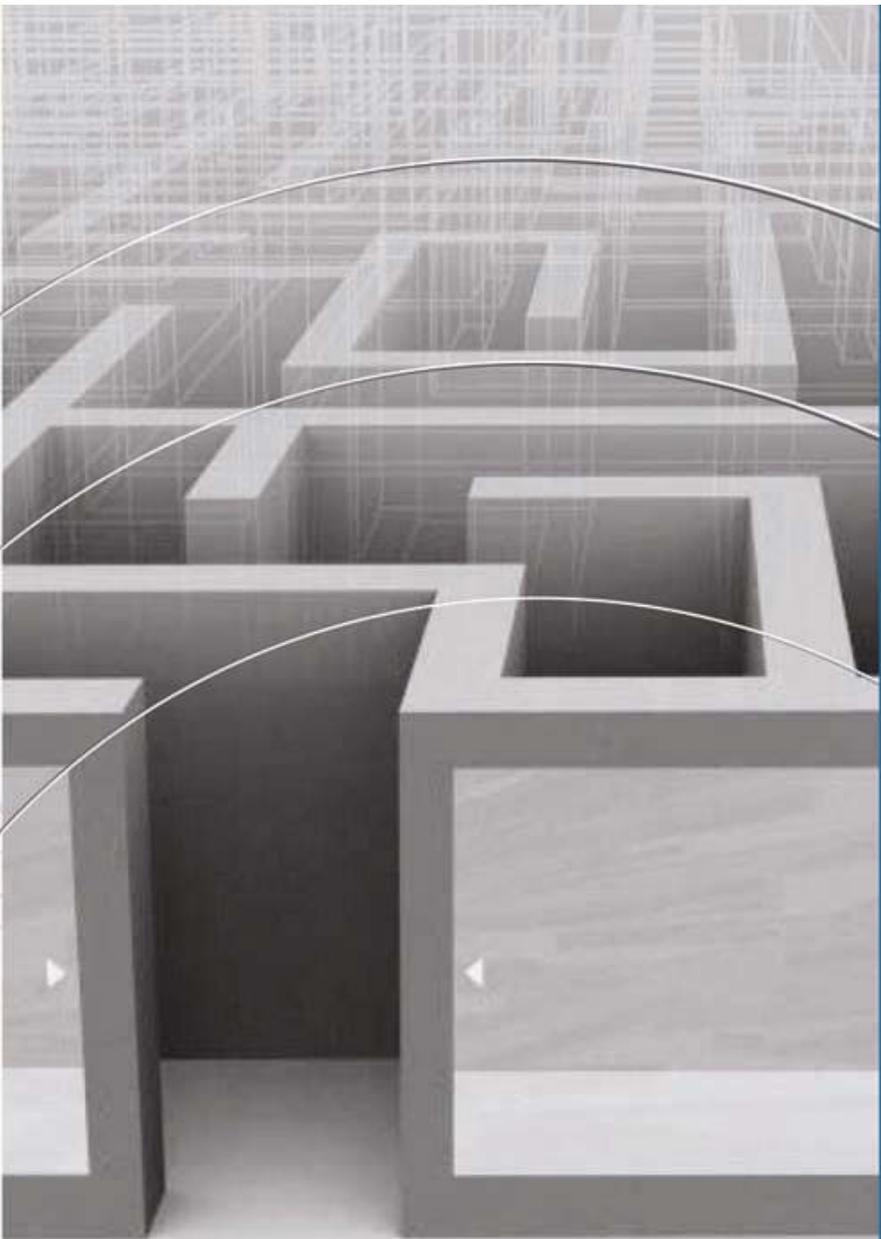




ORGIA CEN
NONPROF



BEING ACCOUNTABLE: Ethical Practices of Georgia Nonprofits

in the **Center** of it all

www.gcn.org



GEORGIA CENTER
for NONPROFITS

BEING ACCOUNTABLE: Ethical Practices of Georgia Nonprofits



© 2005 Georgia Center for Nonprofits. All Rights Reserved.
No part of this publication may be reproduced in any form, or stored in a database or retrieval system, or transmitted or distributed in any form by any means—electronic, mechanical photocopying, recording or otherwise—without prior permission of the Georgia Center for Nonprofits, except as permitted by the Copyright Act of 1976. The information and material contained in this book are provided “as is” without warranty of any kind—express or implied—including without limitation any warranty concerning accuracy, adequacy or completeness of such information or material or the results to be obtained from using such information or material. The Georgia Center for Nonprofits shall not be responsible for any claims attributable to errors, omissions or other inaccuracies in the information or material contained in this book. In no event shall the Georgia Center for Nonprofits be liable for direct, indirect, special, incidental or consequential damages arising out of the use of such information or material.

50 Hurt Plaza, S.E., Suite 845
Atlanta GA 30303
678-916-3000 or 800-959-5015
Fax: 404-521-0487
info@gcn.org | www.gcn.org

Table of Contents

	Page
Introduction	ii
Methodology	1
Key Findings	2
Mission and Program	3
Governance	4
Financial and Legal Operations	7
Openness and Public Affairs	9
Fund Raising	11
Conclusion	12

INTRODUCTION

The governance practices of publicly traded companies and the nonprofit sector – from Enron to the American Red Cross – have received intense global scrutiny in recent years. The demand for ethical, accountable behavior in public businesses is a necessity for both the well-being of global markets, and the individuals whom businesses employ. Accountable behavior is even more important for the nonprofit sector inasmuch as nonprofits are dependent upon public support for their livelihood. The ability of nonprofits to “incubate social innovations” and encourage “social critique” is diminished if all nonprofits “fail to operate in service of the goals they purport to represent.”¹ Failure to conduct ethical business practices dilutes public and private confidence in the importance of nonprofits to the community, and decreases support for the operations of all nonprofits.²

Nonprofits are vital to the communities that they serve. Maintaining ethical business practices ensures that nonprofits not only safeguard their public reputations, thereby preserving and cultivating the support needed to meet their social service goals, but also in order to continue assisting the communities that are often dependent upon them. Nonprofits are currently facing new obstacles – whether voluntary or imposed by government regulation – concerning their governance practices.

Recent hearings lead by Senator Charles Grassley (R-Iowa), chairman of the U.S. Senate Finance Committee, and Ranking Member Max Baucus (D-Montana), examined the need for nonprofit organizations to adopt financial and organizational accountability guidelines like to the 2002 American Competitiveness and Corporate Accountability Act (Sarbanes-Oxley), which dictates governance regulation for publicly traded companies.² Currently, voluntary accountability guidelines are being adopted by nonprofits nationwide, including the Georgia Center for Nonprofits’ *Georgia Standards for Excellence* (www.gcn.org), in anticipation of forthcoming federal regulation of the nonprofit sector.

While many believe that standardized regulation for nonprofit practices would benefit the sector, forced adoption of new governance regulations has inspired controversy. Many smaller nonprofits are concerned that they do not have the financial means to meet the expense associated with the requirements outlined in Sarbanes-Oxley.⁵ Requirements include, but are not limited to, the formation of auditing committees, certification of financial statements, disclosure and conflict of interest safeguards, the protection of whistleblowers, and the development of document destruction procedures.⁸

While there is some indication that implementation of the regulations suggested by Sarbanes-Oxley is not as expensive as previously assumed,⁸ a major issue for nonprofits is that, unlike publicly traded companies, nonprofits must address other concerns in addition to financial regulation. As Dana Brakman Reiser of the Brooklyn Law School points out, nonprofits must also uphold and safeguard the integrity of their mission statements and organizations, ensuring that they not only do what they say they will do, but that they operate in a way that adheres to nonprofit corporate law.⁷ Reiser suggests that in many ways Sarbanes-Oxley is too focused on financial responsibility, and does not take into account the varying ways in which nonprofits require special regulation in order to act ethically and be accountable in their practices.

Criticism of Sarbanes-Oxley aside, nonprofit organizations that have already adopted accountability guidelines and implemented changes to adhere to the law's regulations report positive outcomes, including increased support from donors.⁶ Some of the changes that nonprofits have implemented nationally include fund-raising overhead limits, increased frequency of board meetings, and stricter financial oversight.⁷

The encouraging experiences of nonprofits around the country suggest that the public feels more comfortable supporting nonprofits that safeguard against organizational fraud and are forthright about their social-service missions. Another benefit of voluntary adoption of accountability guidelines is that by doing so nonprofits can set precedence for nonprofit governance regulation, taking into account the differences between their needs and those of publicly traded companies.

The goal of voluntary adoption of ethical and accountability practices in nonprofit governance is not to cause the nonprofit sector hardship, but to safeguard the reputation of the nonprofit sector in a way that fosters the continuation of public support and confidence.

The following report is designed with two goals in mind: to inform Georgia's nonprofits of pressing issues pertaining to nonprofit governance and to assess the ethical practices of Georgia's nonprofits. It is our hope that this report will assist nonprofits across the state both in the evaluation of their ethical practices, and in a smooth structural transition if the choice is made to adopt standardized measures of governance and organizational responsibility.

Methodology

The information in this report was obtained from a survey designed to evaluate the following aspects of nonprofit governance: mission and programs, governing body, conflicts of interests, human resources, financial management and legal requirements, openness, fund raising, and public affairs and policy. The survey was created by researchers at Brandeis University, and disseminated to Georgia's nonprofits electronically in January 2005. Participation in the survey was voluntary and, overall, 482 nonprofit organizations from the state of Georgia participated.

In addition to Georgia, nonprofits from Maryland, North Carolina, Ohio and Pennsylvania also participated in this survey. Results from other states are not included in the present study.

The sample from which data for this report were derived is not representative, and results should not be generalized to the entire nonprofit sector.

Key Findings

When surveyed, over 76% of Georgia's nonprofit leaders stated that they feel Georgia's nonprofit sector would benefit by adopting a standard set of ethical practices. In addition, a majority of organizations surveyed felt that adopting and publicizing standards for ethical practice would improve the image of the nonprofit sector (71%), increase giving to nonprofit organizations (52%), and increase volunteerism for nonprofit organizations (49%). Interestingly, only 39% of organizations indicated that they would definitely adopt a set of standards if they were available to them.

These numbers suggest that there is some trepidation concerning how standardization of practices will impact the sector here in Georgia, in addition to what exactly standardization means. Advisory committees for nonprofits nationally have narrowed nonprofit standardization to include the following aspects:

- 1) Well-defined mission statements and programmatic activities designed to both adhere to and implement an organization's mission.
- 2) Detailed governance guidelines that dictate the activities of an organization's board members, the selection of board members, and human resource policies for both employees and volunteers
- 3) Financial and legal operations
- 4) Organizational openness concerning mission, programs, and finances; factual and honest public affairs and policy
- 5) Ethical fund-raising practices

The *Georgia Standards for Excellence* addresses all of the above, and even though only 14.5% of respondents surveyed for this report were aware of its creation, the majority of Georgia's nonprofits have safeguards in place to ensure ethical practices in each of the areas outlined. Areas for improvement are evident, and the following sections are summaries of the key findings concerning the ethical practices of Georgia's nonprofits in relation to the above. Data concerning practices are assessed according to the guiding principles in the *Standards for Excellence*.

Mission and Program

Standardization for mission and programmatic activities involves not only a clear, well-defined mission statement and program activities to support it, but also the periodic reassessment of an organization's mission and programs to ensure that they are still applicable to the organization's current activities. Over time, a nonprofit may find that its original mission is no longer appropriate in the context of current social trends, or that the mission has not evolved with the activities of the organization. In these cases, an organization would need to make changes accordingly. In addition, programmatic evaluations should always be in place to make certain that an organization is effectively fulfilling the function(s) needed concerning the mission, and that their operation is as fluid as possible.

- When surveyed, 97% of Georgia's nonprofits reported having a written mission statement, and a majority reported revising their mission at some point within the last eight years.
- As *Figure 1* shows, 52% percent of nonprofits surveyed currently have either some or all of their implemented services currently in place with no programmatic evaluation, while 42% reported a regular evaluation of all programs and services.

Does your organization regularly evaluate its program and services?

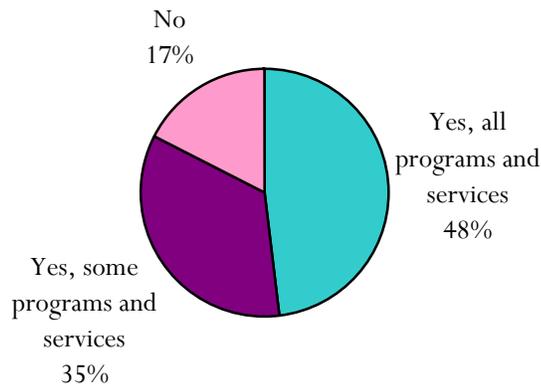


Figure 1

This data suggests that Georgia's nonprofits take great care in composing and evaluating mission statements.

Governance

Governance issues may be divided into several parts: 1) the governing body itself, 2) conflicts of interest, and 3) human resources. How a nonprofit manages each of these can make or break its reputation.

- 64.1% of nonprofits reported term limits for their board members, but 36.1% reported that the service of their board members was not limited by term.
- Of the nonprofits who did report term limits, 46% reported a standard term limit to be 3 years, 26.4% reported 2 years, 5.8% reported 1 year term limits, and 16.1% reported a term limit of 4 years or more.
- 97.2% of nonprofits reported that their boards record and distribute minutes from their board meetings.
- 38.7% of boards meet 4 or fewer times a year, while 58.8% meet 5 times or more a year.
- 0.7% of nonprofits reported both compensation and expense reimbursement for the service of its board members, while 18.4% reported expense reimbursement only, and 76% reported that they do not compensate board members at all.
- 81.1% of Georgia's nonprofits have their organizational budget approved by their full board, but 12.5% reported that their budget is not approved by the full board.

The *Standards for Excellence* suggests the following guidelines for nonprofit boards:

- Board service should include term limits
- Board members must record and distribute minutes from all board meetings
- Boards must meet *at least* four times a year
- Board members must serve without compensation except in the instance of expense reimbursement
- Boards must approve the organization's annual budget.

In addition, the standards recommends that boards of directors in a number of other activities.

Figure II shows how involved Georgia's nonprofits are in other activities recommended in standards.

Figure II: Level of board involvement in the following activities:

Activity	Level of Involvement				
	None	Very Low	Low	High	Very High
Determining and reviewing the mission of organization	4%	5%	9%	42%	40%
Determining whether the organization is achieving its mission	2%	4%	13%	50%	31%
Reviewing the executive director's performance and setting his or her compensation level	9%	5%	12%	31%	43%
Enforcing a written conflict of interest policy related to board members	17%	9%	22%	35%	16%
Developing a strategic plan or strategic goals for the organization	3%	4%	13%	41%	39%
Determining how to invest the reserves of the organization	15%	9%	15%	33%	28%
Establishing the organization's fund-raising strategy	5%	8%	26%	42%	18%
Seeking funds on behalf of the organization	4%	10%	33%	38%	15%
Reviewing the organization's financial performance	2%	3%	12%	48%	35%
Selecting candidates for nomination to the board	2%	4%	13%	43%	38%
Setting personnel policy	14%	16%	31%	27%	12%

More than half of all nonprofit boards in the state have “high” or “very high” involvement in all recommended activities except “setting personal policy.”

Of note, however, is that 48% of Georgia’s nonprofit boards have either no or low involvement when it comes to enforcing written conflict of interest policies for board members. Enforcement of policies safeguarding against possible board conflicts is of special interest to the would-be regulators of nonprofits. Voluntary improvement of this area pending legislation would be a positive improvement.

In addition, the low level of the boards’ involvement in personnel and human resource activities, as indicated in the study should also be addressed by nonprofits attempting to standardize operations. Sarbanes-Oxley’s focus on personnel issues primarily regards whistle-blower protections, but the *Standards* and other nonprofit evaluation programs suggest that nonprofits should have written personnel policies and procedures, along with employee orientations and performance evaluations, in place as part of the organization’s human resource operations.

- 51.7% of Georgia’s nonprofits surveyed have both an employee handbook and written personnel policies, 41.8% have only one or the other, and 15.8% do not have either.
- 75.1% of organizations surveyed reported that they regularly evaluate their employees in writing.

Financial and Legal Operations

Since most scandal in the nonprofit sector has involved either misappropriation or mishandling of funds,⁹ forthcoming regulations are most likely to be concerned with the financial and legal operations of nonprofits. The information below shows current practices regarding the financial accountability and legal compliance of Georgia nonprofits.

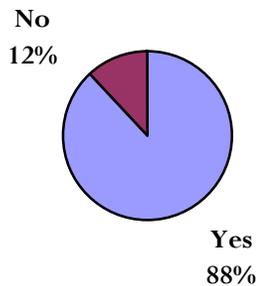
Figure III shows the percentage of organizations that have written policies covering varying categories.

Figure III: Written financial policies		
	Yes	No
Asset investments	55%	45%
Internal control procedures	78%	22%
Purchasing practices	67%	33%
Unrestricted current net assets or “reserve funds”	61%	39%

The categories in Figure III are areas that, according to the *Standards*, nonprofits should maintain written financial policies on, relative to the size and intricacy of the organizations. The majority of nonprofits in Georgia maintain written policies on each of the outlined measures, while a substantial number of nonprofits surveyed indicated that they do not.

Figure IV represents the percentage of Georgia’s nonprofits that have their financial reports annually audited by a certified public accountant.

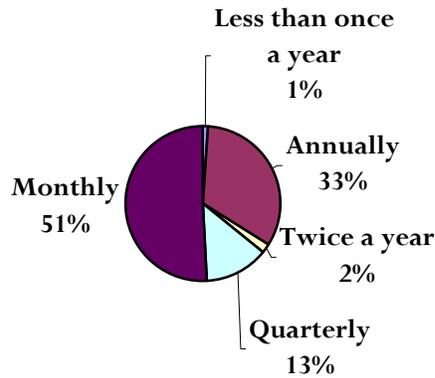
Figure IV: Percentage of nonprofits surveyed that have a certified public accountant audit their financial reports annually.



The *Standards for Excellence* suggests that all organizations with annual revenue exceeding \$300,000 subject their annual financial reports to audit by a certified public accountant. Most of Georgia’s nonprofit organizations meet this requirement.

Figure V represents how often Georgia's nonprofits prepare their financial statements.

Figure V: How often Georgia's nonprofits review their financial statements



The *Standards for Excellence* suggests that nonprofits should prepare internal financial statements on at least a quarterly basis. Our data indicate that while 64% of Georgia's nonprofits prepare internal financial statements at least quarterly (if not monthly), 36% do so only twice a year or annually.

According to the report “**Sarbanes-Oxley and implications for the nonprofit sector,**” written by *Independent Sector* and *BoardSource*, Sarbanes-Oxley requires that members of an organization’s auditing committee serve on the board of directors and be “independent,” that is, serving without compensation and not a part of the company’s management team. Moreover, board members serving on the auditing committee should not be members of the board’s financial committee. The implication for nonprofits is that their boards must include individuals with financial and auditing know-how to serve these committees. The report points out that this may be difficult for nonprofit boards traditionally composed of volunteers. The report suggests that nonprofits with annual budgets of over \$500,000 (the *Standards for Excellence* suggests \$300,000) comply with the Sarbanes-Oxley requirements, while smaller nonprofits that cannot recruit as many board members to fill the committee requirements have their financial audits reviewed or compiled by a professional accountant.¹⁰

Openness and Public Affairs

Nonprofits, and specifically nonprofit boards, are fiduciaries for the funds they use to impact causes. The word “fiduciary” means, “to hold in trust.” Therefore, transparency in financial and operational matters is paramount – execute fiduciary duties and to maintain the public’s trust. Because nonprofits serve the public’s interest, they should strive to be transparent about the quality and state of their operations.

The *Standards* recommends that nonprofits meet criteria for openness by preparing and publishing annual reports with financial data and/or the yearly audit and by being accessible and responsible to the public’s interest in the affairs of the organization.

Both figures IV and IIV indicate that the majority of the state’s nonprofits comply with this recommendation.

Figure IV: Percentage of nonprofits in Georgia that publish an annual report

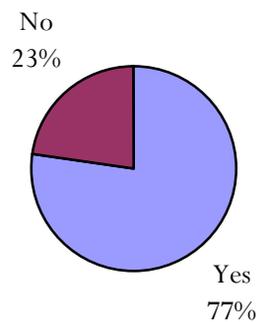
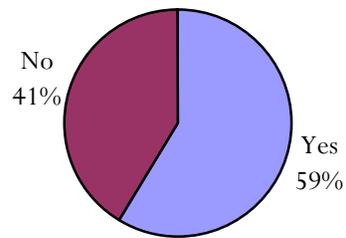


Figure IIV: Percentage of nonprofits in Georgia that regularly publish their financial statements



The *Standards* also recommends that nonprofits provide the public with information on its mission and program activities; this report, however, does not show whether organizations are meeting this requirement.

- Openness extends to factual and honest reports concerning public affairs and policy. It is recommended that nonprofits guarantee they are allocating funds and performing the services they advertise and in the manner they advertise.
- Keep in mind that data concerning the experiences of nonprofit organizations around the country suggests having an openness policy concerning finances and operational activities may help a nonprofit increase its public support. ¹⁴

Fund Raising

Fund-raising practices, along with financial accountability practices, are among the most scrutinized functions in the nonprofit sector. The figures below give some indication of Georgia's nonprofit fund-raising practices.

- 95% of respondents reported that they do not sell or otherwise allow others to view their list of donors.
- When asked if donors have the opportunity to have their names removed from mailing lists that are sold, exchanged or rented, 85% of respondents said "yes," while only 15% said "no."
- Only 27% of organizations surveyed indicated that they employ or contract with external fund raisers and/or development professionals to assist with fund-raising efforts. Of these, 53% check to make sure that the contracted fund raisers are properly registered with the secretary of state's office.

The above suggests that Georgia's nonprofits rely heavily on their own staff and board to conduct fund raising, and that donor privacy is not only valued but maintained.

Conclusion

The majority of Georgia's nonprofits are safeguarding their practices to ensure ethical and accountable behavior, however, based on assessment of the current political climate surrounding the sector and the findings from this study, we suggest that Georgia's nonprofits perform evaluations on the following:

- a) Programmatic activity
- b) Specifications for board responsibilities, conduct, and activities
- c) Grievance policies and whistle-blower protections
- d) Written personnel policies
- e) Financial and legal operations that comply with current local, state and federal law
- f) Dissemination of information to the public concerning compliance

A proactive approach to revamping the perception of nonprofit governance will go a long way in safeguarding the reputation of nonprofits and allowing organizations to continue their service of the community.

Notes

- ¹Anft, Michael and Grant Williams. 2004. "Redefining Good Governance" *The Chronicle of Philanthropy* (9 pages). Retrieved March 15, 2005. (<http://philanthropy.com>)
- ²"New Report Offers Nonprofits Guidance on the Sarbanes-Oxley Act," 2004. Independent Sector. Retrieved March 1, 2004. (<http://independentsector.org>)
- ³Reiser, Dana Brakman. 2004. *Enron.org: Why Sarbanes-Oxley Will Not Ensure Comprehensive Nonprofit Accountability*. Brooklyn Law School Public Law and Legal Research Paper Series. Paper No. 6, March 2004.
- ⁴Reiser
- ⁵Anft, Mihael and Grant Williams. 2004. "Internal Controls System May Prove Costly" *The Chronicle of Philanthropy* (5 pages). Retrieved March 15, 2005. (<http://philanthropy.com>)
- ⁶Silverman, Rachel Emma. 2004. "Charities Start to Engage Themselves" *The Wall Street Journal Online* (4 pages). Retrieved March 15, 2005. (<http://online.wsj.com>)
- ⁷Silverman
- ⁸"The Sarbanes-Oxley Law: Key Requirements," 2004. *The Chronicle of Philanthropy* (4 pages). Retrieved March 15, 2005. (<http://philanthropy.com>)
- ⁹Femont-Smith, Marion R. 2003. "Wrongdoing by Officers and Directors of Charities: A Survey of Press Reports 1995-2002" The Hauser Center for Nonprofit Organizations. The Kennedy School of Government at Harvard University, Working Paper No. 20. *Social Science Research Network Electronic Paper Collection* (26 pages). Retrieved March 21, 2005. (<http://ssrn.com>)
- ¹⁰"Sarbanes-Oxley and implications for the nonprofit sector," 2003. *BoardSource and Independent Sector* (11 pages). Retrieved April 1, 2005. (<http://www.boardsource.org>)
- ¹¹"Sarbanes-Oxley and implications for the nonprofit sector"
- ¹²"The Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector," 2004. Georgia Center for Nonprofits and Maryland Association of Nonprofit Organizations. Retrieved April 20, 2005. (<http://www.gcn.org>)
- ¹³Phillips, Michael M. 2005. "Big Charities Pursue Certification to Quell Fears of Funding Abuse," *The Wall Street Journal Online* (4 pages). Retrieved March 9, 2005. (<http://online.wsj.com>)
- ¹⁴Silverman