major Group in each year.
11. Chi-square analysis by Group was not valid, as it resulted in numerous cells with expected values less than 5.

12. ACFE studies of fraud measure organization size by number of employees, as reported by the Certified Fraud Examiners (CFEs) completing the survey. That information is not available for our sample, so we use two financial measures of size that are available on the Form 990.
13. Our finding that Group 2 organizations are larger and have smaller losses than Group 1 would seem to contradict the positive correlations between Organization size and Fraud loss dollars presented in Table 3, Panel D. We ran additional correlations (not tabled) by Group, noting that the significant positive correlation holds in Group 2, but no significant correlation was found in Group 1. Losses are directly related to the size of the organization, but in Group 2, the comparatively large (vs. Group 1) organizations experience comparatively small (vs. Group 1) losses.
14. The exact date the fraud was discovered is rarely stated in the news story, and because the tax year of discovery drives the 990 disclosure requirement, it is difficult to determine which 990 filing should technically include this information. This problem is compounded by lags in preparing returns, which could lead to an organization unintentionally misreporting the information in the wrong tax year (i.e., in the year of the return being prepared at the time of discovery, rather than the return that covers the year of discovery).
15. To analyze when the material diversion should have been disclosed, the discovery year of the fraud was approximated based on details from the news story. If we determined that the fraud was likely discovered in 2008 or later, then a materiality test was performed using the total assets and total revenues data for the discovery year and the first year of the fraud.
16. Of the other three disclosures, two listed "theft" or "loss from defalcation" as an "other" expense on the return. One listed the item as an "Excess Benefit" transaction on the Form 990. It is possible that a material diversion could also be an excess benefit transaction, but we did not undertake further analysis to determine whether this "Excess Benefit" reporting was appropriate.
17. Nezhina and Brudney (2012) note that two Sarbanes-Oxley Act (SOX) provisions (whistleblower protection and record retention) apply to nonprofit organizations. Other corporate governance requirements of SOX (e.g., audit committee requirements, audits of internal controls) apply only to publicly traded companies.

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## Author Biographies

**Deborah S. Archambeault** is an associate professor of accounting at the University of Dayton, where she teaches auditing. Her primary research interest is corporate governance.

**Sarah Webber** is an assistant professor of accounting at the University of Dayton. She teaches courses in federal income taxation. Her research interests include individual, corporate, and nonprofit taxation.

**Janet Greenlee** is an Emerita professor of accounting at the University of Dayton, where her research focused on issues dealing with nonprofit governance.