Court Appointed Special Advocates (CASA) - A Case Study

Daniel L. Haskin
Texas A&M University-Commerce

Numerous scandals have occurred in not-for-profit organizations in recent years which could have been prevented by the application of sound business practices such as the use of effective internal control practices and the installation of an audit committee. This study discusses a scandal that occurred in the Oklahoma CASA organization and discusses how the situation could have been prevented. The lessons of this case study are a practical example for practitioners and accounting students.

INTRODUCTION

This case illustrates the necessity of sound internal control practices and the usefulness of an audit committee for small and medium-sized, not-for-profit organizations. Many scandals and embezzlements have occurred in the last few years in not-for-profit organizations. Most of these unfortunate situations could have been prevented if the organization had used sound business practices. Almost all not-for-profits depend on the public trust for their existence, so the results of scandals are particularly devastating. The usual monetary result of such a situation would be a decline in donations from the public and the loss of grants from governmental agencies and charitable foundations. In addition, the blow to the prestige of the organization is devastating. As an example and learning tool, this presentation uses an actual scandal which occurred in a not-for-profit organization in Oklahoma from about 1998 through 2008.

WHAT IS CASA?

Court Appointed Special Advocates (CASA) is a not-for-profit organization that supports and promotes court-appointed volunteer advocates to further the interests of abused and neglected children. CASA volunteers endeavor to ensure that abused and neglected children "don't get lost in the overburdened legal and social service system or languish in inappropriate group or foster homes" (Pariano, 2007). CASA was founded in 1977 by a Seattle juvenile court judge who was uncomfortable making drastic decisions, with insufficient evidence, about the futures of children. Citizen volunteers would be appointed to guard the interests of abused and neglected children in the courtroom. There are now more than 900 CASA programs nationwide.

The CASA organization discussed in this case is headquartered in Oklahoma City and provides support to local CASA offices located around the state of Oklahoma. It does not provide direct service to clients, but is supposed to present a statewide voice for abused and neglected children by enhancing the growth of CASA programs throughout Oklahoma. (State of Oklahoma vs. Anna Marie Naukum, 2009). To illustrate the magnitude of this event, about $600,000 to $750,000 was embezzled over the period from 1998 to 2008 by the agency's director and her husband, who was also an employee of CASA.

According to the 2010 financial statements of Oklahoma CASA, the total assets of the organization on December 31, 2010 were $318,906 and the total revenue for 2010 was $1,410,466. The embezzled funds were about twice the total assets for 2010 and about half of the revenue for that year (CASA, Annual Report, 2010).

HISTORY OF SCANDAL

According to the indictment (State of Oklahoma vs. Anna Marie Naukum, 2009) issued in the District Court of Oklahoma County, Oklahoma on August 20, 2009, Anna Naukam was employed by Oklahoma CASA as executive director from September 10, 1998 to September 2, 2008. She had "full access, control, and custody of all association records including, but not limited to, all bank records, grant funding, credit card statements, accounts payable and accounts receivable, among other things." Her husband, Eugene Naukam served a special projects coordinator from February 2006 to September 2008.

The Naukams had filed for bankruptcy in about 2000. In 2001, Anna Naukam obtained a credit card in the name of the Oklahoma City CASA organization using her home address for delivery of the credit card. At about the same time, Eugene Naukam, prior to his employment with CASA, obtained a credit card under the CASA name. The Naukams were likely motivated to obtain these credit cards through CASA because their personal bankruptcy had precluded them from obtaining personal credit cards in their own names. According to the indictment, the credit cards were knowingly and willfully used by the Naukams for non-business related expenses. Payments on the credit card balances were made from CASA Association funds, the source of which were state appropriations, federal funds, grant awards and private donations. From about July 1, 2002 through November 21, 2008, the Naukams made in excess of $600,000 in purchases on these credit cards which they paid with installments from the CASA Association funds.

Oklahoma City media (New9, August 20, 2009, News9.com) reported that Anna Naukam was fired in October, 2008, after the Oklahoma state auditor's office received anonymous tips, and was asked to investigate possible financial irregularities. After investigation, the state auditors concluded that she circumvented an independent bookkeeper by falsifying records and that she dismissed the agency's independent auditor "when he began asking too many questions during an annual audit." The case was subsequently turned over to the Oklahoma Attorney General for investigation.

The CASA case was presented to the Oklahoma County Grand Jury, and the Grand Jury returned indictments against both Naukums. In a press release (Edmonson, 2009) on August 20, 2009, Oklahoma Attorney General Drew Edmondson said, "The grand jury accuses the Naukams of spending taxpayer dollars and donated funds for things like granite counter tops, a hot tub, Texas Tech football tickets, college tuition at the University of Oklahoma, cosmetic surgery, and lingerie from Victoria's Secret." Edmondson said, "None of these things benefitted abused and neglected Oklahoma children. Instead, Anna and Eugene Naukam abused the trust of these children and neglected their duty to help kids in need for their own benefit." The grand jury also detailed thousands of dollars in suspected illicit spending on clothing, home remodel work, dental expenses, health club memberships, magazine subscriptions, veterinarian bills and vacation expenses. Edmondson also said, "Not only did the Naukams waste CASA funds living the good life, they also spent CASA money to pay more than $8,000 in late fees, over limit fees and finance charges. They weren't even good financial stewards of the money they allegedly stole. The indictment unsealed today alleges the Naukams took more than $460,000 in CASA funds. We believe Anna Naukam paid the credit card bills electronically to circumvent her board's knowledge of these activities."

The Naukums both pleaded guilty and were sentenced to lengthy prison terms as well as substantial fines and were ordered to pay restitution. Anna Naukum received a 25-year sentence in state prison and Eugene Naukum received a five-year sentence in state prison. Apparently, the court felt that Anna Naukum was the mastermind of the scheme and Eugene Naukum was an accessory.

The CASA organization was sent reeling from the effects of this fiasco and faced a battle for survival. Sheryl Marseilles, who was appointed CASA's interim director in 2008, said the agency has brought in a team of lawyers and financial experts to overhaul its financial policies and internal controls (News9, August 20, 2009). The organization subsequently managed to reorganize and survive primarily because of the need for its services in the community.

GAAP FOR NOT-FOR-PROFITS

Not-for-profit organizations such as CASA are very important to society and to the economy. They have accounting and auditing requirements which are similar to those of profit-seeking organizations, but at the same time, they have many differences. To clarify the differences in the two environments, and to gain a fuller understanding of how the CASA scandal could have been prevented, a discussion of the GAAP and auditing requirements for not-for-profits follows.

The financial statements of not-for-profit organizations are covered by GAAP issued by the FASB, the body which issues GAAP for business entities. However, there are many differences between business enterprises and not-for-profit entities. FASB's Concepts Statement No. 4 highlights the following characteristics of not-for-profit entities (FASB,1980):

1. Receipts of significant amounts of resources from resource providers who do not expect to receive either repayment or economic benefits proportionate to resources provided.
2. Operating purposes that are other than to provide goods or services at a profit or profit equivalent.
3. Absence of defined ownership interests that can be sold, transferred, or redeemed, or that convey entitlement to a share of a residual distribution of resources in the event of the liquidation of the organization.

Because of these differences, the financial reporting and auditing requirements of not-for-profits have developed somewhat independently from those of business enterprises.

AUDIT REQUIREMENTS

Not-for-profit organizations are subject to essentially the same audit requirements as non-public, for-profit companies. There are generally no federal (such as SEC) or state regulations that require these entities to be audited. Most of them must submit Form 990 to the IRS which contains numerous disclosures, but is not audited. These organizations will have their financial statements audited when the users of the statements such as donors, foundations, and governments agencies request the statements to be audited. Most government agencies and private foundations require their recipients to provide audited financial statements.

AUDIT COMMITTEES

An audit committee plays an important role in supporting the financial reporting integrity of any organization. There are numerous requirements and laws which require audit committees for public companies. The primary requirements for public companies audit committees are legislated through the Sarbanes-Oxley Act, but there is no equivalent set of rules for not-for-profit organizations.

While nearly all of the provisions of the Act apply only to publicly traded corporations, the passage of the bill served as a wake-up call to the entire not-for-profit community. Several state legislatures have already passed or are considering legislation containing elements of the Sarbanes-Oxley Act to be applied to nonprofit organizations. In many instances, not-for-profit organizations have adopted policies and altered governance practices in response to the Act. Some states are beginning to require stricter requirements for not-for-profits. For instance, California requires that any charity with revenues of $2,000,000 or more must have an audit committee.

The Sarbanes-Oxley Act requires that an independent audit committee be established by regulated companies. The audit committee must not be a part of any other board of director's committee. It further requires that each member of a company's audit committee must be a member of the board of directors and be independent. "Independence" in the Act is defined as not being part of the management team and not receiving any compensation (either directly or indirectly) from the company as a consultant for other

professional services, though board service may be compensated. The Act emphasizes financial knowledge by the audit committee members and requires that the company disclose whether there is at least one "financial expert" on the audit committee. A financial expert is a person who has substantial financial experience such as in public accounting or experience as a financial executive.

INTERNAL CONTROL

The Oklahoma CASA scandal could have been prevented if basic principles of internal control had been followed and an audit committee had been in place. Even though an organization of this sort is short on financial resources, alternatives exist. Many financial professionals would help on a no-fee basis. Any cost involved would be a token compared to the financial losses from embezzlement. An adequate internal control system is designed to:

1. Safeguard the assets of the organization and
2. Enhance the accuracy and reliability of accounting records.

Some basic features of a well-designed internal control system are to:

1. Establish responsibilities,
2. Segregate duties, and
3. Perform regular independent reviews.

LESSONS LEARNED

An unfortunate situation such as the Oklahoma CASA scandal can be a valuable learning tool for accounting professionals and accounting students. The most important and valuable teaching lessons are discussed below.

The Oklahoma CASA organization had a strong board of directors composed of reputable members, but the board was not actively involved in finances. It is essential that the boards of small, not-for-profit organizations be actively involved in the financial activities of the charity. The mandate of Sarbanes-Oxley that at least one member of the board should be a financial expert should be heeded by not-for-profit organizations.

Even small, non-profits must follow the basic principles of internal control. Anna Naukum had full access, custody, and control of all association records. She also had the authority to conduct cash, borrowing, and credit transactions for the association. The basic principle of segregation of duties was not heeded at all. It is difficult in a small organization with few employees to adequately separate conflicting duties, but there was not even an attempt in the CASA organization in Oklahoma City. Simple measures such as having one of the board members as a required signer for transactions of a certain size in order to borrow funds or to secure credit would be a great improvement.

Audit committees are needed even in smaller organizations which depend on the public trust. Anna Naukum could not have dismissed the CPA conducting the annual audit if the audit committee was in place and operating per the rules laid down by Sarbanes-Oxley. The audit committee would have hiring and firing authority and would set the fees for the annual audit.

Not-for-profit organizations should make their financial statements widely available. This should extend to publishing audited financial statements on the internet. Not-for- profit organizations depend on the public trust and their audited financial statements should be readily available. CASA of Oklahoma has published partial financial information on the internet since 2010.

Credit checks should be run periodically on employees by the Board of Directors. The Naukum's bankruptcy in 2000 should have raised a red flag as it likely motivated the Naukums to obtain and use the CASA credit cards. Nepotism could also be a red flag as the principal players in this scandal were husband and wife.

This case is an excellent learning tool, and an example of how things can go very wrong if basic principles of financial control are not followed. Both accounting students and accounting professionals can learn valuable lessons from this case.

CONCLUSIONS

Not-for-profit organizations should establish effective internal control systems, and should adopt the relevant provisions of the Sarbanes-Oxley Act, particularly the implementation of audit committees. Self-regulation and proactive behavior will benefit the not-for-profit sector much more than compulsory adherence to laws. There are many CPA's and other financial experts more than willing to serve not-for-profits, many times on a no-fee basis. Numerous scandals have occurred in not-for profit organizations in Oklahoma since the CASA incident, so it would seem the lessons learned from the CASA scandal should be applied on a proactive basis instead of a reactive basis.

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