Journal of Forensic & Investigative Accounting
Vol. 2, Issue 1

Opportunities for Fraud and Embezzlement in Religious Organizations: An Exploratory Study

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Charitable giving in the U.S. increased to $260 billion in 2005, with religious organizations receiving the largest share of $93.5 billion (Sullivan, 2006). A nationwide telephone survey by the Barna Group in 2004 indicated that nearly two out of every three households (63%) contributed to a religious organization, and three out of every four dollars contributed to charity went to religious centers. As a prominent moral authority in our society, church is the last place that people should expect to find crime, corruption, and misconduct. The treasurer or church business administrator is expected to handle the church's money with the highest moral and ethical standards (Throop, 2006). However, church members steal from their own churches (West and Zech, 2007; Throop, 2001; Busby, 2005).

Recent estimates are that embezzlement occurs in one in every twenty businesses (Byers and Hurlburt, 2004). The ACFE 2006 Report to the Nation on Occupational Fraud and Abuse estimates that U.S. organizations lose five percent of their annual revenues to fraud. In the 2006 ACFE study of 1,134 of the largest fraud cases investigated by their members, 14% occurred in non-profit organizations, with a median loss of $100,000 per occurrence. Vargo (1989) estimated that 15% of all churches are at

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one time or another, victimized by an unscrupulous employee or member. Lowe (2005) estimated that in churches nationwide, this ratio is one in five. In a study of all U.S. Roman Catholic dioceses, West and Zech (2007) found that 85% of their respondents reported that embezzlement had occurred in their dioceses within the last five years, with 11% of these totaling more than half a million dollars.

High profile non-profit scandals, such as the Lansing, Michigan United Way embezzlement of $2 million, and the Baptist Foundation of Arizona bankruptcy, with damages exceeding $500 million, are eroding public confidence and providing a wake up call to trustees of non-profit organizations (Snyder, 2005). The passage of the Sarbanes-Oxley Act has prompted many non-profits to examine their financial controls and board oversight practices, and non-profit board members and trustees are increasingly concerned about meeting their fiduciary duties in light of public expectations (Hymowitz, 2005).

When examining the fraud elements of incentive (pressure), opportunity, and rationalization, as set forth by *SAS 99*, one might wonder whether churches are embezzled more than other organizations. Like many small organizations, particularly non-profit organizations, churches have a reputation for having poor internal controls and for being slow to adopt sound business and accounting practices (Busby, 2005). This leads to greater opportunity for embezzlement (West and Zech, 2007). Many of the news stories recounting fraud in churches point to this weakness as the proximate cause (Busby, 2005). However, there may also be additional factors specific to religious settings that may result in a higher opportunity for embezzlement than non-religious organizations of similar size.

The next section of this paper examines the fraud elements of pressure (incentive), opportunity, and rationalization, and the existence of these elements within a church setting, developing a rationale for why religious organizations may be particularly vulnerable to fraud. The second section contains the results of an exploratory study of this rationale within a sample of churches in California and Hawaii.

Fraud and Embezzlement Theory

Cressey's Theory of Embezzlement

Donald Cressey (1953/1973) characterized embezzlement as a criminal violation of financial trust. He developed a generalization explaining the causes of embezzlement. The subjects of his study were 133 prison inmates who had been confined for offenses such as embezzlement, forgery, uttering fictitious checks, conspiracy, grand theft, etc. The crimes for which they were imprisoned needed to fit Cressey's definition of embezzlement, which essentially consisted of two elements: 1) acceptance of a position of trust in good faith; 2) violation of that trust. All of his subjects fit his generalization of the process in which trusted persons become trust violators. They conceive of themselves as having a non-shareable financial problem; the problem can be secretly resolved by violation of their positions of financial trust, and they are able to apply verbalizations to their conduct which enable them to rationalize their conceptions of themselves as trusted persons with their mis-use of the entrusted funds or property. Cressey found that for embezzlement to occur, the entire three-step process must be present, and the absence of any one of the events would preclude criminal violation of financial trust.

Many books on fraud prevention and risk management use Cressey's generalization as a predictor of when fraud is likely to occur. His work led to the development of what is now known as the *fraud triangle,* which has been formally adopted by the AICPA (2002, § 316) as part of Statement on Auditing Standards 99 as a three-pronged framework to be used by auditors to detect risk factors that increase the likelihood of fraud.

Pressure

The first event in the process occurs when the trusted person considers that he has a financial problem that he cannot share with persons who, from a more objective point of view, probably could have helped him. Cressey found that a lot of his subjects related that they were "ashamed" to tell anyone of a certain financial problem, or "had too much false pride" to get help from people. Trusted persons who structure their problems as non-shareable encounter more pressure to secretly misappropriate funds to solve their problem.

One type of non-shareable financial problem that was found particularly relevant to this current study is what Cressey calls a *violation of ascribed obligations.* The term "ascribed obligations" refers to those obligations of a non-financial nature which are expected of individuals in consequence of their incumbency in positions of trust. Organizations often operate on the informal expectation that trusted persons will behave in certain ways, even when off-duty. Consider the example of the banker that frequents a racetrack or bookmaking establishment. When a financial problem occurs as a result of the violation of the obligations ascribed to the role of the trusted individual, the individual perceives of himself as having a non-shareable financial problem. Other types of non-shareable financial problems identified by Cressy include problems resulting from personal failures, from business reversals, from physical isolation, and problems related to status-gaining.

Because there are expectations of Christians to live their lives a certain way and refrain from certain behaviors, the element of pressure due to ascribed obligations may be even more prevalent in church than in non-religious organizations. The Christian has some of the highest ascribed obligations. After all, Christianity preaches pureness, righteousness, and standards of conduct that are set apart and above the ways of the world. However, Christians sometimes behave in ways that violate these obligations. Examples of such behaviors include greediness, the worship of money, and the coveting of material possessions. When the church member commits an act that violates the expectations of him as a Christian, he may feel the need to keep secret the fact that he failed these expectations in order to avoid embarrassment or loss of status. If he incurs a financial problem as a result of his behaviors, he now has a *non-shareable financial problem*.

For example, many leaders of the Christian church are openly against debt. Christian stores are filled with books warning of the evils of credit card debt, and Christian radio talk show hosts dispense advice to the financially troubled. Some churches regularly sponsor financial management seminars and a few dozen congregations have hired stewardship pastors (Kennedy, 2006). Crown Financial Ministries (2004) indicated that in a recent survey of several seminar groups, seventy percent said they believed that the Bible prohibits borrowing. Also, some churches explicitly connect the strength of one's faith with blessings from God in the form of material wealth. The implication is that financial problems may result from a lack of faith or sinfulness on the part of the member. In actuality, some Christians, like many other people, are buried in debt, behind on their bills, and have difficulty making ends meet. Because of the obligations ascribed to them, there is a desire to keep it a secret.

Opportunity

The second element in the process of a trusted person becoming a trust violator is the realization that the non-shareable financial problem can be secretly resolved by violation of the position of financial trust. Here, the trusted person perceives there is an *opportunity* for trust violation. On the element of opportunity, SAS 99 states that inadequate internal control over assets increases the susceptibility of misappropriation of those assets. Gerald M. Zack's (2003) book, *Fraud and Abuse in Non-profit Organizations,* specifically focused on fraud and abuse in the non-profit sector. He wrote that many of the same factors that make a for-profit business vulnerable to fraud are also present in non-profit organizations. However, non-profit organizations sometimes possess certain distinguishing characteristics that make their vulnerability to fraud and abuse different from commercial business. These characteristics include:

- *An environment of trust unlike that found in for-profit enterprises*
- *Excessive control by a founder, executive director, or substantial contributor*
- *Failure to include individuals with financial oversight expertise on the board of directors*
- *The existence of nonreciprocal transactions (donations) that are easier to steal than other forms of income*
- *Failure to devote adequate resources to financial management*

Churches, in general, have a reputation for having poor or nonexistent internal controls. Mark Burgund (1998), administrator at Calvary Church in Naperville, Illinois, has written about his observations of different churches. One example is of a faithful 20-year treasurer whose regular routine was to take the uncounted offering home and deposit the funds, with no accountability to anyone else. Another church had the offering regularly collected by the ushers, but then left only one usher to put the collection into a bank deposit bag and then the depository for counting the next day.

In a recent article about church embezzlement, Bob Smietana (2003) quoted Kent Egging, interim pastor of Bethany Covenant Church in Washington as saying, "I would bet that most churches in America have some or a significant number of financial records at somebody's house in a box or on somebody's computer, because home computers are generally better than church computers. A church wants to make it easy for a volunteer who is working on church finances."

Duncan and Flesher (2002) conducted a survey of 300 churches in the southern U.S. to determine their controls over cash receipts. They found that while large churches often use a counting committee to control offering receipts, most small churches do not have a counting committee and cash is not safeguarded at all times. In addition, small churches typically do not have a paid financial secretary. A volunteer treasurer usually performs the bookkeeping duties and prepares the monthly bank reconciliation. They noted that embezzlement in churches and non-profits has also taken place because the same individual prepared checks for signature, mailed the checks, and performed the monthly bank reconciliation.

There are a number of other factors that may make churches more susceptible to fraud than other organizations. Like many non-profits, church leaders are often not well versed in financial management and would prefer to focus on operational and mission related activities rather than administrative duties. Like small non-profits, churches often use volunteer help in administrative functions as well as mission related services. Many non-profits also assume a high level of morality among their members and staff. However, the level of morality expected of church members is generally more explicit due to expected adherence to biblical commandments, etc., and because Christianity discourages members from judging one another. This may cause suspicions of wrong doing to go unquestioned and uninvestigated more than it would in a non-religious non-profit. In reviewing the literature, we encountered accounts of churches that had been the victims of embezzlement whose members were unwilling to prosecute the perpetrator based on the religious organization's concept of forgiveness, particularly if the person apologized (repented) (Egging, 2005; Smietana, 2003; Throop, 2001). In addition, few non-profit organizations collect cash contributions on a regular basis as often as churches do. Unlike a small business organization, which may also handle frequent cash receipts, churches lack the element of an involved owner who may be monitoring the financial condition of the organization as a matter of self-interest. Finally, one of the most significant differences between churches and other non-profit is that many members donate funds to the church out of obedience to God under the concept of tithing, rather than to support a specific activity or mission of the organization. This may further result in a decoupling of revenue streams and organizational outcomes that reduces accountability for expenditures and may increase the opportunity for financial fraud and embezzlement in religious organizations.

Rationalization

The third element necessary for criminal violation of financial trust is the trusted person's application of verbalizations to his conduct, which enables him to adjust his conceptions of himself as a trusted person with his conception of himself as a user of the entrusted funds or property. Cressey applied the term "rationalization" to this phase. In this phase, the potential trust violator defines the relationship between the non-shareable problem and the illegal solution in language that allows him to look upon trust violation as: 1) essentially non-criminal, 2) as justified, or 3) as a part of a general irresponsibility for which he is not completely accountable. Because the non-shareable financial problem is unusual and extraordinary, he does not consider his behavior immoral. The trust violator does not commit the criminal act, and then rationalize it; he commits the act *because* he is able to rationalize it. In all of the cases Cressey encountered, rationalizations were present before, or at least at the time, and after the criminal act took place.

Almost all who embezzled over a period of time used the rationalization that they were merely "borrowing" the entrusted funds. A sense of entitlement or "the organization owes it to me" is a common rationalization used when someone feels under-compensated. It would make sense that a church employee could feel under-compensated, as most work performed for the church is done on a volunteer basis. Further, it is common that pastors are compensated quite generously, especially in successful churches with large congregations. Egging (2005) wrote that a woman hired as a bookkeeper in a Seattle church was found to have embezzled more than $300,000 over a period of several years. The pastor, in retrospect, traced the genesis of her embezzlement to a conversation he had with her prior to her hiring. In their conversation, she expressed shock at how much money the pastor was making. When confronted about the embezzlement, the woman said that she felt she deserved the money she took because the pastor made so much. In a news article, Mathewson (2005) reported on an embezzlement that occurred in an Altus, Oklahoma church. The treasurer of the church, who was found guilty on 17 counts of embezzlement, said in an affidavit that the money she took was reimbursement for her labors at the church. In its early origins, the Christian church adopted a communal structure with shared property. Therefore, a member might use this to rationalize that he should be able to use church assets to meet his needs.

Trust and Opportunity

Hardin (2002) argues that if there is a reasonable level of trustworthiness in one's present community, one can benefit if he has an adequate capacity to trust. Someone who lacks such capacity will be a relative loser. Roland McKean (1975, p. 29) claims that "greater ability to trust each other to stick with agreed-upon rules would save many costs and make life much pleasanter." In a relatively cooperative populace, people can gain if they have a capacity to trust and to be optimistic about the cooperativeness of others.

However, according to the Centre for Ethical Orientation (2006), eight out of ten people believe strongly that trust in society is on the decline. Greed is seen as the most disturbing motivator for this decline, and is assumed to be the motivation for many scandals that have plagued the public and private sector. Many recent studies of trust point to an eroding of honesty in society. Tamar Frankel (2006) writes that America is becoming used to deception and abuse of trust. This conclusion was not based on a study of people's sentiments, nor a database comparing today's fraud with fraud in the past. Rather, it points to newspapers, magazines, court cases, and various studies. Deception has become widespread throughout the population and across all walks of life. More corporations defraud customers and investors. More students cheat on examinations; more athletes cheat. Science and journalism have been contaminated by fraud. Deception, cheating, and fraud have become so repetitive that they have affected general attitudes, and modern society is moving toward a greater acceptance of dishonesty as a "way of life" and toward justifications such as, "dishonesty is not that bad," or "everyone does it."

In contrast, the publication *Report of Findings of a Survey of Public Trust and Confidence in Charities* (2005), trust in non-profit organizations was found to be at a high level. The main factor that drives this trust is the inherent belief that money that is contributed to them will be spent wisely and effectively. In churches, this belief is grounded in faith rather than in any rationally based expectation, as the majority of churches are not audited, and most members do not do not scrutinize the finances of the churches to which they give money. This high level of trust makes churches particularly vulnerable to fraud.

EXPLORATORY SURVEY

From existing literature, it seems that all three elements of the fraud triangle may be more likely to be found in religious organizations than other organizations. Because opportunity is the element that is most controllable by the organization, we focused our exploratory survey on the element of opportunity in churches. Our study addressed five major issues relating to opportunity for fraud.

Issue 1: Do church members possess a high level of trust in their church leaders and employees handling finances?

If church members have a high level of trust in their church leaders, they may not question how church finances are spent. Further, if the pastor does not want to appear to be questioning the faith or morality of his employees (or volunteers who fill those roles), then those handling church funds may be less likely to be subject to a high level of supervision or monitoring. In many embezzlement cases, trust is misplaced in the embezzler, then internal controls are sidestepped, or at various instances, deemed unnecessary. Up to this point, in current literature, it is only presumed that a high level of trust in church is the main factor contributing to the opportunity for embezzlement. According to Smietana (2005), "They are vulnerable because of trust given to employees.…" Busby (2005) wrote, "Churches are susceptible to fraud because of a desire to trust everyone." Our exploratory survey included questions to validate the presumption that trust is a major factor contributing to increased opportunity for fraud in churches.

Issue 2: Does a high level of trust by the church pastor for his employees lead to a low level of oversight?

The word faith, when used in religious contexts, suggests an unquestioning trust in someone or something, which does not require evidence. Frankel (2004) suggests that the unquestioning faith that church members place in God is transferred to group members with whom they share religious bonds. Further, a church does not instill in its members the negative need to be protected from one another. If the church leader possesses an unquestioning trust for his employees, there would be little need to supervise and monitor them. When there is no supervision, the opportunity for an employee handling church finances to commit embezzlement is magnified.

Issue 3: *Does a high level of trust placed in church leaders lead to a low demand for disclosure?*

The money donated to churches by its members is the church's lifeblood, its main source of revenue. Typically, when one gives or invests money, he would require an accounting or some form of disclosure from the entity to which money was given or invested. This is even true when one donates to charities and non-profits. In church, because there is trust without verification, perhaps there is less need for disclosure. In business, there is not the same level of trust. Investors have no such level of trust or faith in publicly traded companies. However, investors must gain some level of confidence or trust in companies, otherwise there would be no investment. It can be reasoned that when trust is lower, there will be a greater need for monitoring and for fair, accurate, and timely disclosure. Alternatively, when there is a high level of trust, there is not the same need for disclosure.

Issue 4: What are the primary reasons that people give money to church, and will this impact the demand for disclosure?

Money donated to a church by its members goes toward support and maintenance of the church's regular operations, and various programs. However, church members may give money to the church for other reasons. According to one associate pastor interviewed, church members give money to the church out of obedience. There are numerous passages in the Bible that instruct Christians to give a tithe and offering.[3] In Malachi 3:8, Christians are even told that they rob God when they fail to give a tithe and offering. Although many church members may assume that their donations are going to proper use, the manner in which their donations are ultimately utilized may not be of utmost importance to them. The fact that a church member has given, and that he has been obedient, may be more important to him than how the money is ultimately spent. Although many church members may trust that their money is being spent wisely, they may be ignorant of how their tithes and offerings are being spent.

Issue 5: Is there an over-reliance on trust in churches rather than internal controls to prevent fraud and embezzlement?

A high level of trust in church does not necessarily preclude good internal controls. A church can have acceptable or unacceptable internal controls regardless of the level of trust that exists. The quality of a church's internal control system does not necessarily need to be related to the level of trust that exists in the church. However, the literature suggests that: 1) churches have poor internal control systems; 2) churches have an environment of high trust; 3) churches are embezzled. Our exploratory study examines the use of internal controls in churches and the relationship of trust to internal controls.

SURVEY CHARACTERISTICS

The data for the exploratory study were obtained by mailing two separate surveys -- one to a sample of church pastors and another to a sample of church members.

Description of Surveys

[3] Leviticus (27:30-33); Numbers (18:26-32); Malachi (3:8)

Each survey contained questions unique to the subject sample. Prior to mailing, both surveys were reviewed by two associate pastors and a deacon, each of whom attend different churches. They all indicated that the questions sufficiently addressed trust and opportunity.

The survey sent to church pastors was designed to measure trust and opportunity. The focus of the questions was twofold: 1) measure the level of trust that the pastor has for his employees; 2) measure the level of internal controls.

The survey sent to church members was designed to measure several aspects of trust: 1) the overall environment of trust that exists within a church; 2) the trust that church members place in their church leaders; 3) the level of confidence church members have that the church spends money wisely; 4) the church members' motivation for giving to the church; and, 5) the church members' demand for disclosure.

Participants

Pastors

Surveys were mailed to 120 churches and addressed to the attention of the pastor. Churches were located on the islands of Hawaii and Oahu in the state of Hawaii, as well as in the state of California. Hawaii Island churches were selected from a church directory that appears in each Saturday edition of the *West Hawaii Today* newspaper, and also from a church listing that appears in each Friday edition of the *Hawaii Tribune Herald* newspaper. Oahu churches were selected from an on-line Christian church directory for Oahu churches.[4] California churches were selected from an on-line

[4] http://ckn.com/church/churchtx.htm

national church directory.[5] Churches were all Christian-denominated churches: Christian churches, Christian Ministries, Assemblies of God, Christian Fellowships, Non-denominational Christian churches, Churches of Christ, Christian Congregational Churches. Forty-three surveys were returned completed (36% response rate). Thirty-two of the surveys were completed by pastors of churches with regular attendance of at least 150 and are included in the analyses. Of the 32 churches included, 21 are located in the state of Hawaii. Whether or not these churches actually experienced embezzlement is unknown. Whenever they were asked to make a subjective assessment regarding a particular matter, they were asked to quantify the assessment on a Likert scale with 1 as the highest metric.

Church Members

Surveys were sent to members of 12 different churches. For each church, a central contact person was established who received the surveys in the mail and distributed them. The total number of surveys sent via this method was 120. Another 17 surveys were mailed, handed out, or mailed directly to known attendees of Christian churches. A total of 54 completed surveys were returned, representing a response rate of 39 percent. Table 1 summarizes the sample of church members' responses. Because a significant number of questions involved the issue of disclosure, and because the importance of disclosure to an individual typically increases with the amount of money he or she donates, only respondents with annual giving to the church in excess of $1,000 *and* whose annual giving to the church was at least 5% of income are included in the analyses. Further, because poor internal controls and a lack of formal systems and

[5] http://churchangel.com/californ.htm

procedures are characteristics more likely to be found in small organizations, only surveys from churches with regular attendance of at least 150 are included.

Forty-one participants from 10 churches satisfied all of the criteria. All of the 41 church members had been attending church regularly for at least five years, and all 41 had been attending their current church for at least one year (please see Table 1).

RESULTS AND ANALYSIS

Trust of Church Members

Table 2 provides data about the parishioners' trust in church leaders. Seventy-three percent (73%) of respondents believed that their church leaders, which include all church officers and officials, possessed the highest possible level of honesty. Most others believed that church leaders possessed at least a high level of honesty. Perceived honesty is the most significant quality associated with trustworthiness (Hardin 2002). Church members were also asked to rate, on a scale of 1 to 9, how much they trust their church leaders (please see Table 2).

The responses demonstrate that church members perceive their church leaders as being very honest, with 95% of respondents indicating a high or highest level of honesty. Trust in employees handling church finances was also very high. The responses generated a mean trust score of 1.93. The data suggests that church members have a very high level of trust in their church leaders and employees handling church finances.

Trust and Confidence that Church Funds are Spent Wisely

If one does not have trust and confidence that money he donates to an organization is being spent wisely, he would not be inclined to give significant amounts of money to the organization. Typically, one could rely on reports and various disclosures to make the determination of whether or not an organization is spending money wisely. Issue 3 addresses whether the level of trust placed in church leaders leads to a low demand for disclosure. Table 3 contains data about the frequency of financial disclosures and the amount of scrutiny by parishioners of this information (please see Table 3).

Fifty-four percent (54%) of participants said that their church provided disclosures annually or less frequently. Only 22 percent said that disclosures were provided on a quarterly or more frequent basis[6].

Respondents were also asked to rate the level of care and attention they pay to disclosures, with 1 being the highest level of care and attention and 5 being the lowest. The average score of all respondents was 3.11. Although church members most commonly said that disclosures were provided annually or less frequently, the responses to the second question regarding the care and attention devoted to reviewing the disclosures were fairly evenly distributed.

The level of care and attention that the church members devote to reviewing disclosures was inversely correlated to the level of trust they have that their church leaders will behave ethically ($r = -0.6834$). As the level of trust increases, the level of care and attention paid to disclosures decreases, which indicates a greater opportunity for embezzlement in situations where church members are relying on trust.

[6] Interestingly, there were four churches in which members differed on how frequently disclosures were provided. For example, in church #7, four out of five members said that disclosures were provided annually, and one said that disclosures were provided semi-annually. In church #3, four out of five said that disclosures were provided less frequently than annually, and one said they were provided annually. When this type of variation was found in each of the four churches, the number of dissimilar responses within each church was limited to one. When these dissimilar responses were encountered, it was perhaps because the respondent was indicating his/her perception rather than the actual practice of the church. Nonetheless, these dissimilar responses are still counted.

We also asked whether the church members were confident that the money they gave was put to good use. Despite the lack of frequent financial reporting, 80% of church members were confident that the money they give to the church is put to good use. This indicates that there is a high level of trust but a relatively low level of oversight.

The Lack of Importance Placed on Money Reaching an End Cause

Another factor contributing to low demand for financial disclosure may be that there is little importance placed on the end cause to which money is donated in church. To address Issue 4, participants were asked what their reasons for donating to the church were. Table 4 provides information about the motivations for giving to the church (please see Table 4). Over half of the church members indicated that obedience was their primary motivation for donating. Another 12% indicated they had an expectation of a blessing in return. Less than one-third mentioned that support and maintenance of the church and its programs was the most important reason they donated money.

We divided the church members into four groups based on the primary reason they donated to the church. We then used the data for the level of care and attention devoted to reviewing financial disclosures from Table 3, to compute separate mean scores for each of these four groups of respondents. We wanted to examine whether those who donate money to support and maintain the church and its programs would have a greater interest in how their churches spend money, compared to church members who donate money out of mere obedience. For those who answered that obedience was the most important reason they gave money to church (n = 22), their mean score was 3.41.[7]

[7] The six respondents who answered that they did not know how often their church provided disclosures were assigned a score of 5, as not knowing how often disclosure was provided was equated to the lowest level of care and attention to reviewing disclosures.

Those who said that support and maintenance of the church and its programs was the most important reason they donated money (n = 12) had a mean score of 3.33, which was not significantly different from those who said obedience was the most important reason. Therefore, we cannot conclude that when obedience is the reason that the church member donates money, the need for disclosure will be lower. Examination of the data did not reveal any pattern that would support our premise that obedience, together with a high level of trust for church leaders, reduces the demand for financial disclosure in church. Rather, it seems that the level of scrutiny of financial disclosures is moderate to low for most of the respondents, regardless of the reason for donating.

The Trusted Employees and the Lack of Internal Controls

Cressey (1953/1973) said that the mere occupancy of a position of trust provides opportunity for fraud and embezzlement. Dependence upon one or two people who seem to have the utmost integrity, and an over-reliance on a person's conscience or sense of moral duty, dramatically increases the opportunity. The employees referred to in this section are those that are entrusted to handle the church's finances. Most reports of church embezzlement involve the pastor/priest or the church treasurer or bookkeeper (West and Zech, 2007; Busby, 2004). This is because most financial fraud requires the person to have both access to assets and access to the financial records to cover up the defalcation. The higher incidence of embezzlement by pastors is most likely due to the ability of top management to override controls, which is a common weakness of most internal control systems, particularly in smaller organizations.

Issue 2 addresses whether the level of trust the church leader has for his employees leads to a low level of oversight. The overall level of trust was measured by calculating a mean score of all responses from pastors (n = 32) when they were asked to rate the level of trust they have for their employees that handle church finances. The responses are summarized in Table 5 (please see Table 5).

Forty-one percent (41%) of all pastors rated the level of trust in their church employees as the highest possible. The mean score from all responses is 2.13, suggesting that overall trust in church employees is high.

While some may question whether pastors are qualified to interpret financials, many denominations provide financial management training for their pastors and prescribe internal control systems for their churches (West and Zech, 2007; Goodstein and Strom, 2007). To measure oversight of financial management, pastors were asked to rate: 1) how closely they monitor and supervise the employees that handle church finances; and, 2) how closely they review and scrutinize financial reports (please see Table 6). Mean scores were developed from the pastors' responses to each question. The mean score for monitoring and supervision of church employees was 5.41, suggesting a slightly less than mid-level amount of supervision.[8] Reviewing financial statements and raising critical questions is an important function, especially if church finances are handled by only a few people. The mean score for the pastors' scrutiny of financial reports was 5.56, again suggesting a slightly less than mid-level amount of scrutiny.

[8] Pastors were asked to rate the level of scrutiny they exercised over financial reports only if they were actually provided these periodic reports; all responded. All respondents also said that the financial reports provided by the treasurer were subject to review by at least one person.

To test whether or not the lower levels of supervision and oversight by church pastors were related to trust, the responses to the questions regarding supervision and oversight, summarized in Table 6, were correlated with the responses to the question regarding trust in church employees, summarized in Table 5. The results revealed an inverse correlation between trust and supervision of employees ($r = -0.5834$). Similarly, the correlation between trust and scrutiny over financial reports was also negative ($r = -.6429$). Similar to the results for church members, the fact that pastors rely on trust rather than appropriate supervision and oversight provides a greater opportunity for an undetected misappropriation of church assets.

Issue 5 addresses whether there is an over-reliance on trust rather than internal controls to prevent fraud and embezzlement. Improper handling of funds is not uncommon in churches (Duncan and Flesher, 2002; Busby, 2005; West and Zech, 2007). To determine the incidence of embezzlement in the wide variety of denominations throughout the U.S. could be quite difficult, as churches may be reluctant to admit their members or leaders have stolen from the congregation. Often times there is no insurance available for recovery, or there is insufficient evidence to merit prosecution; so many churches choose not to publicize or prosecute members who misappropriate funds, due to embarrassment or a philosophy of forgiveness (Smietana, 2003; Busby, 2004). Therefore, what is measured in this study is the opportunity for fraud resulting from poor internal controls, specifically, lack of segregation of duties. Pastors were asked to select from a list of ten different job duties, all of the duties that are performed by the church treasurer. Table 7 contains the data from this question (please see Table 7). Two respondents answered that they did not know. Of the remaining thirty churches, 23 have treasurers that perform combinations of duties that are unsatisfactory. One example is the handling of both cash receipts and the reconciliation of the bank account. Another example is the maintenance of the records for offerings, handling and depositing of the offerings, and issuing statements to members that detail their offerings, all being performed by the treasurer. These results are consistent with those of Duncan and Flesher (2002) who also found that many churches have poor controls over cash.

Organizations can have a preference to rely on trust or internal controls. These two preferences are not mutually exclusive, and reliance upon some combination of both is probably optimal. The preference for reliance upon trust versus internal controls was measured with two separate questions. The first question asked pastors how strongly they agreed, on a 1 to 9 scale, with the following statement (statement 1): "To prevent fraud and embezzlement, I rely upon the honesty and consciences of the workers who handle church finances." The second question asked pastors how strongly they agreed, on a 1 to 9 scale, with the following statement (statement 2): "To prevent fraud and embezzlement, I rely upon sound business practices, accounting procedures, and internal controls." Table 8 contains the data from these questions (please see Table 8). Sixty-three percent (63%) of pastors agreed more strongly with the first statement. Of the seven churches that have proper segregation of duties, five pastors agreed more strongly with Statement 2, indicating a reliance on internal controls. Of the 22 churches that have improper segregation of duties, 17 agreed more strongly with Statement 1, relying on employee honesty, while only two agreed more strongly with Statement 2.

CONCLUSIONS

It would be difficult to over-emphasize the influence of religion on society, and the significant financial resources commanded by religious organizations. While organizations such as the Roman Catholic Church and the Church of England have played significant roles in history, comprise a significant portion of organizational activity, and control significant wealth, little empirical research has been done regarding the accounting and financial management systems of religious organizations (Booth, 1993). This study clearly demonstrates the existence of the elements of incentive, rationalization, and opportunity for financial fraud within the Christian church. Hopefully, this study will contribute to the literature to alert church leaders and trustees that, despite the high moral values associated with their religion, embezzlement can happen in church. Whether or not the elements of incentive and rationalization of fraud are more prevalent in church than in other organizations is still unknown. What is apparent from this study is that the presence of the element of opportunity is common in churches. Research on fraud and embezzlement make it clear that opportunity is one of the key elements involved in most employee embezzlements (Cressey, 1973; Albrecht, et al, 1995), and thus would be presumed to also be a contributor to embezzlement in churches. Our findings also indicate that trust drives opportunity.

Church members were found to have a high degree of confidence that their church leaders will behave ethically. They also believe that their church leaders possess a very high level of honesty. The high level of trust was found to have an inverse relationship to the need for financial disclosure. As trust increases, the demand for disclosure decreases. Likewise, when there is little or no trust, as is the case in the relationship between the investing public and publicly-traded companies, the demand for disclosure is high. When disclosures are not provided regularly, or not reviewed and scrutinized by church members, an important part of a system of checks and balances is lost. West and Zech (2007) found there was less fraud in Roman Catholic dioceses if the Diocesan Finance Council (DFC) was involved in reviewing the budget. Also, more frequent meetings of the DFC resulted in better fraud detection. Therefore, Church leaders and pastors can play a tremendous role in reducing the opportunities for embezzlement. If they consistently monitor and supervise the employees who handle church finances, the employees will perceive that the opportunity to embezzle is small or nonexistent. Further, they can curtail embezzlement by reviewing the treasurer's reports, or various financial statements. By scrutinizing reports and raising questions, the church can greatly reduce perceived embezzlement opportunities.

Pastors, however, were found to have a high level of trust for their employees. The trust that pastors have for their employees was found to have an inverse relationship to the level of supervision and monitoring they provide to employees. It also has an inverse relationship to the level of review and scrutiny of financial reports. Thus, by placing a high level of trust in his employees, the pastor creates at least a perceived opportunity for embezzlement.

While lack of oversight creates perceived opportunity, a poor segregation of duties creates real opportunity. The majority of churches in this study were found to have unsatisfactory combinations of duties that would allow embezzlement to be perpetrated, and concealed. In these churches, the church leaders' trust for the employees who handle church finances outweighs internal controls as the preferred deterrent to embezzlement.

For various reasons, there is an expectation of trust in church (Throop 2001). If this environment of trust did not exist, the church as an institution would fail. An environment of trust is preferable to one of distrust. Life is more pleasant in an environment of trust, and people can gain if they have a capacity to trust and to be optimistic about the cooperation of others. However, when it comes to handling church finances, trust is not a good deterrent to embezzlement, and may even be a catalyst. Trust should not be a substitute for sound business practices, accounting procedures, and internal controls.

Limitations and Recommendations for Future Studies

As an exploratory study, this study has many limitations. One risk is that the churches selected for study may not be representative of the entire population. As in most survey research, there is also a risk of non-response bias. Our response rates of 36% for pastors and 39% for church members are respectable, and we did not find any systematic difference between respondents and non-respondents. However, the parishioner respondents of our survey are likely more involved than the average parishioner and therefore their attitudes may not be representative of the church members as a whole. The relatively small sample size not only increases this risk, but also somewhat limits the nature of the analysis that can be conducted. The sample is also geographically specific to Hawaii and California, and may not represent churches in other parts of the U.S. or abroad. Future research should strive for larger samples and test specifically for non-response bias.

Furthermore, we did not gather any data from other non-profits or small businesses. Therefore, we do not know whether our premise that churches are more susceptible to fraud than these types of organizations is true. Future research will need to be done to test this.

An empirical study of churches that have experienced embezzlement would be quite beneficial. The recently released study "Internal Financial Controls in the U.S. Catholic Church" by West and Zech (2007) is an excellent example of the type of large-scale research that could greatly benefit the field if replicated in other large denominations. Although their study was not specifically designed to address embezzlements, their findings of the high incidence of embezzlement in the church point to the need for additional research on the causes and remedies for this widespread problem. Such a study could determine if trust and opportunity were the main factors contributing to the embezzlement in actual cases. Some churches, through their message of redemption and forgiveness and through various outreach programs, also attract a number of former drug users, alcoholics, gamblers, ex-convicts, and other people seeking deliverance. Thus, it would be interesting to explore the element of pressure (incentive) and fraud, to see if this element is more prevalent in church than it is in other groups or organizations.

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TABLE 1
Sample of Church Member Participants: Size of Church and Annual Giving

	Number	Percent
Participants	54	100
Attendance ≥ 150	47	87
Annual giving ≥ $1,000	50	93
Annual giving ≥ 5%	44	81
Satisfies all criteria	41	76

TABLE 2
Church Members' Trust in Honesty of Church Leaders

	Number	Percent
Church members belief in the honesty of church officials and leaders		
Highest possible level of honesty	30	73.17
High level of of honesty	9	22.95
Somewhat honest	2	4.88
Level of church members trust church employees handling church finances (1-9)		
1 (highest level of trust)	17	41.46
2	14	34.15
3	7	17.07
4	2	4.88
5	1	2.44
6 – 9 (9=lowest level of trust)	0	0.00

TABLE 3
Frequency of Disclosures and Level of Attention Paid to Disclosure by Church Members

	Number	Percent
How frequently does church provide financial disclosures?		
>Monthly	0	0.00
Monthly	2	4.88
Quarterly	7	17.07
Semi-annually	4	9.76
Annually	12	29.27
<Annually	9	21.95
Do not know	6	14.63
Rate the level of care and attention you devote to reviewing these disclosures (1-5)?		
1 (highest level of care and attention)	4	9.76
2	6	14.63
3	11	26.83
4	10	24.39
5 (lowest level of care and attention)	4	9.76
6 N/A	6	14.63
How confident are you that money you give to the church is put to appropriate use?		
Extremely confident	21	51.22
Confident	12	29.27
Somewhat Confident	8	19.51
Not too confident	-	-
Not confident at all	-	-
Don't know	-	-

Table 4
Church Members' Reasons for Donating to Church

Most important reason church members donate money to church

	Number	Percent
Obedience	22	53.66
Support/maintenance of church & its programs	12	29.27
Expectation of a blessing in return	5	12.20
Other	2	4.88

Table 5
Pastors' Trust in Church Employees

	Number	Percent
Rate the level of trust you have in employees who handle your church's finances (1-9)		
1 (highest level of trust)	13	40.63
2	7	21.88
3	8	25.00
4	3	12.50
5	1	3.13
6-9(lowest level of trust)	0	0.00

Table 6
Pastors' Supervision of Church Employees and Scrutiny over Financial Reports

	Number	Percent
How closely supervised are the employees who handle church finances?		
1 (highest level of supervision)	0	0.00
2	1	3.13
3	7	21.88
4	2	6.25
5	8	25.00
6	4	12.50
7	4	12.50
8	4	12.50
9 (lowest level of supervision)	2	6.25
How closely scrutinized are the financial reports that are prepared by the treasurer or other church employee?		
1 (highest level of scrutiny)	2	6.25
2	1	3.13
3	3	9.38
4	2	6.25
5	7	21.88
6	5	15.63
7	6	18.75
8	4	12.50
9 (lowest level of scrutiny)	2	6.25

Table 7
Pastors' Assessments of Duties Performed by Treasurer

	Maint. general ledger	Maint. a/p ledger	Maint. cash disb. journal	Prep. checks for signing	Recon. bank account	Sign checks	Handle& deposit cash receipts	Generate offering stmts for mbrs	Maint. Offering records	None	Don't Know
R1	X	X	X	X	X		X	X	X		
R2											X
R3	X			X	X		X	X	X		
R4	X			X	X	X	X	X	X		
R5	X			X			X				
R6*	X	X						X	X		
R7	X	X		X	X		X	X			
R8	X	X	X	X	X			X	X		
R9	X			X	X		X	X	X		
R10	X			X			X	X	X		
R11*						X		X	X		
R12	X				X	X	X		X		
R13				X	X		X	X	X		
R14*	X				X			X	X		
R15	X	X		X	X		X	X	X		
R16				X	X		X	X	X		
R17		X	X	X	X		X	X	X		
R18*	X		X	X	X						
R19	X	X	X	X	X	X	X	X	X		
R20*					X			X	X		
R21	X	X	X	X					X		
R22					X		X	X	X		
R23	X	X	X		X		X	X	X		
R24											X
R25*	X		X	X			X				
R26	X			X			X	X	X		
R27	X			X	X		X	X	X		
R28	X	X	X		X		X				
R29	X				X	X	X	X	X		
R30*	X		X				X				
R31	X	X	X	X	X		X		X		
R32	X		X	X	X		X	X	X		

**No unsatisfactory combinations of duties*

Table 8
Relationship between Pastor Reliance Upon Internal Controls or Trust and Level of Segregation of Duties

Reliance on trust (statement 1) vs. Internal controls (statement 2)	Total	Number with proper segregation of duties	Number with improper segregation of duties	Number unaware of duties of treasurer
Pastors with more reliance on trust (Agreement with statement 1)	20	1	17	2
Pastors with more reliance on controls (Agreement with statement 2)	8	5	2	1
Pastors with equal reliance (Agree equally to each statement)	4	1	3	0