

The Valley-Patriots Women's Auxiliary: Asset management in a small nonprofit organization

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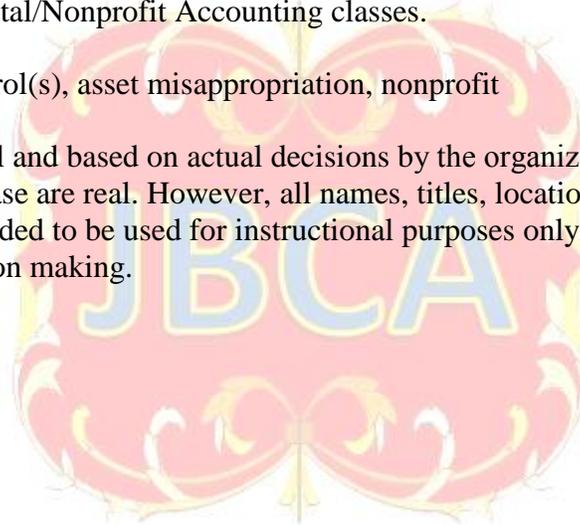
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ABSTRACT

Fraud has been on the rise in the last few years and small nonprofit organizations are especially vulnerable. This case allows students to examine the lack of internal control in a nonprofit organization and suggests processes that could help the organization better manage and thereby protect its assets and membership. The case addresses issues applicable to Accounting, Auditing and Governmental/Nonprofit Accounting classes.

Keywords: Internal control(s), asset misappropriation, nonprofit

Note: This case is factual and based on actual decisions by the organization's membership. All events described in the case are real. However, all names, titles, locations, and dates have been altered. The case is intended to be used for instructional purposes only and not to highlight either good or bad decision making.



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BACKGROUND

Organizational Structure

The American Legion, founded in 1919, is a national social organization reserved for men and women who have served in the armed forces during designated times of military conflict. The American Legion Post is the primary unit of the Legion where each Post represents a small geographical area. To accommodate the families of Legionnaires, two other organizations have been established: The Sons of the American Legion (an organization of men who have either served in the armed forces outside the designated conflict periods or are family members of Legionnaires), and The American Legion Auxiliary (an organization of women who are family members of Legionnaires).

The American Legion Auxiliary has about 800,000 members nationwide and is organized into units connected to an American Legion Post. This case relates to one Auxiliary unit, the Valley-Patriots Women's Auxiliary, and hereafter referred to as the V-P Unit. The primary purpose of all Auxiliary Units is to provide help and support for their local Posts and thereby aid the American Legion to meet its objectives.

Each Auxiliary Unit has a Unit Constitution and Bylaws. The Unit Constitution and Bylaws address items not covered by the Department and National Constitution. Both the Department and National Constitution and the Unit Constitution and Bylaws outline the officers' and committee duties.

Auxiliary Unit

The leadership of the V-P Unit consists of seven elected officers: President, two vice-presidents, secretary, treasurer, chaplain, and sergeant at arms. Formal elections are held in April of each year and all officers are elected to one-year terms. Although elections are held annually, it is not uncommon for some officers to be reelected until they resign or ask to be replaced. Meetings are held the first Monday of each month except for July and August. The V-P Unit is supported by membership dues, fundraising events, and donations.

In addition to the elected officers, the V-P Unit also elects an event manager for an indefinite, term of service. The event manager is responsible for supervising fundraising events with assistance from the members. Elections for the event manager are held whenever the previous manager no longer wants the position or the members decide a change is necessary. Since this a volunteer position, it is often extremely difficult to find someone willing and able to invest the large number of hours required. As a result, other V-P Unit members often exhibit great deference and loyalty to event managers. Upsetting a volunteer event manager could lead to an early departure and a struggle to find a suitable replacement.

Prior to April Election

Attendance at the monthly V-P Unit meeting has continued to deteriorate over the last 10 years. As the older and typically more active senior members become less able to serve, younger members have not been willing or available to step-up into key leadership roles, regularly attend meetings, or generally volunteer to help. Over the past three years in particular, six different treasurers have been elected and subsequently resigned due to the time requirements and stresses

of trying to maintain a declining membership. During the past year, the treasurer, and event manager asked to be replaced. As a result, one member (Bertha Nitchke) has been generously serving as president, event manager, and treasurer. Unfortunately, Bertha has very little accounting experience, and acting as treasurer has been especially challenging and problematic for her. She has major responsibilities over all the Unit's purchasing and money handling and as is typical of many nonprofit volunteer organizations, no background to guide her actions. Consequently, the cash balance of the Unit has been declining and is now reaching the point where it is difficult to pay bills even though there has been no change in the number of fundraising activities.

Subsequent to the April Election

Bertha opened the April 2013 meeting speaking in her capacity as acting treasurer, and announced that the V-P Unit was in financial crisis. She reported that she had trouble remitting the last State Sales tax payment. As a result, the V-P Unit overpaid the quarterly sales taxes plus a late penalty. The eight members in attendance were very concerned and agreed that something had to be done quickly. Volunteers stepped forward to serve as the new president, first and second vice-presidents, treasurer, and event manager.

Due to her previous experience serving as treasurer for another local non-profit, Helen Briggs was elected the new V-P Unit treasurer. She also asked for help from Janice Crowley, another member known by the group to have some basic accounting experience. Together it was hoped they could get the books under control and up-to-date in short order.

Unfortunately, what they found was alarming. For over a year no one had maintained a check register. There was a ledger, but it was difficult to determine what the checks were written for. Additionally, the ledger did not agree with the monthly bank statements after adjusting for deposits in transit and uncleared checks.

Review of the sales tax account revealed that the last quarterly sales tax had been paid a month late which resulted in the late payment penalty. The ST-100 form had also been completed incorrectly. The Unit's receipts had been entered in two places on the form causing the tax to be calculated on twice the actual amount resulting in an overpayment of over \$1,200.00.

Finance Committee

National Bylaws require a formal finance committee to be appointed. The V-P Unit has a finance committee described in their bylaws but there was no provision for membership on this committee. Instead, the customary practice which evolved had been for the committee membership to be the current and previous presidents, and either the first vice-president or one other member. Bylaws also required the treasurer's books to be audited quarterly; however, books for this Unit had not been audited for several years.

FUNDRAISING EVENTS

To support its mission, the V-P Unit's major fundraising events include weekly bingo, Saturday evening dinners, and catering special events for the community at-large.

Bingo

Each week the American Legion Post holds a bingo which averages 100 players in attendance. The V-P Unit supports the Legion at these bingos by providing refreshments for sale through two small fund raising activities; one offering hot food and the other offering drinks, desserts, candy, and cold sandwiches. Volunteers for these activities change each week. The treasurer prepares a start-up envelope for each activity. To improve accountability, the treasurer also includes a cash receipts form in the envelope which each cashier should sign and enter the amount of money placed in the envelope at the end of the event.

The hot food includes weekly specials and standard items such as hamburgers, hotdogs, and fries. Customers place their order at a front counter by writing their name on a short order form listing the food options and checking boxes to indicate their food choices. Unit volunteers take the orders and calculate the amount due. Cash is collected and placed in a cash drawer. The orders are delivered to the kitchen. Kitchen volunteers prepare the orders and deliver them to the order counter where the counter volunteer calls for the customer. Once the food has been delivered to the customer, the order form is destroyed. No written record of the food sold or amount collected is retained.

The second fund raising activity at the weekly bingo is a table selling cold items. Usually one or two volunteers sit at this table. The event manager provides homemade sandwiches. Other Unit members donate cakes. All other items are purchased. It is expected that the event manager make these purchases. However, chips and soda are often purchased by other members to take advantage of area sales. These purchases are made without prior authorization and with the expectation that they will be reimbursed.

Customers pick up their selections as they walk past the table. The volunteer then calculates the amount due and receives cash from the customer which is put into a box sitting on the table. Items sold and inventories are not recorded. The same woman volunteers each week for this table. She often goes out on her own to make purchases without prior authorization to do so. When this is done she leaves the receipt in the envelope and takes cash out of the envelope to cover her costs before she counts the night's receipts and completes the cash receipts form. No one compares her purchases to the receipt.

At the end of bingo, both envelopes are handed directly to the bartender working that evening (this is not always the same bartender). The bartender locks the envelopes in the liquor closet. All the bartenders and Legion board members have keys to the liquor closet. There are 6 Legion board members and at least 5 bartenders with keys. Auxiliary members are not eligible to serve as Legion board members, however, Bertha is a bartender. The envelopes remain in the closet, possibly for several days following a bingo event, until the treasurer comes into the Legion to make the deposit. When the treasurer is ready to deposit the bingo money, she must get a key from a bartender and collect the envelopes from the closet. It has never been the practice for this Legion Post to give the V-P Unit treasurer a key to the liquor closet, however, Bertha did have a key while she was acting treasurer since she is one of the bartenders. The treasurer then counts the money in each envelope and attempts to reconcile her count to the cashier's amount recorded on the cash receipts form. In some cases, the amounts don't agree. Because there are no other records in the envelope, it is simply not possible to reconcile the differences.

Saturday Evening Dinners

Twice a month during the winter, the V-P Unit hosts Saturday dinners. Dinners consist of rolls, soup or salad, choice of one of three entrees, choice of dessert, and coffee, water, or tea for \$13.00. Customers pay a volunteer as they enter the room. The treasurer prepares a start-up drawer for the cashier. The cashier collects the \$13.00 and puts the cash in the drawer which sits on top of the table. She attempts to keep a running count of the number of customers, but because she often gets busy, the count doesn't always agree with the amount of money in the drawer at the end of the evening.

Customers then seat themselves and wait for another volunteer to take their orders. Once the order is processed the order form is discarded. Most customers leave a tip. Some leave the tip on the table and others give it to the cashier at the door as they leave. Volunteers cleaning the tables are instructed to give any tips left on the table to the cashier at the door. The cashier keeps the tip money separate from the dinner receipts.

At the end of the evening the cashier totals both the dinner receipts and the tip money, and writes the amounts on the cash receipts form provided by the treasurer. The cashier also enters her customer count on the form. Once again, the envelope is given to one of the bartenders to lock in the liquor closet until the treasurer is able to collect it and deposit it.

Catering

The V-P Unit often caters weddings and parties in the Legion Hall. These events are booked through the event manager. Clients are given a choice of menus and appetizers. There are on average 3 or 4 of these events each month depending on the season. The number of events during the past season does not seem to be significantly different than past years.

The event manager determines the amount of food to prepare, purchases the necessary ingredients, and arranges for additional volunteers to serve the food, wash dishes, and clean the hall. Food is prepared by volunteers supervised by the event manager. At the end of the event, the event manager summarizes the bill using a standard form and collects payment. Each client's bill is based on their menu selection and additional appetizers and services requested, such as linens and bartender. As a result, each bill is unique. It is the event manager's responsibility to correctly count the number of meals served and to complete the invoice correctly. The event manager holds the payment until she can give it to the treasurer. Payments for such events are usually made by personal check.

Control of Bank Account

The V-P Unit has done business with the same local bank for several years and only has one bank account. Three officers have access to this checking account, the president, the first vice-president, and the treasurer. The account requires two of these officers to sign checks, however, the bank's staff all know the Unit's officers and does not monitor the signatures. It is entirely possible for checks to clear with only one signature. The treasurer has physical control of the check book, check register, ledger and reconciles the bank statement.

Purchases

The event manager is responsible for making all purchases for the Unit's fundraising events. The event manager purchases supplies either by ordering directly from suppliers or by using pre-signed checks obtained from the treasurer. If the food is ordered, the invoice comes to a Legion PO Box where it is picked up by a member of the Legion and then given to the Unit treasurer. If the event manager shops and makes the purchase herself, she asks for a signed check from the treasurer and then returns with the receipt. She puts the food and supplies away without someone matching the receipt to the items purchased. Purchases are made in large quantities and not necessarily for a specific event. As a result, it is not possible to determine the profit or loss on each event. No inventory records are maintained.

QUESTIONS FOR DISCUSSION

1. Is this a case of fraud?
2. Does the V-P Unit have internal control weaknesses?
3. Was the Finance Committee negligent?
4. What could be done to protect the Unit from fraud?

TEACHING NOTES FOR DISCUSSION

1) *Is this a case of fraud?*

The American Legion Auxiliary defines fraud as “a willful or deliberate act with the intention of obtaining an unauthorized benefit, such as money or property, by deception or other unethical or illegal means.”¹ In this case, no actual fraud is identified. However, students should note that fraud in America's charitable organizations is on the rise. Small nonprofits such as religious groups, veterans associations, sports and recreational leagues, and neighborhood associations are especially vulnerable. This case provides an excellent example of the reasons for this vulnerability. Three reasons why small nonprofits are more susceptible to fraud are present in this case:

- a. Small nonprofits are usually governed and managed by volunteers.
- b. They usually have limited resources to allocate to accounting and internal controls.
- c. Most of the receipts for fundraisers are made in cash. It is much easier to misappropriate cash than credit card payments or checks.

2) *Does the V-P Unit have internal control weaknesses?*

The student should be able to identify several internal control weaknesses.

1. Lack of control over cash receipts.
 - a. Bingo: The food order receipts from bingo are discarded. There is no record of the amount of food sold or attempt to reconcile the amount of food sold to the amount of money collected.

¹ American Legion Auxiliary, *National Policy: Fraud and Whistleblower*

- b. Saturday Evening Dinners: The cashier counts customers. However, dinner order forms are discarded. There is no record of what was ordered or how much.
- c. Catering: Payment for parties is usually done by check which is what should happen. Since no verifiable record is kept of the number attending, it is not possible to know if the customer was correctly charged. It would be possible for the event manager to undercharge for the number of meals or omit charges for appetizers or services.

For all three events, there is little control over the cash once it is put in the liquor closet. Too many people have access to the closet. It should be noted that the treasurer has made an attempt to improve control and avoid theft by requiring cashiers to complete and sign the cash receipts forms.

- 2. Lack of control over bank account.
 - a. There is no separation of duties. The same person signing the checks records the amount in the check register and ledger and reconciles the bank statement.
 - b. Although the Unit bylaws require two signatures on each check, the bank does not regulate this and checks are sometimes cashed with only one signature.
- 3. Lack of control over purchases.
 - a. It is possible for volunteers to make unauthorized purchases using their own funds and then ask for reimbursement from the treasurer.
 - b. No one compares the purchase receipts to the items purchased.
 - c. Inventory records are not maintained.

3) *Was the Finance Committee negligent?*

The Finance Committee has a duty to protect the assets of the V-P Unit. Under the current unit bylaws the treasurer's books should be audited quarterly to ensure that revenues and purchases are accounted for appropriately. In this case, audits were not performed according to unit bylaws. Although no actual fraud can be identified, the finance committee is negligent carrying out its duties by not auditing financial records.

Often in small organizations, the members are friends and relatives. In this case, they also live in a small rural community where everyone tends to be well known. The lack of formal controls, and the potential problems they could cause should be explained. It should be clear that no one is at fault. These problems are not unique to the V-P Unit. They exist to some degree in many small nonprofits, particularly when the membership and functions are achieved through volunteer staff. To avoid problems, controls should be put into place.

4) *What could be done to protect the V-P Unit from fraud?*

Based on the facts in the case, it appears the V-P Unit recognized there was a problem and has taken initial steps to provide more control over its assets. Students should be asked to suggest additional controls, and some of the possibilities include the following:

1. **Responsibilities should be clearly defined.**

Currently elected and appointed members are overlapping duties either because the appropriate person does not do their job or because someone attempts to control more than they should.

2. **Persons should be adequately trained and able to do the job.**

It is often difficult in a small organization to find someone trained to handle the accounting, financial, and internal control functions. If this happens, it may be necessary for the organization to employ a bookkeeping or accounting firm.

3. **Monthly profit and loss statements should be prepared.**

The monthly treasurer's report should show all disbursements and receipts for that month. It would also help this organization if the profit and loss from each event could be determined.

4. **Two people should count the cash together and sign the cash receipts forms before they are given to the treasurer.**

When the treasurer counts the money the people signing the tally form should be notified when the treasurer's count doesn't agree. The cash receipts forms should be dated and used to post to the ledger. At the end of the month the total receipts on the tally forms should be compared to the ledger. The ledger amount should agree with the deposits in the check register.

5. **Records should be maintained.**

Food order forms from bingo and the dinners should be pre-numbered and maintained. At the end of each event, the order forms should all be accounted for and reconciled to the receipts recorded on the tally form. Invoices from the parties and weddings should also be pre-numbered, maintained and periodically compared to the ledger.

6. **Checks should be signed by two people.**

Although V-P Unit rules require two signatures, the bank left the enforcement of this up to the Unit. Consequently, there are not always two signatures.

7. **The bank statement should be reconciled by someone other than the treasurer.**

Because this is a very small organization, the treasurer has always reconciled the bank statement. Since the treasurer is responsible for signing checks and handling cash, someone other than the treasurer should open the bank statement and look to see where money was spent.

8. Purchases should be authorized.

The V-P Unit should set a policy for purchases. Members should not be allowed to make purchases and then ask for reimbursement without first getting approval. There should be a limit to the amount that can be paid out in cash. Unless the purchase falls below this threshold, the purchase should be made by check.

9. The Finance Committee should perform reviews of all financial records according to the Unit bylaws.

Original documents such as food orders, cash receipts forms and checks should be compared to the ledger. Each month someone other than the treasurer should compare the bank balance to the check register and ledger.

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