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# What Went Wrong at the Wounded Warrior Project

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Below are two cases, Wounded Warrior Project and American Legacy Foundation, that focus on similar issues. In both these cases a lack of governance and oversight led to misuse of funds and fraud. These cases may be used together or individually. The sections on implications for theory and policy, suggestions for classroom instruction, activities, discussion questions, and resources apply to both cases. In addition, one may choose to zero in on either the governance issues, fraud and financial oversight, or both of these topics.

### **What Went Wrong at the Wounded Warrior Project?**

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The Wounded Warrior Project (WWP) is the largest veteran's charity in the United States. John Melia, a Somalia-wounded Marine veteran initiated, the Wounded Warrior Project when he started giving backpacks full of items to returning Iraq war veterans in 2003. The WWP projected was incorporated on February 23, 2005, for "the purposes of providing vital programs and services to severely wounded service members and veterans to support their transition to civilian life as well-adjusted citizens, both physically and mentally" (Internal Revenue Service, 2014, p. 2).

On March 9, 2016, the WWP board of directors terminated Chief Executive Officer Steve Nardizzi and Chief Operations Officer Al Giordino. The termination of Nardizzi and Giordano occurred after multiple news reports "highlighted lavish spending, including extravagant parties and events, and cited dozens of former staff members describing a toxic leadership culture at the popular veterans charity" (Cahn, 2016). Before the termination of its top two executives, the organization vigorously defended itself against accusations of extravagant spending on staff conferences and events, spending too little on programs for veterans, and too much on fundraising (McCambridge, 2016).

Responding to the May 2016 findings of the Senate Judiciary Committee's investigation of the Wounded Warrior Project, whistleblower Erick Millette expressed his satisfaction: "It

really validates Wounded Warrior Project’s claims that we’re not disgruntled employees, because we’re not. . . We were just upset about the way money was spent, and we’re passionate about those that have served our country” (Bauerlein, 2016). Millette and six other Wounded Warrior Project employees went public in late 2015 with claims of lavish spending and the wasting of donor funds.

John Melia hired Steven Nardizzi, who was head of the United Spinal Association, to join the WWP. Soon, Nardizzi and Melia were fighting for control of the organization’s direction. In 2009, Melia resigned from the organization he created and Nardizzi became president. Nardizzi envisioned an aggressive metric-driven organization modeled after corporate America: “I look at companies like Starbucks - that’s the model. You’re looking at companies that are getting it right, treating their employees right, delivering great services and great products, then are growing the brand to support all of that” (Phillips, 2016). Under Melia’s leadership, the organization experienced incredible financial growth, as total revenues increased from \$26.1 million in 2008 to \$342 million in 2013. At the end of the 2013 fiscal year, the Wounded Warrior Project had \$22 million in cash on hand and \$212 million invested in securities. Net assets now exceeded \$248 million.

In March 2016, following intense media scrutiny, the WWP board issued a statement claiming an independent audit found the organization spent 81% of donations on programming. The board also noted the use of joint cost allocation, common among nonprofits but disregarded by organizations that monitor charity spending. Joint cost allocation is considered a Generally Accepted Accounting Principle (GAAP).

Table 1: *WWP Revenue, Expenses, Assets and Fundraising Costs*

Revenue	Expenses	Net Assets	Fundraising Cost
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Tax Year				
2005	\$ 1.0	\$ 0.9	\$ 3.0	\$ 0.4
2006	\$ 18.6	\$ 15.6	\$ 6.0	\$ 2.0
2007	\$ 21.5	\$ 19.2	\$ 8.2	\$ 3.5
2008	\$ 26.1	\$ 26.6	\$ 7.8	\$ 6.2
2009	\$ 40.9	\$ 34.3	\$ 14.6	\$ 9.3
2010	\$ 74.0	\$ 57.7	\$ 30.3	\$ 13.8
2011	\$ 154.9	\$ 95.5	\$ 90.2	\$ 20.5
2012	\$ 234.6	\$ 158.1	\$ 166.6	\$ 31.7
2013	\$ 342.0	\$ 248.0	\$ 248.2	\$ 43.4

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*Note.* Figures in \$ millions. All data extracted from IRS Form 990 for each respective tax year.

After their termination, Nardizzi and Giordano asked the WWP board of directors to release the report. However, in a written statement, the board indicated a written report did not exist, and the investigators' findings were given orally to the board and that such reviews typically do not result in written reports.

In 2014, the WWP claimed it supported 398 veterans and their caregivers, assisted 302 veterans in gaining employment, and coordinated four-day cycling opportunities, known as Soldier Rides, for an additional 156 veterans. In a reviewing of perceived criticisms of the WWP, the Independent Voter Project stated that for an entity generating nearly \$235 million in revenue, "numbers like those seem curiously low. Still another question is raised by just how some of the services that it [WWP] funded actually helped veterans recover from post-traumatic stress or rehabilitate from combat-related wounds" (Schuette, 2014). A fourth of the \$5.5 million in grants issued were utilized by receiving organizations for recreational activities, and additional \$5.7 million was spent producing the highly-visible Soldier Rides. Other grants provided by the WWP included \$300,000 for a parade, \$50,000 for a monument, and \$25,000 one nonprofit used to lobby and negotiate for postal rates for nonprofit organizations.

Criticism emerged in 2014 from veterans' advocates and veterans themselves, stating the WWP is more concerned with image and public relations impact than it is the long-term well-being of those it claims to serve (Mak, 2014). A double-amputee who served in Iraq, on the condition of anonymity, expressed not only a fear of retribution but disappointment: "They are such a big name within the veterans' community. I don't need to start a war in my own backyard. They're more worried about putting their label on everything than getting down to brass tacks. It is really frustrating." The veteran, who survived an IED destroying his supply truck, continued, "Everything they do is a dog-and-pony show, and I haven't talked to one of my fellow veterans that were injured. . . actually getting any help from the Wounded Warrior Project. I'm not just talking about financial assistance; I'm talking about help, period" (Mak, 2014).

A significant part of the WWP's revenue strategy is the result of branded partnerships, and *The Daily Beast* noted this includes "everything from ketchup to paper towels to playing cards - something that rubs other veterans' groups the wrong way." As stated by one alumni member, "I receive more marketing stuff from them, [and see more of that] than the money they've put into the community here in Arizona. It's just about numbers and money to them. Never once did I get the feeling that it's about the veterans." The same member said there were times he could have used a ride to a Veterans Affairs medical facility. Instead of a ride he received a "fleece beanie" (Mak, 2014).

In 2013, the WWP reported \$189 million in program services expenses including \$42 million in program grants to third-party organizations (Internal Revenue Service, 2013). Of the \$42 million in program services grants, the WWP included \$28 million it transferred to the newly-created Wounded Warrior Long-Term Trust. Excluding this transfer of cash, only 9% of all program services expenses were direct grants to third-party organizations.

Table 2: WWP Reported Program Expenditures and Grants (2013)

Program	Expenses	Program Grants	% Grants / Expenses
Alumni Association	\$ 37,093,075	\$ 4,700,682	12 %
Combat Stress Recovery	\$ 27,946,118	\$ 4,670,046	17 %
Physical Health & Wellness	\$ 16,033,248	\$ 644,108	4 %
Soldier Ride	\$ 15,738,906	\$ 85,809	1 %
Benefit Services	\$ 10,280,128	\$ 487,528	5 %
Track	\$ 7,600,723	\$ 852,136	11 %
Family Support Services	\$ 6,481,174	\$ 651,233	10 %
International Services	\$ 5,762,792	\$ 236,919	4 %
WWP Packs	\$ 1,577,473	\$ 7,986	1 %
Warriors to Work	\$ 9,149,559	\$ 280,745	3 %
Transition Training Academy	\$ 6,207,938	\$ 196,892	3 %
Peer Support	\$ 4,464,335	\$ 162,952	4 %
WWP Talk	\$ 1,731,217	\$ 17,208	1 %
Independence Program	\$ 5,415,463	\$ 217,739	4 %
Warriors Speak	\$ 2,102,805	\$ 0	0 %
Education Services	\$ 3,154,146	\$ 898,438	28 %
Wounded Warriors LT Trust	\$ 28,000,000	\$ 28,000,000	100 %
Total	\$ 189,558,100	\$ 42,100,421	22 %
Less WWP Long Term Trust	\$ 161,558,100	\$ 14,110,421	9 %

Note: Data extracted from the Wounded Warrior IRS Form 990 for FY 2013

In December 2015, the WWP's National Alumni Director, Ryan Kules, described upcoming events for veterans across the United States to WWP staff members, which included (Mak, 2016):

- Family members receiving haircuts and spa services (Minnesota)
- 25 veterans and family members attending *A Christmas Carol* (Alaska)
- 35 veterans will spend an evening bowling (Colorado)
- 20 veterans participate in a holiday Lego club night (Hawaii)
- 100 veterans and guest attend a winter wonderland (California)
- Veterans attend a healthy holiday cooking class (Utah)

The Wounded Warrior Project drew the attention of the Senate. U.S. Senator Charles Grassley (R-Iowa), chairman of the Senate Finance Committee, asked interim CEO Anthony Odierno to provide an account of spending not provided on IRS tax forms, including expenses for travel, meetings, public relations, lobbying, and the Charity Defense Council. The WWP cooperated with Sen. Grassley's request. On August 10, 2016, the Senate Judiciary Committee chairman's staff met with the Wounded Warrior Project's new CEO, retired Army Lieutenant General Michael Linnington. The ongoing investigation includes the following (Gardner & Wallace, 2016; Grassley, 2016).

- 33% of program services claimed by the WWP was free media and advertising.
- The transfer of \$37.1 million to the Wounded Warrior Long-Term Support Trust, which the organization included as program expenses on behalf of veterans.
- 94% of program services to veterans in 2013 and 2014 consisted of tickets to sporting events.
- In 2014, of the \$242 WWP spent on program expenses, approximately \$150 million was not devoted to veterans and a large portion of it was in-kind donations.

In June 2016, The WWP board of directors selected Michael S. Winnington, a decorated veteran, retired Army Lieutenant General, and former employee of the Defense POW/MIA Accounting Agency (DPAA), as the permanent CEO of the organization. Winnington inherited a nonprofit organization experiencing the impact of negative public relations. By September 2016, the WWP reduced its workforce by 15 percent, over 600 employees, and it estimated lost revenues of close to \$100 million due to a 25% decrease in donations (Hrywna, September 1, 2016; Gardner, September 2, 2016). As the Wounded Warrior Project rehabilitates its image, Linnington indicated the need for an increased focus on veteran mental health concerns, specifically post-traumatic stress and traumatic brain injuries, while enhancing organizational transparency and accountability (CBS News, September 1, 2016).

## **THE LEGACY OF THE AMERICAN LEGACY FOUNDATION**

Ruth Bernstein, University of Washington Tacoma

Fraud and embezzlement has moved beyond the corporate sector and infiltrated the nonprofit sector! This was the outcome of an October, 26, 2013 Washington Post article (Stephens and Flaherty, 2013), which found that between 2008 and 2012, greater than 1,000 nonprofit organizations revealed losses of hundreds of millions of dollars to theft, fraud, embezzlement, and other illegal behaviors. This translates to nonprofit and religious organizations experiencing one-sixth of all major embezzlements, second only to the financial services industry. In 2014, over 1.6 million registered nonprofits had \$.5 trillion in assets (not including the estimated 700,000 churches and other organizations not required to file with the IRS); this equates to approximately \$100 billion a year in foregone tax revenue (<https://gbq.com/articles/fraud-report-roils-not-for-profit-sector/>). Since 2008, nonprofit organizations have been required to report diversions of more than \$250,000 or those that exceed 5% of the annual gross on the Form 990 filed annually with the Internal Revenue Service (IRS). This public disclosure enables the public to more easily evaluate how nonprofits handle their finances. A list of nonprofits who have indicated on the Form 990 that they have diversions has been compiled by GuideStar (a nonprofit watch-dog organization) and the Washington Post (<http://www.washingtonpost.com/wp-srv/special/local/nonprofit-diversions-database/>).

One nonprofit on the diversion list was the American Legacy Foundation (Legacy), based in Washington D.C. In 2011, in response to the question about diversion of funds on the IRS Form 990, Legacy officials answered “yes,” but provided only a minimal explanation, stating that they became aware of a diversion in excess of \$250,000. Legacy officials indicated that the diversion was due to fraud committed by a former employee. Only subsequently was it revealed that the organization incurred an estimated \$3.4 million loss.



### **Introduction:**

When the American Legacy Foundation (Legacy) officially opened its doors in 1999 it already controlled \$1 billion in assets emanating from the November 1998 Master Settlement Agreement reached between attorneys general from 46 states, five U.S. territories and the tobacco industry. Legacy's mission was dedicated to building a world where young people reject tobacco and anyone can quit. As noted on the now defunct Legacy website, the Foundation developed programs that address the health effects of tobacco use, especially among vulnerable populations disproportionately affected by the toll of tobacco, through grants, technical assistance and training, partnerships, youth activism, and counter-marketing and grassroots marketing campaigns. With revenues exceeding \$320 million and \$50 million in annual expenditures (Stephens and Flaherty, 2013), Legacy set about fulfilling this mission by publicizing the adverse effects of smoking through massive anti-tobacco campaigns. Perhaps the most visible of these efforts was the so-called "Truth"-campaign and its controversial ads. For example, during the 2000 Olympics, Legacy launched a broadcast showing individuals emptying trucks of 1,200 body bags and dumping them outside the headquarters of Philip Morris in New York, representing the number of Americans who die each day because of tobacco use. The organization enjoyed early success when teen smoking started dropping, and Legacy was given much of the credit.

On its website, Legacy informed the public that "being an honest and dependable source of information is our bread and butter, because the minute we start bending and manipulating the truth, we're no better than the tobacco industry." Moreover, the organization put together a high-profile board with significant political wallop including Idaho Attorney General Lawrence Wasden (R), Missouri Governor Jay Nixon (D); Utah Governor Gary R. Herbert (R), and Iowa

Attorney General Tom Miller (D), former U.S. Secretary of Homeland Security Janet Napolitano, and Senator Thomas R. Carper (D-Del.) (Stephens and Flaherty, 2013).

### **Key Issue: Fraud**

In 2011, after twelve years of being a celebrated nonprofit, the following statement was found on Legacy's tax form:

In fiscal year 2011, Legacy became aware of an unauthorized diversion of assets in excess of \$250,000 committed by a former employee...Foundation leadership notified both its board of directors and law enforcement, with whom the Foundation has cooperated fully in the ongoing investigation. A subsequent insurance claim was filed by Legacy and in fiscal year 2012, was successfully settled.

The employee in question was computer specialist Deen Sanwoola. Hired in 1999 shortly after Legacy began operations, Sanwoola was tasked with creating the IT department. Sanwoola quickly became a highly appreciated employee and valued colleague, and over the years he developed close personal ties to many of Legacy's leaders, including CFO Anthony T. O'Toole. "Everybody loved Deen," O'Toole once acknowledged (Stephens and Flaherty, 2013).

The board acknowledged the importance of a strong IT apparatus in order for the organization to fulfill its mission. Because the agency had strong finances from the very beginning, the board was willing to allocate significant resources to the new IT department for computers, monitors and software. Much of this equipment was purchased from a single Maryland company, Xclusiv.

Apparently, there was a lack of internal financial controls, because the board and Legacy management granted Sanwoola the responsibilities for both ordering and recording the purchasing of electronic equipment. From 1999 to 2007, Sanwoola generated as many as 255 invoices for computer equipment sold to the foundation before he decided to leave Legacy. In 2007, Sanwoola moved to Nigeria where he operated Fun City, a gaming and entertainment center in Lagos. During his eight-years with Legacy, Sanwoola's actions appear to not have

raised any red flags. He rose to the position of assistant vice president with a \$180,000 compensation package, prior to the detection of the fraud.

In late 2007, an executive at Legacy approached the CFO Anthony O'Toole with concerns regarding computers inventoried as purchased, but not in the Legacy offices. O'Toole, a good friend of Sanwoola, whose compensation package totaled \$568,000 in 2012, ignored the complaint without investigating and failed to inform the CEO or the board. Three years later, the same employee took his concerns to a staff person closer to the CEO Cheryl Haelton. Within days after the second complaint, Legacy hired forensic examiners to investigate and Haelton notified the board. A concurrent internal investigation determined that fraud had indeed occurred and determined the amount to be \$3.4 million. Legacy board members notified the Washington D.C. U.S. Attorney's General Office.

The forensic audit detected the first signs of trouble starting almost immediately after Sanwoola's arrival in December 1999, when a computer processor and other equipment was purchased for more than \$18,000, yet the auditors concluded that it should have retailed for less than half of that cost. Thereafter, both the number and size of purchases to the IT department continued to rise, peaking with 49 expenses recorded in in 2006. The audit found that Legacy often paid many times the market price, and in other cases made "phantom purchases" of computer equipment that never arrived. Of the 255 invoices generated by Sanwoola, two thirds of them were deemed to have been fraudulent, translating into \$3.4 million.

Despite finding that millions of dollars were believed to be missing, the board and/or management kept the affair internal until the 2011 annual disclosure (see above), signed by O'Toole, which appears to downplay the total loss by only identifying a fraud of more than \$250,000. The disclosure also indicated that organization had filed an insurance claim that had

been “successfully settled” but the board never said anything regarding the size of the settlement nor whether it fell far short of the loss. Legacy commented that the absence of a total dollar figure in its public filing was the Foundation’s way of being restrained in describing its loss, in deference to the then-continuing federal investigation. Legacy general counsel, Ellen Vargyas, reported to the Washington Post during their investigation, that the organization “*had no obligation to identify the full estimate of the loss*” on the 2011 Form 990 or currently (Stephens and Flaherty, 2013). Additionally, she stressed that more information was in the Foundation’s 2012 Form 990 filing with the IRS. That filing included a reference to \$1.3 million in miscellaneous revenue from an insurance settlement. The day after declining to reveal the amount of the loss to the Washington Post, Vargyas, wrote in an email, that the loss estimate was \$3,391,648.

The FBI visited Legacy in February of 2012, but, within weeks closed the investigation, because, despite warnings, the leadership of Legacy had taken more than three years to report the missing computers and lacked reliable records of what it owned. The U.S. Attorney’s General Office for the district also suspended its case after citing that there would be not criminal prosecution related to the fraud. Heaton said she had expected the criminal case to clear the way to recover its lost money. But now there also will be no civil lawsuit seeking repayment, because as with the criminal case, the statute of limitations has passed.

On Oct. 30, 2012, O’Toole again signed a federal disclosure form for Legacy showing that it received more than \$1 million from an unspecified insurance settlement. Interestingly, the form does not mention the \$3.4 million loss. In a final comment to the Washington Post, CEO Heaton declared: “No excuses. It’s a terrible loss, and it shouldn’t have happened. If we lost \$3.4 million, that’s \$3.4 million that did not go to save lives.”

### **American Legacy Foundation Rises Again:**

On September 8, 2015 Legacy changed its name to Truth Initiative ([truthinitiative.org](http://truthinitiative.org)). Truth Initiative continues work the work of the American Legacy Foundation, striving toward “achieving a culture where all youth and young adults reject tobacco”. Truth Initiative concentrates its efforts in three areas: 1) Truth® a national prevention counter-marketing campaign; 2) the Schroeder Institute for Tobacco Research and Policy Studies which researches effective means to reduce the harms of tobacco, measures effectiveness of interventions and identifies best practices for tobacco control; and 3) working with community partners to counter tobacco’s influence, especially within communities of color and low-income populations ([truthinitiative.org](http://truthinitiative.org)).

### **Instructor/Trainer Guide**

#### **Context and Theoretical Background**

The Wounded Warrior Project tragedy could potentially have been avoided by understanding nonprofit governance in terms of separation between principals (board chair and members) and agents (CEOs) (Fama & Jensen, 1983). Governance issues such as CEO and board relationships, board performance, leadership, and operations are frequently studied using two principal-agent theories: agency theory (Jensen & Meckling, 1976; Fama & Jensen, 1983) and stewardship theory (Davis, Schoorman, & Donaldson, 1997; Sundarmurthy & Lewis, 2001). While both theories are based on a contractual relationship between principal and agent, with agency theory, each actor has different goals and interests. The principal delegates control to the agent yet is dependent on the agent to provide services and information on their behalf. Unfortunately, the agent may not always act in ways that are beneficial to the principal creating information asymmetries, agent opportunism, and goal conflict (Eisenhardt, 1989). According to

this theory, the perspectives of CEOs and the board members regarding effective governance diverge because of the conflicting roles, goals and interests of principals and agents (Caers, Du Bois, Jegers, Geiter, Schepers, & Pepermans, 2006). Caers et al. (2006) note that the application of agency theory to board-management relationships is complex and may be influenced, among other things, by weak or strong board control, CEO power, information asymmetry, and the influence of the CEO on board elections and nominations. This divergence may have resulted in the Wounded Warrior board members being distant from the CEO and contributed to a lack of oversight of the CEO and other top leadership actions providing the opportunity for the agent to commit fraud.

Possibly, the CEO and the board operated in separate environments, one where the CEO that accommodates the complexity of overseeing the operation of the nonprofit organization and another for the board members who are removed from the day-to-day operations and interact primarily with other members of the board. Agency problems frequently occur in nonprofits where a discrepancy between the objectives of those setting vision and those executing it exists (Du Bois, Caers, Jegers, De Cooman, De Gieter, & Pepermans, 2009).

If the Wounded Warriors Project board and CEO had adopted a stewardship theory approach the outcome may have been different. Stewardship theory, which also addresses the principal-agent relationship, makes the assumption that collaboration and trust (rather than control and distrust) exists between the principal (board members) and agent (executives) in part because of their high identification with the organization. Stewardship theory may be viewed two ways (Van Puyvelde, Caers, Du Bois, and Jegers, 2012): (a) the agent will act in the best interest of the principal even if their interests diverge because in doing so they will accomplish higher personal outcomes of achievement, affiliation, and self-actualization (Davis et al., 1997) or (b)

the principal's and agent's goals are in fact perfectly aligned because of commonality of interests (Sundarmurthy and Lewis, 2003). In either case, stewardship theory suggests that the governance perspectives of CEOs and the board will mostly overlap since they have compatible or aligned goals. If the Wounded Warriors Project board and the top leadership were more in alignment, it is unlikely that the top leadership would have felt that they had the right to abuse the organization's funds.

In the case of the Wounded Warriors Project, there was an apparent lack of knowledge by the board of directors of the executive leadership behaviors. This disconnect may be explained by (1) the failure of the board to educate themselves as to their roles and responsibilities, individually and collectively, as board members, (2) information asymmetry, and (3) CEO power (perceived or actual) over the board of directors. Scholarly and practitioner literature (e.g. Axelrod, 1994; Miller, 2002; BoardSource) has converged on a set of suggested board member roles and responsibilities. These responsibilities apply to both the individual board members and the board as a collective. Included in these roles and responsibilities are the evaluation and oversight of the CEO, the protection of assets, and the provision of financial control. The board should have ensured that new members were informed of their roles and responsibilities during the recruiting and orientation process.

Board members rely on the CEO to provide the information necessary to make informed decisions and provide adequate organizational oversight. When the CEO holds back information, this action challenges the board to uncover unknown discrepancies and issues. In the case of miss-use of funds, board members should carefully examine the annual audit report and IRS Form 990. These actions would have enabled the board members to question the fraudulent use of the funds. During new board member orientation, the treasurer should teach those who are not

familiar with reading financial documents how to do so. When an organization has a CEO that is perceived as powerful and competent board members may become trusting and lazy with respect to CEO oversight, which provides the CEO the opportunity for engaging in fraudulent behaviors. Brown and Guo (2010) used CEO tenure as a proxy for CEO power and found that boards in which CEOs have greater power were less likely to talk about their monitoring and oversight functions. Finally, when CEOs have too much influence on selecting new board members, the board may feel less able to confront the CEO on issues of concern.

Although it is important to make a distinction between the CEO and the board due to the need to separate governance and management, CEO and board member behaviors often contribute to ambiguity, confusion, and conflict (Otto, 2003). Nonprofit board members tend to believe that their CEOs will not pursue interests of their own and act in ways aligned with the organizational mission in support of stewardship theory. According to agency theory, the possibility exists that the agent or CEO has his or her personal agenda and acts independently of the board. This independence may be exacerbated when the board provides weak CEO control and oversight (Miller, 2002). Conversely, boards that exert too much control or power may lead to misperceptions and distrust between the board and the CEO. The notion that the board is solely responsible for organizational governance may be too narrow and needs to be replaced with the idea that governance is a set of responsibilities and actions that emerges from multiple actors (Stone and Ostrower, 2007). This may result in a blurring of board and CEO boundaries contrary to the delineation of nonprofit governance regarding of agency theory and the separation between the principals and the agents.



## **Suggestions For Classroom Instruction**

The Wounded Warrior Project and American Legacy Foundation fiascos provides two primary teaching opportunities: governance and fraud. Governance issues of particular relevance are the lack of governance of the organization by the board of directors due to a failure to understand board member fiduciary duties and a poor understanding of individual and collective board member roles and responsibilities. The second topic focuses on fraud and the board member's lack of financial literacy. Included in this discussion is the need for internal and external controls.

**Governance:** The role of the board of directors is to provide governance for the organization. While many definitions of governance exist, a recent one from Cornforth and Brown (2014) states that “the systems and processes concerned with ensuring the overall direction, control, and accountability of the organization” (4-5). Activity #1 (below) focuses on the fiduciary duties of board members. A clear understanding of the fiduciary responsibilities may have encouraged the WWP and ALF board members to engage in CEO and financial oversight, and voice concerns when needed.

Scholarly journals (e.g., Axelrod, 1994; Miller, 2002; Bernstein, Buse, and Slatten, 2015) and the practitioner literature (e.g., BoardSource) identify suggested roles and responsibilities for board members individually and collectively (see activity #2). The significance of board members' understanding of their unique and distinct roles and responsibilities implies that deliberate action must be taking place to explain and identify the nature of these functions. Specific practices, such as board orientation and board training, have been identified as contributing factors leading to high-quality board performance and organizational performance (Herman & Renz, 2000).

**Governance models:** Once students understand the board's fiduciary duties and their roles and responsibilities, the stage is then set for a more advanced analysis of governance models and principal-agent theories. Carver's Policy Governance Model (2006), which is a board-centered model of governance based on assumptions of separation of between the CEO and the board of directors. In this model a clear line is drawn between the board's responsibility for policy-making (as the "moral owners" of the organizations) and the executive's responsibility for implementation and day-to-day operations. The board's role is to establish stewardship through vision, mission, values, strategic planning, secure resources, defining clear roles and responsibilities, overseeing the articulation and documentation of board policies, and accountability to the stakeholders for organizational direction and performance.

A second governance model is Chait, Ryan, and Taylor's (2005) Governance-as-Leadership model that supposes the board is reactive to staff initiatives. Instead of focusing on organizational vision, the board is so mired in managerial details and routine technical work, that they are effectively managing, while the CEO is articulating the visions beliefs, values, and cultures of the organization. The Governance-as-Leadership model is predicated on the board operating in the fiduciary (oversight), strategic (foresight), and generative (insight) modes of governance simultaneously. This model forces the board and CEO to work closely together on "what matters most".

The third governance model is based on the philosophy of "psychological centrality" (Herman & Heimovics, 2005), with the CEO leading the organization, but using a board-centered leadership style, designed to support the board in meeting its governance responsibilities. In other words, the CEO is seen as responsible for the organization's success or failure by taking a role that ensures "that the board fulfills their legal, organizational, and public

roles” (p. 156). However, this does not imply that the CEO holds more formal responsibility or authority than the board, but that the CEO is perceived as responsible, even by members of the board. Herman and Heimovics conclude that CEOs who have developed these board-centered leadership skills are effective in their roles and also have hardworking, effective boards.

**Governance theories:** While there are a number of governance theories, the principal– agent theories are most relevant to this case. A presentation of both agency and stewardship theory and their application to this case highlights the ease in which rogue CEOs may act independently of the board and potentially destroy the organization (see above section on Context and Theoretical Background).

**Fraud and Financial Literacy:** The Wounded Warrior Project and the Amercian Legacy Foundation cases highlight the need for board and organizational fiscal responsibility. The board must, according to the duty of care, provide financial oversight and protect the organization’s assets and reduce the potential for fraud. Amazingly, nonprofit board members often lack even a modicum of financial literacy. Board members should include the ability to read the essential financial documents, including the Statement of Cash Flow, Income Statement or Statement of Activities, Statement of Financial Position or Balance Sheet, Budgets (including the Cash Budget), and Variance Reports. The Board Treasurer or the organization’s Chief Financial Officer should take responsibility for educating board members who lack basic financial literacy skills. With \$40 billion lost to fraud annually in the nonprofit sector (Harvard University Hauser Center, n.d.), students should explore the fraud triangle (<http://www.acfe.com/fraud-101.aspx>). Activity #3, below, focuses on the fraud triangle, which highlights how fraud occurs when individuals experience financial pressures, can rationalize the act, and have an opportunity.

**Internal controls:** A nonprofit organization's first line of defense against fraud is the establishment of internal controls. You may choose to have the students watch in class or as assignment the following videos, *Once Upon an Internal Control (U-tube (2 parts))*: [www.youtube.com/watch?v=1qeibzgSemY](http://www.youtube.com/watch?v=1qeibzgSemY) and [www.youtube.com/watch?v=7KESsI04-XY](http://www.youtube.com/watch?v=7KESsI04-XY). The Committee of Sponsoring Organizations (COSO) divided internal controls into five components: control environment, risk assessment, internal control activities, information and communication, and monitoring. ([http://www.coso.org/documents/COSO%20McNallyTransition%20Article-Final%20COSO%20Version%20Proof\\_5-31-13.pdf](http://www.coso.org/documents/COSO%20McNallyTransition%20Article-Final%20COSO%20Version%20Proof_5-31-13.pdf))

### **Control Environment**

1. Demonstrate commitment to integrity and ethical values
2. Exercise oversight responsibility
3. Establish structure, authority, and responsibility
4. Demonstrate commitment to competence
5. Enforce accountability

### **Risk Assessment**

6. Specify suitable objectives
7. Identify and analyze risk
8. Assess fraud risk
9. Identify and analyze significant change

### **Internal Control Activities**

10. Select and develop control activities
11. Select and develop general controls over technology
12. Deploy through policies and procedures

### **Information & Communication**

13. Use relevant information
14. Communicate internally
15. Communicate externally

### **Monitoring**

16. Conduct ongoing and/or separate evaluations
17. Evaluate and communicate deficiencies

The idea behind all of the above policies, practices, and procedures employed by an organization is to achieve the following **four objectives**:

1. To safeguard assets of the firm
2. To ensure accuracy and reliability of accounting records and information
3. To promote efficiency of the firm's operations
4. To measure compliance with management's prescribed policies and procedures

## Discussion Questions

1. What happened? Was there dishonesty present—embezzlement, theft, diversion of funds, nepotism, partiality, abuse of trust, lying, self-serving misspending, or just plain incompetence?
2. Now that the organization has been exposed for fraudulent behavior, where did the “fault” lie? Is it with the staff, CEO, Board, funders, or other individuals or groups? Or was the “fault” embedded in the very structure and set-up of the organization as a whole? Was it due to a failure of imagination, planning, implementation, management, leadership, or accountability? Was there more than one kind of fault apparent or were different faults the responsibility of different actors?
3. What is the responsibility of the board of directors in this fraud? What actions should the board now take? What actions can the board take to prevent this type of fraud from happening again in the future? At what stage in the case might intervention have saved things? Who should have identified the problems.
4. What legal duties do board members need to abide by? How would knowledge of these duties potentially have eliminated the opportunity for fraud?
5. What are the board member roles and responsibilities, both individually and collectively? How would knowing these have potentially avoided the fraud?
6. What are internal controls and how could they have been utilized to prevent fraud in this case?
7. The IRS may levy intermediate sanctions against board members. What are these sanctions? When can they be levied? Do you think that the board members should have

received these sanctions? What should external regulatory authorities have done? Do laws and processes that apply to the nonprofit sector need reforming in light of this case?

8. Many other nonprofit organizations have had serious public relations issues and have been investigated by Senator Grassley and continued to raise money and serve their mission. An example is the American Red Cross. Do you think that the WWP and ALF will survive?

### **Questions particular to the WWP:**

1. At the time the Wounded Warrior Project crisis was exposed, reporters noted that the organization had \$250 million in reserves. The 2014 budget was \$330 million. Do you agree or disagree with the reporters that having this amount in reserves is problematic? Why or why not? How much reserves are recommended for nonprofit organizations? Why do you think this amount is suggested?
2. What does this case teach us about the power dynamics that existed in the WWP or between the board of directors and the senior leadership prior to March 9, 2016? A follow-up question would be, who, in the WWP, uses power to influence the governance process and how was it deployed? Were there an obvious power struggle between the CEO and the Board of Directors?

### **Student/Training Participant Activities**

**Activity #1 Duties of Care, Loyalty, and Obedience:** Tell the story of the Sibley Hospital Case (for example, Worth, 2014, p. 78-79). Introduce the Duties of Care, Loyalty, and Obedience. Write on the board each of the three board duties and ask the students to identify, from the list below (taken from Worth, 2014), which activities are associated with each of the three duties.

- Paying attention
- Complying with the law (federal, state and local)
- Exercising due diligence in monitoring the organization's finances
- Board members not using their board position to enhance their own business or personal interests
- Exercising common sense and not loose organizational assets due to recklessness, indifference, or failure to seek appropriate advice
- Decisions made are consistent with the organization's mission
- Attending board meetings
- Assuring that business done with board member's companies are paid appropriately for the goods and services received
- The organization's founding documents and charter drive decision-making
- Reading board materials
- Not accepting unreasonable benefit from the organization's funds
- The by-laws of the organization are abided by
- Not using organization funds to pay unreasonable amounts to other board members or executives
- Making independent decisions
- Putting the organization above self
- Voting without understanding the issues

**Activity #2 Board Roles and Responsibilities:** Ask the students to identify what they think are the roles and responsibilities of an individual board member. Record the responses on the board. Ask students to identify the collective roles and responsibilities of the board. Record these responses. Prompt the students to identify the accepted responsibilities (BoardSource.org; Bernstein, Buse, & Slatten, 2015). Compare where these two lists differ and overlap. Use this discussion to highlight the significance of board training.

**Activity #3 The Fraud Triangle:** Present the Fraud Triangle, below (<http://www.acfe.com/fraud-101.aspx>). Define fraud (for example: the intentional deception, misappropriation of assets, manipulation of financial information with the intent to deceive).



1. Give students time to look at the following website, which highlights the ten worst cases of fraud <http://www.accounting-degree.org/scandals/>.
2. Present the following concepts:
  - a. **Fraudulent Statements** – misstating financial statements in a way that benefits the perpetrator
  - b. **Corruption** – an executive, manager or employee in collusion with an outsider (bribery, illegal gratuity, conflicts of interest, extortion)
  - c. **Asset Misappropriation** – assets diverted in a way that benefits the perpetrator
3. Ask students to identify the types of misappropriation (for example: skimming, cash larceny, credit card abuse, fictitious vendor schemes, check tampering, theft of cash, payroll schemes, expense reimbursement, conflicts of interest and misappropriation of non-cash assets).
4. Brainstorm the pressures that promote fraud (such as drug, gambling or shopping addictions, outstanding loans or other debts, marital affairs (for example the United Way scandal, see Glaser, 1994), declining revenues, etc.)
5. Examining fraud may create the opportunity for a lively discussion as students begin to think about situations they have personally experienced where they resisted the temptation to engage in fraud and the frequency of such opportunities.



**Activity #4 Internal Controls:** It is 2014 and you are the board chair of WWP or ALF. The board had voted to keep \$1,000 in cash in the office to meet incidental cash requirements of under \$100 per incident. An example would be to provide cash for a quick trip to Office Depot to get computer paper. You know that you need to implement internal controls on the cash so that it is not misappropriated. Watch the video on the separation of duties.

(<https://www.youtube.com/watch?v=eOSVTdw7Qbg>). For each of the internal controls listed below, describe what measures you would put in place to protect the cash.

- |   |                                      |
|---|--------------------------------------|
| 1. Establish responsibilities                             | 8. Fixed Asset Inventories           |
| 2. Maintain adequate records                              | 9. Automated controls                |
| 3. Double signature, authorizations and back-up documents | 10. Background checks                |
| 4. Supervision  | 11. Audits and board-level oversight |
| 5. Segregation of duties                                  | 12. Encourage whistleblowers         |
| 6. Control access   | 13. Strong compliance program        |
| 7. Independent Verification of processes and records      | 14. Self-audits                      |

**Activity #5 Internal Controls:** Read and discuss the *Nonprofit Quarterly* article by Rick Cohen (<https://www.charities.org/news/washington-post-piece-gives-misimpression-nonprofit-world-rife-fraud>). This article puts a different perspective on the Washington Post Investigation into fraud within the nonprofit sector.

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