

AVOIDING TROUBLE

Prudent policies and procedures can help prevent fraudulent activities happening within a club

*By Thomas F. Blaney, CPA, CFE
and Patrick J. Halloran, CPA*



It seems that every week we read or hear of some type of fraudulent event or misappropriation of assets. These “situations” can come in various forms, from the omission of assets (more recently also the omission of liabilities) on a balance sheet to an act of fraud or theft by an employee. The effects on an organization can be disastrous depending on the seriousness of the situation. The damage could be temporary or even permanent if a company is forced to file for bankruptcy.

While private clubs have their fair share of fraudulent events, the majority of which might not only cause embarrassment, but can be detrimental to the club’s reputation. This can also have an affect on the club’s ability to attract and maintain qualified board members. Because of the possibility of negative publicity, some frauds are “hushed up” and never make the press. The employee is usually terminated and legal action is rarely taken. The problem with this type of response, or lack of response, is that other employees might believe that they are able to take liberties, thinking that if they are caught, little may happen to them. Also, there is the possibility that the episode will be exposed down the road, which will be followed by some negative publicity and the board could be accused of “covering up” the situation.

The majority of fraudulent transactions start small (those that originate in the accounting department usually commence in petty cash or pertain to check signing). Most individuals who commit fraud become comfortable thinking they will never be caught. As time goes by, the frequency and magnitude of the fraud usually increases until the individual committing the fraud is caught or leaves the club.

Board members that suspect an occurrence of fraud should notify their legal counsel immediately. Occurrences of fraud are more probable in environments where the internal controls are relaxed or nonexistent. No accusations should be made to a “suspect” until an investigation is completed. Any discussions

with the suspect should be done with two additional individuals present to act as witnesses. Ideally, one of these individuals would have some training in interview techniques.

Watch Out — Instances of Fraud

When fraud exists, it is often the result of a lack of internal controls or a proper segregation of duties. To follow are some instances of fraud that may have been prevented with a properly functioning set of internal controls:

- When an employee is hired there is a mutually agreed upon starting salary by both parties that is put in the employee’s personnel file. Unfortunately, over time there are increases given but the personnel files are not updated to reflect these payroll modifications. At one organization, the assistant controller gave herself three raises in one year. It was not noticed until the new controller was reviewing the weekly payroll register and saw that the employee’s compensation was too high. When confronted, the employee stated the previous controller approved the pay increases even though the controller was not authorized to increase pay nor was there any documentation in her personnel file.
- Another warning sign of potential fraud is an employee who works excessive hours and is relied upon to control multiple functions because of his/her willingness to work hard. In one instance as a convenience to its employees, an organization faxed a list of employees to the local bank on pay day to authorize the bank to cash their checks. The fax cover sheet had an authorized signer’s approval and was controlled by a supervisor who was in charge of scheduling and approving time sheets. During certain weeks, the supervisor would record hours worked for individuals who were on vacation and would add their name to the weekly fax that was sent to the bank on pay day. The supervisor would go the bank

personally to cash the checks. This went on for over a year until several employees made management aware that their yearly earnings did not agree with their records.

- At one club, the board asked the greens superintendent to seek multiple bids for a major golf course renovation project. One of the contractors who was asked to bid informed a club board member that the greens superintendent asked for “building materials” for his personal residence in order to “steer the renovation project in the right direction.”

An Ounce of Prevention

In order to avoid potential fraud there are certain policies and procedures all clubs should have in place. These should include:

- All checks should be signed by a board officer (if this is not practicable, then the treasurer or a member of the audit committee could review the monthly check register).
- Checks should never be made payable to cash.
- As technology has made banking easier, the officers of clubs should be aware of ways technology can be used to bypass certain safeguards for controlling cash disbursements. Many banks allow payments to be made by wire or electronic funds transfer (EFT). Officers should be aware that an employee cannot set-up these types of disbursements without their authorization.
- On a test basis, a board member or a member of the finance or audit committee, should review an unopened monthly bank statement and accompanying cancelled checks. Furthermore, this same individual, once or twice a year, should distribute the payroll checks.
- Petty cash should be kept to a minimum.
- Competitive bids should be received for capital projects; the submission of these bids should be in a sealed envelope and opened in the presence of two management employees.

While some types of transactions at private clubs are outright illegal acts, others are somewhat questionable in nature... Private club boards should have policies and procedures in place to avoid questionable actions that could discredit the club.

- A board member should physically inspect work connected with major capital projects.
- Any change orders for major capital projects should be approved by a board member (preferably the president or treasurer).
- All employees should be required to take their vacations.
- Prospective employees should undergo detailed background and credit checks.
- The president or treasurer should review the general manager’s expenses and sign-off their approval.
- Any write-offs of members’ account balances should require written approval by the treasurer.
- Cameras should be installed at critical areas, especially receiving areas, entrances and gas pumps.
- Locks to store rooms should be changed periodically.
- The club should have liability insurance for directors and officers, as well as, adequate employee dishonesty insurance.
- The board, finance committee or audit committee should meet annually with the auditors and address recommendations contained in their management letter.

Proceed with Caution

While some types of transactions at private clubs are outright illegal acts, others are somewhat questionable in nature. For example, if a greens superintendent sells the club’s fertilizer and insecticides to home owners, this action should be

considered a misappropriation of assets and absolute fraud. On the other hand, if the club’s general manager opened an expensive bottle of wine for himself and the staff at lunch time, this action would probably be considered poor judgement.

Private club boards should have policies and procedures in place to avoid questionable actions that could discredit the club. Examples of policies and procedures include:

- A conflict of interest policy.
- A policy promoting diversity among its board and staff.
- Anti-harassment policies, including policies on sexual harassment.
- Policies and guidelines on travel and entertainment.
- A formal contract for key management employees.
- An annual executive committee review of compensation and benefits for key employees.
- An updated personnel manual.
- Elimination of tempting items such as corporate credit cards.

Frauds and questionable actions are just some examples of embarrassments that could face a private club today. Board members have a fiduciary responsibility to oversee the implementation of policies and procedures and to protect and insulate their club and themselves from potentially embarrassing situations. By adopting and adhering to prudent policies and procedures, management can help prevent the possibility of fraudulent activities happening within their club. ■