



Charity fraud

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Introduction

The nature and extent of fraud within and against charities in the United Kingdom (UK) is relatively unknown. Much of our current understanding of charity fraud is based upon anecdotal evidence and the occasional media accounts of high-profile scams that capture public interest.

However, the impact of fraud on individual charities and the sector as a whole can be devastating. It can damage reputations, lead to the loss of key employees, volunteers and donors, diminish financial reserves and limit the range and extent of charitable activities that can be undertaken.

The Fraud Advisory Panel hosted a roundtable discussion on 18 February 2008 to obtain a better understanding of charity fraud in the UK and to identify issues for further consideration and research. The roundtable also provided key stakeholders with an opportunity to share and explore experiences.

The roundtable was attended by representatives from a range of organisations with an interest in addressing the problem of charity fraud. Participants included Aid to the Church in Need, Breakthrough Breast Cancer, Chantrey VellacottDFK, Charities Aid Foundation, Charity Commission, Charity Finance Directors' Group, Clydesdale Bank, Office for the Third Sector, Rethink, The Institute of Chartered Accountants in England and Wales, The Princes Trust, WRVS and the Fraud Advisory Panel.

Defining charity fraud

Charity fraud can be broadly defined as any fraud perpetrated within or against a charitable organisation. This covers both internal and external incidences of fraud, including fake or non-existent charities.

The *Oxford Concise Dictionary* defines fraud as 'wrongful or criminal deception intended to result in financial or personal gain'.¹

Under the Fraud Act 2006 the criminal offence of fraud can be committed in three ways: by false representation, failing to disclose information, and by abuse of position. The Act also includes offences for obtaining services dishonestly and of possessing, making and supplying articles for use in frauds. The Act does not extend to Scotland.²

The extent of fraud in the charity sector

There are over 213,000 registered charities in England, Wales and Scotland.³ These range from small local charities to large international organisations.

¹ Oxford University Press (1999) *Oxford Concise English Dictionary* (Tenth Edition). Oxford University Press.

² Except section 10(1) which amends the Companies Act 1985. See Explanatory Notes to Fraud Act 2006. Available from www.opsi.gov.uk.

³ Charity Commission, www.charitycommission.gov.uk; The Office of the Scottish Charity Regulator, www.oscr.org.uk [Both accessed on 16 April 2008].

There are also a large number of other charitable organisations which are exempt or excepted from registration with the Charity Commission and/or The Office of the Scottish Charity Regulator. However new provisions under the Charities Act 2006 will require all excepted and some exempt charities in England and Wales with a gross income in excess of £100,000 to register.⁴

Despite the diversity and vibrancy of this sector very little research exists on the nature and extent of charity fraud in the UK. Much of our current understanding is derived from a limited number of governance and risk management surveys which have touched upon fraud rather than any sector-specific fraud research.

Findings from available research suggest that there is a large variation of between 4 – 18%⁵ of charities reporting fraud within the sector.

Recent research by PKF (UK) LLP in association with the Charity Finance Directors' Group found that 18% of charities reported being a victim of fraud at least once during the last two years, and that the incidence of fraud was higher in larger charities (34% had experienced fraud once).⁶

These figures are consistent with a fraud-specific self-report survey conducted in Australia and New Zealand which found that 16% of respondent organisations had suffered a fraud in the previous two years, and that the likelihood of suffering a fraud also increased with turnover.⁷

Based upon these figures it appears that fraud in the charity sector, as determined through self-report surveys, is much lower than for other sectors of the economy. For example the most recent global economic crime survey by PricewaterhouseCoopers found that 43% of organisations reported suffering one or more significant economic crimes during the last two years, increasing to 48% for the UK.⁸

There are two possible explanations for this discrepancy. Either charitable organisations suffer less fraud or more fraud goes unreported or undiscovered within the sector. Regardless, the cost to the UK economy is likely to be significant.

The Association of Chief Police Officers (ACPO) has estimated that the total cost of fraud to the economy is at least £13.9 billion per year, increasing to £20 billion when income tax and EU fraud are included.⁹ Extrapolating these figures to the charity sector, which accounts for approximately 3.4% of the gross national product (GNP), it is estimated that fraud could cost the charity sector as much as £680 million per year.¹⁰

⁴ Charity Commission & Office of the Third Sector (2007) *Charities Act: What trustees need to know*. Available from www.cabinetoffice.gov.uk/thirdsector.

⁵ Baker Tilly (2007) *Voluntary Sector Governance Survey 2007*. Plaza Publishing Limited. Available from www.bakertilly.co.uk.

⁶ PKF (UK) LLP & Charity Finance Directors' Group (2007) *Managing risk: protecting your assets*. Available from www.pkf.co.uk.

⁷ BDO (2008) *BDO Not-for-profit fraud survey 2008*. Available from www.bdo.com.au.

⁸ PricewaterhouseCoopers (2007) *Global Economic Crime Survey 2007*. Also see PricewaterhouseCoopers (2007) *Economic Crime: People, culture and controls (United Kingdom)*. Both available from www.pwc.co.uk.

⁹ Association of Chief Police Officers (2007) *The Nature, Extent and Economic Impact of Fraud in the UK*. Available from www.acpo.police.uk.

¹⁰ The annual income of the charitable sector is approximately £38 billion which equates to 3.4% of the GNP.

The victims

Charity fraud can have a considerable impact upon a range of victims in a variety of ways.

Ultimately we all pay the price for fraud perpetrated against the charity sector; charities lose money, donors lose confidence in giving, beneficiaries lose access to services, employees lose jobs and wider society loses the important contribution that charities make to the quality of life in our local, national and international communities.

Victims include:

- **The charity** The charity does not receive the full amount of income that has been collected on its behalf or income is misappropriated or misapplied.
- **Donors and financial supporters** The donor is misled into providing donations to fictitious charities or bogus collectors or the full value of the donation (or other form of financial support) is not applied to the charity or in the manner expected.
- **Beneficiaries** The beneficiary is deprived of financial assistance, goods, services, resources or their own money because the charity has not received the necessary/anticipated income to fund activities.
- **Employees and volunteers** The morale of employees and volunteers can be seriously affected. Employees may lose their jobs.
- **Wider society** Fraud can erode public confidence in charities and damage the reputation of the sector as a whole.

Key areas of fraud risk

There is a perception that charities are a 'soft target' for fraud due to their altruistic nature, perceived lack of professionalism, and reliance on the trust and goodwill of supporters and volunteers. However fraud is a key business risk for all organisations and the charity sector is no exception.

Many of the risks to charities are similar to, or the same as, those affecting other sectors of the economy. This includes e-crime, plastic card fraud, data theft, money laundering, terrorist financing and employee fraud.

Charities, like other organisations, can also be vulnerable to internal and external threats of fraud:

- **Internal fraud** is committed by employees or volunteers either alone or in collusion with others. Some common types of internal fraud within the charity sector include financial manipulation and accounting fraud, unauthorised payments to connected parties/nepotism, employment fraud (such as fictitious employees or failure to delete leavers from the payroll), inflated management fees or expenses, theft of trustee, employee, volunteer or donor information and procurement fraud.

- **External fraud** is committed by persons who have no direct involvement in the charity being targeted. Some common types of external fraud include fraudulent payment instructions (such as cheque fraud and phoney foreign payment requests), bogus websites and phishing emails, theft of donor information, impersonation of street collectors, falsification of grant applications, and theft of funds by external partners in receipt of funds (ie bogus beneficiaries).

Other risks are more specific to charitable organisations. These include risks related to fund-raising activities, grant giving, and the reliance on voluntary effort. But even across charities there is a large variation according to the size, nature and geographical location of charitable activities undertaken. For example, an organisation with international operations in high-risk and under-developed countries will have a very different set of risk factors to that of a small locally-based charity that employs one person.

One area of unique vulnerability to the charity sector is the donation cycle. Fraud can occur at the initial point of collection right through to the application of funds to various projects. Frauds perpetrated over an extended time period and involving small sums of money (eg the skimming of collection boxes) can sometimes have more damaging consequences than a critical incident fraud.

The use of charities to finance terrorist activity

There is some evidence to suggest that charities may be used by terrorist organisations to raise, move and use funds. The Financial Action Task Force (FATF) has developed some typologies of the ways in which non-profit and charitable organisations can be used as vehicles for financing terrorist activities and how to combat it.¹¹

The question of reputation

Reputation is important to any charitable organisation. Charities rely upon their reputation and good name to obtain financial support from individuals, businesses and government. Therefore it is crucial for charities to have appropriate policies and procedures in place to manage the risks to their reputation as far as possible. This should include consideration of the organisation's response to fraud and how this is communicated to stakeholders and the general public.

Open and transparent disclosure to stakeholders including employees, beneficiaries, donors and the general public can be beneficial. It may generate positive support for the charity and publicly demonstrate that the organisation takes fraud seriously. It also sends a powerful message to other potential fraudsters that the organisation is not a soft target.

¹¹ FATF (2008) *Terrorist Financing*. Also see FATF (2002) *Combating the abuse of non-profit organisations: international best practices*. Both are available from www.fatf-gafi.org.

Frauds that are ‘swept under the carpet’ but later reach the public domain can result in adverse publicity. These can have severe consequences for the individual charity concerned and to the sector as a whole.

The reputation of the entire charity sector can also come under threat from the emergence of fraudulent charities or bogus collectors following manmade or natural disasters, such as those which appeared following the Indian Ocean tsunami, Hurricane Katrina and the London bombings.¹² These can have damaging repercussions for legitimate charities that collect for the same causes. A collective response from the sector could be an effective way to address this problem.

Reporting fraud

Charities need to ensure that employees and volunteers know what to look for and how to report suspected fraud. Key to this is the establishment of appropriate reporting mechanisms which may include integrity or whistleblowing hotlines or other forms of internal or external reporting.

Approximately half of charitable organisations in the UK have some form of whistleblowing policy in place.¹³

According to Public Concern at Work (PCAW) an independent authority on public interest whistleblowing ‘*someone blows the whistle when they tell their employer, a regulator, customers, the police or the media about a dangerous or illegal activity that they are aware of through their work*’.¹⁴

Charities should always consider whether there is a requirement to report significant frauds to other organisations. This may include:

- The Regulator (Charity Commission or the Office of the Scottish Charity Regulator);
- The police (via the local police station);
- The charity’s insurance company(s); and/or
- The charity’s professional advisers (bankers, accountants or auditors).

Registered charities in England and Wales are required to report serious incidents to the Charity Commission. This includes any actual or suspected fraud, theft or loss from other criminal activity regardless of the scale of funds or value of other property involved. In addition, charities with an income over £25,000 must now declare as part of their annual return that they have reported any serious incidents to the Charity Commission.¹⁵

¹² See for example BBC News (2005) *Warnings of Katrina email scams*, 2 September. Available from www.bbc.co.uk.

¹³ PKF (UK) LLP & Charity Finance Directors’ Group (2007) *Managing risk: protecting your assets*. Available from www.pkf.co.uk. Also see Baker Tilly (2007) *Voluntary Sector Governance Survey 2007*. Plaza Publishing Limited.

¹⁴ Public Concern at Work (2006) *What is whistleblowing?* Available from www.pcaw.co.uk [Accessed on 9 April 2008].

¹⁵ Charity Commission. *Guidance Note: Reporting serious incidents*. Available from www.charitycommission.gov.uk [Accessed on 20 May 2008].

In future charities will be able to report alleged fraud to the new National Fraud Reporting Centre (NFRC). The Charity Commission will lead on those cases where criminal investigation is not possible but civil regulatory powers are necessary. For the first time there will be a single point of contact for reporting and recording fraud. This will enhance the collection of intelligence, investigation, risk profiling and targeted fraud prevention.

National Fraud Reporting Centre (NFRC)

In 2005 the Government commenced a wide-ranging review of fraud in the United Kingdom. One of the key recommendations to emerge from the review was the establishment of a National Fraud Reporting Centre (NFRC) to receive reports of suspected fraud. These reports will be used to collect information and intelligence and, where appropriate, may result in criminal investigation by the police, confiscation investigations or other forms of action. The NFRC is expected to be fully operational within the next two years.¹⁶

What can be done about charity fraud?

There is still much scope for making the charitable sector an undesirable target for fraudsters. Collaboration and co-ordination are crucial to this process and charities, representative bodies and regulators all have a role to play in effectively combating charity fraud.

Overall, greater emphasis needs to be placed on transparency as a fraud disabler – both within and between charities and by government. This can be achieved through increasing awareness of the problem, developing a better and more co-ordinated approach to information-sharing within the sector, and undertaking additional research into the nature and extent of fraud perpetrated within and against charitable organisations.

Public awareness campaigns

A range of educational initiatives should be developed to raise awareness of the opportunities for fraudulent behaviour to occur within the charity sector. Tailored initiatives should be predominantly aimed at the charitable sector (and subsectors therein) and the general public.

Public awareness of common charity scams, such as bogus collectors and phishing scams, appears to be relatively low, although the Charity Commission does aim to raise public awareness through their Safer Giving Campaign. The Charity Commission website contains advice for potential donors on how to avoid becoming a victim of fraud. From time to time individual charities also publicise, often via their websites, current or emerging scams that affect their organisation and/or supporter base.

¹⁶ Government Fraud Review (2006) *Fraud Review: Final report*. Also see Government Fraud Review (2007) *Fighting Fraud Together: The Government response to the Fraud Review*. Both available from www.attorneygeneral.gov.uk.

However current efforts remain disjointed and piecemeal. More is needed.

Safer Giving Campaign

The Charity Commission's Safer Giving Campaign aims to raise public awareness of the safe ways that people can make donations to charities. It includes advice for potential donors on how to recognise a legitimate charity collector from a fraudster when approached at home, on the street or at an event.

Free posters are also available to download from the Charity Commission website.¹⁷

Educating charities

Charities must have robust risk management systems and controls in place to mitigate fraud. This should include ensuring that trustees and senior management have a clear understanding of their responsibilities in respect of fraud. However, recent research suggests that very few charitable organisations currently have formalised fraud policies in place.¹⁸

This situation needs to be urgently addressed and there is an identifiable need for best practice guidance for the sector. This should cover (but is not limited to):

- Preventing fraud – anti-fraud policies, risk management, staff, volunteer and trustee recruitment and training.
- Investigating fraud – investigation process, fraud response planning.
- Reporting fraud – how, when and to whom.
- Illustrative case studies.

Key messages should be disseminated through existing communication channels such as representative bodies and/or regulatory authorities. Dedicated email alerts could also be developed to keep the industry informed of current and emerging frauds that affect the sector.

Small charities with limited resources may also benefit from 'fraud health checks'. These could comprise of self-completion checklists (similar to the Internal Financial Controls Self Checklist produced by the Charity Commission), independent fraud audits undertaken by a pool of voluntary fraud risk professionals from the sector, or a combination of both.

¹⁷ See Charity Commission website www.charitycommission.gov.uk.

¹⁸ PKF (UK) LLP & Charity Finance Directors' Group (2007) *Managing risk: protecting your assets*. Available from www.pkf.co.uk. Also see Baker Tilly (2007) *Voluntary Sector Governance Survey 2007*. Plaza Publishing Limited.

Co-ordinated information sharing

Other sectors, such as the financial services sector, have already clearly demonstrated that information sharing and intelligence gathering can make a significant contribution to combating fraud and financial crime. These industry initiatives have been particularly successful in respect of employee fraud and identity fraud.¹⁹

Charities should explore opportunities to share information about known fraudsters, particularly in relation to grant applications, employees and volunteers. This could be co-ordinated by the Charity Commission and utilise already established networks within the sector.

Research

Very little research (either qualitative or quantitative) has been undertaken on the nature and extent of charity fraud in the UK and how this compares to other sectors of the economy. Baseline research that focuses specifically on fraud in the charity sector would help to ensure that adequate and appropriate resources are applied by charities, regulators and government to address the problem.

¹⁹ See CIFAS – the UK's Fraud Prevention Service website www.cifas.org.uk

Useful links

Fraud Advisory Panel

www.fraudadvisorypanel.org

Chantrey Vellacott DFK

www.cvdfk.com

Charity Commission

www.charity-commission.gov.uk

Financial Action Task Force (FATF)

www.fatf-gafi.org

Government Fraud Review

www.attorneygeneral.gov.uk

Office of the Scottish Charity Regulator

www.oscr.org.uk

Public Concern at Work

www.pcaaw.co.uk

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