

Pell Speaks

As you no doubt gathered by now, I take a special interest in Not-For-Profit frauds and mismanagement. The lack of funding and depth of management makes NFP organizations prime targets for fraudsters. The Catholic Church, being the largest NFP organization in the world, has perhaps the biggest bullseye on it for fraudsters. Elise Ann Allen wrote a splendid article about an interview with George Cardinal Pell, formerly the Vatican official tasked with cleaning up the financial mess at the Vatican. The article was published in John Allen's excellent publication, *Crux* and can be accessed [here](#).

As discussed in this and other articles in *Crux*, several high ranking Vatican officials are on trial for various alleged financial crimes. I gave the above mentioned article to my forensics auditing class as a case study to see what they could come up with. I was stunned by what they did. A summary of their findings follows:

- **There was a general lack of control consciousness in the Vatican, going all the way up to the Pope.** Any student of auditing and management knows the "tone at the top" is a critical component of effective internal control. Without this, no plan of internal control can be effective. Put another way, if the Big Boss isn't interested in it, then why should his subordinates be? The top management at the Vatican did not exhibit the appropriate control consciousness until recently. To be fair though, this has turned around somewhat in the last few years. The Pope has begun changing the organizational culture by dismissing many members of the old cronies network and replacing them with outsiders and has demonstrated an increased awareness of these problems.
- **Organizations, like individuals, resist change.** There must be a change agent in place when essential change is needed. Pell was the change agent. It appears he was not afforded sufficient support in his activities to change the culture of poor financial controls at the world's premier nonprofit organization. Change agents need to be protected. Moreover, it seems Pell did not do what change agents need to do, and this is "communicate, communicate and communicate." One can only speculate about what happened but Pell did not seem to navigate the organizational politics well. As he admits in the article, Pell underestimated the resistance to change in the Vatican.
- **The Pope allowed one of the alleged culprits to fire the auditing firm.** PricewaterhouseCoopers, the world's leading auditing firm was hired by Cardinal Pell to audit the Vatican. The Pope allowed PwC to be fired by one of the alleged fraudsters. The termination of the auditors should have raised alarms. The importance of auditing to the veracity of financial reporting is demonstrated by the fact that publicly traded companies in the United States need to immediately disclose the termination of its auditor since this is a potential indication of fraud and/or inadequate financial controls. Instead, nothing of any consequence was done at the Vatican after the PwC was terminated. Charitably, perhaps Vatican officials did not realize the implications of the action. Cardinal Pell did say he should have been more forceful in this matter, a quality forensic accountants value. To make matters worse, PwC was retained in an advisory

capacity, providing window dressing for the alleged fraudsters. Sadly, the article does not indicate whether an audit will be conducted today. Without an independent audit, the true depth of the financial problem At the Vatican may never be known.

- **The Auditor General resigned.** This position would be roughly analogous to the internal auditor at a large public company. He had been frozen out of financial matters and his reputation had been smeared by the alleged fraudsters. An internal auditor functions as the highest level of internal control. In actuality he, like PWC, was just another form of window dressing. The Auditor General's resignation should have set off alarm bells and required an immediate response. However, this also seems to have been ignored as well.
- **Controls over liquid funds were totally inadequate:**
 - **There was no investment policy.** An investment policy could have prevented the "financial adventure" that cost the Vatican over \$220 million dollars. A reasonable investment policy would have prescribed or at least limited the amount of real estate investment.
 - **Disbursement controls also appear to be nonexistent.** It is almost incomprehensible that over \$7 million was sent to Australia without an adequate description of what the funds were for. It has been alleged the funds were used to orchestrate a criminal smear campaign against Pell.
 - **A significant amount of the Vatican's funds were not under the control of Pell, who functioned as the Vatican CFO.** The Peter's Pence collection seemed to be under the control of the Secretary of State (the papal prime minister) and therefore not subject to what controls (as little as they appeared to be) that were in place. It appears these funds were used to make the investment in the London property.
- **Since there was no balance sheet, double entry bookkeeping could not have been employed.** Granted, the Vatican presents unique accounting issues since it is difficult to put a value on the Sistine Chapel or the Pieta, but modern accounting should have been used to at least account for current operations and current balance sheet accounts. James V. Burke, in his book *The Day The Universe Changed* describes double entry bookkeeping as one of the great inventions of mankind. Not using it was a crime against mankind.
- **The budgeting process (or lack thereof) has to be called into question.** The Vatican has been running huge deficits for years. While religious organizations should not be run with a profit motive, robust financial controls and budgeting discipline are necessary for the organization's survival.
- **Collusion beats internal control.** Given there seems to be ten people under trial the level of collusion seems to be unimaginable. This comes back to the issue of the control environment. The Vatican control environment seems to have been relatively permissive and the corporate culture contains significant deficiencies.
- **The Vatican took its eye off the ball.** Any organization has to secure its funding, in this case, Peter's Pence. Peter's Pence is a collection taken up in all Catholic Churches around the world for the sake of the Vatican. It has been a major source of funding for the Vatican. The lack of controls over the use of the funds has resulted in a major

decrease in donations to Peter's Pence, further exacerbating the Vatican's somewhat precarious financial situation. Management should never take its financing sources for granted, which seems to have been the case here.

This list was developed by an undergraduate class in only one hour. Obviously there could be much more. However, the main point is these are all reasonable observations made by students. The fact the oldest continuously functioning organization in the world could not deal with these problems is shocking. NFP organizations, take heed!