


Public Integrity &gt;

Volume 21, 2019 - Issue 1

 Free access

838 Views | 11 CrossRef citations to date | 15 Altmetric

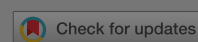
Listen

Articles

# Malfeasance in the Charitable Sector: Determinants of “Soft” Corruption at Nonprofit Organizations

Mark Steven LeClair 

Pages 54-68 | Published online: 01 Mar 2018

 Cite this article  <https://doi.org/10.1080/10999922.2017.1422310> Full Article Figures & data References Citations Metrics Reprints & Permissions View PDF View EPUB

## Abstract

Formulae display:  MathJax 

The causes and effects of organizational corruption have been widely examined in the literature, including malfeasance that is specific to nonprofits organizations. This article draws a distinction between outright (illegal) and “soft” corruption—the latter referring to the continued and deliberate misuse of donated funds to benefit officers of the nonprofit, with little (in some instances less than 5%) going to the nonprofit’s supposed cause. Studies of malfeasance in charities have found that approximately 450 range from 1% to 10% of total revenue is used for officer salaries and other expenses. Ultimately, the continued and deliberate misuse of donated funds to benefit officers of the nonprofit, with little (in some instances less than 5%) going to the nonprofit’s supposed cause, is a form of corruption. This article examines the determinants of “soft” corruption at nonprofit organizations and the requirements for preventing it.

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All


Essential Only

Settings

The economics and pathologies of corrupt organizations have been extensively scrutinized beginning with seminal work by Banfield ([1975](#)), Rose-Ackerman ([1975](#)), and Sherman ([1980](#)). Initially, attention was focused on the general topic of organizational corruption, but more recent work has addressed malfeasance at specific types of institution (e.g., educational establishments). In addition to descriptive work, some scholars have addressed the means by which—through either increased oversight or transformed managerial arrangements—corruption can be addressed.

More recent work on corruption, its causes and consequences, can be found in Jain ([2001](#)) and Aidt ([2003](#)). Organizational malfeasance has been examined by Vardi and Wiener ([1996](#)), Luo ([2004](#)), Baucus and Beck-Dudley ([2005](#)), and Pinto, Leana, and Pil ([2008](#)), while corrupt practices in the corporate sector were detailed by Baucus ([1994](#)), and Anand, Ashforth, and Joshi ([2004](#)). In addition, governmental corruption was analyzed by Banfield ([1975](#)) and Rose-Ackerman ([2005](#)). Baucus and Near ([1991](#)) and Steinberg ([2010](#)) focus on corporate governance and its relationship to ethical lapses.

Nonprofits are deemed to fulfill a special role in the economy. Given the goals of the charitable sector, it might be assumed that self-interested individuals would choose careers elsewhere, but malfeasance at nonprofits is surprisingly common. Works by Fremont-Smith ([2004](#)), Fremont-Smith and Kosaras ([2003](#)), Gibelman and Gelman ([2001](#)), Archambeault, Webber, and Greenlee ([2014](#)), Rhoades and Packel ([2009](#)), Holfreter ([2008](#)), and Greenlee, Fischer, Gordon, and Keating ([2007](#)) have all examined corruption and fraud at charities and nongovernmental organizations. Tangentially,



### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

This article will examine the underlying causes of corruption at nonprofit institutions, arguing that differences in stakeholder relationships, notably in comparison to organizations such as private businesses, make such behavior possible. As a rule, malfeasance in the corporate sector is checked either through legal means (threat of prosecution), or by instituting control mechanisms that prevent managers from acting against interested parties. In order for such controls to work, however, stakeholders must be aware of transgressions (a feedback loop)—a situation that does not usually prevail in the nonprofit sector. Small, intermittent donors to charitable organizations are not only unlikely to demand an accounting of how their donations were spent, but the charity would, in all probability, be unable to detail the impact of any specific donation. This results in an agency problem, where contributors surrender control of their donations to nonprofit managers, potentially leading to either a redirection to a cause that is more in line with the managers' wishes, or misuse of the contribution (see Jegers, [2009](#)) for an overview of the literature on agency problems at nonprofits).

## Corruption or Simply Misbehavior

Some actions on the part of charitable organizations can be seen as simple misbehavior, such as making inappropriate use of their donations (at least in the eyes of benefactors). While this form of malfeasance violates the trust of the contributor, it does not involve personal gain. In the flurry of donations after the September 11 terrorist attacks, the American Red Cross was flooded with contributions that, in the view of the organization, outstripped any reasonable need. According to critics of the Red Cross, the "excess" donations were used for other purposes deemed more pressing. More generally, those that give to a cause through a bequest surrender control over how the assets are put to use, and little recourse exists even if the funds are redirected to a cause that may have little to do with the interests of the benefactor, unless the donor's decedents somehow intervene. The overall effect of misdirected use of funds may discourage donors, and may discourage particular charity. Behavior that misuses funds for conduct (donor) not

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings



and salaries rather than risk the commission of an actual crime (e.g., America's Worst Charities [<http://www.tampabay.com/topics/specials/worst-charities>], annual report by the Tampa Bay Times). In this context, the commission of actual criminal activity seems both unnecessary and potentially self-harming. This circumstance will be referred to as "soft corruption": practices that are unethical but not prosecutable—the characteristics of rogue, not unlawful, charities, those that collect donations but give little or nothing to any cause. It has been argued that high fund-raising expenses can represent a charity that is innovative, with a strong vision and significant accomplishments. The criteria that will be used to define "soft corruption" are a failure on seven financial measures that overall indicate the performance of an organization.

This approach is not without controversy. While the National Charities Information Bureau and the American Institute of Philanthropy both set minimum threshold levels for program expenses—a minimum of 50% at the NCIB and 60% at AIP—these standards have been questioned by others who evaluate charitable performance. Weber ([1994](#)) argues that fundraising efficiency is best utilized when comparing the performance of like organizations. Conversely, Hager, Pollak, and Rooney ([2001](#)) note that controlling for group-specific characteristics explain only a minor part of the differences in fund-raising efficiency. McLean and Coffman ([2004](#)) in "Why Ratios Are Not the Last Word" assert that program expenses should only be used in the context of other financial variables, and provide a side-by-side comparison of two hypothetical charities—one that would be deemed more effective based on financials, but less impactful based on outcomes. Charity watchdogs such as Charity Navigator and CharityWatch also caution against uncritical use of financial ratios. Batts ([2013](#)) argues that the calculation of financial ratios at nonprofits is a form of "voodoo" and should not be the only basis for evaluating charities. Batt instead argues for outcome evaluation: is the charity doing what it promised to its donors? Similarly, Larkin ([2013](#)) argues that outcome measures are more appropriate than financial measures.

#### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only


Settings



# REGULATORY CONSTRAINTS ON MALFEASANCE AT NONPROFITS

The regulatory environment within which charitable organizations operate includes multiple levels of oversight, but (in practice) ineffective disclosure requirements. Charitable nonprofits must maintain their 501(c)(3) standing with the Internal Revenue Service in order to solicit tax-deductible contributions. When charities are determined to be wholly corrupt organizations, legal action is taken by states’ attorneys general under fraud statutes. At the national level, The Federal Trade Commission (FTC) can file civil actions against sham charities when it concludes they are little more than money-churning entities for their managers (In May 2015, for example, the FTC accused four cancer charities of collecting nearly \$185 million in donations and channeling little, if any, of the money to appropriate causes). Some individual states impose disclosure requirements on nonprofits, mandating that organizations that reach a threshold size (which varies by state) release audited financials. The Urban Institute’s Center on Nonprofits and Philanthropy provides a complete breakdown of the differing requirements by state (Lott, Boris, Goldman, Johns, Gaddy, & Farrell, [2016](#)). Requiring release of Form 990 would duplicate current federal law.

The problem with these forms of oversight is that, until malfeasance reaches some threshold, a nonprofit can continue to operate. The four cancer charities closed by the FTC (noted above) had operated and received donations for years. Disclosure requirements assume that contributors will take advantage of the now public information; difficult to believe given the number of charities that have recently come under scrutiny for misuse of donated funds. Authors such as Britton ([2007](#)) argue that disclosure requirements could be made to work if government granting agencies were



**About Cookies On This Site**

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

unwarranted) expansion of federal authority over an area that is now regulated by the states. Neely ([2011](#)) examines the impact of Sarbanes-Oxley-style enforcement at the state level, detailing California’s Nonprofit Integrity Act of 2004. Ebrahim ([2011](#)) notes that various forms of nonprofit accountability exist, and none of them are appropriate for all organizations.

## Nongovernmental Oversight

The most obvious form of oversight at charities is the presence of an independent voting board (IVB) that provides general guidance on the scope and aims of the organization and monitors the entity’s financial integrity (see Miller, [2002](#), [2007](#) for a critical evaluation). In the context of nonprofit management, an IVB refers to individuals who did not receive compensation from the nonprofit as an officer or employee and did not conduct any transaction with the organization that must be reported on IRS Schedule L, Transactions with Interested Persons. Hodge and Piccolo ([2011](#)) provide details on effective board management and the financial stability of a nonprofit. Yetman and Yetman ([2012](#)) examine how the level of effectiveness of a nonprofit’s board affects the accuracy of its expense reporting. Boozang ([2007](#)) argues that nonprofit boards may be excessively concerned with compliance and lose focus on the effectiveness of a charity’s activities. Conducting an independent audit provides another level of accountability, particularly if the results of the audit are included on the nonprofits’ 990 form. For many small nonprofits, the cost of an independent audit may be prohibitive. Prakash and Gugerty ([2010](#)) argue that nonprofits that voluntarily agree to additional regulatory controls can utilize their participation in such programs as a means to differentiate themselves from organizations that eschew added oversight. Finally, Williams and Taylor ([2013](#)) argue for a holistic form of accountability that takes into account the numerous stakeholders that have an interest in effective leadership at nonprofits.

About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

seven financial criteria, including having excessive fundraising and management expenses. Currently, Charity Navigator ranks approximately 8,200 nonprofits.

Although these rating bodies provide another level of oversight, it is still up to donors to make the effort to investigate before giving. As argued earlier, the lack of a feedback loop that informs donors about how (and how well) their donations are utilized is missing. Thus, the charitable sector remains a “donor beware” environment.

## COMPARISONS OF HARD AND SOFT CORRUPTION

The term “hard corruption” will be used to refer to organizations that have committed outright fraud that ultimately led to a criminal prosecution. It is widely recognized that not-for-profits might “adjust” their Form 990 s so as to enhance their attractiveness to potential donors (note that Froelich, Knoepfle, and Pollak ([2000](#)) found no systematic manipulation of figures on Form 990 s for those nonprofits that conduct an independent audit). Yet, hard corruption involves the deliberate misuse, for personal gain, of donations intended for a philanthropic cause. The illustrations below are meant to differentiate this form of criminal behavior from cases of “soft” corruption.

Not all instances of hard corruption at nonprofit organizations are widely publicized. CharityWatch, however, provides a list of the most egregious examples of illegal activity on the part of nonprofits (CharityWatch Hall of Shame [<https://www.charitywatch.org/charitywatch-articles/charitywatch-hall-of-shame/63>]). The scandal involving William Aramony, who led United Way from 1970 to 1992, is perhaps the most widely known example of malfeasance. Aramony was charged with misappropriation of donated funds and filing false tax returns. He was also found to have siphoned off funds to acquire apartments in New York and Miami, and to have utilized (Aramony was sent to prison for 18 months in 1994, the United States Department of Justice announced that Aramony had resigned the position of CEO of United Way in 1992). Angelina Jolie and Brad Pitt's 2004 adoption of two children from Cambodia was also a controversial move. In this article

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings





individuals. The indictment charged the Wingos both with siphoning off donated funds and with paying (criminally) excessive salaries. Ultimately, both Wesley and Andrew Wingo received seven-year prison terms (Linda Wingo received a suspended five-year sentence).

The charitable sector is capable of innovation when it comes to crafting new corrupt practices. The Foundation for New Era Philanthropy, founded by John Bennett, Jr., promised nonprofits a simple means of doubling their contributions. The charity deposited a large sum of money with New Era—after a period of time the money was matched by an anonymous donor with similar interests and returned. In reality, New Era was simply a Ponzi scheme, with new deposits being used to match old deposits (for a description of the structure of Ponzi Schemes, see Jory & Perry, [2011](#)). When Bennett could no longer cover the inevitable shortfalls, he turned to borrowing money, eventually accumulating \$50 million in unpayable loans. After being exposed in the press in 1995, Bennett was charged with 82 counts of bank/wire fraud and money laundering and sentenced to 12 years in prison in 1998. At the time of his indictment, he finally confessed that no anonymous donors ever existed.

The United States Navy Veterans Association (USNVA) was a wholly corrupt organization started and managed by John Donald Cody (aka “Bobby Thompson”). The USNVA collected nearly \$100 million over a ten-year period ostensibly to assist veterans. Although the organization claimed over 60,000 members, it actually was run entirely by Cody out of a duplex in Florida, and no evidence exists that the organization ever assisted any veterans. In 2010, questions were raised about the “charity” and Cody fled the state to avoid prosecution. He was captured in Oregon by federal marshals in 2013 and eventually convicted of 23 counts of theft, money laundering, and record tampering. At the conclusion of his trial, Cody was sentenced to 28 years in prison.

Other major examples of corruption in the nonprofit sector include the American Red Cross (1989), Feed the Children (2000), the American Hospital Association (2000), and the National Endowment for the Arts (2000). These last three examples are discussed in more detail in the next section. Examining the Times published the Worst Charities in America (2002) give



### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings




are frequently in the 80–90% range, indicating that these organizations are simply “mills” for generating contributions, with little or no interest in pursuing their supposed philanthropic interest. Causes “supported” by these charities are predictable—focusing on those that will elicit a strong response from potential donors: Firefighters and police (14), treating or preventing cancer (10), children’s causes (8), and support for veterans (5). The prevalence of these organizations in the philanthropic sector reflects the ease by which sham nonprofits can be formed and successfully operated within the existing legal framework. It then falls upon donors to seek out further information on charities before giving. It should be noted that New York’s Attorney General issues a generalized report (“Pennies for Charities”) that describes charitable solicitation practices that result in a high proportion of donations to fundraising, rather than the identified cause of nonprofits.

As noted above, Charity Navigator (CN) also provides assessments of nonprofits. Evaluations of each charity include a financial, transparency and overall ranking. Poor performance in one criteria (e.g., financials) can be somewhat offset by better performance in the other (transparency), and charities receive an overall ranking (0–4 stars) that reflects CN’s assessment. Nonprofits receiving “0 star” rankings generally represent entities with both poor transparency and fundraising or compensation costs that consume most of what is donated to the organization. The effectiveness of charity oversight by organizations such as CharityWatch and Charity Navigator has been examined by authors such as Cnaan, Jones, Dickin, and Salomon ([2011](#)), who question the usefulness of ratings services when they are used by few donors. Additionally, Rao ([1998](#)) argues that political leanings may tamper with the accuracy of consumer ratings of organizations in general.

MODELS

The model  
([2003](#)).  
chari  
utilize  
that hav  
the auth



### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

and Trussel  
predict which  
author  
se nonprofits  
Notably,

Conversely, the work presented here will label as “soft corrupt” those organizations that achieve a zero-star financial rating from Charity Navigator—a score that represents poor performance on seven financial indicators. Trussel’s approach eliminates the need to accept self-reported financials. The only limitation to his methodology is there is no means to differentiate between those nonprofits that are actually misrepresenting their financials from those that simply appear to be.

A test of the determinants of soft corruption will be presented here. An empirical model using cross-sectional data on 450 charitable organizations (drawn from the over 8,000 nonprofits evaluated by Charity Navigator using a random number generator) will examine the relative importance of the presumed underpinnings of malfeasance. All charities that receive a zero-star ranking for financials will be included in the sample. The financial ranking is comprised of seven specific criteria that measure both whether donations are put to good use (e.g., Fundraising Expense Ratio) and the viability of the organization (Working Capital Ratio). Additional factors include administrative expenses (percentage), program expenses (percentage), fundraising efficiency, program expense growth, and liabilities to asset ratio.

Although there might be some disagreement about how one would define “soft” corruption, those charities receiving a zero-star financial ranking donate little or nothing to their prescribed causes. Neither the overall ranking nor the accountability and transparency ratings are appropriate, as this would create a problem with bi-causality, as some of the factors that will be used as explanatory variables (e.g., whether the organization conducts an independent audit) partially establish both a charity’s transparency score, and thus its overall ranking.

Although Charity Navigator provides, by far, the most comprehensive database of charitable organizations, some limitations should be noted. It does not rank hospitals, schools, or other health care facilities, which limits the applicability of the findings. The data is self-reported and may not fully reflect the reality of the organizations. The data is not fully reported and may not be significant or accurate. A significant portion of the data is self-reported and may not be significant or accurate. A significant portion of the data is self-reported and may not be significant or accurate.

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All


Essential Only

Settings

charities, high fundraising outlays are a necessary part of establishing the reputation of a new organization. It will not be argued here that “excessive” fundraising expenses are the only indicator of a poorly run organization, but simply part of what is utilized to evaluate performance. Perhaps the most significant drawback to using CN’s designation is the “black box” nature of the rankings. The seven criteria that are utilized to establish a financial ranking are available, and a diligent individual could extract a ranking from those measures, but the precise rubric used to establish a rating is still somewhat of an unknown (see <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=48> for a description of the procedures used by Charity Navigator).

An additional limitation of the Charity Navigator dataset is that much of the data is self-reported, suggesting that charities that are poor performers might exaggerate financials (e.g., program expenses/total expenses) to improve their ranking within CN’s rubric. This is an inherent imperfection in the procedure used to label zero-star charities. This would suggest, however, that these organizations are even worse than reported, still placing them in the category of soft corruption. In addition, CN utilized seven criteria to establish a financial ranking, not just the figure spent on programs. The concern here, in the end, might be with one-star charities that have misreported their financials, and should have been dropped into the zero-star category, a fruitful topic for future research.

Previous work on nonprofit corruption has focused on hard corruption; those organizations where civil or criminal wrongdoing was committed and announced in the press. Unfortunately, this is an unknown when one examines a database of charitable organizations since, given the number of instances of corruption revealed each year, it is certain that additional cases of fraud are present but simply have not yet been exposed. As argued earlier, nonprofits that receive a zero-star financial ranking (soft



### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

nonprofits in this category earned the lowest financial ranking. For charities in the Health subsector, 1.5% of all organizations are zero-ranked. This variation across categories will be incorporated into the estimation.

TABLE 1 Zero-Star (financial) Charities, Number and as a Proportion of Total by Category



Download CSV   Display Table

Variables

Corruption in the nonprofit sector can be partly attributed to agency problems. Smaller donors expect neither a return nor donor-specific accountability, enabling charitable organizations to misuse funds without immediate consequences. Hence, one of the primary determinants of potential malfeasance is the degree of oversight under which the organization operates, and whether the details of that oversight are released to the public. Those organizations that maintain an independent voting board and release the names of those board members (`indboardi`) are less likely to violate donors’ intentions (consistent with cited work by Boozang, [2007](#); Hodge & Piccolo, [2011](#); Miller, [2002](#)). Nonprofits that accept government grants (`govti`) assume an additional level of oversight, and one that carries potential legal peril for misconduct. Likewise, charitable organizations that conduct and release the results of an independent audit (`auditi`) are, in most instances, voluntarily imposing an added external control (follows work by Britton, [2007](#); Froelich, et al., [2000](#) on disclosure). State-specific disclosure requirements (`statei`) are presumed to deter corruption, with the probability of malfeasance higher in those states with lax reporting obligations, addressing the work by Neely ([2011](#)) and Lott et al. ([2016](#)). (For a comprehensive look at state regulations affecting charities, see State Regulation and Enforcement in the Charitable Sector

About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

✕

Accept All

Essential Only

Settings

One of the potential “truisms” of misbehavior in the nonprofit sector is the idea that it is confined to smaller, less visible, organizations. The annual expenditures (expend<sub>i</sub>), labeled “total functional expenses” in the vernacular of Charity Navigator, will be used as a measure of size. One might also assume that this form of malfeasance is more likely in upstart, rather than established, charities. Hence, the age (age<sub>i</sub>) of the institution will be incorporated into the sample. Finally, it is possible that malfeasance is more common in certain subsectors (different giving categories) of the nonprofit universe. Binary variables (categ<sub>i, j</sub>) will be used to determine if significant variation is present in the sample across categories of giving. As utilization of binary variables is confined to  $n - 1$  cases (to avoid overspecification), preliminary testing was employed to determine within which subsectors malfeasance was more likely. Binary variables were included for “Animals,” “Health,” “Human Services,” and “Religion.”

Prior work on nonprofit corruption (e.g., Greenlee et al., [2007](#)) has focused on the magnitude of corruption and its determinants, attributing the scale of malfeasance to the compensation, tenure, and gender of perpetrators. It is unclear whether these influences would impact the decision to engage in soft corruption. In addition, as this form of misbehavior is frequently characterized by excess salaries, bi-causality is an issue. Hence, these additional factors will be omitted from the estimation. As noted above, Trussel ([2003](#)) used accounting variables to predict which nonprofits were likely to be misrepresenting their finances. In this estimation, however, the zero-ranked charities achieved that distinction as a result of financial variables. Utilization in an estimation would make the explanatory variables a function of the dependent variable (bicausality), For an additional evaluation of which numbers matter in evaluating the strength/effectiveness of a charity, see Ritchie and Kolodinsky ([2003](#)).

In summary, the probability that a particular nonprofit receives a zero financial ranking (rank<sub>i</sub>) from Charity Navigator will be established as a function of oversight (indboard<sub>i</sub>,

#### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings



(1)

where:  $\text{rank}_i = 1$  for 0-star (financial) charities, 0 otherwise

$\text{age}_i$  = Age of the nonprofit

$\text{indboard}_i = 1$  for charities with named independent boards, 0 otherwise

$\text{audit}_i = 1$  for organizations that release an annual audit, 0 otherwise

$\text{govt}_i = 1$  for nonprofits with partial government funding, 0 otherwise

$\text{state}_i$  = Reporting requirement, 0 for none, 1 for legal requirement

$\text{expend}_i$  = Annual level of giving

$\text{categ}_{i,j}$  = Category of giving;  $j = 1, 5$

As Equation (1) utilizes a binary dependent variable, it will be estimated using both logit and probit models, although it is anticipated that there will be little difference in the results (logit models provide elasticities, which might be of interest to some researchers). Missing data, particularly on the age of the nonprofit, eliminated 40 observations, resulting in a total of 410 observations in the final estimations.

## Results

The results are provided in Tables 2 and 3. Both the probit and logit models produced approximately the same degree of explanatory power (pseudo- $R^2$  of approximately 38%). The most important explanatory variables in each instance (significant at the 1% level in both cases) were the presence of a transparent independent voting board and the publication of the outcomes of an independent audit. The expected negative signs indicate a measurable drop in the probability that a nonprofit will engage in soft

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings



where no such accountability exists. The other form of oversight, state reporting requirements widely regarded as an important check on misbehavior by nonprofits, does not test as significant (rejected by the model, with a z-score of 0.27 in both models). The two variables that were incorporated to reflect the “stature” of the organizations, age, and magnitude of expenditures, were also rejected in both instances. This is a somewhat surprising result, as seasoned charitable organizations would be expected to have developed a reputation and would not want to alienate long-time donors.

TABLE 2 Results of Estimation, Probit Regression

Download CSV   Display Table



TABLE 3 Results of Estimation, Logit Regression

Download CSV   Display Table



Two of the four binary variables included in the model were significant: Those representing Health and Human Services causes. In both the probit and logit estimations, charities that pursued heath causes were significantly more likely (at the 5% level) to receive a zero ranking. Similarly, in both estimations there was a greater likelihood that human services organizations would be zero-ranked (significant at the 1% level). Conversely, there was no difference between nonprofits in the Research and Religion categories and charities in general. In the latter case, this is partly explained by a tendency of religious organizations not to utilize an independent voting board (already a highly significant variable) washing out any measurable impact.

CONC

Trust i

Scan

seldom

neither

of reform

In this article



About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

gile.

r firm, but

being

n promises

consider





being an appropriate example). Once trust is broken in the charitable sector, however, the damage can be permanent and systemic. A contributor to a nonprofit who discovers that a donation was misused or appropriated is not only unlikely to donate to that organization again, but may forswear charitable contributions altogether (see Light, 2008, p. 2). As the philanthropic sector plays a positive and significant role in a wide range of social programs in the U.S. economy, the damage from scandals in the nonprofit sector may be considerable.

The empirical work presented here indicates that two forms of oversight—maintaining an independent voting board and contracting for an independent audit—are the best means of avoiding organizational malfeasance at nonprofits. Governmental oversight, whether through reporting requirements or through the oversight inherent in the federal grant process, does not test as significant. This indicates that most concerns could be addressed by requiring both an independent board and an annual audit for all nonprofits with 501(c)(3) status. This is not to say this requirement would be a panacea for the problem of soft corruption—Aramony managed to manipulate the United Way Board during the 1992 scandal at the organization—but simply that this form of malfeasance would be less common with this form of oversight in place.

This article has also highlighted the unique circumstances that surround nonprofits, particularly when compared to the corporate sector. Most donors receive nothing—either informational or monetary—from organizations to which they donate, resulting in an agency problem. This enables managers of charities to misdirect, misuse, or pocket (through excess salaries) donations with few consequences. Independent audits and the presence of an independent board would reduce the number of instances of corruption arising from this agency problem.

REFE

- 1. Ai  
F632



About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).




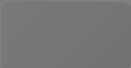
Accept All

Essential Only

Settings

al, 113,



2. Anand, V., Ashforth, B., & Joshi, M. (2004). Business as usual: The acceptance and perpetuation of corruption in organizations. *Academy of Management Executive*, *19*, 9–23. doi:10.5465/ame.2004.13837437.
-  | [Google Scholar](#)
3. Aprill, E. (2007). What critiques of Sarbanes-Oxley can teach about regulation of nonprofit governance. *Fordham Law Review*, *76*, 765–794. Retrieved from <http://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=4311&context=flr>
- [Web of Science ®](#) | [Google Scholar](#)
4. Archambeault, D., Webber, S., & Greenlee, J. (2014). Fraud and corruption in U.S. nonprofit entities. *Nonprofit and Voluntary Sector Quarterly*, *44*, 1194–1224. doi:10.1177/0899764014555987.
-  | [Web of Science ®](#) | [Google Scholar](#)
5. Banfield, E. C. (1975). Corruption as a feature of governmental organization. *Journal of Law and Economics*, *18*, 587–605. doi:10.1086/466826.
-  | [Web of Science ®](#) | [Google Scholar](#)
6. Baucus, M. (1994). Pressure, opportunity and predisposition: A multivariate model of corporate illegality. *Journal of Management*, *20*, 699–721. doi:10.1016/0149-2063(94)90026-4.
-  | [Web of Science ®](#) | [Google Scholar](#)
7. Baucus, M., & Beck-Dudley, C. (2005). Designing ethical organizations: Avoiding the long-term negative effects of rewards and punishments. *Journal of Business Ethics*, *56*, 355–370. doi:10.1007/s10551-004-1033-8

#### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

 Accept All

Essential Only? An event  
/256300

Settings



 | Google Scholar

10. Britton, R. (2007). Making disclosure regulation work in the nonprofit sector.

University of Illinois Law Review, 437, 437–458. Retrieved from

<https://illinoislawreview.org/wp-content/ilr-content/articles/2008/1/Britton.pdf>

Google Scholar

1. Cnaan, R., Jones, K., Dickin, A., & Salomon, M. (2011). Nonprofit watchdogs: Do they serve the average donor? Nonprofit Management and Leadership, 21, 381–397.

doi:10.1002/nml.20032.

 | Web of Science ® | Google Scholar

2. Ebrahim, A. (2011). The many faces of nonprofit accountability. In D. Renz & R.

Herman (Eds.), The Jossey-Bass handbook of nonprofit leadership and management (3rd ed.) (pp. 110–121). San Francisco, CA: Wiley & Sons.

doi:10.1002/9781119176558.ch4.

 | Google Scholar

3. Fremont-Smith, M. (2004). Pillaging of charitable assets: Embezzlement and fraud.

Exempt Organization Tax Review, 46, 333–348. Retrieved from

<https://www.taxnotes.com/exempt-organization-tax-review/charitable-giving/pillaging-charitable-assets-embezzlement-and-fraud/2004/12/01/t6jx>

Google Scholar

4. Fremont-Smith, M., & Kosaras, A. (2003). Wrongdoing by officers and directors of

charities: A survey of press reports 1995–2002. Exempt Organizations Tax Review,

42, 25

review

report

G



#### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

5. Froelich

organ

profit

atement

data. Nonprofit and Voluntary Sector Quarterly, 29, 232-254.

doi:10.1177/0899764000292002.

 | [Web of Science ®](#) | [Google Scholar](#)

6. Gibelman, M., & Gelman, S. (2001). Very public scandals: Nongovernmental organizations in trouble. *Voluntas: International Journal of Voluntary and Nonprofit Organizations*, 12, 49-66. doi:10.1023/A:1011242911726.

 | [Google Scholar](#)

7. Greenlee, M., Fischer, M., Gordon, T., & Keating, E. (2007). An investigation of fraud in nonprofit organizations: Occurrences and deterrents. *Nonprofit and Voluntary Sector Quarterly*, 36, 676-694. doi:10.1177/0899764007300407.

 | [Web of Science ®](#) | [Google Scholar](#)

8. Hager, M., Pollak, T., & Rooney, P. (2001). Variations in overhead and fundraising efficiency measures: The influence of size, age, and subsector (Overhead Cost Study Working Paper). Miami, FL: Association of Fundraising Professionals/Association for Research on Nonprofit Organizations and Voluntary Action. Retrieved from [https://philanthropy.iupui.edu/files/research/variatiions\\_in\\_overhead\\_and\\_fundraising\\_efficiency\\_measures.pdf](https://philanthropy.iupui.edu/files/research/variatiions_in_overhead_and_fundraising_efficiency_measures.pdf)

[Google Scholar](#)

9. Harris, E., Petrovits, C., & Yetman, M. (2015). The effect of nonprofit governance on donations: Evidence from the revised from 990. *Accounting Review*, 90, 579-610. doi:10.2308/accr-50874.

 | [Web of Science ®](#) | [Google Scholar](#)

10. Heyne, J. (2015). The effect of nonprofit governance on donations: Evidence from the revised from 990. *Accounting Review*, 90, 579-610. doi:10.2308/accr-50874.

Developed by



21. Hodges, J. (2015). The effect of nonprofit governance on donations: Evidence from the revised from 990. *Accounting Review*, 90, 579-610. doi:10.2308/accr-50874.

In this article

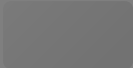

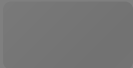


### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click "Settings". For further information about the data we collect from you, please see our [Privacy Policy](#).

[Accept All](#) Education

[Essential Only](#)

[Settings](#) philanthropy,

22. Holfreter, K. (2008). Determinants of fraud losses in nonprofit organizations. *Nonprofit Management and Leadership*, **19**, 45–63. doi:10.1002/nml.204.  
 | [Google Scholar](#)
23. Jain, A. (2001). Corruption: A review. *Journal of Economic Surveys*, **15**, 71–121. doi:10.1111/1467-6419.00133.  
 | [Web of Science ®](#) | [Google Scholar](#)
24. Jegers, M. (2009). “Corporate” governance in nonprofit organizations: A non-technical review of the economic literature. *Nonprofit Management and Leadership*, **20**, 143–164. doi:10.1002/nml.246.  
 | [Web of Science ®](#) | [Google Scholar](#)
25. Jones, J. (1991). Earnings management during import relief investigations. *Journal of Accounting Research*, **29**, 195–228. doi:10.2307/2491047.  
 | [Web of Science ®](#) | [Google Scholar](#)
26. Jory, S., & Perry, M. (2011). Ponzi schemes: A critical analysis. *Journal of Financial Planning*. Retrieved from <https://www.onefpa.org/journal/Pages/Ponzi%20Schemes%20A%20Critical%20Analysis.aspx>  
 | [Google Scholar](#)
27. Larkin, R. (2013, July 2). Using outcomes to measure nonprofit success. *Nonprofit Quarterly*. Retrieved from <https://nonprofitquarterly.org/2013/07/02/using-outcomes-to-measure-nonprofit-success>  
 | [Google Scholar](#)


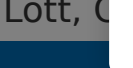
#### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).


Accept All

Essential Only

Settings

28. Light, J. (2016). The role of the Washington State Office of the Auditor General in building public confidence. *Journal of Public Administration*, **1**, 1–10. doi:10.1002/jpa2.10001.  
 | [Google Scholar](#)
29. Lott, C. (2016). The role of the Washington State Office of the Auditor General in building public confidence. *Journal of Public Administration*, **1**, 1–10. doi:10.1002/jpa2.10001.  
 | [Google Scholar](#)

Institute Center on Nonprofits and Philanthropy. Retrieved from <https://www.urban.org/sites/default/files/publication/84161/2000925-State-Regulation-and-Enforcement-in-the-Charitable-Sector.pdf>  
Google Scholar


30. Luo, Y. (2004). An organizational perspective of corruption. *Management and Organization Review*, 1, 119–154. doi:10.1111/j.1740-8784.2004.00006.x.  
 | Google Scholar

31. MacWilliams, B. (2002). In Georgia, professors hand out price lists. *Chronicle of Higher Education*, A34. Retrieved from <https://www.chronicle.com/article/In-Georgia-Professors-Hand/33565>  
Google Scholar

32. McLean, C., & Coffman, S. (2004, June). Why ratios aren’t the last word. *Philanthropic Research/GuideStar*. Retrieved from <https://www.guidestar.org/Articles.aspx?path=/rxa/news/articles/2004/why-ratios-arent-the-last-word.aspx>  
Google Scholar

33. Mead, J. (2008). Confidence in the nonprofit sector through Sarbanes-Oxley-style reforms. *Michigan Law Review*, 106, 881–900. Retrieved from <https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1400&context=mlr>  
Web of Science ® | Google Scholar

34. Miller, J. (2002). The board as a monitor of organizational activity: The applicability of agency theory to nonprofit boards. *Nonprofit Management & Leadership*, 12, 429–450. doi:10.1002/nml.12407.

35. Miller, J. (2002). The board as a monitor of organizational activity: The applicability of agency theory to nonprofit boards. *Nonprofit Management & Leadership*, 12, 429–450. doi:10.1002/nml.12407.  
 Web of Science ® | Google Scholar




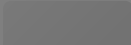
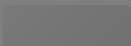
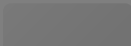
About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings

6. Mulligan, L. (2007). What is Good for the Goose is not for the Gander: Sorbanes-Oxley-Style Nonprofit Reforms. *Michigan Law Review*, 105, 1951–2009.  
 | [Web of Science ®](#) | [Google Scholar](#)
7. Neely, D. (2011). The impact of regulation on the U.S. nonprofit sector: Initial evidence from the U.S. Nonprofit Integrity Act of 2004. *Accounting Horizons*, 25, 107–125. doi:10.2308/acch.2011.25.1.107.  
 | [Web of Science ®](#) | [Google Scholar](#)
8. O'Neill, M. (2009). Public confidence in charitable nonprofits. *Nonprofit and Voluntary Sector Quarterly*, 38, 237–269. doi:10.1177/0899764008326895.  
 | [Web of Science ®](#) | [Google Scholar](#)
9. Pinto, J., Leana, C., & Pil, F. (2008). Corrupt organizations or organizations of corrupt individuals? Two types of organization-level corruption. *The Academy of Management Review*, 33, 685–709. doi:10.5465/amr.2008.32465726.  
 | [Web of Science ®](#) | [Google Scholar](#)
10. Prakash, A., & Gugerty, M. (2010). Trust but verify? Voluntary regulation programs in the nonprofit sector. *Regulation & Governance*, 4, 22–47. doi:10.1111/j.1748-5991.2009.01067.x.  
 | [Web of Science ®](#) | [Google Scholar](#)
11. Rao, H. (1998). Caveat emptor: The construction of nonprofit consumer watchdog organizations. *American Journal of Sociology*, 103, 912–961. doi:10.1086/231293.  
 | [Web of Science ®](#) | [Google Scholar](#)

#### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All 

Essential Only

Settings



12. Reiser

nonpr

Law S

13. Rhoad

Review



4. Ritchie, W., & Kolodinsky, R. (2003). Nonprofit organization financial performance measurement: An evaluation of new and existing financial performance measures. *Nonprofit Management & Leadership*, **13**, 367–381. doi:10.1002/nml.5.

 | [Google Scholar](#)

5. Rose-Ackerman, S. (1975). The economics of corruption. *Journal of Public Economics*, **4**, 187–203. doi:10.1016/0047-2727(75)90017-1.

 | [Google Scholar](#)

6. Rose-Ackerman, S. (2005). *Corruption and government: Causes, consequences, and reform*. Cambridge, UK: Cambridge University Press. doi:10.1017/CBO9781139175098.

 | [Google Scholar](#)

7. Sherman, L. (1980). Three models of organizational corruption in agencies of social control. *Social Problems*, **27**, 478–491. doi:10.1525/sp.1980.27.4.03a00120.

 | [Web of Science ®](#) | [Google Scholar](#)

8. Steinberg, R. (2010). Principle-agent theory and nonprofit accountability. In K. Hopt & T.von Hippel (Eds.), *Comparative corporate governance of non-profit organizations* (pp. 73–126). Cambridge, UK: Cambridge University Press. doi:10.1017/CBO9780511712128.006.

 | [Google Scholar](#)

9. Trussel, L. (2002). Assessing potential accounting manipulation: The financial character of nonprofit organizations. *Journal of Nonprofit & Social Enterprise*, **4**, 1–14. doi:10.1017/S1522243002000014.

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

 Accept All

Essential Only

Settings

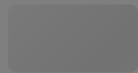
10. Vardi, Y. (1990). The social responsibility of nonprofit organizations: A framework. *Academy of Management Review*, **15**, 636–646.

1. Weber, N. (1994). Misusing charitable statistics in evaluating fundraising performance. In J. M. Greenfield (Ed.), *Financial practices for effective fund-raising*. San Francisco, CA: Jossey-Bass.



[Google Scholar](#)

2. Williams, A., & Taylor, J. (2013). Resolving accountability ambiguity in nonprofit organizations. *Voluntas: International Journal of Voluntary and Nonprofit Organizations*, *24*(3), 559–580. doi:10.1007/s11266-012-9266-0.



[Web of Science ®](#) | [Google Scholar](#)

3. Yetman, M., & Yetman, R. (2012). The effects of governance on the accuracy of charitable expenses reported by nonprofit organizations. *Contemporary Accounting Research*, *29*, 738–767. doi:10.1111/j.1911-3846.2011.01121.x.



[Web of Science ®](#) | [Google Scholar](#)

[Download PDF](#)

## Related research

People also read

Recommended articles

Cited by  
11



### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

 Accept All

Essential Only

Settings

## Information for

Authors

R&D professionals

Editors

Librarians

Societies

## Opportunities

Reprints and e-prints

Advertising solutions

Accelerated publication

Corporate access solutions

## Open access

Overview

Open journals

Open Select

Dove Medical Press

F1000Research

## Help and information

Help and contact


Newsroom

All journals

Books

## Keep up to date


Register to receive personalised research and resources by email

 Sign me up



Copyright © 2024 [Informa UK Limited](#) [Privacy policy](#) [Cookies](#) [Terms & conditions](#)

[Accessibility](#)

 Taylor & Francis Group  
an informa business

Registered in England & Wales No. 3099067  
5 Howick Place | London | SW1P 1WG

### About Cookies On This Site

We and our partners use cookies to enhance your website experience, learn how our site is used, offer personalised features, measure the effectiveness of our services, and tailor content and ads to your interests while you navigate on the web or interact with us across devices. You can choose to accept all of these cookies or only essential cookies. To learn more or manage your preferences, click “Settings”. For further information about the data we collect from you, please see our [Privacy Policy](#).

Accept All

Essential Only

Settings