



American Legion Auxiliary

**Department
Operations
Guide**

**Chapter 3:
Financial Operations**

CHAPTER 3

FINANCIAL OPERATIONS

Executive Summary

This section provides information and resources about financial controls and tools that your department can use to promote fiduciary responsibility. Fiduciary responsibility means that department officers (the fiduciaries) are accountable to contributors, members, and government regulators for the department's programs and finances. Fiduciary responsibility is best achieved through a combination of sound financial controls and policies and through a supportive ALA governance and management culture, which are explained in detail in this chapter.

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Section 1

Fiduciary Responsibility

What is Fiduciary Responsibility?

Fiduciary responsibility literally means the responsibility of trust. Fiduciary responsibility is the legal obligation of the organization's officers and directors – its governing board members – to act in the best interest of the members with the highest standard of care to protect the assets and reputation of the organization. Department officers and members of the department governing board (commonly known as the Department Executive Committee or department board in most departments) are accountable for the department's governance and financial well-being to members, current and potential donors, state and federal taxing authorities, state agencies that regulate charitable organizations, federal granting agencies, and charity watchdog organizations.

Fiduciary responsibility imposes three (3) duties that apply to department officers and governing board members:

1. **Duty of Care:** department officers and governing board members must act with the care that a reasonably prudent person in a similar situation would use.
2. **Duty of Loyalty:** department officers and governing board members must place the interests of the organization over their own personal interests and refrain from using their position to further their own personal gain.
3. **Duty of Obedience:** department officers and governing board members must perform their duties in accordance with applicable statutes and with the organization's rules, bylaws, and policies.

Failure to fulfill these duties is a breach of fiduciary responsibility and could result in financial liability for the department and personal liability for its officers and governing board members.

To carry out its fiduciary responsibilities, departments are advised to:

1. Adhere to the organization's mission that fulfills the organization's tax exempt purpose.
2. Be knowledgeable of and comply with all applicable federal, state, and local laws and government regulations.
3. Create and adhere to recommended written policies that safeguard the assets and reputation of the organization.
4. Protect the rights of members such as the rights of board members and delegates to be notified of meetings and made aware of the rules governing the conduct of business, the right to participate in the governance of the organization through elections, and the right to see minutes of board meetings.
5. Prepare and file its annual IRS Form 990 and appropriate state tax and regulatory filings.
6. In accordance with Public Disclosure Laws, departments are advised to make its Form 990 filings available to all officers, members of the department governing board and any member of the American Legion Auxiliary (ALA) or public who requests it.

All department officers and governing board members should be fully aware of their fiduciary responsibility. Particular duties required of an officer depend on the position she holds. For example, in keeping with the division of the roles and responsibilities of governing officers, department secretaries implement or oversee the execution of policies and procedures that address and fulfill fiduciary responsibilities of officers, directors (governing board members) staff, and committee members. The department's governing board and appropriate committees designated by the department's governing board approve department policies, and ensure that appropriate procedures are in place that fulfill those policies that promote the fiduciary responsibility of the governing board and its appropriate committees. Depending upon the resources and time availability of department officers, the most practical way to develop specific policies that promote accountability and protect the integrity of the organization to its members, contributors, and government regulators is for the department's governance leaders and management leaders to collaboratively develop appropriate policies. The following section provides information and resources about financial controls and tools that departments can use to promote fiduciary responsibility.

Transparency Best Practices

There is increased demand from the public and the government for accountability from nonprofit organizations to demonstrate that a nonprofit is indeed serving the public good and fulfilling the charitable purpose for which they were granted federal tax exempt status. Donors and volunteers have a vast number of different options when considering how and to which nonprofit charity they will contribute their time and/or financial resources. Members, corporations, and volunteers want to be sure their donation(s) will actually be used to further the mission of the organization they have chosen to support.

“Transparency” merely refers to the level of openness in which a nonprofit operates and reports to the public. Transparency refers to the widespread availability of relevant, reliable information about the performance, financial position, and governance of an organization. In other words, it is the amount of information that an organization tells the public about itself and how honestly and quickly it reveals this information. Many nonprofits will take steps beyond the legally required minimums to assure the public that they are a trustworthy and efficient organization. The public's and government's concerns about transparency are balanced against a department's concerns about administrative costs. As a “best practice,” many nonprofits follow the following five (5) steps to increase the organization's public transparency. These are presented as suggestions from other nonprofits and not legal requirements:

1. Regularly update the organization's website with current, detailed information about the organization's programs and their performance, including information regarding strategy and evaluations. The ALA national website devotes a page to each of our nationwide programs and committees, and the annual convention guides are written as annual reports and posted on the ALA national website.
2. Post board and key staff members' names, titles, and bios that highlight each person's skills and contributions. The national website includes such information about the national officers and department presidents.
3. Post the organization's annual report on its website. The ALA's national annual reports are posted on the national website at www.ALAFORVeterans.org.

4. Post any audited financial statements on its website. The ALA's 990s, which include the findings of the annual external audits, are posted on the ALA national website. The current IRS Form 990 is tantamount to an organization's annual organization and financial report.
5. Post the organization's IRS letter of determination on its website. The ALA's IRS Letter of Determination granting a group tax exemption to the American Legion Auxiliary is readily available to anyone and included in the documentation for the annual financial audit. The ALA National Headquarters has provided this document to departments at least annually. Note: The ALA IRS Group Exempt Status Letter of Determination is dated 1973 and the 1973 Letter is the ALA's current IRS Letter of Determination. Simply, the IRS made its most recent determination in 1973 and the determination stands until the IRS revokes or amends its exempt status determination about a charitable nonprofit. As an aside, not all nonprofits qualify for exempt status, and many that once qualified as charitable organizations no longer qualify or failed to comply with exempt status reporting requirements and have had their exempt status revoked.

These five (5) practices are in line with the public reporting requirements expected of tax-exempt organizations, plus allow potential supporters to see the value of the organization's mission at all levels. If your department does not have a website, you are advised to make the information listed above available to the public on demand.

The expectation for greater transparency in the nonprofit sector must always be balanced against concerns about what type of information can and should remain confidential. Certain kinds of information must remain confidential – that is kept in confidence by the officers and board members – in order to protect the individual privacy expectations of members and their leaders.

Transparency is the disclosure of information to the public and supporters to indicate the organization is managed well, functions in an ethical manner, and handles its finances with efficiency and responsibility. It's part of a board's *duty of obedience*.

Confidentiality is the obligation and right not to disclose information to unauthorized individuals, entities, or processes if it would harm the organization, its business relationships, or an individual. It's part of a board's *duty of loyalty*.

Board members generally understand that its stakeholders – its members, donors, the government, the service sector – want and expect transparency from the organization. And to this end, the IRS Form 990 now asks for far great disclosure about the make-up of the board, compensation of officers, how frequently the organization amends its bylaws, if certain policies are in place, etc. The new 990 implemented in 2008 raised the expectations that all information about a nonprofit is fair game for public knowledge.

But transparency does not, and should not, extend to boardroom decision making. Board discussions are confidential. Even public organizations subject to sunshine laws have exceptions for topics requiring confidentiality such as legal matters, officer/leader disciplinary issues, and those personnel issues that fall under the purview of the governing board. Note: matters of compensation and discipline of employees that report to the Department Secretary in her role as department headquarters executive do not fall under the purview of the department governing board nor of the department president, in keeping with federal labor and employment laws.

Please see the document in the Appendix entitled *Board Confidentiality and Organizational Transparency – Both are Vital for Organizational Effectiveness*.

To safeguard the department regarding matters requiring confidentiality, departments are advised to address the following:

1. Ensure your department policies are internally consistent. For example, if you have a policy that states donors' gifts will be kept confidential, you should not be putting donor names on your website. The same goes for employees, members, clients, or any other group.
2. Educate officers and board members about board confidentiality. Make sure that board members understand key concepts such as the fact that any board discussions handled in an executive session should be kept confidential. Also make sure they understand the concept of trade secrets and why those should likewise be kept confidential. Please see the Appendix for a copy of the ALA National Confidentiality Policy, Procedures, and Agreement to be used as a sample.
3. Consult with an attorney. Seeking legal counsel is especially important with pending litigation.
4. Read the fine print in contracts or grant awards. There may be a clause requiring confidentiality of the client or other obligations to safeguard certain information.
5. Determine if there are special privacy rules related to releasing information about the type of client served. Programs working with drug and abuse treatment, children, victims of violence, or healthcare patients often require high levels of confidentiality. There may be federal or state laws which require these higher levels of confidentiality.
6. Understand any disclosure rules regarding information about employees and other related considerations: For example, employment laws may limit what you can reveal about performance reviews and salaries of certain staff members. Federal laws limit the amount and kind of health information about employees or clients that can be disclosed.
7. Determine what is not required to be public and evaluate whether to disclose or keep private such information. Some states require board meeting minutes to be available for public review, others do not. Check your local laws to make sure you are in compliance.
8. Develop a policy for transmitting confidential information. Decide who can transmit confidential information, to whom, and under what circumstances. If transmitting confidential information electronically, it is strongly recommended you convert the document containing the sensitive information into a PDF file (portable document format) since PDF files cannot be altered as easily as something like a Microsoft Word document or other "open" office suite formats.

It is up to your department to determine what transparency policy best fits your organization. The best policy should be tailored to your department's missions, needs, policies, and legal issues.

Code of Ethics

Code of Ethics statements define acceptable and unacceptable behavior, eliminate ambiguity, and encourage officers, board (e.g., DEC) members, committee members, and employees to do the right thing. Ethics statements for employees should be included in your department personnel manual. See the chapter on Human Resources for additional guidance.

Department ethics statements should address:

- Relevant laws
- Values of personal integrity such as: honesty, fairness, professionalism, etc.
- Decisions that should be made when the choice is clear, but employees may be tempted to do otherwise
- Decisions that require a choice among competing options

A Department Code of Ethics statement should clearly state potential consequences for misconduct. For example, violators may be given a verbal or written warning, terminated, expelled, and/or subject to prosecution.

The Code of Ethics adopted by the National Executive Committee is provided in the Appendix. It is strongly recommended that all chartered entities and affiliated organizations at all levels adopt a Code of Ethics and conduct themselves accordingly.

Section 2 Fraud in Nonprofits

The risk of fraud can be greatly minimized with a combination of solid financial controls and a supportive ALA governance and management culture. Officers, members of your department governing board (e.g. DEC), staff and members do have accountability to one another to use Department resources wisely.

Establishing a culture of stewardship and accountability enhances effectiveness and reduces opportunities for fraud. Diligence about financial processes must be matched with a culture that recognizes the value and responsibility of internal controls. It is important to establish a culture of trust, but trust isn't a substitute for internal controls. Proper internal controls affirm the values of accountability and stewardship.

Fundamental measures for fraud prevention:

1. **Segregation of duties** – No one person should be responsible for both accounts payable and receivable or for all elements of either.
2. **Double signatures** – For expenses over a predetermined level, more than one authorization should be required, either from two staff executives or one staff and one board member.
3. **Multiple reviewers** – Bank and credit card statements, expense reports, and other financial documents should be reviewed by more than one (1) person, again potentially utilizing board members.
4. **Diligent background checks** – For any staff or volunteer positions that would interact with financial transactions, background checks can reveal previous criminal records.
5. **Recurring fraud-risk assessments** – Periodically select certain financial processes and test them to be sure policies and procedures are being followed. Even the mere presence of such reviews can act as a deterrent.

What to Do When Fraud Happens

The moment you detect fraud, you must take a course of action that is appropriate, clear, and swift. The organization's reputation is now at stake. Transparency and a swift investigation can

help avert the spread of rumors and negative press. Without handling the matter properly, winning back the trust of members and the public will be a steep climb. In general, you must do the following:

1. Start an investigation by notifying legal counsel and law enforcement and securing electronic and physical documents of the officer, member, or employee in question, plus anyone else who might have been involved.
2. Following the laws of your state, interview staff and/or members who might be involved or know something about what happened. Hire an accounting firm experienced in forensic accounting to analyze pertinent records. Depending on the severity of the fraud, your local or state police or the FBI may conduct their own interviews.
3. Consult with your attorney about crisis communications – how and when to notify the board, plus what and when to communicate to the members and the public. It is important that you consult an attorney about what can and cannot be stated, and prepare the official statement on the matter.

All officers and directors of the corporation (e.g., your DEC, board members) should be given a clear written statement with clear instructions about what they can and cannot state. There should be one (1) spokesperson designated to take calls or questions from members and public. The comment should then be the written statement only, unless advised by your attorney to state anything else. Commenting “off the cuff” and stating anything other than the official statement can jeopardize the investigation and pose further serious liability to the organization.

4. File the appropriate insurance claim. Determine what portions of the losses can/will be covered by your department's fraud insurance policy or bond.
5. Fix what went wrong. Follow the advice of your outside attorney and file any lawsuit(s) against the member, employee and/or other persons involved. Acknowledge procedural gaps identified by the accounting firm and put corrective measures in place.
6. Throughout the investigation, regularly apprise the board of its progress, including any findings about the incident by legal counsel or reported findings by the external accountant.
7. Discipline or terminate the member(s) or employee(s) involved in the fraud as soon as recommended by your attorney, and have the action taken ratified by the governing board (commonly the DEC or department board).
8. Note: It is wrong, and in many instances illegal, to mete repercussions to the person/employee who reports the alleged/suspicious fraudulent acts. Any action against a member or employee who acts in good faith to protect the organization that causes harm to that member or employee, e.g. verbal or physical assault, suspension, or termination, is grounds for a lawsuit against the officers and directors. Any act of retribution that is found to be unwarranted renders the offending party(ies) liable for punitive damages. Willful, wrongful acts of retribution, also can nullify any directors and officers liability policy coverage; the offending party(ies) may become personally liable for a court judgement. The purpose of a Whistle Blower policy is to protect the rights of the person “blowing the whistle”. The ALA National organization's Whistle Blower Policy, approved by the national governing board (NEC), may be used as a template for departments and is available in the Member Resources of the ALA national website www.ALAforVeterans.org.

Section 3

Financial Controls, Policies, and Best Practices

Financial controls promote sound management, minimize fraud, and are a great way to exercise risk management. Financial controls increase the likelihood that financial information is reliable; assets and records are not stolen, misused, or accidentally destroyed; department policies are followed; and government regulations are met.

Segregation of Duties

1. To reduce any one person's opportunity to both commit and conceal errors, at least two (2) people should have responsibility for:

Authorizing transactions, purchases, and contracts:

- Department financial policy can set a dollar amount below which the Department Secretary may sign checks or contracts without oversight and a dollar amount above which at least two signatures are required.
- When two (2) signatures are required, one (1) signature should always be the Department Secretary, and the second signature should be a department officer or Finance chair.
- See the Appendix for a copy of ALA National Headquarters' check signing policy to use as a sample.

Recording transactions:

- At least two (2) people should review the general ledger and bank, credit card, and investment statements.
- Financial institutions are able to send a duplicate statement to department headquarters AND to a department officer or finance committee member upon request.
- Someone independent of the request for wire transfers should verify all wire transfers.

Maintaining custody of assets (including cash receipts):

- Review the vendor list, preferably at least annually, to see if any vendor address matches that of an employee, officer, or committee member requesting supporting documentation of randomly selected vendors; or for any other irregularities concerning the vendor list.
 - Review bank, credit card and investment statements to ensure that purchases and investments are in-line with the budget and the department's mission.
2. For a department headquarters with only one (1) employee or volunteer, it is recommended that department officers or other volunteers assist with the segregation of duties on a regular basis.

Controls for Cash and Checks

1. Cash disbursements

- Require receipts for all purchases of \$25 or more.
- Ensure that cash is disbursed only upon proper written authorization and then properly recorded into the books and records of the department in a timely manner.
- All bills should be paid in a form other than cash. National Headquarters prefers that membership dues be remitted by debit or credit card, and encourages departments to allow electronic/online payments. Bills paid via credit card have the added protection of reduced liability should the card be compromised. If a check is lost or stolen, a department's bank account can be depleted in moments with no recourse for recovery. If credit card information is stolen or compromised, the card issuer limits the liability of the cardholder for unauthorized charges and will cancel a card immediately once fraud is detected or reported.
- Blank checks should never be pre-signed and cash or check disbursements should have the number of signatures as required by the department's Check Signing Policy.
- Access to cash and check stock should be limited.
- Cash and check stock should always be secured.
- Voided checks should be defaced and retained as required by the department's Record Retention and Disposal Policy. See the Appendix for ALA National Headquarters' Record Retention and Disposal Policy to use as a sample.
- Someone independent of the request for wire transfers should verify all wire transfers
Note: Record retention and disposal rules are dictated by state law. Please refer to your state's requirements regarding record retention and disposal.

2. Controls over Cash Receipts

- Assign someone unrelated to the accounting process to open the mail, restrictively endorse all incoming checks (registration fees, dues, etc.) and prepare a list of checks received to compare to deposits made.
- Two (2) or more people should handle and count cash receipts and certify the total together.
- Ensure that all cash received is promptly deposited, properly recorded, and kept under adequate security.
- Issue receipts for all money received.
- Arrange for the bank to send a duplicate statement to a department officer or to a member of the finance committee not involved in processing payments.
- Bank statements should be reconciled every month by someone independent of bookkeeping and/or check signing responsibilities.
- Reconciliations completed by someone not independent of bookkeeping and/or check signing responsibilities should be reviewed by a supervisor and/or finance committee member.
- Review should be documented and include examination of cancelled checks. Reviewer should randomly request source documentation for certain reconciled item(s).

Bookkeeping

1. Develop a bookkeeping system that records, documents, and retains all financial transactions in a timely manner.

2. Allocate revenue/expenses to the general ledger in the same manner they were budgeted.
3. Follow accounting principles generally accepted in the United States of America (U.S.GAAP).
4. A properly developed and maintained bookkeeping system produces timely, reliable, and usable financial reports.

Budgeting

1. Prepare a detailed annual budget that plots out when you anticipate receiving revenue and making expenditures.
2. Consider operating reserves. Operating reserves are unrestricted funds that are set aside in the bank to be used for operating and program expenses when there is a crisis or unanticipated shortfall in revenues and budgeted expenses cannot otherwise be met. Operating reserves are often referred to as a "Rainy Day Fund" to use for unanticipated or out-of-the-ordinary expenses. Operating Reserve Funds serve as a critical component of your department's budget planning process for the financial security and sustainability of your department.
3. Follow a proper budgetary process concluding with the DEC voting to approve the annual budget.
4. Review actual to budgeted financial reports monthly to monitor that your department is operating within the framework of the budget.

See more details about this topic under "Budget Planning."

Regular Financial Reporting

1. Prepare monthly financial reports that track revenue and spending, comparing actual revenue and expenses to budgeted funds.
2. Explain any significant variation between actual revenue/expenses and budgeted revenue/expenses.
3. Present financial reports to management, finance committee, and DEC.

Screening Employees

1. The Department Secretary or other senior-level person should complete the screening process. Screening for the department secretary position is typically completed by the human resources committee or a specially appointed search committee.
2. Include questions as to background and references. Conduct full background checks which should include credit checks.
3. Integrity of the bookkeeper/accountant is very important. A fidelity bond will not cover individuals known to have committed fraudulent acts.

Written Financial Policies

1. Department financial policies do not need to be elaborate or formal manuals; simple/brief instructions can be adequate. Written financial policies create an atmosphere and culture that is transparent and opposed to wrongdoing because they define and support mechanisms to minimize, detect, and report fraud and theft.

Financial Policies and Procedures should be written and address:

- Purchasing Business Credit Card, including agreement
- Check Signing
- Confidentiality, including agreement
- Audit and Tax Filing Accounting Principles Generally Accepted in the United States of America (U.S.GAAP)
- Investment Endowment
- Spending/Contract Approval and Signature Authority
- Protection of Department President's Signature
- Conflict of Interest, including compliance and disclosure forms
- Fraud and Whistleblower
- Travel Reimbursement
- Record Retention and Disposal
- Reserve Funds

Financial Policies and Procedures should be:

- Reviewed by an appropriate committee such as by the Finance Committee (FC) or Audit Committee and approved by the department governing board (e.g. DEC).
- Distributed to department officers, DEC, committee members, and employees as appropriate.
- Reviewed and maintained by management and an appropriate committee, such as the finance committee or the audit committee, and approved by the DEC on a regular basis, such as every three to five years.
- Please see the Appendix for copies of above Policies, Agreements, and Disclosure forms.

Section 4

External Audits and Financial Reviews

Audits and financial reviews are best practices that promote sound financial management and accountability and that can help meet the increasingly rigorous demands of current and potential donors, members, state and federal taxing authorities, state agencies that regulate charitable organizations, federal granting agencies, and watchdog organizations. Departments should have their financial records audited or reviewed at the end of each fiscal year by an independent external auditing firm. An internal audit should also be conducted if a new treasurer is appointed/elected mid-term and before a new bookkeeper and/or finance director is hired.

What Is an External Audit?

An external audit is a comprehensive analysis of the financial records and practices (including tests of financial controls) of an organization and is conducted by an independent external auditing firm. The objective of an audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all materials respects, in accordance with accounting principles generally accepted in the United States of America (U.S.GAAP), and to report on the financial statements, and communicate as required by auditing standards generally accepted in the United States of

America (U.S. GAAS), in accordance with the findings of the audit. See Appendix for Audit and Tax Filing Policy.

What Is an External Financial Review?

An external financial review is conducted by an independent external auditing firm. The objective of an external financial review is to examine the organization's financial statements and determine whether the financial statements are consistent with U.S.GAAP. A review shares the goals of an audit, however a review is not conducted with the same level of investigation or analysis as an independent audit. A review does **not** include an examination of the organization's internal controls (which is normally included in the external independent audit). Instead the review provides a limited level of assurance that the financial statements are free of misrepresentations.

What Is an External Compilation?

An external compilation is literally a compilation of financial records into a format required by accounting standards. Accounting standards require the auditor to assess whether the records are free from obvious errors. During a compilation the auditor does not examine the internal controls that are used to manage the risks of embezzlement or fraud, does not collect and examine source documents, and does not provide an opinion or assurance that the financial statements accurately reflect the financial position of the organization (all of which are part of an independent audit). The auditor reformats the financial statements, but does not make any determination of whether the account balances are reasonable (which is part of a review).

What Is an Internal Audit?

An internal audit is a voluntary appraisal activity by an organization to provide assurance over the effectiveness of internal controls, risk management, and governance to facilitate the achievement of organizational objectives. The internal audit is performed by employees of the organization who report to the audit committee of the department governing board (e.g., DEC). The scope of an internal audit is very broad and can include any matters which affect the achievement of organizational objectives.

How to Prepare for an External Audit

The Audit Committee, or if an Audit Committee does not exist, the Finance Committee, should engage an independent external auditing firm to provide an independent audit. The independent external auditing firm or does not work for or report to management.

Suggestions for a Smooth and Successful Audit:

1. The independent external auditing firm and management should work together and maintain a good relationship.
2. Management is responsible for the financial statements.
3. The independent external auditing firm presents their report to department governance (audit committee, finance committee, and DEC).
4. Communication should be open and flow both ways. The independent external auditing firm and management should be comfortable communicating directly with audit committee members or finance committee members if no audit committee exists.

5. The Audit Committee, or Finance Committee if no Audit Committee exists, and/or DEC should discuss the report with the independent external auditing firm and ask about any unusual situations or questionable figures.
6. The Audit Committee, or Finance Committee if no Audit Committee exists, should ensure that the DEC reviews and accepts the audit report.

Overview of Audit Committee Responsibilities

The audit committee's purpose is risk aversion. It does not manage or duplicate the roles and responsibilities of a finance committee. The typical responsibilities of a nonprofit Audit Committee will encompass, but not be limited to the following:

Oversight of the independent audit function: The primary duties of the committee in this area:

1. Reviewing the proposed scope of the annual audit with the independent external auditing firm.
2. Accepting of the independent external auditing firm's management report on the organization's financial statement at the conclusion of the audit.
3. Reviewing the independent external auditing firm's governance letter which includes reporting of audit findings, as well as management's responses to the audit findings.
4. Recommending to the board the engagement of the independent external auditing firm.
5. Engaging the independent external auditing firm if the authority to do so has been delegated to the Audit Committee by the DEC.

Establishing policies and practices to prevent financial fraud: This includes a full understanding of the areas of risk as they relate to potential fraud within the organization, as well as accumulating the fraud-related findings of the independent external auditing firm (and of the organization's internal auditors, if there are any).

Ongoing understanding of the internal-control environment: The objective here is to ensure that controls are in place to provide reasonable assurance that assets are safeguarded, that transactions are authorized and properly recorded, and that the organization is in compliance with applicable laws and regulations.

Oversight of the financial-reporting process: The committee should ensure that the organization's internal financial reports are providing meaningful data and that the information contained is timely and accurate.

Section 5 Budget Planning

The Importance of Budget Planning

Nonprofit boards and officers have a fiduciary duty to effectively manage the assets of their organization. One important duty is financial planning, or budgeting. A budget represents the anticipated revenue and anticipated expense of the organization over a year. A budget is a plan, not a contract, and can change due to the realities of day-to-day operations.

A budget provides a framework for decision making, as it clarifies what programs you are financing and what your resources are being spent on. Your budget serves as a tool for

monitoring financial activity, and lets you check to make sure your expenses are aligned with revenue; if not, it serves as a tool to see where you can possibly reduce expenses or improve revenue. A budget is a plan for your organization's finances; a financial statement is the actual facts of your financial situation at a certain point in time and for a certain time period.

The Budget Planning Process

Write out your budget process: Writing down your actual process creates a timeline by which to measure your progress and a checklist to ensure thoroughness.

Decide who should be involved and when: Your senior management and officers should be involved, but staff or volunteers who have responsibility for following the budget should have a voice as well. Staff and committed volunteers often have more operating knowledge on certain budgetary matters than the board and can provide a more accurate reflection of your department's projected needs.

Create a timeline: There may be periods of the year in which your department has more time to devote to the budget planning process. Create a timeline to stay on task, and follow as closely as possible.

Create specific tasks and responsibilities: If someone knows they will be held responsible for tasks, they are more likely to do them. Many people can be assigned to a task, but choose someone with ultimate responsibility for ensuring completion.

Align budget and financial statements: Make sure that your budget planning actually aligns with the reality of your finances. If your financial statements are repeatedly out of line with what your budget planned for, you may need to seriously rethink your budget planning or more closely examine how exactly you are managing your money in day-to-day operations.

Adopt policies to adhere to budget and handle variances: A variance policy can determine to what extent management has discretion in implementing the budget. For example, you might have a policy stating if an actual expense is 10% over budgeted amount, it needs to be reported to your finance committee.

Guidelines for Budgeting Contributed Income

Accounting standards require that nonprofit organizations report contributed income in one of three categories – unrestricted, temporarily restricted, or permanently restricted. These different income classifications are determined by either the absence or the existence of donor-imposed restrictions on the use of contributed funds. Although restricted contributions and grants pose financial management challenges, these sources of funds are important and desirable.

Unrestricted Contributions: Unrestricted contributions received are not subject to donor-imposed restrictions. Unrestricted contributions may be used for the general operations of the organization.

Temporarily Restricted Contributions: Temporarily restricted contributions received have donor restrictions that limit the use of the donated assets. When a donor restriction expires, temporarily restricted funds are classified as unrestricted funds..

Permanently Restricted Contributions: Permanently restricted contributions received are held inviolate and in perpetuity. The net income from these investments is available to be utilized toward the mission of the organization.

Once a contribution or grant is identified as restricted, the accounting and record-keeping requirements are of paramount importance. Two principles are at the core of the accounting requirements. First, restrictions are imposed by the donor when they make the gift or grant. Second, income must be recognized, or recorded in the accounting records, in the year that an unconditional commitment for the funds is received regardless of when the related expenses will occur. These principles add a complexity to nonprofit financial reports due to the timing of funding, which makes accurate and reliable accounting especially important.

Not only do nonprofits have an obligation to their donors to spend contributed dollars as designated, they are also bound by law. If a condition on restricted funding has not been fulfilled and the money has been spent, the donor can demand that the funds be returned, pursue legal action, or contact the Office of the Attorney General.

In addition to these tracking and recording requirements, nonprofits that receive restricted funds face increased management challenges. When making financial decisions with restricted funds, consider these guidelines:

1. Do not budget to spend money unavailable to you.
2. Educate staff and board members with financial responsibility on funding restrictions.
3. When analyzing financial reports pay close attention to unrestricted funds and, unless you are making decisions regarding programming for which the funds have been restricted, avoid basing decisions on restricted funds.
4. Understand how restrictions will impact cash flow and availability of funds.
5. Know when the restrictions are satisfied and how to release the funds from restriction.
6. Develop a simple and reliable way to track restrictions on funds.

Guidelines for Budgeting Expenditures

Expenditure guidelines for nonprofits: One problem many nonprofits face is communicating in a clear manner their organization's effectiveness in fulfilling its mission. Many financial supporters and charity watchdogs have placed great importance on financial indicators based on functional expenses. Two commonly used indicators are the program spending ratio (percent of expenses actually spent on programs) and fundraising efficiency ratio (amount raised through fundraising vs. amount spent on fundraising). The numbers used to calculate these amounts generally come from the Form 990, which is public information, and any financial information the nonprofit makes public. When drafting a budget, it is important to accurately classify expenditures in the correct categories of programs and member services, management and general, and fundraising.

Program Service Expenses: These are costs related to providing the nonprofit organization's programs or services in accordance with its defined mission. For established nonprofit organizations, program service expenses generally represent the majority of the overall expense of the organization. The public generally prefers to see a nonprofit organization with the largest allocation to this category.

Management and General Expenses: These are costs related to administering the day-to-day activities of the nonprofit organization. These expenses do not directly relate to the purpose for which the organization exists and typically include activities such as bookkeeping, management, and governance. While important to the operation of the nonprofit, organizations generally try to minimize these costs as much as possible.

Fundraising Expenses: These are costs of all activities that relate to an appeal for financial support or for a contribution to an organization. Examples of these expenses are the costs of holding a fundraising event, solicitation of contributions, or the compensation (salary/wages) of individuals involved in the fundraising process.

Assigning or Allocating Expenses: When assigning expenses, it is entirely possible that you may find an item that could conceivably fall into more than one category. When possible and practical, assign expenses to the specific program or supporting service they benefit. Consider directly assigning major expenses such as payroll and occupancy to programs or specific supporting services. Expenses that are impossible or impractical to trace to a specific program or supporting service can be pooled and allocated to various programs and supporting services using an appropriate formula. A department can ask its external audit firm or professional accountant for advice on how to allocate expenses.

Section 6

Unit-Specific Guidance for Financial Operations

Minimum Standards

At a minimum, ALA Units should make certain to do the following:

1. Obtain a federal identification number from the Internal Revenue Service; also known as Tax Identification Number (TIN) or Employer Identification Number (EIN).
2. Submit membership dues to your department in a timely manner - do not hold these in suspension. Members who have paid their dues expect that the dues will be remitted in a timely fashion. National Headquarters receives many irate calls every year from members who have paid their dues months earlier yet are not receiving member benefits because the dues were not posted in a timely fashion. National Headquarters also receives many calls and emails from irate members who have been told these delays are “National’s fault” when indeed it is the unit or department that has not remitted the member’s dues and is purposefully and unjustly blaming National Headquarters. The intentional delay in remitting dues is a critical problem of poor business ethics that will continue to be publicly addressed by the National organization. The ALA National governing documents require dues be remitted monthly.

Note: A common excuse for delaying the remittance of members’ dues by either a unit or department is that the unit/department needs to hold onto the money collected to pay current bills. This practice abuses members who pay in good faith expecting that their dues will be processed in a timely manner. The 2015 ALA National Organization Effectiveness Assessment found that members do not view ALA dues as expensive. Departments and units are advised to raise dues or assess fees to cover the costs of operating efficiently, and not rely on holding onto members’ dues payments as an unethical way to take care of department or unit cash flow needs.

3. Pay specific fees per department bylaws or department governing board (e.g., DEC) mandate.
4. Submit to department the unit's portion of group bonding insurance provided by the national organization.
5. Review annual department budget and reports of Department Secretary and Finance Committee.
6. Complete a Form 990 annually.

Best Practices

Entrusting Volunteers with Money; Issues of Not Returning un-used ALA funds

Volunteers or members are often entrusted with department or unit funds for a particular task or program activity. All money should be accounted for upon being handed over, receipted and accounted for during its use, and returned if unused. But what should you do if money is not returned?

If you are dealing with a volunteer or member who has not returned or refuses to return unused department funds, it is a matter of illegal possession of department funds. In such cases, it is recommended that your department take legal action.

Guidelines for legal action:

1. Give the volunteer or member a deadline. It is recommended the department president or Legion department judge advocate send the possessor of the money a certified letter stating the balance owed and the date upon which the money should be returned. The letter should also state that if the funds are not returned in total on said date, the department will consider all legal options available.
2. The department may proceed as it deems most appropriate, but it does have a fiduciary responsibility to take some action.
3. You are advised to consult your Legion department judge advocate or an attorney. Options to consider may include filing theft charges with the understanding that such charges will become a matter of public record; establishing a non-extendable deadline for the volunteer to return the funds and informing her that if the funds are not returned by the stated deadline that all available options will be pursued to collect; and/or presenting the matter to the DEC for other action(s).
4. If the department president sends the certified letter, it is recommended that she copy the department judge advocate, department vice president, and chairman of the department Finance and/or Audit Committee.

Distribution of a Dissolved Unit's Funds

When a Unit ceases to function or its charter has been revoked or canceled, the American Legion Auxiliary National Standing Rules provide that the charter and all Unit records and funds shall be immediately forwarded to department headquarters, which has no obligation to assume any of the Unit's debt or other obligations.

If a nonprofit organization has been granted tax exempt status by the IRS, either singularly or as part of a group exemption (GEN), and that nonprofit organization dissolves (as a corporation) or ceases its operations and ceases to exist (an unincorporated organization), then the

organization must distribute its remaining assets (after the settlement of all the organization's outstanding debts) to fulfill another tax exempt purpose. That is to say a tax exempt nonprofit that dissolves or ceases to exist must distribute its assets (money, financial holdings, and real and business personal property) to another tax exempt organization.

The answer to how a nonprofit that is ceasing operations must distribute its remaining assets/funds/ is rooted in the reason why the organization was granted exempt status in the first place. The IRS grants to organizations that exist for the betterment of the public good an exemption from paying federal taxes, i.e. to those organizations whose purpose is to benefit the good of society (e.g. charitably, educationally, spiritually). Every tax exempt organization must annually report to the IRS (via the IRS Form 990) that it is serving the public good and has continued to fulfill its charitable purpose, and, therefore, has continued to earn the privilege granted by the federal government to waive the payment of federal taxes in exchange for the public good performed by the organization.

Inherent in the whole government philosophy of granting a reprieve from paying federal taxes to those organizations that contribute to the public good is the expectation that funds raised by the tax exempt organization are used for the organization's charitable purpose, and not to pay monetary dividends to stakeholders.

For-profit organizations are not tax exempt because corporate profits are used for personal gain – dividend paid to shareholders. For-profit organizations pay taxes on their income. The customers who buy the goods and services offered by for-profit organizations do not receive any personal tax benefit for making the purchase (“giving” the organization personal money in exchange for an item or service). The profit realized on a customer's purchase yields no tax break to either the organization or to the paying customer. In the for-profit sector a paying customer is just that – a paying customer.

Funds received by nonprofit organizations are tax-exempt because the funds are used for the delivery of charitable purposes – there are no profit-dividends paid to shareholders. Persons giving money to a nonprofit are doing so to help the nonprofit fulfill its charitable purpose. In return for this voluntary exchange of money for mission delivery, the nonprofit is “awarded” by the government with a waiver of paying federal taxes, and the donor is “awarded” a tax deduction on his/her personal income tax return. In the nonprofit sector a paying customer is a donor. And a donor expects more than personal gratification from a purchase; a donor expects that the nonprofit organization will use his/her money to serve a charitable good.

This concept is important to understand when a tax-exempt nonprofit organization undergoes the process of “winding down” (a bona fide legal term and its board/officers decide how to distribute the organization's remaining assets. The assets were obtained to fulfill a charitable purpose. Both the organization and its many donors received income tax breaks for the money received; therefore, the organization cannot use the remaining assets for personal gain or personal delight. The funds/assets were obtained for a charitable purpose and they must continue to be used for a charitable purpose.

Since the American Legion Auxiliary was created and exists to support the purposes of The American Legion, Counsel General has long advised that the department of an ALA entity ending its existence distribute its remaining assets either a) another ALA entity (e.g. to the department, another unit, or national), b) to an entity of The American Legion (e.g. its home post, or department, or national) or c) to divide the asset distribution and give portions to a combination of ALA/TAL entities.

Note: Not all nonprofits are tax exempt; but all ALA chartered units were tax exempt under the American Legion Auxiliary National Group Exemption (GEN). Therefore, even though a unit's exempt status may have been revoked by the IRS, that unit still acquired its assets for a charitable purpose recognized by the federal government. Those proceeds, in turn, must still be used for a charitable purpose or else distributed to another nonprofit entity to fulfill a similarly tax-exempt charitable purpose.

A dissolved unit's records must be submitted to its ALA department as soon as possible. (*Also see FAQ below on the subject of distributing a dissolved unit's assets*)

Section 7

Important Tax Information

Please consult the Appendix for the *Important Tax Information* document, an overview of federal and state tax reporting requirements, nonprofit taxations matters, and other related topics. The information in this Guide and the Appendix is not intended as legal advice or directives from the national organization. It is provided to help your department, units, districts/counties/councils understand and meet your and their federal and state tax regulations and reporting requirements, and to offer general guidance and best practices in nonprofit management or governance.

If, after reading this information, you still have questions -- particularly about meeting legal requirements or filing federal and state tax forms correctly -- consider consulting a licensed attorney, nonprofit expert, and/or certified professional accountant knowledgeable and experienced with nonprofits and the tax laws of your state. We hope that this information will answer your questions and give you more insight into why the national organization promotes best practices in nonprofit management or governance.

Section 8

Frequently Asked Questions (FAQs)

FAQ 1: Does our ALA Unit, Department, or D/C/C need to file a 990-N?

RESPONSE: Organizations that accept money must account for receipts (revenues and contributions). Organizations whose receipts are less than \$50,000.00 in total for the organization's tax year are eligible to file the 990-N (e-postcard) series electronically - (www.irs.gov). Organizations with receipts \$50,000 and over must file a Form 990 EZ or 990. See the next two questions.

FAQ 2: Does our ALA Unit, Department, or D/C/C need to file a 990-EZ?

RESPONSE: Organizations with receipts (revenues and contributions) that are less than \$200,000.00, and with total assets of less than \$500,000 for the organization's tax year are eligible to file the 990-EZ series of tax return - (www.irs.gov).

FAQ 3: Does our ALA Unit, Department, or D/C/C need to file a 990?

RESPONSE: Organizations with receipts (revenues and contributions) that are greater than/equal to \$200,000.00, OR the ALA Unit, Department or District/County/Council has total assets of greater than/equal to \$500,000.00 for the organization's tax year meet the IRS requirement to file the 990 series tax return - (www.irs.gov).

FAQ 4: The ALA Units, Departments or Districts/Counties/Councils have tried to file a 990 series tax return for a prior year, and the IRS has rejected the tax return. What should we do?

RESPONSE: While there are many different situations that result in the IRS rejecting a 990, the most common reasons are:

1. According to IRS records, the TIN/EIN used on the 990 does not belong to the ALA Unit, Department or District/County/Council filing the 990.
2. According to IRS records, there were no 990s for that TIN/EIN filed the last three (3) years.

The ALA Units, Departments or Districts/Counties/Councils should only use the TIN/EIN assigned specifically by the IRS for the ALA Unit, Department, or District/County/Council organization on all relative tax returns and correspondence with the IRS.

FAQ 5: We understand the importance of obtaining Social Security Numbers and sending out 1099s to people who earn more than \$600 for making poppies; however, the veterans who make poppies in our department live in veterans' homes. These vets are scared and suspicious that the income reported will impact not only their tax status, but their ability to continue to live in a government-funded facility. Will turning in the 1099s have an impact on their ability to remain in the veterans' homes? And, will it have any impact in terms of having to pay taxes, since most of them earn \$2,000-\$4,000?

RESPONSE: Issuing 1099s to veterans who make poppies and receive other government subsidies: A department that pays a veteran more than \$600 in a calendar year for making poppies must issue a 1099 to that veteran. Departments must comply with the federal and state law and IRS rules regardless of the ramifications to the recipient(s). Every employer is required to send a 1099 to an individual who receives \$600 or more in income from that employer.

If veterans making poppies receive government subsidies, including living in government-subsidized housing, those earning \$600 or more from making poppies will need to be issued 1099s, and they will need to determine what the income threshold rules are to continue to receive subsidized housing. Rules can vary by state and by federally funded entities providing subsidized housing. 1099 recipients also need to determine what the maximum income threshold is for social security and other government subsidies or pensions. If the veterans making poppies live in U.S. Department of Veteran Affairs subsidized housing, they may find guidance on income thresholds by contacting their state's VA information officer to obtain these answers.

FAQ 6: If an ALA Unit dissolves, where do their remaining funds go? To the Legion post?

RESPONSE: No. When a unit ceases to function or its charter has been revoked or canceled, the American Legion Auxiliary National Standing Rules provide that the charter and all unit records and funds shall be immediately forwarded to department headquarters, which has no obligation to assume any of the unit's debt or other obligations. The department's governing board determines the distribution of the dissolved unit's assets. There is no national requirement that the funds of a dissolved unit must go to its Legion post. Likewise, there is no prohibition against distributing any of the assets of a dissolved unit to its post as an appropriate action when the bylaws of the unit or department do not otherwise specify how remaining funds and assets must be distributed. (Note, similarly, The American Legion's national governing documents require that a dissolved post's assets must go to the Legion department.)

It is recommended that you check your department and unit bylaws for direction. If your unit bylaws are silent on the subject, contact your department office and ask if the department has a bylaws or additional policy requirement for handling the remittance of the assets of a dissolved unit to the department. If there are no such written requirements, then the unit governing body (its unit executive committee or board) can meet and determine how they would like the assets to be distributed and make that preference known to its department. The unit is advised to take copious minutes of the meeting where the dissolution is determined and the preference of asset distribution is adopted. Those minutes must be provided to the ALA department and retained for safekeeping.

Absent any department requirements in its governing documents that address how assets are to be distributed, the department governing body may distribute any or all of the assets to another organization or organizations whose mission is compatible with that of the ALA. Assets can be divided and distributed to multiple nonprofit organizations, as long as there is a record of official action approving the distribution. Since the organization whose mission is most closely aligned with the ALA Unit is its ALA Department, the dissolving unit may expect that the department would retain the assets, or that the Legion might be a designated recipient of some of the remaining assets.

Note: It is not allowable for a dissolving ALA entity to distribute any assets to individuals. Neither officers nor members can receive any assets belonging to an ALA entity. The only exception would be an item that a member allowed her unit to use. In that case the item may be returned to the member as its personal owner, but under no circumstance can cash be distributed to a member unless there is a legitimate ALA expense claim on file that has been duly approved.

When a unit is dissolving, it is advisable to note the payment of specific claims in the unit minutes to ensure transparency in transactions occurring prior to the Unit dissolving. Upon dissolution, records and any remaining undistributed funds and assets must be given or forwarded to the Department.

Whether a unit is taking steps to dissolve on its own accord, or a unit is dissolving due to the revocation or cancellation of its charter, it is highly recommended that the unit consult with its department office or the Legion's Department Judge Advocate prior to the unit's dissolution.

In addition to official records, funds, and assets, a dissolved unit's historical records and artifacts should also be preserved. A dissolving ALA entity should give its historical records and artifacts to the department, or, with the department's consent, the historical documents and artifacts may also be donated to a local preservation organization.

FAQ 7: One of our Units would like to know what their liability is to the post when it comes to funds. The Unit has \$30,000 in CDs that is money they have saved from fundraisers for scholarships, poppies, ALA Girls State and other designated programs. The post is having financial difficulties and wants them to give them this money. Some of their members think it would be okay to do this, and others think they would be defrauding the people who had gotten the money for the above programs. The members of the post are telling them they are to support all the post activities no matter what and need the money to save the post (the bar has drained the Legion funds), and they are demanding this money. They have asked for the official opinion from the National Judge Advocate and asked me to contact him for them. Can you please forward this or advise me as to whether you feel this would be fraud or not and what their responsibility is when it comes to this kind of project? They really want to know if it would be "fraud" to give up this money. I told them they were under no obligation to give up their savings to the post, but I did not know if it could be considered defrauding the public for taking this money for one thing and spending it on another. Please advise.

RESPONSE: This is addressed in the ALA National Constitution & Bylaws and Standing Rules. Units and posts are separate entities. Neither has authority or control over the other.

Via a prearranged agreement between both parties, a unit may agree to pay a post for specific stated purposes such as meeting expenses or use of space, but otherwise a post has no authority to demand money from a unit. An ALA department/unit is not responsible for a Legion department/post's debts and has no liability for same and vice versa.

Donations received by any nonprofit are to be used in keeping with the donor's intent and may not be used for any other purpose. If donors contributed to the ALA at any level for a specified purpose, such as scholarships or a service program, the ALA entity cannot use that money for any other purpose.

If an ALA unit is not going to use the collected funds for the purpose for which they were collected, the unit must return the funds to the donors or may only use them for a like purpose (e.g., another scholarship or a similar service project). It is fraudulent for any ALA entity - national, department, intermediate bodies, subsidiaries, units, et. al. - to use funds that were collected for a specific charitable mission purpose for any other purpose.

FAQ 8: If one of our department's units wanted to open up a thrift store in the name of their ALA unit, would that be allowed?

RESPONSE: There is nothing in the national governing documents or policies that prohibit a department or unit from operating a commercial enterprise as long as they follow all the appropriate state laws. Just make sure that if they are going to use the name/emblem of the ALA on a store front that they get the use approved from the national secretary.

FAQ 9: One of our department's hospital/gift shop representatives failed to distribute all funds in the form of Christmas gifts, nor did she return the funds to the department. Rather, it was reported that she used the money for personal reasons as her husband is ill and the family is

having a hard time financially. Our Department President has indicated that we should proceed with legal action and to bring to the Finance Committee's attention. I need advice as to the proper steps to take to assure consistent application of policies and/or procedures. Thank you.

RESPONSE: In matters like these, first the facts are determined, then it is determined if there are any extenuating circumstances, then it is determined who has the authority to seek redress. According to what you have shared:

The member was entrusted with department funds for a specific purpose and she has not fulfilled that purpose. The money should either be spent for the stated purpose within a specified deadline or returned.

A person's indigence is not a defense for failing to use funds entrusted for a specific purpose for another purpose. It is also not responsible to ignore a wrongful act simply because similar wrongful acts have been ignored in the past.

If she has not used the funds, the funds should still exist somewhere and be returned. If the funds are not available, then it is speculative that she has used the funds for her personal benefit; that is not acceptable. If she has stated to anyone in leadership, and that includes the department secretary or any volunteer leader, that she has used the funds for a purpose other than that for which the department entrusted her to use the funds, then the department is advised to take action to recover the funds.

The department may proceed as it deems most appropriate, but has a fiduciary responsibility to take some action. You are advised to consult your department judge advocate or an attorney. Options to consider may include filing theft charges with the understanding that such charges will be matter of public record; establishing a non-extendable deadline for her to return the funds and informing her that if the funds are not returned by the stated deadline that all available options will be pursued to collect; and/or presenting the matter to the DEC for other action(s).

An organization's finance committee should be informed of the matter, but a finance committee has no authority to take action; only the Department President can pursue legal action in consultation with the governing board (DEC) who should be advised about any cost the department will incur to pursue legal action.

While matters such as these are not pleasant to address, the department has a fiduciary responsibility to its dues paying members to appropriately use and safeguard department funds.

FAQ 10: Whistleblower protection

If a department does not have a whistleblower policy, can the whistleblower be protected by the National policy?

RESPONSE: The national whistleblower policy does not protect a member whistleblowing about a department matter. If a department does not have a whistleblower policy, the whistleblower would only be protected if the matter involved someone or something at the national level.

There may be some limited federal law protection, but most whistleblower protection is enacted via a state's laws, because the whistleblower would be reporting an alleged incident about someone in a position of authority within the ALA department, which is a state corporation, or an alleged impropriety about something within the corporation. Civil and criminal codes vary from state to state; therefore, a department is strongly advised to have a whistleblower protection policy for the department, which is a corporation registered with the state. If a whistleblowing

incident occurs in a department, the department is advised to consult with an attorney knowledgeable in that state's laws governing improprieties occurring in a state corporation.

Note: Officers and directors of the department who commit acts of retribution against a whistleblower who acted in good faith may be subject to a lawsuit and could become personally liable for a judgement of malicious retribution.

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