Fraud in focus

Increasing risks of financial crime impacting Australian charities and Not for Profits

Introduction

The Not for Profit sector contributes around $43 billion to Australia's gross domestic product, derived from approximately 600,000 organisations[1]. This is an attractive sum of money for people intent on unlawful gain, which typically occurs through theft, fraud, bribery and corruption, money laundering and the financing of terrorism.

Charities and other Not for Profit organisations (Not for Profits) are too often an easy target for financial crime due to the trusting nature of many sector employees and those charged with governance, whose priority is the passionate and well-meaning delivery of services to those in need. Further, in maximising the benefit of such services, sometimes resources applied to risk management can be less than what is ideally required to protect the assets, integrity and beneficiaries of Not for Profits.

This article discusses key findings of various reports issued in 2014 and 2015 by the Australian Government and overseas bodies that all identified the rising risk of financial crime impacting Australian charities and other Not for Profit organisations.

Compliance

It is critical for those charged with the governance of Not for Profits to understand their obligations. They may be personally liable, along with their organisations, for failing to comply with the various pieces of legislation introduced to protect their organisations from financial crime.

For example:

- The ***Corporations Act 2001*** ss 180−184, s. 286 and ss 588G and J provide penalties in respect of care and diligence, good faith, use of position and information, acting recklessly, intentional dishonesty, books and records as well as insolvent trading.
- The ***Australian Charities and Not for Profits Amendment Regulation 2013 (No. 1)*** under *Governance standard 5: Duties of responsible entities* (Div. 45.25), provides very similar obligations as the *Corporations Act 2001*, plus disclosure of conflicts of interest.
- The ***Criminal Code Act 1995 (Cth)*** under Div. 70 prohibits bribery of foreign and Commonwealth public officials, including soliciting bribes.

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[1] Australian Charities and Not for Profit Commission, March 2015, Background to the Not for Profit sector, accessed 4 August 2015, <https://www.acnc.gov.au/ACNC/About_ACNC/Research/Background_NOT_FOR_PROFIT/ACNC/Edu/NOT_FOR_PROFIT_background.aspx?hkey=e88db8f0-3e48-4408-ab99-c2acb6ef8a1d&TemplateType=P>.

- The ***Foreign Corrupt Practices Act 1977 (US)*** also prohibits bribery of foreign officials and applies to Australian charities and other NOT FOR PROFIT organisations operating anywhere in the world if they also conduct activities within the jurisdiction of the United States.
- The ***Bribery Act 2010 (UK)*** prohibits bribery, facilitation payments (fast-tracked routine services) and promotional expenses in both the public and private sector. It also creates a corporate for failing to prevent bribery of both public officials and private persons and applies to Australian Not for Profits operating anywhere in the world if they also conduct activities within the jurisdiction of the United Kingdom.

Reports and increasing risks of financial crime

ACNC Charity Compliance Report

Of the approximately 600,000 charities registered with the Not for Profit sector, 6,000 new entrants were registered between December 2012 and December 2014. A compliance report issued in June 2015 by the Australian Charities and Not for Profits Commission highlighted the risks currently facing the sector[2].

The ACNC report *Charity Compliance Report December 2012 – December 2014 and beyond* identifies that in those two years the most common complaints it received against charities concerned:

- Charitable resources being used inappropriately for the private benefit of individuals controlling the charity or their associates.
- Possible financial mismanagement and fraud within the charity.
- Charities failing to follow their constitutions and not being transparent or accountable to members.
- Charities that appear to be harming their beneficiaries.
- Sham charities soliciting funds, and fundraising scams generally.

The key focus of the regulator's compliance work for 2015/2016 will entail charities operating overseas, charities that provide private benefits to their responsible persons or associates and charities that are involved with illegal activity or tax avoidance.

Operating overseas is a significant area of increasing risk. Australia's non-government aid and development organisations spend around $1.3 billion annually, with approximately $875 million coming from public donations. An ACNC media release dated 29 June 2015 noted that over 4,000 Australian charities operate overseas and found the risk that funds are used to finance terrorism most alarming3.

Risks associated with charities operating overseas include the payment or receipt of bribes, facilitation payments and terrorist financing. This can result in significant penalties in Australia and, subject to jurisdictional matters, the host country and other countries in which the organisation conducts business; added to which is the reputational damage, which can have a far greater impact.

AUSTRAC report – Terrorism financing in Australia 2014

Closely mirroring the ACNC findings and comments regarding risks of terrorist financing, the Australian Transaction Reports and Analysis Centre (AUSTRAC) 2014 report, *Terrorism financing in Australia 2014* noted "the integrity and work of non-government organisations such as charities and humanitarian groups can be seriously undermined if they are misused as a cover for terrorism financing activity"[3]. It reported that

[2] Australian Charities and Not for Profit Commission, March 2015, ACNC Charity Compliance Report December 2012 – December 2014 and beyond, accessed 4 August 2015 <http://acnc.gov.au/ACNC/Publications/Reports/ComplianceRpt2012_2014.aspx>

[3] The Australian Council for International Development, http://www.acfid.asn.au/about-acfid/what-is-acfid

[3] Australian Transaction Reports and Analysis Centre 2014, Terrorism financing in Australia 2014, p. 5, accessed 4 August 2015 < http://www.austrac.gov.au/publications/corporate-publications-and-reports/terrorism-financing-australia-2014>

some Australian charities have been used to raise funds for terrorist groups by:

- Using their organisations to disguise international funds transfers to high risk regions.
- Mixing funds for terrorism with funds for legitimate humanitarian purposes.
- Intercepting legitimate funds either in Australia or once such has arrived overseas then diverting such for terrorism.

Anti-money laundering and counter-terrorist financing measures

In April of this year, the Financial Action Task Force (FATF) and the Asia/Pacific Group on Money Laundering (APG) together issued the *Anti-money laundering and counter-terrorist financing measures – Australia – Mutual Evaluation Report.*

FATF, based in Paris, is an intergovernmental body that sets standards, recommendations and measures for combating money laundering on a global scale. APG, based in Bangkok, is an international organisation working in research, policy development, education and evaluation on anti-money laundering and counter terrorist financing. Australia is a member of both bodies.

The report indicates increasing risks of financial crime impacting Australian charities and other Not for Profit organisations through money laundering and counter terrorist financing. While generally a very positive report on Australia's response to the threat, it states that Australia has failed to comply with FATF recommendations in terms of sector-wide risk assessment, outreach to Not for Profit organisations and measures to be applied to those organisations identified as high risk[4]. The report recommended the following priority actions:

> *Australia should implement a targeted approach in relation to preventing NPOs (non-profit organisations) from TF (terrorist financing) abuse. As a first step, Australia needs to undertake a thorough review of the TF risks that NPOs are facing [beyond the issues already covered in the NTA (National Threat Assessment) and the potential vulnerabilities of the sector to terrorist activities.*[5]

Summarising the risks

The growth in number of Australian charities and NOT FOR PROFIT organisations, the demand for their services domestically and abroad, together with the increasing complexity of financial crime activity, all contribute to an increasingly high-risk environment.

Specifically, increasing risks that the sector must be alert to include:

- Misappropriation of funds through false invoicing, over charging, credit cards fraud and payments for non-authorised purposes. Funds misappropriation traditionally increases for operations overseas where cultural practices, internal controls, training, supervision and checking is often more vulnerable than in Australia.
- Awarding of contracts and other appointments through conflict of interest, abuse of position and other corrupt and collusive conduct.
- Co-mingling of funds to be used for legitimate and terrorist purposes to disguise all funds as being for legitimate purposes.
- Scam pop-up charities whose sole purpose is to raise and transfer funds overseas for terrorist purposes.

Where there is a lack of awareness of compliance obligations, risk identification and assessment, and inadequate preventative and detective controls, these risks can and will result in financial crime.

Often this situation is backgrounded by a lack of policies, procedures and resources to ensure basic internal controls are in place, including measures such as segregation of duties, competitive tendering, background checks and due diligence, financial reporting,

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4 Financial Action Task Force 2015, Anti-money laundering and counter-terrorist financing measures in Australia, accessed 4 August 2015 <http://www.fatf-gafi.org/topics/mutualevaluations/documents/mer-australia-2015.html>

5 Ibid., p. 11

budgeting analysis and auditing, whistleblowing programs and enforcement.

However, the overriding reason many charities and Not for Profit organisations succumb to financial crime is culture. This often reflects complacency, management override and lack of enforcement of compliance by "turning a blind eye for the greater good". This is particularly the case where, prima facie, strong internal controls appear to be in place; however, in practice, management overlooks inadequate procedures and questionable actions with the rationale that corners need to be cut in order to deliver urgent services and aid.

A typical example is making facilitation payments and cash bribes in order to ease delivery of foreign aid in developing countries suffering from conflicts and/or natural disaster, which invariably have more accepted practices of bribery and corruption.

Directors and committee members need to ensure informed decisions regarding the organisation's appetite for risk are canvassed up-front. They also need to be alert to indicators of cultural practices that provide opportunities for financial crime, such as those outlined above.

What to do

There is a wealth of documentation plus accepted standards and guidance to assist Directors and committee members ensure their organisations have strong integrity frameworks in place in order to ensure compliance with obligations relating to financial crime.

The actions they must ensure are undertaken can be summarised into the following four key principles:

Risk identification and assessment
Identify and assess risks annually and as operations change, which could include on a project-by-project basis; particularly regarding operations overseas
Adequate procedures
Ensure that effective and proportionate procedures are in place to prevent, detect and respond to those risks
Communication
Ensure that policies and procedures are effectively communicated to employees and suppliers and remain so through regular training and other activities
Monitoring and review
Ensure ongoing monitoring of the relevance, existence and effectiveness of the overall integrity framework

The above elements should be documented in a Fraud and Corruption Control Plan or similar, which demonstrates the organisation's compliance with obligations as well as being a practical working tool to be followed and referenced.

Particular emphasis should be placed on how Australian charities and other Not for Profits respond to risks, allegations and regulatory enquiries into alleged financial crime within their organisation. It is imperative that the Control Plan prescribes and guides what actions must be taken, including preliminary triage assessments, investigations, dealing with potential perpetrators, internal and external communications including with volunteers and donors, and how to respond and report findings to Government funding bodies and regulators.

Further key standards and guidance can be found in:

- Australian Standards such as AS 8001-2008 Fraud and Corruption Control
- ACNC Governance Standards and Guide to Fraud Prevention
- Anti-Bribery Principles for Not for Profit Organisations issued by Transparency International UK.