

Nonprofit Accountability and Ethics: Rotting from the Head Down

by Woods Bowman

From lying to staff to conflicts of interest, unethical behavior in nonprofits abounds. Here the author outlines three particularly relevant markers of a responsible organization as well as four trends shaping future standards for nonprofits.

Editors' note: This article was excerpted from a chapter in a forthcoming book, *Practicing Professional Ethics in Economics and Public Policy*, by Elizabeth A. M. and Donald R. Searing, published by Springer. Used with permission.

ARGUABLY, THE PUBLIC HOLDS nonprofits to higher ethical standards than government or businesses. Over 25 percent of Americans report having “a lot” of confidence in charitable organizations compared to 9 percent for government and 7 percent for major corporations,¹ but do nonprofits deserve that confidence?

An article earlier this year and many newswires published by the *Nonprofit Quarterly* have reported stakeholder rebellions in response to nonprofits ignoring their responsibility to stakeholders. Does Susan G. Komen for the Cure sound familiar? These responsibilities extend well beyond checks and balances in the financial system or misreporting performance statistics—they extend to governance. Do nonprofits listen to stakeholders? Are they in the habit of taking money from them—and in their name—and then ignoring them until they shout?

Even in the Small Stuff, Nonprofits Are No Great Shakes . . .

Thanks to the Ethics Resource Center, there are fairly reliable and

comprehensive data on ethics in nonprofits, such as its *National Nonprofit Ethics Survey*.² The best news is that nonprofits generally have a strong ethics culture compared to business or government: 58 percent of employees in nonprofits report a strong, or strong-leaning, ethics culture compared with 52 percent in business and 50 percent in government. The difference, however, while statistically significant, is not impressive. Furthermore, a strong ethics culture in nonprofits is only one-fourth as prevalent as a culture “leaning” in that direction. Clearly, there is more work to do, even at the top of the scale.

Slightly more than half of employees in nonprofits observed misconduct in the previous year, and this is roughly on par with that observed in the other sectors. “On average,” the report states, “nonprofits face severe risk from a handful of behaviors: conflicts of interest, lying to employees, misreporting hours worked, abusive behavior, and Internet abuse.” The value of a well-implemented ethics program is beyond question. In organizations with little to no ethics and compliance program, 68 percent of employees observed two or

more types of misconduct over the course of a year. This is significantly reduced to just 22 percent in organizations with a well-implemented program.

Although 60 percent of nonprofit employees who observed misconduct reported it, nearly 40 percent of witnesses remained silent, due largely to feelings of futility or fear of retaliation. Indifference is harder to combat than fear. Several famous controlled psychological experiments clearly demonstrate that most people in a crowd will wait for someone else to take action—whether it is helping someone in distress or reporting a crime. Even if employees do not fear the kind of retaliation that is forbidden—discharge, demotion, stalled advancement, and reassignment—they may not want to “get involved” in other people’s affairs. “It’s not my job,” they might say. The best ethics programs address this perverse psychology by providing training that sensitizes people to their personal responsibility in addition to the rules and regulations.

Although nonprofits may believe they have a strong ethical culture, this does

not always translate into better ethical behavior or better reporting of unethical behavior. So possibly nonprofits do not deserve the public's confidence.

... But the Big Stuff Sets the Stage

"Fish rots from the head down," as the saying goes. Applied to nonprofits, it describes accountability on the largest possible scale. Accountability involves being "answerable" and "responsible." Answerability describes a family of relationships between a nonprofit organization and external entities, implying sanctions or other forms of redress. Responsibility is a "felt sense of obligation," and responsible organizations respond to stakeholders' needs and views by "revising practices and enhancing performance as necessary."³

A sense of autonomy easily leads to a disregard for actively seeking input from stakeholders. Revealing a distressing lack of concern, "over 70 percent of nonprofit board members believed that they were accountable only to their board or to no one."⁴ Executive directors of *community-based* organizations in three low-income neighborhoods of Philadelphia defined the needs of their communities differently from the residents they served. "Nonprofit directors across neighborhoods held more similar views with each other than they did with residents of their own communities, even though the communities were quite different."⁵ Granted, this research was limited to one city, but there is no reason to believe that Philadelphia is unique.

Formally, nonprofits are answerable to state attorneys general and (if they are also tax-exempt) the U.S. Internal Revenue Service, but they ought to feel answerable to the people they serve and to the public as well. Nonprofit status, tax exemption, and deductibility of charitable contributions are legal artifacts—privileges granted by the public's elected

representatives to organizations run by law-abiding, personally disinterested, socially minded individuals performing socially desirable activities. Most nonprofit organizations may not discern the general public as a major actor, let alone the dominant one, yet it is the ultimate source of every privilege they enjoy.

Given generally weak public supervision, nonprofits aspiring to be ethical organizations must shoulder greater responsibility. It behooves all nonprofit organizations—but public charities particularly—to have a felt sense of obligation toward their constituents and toward the public.⁶ One can observe an organization's sense of obligation in its actions.

What Are the Markers of a Responsible Organization?

There are many ways to identify responsible organizations, but three are particularly relevant to nonprofits.

Marker 1: Responsible organizations are true to their missions. Nonprofits are increasingly relying more on earned income and less on donations and grants. Consequently, "missions of nonprofits engaged in commercial activities will grow more ambiguous through time. New demands on senior management to pay attention not only to nonprofit but to for-profit goals, the adoption of new structures such as joint ventures that create mixed missions and messages for participating entities, and the tendency of senior management to look at activities from the perspective of their contribution to revenues may create an environment in which nonprofits must work especially hard to keep their charitable mission in daily focus. Increased responsibility will likely fall on boards of directors of commercial nonprofits to ensure that a dilution of charitable mission does not occur."⁷

This is not to say that nonprofits should avoid commercial ventures or

changing their missions, but they should do so deliberately after a process of soul-searching that respects their stakeholders' interests. Nonprofits should keep this in mind: actions and methods that are acceptable in for-profit businesses may be grotesquely inappropriate for nonprofits to practice. Nonprofit hospitals across the country have recently come under heavy criticism for being overly aggressive in collecting debts from "charity" patients. Some of them even lost their property tax exemption as a result.

Marker 2: Responsible organizations act as if outcomes matter. Doing good requires doing the right thing, not just the easy thing. Feeding America (formerly America's Second Harvest), the preeminent food bank network in the United States, began as a way to channel surplus foodstuffs to hungry people. However, these items were typically nonperishable, which provided a diet that was high in carbohydrates and low in protein. As one of Feeding America's executives explained to me, the organization became concerned that it was not providing recipients with a balanced diet, so it began to supplement its gifts in kind with fruits, vegetables, and meats purchased in the open market.

Marker 3: Responsible organizations are candid. They do not wait for others to reveal suspected misbehavior. They police themselves, and they share the results of their investigations with the public. In 2004, Oxfam International responded to a tsunami in Indonesia but temporarily suspended its efforts when an internal audit uncovered "financial irregularities."⁸ Oxfam could have conducted further investigations without suspending aid to avoid raising questions, but it took the more responsible course.

By contrast, trustees of the J. Paul Getty Trust of Los Angeles, one of the

world's richest art institutions, appointed a committee to investigate charges of financial mismanagement and dealing in stolen antiquities ten months *after* critical newspaper stories first appeared, and then *only after* California's attorney general opened an investigation.⁹

Four Trends Already Shaping Future Ethical Standards for Nonprofits

Ethics is always evolving. What was acceptable behavior in one era may be discouraged—and even punished—in a later era.

Trend 1: Small donors will demand that charities pay the same deference to their wishes and expectations that these charities have always accorded large donors. Do you remember the unprecedented public generosity following the tragedies of September 11, 2001? Donors presumed that the receiving charities would use their money to provide relief for families of victims. Many of them became angry upon learning that half

of the donations to the American Red Cross went for “investments in volunteer mobilization, chapter development for response to weapons of mass destruction, expanded blood security, and continuity of operations efforts.”¹⁰ Three years later, Doctors Without Borders, responding to a tsunami that destroyed parts of Southeast Asia, set a new ethical standard when it ceased fundraising after only three days, once it determined that it had raised sufficient funds.¹¹

Trend 2: Courts will become less tolerant of sweeping generalizations and vaguely misleading statements made by charities in the course of fundraising. According to legal briefs, commercial solicitors working in Illinois for Telemarketing Associates told prospects that a “significant amount of each dollar donated would be paid over to VietNow,” a charitable veterans assistance organization. In fact, the contract provided only 15 percent for VietNow, which in turn spent only 3 percent of its \$1.1 million

share on charitable programs. The attorney general of Illinois prosecuted Telemarketing Associates for fraud (though not VietNow).¹² The case went all the way to the U.S. Supreme Court, which sent it back to the trial court for a hearing on the merits, whereupon the parties settled off the record.

It may not sound like much of a victory for honesty in fundraising, but be forewarned: deception may be fraudulent. It is certainly unethical.

Trend 3: “The nonprofit community in the United States (and increasingly elsewhere) has begun to shift its attention from measuring outputs as indicators of progress to measuring outcomes.”¹³ To continue with the disaster relief example: *outputs* are things like meals served, bottles of water distributed, etc., while *outcomes* are measured in terms of the well-being of victims. Outcomes might be the proportion of displaced persons whom the agency housed, fed, and assisted medically, or the average

we've got issues

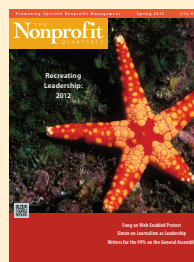
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length of time that people lived in shelters before finding permanent replacement housing.

Trend 4: More regulation. A minimal ethical standard is obedience to the law.¹⁴ The U.S. Senate Finance Committee recently considered—before rejecting—staff proposals requiring nonprofits to establish, approve, and review program objectives and performance measurements and report the results to the IRS on their 990 forms. But, because of the third trend above, the issue is unlikely to go away. The IRS is taking an increased interest in how nonprofits manage conflicts of interest. The Form 990 now includes a question about the existence of an organizational policy, and the Form 1023 (Application for Recognition of Exemption) has an appendix containing a sample policy. Since the IRS rarely does anything gratuitously, it seems likely that conflict-of-interest regulation will eventually find its way onto the public agenda.

Conclusion

In some ways, our financial models are a setup for irresponsibility because they often have us paid by one stakeholder to provide service to another. This interrupts the direct line of accountability between customer and provider. Nonprofit constituents often cannot vote a nonprofit leader out of office, nor can they necessarily stop using the service. Thus, nonprofits have a greater power advantage relative to the people they serve than for-profit businesses have relative to their customers—or than politicians, arguably, have vis-à-vis constituents.¹⁵ More and more often, however, perhaps aided by social media, stakeholders are realizing that they can protest unaccountability.

The Ethics Resource Center's report states, "An enterprise-wide cultural approach to organizational ethics creates

an environment in which ethical behavior occurs for reasons beyond deterrence and sanctioning by authority." A strong culture features four major components: (1) ethical leadership, (2) supervisor reinforcement of ethics, (3) peer commitment to ethics, and (4) embedded ethical values. Are you and your organization prepared for the integrity needed to survive?

NOTES

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3. Karine Levasseur and Susan D. Phillips, "Square Pegs in Round Holes: Vertical and Horizontal Accountability in Voluntary Sector Contracting," *The Philanthropist* 19, no. 3 (2005): 214, www.thephilanthropist.ca/philanthropist/index.php/phil/article/view/48/48.
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5. Rebecca J. Kissane and Jeff Gingerich, "Do You See What I See? Nonprofit and Resident Perceptions of Urban Neighborhood Problems," *Nonprofit and Voluntary Sector Quarterly* 33, no. 2 (June 2004): 38, nvs.sagepub.com/content/33/2/311.
6. Robert Gregory, "Accountability, Responsibility and Corruption: Managing the 'Public Production Process,'" in *The State under Contract*, ed. Jonathan Boston (Wellington,

New Zealand: Bridget Williams Books, 1995).

7. Howard Tuckman, personal communication, in Burton A. Weisbrod, "The Pitfalls of Profits," *Stanford Social Innovation Review* 2, no. 3 (Winter 2004): 44, www.ssireview.org/articles/entry/the_pitfalls_of_profits.
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11. Strom, "Nonprofit Groups Draw a Line at Some Donors," *The New York Times*, January 28, 2007, www.nytimes.com/2007/01/28/us/28charity.html.
12. *Madigan v. Telemarketing Associates, Inc.* 538 U.S. 600 (2003).
13. Alnoor Ebrahim, "Accountability Myopia: Losing Sight of Organizational Learning," *Nonprofit and Voluntary Sector Quarterly* 34, no. 1 (March 2005): 68, nvs.sagepub.com/content/34/1/56.
14. If a law is unjust, then a direct challenge would be in order, but self-serving disobedience never is.
15. O'Neill, "Ethical Dimensions of Nonprofit Administration," *Nonprofit Management & Leadership* 3, no. 2 (Winter 1992): 199–213, onlinelibrary.wiley.com/doi/10.1002/nml.4130030207/abstract.

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