From Compliance to Culture: Building Nonprofit Ethics

Alicia M. Schatteman

DeKalb County Nonprofit Day 2017
Scandal for United Way and the Nonprofit Sector

- William Aramony was President of United Way of American from 1970-1992
- He was jailed in 1995 for defrauding the organization of more than $1 million
- Convicted in 1995 on 23 counts of felony charges, including conspiracy, fraud and filing false tax returns
Nonprofit head found guilty in fraud trial with ties to politicians

Franzhuin Styles, photographed Aug. 4, 2015, at the Ortega U.S. Courthouse in Chicago, is now on trial after being accused of using state grant money for a personal spending spree. (Pat Nabong/Chicago Tribune)

By Jason Meisner · Contact Reporter
Chicago Tribune

MAY 23, 2017, 6:44 PM
Former Bear Chris Zorich sentenced to probation in tax case
Men create bogus Sept. 11 charity, swipe cash raised

Two Jersey Shore men admitted guilt Monday in a scheme in which they stole thousands of dollars in donations by falsely claiming they were raising money to help families of those who died in the Sept. 11, 2001, terrorist attacks on the World Trade Center.
Little of nonprofit’s money goes to charity

Red Cross responds, building only six homes to report about 2010 quake in Haiti after

By Michael Martinez, CNN

Updated 4:33 PM ET, Fri June 5, 2015

Payments to charity Executive Director Mary Ann Grossert and Vice President Charomi Smith, sisters of President Rhonda McCullough, are identified as “investment management fees” to a firm listed as “IOTA.” Bernie Mac Foundation Treasurer Edward Williams is president of IOTA 3759 Investments Ltd., which is based at the same office as the charity.

Grants to the Foundation for Sarcoidosis Research and the University of Illinois Hospital & Health Sciences System are with Edward A. Associates Ltd., which is based at the same office as the charity and is listed as its tax preparer.

SOURCE: Illinois secretary of state, Illinois attorney general, tax filings
Wounded Warrior Project Spends Lavishly on Itself, Insiders Say

By DAVE PHILIPPS  JAN. 27, 2016
Spending by veteran charities

In millions of dollars

- Revenue spent on fundraising, salaries and benefits
- Revenue spent on grants

**Wounded Warrior Project**

Tax period ending Sept. 30, 2013

- Total revenue: $234.7 million
- $217.0 million spent on fundraising, salaries and benefits
- $17.7 million spent on grants

**Disabled American Veterans**

Tax period ending Dec. 31, 2013

- Total: $146.2 million
- $142.6 million spent on fundraising, salaries and benefits
- $3.6 million spent on grants

**Paralyzed Veterans of America**

Tax period ending June 30, 2013

- Total: $81.9 million
- $75.9 million spent on fundraising, salaries and benefits
- $6.0 million spent on grants

**Help Hospitalized Veterans**

Tax period ending July 31, 2013

- Total: $24.7 million
- $21.1 million spent on fundraising, salaries and benefits
- $3.6 million spent on grants

**National Veterans Services Fund**

Tax period ending June 30, 2012

- Total: $9.1 million
- $9.0 million spent on fundraising, salaries and benefits
- $0.07 million spent on grants

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1: Does not include $7.6 million in “Direct Response Service” costs
2: Does not include an additional $2.4 million in printing, $1.8 million in postage and $232,066 in list rental costs

Source: IRS Form 990s

*Your Future, Our Focus*
Why Confidence in the Nonprofit Sector Has Decreased

<table>
<thead>
<tr>
<th>Factor</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scandals in the sector</td>
<td>73%</td>
</tr>
<tr>
<td>People don’t understand the complexity of the sector</td>
<td>48%</td>
</tr>
<tr>
<td>Nonprofit executives’ salaries</td>
<td>45%</td>
</tr>
<tr>
<td>Low program ratios</td>
<td>12%</td>
</tr>
<tr>
<td>Its much easier to get information on nonprofits today</td>
<td>9%</td>
</tr>
</tbody>
</table>

Source: Coffman (2006)
Causes of Misconduct

• Some of these challenges can result in criminal violations or civil liability: fraud, misrepresentation, and misappropriation of assets fall into this category.

• More common ethical problems involve gray areas —activities that are on the fringes of fraud, or that involve conflicts of interest, misallocation of resources, or inadequate accountability and transparency.
Illegal – Unethical - Immoral

- Parking in a handicapped parking spot
- Using false identification
- Putting incorrect information your resume
- Keeping money you found on the street
- Taking office supplies home from work
- Calling in sick when you are not
- Not correcting a bill when a cashier obviously forgot one of your items or undercharged you
- Not claiming cash income on your taxes
- Watched other people take or use something that didn’t belong to them
Where is the bar?

Level of Compliance

<table>
<thead>
<tr>
<th>High</th>
<th>Low</th>
</tr>
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<tbody>
<tr>
<td>People First</td>
<td>Narrow Application</td>
</tr>
<tr>
<td>Donor-Centered</td>
<td>Financial Transparency</td>
</tr>
<tr>
<td>Environmental Impact</td>
<td>Ethics Test</td>
</tr>
</tbody>
</table>

VALUES

ETHICS

Your Future, Our Focus
Definition of Ethics

Ethics are applying values to a process, rather than a rigid determination of right and wrong.
Ethics as a Process

- Ethics is a process by which a decision is made and that process not only uncovers values but also allows you to prioritize them.
- Distinguish between ethical and legal.
## Stages of Moral Reasoning

<table>
<thead>
<tr>
<th>Stage</th>
<th>What’s Right?</th>
<th>Reason to be good?</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Stage 0:</strong></td>
<td>I should get my own way</td>
<td>To get rewards and avoid punishments</td>
</tr>
<tr>
<td>Egocentric (0-4)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Stage 1:</strong></td>
<td>I should do what I’m told.</td>
<td>To stay out of trouble.</td>
</tr>
<tr>
<td>Unquestioned</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Obedience (4-6)</td>
<td>What’s Right?</td>
<td>Reason to be good?</td>
</tr>
<tr>
<td><strong>Stage 2:</strong></td>
<td>Self-interest: What’s in it for me?</td>
<td></td>
</tr>
<tr>
<td>What’s in it</td>
<td>I should look out for myself but be fair to those who are fair to me.</td>
<td></td>
</tr>
<tr>
<td>for me? (6-8)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Stage 3:</strong></td>
<td>I should be a nice person and live up to the expectations of people I know</td>
<td>So others will think well of me (social approval) and</td>
</tr>
<tr>
<td>Intrapersonal</td>
<td>and care about.</td>
<td>I can think well of myself (self-esteem)</td>
</tr>
<tr>
<td>Conformity</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(9-15)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Stage 4:</strong></td>
<td>I should fulfill my responsibilities to the social or value system I feel</td>
<td>To keep the system from falling apart and to maintain</td>
</tr>
<tr>
<td>Responsibility</td>
<td>part of.</td>
<td>self-respect as somebody who meets my obligations.</td>
</tr>
<tr>
<td>to the system</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(15-20)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Stage 5:</strong></td>
<td>I should show the greatest possible respect for the rights and dignity of</td>
<td></td>
</tr>
<tr>
<td>Principled</td>
<td>Every individual person and should support a system that protects human</td>
<td></td>
</tr>
<tr>
<td>Conscience</td>
<td>What’s Right?</td>
<td></td>
</tr>
<tr>
<td>(20+)</td>
<td>Should demonstrate the greatest possible respect for the rights and dignity</td>
<td></td>
</tr>
<tr>
<td></td>
<td>of every individual person and should support a system that protects human</td>
<td></td>
</tr>
<tr>
<td></td>
<td>rights.</td>
<td></td>
</tr>
</tbody>
</table>
Leadership and Ethics

The Top 10 Leadership Competencies, Grouped Into Five Themes
When 195 global leaders were asked to rate 74 qualities, these rose to the top.

<table>
<thead>
<tr>
<th>Competency</th>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong ethics &amp; safety</td>
<td>67%</td>
<td>Has high ethical and moral standards</td>
</tr>
<tr>
<td>Self-organizing</td>
<td>59%</td>
<td>Provides goals and objectives with loose guidelines/direction</td>
</tr>
<tr>
<td>Efficient learning</td>
<td>56%</td>
<td>Clearly communicates expectations</td>
</tr>
<tr>
<td>Nurtures growth</td>
<td>52%</td>
<td>Has the flexibility to change opinions</td>
</tr>
<tr>
<td>Connection &amp; belonging</td>
<td>43%</td>
<td>Is committed to my ongoing training</td>
</tr>
<tr>
<td></td>
<td>42%</td>
<td>Communicates often and openly</td>
</tr>
<tr>
<td></td>
<td>39%</td>
<td>Is open to new ideas and approaches</td>
</tr>
<tr>
<td></td>
<td>38%</td>
<td>Creates a feeling of succeeding and failing together</td>
</tr>
<tr>
<td></td>
<td>38%</td>
<td>Helps me grow into a next-generation leader</td>
</tr>
<tr>
<td></td>
<td>37%</td>
<td>Provides safety for trial and error</td>
</tr>
</tbody>
</table>
Start With Values: Guideposts

Honesty, Integrity, Freedom, Respect, Justice, Peace, Love, Kindness

Your Future, Our Focus
What we believe in: Values
What we want to be: Vision
Why we exist: Mission

Your Future, Our Focus
What are your organization’s values?

• What are those standards that we are going to hold ourselves accountable?
• What can the people we serve expect from interactions with your organization, no matter what the circumstances?
• What sets us apart from others who do similar work?
• Can we live up to our values in everything we do?
Governance
Nonprofit Governance

Internal
- Board
- CEO
- Program dir.
- Program officers
- Evaluation staff

External
- Gov't (decision makers)
- Media
- Other funders/NPs
- Industry
- Grantees
- Gov't (staff)
- Other funders/NPs
- Academics
Who is responsible for managing risk?

- The Board is responsible for understanding:
  - the rules in the organization
  - The risk management process
  - How the organizational policies are communicated and implemented
  - Issues such as law, litigation, compliance, ethics and disclosure
Charities should generally not compensate persons for service on the board of directors except to reimburse direct expenses of such service. ... Charities may pay reasonable compensation for services provided by officers and staff. In determining reasonable compensation, a charity may wish to rely on the rebuttable presumption test of section 4958 of the Internal Revenue Code and Treasury Regulation section of 53.4958-6.

Source: IRS publication Governance and Related Topics - 501(c)(3) Organizations (2008)
Directors and Officers Liability

• Risk areas:
  NOT
  – Exercising due diligence
  – Enforcing term limits
  – Properly recording board actions in minutes
  – Giving comprehensive new board member orientation
  – Requiring or enforcing board member performance expectations
  – Providing board members with the requisite data and background information for informed decisions
## Interview Checklist

If you’re thinking of joining a charity board, here are 10 questions you might want to ask:

| ✔ Can I see the organization’s annual report? |
| ✔ Can I see the most recent audited financial statement? |
| ✔ Can I see the long-range program and financial plan? |
| ✔ Can I see a list of current board members, titles, and all affiliations? |
| ✔ Can I see a description of board members’ responsibilities? |
| ✔ Can I see a board organization chart? |
| ✔ Can I see a staff organization chart? |
| ✔ How much is each board member expected to give? Is there a minimum? |
| ✔ How many board meetings are there per year? |
| ✔ Can I go on a program site visit? |

*Source: WSJ reporting*
Board Standards of Conduct

- **Duty of care**: board members act like any reasonable person in similar circumstances (diligent, attending meetings, understanding the issue before decisions)

- **Duty of loyalty**: act primarily in the interest of the organization not themselves

- **Duty of obedience**: act according to the law and in accordance of their mission
State Law Considerations
Illinois Requirements

- Initial registration with Attorney General’s office (fee)
- Need to file articles of incorporation (filed with Secretary of State) and bylaws
- Annual financial report due within six months of fiscal year, CPA opinion must accompany report if revenues exceed $300,000 (as of January 2010)
- Fees for late registration or annual report
Charitable Organization Laws

1. The Illinois Charitable Trust Act
2. Solicitation for Charity Act
3. Illinois Criminal Code
Federal Law Considerations

- IRS: charitable contribution deductions, unrelated business income tax, noncash gifts, donor advised funds
Tax-Exempt Status Benefits

• The benefits of having 501(c)(3) status include exemption from federal income tax and eligibility to receive tax-deductible charitable contributions.

• Another benefit is that some organizations may be exempt from certain employment taxes.

• An IRS determination of 501(c)(3) status is recognized and accepted for other purposes. For example: state officials may grant exemption from state income, sales, and property taxes; and the U.S. Postal Service offers reduced postal rates to certain organizations.
Need to Know

• State employment law
• Federal employment law
• Staff benefits
• Employment tax collection and submission
• Payroll management
• Volunteer management
• Job descriptions for staff and volunteers
• Liability for staff and volunteers
Staff Compensation

Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1a Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization’s tax year.

- List all of the organization’s current officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.
- List all of the organization’s current key employees, if any. See instructions for definition of ‘key employee’
- List the organization’s five current highest compensated employees (other than an officer, director, trustee, or key employee) who received reportable compensation (Box 5 of Form W-2 and/or Box 7 of Form 1099-MISC) of more than $100,000 from the organization and any related organizations.
- List all of the organization’s former officers, key employees, and highest compensated employees who received more than $100,000 of reportable compensation from the organization and any related organizations.
- List all of the organization’s former directors or trustees that received, in the capacity as a former director or trustee of the organization, more than $10,000 of reportable compensation from the organization and any related organizations.

- **Reasonable Compensation:** based on size of budget, number of employees, education and training required, market area (cost of living)
Nonprofit Sustainability = “the double bottom line”

**Financial EFFICIENCY**

Money
- Are we managing our resources for maximum efficiency?
- Are we getting enough financial return/profitability to continue?
- How do we measure this?

**Program EFFECTIVENESS**

Mission
- Are we meeting our program goals and objectives (inputs, outputs, outcomes)?
- Are we having an impact on our mission?
- How do we measure this?

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*Your Future, Our Focus*
Sarbanes-Oxley and Nonprofits

• The Act mostly does not apply to nonprofit
• BUT it does apply to nonprofits in the provisions relating to penalties for obstruction of justice, including through document destruction or retaliation against whistleblowers
The Nonprofit Accountability Climate

- Government: more regulation
- Self-regulation: accountability clubs, standards and codes within the sector and within sub-sectors
- Public: call for transparency, accountability, effectiveness
- “Fuzzy” definitions of nonprofits; partnerships, contractual relationships, social-entrepreneurs, quasi-public, quasi-nonprofits
Myths

• The larger the organization, the higher the risk for fraud or other ethical violations
• Policies prevent fraud and ethical violations
• The staff makes sure the organization is protected
Practices that Demonstrate Accountability and Transparency

- Code of ethics
- Conflict of interest policy
- Document retention policies
- Ethical fundraising practices
- Ethical leadership
- Financial transparency
- Internal controls
- Public disclosure policy - State laws may independently require nonprofits to disclose various documents to the public.
- Whistleblower protection policies
Types of Reporting

Mandatory

- IRS 990
- Audited Financial Statements
- Board Minutes

Voluntary

- Annual Report
- Audited Financial Statements
- Strategic Plans
- Meetings
- Budgets
- Strategic Plans
- Website
- Ads

External

Internal

Performance Data Reports
Online Accountability: Website

- Policies and code of ethics
- Financial transparency: years of 990s, audited financial statements
- Annual reports
- Strategic plans
- Performance Reports
- Board names, bios, contact information
- Staff names, bios, contact information
What you can do

• Know your risks
• Have a communications plan to address a crisis
• Review and update any policies concerning privacy of clients, employees etc.
• Have open and frequent discussions about ethics, what your organization stands for
• Model high ethical standards for staff, board members and staff
• Admit when something goes wrong and work openly to fix it
Resources

- Nonprofit Times
- Nonprofit Quarterly: The Ethicist column
- National Council of Nonprofits
- Forefront: state nonprofit association
  [https://myforefront.org/](https://myforefront.org/) Free and fee-based programs and events
Charity Watchdogs

- Guidestar [www.guidestar.org](http://www.guidestar.org)
- BBB Wise Giving Alliance [Standards for Charitable Accountability](http://www.bbb.org)
- Charity Navigator [Charity Navigator Ratings](http://www.charitynavigator.org)
- Standards for Excellence Institute [Standards for Excellence: An Ethics and Accountability Code for the Nonprofit Sector](http://www.sfeinstitute.org)
Board Source

- BoardSource offers Downloadable Policy Samplers in 10 different topic areas to help you create specific policies.
- Publication Date: 2013
  - $ 13.25 - Member Price
  - $ 19.50 - Nonmember Price
- The Ethics and Accountability Sampler includes 46 samples on the following:
  - Mission and Vision
  - Values
  - Code of Ethics
  - Diversity Statement
  - Conflicts of Interest
  - Confidentiality
  - Whistleblower Protection
  - Record Retention and Document Destruction
CODE OF ETHICAL STANDARDS

ETHICAL STANDARDS (Adopted 1964; amended Oct 2014)

The Association of Fundraising Professionals believes that ethical behavior fosters the development and growth of fundraising professionals and the fundraising profession and enhances philanthropy and voluntarism. AFP Members recognize their responsibility to ethically generate or support ethical generation of philanthropic support. Violation of the standards may subject the member to disciplinary sanctions as provided in the AFP Ethic Enforcement Procedures. AFP members, both individual and business, agree to abide and ensure, to the best of their ability, that all members of their staff abide by the AFP standards.

PUBLIC TRUST, TRANSPARENCY & CONFLICTS OF INTEREST

Members shall:
1. not engage in activities that harm the members’ organizations, clients or profession or knowingly bring the profession into disrepute;
2. not engage in activities that conflict with their fiduciary, ethical and legal obligations to their organizations, clients or profession;
3. effectively disclose all potential and actual conflicts of interest; such disclosure does not preclude or imply ethical impropriety;
4. not exploit any relationship with a donor, prospect, volunteer, client or employee for the benefit of the members or the members’ organizations;
5. comply with all applicable local, state, provincial and federal civil and criminal laws;
6. recognize their individual boundaries of professional competence;
7. present and supply products and/or services honestly and without misrepresentation;
8. establish the nature and purpose of any contractual relationship at the outset and be responsive and available to parties before, during and after any use of materials and/or services;
9. never knowingly infringe the intellectual property rights of other parties;
10. protect the confidentiality of all privileged information relating to the donor/prospect relationships;
11. never disparage competitors untruthfully.

SOLICITATION & STEWARDSHIP OF PHILANTHROPIC FUNDS

Members shall:
1. ensure that all solicitation and communication materials are accurate and correctly reflect their organization’s mission and use of solicited funds;
2. ensure that donors receive informed, accurate and ethical advice about the value and tax implications of contributions.

COMPENSATION, BONUSES & FINDERS’ FEES

Members shall:
1. not accept compensation or enter into a contract that is based on a percentage of contributions, nor shall members accept finder’s fees or contingent fees;
2. be permitted to accept performance-based compensation, such as bonuses, only if such bonuses are in accord with prevailing practices within the members’ own organization and are not based on a percentage of contributions;
3. neither offer nor accept payments or special considerations for the purpose of influencing the selection of products or services;
4. not pay finder’s fees, commissions or percentage compensation based on contributions;
5. meet the legal requirements for the disbursement of funds if they receive funds on behalf of a donor or client.

TREATMENT OF CONFIDENTIAL & PROPRIETARY INFORMATION

Members shall:
1. not disclose privileged or confidential information to unauthorized parties;
2. adhere to the principle that all donor and prospect information created by, or on behalf of, any organization or a client is the property of that organization or client;
3. give donors and clients the opportunity to have their names removed from lists that are sold, rented or exchanged with other organizations;
4. when soliciting fundraising results, use accurate and consistent accounting methods that conform to the relevant guidelines adopted by the appropriate authority.
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www.nonprofitscholar.com