

Singing the Same Old Song

Identifying topics of interest for our readers is always a challenge. Often we identify items that appeal to too narrow a market. There are other topics that seem to arise repeatedly because events reoccur. When writing an article, we worry about being redundant, but accept the fact that certain topics need to be revisited periodically.

We were reminded once again of the frailty of humankind when yet another parish employee recently was accused of misappropriating over \$1 million. The case, involving a Connecticut diocese, allegedly occurred over many years and involved multiple parishes. This is not the first time since our October 2004 newsletter article “Good Controls Can Help Prevent Fraud” that an allegation such as this has appeared in the headlines. The effects of original sin have obviously not been overcome, and fraud appears to be one of those recurring topics.

In our earlier article, we noted that three elements had to be present for fraud to occur: opportunity, need and rationalization. Permit us to briefly define each element. Opportunity: does an environment exist that permits or encourages the incidence of fraud? Religious institutions are especially susceptible to fraud because of the presumed trustworthiness of employees. The shortage of resources, financial and otherwise, makes it easy to ignore the need for sound internal controls and specific written policies. This void creates an environment ripe for exploitation.

Need is the second critical element. We live in a materialistic society, and so need can be something as simple as desiring a higher lifestyle. Also, true need certainly can manifest itself in today’s turbulent economy, as unemployment and market problems roil even the stablest families.

The final corner of the triangle is rationalization. Perpetrators usually find a way to intellectually justify

their fraudulent actions, and there is no shortage of rationalizations.

A common denominator in all fraud cases is that people who have been entrusted with financial resources have violated this trust. In the Arrest Warrant Affidavit in the Connecticut case, all three elements described above were clearly illustrated. What is most regrettable is that the entire situation could have been averted, had the internal controls present not been circumvented or ignored while good, well-intentioned people looked on.

The application of internal controls and the articulation of clear expense policies, in addition to frustrating the fraudulent, can also prevent misunderstandings between employees and their supervisors. As an example, some parishes/schools will permit their employees to charge certain expenses on corporate credit cards. What is or is not a permitted expense can become the subject of great debate in the absence of a written spending policy. This can be the cause of many hard feelings after a confrontation occurs, even if no fraud was involved.

Another key to fraud prevention is the separation of duties. Separate the approval oversight function from the task of executing a financial transaction. Whether executing a credit card transaction, writing checks or writing a purchase order, someone other than the person who performed that function needs to review the results. Parishes and schools can consult with an accountant or auditor regarding adequate separation of duties. Even if you have a small staff, it is still possible to have excellent internal controls and receive a clean audit opinion by using external parties to assure the separation of duties.

As Ronald Reagan famously said, “trust, but verify.” Whether applying this to nuclear arms treaties or internal controls, we think it’s great advice.

Oh Where, Oh Where Has My Credit Line Gone?

Many Catholic institutions have historically maintained lines of credit at their local banks as an available tool to even out cash flow. Lately, when institutions go to draw on their credit line, some are finding out that it is no longer available. Upon further investigation, the institutions often find that a failure on their part to “renew” the line of credit has allowed it to expire.

Due to the financial crisis that has enveloped the banking industry for the last several years, federal and state regulators are scrutinizing lending practices more closely. Gone are the days when lines of credit automatically renew without some ongoing due diligence by the bank. Most often, we at CFC observe lines not being renewed because some affirmative action required of the borrower and spelled out in the loan documents is not undertaken. Borrowers need to read their documents carefully. A common provision is the requirement that there must be at least one day, and maybe as many as 30 days, where the line is not drawn upon in any 365-day period. Failure to observe this provision may result in a line not being renewed and in fact becoming immediately due and payable! Furthermore, once lapsed, it is often much more difficult to get a line of credit re-established, particularly if one’s financial situation has recently deteriorated.

Institutions also need to pay attention to the requirements of their local Bishop. For example, in the Archdiocese of Saint Paul and Minneapolis, there is a provision in the articles of incorporation for every parish that reads as follows: “Any indebtedness resulting from operating deficits shall not exceed 5% of the prior year’s annual operating budget, without the *unanimous* [emphasis added] consent of the Board.” This means that even if there is an existing line of credit in place, it may not be used to fund an operating deficit that exceeds the 5% test without the specific approval of, in this case, the Archbishop to make a draw on the line for that purpose.

Questions? Give us a call at CFC. We can help.

CFC Welcomes Summer Interns

Ruth Kappes was born and raised in Eagan, Minnesota. Ruth graduated from Eagan High School in 2007, and is currently pursuing her undergraduate degree at Franklin College, located in Lugano, Switzerland. For the last three years, she has lived and traveled abroad while working towards her degree in political science and international banking and finance. Ruth will graduate in December, after which she plans to continue her education in business and economics.

Clash Lo is from Maplewood, Minnesota and has lived in the Twin Cities all his life. Clash graduated from Tartan High School in 2007, and is currently a student at Saint John’s University. He is studying accounting, with the intent to become a Certified Public Accountant (CPA) after he graduates in May 2011. In his spare time, Clash plays for Saint John’s soccer team.

CFC is grateful to have the extra help this summer!

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