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Influence of Leadership Positions on Internal Controls and Reported Fraud In Religious Organizations

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In this study, we survey church financial leaders to assess whether particular leadership positions or governance bodies within the church are associated with the presence of accounting controls and the reported rate of fraud. We also examine the association between church internal controls, the reported occurrence of fraud, and the perception by church financial managers of their organization's vulnerability to fraud.

Prior research finds that church members generally trust their leaders to manage church financial affairs. Specifically, Ventura and Daniel (2010) report that although church financial disclosures are relatively infrequent and not uniform across churches, this deficit does not appear to alter the confidence of church members that their contributions are being used appropriately. They also find that pastors consistently trust their employees and that in managing church finances, 63 percent of the pastors rely more heavily on the concept of trust than on deployment of effective internal controls. With respect to the particular role of clergy in church financial oversight, Booth (1993) finds that professional clergy might not be trained or predisposed to exercise sound accounting management practices; consequently, other parties need to be involved in church financial governance to ensure that funds are accounted for and used properly. This development leads to the question as to which church leadership positions or governance bodies are effective at instituting internal controls or preventing fraud.

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Stewardship over church financial resources has a significant impact at the individual, church, and societal level. Many individuals devote a substantial portion of their income to religious organizations, presumably under the assumption that the contributions will be put to their intended use. A Barna Group (2010) study finds that 7 percent of all adults donate at least 10 percent of their income to churches. In total, individuals, foundations, corporations, and others donated $291 billion to charities in 2010. Religious organizations received $101 billion (35%) of this amount, which was more than double the amount ($42 billion) received by the next largest beneficiary group (education).

These donations can produce many benefits but also come at a cost that accrues to more than the donors. The tax deductibility of these contributions creates a social cost by diverting significant funds from federal and state treasuries. As far back as the 1990s, the tax exemptions received by nonprofit organizations (NPOs) were estimated to be worth about $166 billion annually (Brody and Cordes, 1999). The public good that would be produced by tax dollars is traded for a public good to be produced by nonprofits. This exchange creates an additional obligation for good stewardship over the substituted dollars.

Despite the significant social and economic impact of churches, they are subject to little regulatory oversight from federal or state governments. Unlike other NPOs, churches are exempt from filing informational tax returns with the Internal Revenue Service. Without any mandatory reporting requirements, the only parties likely to review a church's financial information are a parent denomination (if one exists), a governing board for the church, and possibly church members. This lack of disclosure makes churches ripe media for the growth of various forms of fraud and abuse.

Although churches are prominent institutions, both economically and spiritually, there is a paucity of research with respect to their accounting practices. Carmona and Ezzamel (2006) attribute this shortage to an overall lack of academic interest in the area. However, given the economic and social importance of churches, it seems imperative to develop an adequate

understanding of the mechanisms (including internal controls) that can contribute to responsible stewardship of their resources.

Our work responds to the call for additional research on the presence of internal controls and fraud in churches. We use a sample of 129 houses of worship with considerable variation in organizational characteristics, including size (measured by membership and budget), denomination, and age. Our survey is conducted via an in-person, structured interview with an individual (e.g., member, volunteer, or employee) specifically involved in directing and managing the organization's financial affairs. The structured interview questionnaire covers four main aspects of church financial oversight: (1) organizational descriptive characteristics, (2) the presence or absence of specific internal controls, (3) the church's perceived vulnerability to fraud and/or embezzlement, and (4) the extent to which fraud has been detected in the previous five years.

This work adds to the relatively sparse but growing academic literature on the use and effectiveness of internal controls by churches. Specifically, our paper is most closely related to and extends the work of Wooten, Coker and Elmore (2003), West and Zech (2008), and Ventura and Daniel (2010). However, our research is different from the aforementioned papers in several respects. First, we do not limit our sample to one denomination. Second, our sample includes a wide variety of church sizes, measured by both annual budget and membership. Third, we capture data with respect to the reported occurrence of fraud in the past five years within the subject organizations.[1] Fourth, we examine the perceptions that church financial officers have with respect to their vulnerability to fraud. Fifth, we examine the extent to which the presence of

[1] West and Zech also track the incidence of embezzlement in their sample. However, their sample is fundamentally different in that their survey is administered at the diocese level, and a diocese is responsible for numerous churches. Accordingly, their results do not allow inferences regarding the number of individual churches reporting fraud or embezzlement.

internal controls and the occurrence of fraud are associated with particular aspects of church financial governance, including (1) an oversight organization, (2) professional clergy, (3) professional staff, (4) a board of directors, (5) a financial expert on the board of directors, and (6) a Certified Public Accountant (CPA) involved in audits of the entity. Finally, we examine specific internal controls that are not examined in the prior literature, including term limits, mandatory vacation, mandatory position rotation, related-party restrictions, and types of background checks.

Overall the results suggest that some parties, especially a financial expert on the board of directors, may have a positive impact on the level of internal controls in a church. At the same time, professional clergy may negatively affect the deployment of internal controls. However, we fail to find that the presence of more internal controls is associated with a lower reported rate of fraud. We offer a variety of possible explanations for this result. Some of these explanations address the chasm between actual and reported fraud, while others address the effectiveness of internal controls.

The next section of this paper describes the economic importance of churches in the overall economy and reviews prior research on the presence and effectiveness of accounting controls in religious organizations. The third section contains a description of our structured interview questionnaire, presents descriptive statistics of our sample, and presents the results of our empirical analyses. The final section contains our concluding remarks.

Economic and Societal Importance of Nonprofit Organizations

Despite the expectation that churches should be pillars of moral and honest behavior, the reality is that church members, volunteers, and employees do indeed embezzle from their religious institution (Throop, 2001; Busby, 2005; West and Zech, 2008), and some of these thefts

are quite substantial. Marquet (2011) examines 21 high profile embezzlements from churches that occurred in the first half of 2011. The dollar amount of these embezzlements ranges from hundreds of thousands of dollars to four cases in which over a million dollars was embezzled. These frauds include a $2.1 million embezzlement from the Visalia First Assembly of God church in California and a misappropriation of more than $1.5 million dollars from the Calvary Chapel Chino Hills church in California. Marquet's (2011) report indicates that the nonprofit industry, which includes churches, ranks third behind only financial institutions and government entities in the frequency of fraud and embezzlement; and the rate of these frauds appears to be increasing.

The preceding cases highlight the importance of understanding internal controls in churches, as some of the thefts received national news coverage. This type of notoriety can damage the reputation of churches and lead to a reduction in contributions by gun-shy donors. Consequently, to the extent that good controls could prevent these types of events and their accompanying media coverage, the victim churches and others would all be better off.

Aside from the obvious need to protect church resources and reputation, internal controls are important at the societal level because these resources make up a significant component of the U.S. economy. There are an estimated 1.6 million charities in the United States, which generated $1.4 trillion in revenues in 2007 and had $2.6 trillion in total assets (NCCS, 2010). Charities employ about 10 percent of the U.S. work force (Independent Sector 2010), pay over 8 percent of all wages and salaries (Wing, Pollak, and Blackwood, 2008), and account for 5 percent of gross domestic product (Independent Sector, 2010). In 2010, religious institutions received $101 billion in donations, which represented 35% of all charity donations; and 2010

was the 56th consecutive year in which donations to religious institutions outpaced all other nonprofit sectors (Giving USA Foundation, 2011).

Furthermore, the tax-deductibility of donations to churches results in significant loss of tax revenue to federal and state governments. The tax deductions are provided to donors under the assumption that the entity applies these revenues to its nonprofit purpose. This societal cost makes it imperative that donations are put to their intended use and not diverted to the pockets of embezzlers. Internal controls should play an important role in providing that assurance, and our study provides insight into whether these controls are sufficient.

Differences between Non-Profit and For-Profit Entities

Several characteristics of NPOs differentiate them from for-profit businesses. Most importantly, NPOs act out of a sense of social responsibility and their mission is to provide a service (Wooten, et al, 2003). This service may be medical care provided to indigent patients by a nonprofit hospital or spiritual salvation in a religious setting. On the other hand, for-profit firms operate with a primary goal of earning profits for shareholders.

Second, NPOs do not have stockholders as do publicly-traded or privately-held, for-profit businesses. Company ownership by shareholders inherently confers numerous legal rights and protections that do not accrue to NPO donors. Duncan, Flesher and Morris (1999) argue that "managers might not consider themselves as accountable to donors as they would to owners." Shim and Siegel (1997) and Wooten, et al. (2003) state that the inherent goals of NPOs likely result in these organizations devoting less attention to internal controls than their for-profit counterparts.

Indeed, the NPO structure leads to an extension of the agency theory dialogue (Fama & Jensen 1983a, 1983b). In the NPO setting, a separation between management and donors is substituted for the separation between management and investors that occurs in the for-profit setting. Given this substitution, donors may not have the same incentives as stockholders to monitor and prevent potential self-serving behaviors by management (Baber 2002). Agency theory is used to examine research relating to the motives of NPO managers to inflate reported efficiency ratios (typically measured as the ratio of program expenses to total expenses). Baber (2002) finds that such inflation of efficiency ratios results in higher levels of donations, which can then lead to higher compensation for NPO management. Krishnan, Yetman and Yetman (2006) show that NPOs in which donations and management compensation are sensitive to efficiency measures are more likely to inflate their efficiency measures. In all, the evidence suggests that self-serving behavior by management can exist in an NPO, just as it does in a for-profit setting, and that in at least some scenarios, donors are not effective at attenuating this behavior.

NPOs also differ from for-profits in a third way. Duncan, et al. (1999) note that the demand for and use of financial reporting is fundamentally different between for-profit and nonprofit firms. A for-profit entity issues four basic financial statements: an income statement, a statement of stockholders' equity, a balance sheet, and a statement of cash flows. If the entity is publicly traded, these statements must be audited by a CPA. Because the success or failure of the for-profit entity is largely measured in financial terms, the for-profit financial statements are quite useful in understanding the relative success or failure of the organization. On the other hand, FASB standards outline three financial statements for nonprofits: a statement of financial position, a statement of activities, and a statement of cash flows. Very few nonprofits are

required by statute to produce these financial statements or to have them audited. Because the main objective of the nonprofit is typically nonfinancial, the financial statements are not as useful in interpreting the success of the organization in achieving its objectives. Consequently, FASB Concepts Statement 4, issued in 1980, encouraged financial statement disclosures of service efforts and accomplishments by non-business organizations (GASB, 2011) but fell short of making such disclosures mandatory.

With respect to churches, there is considerable variation in the frequency and type of financial disclosures that they produce (Wooten, et al, 2003). They rarely provide all three financial statements on a quarterly basis, and some never provide financial disclosures of any sort (Wooten et al. 2003). When provided, church financial reports are of limited usefulness in assessing whether the church has achieved its main objectives (Duncan, et al, 1999).

It is also worthwhile to consider the role of the fraud triangle (Wells 1997) in the church setting. Fraud is generally thought to be more likely when the elements of the fraud triangle—pressure, opportunity, and rationalization—all coalesce. These three elements are present in a church, as in any other entity, but may take on a slightly different form. A particular source of both pressure and rationalization in churches may result from an unspoken expectation that ministers and church staff live a frugal lifestyle while simultaneously mingling with the wealthiest members of their congregation. This conflict may lead to a pressure to "keep up" with members of the congregation and/or a rationalization that they deserve more compensation because they are underpaid and overworked.

In describing the fraud triangle, Cressey (1953) specifies that the element of pressure is "nonshareable." Pressures that lead to fraud often arise from a perpetrator's issues with vices such as gambling, drug or alcohol addiction, or extra-marital activities. Within a church

environment, where expectations of virtue tend to be elevated, financial problems arising from such vices are likely to be deemed especially non-shareable, exacerbating the need to resort to illicit means to cover the financial aspects of these "needs."

The element of opportunity may be more pronounced in a church than in most other entities. This enhanced opportunity arises from a variety of factors. First, churches tend to be small, which typically means they have difficulty segregating duties and hiring professionals with financial expertise. Secondly, they have close-knit cultures—often hiring family members and friends—which can facilitate collusion. Third, they tend to value confidentiality—which may mean they are not adept at creating the perception of detection or the perception of consequences that are critical to deterring fraud. Fourth, they are subject to little or no regulation. Finally, they tend to be fueled by high levels of trust.

The element of opportunity may be less problematic in large churches than in small churches, because large churches may have more resources to prevent and/or detect fraud and because trust may more readily blind members in a small church. On the other hand, large churches may still be too small and too trusting to effectively segregate duties. At the same time, there are more assets that can be stolen in large churches, more employees and members that have access to those resources, and more complex financial transactions that may help cloak a fraud. Small church settings, where everyone knows each other, may also create an environment where it is more difficult to rationalize the commission of a fraud.

Research on Internal Controls in Religious Organizations

A considerable amount of research examines accounting information systems and the effectiveness of internal controls in NPOs such as public-sector organizations and nonprofit

hospitals and universities (Wildavsky, 1975; Van Gunsteren, 1976; Hopwood and Tomkins, 1984; Covaleski and Dirsmith, 1986a, 1986b, 1988; Hamburger, 1989). However, relatively little research examines the role of accounting in religious institutions. As Carmona and Ezzamel (2006) note: "Research on the relationship between accounting and religion or religious institutions is in short supply." Within the subset of accounting research that includes churches, only a few studies evaluate the effectiveness of internal controls in a church setting.

Duncan, Flesher and Stocks (1999) use a sample of 317 surveys from three different denominations of churches to examine whether internal controls are related to size and organizational form of churches. Specifically, they examine Presbyterian, United Methodist, and Southern Baptist churches to determine whether there are cross-denomination effects due to differences in the organizational structure of churches. Three main types of organizational form, or polity, exist in churches: (1) Congregational, (2) Episcopal and (3) Presbyterian (Gray and Tucker, 1990; Duncan, et al, 1999). Congregational churches, such as Southern Baptist churches, function in a highly autonomous environment, with the final authority residing in the will of the majority of the members of the individual church. Episcopal churches, such as United Methodists, operate in an environment which is governed by the highest-level bishop; and authority is delegated down to the clergy. Presbyterian churches represent an organizational form that falls between that of Congregational and Episcopal churches; i.e., they elect a governing body of presbyters from the church membership. This group of presbyters then meets to make decisions on a majority basis, and each presbyter holds equal standing. Duncan, et al. (1999) find evidence of both a denomination effect and a size effect. Specifically, they find that United Methodist and Presbyterian churches have stronger internal controls than Southern Baptist

churches. They also find that large churches have better internal controls than small churches and that this size effect is consistent across the three denominations.

Wooten, et al. (2003) use a sample of 548 Southern Baptist churches that have at least 100 members. They examine (1) whether there is a relation between size and internal controls; and (2) whether churches that are audited by a CPA have stronger internal controls. They present evidence that churches in their sample have adequate internal controls over cash coming into the organization. However, they find that overall internal controls are quite weak, including controls over cash disbursements and financial reporting. Consistent with Duncan, et al. (1999), they report that larger churches have stronger internal controls and are also more likely to have an external audit performed by a CPA, partly because they have more resources available to hire professional auditors.

West and Zech (2008) examine the effectiveness of internal controls in Catholic churches in a survey of 78 diocesan chief financial officers. The sexual-abuse scandals that plagued the Catholic Church were associated with a set of financial improprieties that led to some scrutiny of church internal controls. This examination revealed that a number of internal controls had been in place, as required by canon law, but their effectiveness was certainly in question. In the aftermath of this discovery, West and Zech (2008) conduct a survey that focuses on high-level internal control policies and financial reporting practices, rather than specific internal controls. Interestingly, they find that 85 percent of the finance councils have at least one CPA as a member. They also report that 85 percent of the dioceses reported instances of embezzlement within the prior five years. Over 90 percent of these embezzlements were actually reported to the police, presumably as a deterrent to future theft. The reporting of these thefts is surprising given the claim that many churches do not prosecute embezzlement because of the Christian principle

of forgiveness. In contrast to the results of Duncan, et al. (1999) and Wooten, et al. (2003); West and Zech (2008) find no evidence that larger dioceses are associated with less fraud. Finally, they show that the frequency of internal audits is the most important internal control in preventing embezzlement.

In interpreting the evidence from West and Zech (2008), it is important to note that their survey was administered at the diocese level with each diocese overseeing numerous individual churches.[2] For example, the state of Arkansas consists of only one diocese, which oversees all Roman Catholic churches in Arkansas. Consequently, the finding that 85 percent of dioceses experienced an embezzlement does not mean that 85 percent of Catholic churches experienced an embezzlement. However, their evidence that embezzlement occurs quite frequently in religious institutions is consistent with prior work (Throop, 2001; Busby, 2005; Marquet, 2011). Similarly, while the West and Zech (2008) study presents evidence of highly-qualified and experienced directors, this result appears to be at odds with prior research noting that many churches do not have employees with formal accounting or finance training and often rely on volunteers (Duncan, et al, 1999; Wooten, et al, 2003). The key to reconciling this apparent difference lies in realizing that dioceses are very large organizations in terms of size of budget. Thus, the evidence in West and Zech (2008) that a large percentage of finance councils contain highly-qualified professionals is consistent with the evidence that larger churches are more likely to hire an external CPA to perform their audit (Wooten, et al, 2003).

Using a survey sample of 43 pastors and 54 church members, Ventura and Daniel (2010) examine how trust relates to internal controls and demand for financial disclosures. They present evidence that church members have a very high degree of trust in church leaders, including those

[2] At the time of their questionnaire, there were 174 Catholic dioceses in the United States. The 78 that responded comprise their sample. This is a 45 percent response rate.

that handle church finances. Members are only included in this sample if (1) the subject donates at least $1,000 per year; (2) the donation represents at least 5 percent of the member's annual income; and (3) the subject's congregation has attendance of at least 150 people per week. These restrictions are imposed to create a sample of respondents that likely have a high demand for financial reporting. The researchers find that church financial disclosures are relatively infrequent and vary in the type of disclosures made; however this lack of frequent reporting does not alter the confidence of church members that their donations are being used in an appropriate manner. Additionally, they present evidence that pastors consistently have high levels of trust in employees. In conducting financial oversight, 63 percent of the pastors in their survey rely more heavily on the concept of trust than effective internal controls. A summary of the relevant academic research on church internal controls is presented in Table 1.

Our research extends the work of Ventura and Daniel (2010) to investigate which individuals involved in church governance are associated with better internal controls and with a lower occurrence of reported fraud.

Structured Interview Questionnaire and Sample

Our survey was conducted via an in-person, structured interview with an individual (e.g., member, volunteer, or employee) specifically involved in directing and managing church financial affairs. Accounting students administered 131 structured interviews by soliciting an individual for the interview, conducting the interview, and reporting the results of the interview. Training was provided on how to conduct the structured interview and report the results. Two of

the interviews were duplicative and were eliminated. Consequently, our final sample is comprised of 129 structured interviews.[3]

Our structured interview questionnaire, which is presented in full in Appendix A, covers four main aspects of church financial oversight: (1) organizational descriptive characteristics, (2) the presence or absence of specific internal controls, (3) the church's perceived vulnerability to fraud and/or embezzlement, and (4) the extent to which fraud had been detected in the previous five years.

Sample Characteristics

The majority of religious organizations in our sample are Christian houses of worship (96.1%). Within the Christian denominations, 22.6% are Baptist denominations, 17.7% are Methodist, 10.5% are Catholic, and the remaining 49.2% are from a wide variety of other denominations and non-denominational organizations.

Aside from the common thread of Christianity, the other institutional characteristics are quite diverse. Table 2 provides descriptive statistics for the entire sample. Panel A of Table 2 shows that the age of the churches ranged from 2 to 167 years, with a median age of 50 years. Membership ranges from 25 to 37,500 members, with a median of 400 members. The largest church (37,500 members) is a partially-online (i.e., Internet based) church that broadcasts its services to a number of remote locations. Paid employees range from 0 to 350, with a median of

[3] While our final sample consists of 129 responses, not all respondents answered all questions or gave a response that was accurately quantifiable. For instance, respondents may have answered the question about organization membership as "three wards" or "150 families." Additionally, some respondents declined to comment on whether a fraud had been detected and reported during the previous five years. Therefore, the number of observations used in our tests and statistical measures do not always include all 129 conducted interviews. In order to maximize the statistical power of our tests we use all available data for the particular question item used in the test. For all but two of our measures (budget and CPA involved in audit), we have well over 100 observations.

8. Finally, the annual budget ranges from $10,000 to $30 million, with a median budget of $500,000.

In Panels B and C, we partition the churches into "small" and "large" subsets and again present descriptive statistics. We classify churches as "small" if they have 400 members or less and "large" if the membership is over the median of 400. The average age of small (55 years) and large (58 years) churches is not dramatically different. Not surprisingly, large churches have considerably higher budgets and more paid employees.

Results and Analysis

Table 3 provides further information about the distribution of responses to the survey. Data are summarized with respect to (1) subject responses about themselves, (2) whether there was a detected and reported fraud over the past five years, (3) the subject's perceptions of vulnerability to fraud, (4) the house of worship with which the subject is affiliated, (5) control practices in the house of worship, and (6) specific control practices with respect to segregation of duties.[4] Again we present the results for our full sample as well as partitioned by small versus large houses of worship.

Respondents, Rate of Fraud, and Sense of Vulnerability

Panel A of Table 3 reports the proportion of interview subjects who (1) were members of the clergy, (2) had a business education, (3) indicated that the church had been the victim of a fraud within the past 5 years, and (4) believe the church is at least slightly vulnerable to fraud. Results indicate several statistically significant differences between large and small churches. First, the financial officer who was interviewed is more likely to have a business education in the

[4] See full structured interview questionnaire presented in Appendix A for further details.

large churches. Second, large churches more frequently report a perception of at least a slight vulnerability to fraud. Third, large churches are also more likely to report that a fraud occurred in the church within the last five years. When asked, 20 percent of interviewees in large churches indicated a fraud had occurred, whereas only 6.9 percent of interviewees in small churches acknowledged a fraud.

At first blush, the reported rate of fraud in large churches seems counterintuitive. The 2008 *Report to the Nation on Occupational Fraud and Abuse* (ACFE, 2008) reports that the frequency of fraud in small organizations (less than 100 employees) was significantly higher than in larger organizations. The lack of segregation of duties and professional staff, in combination with an over-reliance on trust, is generally associated with a higher frequency of fraud in smaller organizations.

The reported frequency of fraud in churches is, however, a function of several factors including (1) the actual occurrence rate of fraud in the last 5 years, (2) the detection rate of the frauds, (3) knowledge by the respondents that the frauds have occurred, and (4) willingness of the respondents to admit to the interviewer that the frauds have occurred. Consequently, the significantly higher rate of reported fraud in the larger churches may indicate that fraud is occurring more frequently or may mean that a better job of detection is being done.[5] Detection can be seriously delayed in churches, as Marquet (2011) reports that the average church embezzlement lasts seven years, whereas the median duration for the longest-lasting fraud scheme reported by the ACFE (2008) was only 30 months. Consequently, it's possible that small churches have frauds of a long duration, and the delay in detection means that these undetected frauds fail to show up in the statistics for reported frauds.

[5] In their study of fraud in Catholic diocese, West and Zech (2008) offered possible interpretations of high reported rates of fraud as evidence of better detection and low reported rates of fraud as evidence of better prevention.

On the other hand, it's quite possible that fraud does occur more often in larger churches simply because there is more money available to steal, more people to steal it, and/or more opportunities to steal it by virtue of the broader spectrum of activities that tend to take place in larger churches. Additionally, it is notable that when comparing Catholic dioceses, West and Zech (2008) did not find a difference in fraud rates between small and large dioceses. However, a diocese is a much larger entity than a house of worship and incorporates numerous parishes, which are analogous to the houses of worship in our study.[6] The overall reported occurrence rate of fraud in our study (13.8%) is very similar to the 15% rate estimated by Vargo (1989).

Institutional Characteristics of the House of Worship

Panel B of Table 3 also reports the responses to questions as to whether the church has a paid clergy and whether it has a parent organization that provides oversight. In total, 86.7% of the respondents indicate that their church has a paid clergy, and a little over half (52.4%) have a parent organization that provides oversight. There is not a statistically significant difference in the rate of either of these two factors between large and small churches.

Internal Control Practices

Our interviewers asked respondents whether a variety of internal controls were present in their organization. Rather than confining the interview to controls that are most commonly used in church, we include controls that are mentioned in the *Report to the Nation* (ACFE 2008) as controls that are important in detecting or limiting asset misappropriations, with the notion that just because a control may not be commonly used in church does not mean it should not be used.

[6] As previously discussed, West and Zech (2008) report that 85 percent of dioceses in their sample experienced embezzlement. However, it is inappropriate to compare this number to our metric of detected and reported fraud because a diocese with 200 churches under its auspices and one parish reporting a fraud would be coded as the diocese experiencing a fraud. At the time of West and Zech's (2008) paper there were a total of 174 dioceses in the United States.

The most common controls were the presentation of regular financial statements to church leadership (96.4%), maintenance of a board of directors (87.8%), and checking of references for employees or volunteers (87.5%). The least common controls were credit checks for employees or volunteers (22.4%), required vacations for individuals in financial positions (19.7%), rotation of duties (14.2%), and surprise audits (13.0%).

Large churches are significantly more likely than small churches to use a number of control activities. Specifically, they are more likely to (1) have a code of conduct, (2) require vacations, (3) conduct reference checks and criminal background checks, (4) have a board of directors, (5) select individuals for that board for their financial expertise, (6) present regular financial reports, and (7) conduct surprise audits.[7]

Segregation of Duties

Panel D of Table 3 provides data regarding separation of duties. We gathered data for situations in which the same position was named as being responsible for (1) writing and recording checks, (2) writing and signing checks (3) depositing and recording receipts, and (4) depositing receipts and reconciling the bank statement. Subjects were also asked whether related parties could serve in incompatible positions and whether related parties could serve on the board of directors.

[7] Additionally, we re-segmented the sample into three partitions (small, medium, and large) based on membership size. We then compared the large-membership partition (churches with more than 800 members) to the small-membership partition (churches with 210 members or less). For each response item in Table 3, the direction of the difference between the large and small segments was the same as the direction of the differences when the sample was partitioned into three segments. Degree of statistical significance varied for several items, partially because the smaller subsamples decreased the statistical power of the tests.

A total of 91.4% of all churches fail to separate the custody and recordkeeping functions in the expenditure cycle by allowing the same person to write and record checks. Custody and recordkeeping are also not well separated in the revenue cycle, as 72.2% of churches allow the same person to record and deposit receipts.

Additionally, only 14.3% of the church officials indicated that related individuals are allowed to serve in incompatible positions. This question was posed after asking subjects to name the party responsible for particular functions such as writing checks, reconciling bank accounts, etc. The specific question was worded as: "Are any of the individuals that perform the preceding activities related to each other (e.g., husband/wife, father or mother/child, siblings)?" Clearly, the subjects were assuming that an individual is not related to him/herself, since previously-discussed results indicate that the same person often performs these incompatible functions.

When it comes to board positions, almost half (46.7%) allow relatives to serve together on the church board. Large churches differ significantly from small churches in that they are (1) less likely to allow the same person to write and sign checks, (2) less likely to allow the same person to deposit receipts and reconcile the bank statement, and (3) less likely to allow related individuals to serve on the board of directors.

Relation Between Occurrence of Fraud and Church Characteristics

Before examining the role that various influential parties play in the quality of internal control and the reported occurrence of fraud, we examine the relation between reported fraud and other characteristics measured in the interview, including (1) the respondent's perception about the church's vulnerability to fraud, (2) the age of the church, (3) the size of the church, as

proxied by number of members, size of budget (dollars and range), and number of paid employees, (4) whether the church has paid clergy, (5) the church payroll as a percent of budget, and (6) whether the church is governed by a parent organization. The Pearson correlation coefficients between these characteristics and the fraud measure (i.e., whether a fraud was reported in the last five years) are presented in Table 4. Only four of our measures are significantly associated with a reported fraud. These associations are positive and marginally significant. The report of a fraud is positively associated with the age of the church, the membership size of the church (small versus large), the budget range of the church, and the number of paid employees. Thus, the results suggest that a fraud is more likely to be reported if a church is older and larger (as measured by membership, budget, and paid employees).[8]

Effects of Various Parties on Internal Controls and Fraud

A variety of leaders or governance bodies may be in a position to influence the extent to which strong internal control practices are implemented in a church. While churches have vastly different organizational structures, there are a number of common positions that may be influential in almost all of them. We focused on the influence of (1) an oversight organization, (2) professional clergy, (3) professional staff, (4) a board of directors, (5) a financial expert sitting on the board of directors, and (6) a CPA involved in audits of the entity. Some of these positions (e.g., a financial expert on the board) are a form of internal control themselves. Our

[8] In untabulated results, we examine the occurrence of fraud across the three different organizational forms, or polity, that exists in churches. Following prior research, we classify our sample into the following groups: (1) Congregational, (2) Episcopal and (3) Presbyterian (Gray and Tucker, 1990; Duncan, et al, 1999). Congregational and Presbyterian classifications have an occurrence of fraud of 10.8 percent (7/65) and 10 percent (1/10) respectively. Additionally, Episcopal organizations have a higher reported fraud occurrence of 20.5 percent (9/44). These results should be interpreted with some caution as the sample sizes are quite small and our study is not focused on differences across church polity.

objective was to examine whether the presence of these individuals or groups was consistent with the presence of better internal controls, fewer violations of segregation of duties, and/or a lower reported rate of fraud.

Table 5 presents the results of this examination. The column headings in this table correspond to the presence of these various bodies. We use the answer to the question of whether the clergy was paid as a proxy for the professionalism of the clergy. We use two proxies to measure the professionalism of the staff,—the number of paid employees and the church payroll measured as a percent of the total budget. Our rationale for these choices is that the more employees a church has and the more it is able to pay its employees, the more likely it will have more professional (and/or more specialized) employees.

Panel A of Table 5 presents the associations between these leadership positions or bodies and the presence of particular internal controls in the church. If the presence of an entity such as a parent organization or a board of directors was associated with the presence of these controls, then there should be a positive association between these two variables.

Results indicate that many of the correlations are positive and statistically significant which is consistent with our predictions. Specifically, code of conduct, audits, surprise audits and term limits are positively associated with several of the proxies for influential individuals/bodies.

On the other hand, not all correlations are positive, and many are not statistically significant. The correlations between the presence of paid clergy and the presence of periodic audits, surprise audits, and rotation of duties are notably negative and statistically significant. Likewise, a large payroll as a percent of budget, which was intended to proxy for professional staff, is significantly negatively associated with the presence of periodic audits, surprise audits,

rotation of duties, and term limits for individuals in financial positions. Also, having a CPA involved in the audit is significantly negatively associated with the use of surprise audits.

Panel B of Table 5 presents the correlations between these leadership proxies and the six previously-discussed violations of segregation of duties. Each of these segregation-of-duty variables would have been a zero if the church did not allow the violation and a one if it did allow such a violation. Consequently, the correlation coefficient between parent organization and record and write checks would be positive if the presence of a parent organization is associated with this violation of separation of duties. We predict a negative association between these influential individuals or groups and the presence of these violations. That is, we expect that these influential people or groups would discourage violations of separation of duties.

All of the significant coefficients in this part of the table are negative and consistent with our predictions, except for three. The presence of paid clergy is positively associated with a violation wherein the same individual can both write and record checks. A board of directors and high payroll are associated with a violation wherein relatives can serve together on the board of directors.

In Panel D of Table 5, there is a calculation of two scores for each of the influential people or bodies. The "Consistent Score" is a count of the number of times a correlation coefficient in Panel A or B is significant and in the predicted direction. The "Inconsistent Score" is a count of the number of times a correlation coefficient is significant but runs opposite of the predicted direction. One way to assess which individual or body is most closely associated with the presence of good internal controls is to determine the body that has the highest Consistent Score and the lowest Inconsistent Score. Using this basis for assessment, the party most clearly

associated with good internal controls is a financial expert on the board of directors. For the financial expert, the Consistent Score is 11, and the Inconsistent Score is zero.

The body with the highest Inconsistent Score is the paid clergy, which has a Consistent Score of 2 and an Inconsistent Score of 4. The results for paid clergy seem to contradict the notion of clergy being sound financial managers and to be more consistent with Booth's (1993) description:

> "As a general tendency . . . the clergy would be expected to support the dominance of religious beliefs in the management of churches. They, therefore, may be significant sources of resistance to the use of accounting and other secular management practices."

Additionally, the clergy results can also be seen as consistent with Conway's (1999) survey finding that only 7 percent of clergy indicated they were either extremely satisfied or very satisfied with the seminary training they received with respect to their financial responsibilities.

We use the number of paid employees and the amount of payroll as a percent of budget as proxies for a professional staff. These two factors, however, produce contradictory results. The number of paid employees produces a Consistent Score of 6, while the payroll as a percent of budget produces a Consistent Score of 1 and an Inconsistent Score of 5.

The presence of a parent organization results in a Consistent Score of 6 and an Inconsistent Score of 1. This result is consistent with Duncan, et al, (1999), which finds that church polity affects the quality of internal control. A CPA involved in the audit has a Consistent Score of 3 and an Inconsistent Score of 1. This result suggests that the CPA has relatively little influence on the level of controls in the church.

The "fraud" row in Panel C of Table 5 presents the correlation coefficient between the presence of the specified individuals or groups and whether or not a fraud has been reported in

the entity within the last five years. We predict a negative association between the presence of these bodies and the reported rate of fraud. In particular, we expect that influential parties will be negatively associated with the reported rate of fraud. Somewhat surprisingly, the only significant correlations are positive. A professional staff (as measured by the number of paid employees) and CPA involvement in the audit are positively associated with reported fraud. This result begs the question of whether the presence of these bodies is associated with higher occurrence rates of fraud, higher detection rates for fraud, or higher rates of willingness to admit the frauds.

Overall the results suggest that some parties, especially a financial expert on the board of directors, may have a positive impact on the level of internal controls in a church. However, we fail to find that better internal controls are associated with a lower reported rate of fraud. There are a variety of possible explanations for this result. First, it is possible that the reported fraud is a better indication of fraud detection than fraud occurrence. If so, there could be a positive association between the presence of influential parties and reported fraud. Secondly, it is possible that the internal controls reported in the interviews weren't instituted until after a fraud was detected and reported. Third, it is possible that internal controls in churches simply aren't effective at preventing fraud—possibly because effective segregation of duties is difficult to achieve even in the largest churches. Another possible explanation is that the primacy of trust in a church environment makes it too easy to override the controls. Finally, although generally regarded as heresy among fraud examiners, it is conceivable that trust actually works better as a control, especially in a church setting, than we (or the existing research) are willing to acknowledge.

Conclusions and Future Research

Our study of the accounting controls in 129 different religious entities investigates important organizational characteristics associated with the financial oversight function of these churches. We examine how the presence or absence of certain individuals as part of church financial governance affects the number of internal controls and the reported occurrence of fraud within the church. We also examine the association between internal controls, fraud, and other church characteristics, such as age and size. Since there is little in the way of governmental regulation or oversight that might detect or deter a church fraud, effective leadership and internal controls are currently the main lines of defense against fraud in churches.

Our work adds to the relatively sparse but growing academic literature on the use and effectiveness of internal controls by churches. Ventura and Daniel (2010) find that church financial disclosures are relatively infrequent and non-uniform and that church clergy generally trust their employees to act with integrity when managing church financial affairs. However, Booth (1993) suggests that professional clergy are ill-prepared to provide sound financial management within churches. We attempt to fill the void by identifying leadership and governance positions that are likely to institute internal controls and prevent fraud. Our results suggest that some parties, especially a financial expert on the board of directors, may have a positive impact on the level of internal controls in a church. However, we fail to find that better internal controls are associated with a lower reported rate of fraud.

There are several possible reasons for the lack of association between governance parties and a lower reported occurrence of fraud. First, it is possible that the reported fraud is a better indication of fraud detection than fraud occurrence. If so, there could be a positive association between the presence of influential parties and reported fraud. Secondly, it is possible that the

internal controls reported in the interviews were not instituted until after a fraud was already detected and reported. Third, it is possible that internal controls in churches simply aren't effective at preventing fraud—possibly because effective segregation of duties is difficult to achieve even in the largest churches. Additionally, because it is deemed rather impolite to appear to distrust others in a church, the predominant role of trust in such a culture may facilitate control overrides. Finally, there is the possibility that trust has some use as an internal control, particularly in a church setting.

Within our sample, we also find a higher reported rate of fraud in large churches. This result may suggest that larger churches do a better job of detecting the fraud. Alternately, it's quite possible that fraud does occur more often in larger churches simply because there are more resources, more opportunities, and more people with perceived, non-shareable pressures. Fraud examiners generally ascribe to the notion that there is no small fraud—only early frauds that haven't yet been detected. Likewise, the anecdotal history seems to be that most frauds escalate. If these patterns are reflective of reality, then in a small church with few resources, an escalating fraud would seem likely to appear sooner because resources would be exhausted more quickly. It appears that regardless of church size and the presence of internal controls, the controls themselves are somewhat ineffective--perhaps because of a "trust override." Consequently, our subjective assessment is that the higher rate of reported fraud in larger churches probably indicates a higher rate of actual fraud in these churches. However, this area is ripe for further research.

Although churches, both large and small, tend to provide regular financial statements to church leadership, maintain a board of directors, and check references for employees or volunteers, these types of controls are least effective against financial malfeasance.

Embezzlements are often conducted by individuals involved with access to cash contributions, authority over deposits or expenses (including check signing), and access to bank statements. Almost all churches fail to separate the custody and recordkeeping functions in both the revenue and expense cycles. The same person is typically allowed to record and deposit receipts, and the same person can record and write or sign checks. Very few churches prohibit related individuals from serving in incompatible positions; and almost half allow relatives to serve together on the church board. It does appear that some parties, especially a financial expert on the board of directors, may have a positive impact on the level of internal controls in a church. Unfortunately, despite these higher levels of control, embezzlements seem to occur anyway.

Because churches typically emphasize the importance of good acts and deeds, one might expect that excellent tone at the top could translate into a lower incidence of fraud. Given the lack of association between internal controls and fraud in churches, it's possible that tone at the top may be a reason why fraud is not even more prevalent in churches. It's clear that future research needs to further examine (1) the relation between church internal controls and fraud, and (2) the discovery of internal controls that are both viable and effective in a church culture.

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Table 1
Summary of Empirical Literature on Church Internal Controls

Empirical Study	Key Results and Inferences
Booth (1993)	-Professional clergy are frequently not trained in accounting management practices.
Duncan, Flesher, and Morris (1999)	-Manager may perceive themselves less accountable to donors of a church than they would to owners. -The demand for and use of financial reporting is fundamentally different between NPOs and for-profits.
Duncan, Flesher and Stocks (1999)	-Present evidence of a denomination effect and size effect on internal controls. -United Methodist and Presbyterian churches have stronger internal controls than Southern Baptist. -Large churches have better internal controls than small churches and this size effect is consistent across the three denominations.
Wooten, Coker and Elmore (2003)	-Inherent goals of NPOs likely result in less attention to internal controls than for-profit firms. -Churches rarely provide all three financial statements on a quarterly basis. -Churches have adequate internal controls over cash coming into the church. -Overall internal controls are quite weak, including disbursements and financial reporting. -Large churches have stronger internal controls and are more likely to have CPA audit.
West and Zech (2008)	-85 percent of Catholic diocese finance councils have at least one CPA member. -85 percent of Catholic dioceses reported embezzlement in past five years. -Over 90 percent of the embezzlements were reported to police. -The frequency of internal audits is the most important internal control in preventing embezzlement.
Ventura and Daniel (2010)	-Financial disclosures are relatively infrequent. -Infrequent financial disclosures doesn't alter the confidence of church members that their contributions are being used appropriately. -Pastors consistently have high levels of trust in employees.

Table 2
Descriptive Statistics

PANEL A - ENTIRE SAMPLE

Descriptor	n	Mean	Median	Maximum	Minimum	Standard Deviation
Age (in years)	127	58.5	50.0	167.0	2.0	41.6
No. of Members	118	1,174.0	400.0	37,500.0	25.0	3,582.2
No. of Paid Employees	125	16.7	8.0	350.0	-	35.3
Approx Annual Budget	95	$ 1,072,004	$ 500,000	$30,000,000	$ 10,000	$ 3,133,731

PANEL B - SMALL CHURCHES - 400 MEMBERS OR LESS

Descriptor	n	Mean	Median	Maximum	Minimum	Standard Deviation
Age (in years)	61	55.0	48.0	167.0	2.0	44.3
No. of Members	62	189.0	175.0	400.0	25.0	111.2
No. of Paid Employees	60	6.0	4.0	41.0	-	6.8
Approx Annual Budget	43	$ 252,711	$ 150,000	$ 800,000	$ 10,000	$ 228,054

PANEL C - LARGE CHURCHES - OVER 400 MEMBERS

Descriptor	n	Mean	Median	Maximum	Minimum	Standard Deviation
Age (in years)	55	58.3	45.0	140.0	9.0	36.2
No. of Members	56	2,264.6	1,100.0	37,500.0	425.0	4,997.9
No. of Paid Employees	54	29.1	18.0	350.0	-	49.9
Approx Annual Budget	42	$ 1,886,803	$ 1,000,000	$30,000,000	$ 10,000	$ 4,540,368

Table 3
Responses to Binomial Questions
Partitioned on Size of Church as Measured by Membership

Panel A - Respondent

Responses	Small Churches (≤ 400 Members)		Large Churches (> 400 Members)		All Responses		
	No. of Responses	% For Which Statement is True	No. of Responses	% For Which Statement is True	No. of Responses [a]	% For Which Statement is True	
Survey respondent is a member of clergy	62	30.6	55	25.5	128	28.1	
Survey respondent has a business education	62	27.4	56	46.4	129	36.4	**
Acknowledges a fraud within last 5 years	58	6.9	55	20.0	123	13.8	**
Think they are at least slightly vulnerable to fraud	60	70.0	55	85.5	126	77.0	*

Panel B - House of Worship

Responses	Small Churches (≤ 400 Members)		Large Churches (> 400 Members)		All Responses	
	No. of Responses	% For Which Statement is True	No. of Responses	% For Which Statement is True	No. of Responses [a]	% For Which Statement is True
Panel B - House of Worship						
Entity has paid clergy	61	86.9	56	91.1	128	86.7
Has a parent organization that provides oversight	59	59.3	56	46.4	126	52.4

*, **, *** p-value on binomial test of proportions between small and large churches is significant at less than .10, .05, and .01 respectively.
[a] Total responses will exceed sum of small and large-church responses, because some churches did not provide useable data on number of members.

Table 3 (Continued)
Responses to Binomial Questions
Partitioned on Size of Church as Measured by Membership

Panel C - Control Practices

Responses	Small Churches (≤ 400 Members)		Large Churches (> 400 Members)		All Responses		
	No. of Responses	% For Which Statement is True	No. of Responses	% For Which Statement is True	No. of Responses [a]	% For Which Statement is True	
Has a code of conduct for individuals with financial responsibility	62	62.9	55	89.1	128	75.8	***
Checks references for employees or volunteers	61	82.0	56	94.6	128	87.5	**
Conducts credit checks for employees or volunteers	61	18.0	54	25.9	125	22.4	
Conducts criminal background checks for employees or volunteers	61	68.9	56	89.3	128	79.7	***
Has periodic audits of accounting books	51	72.5	51	66.7	112	71.4	
Has CPAs involved in audits	37	48.6	34	52.9	80	48.8	
Conducts surprise audits	46	6.5	43	18.6	100	13.0	*
Requires vacations of individuals in financial positions	61	9.8	55	30.9	127	19.7	***
Imposes term limits for positions with financial duties	61	29.5	55	36.4	127	33.1	
Rotates duties for financial positions	61	13.1	55	12.7	127	14.2	
Has a board of directors	59	81.4	56	94.6	115	87.8	**
Reports to church leadership on entity's financial statements	47	93.6	53	100.0	111	96.4	*
Some individuals selected for board because of financial expertise	47	34.0	52	53.8	109	48.6	*
Has an anonymous reporting mechanism	57	28.1	55	27.3	123	30.1	

*, **, *** p-value on binomial test of proportions between small and large churches is significant at less than .10, .05, and .01 respectively.

[a] Total responses will exceed sum of small and large-church responses, because some churches did not provide useable data on number of members.

Table 3 (Continued)
Responses to Binomial Questions
Partitioned on Size of Church as Measured by Membership

Panel D - Segregation of Duties

Responses	Small Churches (≤ 400 Members)		Large Churches (> 400 Members)		All Responses		
	No. of Responses	% For Which Statement is True	No. of Responses	% For Which Statement is True	No. of Responses[a]	% For Which Statement is True	
Allows same person to write and record checks	61	90.2	56	92.9	128	91.4	
Allows same person to write and sign checks	61	62.3	54	42.6	126	52.4	**
Allows same person to deposit and record receipts	61	73.8	54	68.5	126	72.2	
Allows same person to deposit checks and reconcile bank statement	60	56.7	53	37.7	124	48.4	**
Allows related individuals to serve in incompatible positions	59	18.6	56	10.7	126	14.3	
Allows related individuals to serve on board of directors	47	61.7	50	36.0	107	46.7	**

*, **, *** p-value on binomial test of proportions between small and large churches is significant at less than .10, .05, and .01 respectively.
[a] Total responses will exceed sum of small and large-church responses, because some churches did not provide useable data on number of members.

Table 4
Pearson Correlation Coefficients Between Reported Fraud And Church Characteristics

Church Characteristic	Reported Fraud
Feels at least slightly vulnerable to fraud[a]	0.1394
Age of house of worship[b]	0.1640 *
Number of members[c]	0.0316
Member size category[d]	0.0405 **
Size of budget (dollars)[e]	0.0297
Budget range[f]	0.1623 *
Number of paid employees[g]	0.1592 *
Whether clergy is paid[h]	0.0252
Payroll as percent of budget[i]	0.1427
Presence of parent organization[j]	-0.0921

*,**,***Significant at $p \leq .10$, $p \leq .05$ and $p \leq .01$ respectively.
[a] Recorded as 1 if subject indicated that they felt slightly vulnerable, vulnerable, very vulnerable, or extremely vulnerable to illegal or unethical financial actions by employees or members; zero otherwise.
[b] Age in years of house of worship.
[c] Total estimated number of members in the church.
[d] 0 if number of members is at or below the median of 400 and 1 otherwise.
[e] Total estimated annual budget for church.
[f] 1 for $0-$250,000; 2 for $250,000-$500,000; 3 for $500,000-$750,000; 4 for $750,000-$1,000,000; and 5 for over $1 million.
[g] Respondent's count of paid employees in church.
[h] 1 if clergy is paid and 0 otherwise.
[i] 1 for 0-25%; 2 for 25-50%; 3 for 50-75%; and 4 for 75-1005%.
[j] 1 if there is a parent organization and 0 otherwise.

Table 5
Pearson Correlation Coefficients Between Parties Who Can Influence the House of Worship Internal Control Structure And Presence of Internal Controls and Fraud

Panel A - Controls

Internal Control	Pre-dicted	Parent Org.	Paid Clergy	Paid Employees	Payroll	BOD	Financial Expert	CPA
Code of Conduct	+	0.1816 **	0.0996	0.1794 **	0.0239	0.1568 **	0.2405 ***	0.1431
Check References	+	(0.0326)	0.1992 **	0.1160 *	0.0503	0.0250	0.1115	0.1297
Credit Checks	+	0.1121	(0.0301)	0.1153	(0.0847)	0.1885 **	0.2054 **	0.0867
Criminal Background Checks	+	0.0000	0.1444 *	0.1614 **	0.1069	0.1395 *	0.1478 *	0.2768 ***
Audits	+	0.2978 ***	(0.2046) **	0.0503	(0.2068) **	(0.0248)	0.2145 **	0.0000
Surprise Audits	+	0.0468	(0.2528) ***	(0.0566)	(0.2022) **	0.1230	0.0755	(0.2809) ***
Vacation	+	(0.0646)	0.0800	(0.0108)	0.0129	(0.0127)	0.2519 ***	(0.1296)
Term Limits	+	(0.1712) **	0.0821	(0.0539)	(0.1187) *	(0.0221)	0.1210 *	(0.0592)
Rotation	+	0.1176 *	(0.1707) **	0.0285	(0.2103) **	(0.0711)	0.1166	0.0441
Financial Reports	+	0.0041	0.0260	0.0944	0.0230	0.3338 ***	0.1409 *	0.2001 **
Anonymous Mechanism	+	0.2015 **	(0.0078)	0.1502 *	0.0309	0.1555 **	0.2882 ***	(0.0803)

Panel B - Segregation of Duties

Internal Control	Pre-dicted	Parent Org.	Paid Clergy	Paid Employees	Payroll	BOD	Financial Expert	CPA
Record & Write Checks	-	(0.0724)	0.1256 *	0.0413	0.0909	(0.0199)	(0.0155)	0.1090
Write & Sign Checks	-	(0.2208) ***	0.0456	(0.1924) **	(0.0478)	(0.0680)	(0.2378) ***	(0.2100) **
Record & Deposit Receipts	-	0.0334	(0.0395)	(0.0730)	(0.0837)	(0.0479)	0.0949	(0.0591)
Deposit & Reconcile	-	0.0252	(0.0641)	(0.1441) *	(0.2574) ***	(0.1147)	(0.0383)	(0.0677)
Relatives in Incompatible Position	-	(0.0805)	0.0285	(0.0226)	0.0411	(0.0060)	(0.1982) **	(0.1060)
Relatives on Board	-	(0.2525) ***	0.0679	(0.1060)	0.1827 **	0.1941 **	(0.2625) ***	(0.0292)

Panel C - Occurrence of Fraud

Internal Control	Pre-dicted	Parent Org.	Paid Clergy	Paid Employees	Payroll	BOD	Financial Expert	CPA
Fraud	-	(0.0921)	0.0252	0.1592 **	0.1427 *	0.0546	0.1196	0.1562 *

Panel D - Consistency Score for Internal Controls and Segregation of Duties

Internal Control	Parent Org.	Paid Clergy	Paid Employees	Payroll	BOD	Financial Expert	CPA
Consistent Score	6	2	6	1	5	11	3
Inconsistent Score	1	4	-	5	1	-	1

*,**,*** = Significant at $p \leq .10$, $p \leq .05$, $p \leq .01$ respectively.
Consistent Score = count of number of coefficients that are significant and in the predicted direction.
Inconsistent Score = count of number of coefficients that are significant but opposite the predicted direction.

Appendix A – Structured Interview Questionnaire: Religious Organization Managerial Accounting Procedures Survey

Directions to student: Speak with an individual in a house of worship (e.g., church, meetinghouse, mosque, temple, etc.) who has some responsibility for financial oversight. This might be a religious leader, such as a bishop, Brahmin, minister, mullah, pastor, priest, rabbi, etc.; or it could be a layperson, office manager, head of a church board, etc. Obviously the positions can vary greatly with the size, theology, and nature of the institutions.

Please record below information about the religion and denomination of the house of worship that you visit:
Religion (circle one): Buddhist Christian Jewish Hindu Muslim Other (explain)
Explanation for "Other":_____
Denomination (e.g., Baptist, Catholic, etc.): _____

Here is the script you should use for your interview with this individual:

Background Position: Before we get started, it helps to get a little background information. Can you please tell me what your title or office is within this organization and explain the responsibilities of your position to me?

Title:
Responsible for (generally):
Specifically, what are your financial responsibilities in the organization?
What is your educational background?
What training (formal or informal) have you had in finance or accounting?
What experiences in the past have prepared you for your financial role in this organization?

Background of the Organization

- How old is this organization? (We're referring to the specific church or temple at this location, not the religion or denomination.)
- Approximately how many members does it serve?
- Do you have a formal budgeting process each year?
- Who proposes the budget?
- Who approves the budget?
- What is the approximate size of your annual expense budget? $ _____
- If the participant is uncomfortable or uncertain about the dollar amount of the budget, you can offer categories:
    - $0 - $250,000
    - $250,000 - $500,000
    - $500,000 - $750,000
    - $750,000 - $1 million
    - Over $1 million
    - Prefer not to answer
- Approximately how many paid employees does the organization have?
- Approximately how many unpaid (*volunteer*) employees does the organization have?
- Does your organization have a paid clergy?
- Approximately what percent of your annual budget is payroll?
    - Possible categories:
        - 0-25%
        - 25-50%
        - 50-75%
        - 75-100%
- Does your organization have a parent organization, or does it operate independently. (For example, individual Roman Catholic churches operate under the purview a of wider organization—ultimately

headquartered in Rome. Some Christian churches are independent congregations that operate strictly on a local basis and have no organization that provides any oversight.)

- Yes, there is an oversight organization
- No, the entity is completely independent

Controls in Place

Now let's discuss some controls that some religious institutions have.

- Do you have a code of conduct or code of ethics for individuals that have financial responsibilities in the organization? By this, I mean a specific set of behaviors or practices that are to be followed? (This is not to include behaviors or practices that are simply implied by your religious beliefs or sacred books.)

  Circle one:
  - We do have a code of conduct / code of ethics
  - We had a code of conduct / code of ethics in the past but no longer have
  - We have never had a code of conduct / code of ethics
  - I wish we had a code of conduct / code of ethics

  Additional comments:
- ***Ask these question <u>only if</u> they do have a code of conduct.***
  - To what positions does this code of conduct apply, i.e., who gets a copy of it?
  - Are individuals who are subject to the code of conduct asked to:
    - Read it regularly?
    - Sign it?
    - If so, how often are they asked to re-read it or re-sign it?

Do you ever conduct any of the following for employees or volunteers in your organization? If so, under what conditions?

- Do you check references for employees or volunteers?
  - We do check references
  - We do NOT check references and never have
  - We have checked references in the past but no longer do
  - I wish we checked references

  If you do check references, under what conditions and for what positions do you check references?
- Do you conduct credit checks for employees or volunteers?
  - We do conduct credit checks
  - We do NOT conduct credit checks
  - We have done credit checks in the past but no longer do
  - I wish we did credit checks

  If you do conduct credit checks, under what conditions and for what positions?
- Do you conduct criminal background checks?
  - We do conduct criminal background checks
  - We do NOT conduct criminal background checks
  - We have done criminal background checks in the past but no longer do
  - I wish we did criminal background checks

  If you do conduct criminal background checks, under what conditions and for what positions?
- Do you conduct any other types of checks? If so, please explain.

- Does your organization have periodic audits of the "accounting books" ?

  Yes No

  - If so, who conducts the audits?
    - A CPA firm
    - A member of your organization
    - An internal committee of your organization
    - A denominational representative or committee from outside your immediate location

    - Other? (Please explain) _____
- How often are the audits conducted?
    - Once every _____ (quarter, year, two years, etc.)
    - Only when there is a concern
    - Other? (Please explain)
- Are there ever surprise (unexpected) audits?

Positions with financial responsibility:

- What position in your organization is responsible for recording financial transactions?
- What position in your organization is responsible for *writing* checks?
- What position in your organization is responsible for *signing* checks?
- What position in your organization is responsible for depositing cash and checks that are received?
- To whom (what position) in the organization are bank statements mailed?
- Who reconciles the bank statements?
- Are any of the individuals that perform the preceding activities related to each other (e.g., husband / wife, father or mother / child, siblings)? If so, how are these individuals related?
- Are any of the positions that perform financial activities required to take a vacation each year? If so, which positions and for how long?
- Do any of the positions that perform financial duties have term limits? If so, how many years?
- Are any of the positions that perform financial duties rotated so that they do someone else's job for a period of time and someone else does there job? If so, explain.
- Describe the procedure that is followed to handle incoming cash, such as offerings (donations) from members.
- Do you have a board of directors (or other oversight board) that provides oversight to the organization?
- How often does the board meet?
- Are same-family relatives allowed on the board at the same time?
- Does the board receive reports on the organization's financial statements?
- If so, how often does the board get reports and who generates the reports?
- Are there individuals specifically selected to the board of directors because they have financial expertise? (If so, please describe how the selection occurs and the level of expertise necessary to hold this position.)

Reporting Issues:

- If an employee or volunteer in your organization were to suspect another employee or volunteer of unethical, illegal, or inappropriate activity with respect to your organization, what should that employee or volunteer do?
- Do you have any anonymous mechanisms through which an employee or volunteer could report suspicions of unethical, illegal, or inappropriate activity?

  If so, please describe here:
- If you were certain that an employee or volunteer was taking cash, property, or information to which they were not entitled from your organization, what actions would you take?
- In the past five years, have you had any instances of an employee or volunteer taking cash, property, or information from your organization to which they were not entitled?

  If so, please describe here:
  What type of valuables were taken (cash, property, information, etc.)?
  What was the approximate dollar value? $_____
  - For how long was this individual taking things to which they were not entitled (in days, weeks, months, years, etc.)
  - Was the responsible individual identified? (Yes/No)
  - What consequences accrued to the responsible identified? (Check all that apply.)
    - Reprimanded
    - Terminated from paid job
    - Terminated from volunteer position

        - Terminated from participating in the organization in any capacity
        - Sued civilly
        - Required to pay restitution
        - Criminal prosecution
    - If there was a civil suit, what was the outcome of that suit?
    - If there was a criminal prosecution, what was the outcome of that case?

Perceptions

How vulnerable do you think your organization is to illegal or unethical financial actions by employees or members?

- Not vulnerable at all
- Slightly vulnerable
- Vulnerable
- Very vulnerable
- Extremely vulnerable

Explain why you gave the response you gave.

If I wanted to truly understand controls in religious organizations, what questions should I have asked that I did not ask?

Is there anything else you would like to tell me about how your organization operates?