



## Charities, scams and insider fraud

**Shivaji Shiva** of Michelmores Solicitors looks at how charities can protect themselves.

The risk of losing money to scams or other fraud is a real concern for charities. A recent analysis of the issues raised by Charity Commission inquiries found that 11% involved allegations of fraud or theft, while as many as 43% identified inadequate financial systems. The number of actual instances of fraud within charities is relatively small but it does happen and the impact can be considerable.

This risk has taken on another dimension recently with the increased risk of charity funds being misused by terrorists. The Charity Commission is consulting on its strategy for dealing with the terrorist abuse of charities. The draft strategy emphasises the importance of good housekeeping to prevent misuse of funds.

The risk to charities can come from outside or within, with more or less serious results. As the Commission observes: "Charities which implement good general risk management policies and procedures will be better safeguarded against a range of potential misuses".

### External scams

Common examples of external scams include:

#### **Administrative fees and directory listings**

Many charities have received letters with an official looking letterhead, requesting payment to

'renew' a directory listing. The amount requested is generally pitched at a level designed to invite the recipient to authorise the payment without scrutinising it carefully. On close examination, the payment is for listing in a 'private directory' which never materialises. Variants refer to legal processes such as registration with the Office of the Information Commissioner or the Intellectual Property Office and solicit substantial fees for similarly illusory services.

**Prevention:** Clear financial authorisation procedures should ensure that requests like these are seen by an appropriate member of staff before any payment is made.

#### **Misuse of charity name or logo**

The misuse of charity names or logos on websites is increasingly common. Often the name of a well known charity is used to induce members of the public to visit the scammers' website either to drive traffic to the site or to derive income from 'click through' advertising. While there is no direct financial loss to the charity, the loss of goodwill can be significant particularly where the content to which people is directed is unsavoury.

**Prevention:** The steps involved in resolving disputes of this sort will depend on the nature of the problem. They may include taking proceedings for passing off or trade mark infringement or using the dispute resolution

procedure of a domain name registrar to seek control of the website address. It will, however, generally be helpful to ensure that the name of the charity and any distinctive logo are protected as registered trade marks.

### **Dodgy donors**

A donor sends you a substantial donation. Before the cheque is cashed, the donor asks you to return a portion of the donation to a different bank account, saying that the original donation was overpaid by mistake. You do so, and subsequently discover that the original cheque has bounced and the charity is out of pocket.

**Prevention:** In the wake of an attempted fraud of this nature, the Charity Commission has made it clear that charities should never return any donation before the original cheque has cleared. A clear procedure on the circumstances in which donations may be returned will help avoid fraud as well as addressing the complex ethical and charity law issues which can arise in relation to the return of donations.

### **Gift Aid fraud**

Charities which provide details of their bank accounts on Gift Aid forms have found that the details are used by criminals seeking unauthorised access to the charity's account.

**Prevention:** A simple solution is to open a deposit-only account for such donations or invite donors to contact you so that you can email them a form.

### **Internal fraud**

Sometimes the most serious fraud is from staff or volunteers within the charity. An insider has more time, more access and more information than

outsiders do. Such frauds have caused considerable damage to charities and even caused them to be dissolved. In addition to the financial loss, such fraud demoralises staff, trustees and volunteers and injures the charity's reputation with funders, the Charity Commission and the public.

This takes many different forms. In one example, a well-respected individual was appointed clerk to the trustees of a grant-making trust. He was later convicted of fraud amounting to £300,000. A Charity Commission investigation found that "as a result of minimal supervision and a lack of accountability, the clerk had been able to alter bank mandates from three signatures to solely his own". The trustees had been persuaded to sign cheques on which the payee was left blank.

### **Preventing internal fraud**

Key steps include:

- **Communication and culture**  
An organisation's culture is its first line of defence. The charity should promote honesty and transparency, and take a consistent stance against dishonesty. Tolerating the fiddling of expenses, for example, may encourage other forms of dishonesty.
- **Systems**  
This concern to promote honesty should be reflected in the charity's internal procedures. When staff are recruited, references should be taken up, qualifications checked and questions asked about any unusual gaps in a candidate's employment history. Once staff are in post, there should be clear authorisation limits and authority should be acquired gradually. Staff records should be kept up to date.

- **Effective monitoring**  
Arrangements for staff management and appraisal provide opportunities for further monitoring. This should include checking work done and letters (or emails) in and out. It may be appropriate to amend the charity's employment contracts and email policies to make clear that telephone calls and email may be monitored.
  - **Security precautions**  
Appropriate use of computer passwords, locked drawers and limits on access to information will help, provided that the restrictions do not become so onerous that people are encouraged to circumvent them or are prevented from working effectively.
  - **Limits to authority**  
It is dangerous for anyone to have too much authority. Charities should give careful consideration as to: who can sign or countersign cheques and to what limit; who can change bank mandates; who can access computer systems—in particular the accounting systems.
  - **Effective use of auditors**  
An important initial step for most charities is to ensure that their auditors are familiar with the sector, understand the work of the charity and are involved in improving the charity's financial controls. Auditors have a clear role in finding inconsistencies in the accounts.
  - **Formal monitoring**  
The organisation should also consider what other formal monitoring it should carry out. This may include internal audit procedures or, where the charity handles a lot of cash or stock, appropriate checks such as random stock takes or counts of cash.
  - **Informal monitoring**  
Informal monitoring can be enormously effective if supported by the type of organisational culture referred to above. Otherwise, it is all too easy for standard processes such as countersigning cheques to become little more than an exercise in rubber stamping. Large or unusual payments should be questioned. Blank cheques or other documents with important blanks should never be signed.
- Clearly, prevention is better than cure. However, where an instance of fraud is discovered, the charity should ensure that a full investigation is carried out. This will generally involve instructing solicitors at an early stage.
- The charity trustees will need enough information to decide how to proceed. A full examination of the steps involved in investigating fraud is beyond the scope of this article. But the process will generally involve asking questions such as those below:
- What was lost, how was it done and who was responsible?
  - Is there sufficient evidence to convince the court, police or other agencies to assist?
  - What action should be taken to catch those responsible, prevent further fraud or recover assets?
  - Are third parties at fault? Did the bank release money in breach of mandate? Did an auditor miss irregularities?
  - Should the Police and the Charity Commission be informed? The Charity Commission expects charities to inform the police where a crime is suspected unless there is a good reason not to do so. It will

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generally be appropriate to seek legal advice where there is any uncertainty.

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