IMA EDUCATIONAL Case Journal | Case Study

The Association of Accountants and Financial Professionals in Business

ISSN 1940-204X

West Coast Equestrian Association

Doug Kalesnikoff
Assistant Professor
University of Saskatchewan

Vince Bruni-Bossio
Assistant Professor
University of Saskatchewan

Suresh Kalagnanam
Associate Professor
University of Saskatchewan

INTRODUCTION

It was May 15, 2014. The sun was shining as Doug Lawrence smiled and watched Excalibur, his favorite horse, running circles in the field outside his house. Doug loves horses, which is why he decided to volunteer as chair of the board of the West Coast Equestrian Association (WCEA). The WCEA has been around for 35 years, and Doug remembered when his dad would take him to WCEA events. As Doug thought about recent events at WCEA, his smile disappeared, and he looked very concerned. WCEA was not doing well. Membership and participation was up, but Doug had recently become aware of many internal problems at multiple levels and substantial sums of money that apparently went missing. WCEA was, in fact, very close to folding because of fraud allegations, management control, and governance issues.

Less than a month ago, Doug had received a telephone call from a staff member of WCEA that the executive director of 21 years, Marvin Pendleton, had disappeared. Doug had taken it upon himself to make some inquiries. Marvin's spouse was distraught. She claimed that, when she arrived home one day, Marvin was nowhere to be found. She saw that some of his clothes were missing, along with his passport. She had reported Marvin as a missing person to the police. The police undertook an investigation and found that Marvin had boarded a flight to San Salvador on April 3, 2014, the day of his disappearance. Furthermore, the police reported that his traveling companion was Joan Walton, the auditor for WCEA.

Upon hearing this news, Doug grabbed a copy of the 2013 audited financial statements that had been approved at the last board of directors meeting. He read WCEA's statement of operations and statement of financial position (see Tables 1 and 2) and tried to verify the balance in WCEA's bank account and investments. Much to his horror, Doug found that the bank's year-end account balance was only $45,354, compared with the $102,473 that was reported in the financial statements. Even worse, he could not find any reference to an investment account, and none of the current staff knew anything about any investment account. Doug obtained a copy of the bank statement for the three months since year-end and found that 17 unexplained checks of $2,000 had been written in the weeks leading up to Marvin's disappearance, and the bank account had been depleted to less than $10,000.

Doug had no accounting training, but even he could see that the organization suffered from a lack of proper record keeping. WCEA only had one laptop, which held some accounting records and files, and an old desktop computer that contained other files. The only other filing system consisted of two storage rooms filled to the ceiling with boxes of materials. To make matters worse, the WCEA board of directors had never seen a budget and was only provided with financial statements on an annual basis. Moreover, no one in the organization, including board members, had any understanding of the operations or finances of the organization. Doug sighed, looked back at Excalibur, and thought to himself, "I had blind trust in Marvin. I just did not think that things were this bad."

The directors met in an emergency meeting to review their liability insurance policy. The policy covers the directors for errors and omissions due to theft or fraud up to $100,000, provided that the directors were not negligent. Thus, the directors could be held culpable for any losses exceeding $100,000 and for all loses if they were found to be negligent.

HISTORY

The organization started 35 years ago as a grassroots nonprofit organization to support equestrian sports and recreation on Canada's west coast. Over the decades, the organization has developed into one with a membership base growing from 2,300 in 2012 to 2,500 in 2013, with reported annual revenues of about $750,000 per year. To facilitate this growth, WCEA has held membership fees firm at $220 per year for the past five years. Memberships are renewable annually by March 31. A membership receipt is issued to each member, as they are eligible to receive a discount in insurance premiums for horses.

SERVICES

WCEA wants to grow and provide more services and programs to equine owners that support their interests. WCEA programs cover a wide range of equestrian activities, which include initiatives for beginners and advanced riders. Included in these services are certification and education programs. 2013 was the first year that at least one certification or education program was delivered each month of the year, and two programs were delivered in each of the summer months (June, July, and August). This surpassed the previous record of 11 program deliveries in 2012. Each participant of these programs paid a fee of $150 per session, and attendance is generally between 20 and 30 participants. Since many participants cannot claim these program fees for tax purposes, only a fraction of the participants ask for a receipt.

The organization also receives donations from bequests and from collection boxes placed in chain stores that sell sporting goods.

WCEA also sells merchandise such as t-shirts, belt buckles, coasters, and art depicting equestrian settings. These items are priced at a 50% markup from cost.

WCEA is also funded by a grant of $225,000 ($220,000 in 2012) from Western Sport Lotteries. The grant is contingent upon receiving audited financial statements.

Although the grant and some of the membership program fees and donations are received in the form of checks, many of the remaining receipts are handled in cash.

GOVERNANCE

Doug had always been unclear about the role of the board. The WCEA board has always consisted of horse enthusiasts who want to promote equine activities but have little understanding of accounting or controls. Board members had always been more interested in pursuing activities such as coaching, promoting, veterinary care, and so on than they were in performing their jobs as board members.

The board has 14 members. They serve four-year staggered terms, and elections are held every year at the annual general meeting. The former executive director offered very little transparency into board activities, and, in fact, used this lack of information to control the board. The executive director developed unique rules over the years that limited the sharing of information between administration and the board. This included a rule stating that board members were not allowed to enter the executive director's office.

The former executive director was seldom questioned by the board. Since most board members were specialists in their own equine areas, they did not want to be distracted from doing what they loved most. This resulted in most board members being happy to have such a strong executive director in place because it meant they did not have to attend as many meetings or deal with "all that financial stuff."

The result of this secrecy was that many board members could not comment on or answer questions regarding what the organization was doing. This impacted WCEA's members, who felt that board members were either clueless, did not care, or that the organization was hiding things.

Another issue was that board directors lacked any formal training pertaining to their roles and responsibilities. WCEA also had very few governance policies. Instead, it had a brief orientation book that only dealt with Robert's Rules of Order, which discussed concepts such as how to make a motion and vote on issues. There were almost no policies detailing the actual job responsibilities of the board.

Concerned about the lack of oversight at the board level, Doug decided to research the topic of governance. He reviewed a binder full of material that he had received in a course on governance during his university days and made some notes. The results of his research and accompanying notes are in Figure 1.

REQUIRED

Doug has now contacted you in your capacity as a professional accountant. A second emergency meeting is to be held in two days. Doug would like you to write up a discussion memo outlining:

1. An estimate of how much money might be missing.
2. What management controls could be put in place to help prevent this from happening again?
3. What changes in the governance policies should be considered by the organization? This should include a review of the fiduciary duties that a board must follow and make recommendations about how WCEA can ensure that it meets its responsibilities at this level.

Table 1: WCEA's Statement of Operations

For the year ended December 31, 2013

		2013	2012
Revenue			
	Memberships	$435,098	$465,444
	Grants	225,000	220,000
	Donations	29,350	26,998
	Education programs	38,876	30,643
	Sales	24,567	22,113
	Other	13,453	10,087
		$766,344	$775,285
Expenses			
	Salaries and benefits	$360,435	$351,989
	Director Insurance	12,209	12,334
	Education programs	46,089	39,854
	Advertising and promotion	159,366	170,564
	Office administration	97,654	94,544
	Rent	45,342	43,094
	Cost of sales	25,987	24,098
	Audit fees	6,500	6,000
	Meeting costs	5,643	4,339
	Amortization	4,097	3,976
	Other	554	476
		$763,876	$751,268
Excess (Deficiency)		$ 2,468	$ 24,017

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Table2: WCEA's Statement of Financial Position

As at December 31, 2013

		2013	2012
Current Assets			
	Bank	$102,473	$103,486
	Accounts receivable	5,987	4,665
	Prepaid expenses	12,098	11,543
		120,558	119,694
Capital Assets		17,989	16,917
Investments		100,000	100,000
		$238,547	$236,611
Current Liabilities			
	Accounts payable	$ 21,098	$ 14,543
	Accrued liabilities	5,800	5,300
	Unearned membership fees	108,775	116,361
		135,673	136,204
Net Assets		102,875	100,407
		$238,547	$236,611

Figure 1: Notes from the Governance Manual

What is Governance?
Governance is "the exercise of authority, direction and control of an organization in order to ensure that its purpose is achieved."[1] Governance seeks to answer the following questions:

- Who is in charge of what?
- Who sets the direction and the parameters within which the direction is to be pursued?
- Who makes decisions about what?
- Who sets performance indicators, monitors progress, and evaluates results?
- Who is accountable to whom and for what?

Key Components of Governance

Governance Structure
Good governance starts with a proper organizational structure. It is also very important that the board understands the difference between an operational committee (a committee that assists with operations) and a standing committee (a board level committee), as well as the reporting relationship as illustrated here:

(Doug reflected on past confusions within WCEA about committees. Many board directors did not understand that, when serving on an operational committee, they could not use their board director status to influence the committee. In fact, as members of an operational committee, board directors were under the direction of the executive director. Conversely, when board directors were members of standing committees, such as the Governance committee or the Finance & Audit committee, they had the right to ask for clarification from the executive director in completing these functions. In the past, however, Board directors serving on standing committees had been too willing to abdicate responsibilities by handing over their duties to the former executive director.

("What a mess," Doug thought, "we need to train our board members on when to put on their operational committee hats and when to put on their governance hats.")

Fiduciary Duties[2]
Board members must know, understand, and legally fulfill the following fiduciary duties, or they could be found liable.

Duty of Due Diligence: This includes being informed about the requirements of the relevant laws and becoming familiar with the organization's articles, bylaws, and governing policies. It also means being aware of the organization's mission, vision, and values and being informed about the organization's programs and activities.

(Currently, there were no written policies to guide board directors. Although bylaws exist, Doug wondered how many of the board directors had actually read them even once.)

Duty of Care: This includes being prepared and willing to participate fully in board (and committee) decision making. Board directors are required to act ethically and be open and transparent. The idea here is that each board director should look after the organization with care and attention as if he or she were the owner. This was really about acting in good faith.

(Doug recalled that most meetings were short and hardly involved any decision making.)

Duty of Loyalty: This is really about doing what was in the best interest of the organization. It means putting aside personal interests and ensuring that confidentiality is maintained. Full disclosure of any potential conflicts of interest was integral to the Duty of Loyalty.

(Doug believed that the board had the right intentions, but many directors did not understand how to act in the best interest of the organization. For example, most board directors did not realize that they created a conflict-of-interest situation by advocating only for those equine initiatives that they were personally invested in.)

[1]Note: Much of the discussion about "what is governance?" is adapted from: Mel D. Gill, *Governing Results: A Director's Guide to Good Governance*, Trafford Publishing, Crewe, U.K., 2005.

[2]Material in this section is adapted from: "Primer for Directors of Not-for-Profit Corporations: Rights, Duties and Practices," Ch. 2, Industry China, 2002, www.ic.gc.ca/eic/site/cilp-pdci.nsf/vwapj/Primer_en.pdf/$FILE/Primer_en.pdf.