

## Improving internal controls at the Church of God: a case study

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### ABSTRACT

Criminal justice students as well as students aspiring to be accountants or forensic accountants will inevitably encounter mismanagement or, worse, outright fraud. We hope our research will find its way to a classroom (or even a boardroom) and perhaps one less fraud will be committed or one more fraud will be quickly detected. Although some fraud occurs in many, if not all, organizations, both private and public, fraud against churches is especially egregious due to the high level of trust placed by church parishioners in the perceived honorable work of the church employee.

After careful study of this case the student should be able to:

1. Discuss how the three legs of the fraud triangle can indicate possible fraudulent activity and provide specific examples from the Church of God case.
2. Explain how effective risk mitigation strategies can prevent or reduce the possibility of fraud.
3. Recognize the “Red Flags” of fraud and explain why such indicators are important in detecting a possible fraud.
4. Understand the fraudster’s profile and its importance in assessing fraud.
5. Describe how the relevance and reliability qualities of the financial statements can be impacted by undetected fraudulent activities.

This paper begins with a few comments about fraud as reported by the Association of Certified Fraud Examiners in their 2018 *Report to the Nations*. We then provide a brief history and description of The Church of God (The Church) and examine one specific fraud committed by a trusted employee of The Church in Cleveland, Tennessee. Appendix 2 provides discussion questions to further the student’s understanding of fraud and its mitigating controls.

Keywords: embezzlement, ecclesiastical crime, internal controls, fraud

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## INTRODUCTION

The General Assembly Cabinet Chairman and Operations for Communications Director at the Church of God was a trusted and well-respected employee with significant responsibilities for facilitating the Church's biennial conventions. Making in excess of USD 100,000 per year, his fall to fraud rocked the very foundation of the Church.

## FRAUD STATISTICS – YOU MAYBE SURPRISED! 2018 Global Study

Would you suspect there is a direct effect from the size of an organization to fraud opportunities and certain anti-fraud mechanisms being enacted? According to the Association of Certified Fraud Examiners' (ACFE) *Occupational Fraud and Abuse 2018 Global Study*, small organizations (fewer than 100 employees) represented the largest percentage (28%) of cases in the ACFE study and experienced the biggest median loss (USD 200,000). Appendix 1 Table 1 presents a brief analysis of the relationship of an organization's size and its fraud risk.<sup>1</sup>

Moreover, the ACFE reported that while the greatest number of cases according to their study were in sections such as public administration, financial services, banking, government, and manufacturing sectors, religious, charitable, or social services accounted for 60 cases and a median loss of \$90,000.<sup>2</sup>

What might describe a fraudster's behavior and at what level in the organization is fraud being committed? As shown in Appendix 1 Table 2, the ACFE identifies Red Flags of Fraud for both Owner/Executive and employees. Concerns about inadequate pay, and financial difficulties are Red Flags of employee fraud while the owner/executive might demonstrate unusually close associations with a vendor/customer or demonstrate a "wheeler-dealer attitude".<sup>3</sup>

### Profiling the Fraudster

- Are prior fraud related convictions common among perpetrators?
- What is the relationship between occupational fraud and the number of perpetrators in a fraud?
- Does the perpetrator have unfavorable HR-Related issues before or during the fraud?
- Do fraudsters engage in non-fraud related misconduct?

Some of these questions are answered in Appendix 1 Table 3. For example, 89% of the fraudster's noted in the ACFE study were never charged or convicted and 85% were never punished or terminated by their employer

### Scope of Ecclesiastical Crime – It Never Ends Well!

According to a report by the Gordon-Cornwell Theological Seminary, Center for the Study of Global Christianity, Christian giving embezzlement may reach approximately USD 100 billion (10%) by 2025. The study cites the following example cases:<sup>5</sup>

### Radio Maria, San José, Costa Rica

Broadcasting on Costa Rica's Radio Maria began on March 11, 1999. Instead of registering the station in the name of the Catholic Church, Minor de Jesus Calvo, its founder,

used his own name. Calvo and two associates were misappropriating donations of approximately USD 2,500 per day. Following the Archbishop's June 26, 2001 order to close the station due to "debt", one of the associates was shot outside his home on July 7<sup>th</sup>. The other two perpetrators were subsequently convicted of stealing USD 3 million in donations between 1999 and 2001. Most of the stolen monies were used to pay for luxuries such as expensive cruises.

### **Uniting Church of Australia, Melbourne**

Tanya Jane King was an employee of the Uniting Church of Australia in Melbourne. She was charged with acquiring church funds by forging withdrawal slips and checks from 2004 through 2011. The church funds came from bank accounts designated for out-reach projects and from several congregations. It was reported that King stole at least USD 3.65 million before an audit of church accounts revealed the fraud. Before having to face charges in court, she committed suicide in 2013. The Uniting Church was paid in full by its insurance company.

### **Yoido Full Gospel Church: Seoul South Korea**

Pastor David Yonggi Cho, founder of Yoido Full Gospel Church in Seoul, South Korea, was accused of stealing USD 20 million by diverting church funds to buy stocks from his son at three to four times market value, costing the church USD 12 million in losses.. In 2014 the Seoul court convicted Cho of the embezzlement in addition to attempting to circumvent KRW 5.5 billion in taxes. Cho's son was also convicted.

## **THE CASE**

### **The Church of God History and Organization.**

The establishment of the Church of God (The Church) began on Thursday, August 19, 1886 in a millhouse along Barney Creek in Monroe County, Tennessee. The eight persons in attendance formed the "Christian Union" led by former Baptist Elder Richard Spurling for the purpose of following the New Testament "as their rule for faith and practice". Twenty-one years later during the Second Assembly held in Union Grove, near Cleveland, Tennessee, the movement adopted the name Church of God. The Church has world-wide membership of over seven million with a presence in nearly 180 countries and some 36,000 congregations.<sup>6</sup>

Policies and ministries of The Church are established by the International Executive Council which is composed of the International Council of Eighteen ministers elected at the biennial General Assembly and by the International Executive Committee.<sup>7</sup>

The General Assembly of the Church of God met for the first time in 1917 and, in 2015, the Constitution and Bylaws were revised to define its purposes and constituency. Accordingly, the purpose of the Assembly is to "further the ends of the Church of God: unity and holiness". In addition, the Assembly conducts the general business of the Church and identifies, selects, and empowers the leaders of the Assembly along with the ministries and agencies within the Assembly.<sup>8</sup>

The Church describes itself as "positioned in the mainstream of Evangelical Protestantism." It is a Christian Church, based upon the teachings of Jesus Christ, Son of God and adheres to the doctrinal positions of Evangelical, Pentecostal, Charismatic, and Evangelistic.<sup>9</sup>

## Case Study Facts

The April 2, 2015 headline of the *Times Free Press*, Chattanooga, Tennessee reported: “\$1 million theft of Church of God almost 9 times what was first reported”.<sup>10, 11</sup>

Troy Scot Carter, General Assembly Cabinet Chairman for the Church of God International and former Director of Operations for Communications admitted to stealing USD 889,766 according to a Plea Agreement negotiated with the U.S. Attorney. Carter’s position, which paid USD 115,000 to 125,000 per year, was second to the highest position in the Church which oversees some 36,000 congregations worldwide. The fraud was discovered when the financial records were reviewed by a third person who was tasked with identifying possible savings.<sup>11</sup>

Mr. Carter handled all matters relating to the Church of God conventions (that occur every two years) including contracting with companies that provide audio-visual services. Carter personally owned two companies (Scot Carter Productions and Platinum Productions) that purportedly provided the audio-visual services. Carter also had substantial flexibility in deciding what work should be done by the considerable number of employees under his supervision.<sup>11</sup>

Mr. Carter was sentenced to 34 months in federal prison and ordered to repay USD 880,000.<sup>12</sup> Details of the USD 889,766 theft as outlined in a plea agreement with the U.S. District Court, Eastern District of Tennessee are presented below.<sup>11</sup>

Although the plea agreement included Carter’s admission of stealing USD 889,766, the Circuit Court of Bradley County, Tennessee, Tenth Judicial Circuit awarded a judgment for an additional USD 2,762,784 including punitive damages, pre-judgement interest, and USD 643,242 of “additional monies stolen by Carter and others acting in concert with him by various other acts of embezzlement, larceny, fraud and transportation of securities”.<sup>11</sup>

Here are the facts of the case outlined in his guilty plea and reported by the *Cleveland Daily Banner*, August 14, 2015; *The Chattanooga*, August 13, 2015; and transcripts from Tennessee’s Eastern District of the United States District Court. See how many “Red Flags” you can identify.

### A Tale of Four Frauds

Starting on or about January 2010 until December 2012, Mr. Carter developed a scheme to steal from The Church. He executed the scheme in four different but related matters:<sup>11</sup>

**USD 372,350.** Carter presented false invoices to The Church showing his company, Platinum Productions, performed audio-visual services for the conventions when, in fact, it had not. According to local press releases, the address given for Platinum Productions existed, but the “individual there had never heard of Platinum”.

**USD 300,416.** Rebates from hotels sponsoring the conventions, which should have gone to The Church, were directed by Carter to Platinum Productions, the company he owned.

**USD 117,000.** In 2012, Carter requested a refund from a firm hired by The Church to provide audio-visual services at a convention in Florida. He told the firm that (1) The Church had mistakenly paid prior to the services being provided and, (2) that the refund should be paid directly to his personal company. Carter kept the refunded monies and directed The Church to pay the refunded amount, causing The Church to pay the same amount twice.

**USD 100,000.** The last fraud addressed in the plea deal included a scheme whereby Scot Carter Productions obtained a contract to provide audio-video services for the Empowered 21 Convention (not associated with The Church). Carter subcontracted with Majestic Productions to provide the services. In the agreement, Carter would receive USD 44,520 and Majestic Productions was to be paid USD 166,900 for a total payout by Empowered 21 Convention of USD 211,420 – all of which was paid to Carter. Carter then paid USD 66,900 to Majestic rather than the full amount of USD 166,900. The remaining USD 100,000 was paid to Majestic Productions by The Church based on a false invoice presented by Carter.

A summary schedule of the four frauds is presented in Appendix 1 Table 4

#### Noteworthy Clues to the Fraud

- Carter prepared invoices manually for approval by the Church. When the invoices were paid, Carter deposited the funds into the Platinum account before moving the monies to his personal account.
- Carter’s position “was at the apex” of the Church permitting him to have a “great deal of major discretion in business matters. He handed the church a \$100,000 bill and they paid it.” (U.S. District Judge Curtis L. Clollier)
- Carter purchased luxury Porsche automobiles, traveled to New York, and provided money to friends and family.
- Carter stated he needed treatment for alcohol abuse and that a “bad business venture” led to the embezzlement.
- Carter’s statement to the press: “I have talked to many of these individuals and done everything in my power to recover the funds that were misappropriated. I am sorry. I never would have dreamed I would have gotten myself into this.”<sup>12, 13</sup>

#### Internal Controls Adopted by the Church of God

The International Executive Committee developed procedures to secure donations made to the church and asked for prayers for The Church of God as their ministry continued. During our interviews, one church administrator stated “Now, there are multiple people doing what one person was doing”.

The above statement reflects a complete understanding of the fiscal responsibilities of The Church to its parishioners. Some of the new commitments and revised policies and procedures reported to us by The Church of God included:

- Maintaining employee dishonesty insurance (which covered a sizable portion of the loss).
- Demanding recovery from a “co-conspirator” and threatening litigation. A sizable portion of the loss was recovered.

- “Decentralizing” the functions relating to the General Assembly convention—one single person will not have control and supervision over so many aspects of the convention.
- Creating several new committees and oversight efforts.
  - There is a functioning “General Assembly Cabinet” with greater control over all aspects of the convention. All financial transactions are reviewed.
  - There is a functioning “General Assembly Contracts Review Committee” that reviews every contract relating to the General Assembly.
  - There is a functioning “General Assembly Audit Committee.”
  - A functioning Internal Controls Committee also exist.
- Bidding is required for all General Assembly contracts.
- Removing the outside “Agent of Record” and creating an internal “Agent of Record” relating to the convention.
- Becoming a member of the Evangelical Council for Financial Accountability-“ECFA”
  - The ECFA provides accreditation to leading Christian nonprofit organizations that “demonstrate compliance with established standards for financial accountability, transparency, fundraising and board governance.” Complete and accurate financial statements must be prepared and submitted to an independent certified accountant approved by the governing board of the entity. Internal controls and any significant risks must also be assessed.<sup>14</sup>

### Final Reality Check

Before closing with a few comments, think about the magnitude of church frauds, the need for strong controls to protect church assets, and, most importantly, the vulnerability of churches to financial misdealing. Patricia Lotich, founder of “Smart Church Management” presents some “Shocking Facts About Church Embezzlement”. Here are a few of her statistics.<sup>15</sup>

1. Annual Church losses due to fraud average \$120,000 – and grow every year.
2. It is estimated that 80% of fraud cases experienced by churches go unreported.
3. Most church thieves are creative.
4. Church leaders doubt that stealing is committed by someone in their congregation.
5. The most trusted people of the church are often the ones committing fraud.
6. More than \$39 billion was stolen by Christians in church related financial fraud during the first half of 2014 while \$35 billion was spent on worldwide mission work during the same period.
7. Researchers are expecting church financial fraud to reach \$60 billion by 2025.
8. Due to the very nature of the church and the counterintuitive nature of suspecting someone of stealing, churches are especially susceptible to fraud.
9. Because of their position, church thieves can acquire access to church funds.
10. There is no process in place in an estimated 60 percent of churches to report suspected financial crimes.
11. Church thieves are only as successful as the financial controls over church resources.
12. One third of all congregations will fall victim to fraud.
13. Eighteen months usually pass before most fraudsters are caught.
14. Eight years is the average tenure of a church thief.
15. A tip is used to catch 40% of frauds.
16. The fear of getting caught is the number one deterrent of fraud.

### **Concluding Comments**

Questions for thought and discussion relative to the frauds in this article are listed in Appendix 2. Students should apply their knowledge of the “fraud triangle” while thinking about the conditions that allowed the frauds to occur, the needed controls to prevent future frauds, and the possible effects on the financial statements when revenues and expenses are misstated.

The Church of God administrators instituted many safeguards to detect and prevent misuse of church assets. They should be applauded for these efforts and for the cooperation they extended in the preparation this article.



## APPENDIX 1

**Table 1 Organization's Size vs. Occupational Fraud Risk**

Number of Employees	< 100	100-999	1,000-9,999	10,000 +
% of Cases Reported to the ACFE	28%	22%	26%	24%
Median Loss	\$200,000	\$100,000	\$100,000	\$132,000

**Table 2 The Red Flags of Fraud**

Red Flags	Owner/ Executive	Employee
Unusually close association with vendor/customer	24%	16%
Control issues, unwillingness to share duties	21%	8%
“Wheeler-dealer” attitude	22%	9%
Irritability, suspiciousness, or defensiveness	18%	10%
Financial difficulties	23%	35%
Complained about inadequate pay	4%	11%

**Table 3 Fraudster's Prior Convictions, Collusion, and Employment Issues**

<b>Prior fraud convictions</b>	89% Never charged or convicted	6% charged but never convicted	4% had prior convictions
<b>Collusion by multiple perpetrators</b>	52% one perpetrator	19% two perpetrators	30% three or more perpetrators
<b>Perpetrators employment history</b>	85% never punished or terminated	9% previously terminated	6% previously punished
<b>Negative HR issues</b>	14% poor performance evaluations	13% Fear of job loss	5% actual job loss
<b>Non-fraud misconduct</b>	21% bullying or intimidation	14% excessive absenteeism	10% excessive tardiness

**Table 4 Fraudulent Schemes**

<b>Carter's \$889,766 in fraudulent schemes included:</b>	<b>USD</b>
Billing the church for services not performed	372,350
Collecting rebates from convention hotels that should have gone to the church.	300,416
Collecting monies by paying one bill twice & keeping one of the payments.	117,000
Presenting false billings for convention expenses	100,000
<b>Total Amount Entered in the Plea Filing</b>	<b>889,766</b>



**Appendix 2****Discussion Questions:**

1. What are the main elements of the fraud at the Church of God?
2. What conditions might have existed that enabled the fraud to occur?
3. Discuss how the fraud occurred and why it was not detected in a timely manner, using the following elements of the fraud triangle:
  - (i) Motivation - (motive or pressure is the need for committing fraud - need for money, etc.)
  - (ii) Rationalization – (the mindset of the fraudster that justifies them to commit the fraud)
  - (iii) Opportunity – (the situation that enables fraud to occur - often when internal controls are weak and/or nonexistent).
4. What risk mitigation strategies were put in place to prevent the embezzlement?
5. Of the red flags identified in the case (as listed below), explain which one was the most prevalent in the Church of God fraud?

**The Red Flags of Fraud**

<b>Red Flags</b>	<b>Owner/ Executive</b>	<b>Employee</b>
Unusually close association with vendor/customer	24%	16%
Control issues, unwillingness to share duties	21%	8%
“Wheeler-dealer” attitude	22%	9%
Irritability, suspiciousness, or defensiveness	18%	10%
Financial difficulties	23%	35%
Complained about inadequate pay	4%	11%

6. Explain how (in what ways) the employee fit the profile of a fraudster?  
The profile of a fraudster includes:
  - (i) Having prior fraud-related convictions
  - (ii) Relation to occupational fraud
  - (iii) Having prior employment-related disciplinary actions for fraud
  - (iv) Have experienced prior negative Human Resources-related issues
  - (v) Having engaged in non-fraud related misconduct.
7. The Statement of Financial Accounting Concepts No. 2 provides the following nine qualities and characteristics that enable financial statements to be valuable to investors, analysts, creditors, and other stakeholders of financial information:
  - Relevance
  - Timeliness
  - Reliability
  - Verifiability
  - Representational faithfulness

- Neutrality
- Comparability and consistency
- Materiality
- Feasibility or costs and benefits

Describe how the fraud could have impacted the financial statements (under statements and over statements), and explain how they might have been misleading, considering any three of the above qualities and characteristics?

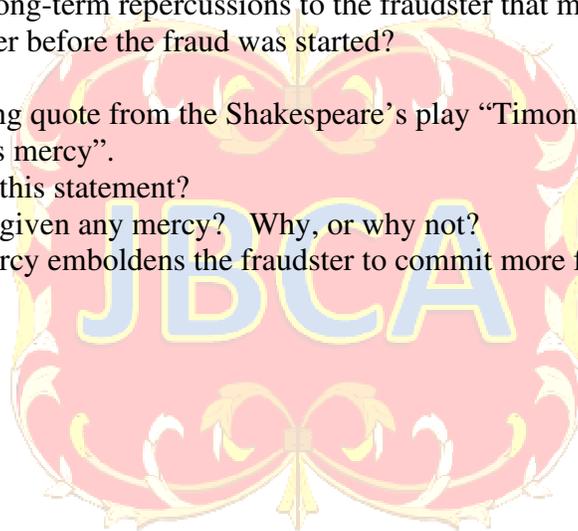
8. Identify and explain the possible consequences of issuing misleading financial statements as it relates to:

- (i) Donations from current church members - tithers
- (ii) Donations (funding) received from the General Assembly that could have been awarded to other churches within the assembly.

9. List and describe the long-term repercussions to the fraudster that may not have been considered by the fraudster before the fraud was started?

10. Consider the following quote from the Shakespeare's play "Timon of Athens:" "Nothing emboldens sin so much as mercy".

- (i) What do you think of this statement?
- (ii) Should a fraudster be given any mercy? Why, or why not?
- (iii) Do you think that mercy emboldens the fraudster to commit more frauds?



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