Charles Counter scanned the computer screen for the number. He found it in cell H87 of the spreadsheet: $61,238.16. Charles leaned back in his chair, took his glasses off, and rubbed his eyes.

He had known Cletus William for 31 years. Cletus was the man who had welcomed him to the recreation center at First Church when he was just 12-years old. Cletus was always at the church--working in the office, fixing broken kneelers, adjusting chemicals in the recreation center pool. Cletus was the resident handyman and he knew everybody.

Now Cletus William was accused of the unthinkable--stealing $61,238.16 from First Church. Charles could hardly believe it. He had never known Cletus to even utter a mild profanity, much less steal from the church that had been the center of his life.

What had gone wrong, he thought? What had happened to Cletus...? But Charles couldn't help but wonder something else. What kind of system allows this level of theft for ten years without discovery?

Providing accounting and auditing services for not-for-profit entities can create significant problems for the CPA. The environment surrounding this type of entity, the management style normally associated with these enterprises, and the diversity of problems connected with these organizations often make any engagement related to not-for-profits a challenging venture.

An example of a recent fraud that went undetected for a number of years in a religious organization illustrates the unique problems often encountered in providing services to a not-for-profit organization. While the actual case deals with a church fraud, the lessons learned from this type of engagement can be applied to any not-for-profit.

The First Church Internal-Control Structure

Charles Counter, a CPA, was hired by the church after the discovery of a $60,000 theft. Church officials asked Charles to explain how their accounting system allowed something like this to occur. Charles was also asked to suggest improvements to help prevent this type of fraud in the future.

As is the case with many small businesses, Charles found the internal- control structure of First Church was lacking in a number of areas. Those responsible for monitoring record-keeping operations of the church had limited accounting knowledge. Charles concluded a number of fraudulent acts could have easily been detected had the governance board only recognized the improper accounting treatment for certain transactions. For example, Cletus was able to siphon off funds on a number of occasions and record charges to "salary advances." These amounts were never repaid, but instead were written off to expense accounts. A basic knowledge of accounting would have helped identify this type of recording discrepancy.

Another control weakness was related to the entity's attitude and understanding of internal accounting control in general. Not only were the leaders of the church not knowledgeable of basic accounting practices, but they also lacked a sufficient understanding of key controls that should have been in place when dealing with highly liquid assets. Additionally, there appeared to be an apparent lack of concern over weaknesses present in the internal-control structure. After all, it is a church, and everyone there is assumed to be of the highest moral character. This is possibly the worst case scenario for any organization.

Church leaders were inactive and ineffective in their oversight function. For example, on numerous occasions, Cletus, the church administrator, wrote large checks out to cash, and subsequently deposited them into his own account. No one challenged this practice. Additionally, he would generate extra paychecks for himself. He would generate one payroll check and have it signed by an authorized check signer. He would then generate another check and have it signed by a different check signer. Nobody but Cletus ever reconciled the bank statements to spot the duplicate payroll payments.

The lack of involvement of church leaders was most apparent in the area of general expense payments. Cletus wrote checks for basic expenditures that greatly exceeded previous disbursements for those areas. For example, checks were written for over $500 for supposed expenses related to a special occasion breakfast. Comparison with previous years revealed this outlay to normally total about $50.

Additionally, the oversight board placed too much reliance on the expertise of the individual performing the accounting function. In this case, the accounting work was done by one person--Cletus William. Cletus was known as someone who could do just about anything, and, unfortunately, he lived up to that reputation. He was given total control and oversight responsibilities for the accounting system and basic cash expenditures. The only minimal exception to this was the area of payroll. In this case, payroll checks had to be signed by someone other than Cletus.

This presented no great obstacle though, because Cletus was responsible for all data that generated those paychecks. Additionally, no verification of the data was ever performed by various authorized payroll check signers. Cletus was able to generate greatly payroll checks. On numerous occasions, these checks were written for five to six hundred dollars more than called for. Additionally, since he was responsible for compiling and signing all payroll tax documents for the church, he was able to manipulate tax records to show a much lower salary. In this way, he was also able to avoid significant income taxes.

Final assessment of the payroll area indicated over $9,000 of income tax withholding taxes were owed to the IRS due to Cletus' manipulations.

The church never thought about separation of duties, the very basic precept of internal control that provides an effective safeguard of highly negotiable assets. The governing body was uninformed, uninvolved, and very trusting of the one person who could best take advantage of the situation. Unfortunately, Cletus did exactly that.

Net-for-Profit Environment and Problems

The previous scenario reflects a number of issues that could relate to any not-for-profit entity. The issues and basic environment under which most not for profits operate are basically the same.

Ineffective Controls. Not-for-profit organizations by their nature often are involved in noble and idealistic activities seeking to improve society and the well being of all. The leaders are often devoted and very conscious of the ir eleemosynary objectives. They take for granted that all involved with the activity are of a similar bent and disposition and think there is no need for controls against employee dishonesty. Unfortunately, that is just not the case. Even when directly confronted by church elders about his thefts, Cletus William maintaIned he had not stolen anything: the money was owed him for additional work not covered by his employment contract, or was needed to offset a cut in pay the church board had enacted three years earlier.

This scenario could unfold in almost any not-for-profit. Hospice: "None of our people would steal money from those under our care." Drug treatment center: "None of our people would steal money from these poor drug-ravaged souls." Neighborhood recreation center: "None of our people would steal money from these underprivileged kids." Yet people can and do steal from these organizations and often create their own elaborate justifications for their actions.

Leaders of not-for-profit organizations have responsibility to implement practices and policies businesses use to discourage employee fraud and embezzlement. To rely on employees' consciences or sense of moral duty is to invite serious problems. And in many cases the absence of reasonable controls can provide a temptation to the employee with a financial burden or an expensive habit. However, all too often their leaders don't understand this.

Dominant Leadership. Not-for-profit enterprises are often under the leadership of dominant personality types. These personalities can work at odds with what is considered to be a proper internal-control structure. For example, in the medical field, medical doctors are often found in leadership positions. They are used to being in charge in the operating room or clinic and expect to see a carryover of this authority into the business aspects of the not-for-profit's activities. When this happens, because of a lack of understanding, suggestions for improvements and comments related to significant internal control weaknesses can be viewed as unimportant and not receive proper consideration.

Overemphasis on Enterprise Goals. Another related issue often prevalent in not-for-profits is the problem encountered when the goal of the enterprise supersedes all else. When the entity is managed by a dominant personality, this issue becomes even more pronounced. In one medical rehabilitation center, the basic premise that drove the enterprise was to provide as much service to as many individuals as was humanly possible. Unfortunately, as with many not-for-profits that receive state assistance, the funds supplied from year to year can vary greatly. Instead of looking more towards the future and anticipating changes, the unskilled manager may inappropriately cling to an objective that is untenable in the face of diverse swings in funding. Couple this with a management attitude that brooks no interference with goals of the enterprise, and disaster may be not far ahead.

Lack of Accounting Orientation and Education. Because of the focus on the purpose and objectives of the typical not for profit, there is often a significant lack of accounting education and orientation on the part of management. For example, in one enterprise, directors of the institution were extremely competent at diagnosing drug dependency problems and outlining recovery programs for patients. However, they failed to recognize the antiquated and expensive nature of their operations. As long as funding from the state was adequate, operations ran fairly smoothly. Once they experienced a significant downturn in funds however, they had to markedly curtail their treatment program because funds were no longer available. In this case, management lacked the expertise to appropriately budget and plan for the future. Their perspective was so oriented towards the accomplishment of the goals of the enterprise they lost sight of the fact the entity must stay solvent to provide those services.

Additionally, not-for-profits have historically relied heavily on volunteer assistance, and volunteers are often given accounting or management duties for which they have little qualification. Or the organizations have so little money budgeted for a key position, that highly qualified people have no interest in applying.

First Church was paying Cletus William $12,000 a year to be church administrator. At the $12,000 salary, First Church would have been fortunate to hire a first-class bookkeeper, much less a church administrator. This was obviously an unrealistic salary for the level of managerial and financial responsibilities Cletus was assigned to undertake. Something had to give. Either Cletus would perform at a substandard level, or he would be inclined to supplement his salary off- the-books to bring it to something more approximating market level. In Cletus' case, it was the latter.

Failure to Operate Entity in a Business-like Fashion. An ancillary problem normally faced by most not for profits is the failure to operate the entity in a businesslike fashion. As previously discussed, the goal of the not-for-profit becomes the end aim for everything done on a daily basis. Projects are initiated, patients are admitted, or campaigns are launched without regard for common business issues. This failure to treat the enterprise as a business is probably the most prevalent and perplexing attribute of a not for profit.

It is in this area the accountant experiences the most frustration. Often, management does not know of the existence of basic system and accounting control concepts, much less recognize the need for their implementation.

CPAs often encounter people who believe not-for-profits cannot be run like businesses and are expected to lose money every year. But the simple fact remains a not-for-profit that consistently loses money can not, in the long run, survive.

It is not unusual for the CPA to hear something like this from not-for- profit personnel (in this case, a mental health counselor): "I've got people out there ready to do harm to themselves and you want me to do paperwork!" A good response would be: "If you don't do the paperwork, you can't collect your fees, and you'll go out of business. What will happen to all the people who depend on you?"

Additionally, a strong, financially healthy not-for-profit will be able to render even better services to its clients. How can not-for-profit employees do their best work when they're worried about being laid off? Financial strength can also help a not-for-profit weather funding cuts from the government or funding organizations such as United Way.

Negative Viewpoints Regarding the Accounting Function. It is not uncommon for accountants within the not-for-profit organization to be relegated primarily to bookkeeping functions. While they may possess the professional skills to be of real service to the entity, they are kept out of the decision-making process. Financial positions lack any real power or influence. The result can be job dissatisfaction and high turnover of the position.

Also, many not-for-profit managers, view accounting and finance departments as a necessary evil. Accountants and auditors are generally regarded as a regulatory or governing board requirement that inhibits the accomplishment of the organization's goals.

If the accounting and finance departments are not viewed as being important, then the policies and procedures implemented by these "bean counters" are not likely to be considered important either. These policies and procedures may not be consistency enforced or enforced at all.

Over Reliance on One Individual. When a not-for-profit organization hires a competent individual in the accounting and finance area and the agency director delegates significant authority to this person, a very different scenario is created. Under these circumstances, this individual establishes, implements, monitors, and enforces the controls within the entity. In many ways, nothing happens without the approval and signature of this person.

Heavy reliance is placed on the knowledge and actions of the one competent person. As a result, CPAs engaged to audit the entity tend to rely heavily on the controls in place in a manner similar to that found in an owner-managed, small business.

The problem with this scenario is obvious. The person is not an owner; therefore the CPA's reliance on owner controls is not only unwarranted but possible misplaced. Reliance on owner controls is based on the notion of an owner with his or her own capital at risk being actively involved in the day-today operations of entity. It is reasonable to assume the manager/owner would not try to steal from himself. However, the same would very rarely hold true for the key financial person in a not-for-profit enterprise; they have no vested interest in the firm.

The CPA must understand the role of the board of directors and top management for the potential absence of mitigating controls. The key question is how much reliance should be placed on any one individual, no matter how trusted or competent that person might be.

There are other aspects of the not-for-profit entity that also make the CPA's reliance on "owner controls" unrealistic. Since there is no profit motive, concentration is on the program, and not on financial performance or efficiency. The basic viewpoint in this type of environment is, "If we are getting by financially, there is little need for any attention." It is exactly this lack of attention that allows fraudulent activities to occur.

Volunteer Boards. Not-for-profit organizations are characterized by volunteer boards of directors or trustees. The volunteer nature of their oversight activities can often create a situation where little effort is generated to ensure a properly working internal-control structure exists. In one instance, after catching an executive director of a very large not-for-profit agency misappropriating assets, the manager was simply reprimanded by the board. When questioned why the director was not fired, one board member replied, "You have got to remember we are volunteers. We have our own businesses to run. We don't have time to run this one too."

Role of the CPA as Adviser

When interacting with a not-for-profit organization, the CPA often finds him- or herself in either the role of an accountant providing management services or of auditor. As an auditor, the CPA may generate management letter comments addressing the entity's internal-control structure and other areas where efficiency can be improved. In both these capacities, there are several ways a CPA can enhance his or her role as an adviser to a not-for-profit.

The CPA should seek to educate top management in their understanding of the importance of the control environment, as well as the importance of their accounting and finance staff.

One way to educate top management is to design and clearly and completely explain simple control systems. For example, almost everyone understands the need to balance his or her own checkbook, but few understand the necessity of physical control over voided checks.

Additionally, few in the not-for-profit enterprise understand the relevance of internal control to their corporate mission of helping people. The CPA must learn to communicate on the level and in the language of the manager. The CPA must also contend with a very different mind set and priorities than with a typical for-profit CEO.

Providing services to a not-for-profit can be a risk-laden venture. It is only through patient and professional communication that the CPA can hope to provide a viable service for the not-for-profit, while minimizing the existing potential risk exposure.

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