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Nonprofit Organizations:
Challenges, Public Perception, Effective Management

author:
M. Louise Walters

The Leadership Center
912.349.7989
Savannah, GA 31406 USA

Nonprofit organizations:

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by:

M. Louise Walters

In Partial Fulfillment of the Requirements for the Degree

Doctor of Philosophy

Capella University

School of Public Service Leadership

May 14, 2015

Introduction

Nonprofit organizations have been encouraged to imitate the operations of their for-profit corporate cousins in the business sector. Eisenberg (2004) believes this is bad advice and is not in their best interest, in the best interest of the groups that nonprofits serve, nor in the best interest of society.

This discussion begins with the evolution of nonprofit organizations in the United States. It moves on to a discussion of the public perception of the operations of nonprofit organizations. That examination is followed by a discussion of ways to manage nonprofit organizations effectively and efficiently. Ethical and legal practices, financial solvency and missions of service options are identified, and recommendations are made.

The Public Perception of Nonprofit Operations – A Discussion

Over a two-year period, Smith and Richmond (2007) surveyed undergraduate seniors in a university business program and also members of a local Chamber of Commerce. The researchers discovered that eighty-five percent of respondents considered nonprofit groups to be 'real' businesses, twenty-five percent believed nonprofits could not make a profit and twenty-six percent believed that nonprofits could only 'break even.' It is no wonder that people are confused about what a nonprofit is and what it does.

An organization may qualify for exemption from federal income tax if it is organized and operated exclusively for the purpose of religion, charity, science, testing for public safety, literary efforts, education, national or international amateur sports competition, or prevention of cruelty to children or animals (IRS, 2015). The Internal Revenue Service recognizes over thirty classifications of nonprofit organizations. The breadth and the reach of nonprofit organizations is evident in their variety: federal credit unions, public charities and private foundations, social welfare and civic leagues, business leagues and professional societies, religious groups and fraternal groups, cemeteries and farmers' co-operative groups.

In 2004, Eisenberg issued his warning in response to what he believed was ill-conceived thinking that nonprofit organizations should operate like businesses. He penned his article as events unfolded which exposed the unethical and illegal actions of several multi-billion dollar U.S.-based corporations. The corruption and greed of a few executives at Enron, WorldCom and Tyco resulted in financial collapses of all three (and several other) multi-billion dollar corporations -- including some of the biggest corporations in the United States. Eisenberg identifies self-dealing, excessive compensation, mismanagement, and unethical conduct by corporate leaders as the primary reasons for the financial collapse. Those corporate actions tarnished the reputation of the for-profit business world and resulted in a lack of public confidence that would linger for years. Nonprofit groups would also experience some repercussions.

The nonprofit – or social – sector measures its value in terms of human capital. For-profit business gauges success in money-related terms such as whether the value of a shareholder's stock is worth more at the end of the year than at the beginning of the year, or if the corporation's assets exceed liabilities. So, given that business people frequently comprise the majority of volunteers who serve on committees and on boards of directors of nonprofit organizations, it is not uncommon for them to champion the idea that nonprofit groups should be more business-like in their thinking, in their operations, and in their acceptance of the business model. Yet there is a fundamental flaw in this view, because nonprofit organizations are not supposed to be businesses that are solely concerned with their bottom line. Eisenberg (2004) concurs with that view and goes on to warn that their thinking conflicts with the role of nonprofit groups, which is to advocate on behalf of and provide services to the nonprofit's clientele which ultimately will transform society. He even goes so far as to encourage nonprofit organizations to distance themselves from for-profit businesses that often have ethical lapses and use dubious management practices. Otherwise, the nonprofit sector, too, could experience a similar erosion in the public's confidence, he cautions. In order to avoid a similar fate, Eisenberg encourages nonprofit organizations to embrace sound planning, financial and management practices.

In the last seventy-five years in the United States, over ninety percent (in excess of 1.5 million) of all nonprofits have been created (Renz, 2010). In the past fifty years, in response to decreases in government funding of programs like community-based housing, communities have increasingly turned to nonprofit organizations to fund a variety of social programs like affordable housing (Silverman (2009). United States citizens are becoming increasingly alienated and estranged from government, so Ott (2012) advocates a re-engagement in government by citizens, calling the re-linkage a "…necessity, not a nicety…" (p. 219).

The nonprofit sector evolved quickly in the second half of the twentieth century during which management expert Peter Drucker became a high-powered consultant to big business. At first, Drucker seemed almost disinterested in the nonprofit sector, calling it "…marginal to an American society dominated by government and big business respectively" (Drucker, p. xiii). However, the long-term growth of the nonprofit sector removed Drucker's misgivings.   Some fifty years later, Drucker had written a book, *Managing the Nonprofit Organization – Principles and Practice*, in which he declared nonprofit organizations to be "…central to American society and are indeed its most distinguishing feature…" because they "…exemplify and fulfill the fundamental American commitment to responsible citizenship in the community" (Drucker, p.

xvi). Drucker would go on to state that "…nonprofit institutions are central to American society and are indeed its most distinguishing feature" (Drucker, p. xiii).

Yet, there were changes in the nonprofit sector at the end of the twentieth century. There were calls for nonprofit organizations to operate more like a business (Eisenberg, 2004). There were also financial scandals and indiscretions by nonprofit executives that eroded the public's perception of nonprofit organizations. In 2002, Americans said they were skeptical of charitable performance; in fact thirty-four percent said they had no confidence in charitable organizations (Light, 2008). In 2007 it was found that forty percent of nonprofit employees had observed misconduct within their own organization but did not report it. According to a Harris poll conducted in 2006, only ten percent of the public strongly believed that charities were ethical and honest in how they dealt with public funds (Rhode, 2009). This is corroborated by Mead (2008) who found that the public's view of nonprofit organizations was dim, and, in fact, that the public perception was that nonprofits were dysfunctional at best and inept or corruptly managed at worst. Mead infers that, in place of voluntary adherence to principles and values of the highest order, a legal mandate was needed. The assumption was that laws would help restore the public's trust in nonprofit organizations.

In 2008, legal changes transpired in how nonprofits operated. Beginning that year, tax exempt organizations were required to report financial and related operational information to the Internal Revenue Service (IRS) using the newly revised Form 990. There were changes in a number of areas of the form, and two were significant. One change required nonprofit organizations to report the names and amounts of compensation paid to top executives. For the first time, the public had access to reports that spelled out compensation and benefit packages of nonprofit executives. Anyone conducting a computer search could quickly find salaries, perks, deferred compensation and bonuses paid to the executives of charities and foundations, including the CEOs of the American Cancer Society and the Boys and Girls Clubs of America who were paid over $1 million annually.

Another change to the IRS Form 990 was the addition on Part VI, Section A, Line 5 which asked whether the organization became aware during the year of a significant diversion of the organization's assets. That means, for example, that if a nonprofit was the target of an embezzlement, the organization was required to disclose that fact on Form 990. In years past, organizations that discovered embezzlements frequently negotiated for the return of the embezzled funds in exchange for not prosecuting the offender. Those in charge of the nonprofit (board members and staff) did not want the exposure of adverse publicity and a public trial -- nor did they want to run the risk of losing public trust. Volunteer board members were concerned that public exposure of the embezzlement incident could reflect poorly on them, and by extension, on their businesses.

The changes to IRS Form 990 were brought about by Public Law 107-204 116 Stat. 745. Although the act's official title is 'The Public Company Accounting Reform and Investor Protection Act,' it is more commonly referred to as the 'Sarbanes-Oxley Act' or 'SOX.' The intent of this legislated code of ethics was "To protect investors by improving the accuracy and reliability of corporate disclosures" (PL 107-204, 2002) by establishing new rules on the oversight roles and responsibilities that corporate boards of directors, officers and auditors had in influencing the accounting and handling of corporate funds. SOX also mandated that top corporate executives personally sign-off on the accuracy of financial information, effectively eliminating the 'I did not know' excuse used by transgressors.

SOX was intended to curb bad conduct within the business sector, and, although the law's language did not specifically refer to the nonprofit sector, it did heighten awareness and it created a dialogue in the nonprofit sector about financial transparency, accountability and the responsibility of governance (Stone and Ostrower, 2007). Because of the omission, the Independent Sector (a coalition of corporations and nonprofit groups organized to support strengthened nonprofit initiatives) voiced its concern that the Sarbanes-Oxley Act did not specifically address and mandate reforms within the nonprofit sector. Because the Independent Sector believed the Sarbanes-Oxley Act was only a partial solution, it prevailed on Congress to address the void. In turn, Congress established the Panel on the Nonprofit Sector that made recommendations specific to the nonprofit sector on ethical conduct, un-biased governance, accountability, transparency, disclosure and focused attentiveness (Smith and Richmond, 2007).

O'Neill (2009) points out that, while major scandals in the nonprofit sector such as the million dollar "sex-and-money scandal" (p. 263) involving William Aramony (United Way of America's former CEO) appear to have a negative effect on the public's perception of nonprofit groups, that 'crisis of confidence' can be short-lived.

Recommendations to Manage Nonprofit Organizations Effectively and Efficiently

There is pressure on nonprofit organizations to conduct their operations in a more business-like manner. There is also pressure to use business-type terminology: using the word 'investor' to replace the words 'funder,' 'contributor' and 'member,' changing the chief staff person's title from 'executive director' to 'president,' and renaming the nonprofit's 'program of work/action' a 'business plan.' These changes come from business people who voluntarily populate nonprofit committees and boards of directors and who attempt to govern nonprofit organizations in much the same way they run their own corporations and small businesses.

With that as background, it should come as no surprise that nonprofit organizations need a planning and operating document that guides their actions over a given period of time (usually one year). That document is frequently referred to as a 'business plan,' although it may also be called a 'plan of work,' 'plan of action' or 'operating plan.' For clarification purposes, a business plan typically covers one year (or, in some unusual circumstances, up to two years). This is different than a strategic plan that covers three to five years.

Development of the business plan should begin about six months in advance of the organization's new year. It should start at the committee level where committee members discuss results of a member input survey. Committees are responsible for much of the organization's activity throughout the year, so results of the member survey are used to guide committee planning discussions. An annual member survey produces information invaluable to the organization. The results of the survey will guide committee members as they evaluate the organization, as they suggest ways to improve existing programs, as they recommend retirement for those activities that are no longer popular or are outdated, and as they recommend adding new programs.

Two additional documents are necessary components to the discussion: the current business plan and an up-to-date financial report. Using the current business plan, committees will discuss each existing activity, evaluating it in one of three ways: continue the activity as is, continue the activity with modifications, or delete/discontinue the activity. During this process, the committee also considers the input from the member survey to determine if new activities should be included. The committee works with the organization's staff to develop financial projections that complete the suggested package. Recommendations are presented to the organization's board of directors for review, last minute modifications and, ultimately, approval.

It is this final document which includes all committee activities and all income and expense projections that will drive the nonprofit's programs for the next twelve months. It is this document that will become the starting point when the process begins again. The business plan is also the document that assists board members and staff in determining whether or not the nonprofit is accomplishing its objectives.

Members, donors, clients, partner organizations and the communities in which the nonprofit is located place trust in the nonprofit organization and the individuals who lead them. Boards of directors are elected to act in the best interest of the organization. Board members individually and severally have both a fiduciary responsibility and a governance responsibility to protect the nonprofit organization and not compromise that trust.

Maintaining Sound Ethical and Legal Practices

Funders, contributors and members of nonprofit organizations want to know exactly where their money goes, so, creating business-like financial procedures and transparent accounting processes is important. Eisenberg (2004) notes that it is laudable that nonprofit organizations pay attention to the bottom-line and strive to operate like a business. How the public perceives a nonprofit organization can help policymakers determine priorities of funding (Maguire and Lam, 2014).

There are a number of ways nonprofit organizations can maintain sound ethical and legal practices, including:

Accountability. Complying with professional codes of conduct (or ethics codes) are a way to improve transparency and accountability (Bromley and Orchard, 2015).

Full Disclosure. Recording (or writing) meeting minutes of all board of directors meetings is a necessity. The minutes should reflect all official actions taken. Meeting materials including financial reports, committee recommendations and program status updates should be distributed in advance of each board of directors meeting.

Transparency. Minutes of all board of directors meetings, complete financial information, audited financial statements, and the IRS letter of tax exempt status should be posted on the organization's website.

Legal Counsel. There will be times when the nonprofit should seek legal counsel. Having a lawyer who is well versed in the nonprofit sector is a big help.

Risk Management. Directors and officers insurance and errors and omissions insurance are intended to financially protect both the organization itself and those that serve on its behalf should a lawsuit arise. Other insurances include special events insurance, business protection, and theft/embezzlement. Other risk management related documents include an up-to-date internal operational procedures manual, a personnel handbook with whistleblower provisions, and an emergency safety and contingency operations plan.

Remaining Financially Solvent

Nonprofit organizations remain financially solvent because they maintain or increase revenues; they decrease, maintain or proportionately increase expenditures; or some combination of both. In the past, it has been difficult for potential donors, governmental entities, members of nonprofit groups and the public at large to determine the financial stability and worthiness of a charity or foundation. Part of the problem has been lack of information about nonprofit groups. In the past, about the only way a prospective donor could determine the financial stability and worthiness of a charity or foundation was to spend hours sleuthing newspapers, talking with other donors, or serving as a member of the charity or foundation board. Today, however, more information is available by conducting keyword web searches, by using programs like GuideStar and Charity Navigator, through information posted on the Internal Revenue Service website, and by accessing the nonprofit group's own website. Maguire (2014) also suggests that board members should have 'view only' access to all bank accounts, thereby ensuring transparency.

Revenues

One usually thinks of expense over-runs or out-of-control spending if an organization is having financial difficulties. While overspending may be a reason, there are other considerations on the revenue side. The primary funding streams of most nonprofit organizations include some combination of membership dues, special events, advertising, sponsorships and fees-for-services. These must be managed if the organization is to bring in adequate revenues.

Membership. Using membership numbers from the prior year to forecast the number of members the nonprofit will have in the upcoming year is common industry practice. But that is only one part of the analysis. The dollars associated with the different categories of membership are also a consideration. Unfortunately, some nonprofit groups do not subscribe to the practice of increasing membership dues annually by a certain dollar amount or percentage; instead, they choose to raise dues every second year, every third year or at some other point in time, usually creating the appearance of large dues increases. For nonprofits that rely on membership dues to fund operations, the organization can quickly get into financial trouble if membership numbers begin to decrease or if members drop out because they receive a dues billing that includes a large increase (not remembering their dues did not increase for the previous five years).

Special Events. Golf tournaments, member mixers, industry trade shows, fun runs and member-of-the-year award banquets are some of the many ways nonprofits raise supplemental operating funds. Problems can quickly arise when not enough golfers play, too few members attend a mixer, the trade show attracts fewer exhibitors, the fun run gets rained out, or the award banquet goes over budget. Instead of being revenue producers, these activities can quickly become financial disasters.

Advertising. Newsletter advertising and website advertising are good ways to generate non-dues revenue. Usually, organizations contract with a publisher to print a certain number of copies and a specific number of pages each month (or quarter). To develop the budget, the nonprofit uses the current year's anticipated advertising sales revenue on which to base the publication projections for the coming year. If ad sales drop off, the nonprofit is still committed to pay the newsletter publisher the originally agreed upon cost. The same can be said of the costs of the website design company.

Sponsorships. Sometimes nonprofits put packages together that include a combination of advertising, events, and special membership categories which provide a sponsor with increased exposure. There are several benefits. By virtue of consolidation, the nonprofit staff saves time selling the package rather than having to sell numerous individual events. The sponsor is only contacted once during the year, and the sponsor needs to write just one check or make only one payment. The caution is that (just like the previous example above about 'advertising'), regardless of what happens, the nonprofit is still responsible for honoring the sponsorship agreement (all the events and levels of services in the contract).

Fees-For-Services. Fees-for-services are common in the health care industry. Some nonprofit hospitals are in this category because they charge for the services they provide. AAA (the American Automobile Association) also charges fees for certain services, including roadside assistance, issuing international driver's licenses, and travel agency trip planning.

Expenditures

Audit Committee. Audit committees are a way that nonprofit organizations 'police' their own financial processes and actions. The purpose of the audit committee is to assist the board of directors in monitoring financial transactions made from and to the nonprofit organization. The audit committee also helps the board of directors ensure that the organization is in compliance with its own internal financial procedures regarding how it records and how it reports financial transactions and that those processes comply with generally accepted accounting principles (GAAP).

Segregation of Duties. Processes for handling receipts should clearly detail the segregation of duties (opening mail, recording receipts, processing checks, credit card transactions, handling cash, making bank deposits, and reconciling bank statements) and identify the staff member(s) responsible.

Financial Reports. Complete financial reports should be prepared and distributed to the board of directors every month.

Bank Statements. Bank statements should be sent directly to the Treasurer.

Payments. Non-recurring or one-time payments should be paid from invoices and should be accompanied by an authorization from the staff person or volunteer initiating the request. The authorization should be signed and dated and should specify the appropriate accounting code.

Signatures on Official Documents. Two of three signatures should be mandatory on every check and every electronic transfer of funds (usually a combination of the treasurer, the chairman/chairwoman of the board or the CEO).

Authorization to Obligate. There should be restrictions on who is authorized to obligate the organization's resources (such as initiating or signing contracts and agreements or authorizing work).

Audits and Auditors. A full audit by a certified public accountant with an outside accounting firm should occur every year. Accounting firms should be changed every three years.

View Only. All members of the board of directors should have 'view only' privileges for all financial accounts of the organization.

Attending to Missions of Service

Mission statements tell why organizations exist and what the organization does. They are used as a measurement in determining whether or not the organization is meeting its goals. Mission statements communicate what the organization is and where it is going (Cady, Wheeler, DeWolf and Brodke, 2011). Organizational missions (regardless of whether they are called 'mission statements' or 'missions of service') can be likened to a roadmap or a GPS. The roadmap is helpful because it not only shows where you are going, it also show different routes (or ways) to get there. The GPS goes one better – it will show restaurants, points of information and real-time traffic conditions.

Conclusion

The focus of nonprofit organizations is different than the focus of for-profit corporations. That difference is not just a 501(c) classification or a dollar figure on the year-end bottom-line. For profit corporations focus on creating profits. Nonprofit organizations focus on developing the environment to improve society. Nonprofit organizations "…function on an ideology that is centralized on creating change for the individual, community, region, nation, or world" (Fox, p. 72) and they accomplish that change through their missions of service.

Although some people believe that nonprofit organizations should adopt a more corporate style, others believe that, given the bad reputations of some huge for-profit corporations, nonprofit groups should not attempt to function like for-profit organizations.

Public perception of nonprofit organizations has been mixed. On the one hand, a huge number of nonprofits organizations have been created in the last one hundred years, and this reflects the public's belief that the nonprofit sector can be an effective tool for solving society's problems. Meanwhile, surveys indicate that the public does not have a high confidence level in nonprofit organizations.

Nonprofit organizations can be managed effectively and efficiently. Surveys of members should be conducted. Business plans should be developed and followed. Financial projections should be developed, and budgets should be adhered to.

Ethical and legal practices can be maintained by adopting and adhering to practices that include accountability, full disclosure, transparency, and risk management, along with having and using legal counsel.

Nonprofit organizations will remain financially solvent by practicing transparency – including publishing financial and other pertinent information on their websites. Revenues for many nonprofits include a combination of membership dues, special events, advertising, sponsorships and fees-for-service. Expenditures can be controlled by steps including: the establishment and use of an audit committee, the segregation of duties, timely and accurate financial reports, handling of bank statements, payment protocols, signature protocols, controls on the ability to obligate the organization, audits, and ready access to financial information.

Nonprofit groups should devote attention to their missions of service. The mission statement language should be used as a measurement in determining whether the organization is meeting its goals.

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