The Effects of Nonprofit Accountability Ratings on Donor Behavior

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Although accountability systems are established to ensure organizational adherence to financial and ethical standards for nonprofit organizations, the reality of whether such standards make a difference to donors has not been measured. This article discusses the current landscape of accountability systems and accountability ratings and describes a model for estimating the effect of ratings systems on donor behavior within the theoretical context of information asymmetry. Hypotheses are tested with nonprofit ratings for New York charities from the Better Business Bureau’s Wise Giving Alliance to estimate the effect of accountability ratings on the amount of contributions an organization receives. Results indicate that the Wise Giving Alliance “pass” ratings have a statistically significant effect on the contributions received; however, “did not pass” ratings are nonsignificant. The study is important for academics as well as practitioners who are monitoring time and money spent on accountability issues.

Keywords: accountability; nonprofit ratings; charity standards; watchdog ratings

We want our nonprofit organizations to do good and to be good. Although accountability systems are established to ensure organizational adherence to financial and ethical standards for nonprofit organizations, the reality of whether such standards make a difference to donors has not been explicitly measured.

Accountability is necessary to promote public trust in the third sector. Although state regulations monitor fiscal policy and practices in conjunction with the laws of the state, many watchdog organizations and nonprofits themselves feel that these state regulations fall short of the need for accountability. After calls in the 1980s and 1990s for greater accountability in the nonprofit sector as evidenced by legislative hearings, multiple organizations created their own standards or voluntarily adopted those already established by another organization. Early accountability standards concentrated on financial and fund-raising best practices; however, these early models have expanded in recent years to encompass all areas of institutional governance. Along with suggesting or promoting guidelines for accountability in an effort to alleviate...
information asymmetry,\(^1\) or varying levels of information between organizations and their individual target groups, some organizations such as the Better Business Bureau (BBB), Ministry Watch, the Maryland Association of Nonprofit Organizations, and other watchdog nonprofits have instituted ratings systems that are available to the public, along with extensive reports on individual charities. The ratings provide easier outside scrutiny of an organization over a range of disclosures and best practices. Such ratings are the subject of this study.

Toward the end of understanding how such ratings affect nonprofits, this article discusses the current landscape of accountability systems and accountability ratings and the scholarly work in the subject and, finally, describes a model for estimating the effect of ratings systems on donor behavior. Some scholars agree that accountability measures are necessary and greater accountability is required (Moore, 2001); however, we have failed to statistically measure whether or not such mechanisms influence a donor’s decision to give. This study fills this void in the literature and informs the decisions of academics and nonprofit managers.

**Literature Review**

The issue of accountability has received broad attention. Although most scholars in the field recognize the need for and promote the use of accountability systems (Brody, 2002; Gronbjerg, 1993; Salamon, 1999, 2002, 2003; Weisbrod, 1977), some have focused specifically on the effectiveness of nonprofit accountability systems (Bennett & DiLorenzo, 1994; Bies, 2001; Edwards & Hulme, 1996; Kanter & Summers, 1987; Murray, 2001), yet none to date has systematically pursued the effect of accountability ratings on organizations or their donors. Although accountability has been defined in a variety of ways, within this context of ratings systems, the definition of accountability relies on the boundaries established under these systems. For example, accountability means meeting the requirements set forward by ratings organizations within the categories of financial transparency, human resources equity, open disclosure in marketing and fund-raising publications, and so on. As such, this accountability definition incorporates the tendencies of ratings systems to combine both general management practices (e.g., specifying how often boards should meet and their recommended composition) and disclosure activities (e.g., requiring an annual report available for public review). Therefore, this definition complements but is not limited to more formal definitions of accountability, which include the process of financial reporting, aligning mission with resources or managing resources in a way to optimize performance.

Accountability in terms of federal and state regulatory compliance has been examined (Irvin, 2005; Peters, 2001) and criticized for focusing too intently on adhering to accountability measures regardless of programmatic outcomes, whereas other academics and practitioners offer prescription for governmental oversight (Moore,
2001) or greater nonprofit autonomy (Biggs & Neame, 1996). On a broader scope, other scholars have examined the accountability landscape of entire countries, including Ireland (Hayes, 1996), Bombay (Desai & Howes, 1996), Bangladesh (Karim, 1996), Africa (Anheier, 1987; Gariyo, 1996), Latin America (Bejar & Oakley, 1996), Europe, and Central America (Biekart, 1996).

Bennett and DiLorenzo (1994) provide an empirical study of effectiveness of accountability measures in their study of the health care industry. After scrutinizing the “Big Three” medical research and health promotion charities—the American Cancer Society, the American Heart Association, and the American Lung Association—the authors conclude that accountability standards within the health care industry are ineffective. After discussing donors’ decisions to give to health care charities, the authors turn to ratings systems by two watchdog agencies—the National Charities Information Bureau (NCIB) and the Philanthropic Advisory Service (renamed the Wise Giving Alliance) of the BBB—stating, “Neither auditors nor rating services have uncovered malfeasance in the past. . . . Clearly, something is amiss” (Bennett & DiLorenzo, 1994, p. 222). What do the authors recommend as a cure to this ill? In part, they recommend greater flow of information to the public with regard to a charity’s activities. Information asymmetry between donors and organizations will provide the basis for the hypotheses presented in this article.

**Current Accountability Ratings**

As normative frameworks, ratings systems are designed to influence the behavior of nonprofit managers and their organizations. By conforming to standards or best practices recommended by rating organizations, a nonprofit signals to donors, board members, and other target groups its professionalism and responsibility in carrying forward its service or activity in accordance with public trust. To the extent that such standards are coercive, organizations may respond within the spirit of the standards, that is, for the betterment of the organizations and its target groups, or outside the spirit of the standards, providing the appearance of conformity without genuinely disclosing information or altering an organization’s operations accordingly. However, accountability recommendations and ratings systems in particular generally engender positive and admirable efforts on behalf of nonprofits to communicate honestly and effectively with the public and manage responsibly.

According to a 2001 Wise Giving Alliance survey of 2,003 adult Americans conducted by Princeton Survey Research Associates, donors prefer to get information from charities directly, followed by friends and family, and then watchdog organizations. Although charities, families, and friends all convey specific biases in their information, ideally, watchdog organizations provide unbiased, objective information concerning an organization. Recommendations for organizations seeking to convey greater accountability abound from watchdog groups, professional organizations, and
concerned agencies. The Independent Sector’s (2008) clearinghouse of accountability standards compiles close to 100 codes and standards governing (a) public charities, (b) foundations, (c) professional practices and standards for individuals, (d) standards for online giving, (e) standards for gift-in-kind, and (f) marketing guidelines. Even so, organizations of external review are few with most nonprofits left to their own self-regulation; however, the BBB’s Wise Giving Alliance, American Institute of Philanthropy, Charity Navigator, and Ministry Watch offer an external review process resulting in a rating or ranking of the charities they analyze. These external organizations rate institutions according to varying criteria concerning governance, fund-raising, human resources, informational transparency, and others and, in so doing, establish a set of best practices and disclosure activities toward which an organization should purportedly strive. In addition, some nonprofit watchdog groups provide standards and accountability grades to nonprofits within specific geographic borders, such as the Maryland Association of Nonprofits.

The underlying theme of such ratings systems is that of helping donors make well-informed decisions about where to place their giving power. For example, the Wise Giving Alliance (2007) states, “The BBB Wise Giving Alliance offers guidance to donors on making informed giving decisions through our charity evaluations”; Charity Navigator’s (2007) self-avowed purpose is “to advance a more efficient and responsive philanthropic marketplace by evaluating the financial health of America’s largest charities”; Ministry Watch (2007) calls itself “a place where you can learn about how to be a ‘responsible giver’”; and the American Institute of Philanthropy (2007) refers to itself as “a nationally prominent charity watchdog service whose purpose is to help donors make informed giving decisions.”

Ironically, in some academic articles, the effects of accountability on donor behavior are viewed as somewhat incidental to the issue. For example, in Hayes’s (1996) study, donors’ response to accountability is listed under the category of “perceived advantages of accountability.” In other words, organizations believe that accountability matters to donors, but they are not certain. Such uncertainty results from the fact that organizations have incomplete information about donor behavior, and at the reverse end of the spectrum, donors have incomplete information about organizations.

Incomplete information on the part of the donor translates into information asymmetry where nonprofit organizations gain a strategic advantage over donors by withholding negative information and publicizing positive ratings and other information such as “feel good” stories about their organization. The Wise Giving Alliance study addresses this phenomenon, citing that inability to access relevant information limits people’s ability to distinguish charities that deserve their support from those that do not. Seven in 10 adults (70%) say it is difficult to know whether or not a charity asking for their support is legitimate. . . . People’s main source of information to help make giving decisions are the charities themselves, but only half (50%) of the public credits charities with making the appropriate information available. (www.give.org)
The Wise Giving Alliance study indicates that half of the donors surveyed are aware of selective information sharing on the part of nonprofits (whether through purposeful neglect or some more benign reason such as lack of understanding of reporting requirements) and also that organizations are the preferred source of gathering information, a definite conflict and potential source of frustration for donors. Understanding this, the nonprofit watchdog organization Ministry Watch has a special transparency rating that relates how difficult it is to obtain information from the organization, a rating that recognizes that some organizations purposefully withhold information to maintain an advantage over potential donors.

A donor will possess varying amounts of information with regard to an organization he or she is considering supporting. Most likely, high-end prospects, those with the capacity to make a major gift to a nonprofit, will receive the most attention from an organization and therefore will have more information than donors who are solicited at a lower dollar amount. If this holds true, donors in the higher prospect categories will be well informed with organizations providing less information to donors expected to make a smaller donation. From the donor’s perspective, someone who is not making a major contribution is not making as large of a financial investment in the organization and will therefore have less interest in learning a great deal about its accountability practices. Although the current data do not allow for analysis of the size of individual donations, from a theoretical perspective, we would expect high-capacity donors to be most affected by ratings because a larger investment constitutes more information gathering; however, ratings would also affect highly motivated donors with lower capacity who actively seek information.

Although the ratings systems are intended to alleviate the problem of incomplete information and information asymmetry, at least from the donor perspective, this study seeks to determine whether or not they accomplish this goal. To test the effect of such ratings on donor behavior, the discussion needs to be placed within the theoretical context of information asymmetry, which leads to three possible hypotheses.

Hypothesis 1: An unknown rating will not affect donations, either positively or negatively.
Hypothesis 2: A known “pass” rating will increase donations to an organization.
Hypothesis 3: A known “did not pass” rating will decrease donations to an organization.

Data

To estimate the effect of accountability ratings on the amount of contributions an organization receives, this study focuses on the Wise Giving Alliance ratings for organizations in New York State with an emphasis on New York City. The model incorporates the variables as described in Table 1, including total contributions, rating, total revenue, fund-raising expense, and organization type from a group of 683 New York 501(c)(3) organizations.
The Wise Giving Alliance rating is conferred on an organization after the BBB has assessed the organization relative to the categories of Governance & Oversight, Measuring Effectiveness, Finances, and Fundraising & Informational Materials. (See the appendix for a complete description of each BBB criterion.) In 2005, more than 2.2 million charity reports were viewed online through this service (www.give.org). A print version of the New York State Wise Giving Guide is also available and provided the ratings for this study. Because the Wise Giving Alliance cannot feasibly rate every nonprofit organization, one limitation of this process is that rated organizations are selected for assessment in response to a consumer/donor request outside of the BBB or a contact from someone within an organization that wishes to be rated. In this environment, consumer contacts receive priority and the BBB has a policy of giving assessment priority to those organizations that are larger and/or receive the most consumer requests for ratings. As a result, larger organizations with higher revenues are more likely to be rated than smaller, less well-known organizations. The sum of these processes means that the Wise Giving Alliance can only assess a small portion of the total nonprofit population within the state.

The data for the New York State organizations’ contributions, total revenue, fund-raising, and NTEE classification are found in the Internal Revenue Service (IRS) 990 data for the years 2000 and 2001 located on the IRS Web site. These data sets contain information from the IRS Form 990, which nonprofit organizations having total revenues greater than $25,000 are required to file annually. Limitations on the 990 data exist because (a) only organizations required to do so file the reports so that many small organizations are omitted, and (b) the reporting is self-disclosed. According to the National Center for Charitable Statistics (2006), approximately two thirds of organizations registered as nonprofits do not file 990s.

Furthermore, research indicates that nonprofits egregiously underreport fund-raising expenses on Form 990 (Hager, 2003; Hager, Rooney, & Pollak, 2002; Krishman,

<table>
<thead>
<tr>
<th>Variable Identity</th>
<th>Variable Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions</td>
<td>the amount of private contributions and dues received by the nonprofit organization, including grants</td>
</tr>
<tr>
<td>Rating</td>
<td>a dummy variable for Better Business Bureau rating (1 = pass, 2 = did not pass, 3 = not rated, 4 = cannot be determined)</td>
</tr>
<tr>
<td>Total revenue</td>
<td>the total revenue of the organization</td>
</tr>
<tr>
<td>Fund-raising</td>
<td>a fund-raising composite variable that includes any professional fund-raising fees, internal fund-raising fees, and special events expenses</td>
</tr>
<tr>
<td>Organization type</td>
<td>a dummy variable for organizational classification derived from the National Taxonomy of Exempt Organizations, as noted in Table 4</td>
</tr>
</tbody>
</table>
Yetman, & Yetman, 2006; Tuckman & Chang, 1998), which warrants caution when interpreting results on the fund-raising variable. The fund-raising variable is a composite of any professional fund-raising fees, special events expenses, and total internal fund-raising expenses as reported by the organization.8 Total revenue for each organization was used as a measure of the scale of the organization under the assumption that larger organizations would have the human resources capacity to garner additional resources through fund-raising activities. The contribution variable is taken from the Form 990 gifts, grants, and contributions line.

The National Taxonomy of Exempt Entities (NTEE) developed by the National Center for Charitable Statistics provides a classification system for organizations based on organizations’ self-described, primary purpose as revealed to the IRS (Lampkin, Romeo, & Finnin, 2001). These classifications are expressed in categories ranging from 10 to approximately 400 stratifications, depending on the level of specificity required. Although some organizations serve more than one purpose, the NTEE code demonstrates the primary purpose of the organization; a drawback of these data is their inability to reflect multiple missions. The NTEE Major Group code was selected for this project because it contains 26 classification codes, enough to provide ample variation of the data without overconstraining the results. Because the data are cross-sectional instead of panel, the year is included as a dummy variable to determine whether the year of data collection had an effect on the model.

The original data sets contain organizations from all 50 U.S. states; therefore, New York organizations were extracted from the whole. First, any organization that did not contain information in the total revenue category was extracted from the list through a process of selective deletion. The remaining New York organizations were then matched with their corresponding BBB rating according to the 1999 and 2000 ratings published in the Wise Giving Guide. The 1999 ratings were matched with financial data from 2000, and the 2000 ratings were matched with financial data from 2001 with the understanding that organizations would reap the benefit of a good rating or detriment of a poor rating in the following giving year. This lagged variable effectively deals with any endogeneity between prior year giving and other potential endogeneity problems.

One hundred forty-six organizations in the abbreviated New York State nonprofit list had a corresponding BBB rating, and 537 organizations in New York that did not have a BBB rating were randomly selected from the remaining organizations to serve as a base of comparison, for a total sample of 683 organizations. Of those organizations assessed by the Wise Giving Alliance, 66% had a pass rating, 17% were listed in the Giving Guide with no rating given, and 16.3% received a mark of undetermined.9 From the 1999 and 2000 Wise Giving Guide, several organizations were given a rating for which IRS data were not available and were subsequently omitted from the regression. Tables 2 through 4 contain descriptive statistics for the variables of both the rated and unrated portions of the data.10
The model asserts that contributions are a function of the rating, total revenue, fund-raising, year, and NTEE classification for each organization, or

\[ \text{Contributions} = f(\text{Rating}, \text{Total Revenue}, \text{Fund-raising}, \text{Year}, \text{and NTEE Classification}) \]

The effect of the rating was estimated using OLS (ordinary least squares) regression, and the Wald test determined that all explanatory variables were significant to the model. The BBB pass rating, total revenue, and fund-raising variables have a statistically significant effect on the contributions received by an organization after controlling for fixed effects of organization type, year, and rating. Heteroskedasticity was controlled for because it can be expected that contributions and revenue would associate at a nonconstant rate. All ratings coefficients held the expected signs, except the no pass rating, with pass ratings associated with an increase in giving.\textsuperscript{11} Applying the one-tailed test to the ratings coefficients, which is consistent with Hypotheses 2 and 3, still does not cause the did not pass coefficients to fall within the 90% confidence level. Although the pass rating is significant, the did not pass rating and undetermined rating are not significant.

This finding supports Hypothesis 1, which states that where information is not known, ratings will not affect contributions, and Hypothesis 2, which states that when ratings are known, a positive rating will result in increased contributions. The findings do not support Hypothesis 3, which posits that a known did not pass rating

### Table 2
**Descriptive Statistics for Continuous Variables**

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Median</th>
<th>Standard Deviation</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions</td>
<td>137.75</td>
<td>87.27</td>
<td>313.86</td>
<td>0.00480</td>
<td>3328.79</td>
</tr>
<tr>
<td>Total revenue</td>
<td>373.27</td>
<td>68.15</td>
<td>1,431.88</td>
<td>0.07201</td>
<td>2,1926.33</td>
</tr>
<tr>
<td>Fund-raising</td>
<td>15.29</td>
<td>10.11</td>
<td>32.98</td>
<td>0.00087</td>
<td>397.95</td>
</tr>
</tbody>
</table>

### Table 3
**Percentage of the Data Set With Respective Ratings**

<table>
<thead>
<tr>
<th></th>
<th>% of Data</th>
<th># of Organizations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pass rating</td>
<td>14.20</td>
<td>97</td>
</tr>
<tr>
<td>No pass rating</td>
<td>3.60</td>
<td>25</td>
</tr>
<tr>
<td>Undetermined rating</td>
<td>3.50</td>
<td>24</td>
</tr>
<tr>
<td>Unrated</td>
<td>78.20</td>
<td>537</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>683</td>
</tr>
</tbody>
</table>

**Model and Results**

The model asserts that contributions are a function of the rating, total revenue, fund-raising, year, and NTEE classification for each organization, or

\[ \text{Contributions} = f(\text{Rating}, \text{Total Revenue}, \text{Fund-raising}, \text{Year}, \text{and NTEE Classification}) \]

The effect of the rating was estimated using OLS (ordinary least squares) regression, and the Wald test determined that all explanatory variables were significant to the model. The BBB pass rating, total revenue, and fund-raising variables have a statistically significant effect on the contributions received by an organization after controlling for fixed effects of organization type, year, and rating. Heteroskedasticity was controlled for because it can be expected that contributions and revenue would associate at a nonconstant rate. All ratings coefficients held the expected signs, except the no pass rating, with pass ratings associated with an increase in giving.\textsuperscript{11} Applying the one-tailed test to the ratings coefficients, which is consistent with Hypotheses 2 and 3, still does not cause the did not pass coefficients to fall within the 90% confidence level. Although the pass rating is significant, the did not pass rating and undetermined rating are not significant.

This finding supports Hypothesis 1, which states that where information is not known, ratings will not affect contributions, and Hypothesis 2, which states that when ratings are known, a positive rating will result in increased contributions. The findings do not support Hypothesis 3, which posits that a known did not pass rating
will result in a decrease in donations, thus indicating the impact of information asymmetry on donor behavior. This story can be explained because organizations would happily report a positive rating but tend to hold back a negative rating from public exposure, when possible. Organizations receiving pass ratings from the Wise Giving Alliance are allowed to publish such information and can elect to use the Wise Giving Alliance logo in publications,\(^{12}\) practices that increase the visibility of a pass rating. Therefore, positive ratings are much more likely to be known than negative ratings. In the latter case, a donor or potential donor would need to search the Wise Giving Alliance database directly for the charity’s negative rating to be known.

The coefficient on the rated variable indicates that a BBB pass rating translates into approximately $75,000 more in increased donations to an organization. The total revenue coefficient demonstrates that for every $1,000 in total revenues, an organization will receive approximately $71 in contributions. In terms of organization type, there is no statistical difference between the sectors except for youth development

### Table 4
Number of Organizations in Each National Taxonomy of Exempt Entities (NTEE) Category

<table>
<thead>
<tr>
<th>Organization Type</th>
<th># of Organizations in Each Category</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arts, Culture &amp; Humanities</td>
<td>82</td>
</tr>
<tr>
<td>Education</td>
<td>42</td>
</tr>
<tr>
<td>Environment</td>
<td>14</td>
</tr>
<tr>
<td>Animal-Related</td>
<td>10</td>
</tr>
<tr>
<td>Health Care</td>
<td>83</td>
</tr>
<tr>
<td>Mental Health and Crisis Intervention</td>
<td>19</td>
</tr>
<tr>
<td>Diseases, Disorders &amp; Medical Disciplines</td>
<td>13</td>
</tr>
<tr>
<td>Medical Research</td>
<td>9</td>
</tr>
<tr>
<td>Employment</td>
<td>38</td>
</tr>
<tr>
<td>Housing &amp; Shelter</td>
<td>29</td>
</tr>
<tr>
<td>Public Safety, Disaster Preparedness &amp; Relief</td>
<td>6</td>
</tr>
<tr>
<td>Recreation &amp; Sports</td>
<td>26</td>
</tr>
<tr>
<td>Youth Development</td>
<td>16</td>
</tr>
<tr>
<td>Human Services</td>
<td>99</td>
</tr>
<tr>
<td>International, Foreign Affairs &amp; National Security</td>
<td>7</td>
</tr>
<tr>
<td>Community Improvement &amp; Capacity Building</td>
<td>33</td>
</tr>
<tr>
<td>Philanthropy, Volunteerism &amp; Grantmaking Foundations</td>
<td>25</td>
</tr>
<tr>
<td>Public &amp; Societal Benefit</td>
<td>6</td>
</tr>
<tr>
<td>Religion-Related</td>
<td>10</td>
</tr>
<tr>
<td>Membership &amp; Mutual Benefit</td>
<td>67</td>
</tr>
<tr>
<td>Unknown</td>
<td>37</td>
</tr>
<tr>
<td>Other(^{a})</td>
<td>12</td>
</tr>
<tr>
<td>Total</td>
<td>683</td>
</tr>
</tbody>
</table>

\(^{a}\) Other is a combined variable including Crime & Legal Related (5), Food, Agriculture & Nutrition (2), Civil Rights, Social Action & Advocacy (2), Science & Technology (1), and Social Science (2).
charities and philanthropy, and volunteerism and grantmaking foundations. As anticipated, the fund-raising variable (which is problematic for reasons mentioned earlier) is highly significant to the model, indicating that for every $1,000 spent on fund-raising, an organization receives $4,766 in contributions. Table 5 demonstrates the regression results for the spectrum of variables included.

Conclusion

This study is significant for academics as well as practitioners who are monitoring time and money spent on accountability issues. Within the constraints of the data, the study estimates that positive accountability ratings increase donors’ contributions to a nonprofit; however, it does not explain why negative ratings do not matter to donors. Negative ratings could be ineffective for several reasons, including the following: (a) Donors and/or potential donors do not know about the ratings given to organizations (the information asymmetry argument), (b) donors and/or potential donors do not care about the ratings because their giving is based in other considerations, such as emotional attachment to a cause, (c) donors and/or potential donors do not attach credence to ratings that evolve from a system of self-regulation, or (d) donors and/or potential donors who are informed about a particular charity may be aware of extenuating circumstances that resulted in a negative rating. For example, in the latter case, a board member may know that a nonprofit was rated poorly due to its board meeting once a year instead of the recommended three times.

Even though this study indicates that a known Wise Giving Alliance pass rating increases positive financial returns for nonprofits, information asymmetry is not completely removed by ratings, even when known. Because of the complex nature of nonprofits as well as the variability in ratings systems, the possibility exists that ratings may be misunderstood, “misinterpreted,” or “misused” (National Council of Nonprofit Associations and National Human Services Assembly, 2005). To be truly well informed, donors may need to invest additional time and energy into researching an organization, so that after discovering an organization’s rating, they may understand the rating’s full significance before making the decision to give to the organization.

If self-regulatory measures, such as ratings provided by watchdog groups, fail to reproach negative practices in the nonprofit sector, the threat of greater government regulation gathers strength (Moore, 2001). Although more than 100 organizations and/or agencies provide accountability frameworks including best practices in general management and the disclosure of information to the public and organizations embrace accountability practices, there are few sanctions for noncompliance outside of donor influence or governmental intervention. Evelyn Brody (2001) determines that donors themselves bear the primary responsibility to hold nonprofits to strict accountability standards; however, this study implies that information asymmetry may prevent donors from obtaining and interpreting ratings from watchdog groups.
to their full advantage. If watchdog organizations can increase the visibility of their ratings systems, perhaps negative ratings as well as positive ones will begin to affect an organization’s contributions, resulting in greater accountability across the sector.
## Appendix

### Better Business Bureau (BBB) Rating Criteria

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Criterion Description</th>
</tr>
</thead>
</table>
| Governance & oversight     | a board of directors that provides adequate oversight of the charity’s operations and its staff  
                              a board of directors with a minimum of five voting members  
                              a minimum of three evenly spaced meetings per year of the full governing body with a majority in attendance, with face-to-face participation  
                              not more than one or 10% (whichever is greater) directly or indirectly compensated person(s) serving as voting member(s) of the board; compensated members shall not serve as the board’s chair or treasurer  
                              no transaction(s) in which any board or staff members have material conflicting interests with the charity resulting from any relationship or business affiliation |
| Measuring effectiveness    | have a board policy of assessing, no less than every 2 years, the organization’s performance and effectiveness and of determining future actions required to achieve its mission  
                              submit to the organization’s governing body, for its approval, a written report that outlines the results of the aforementioned performance and effectiveness assessment and recommendations for future actions |
| Finances                   | spend at least 65% of its total expenses on program activities  
                              spend no more than 35% of related contributions on fund-raising  
                              avoid accumulating funds that could be used for current program activities; to meet this standard, the charity’s unrestricted net assets available for use should not be more than three times the size of the past year’s expenses or three times the size of the current year’s budget, whichever is more  
                              make available to all, on request, complete annual financial statements prepared in accordance with generally accepted accounting principles  
                              include in the financial statements a breakdown of expenses (e.g., salaries, travel, postage, etc.) that shows what portion of these expenses was allocated to program, fund-raising, and administrative activities  
                              accurately report the charity’s expenses, including any joint cost allocations, in its financial statements  
                              have a board-approved annual budget for its current fiscal year, outlining projected expenses for major program activities, fund-raising, and administration |
| Fund-raising and           | have solicitations and informational materials, distributed by any means, that are accurate, truthful, and not misleading, both in whole and in part  
                              have an annual report available to all, on request, that includes                                                                                     |
| informational materials    |                                                                                                                                                                                                                      |
### Appendix (continued)

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Criterion Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>the organization’s mission statement</td>
</tr>
<tr>
<td>2.</td>
<td>a summary of the past year’s program service accomplishments</td>
</tr>
<tr>
<td>3.</td>
<td>a roster of the officers and members of the board of directors</td>
</tr>
<tr>
<td>4.</td>
<td>financial information that includes (a) total income in the past fiscal year, (b) expenses in the same program, fund-raising, and administrative categories as in the financial statements, and (c) ending net assets</td>
</tr>
</tbody>
</table>

include on any charity Web sites that solicit contributions the same information that is recommended for annual reports, as well as the mailing address of the charity and electronic access to its most recent IRS Form 990.

address privacy concerns of donors by

1. providing in written appeals, at least annually, a means (e.g., such as a check-off box) for both new and continuing donors to inform the charity if they do not want their name and address shared outside the organization

2. providing a clear, prominent, and easily accessible privacy policy on any of its Web sites that tells visitors (a) what information, if any, is being collected about them by the charity and how this information will be used, (b) how to contact the charity to review personal information collected and request corrections, (c) how to inform the charity (e.g., a check-off box) that the visitor does not wish his or her personal information to be shared outside the organization, and (d) what security measures the charity has in place to protect personal information

clearly disclose how the charity benefits from the sale of products or services (i.e., cause-related marketing) that state or imply that a charity will benefit from a consumer sale or transaction; such promotions should disclose, at the point of solicitation,

1. the actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to abc charity for every xyz company product sold)

2. the duration of the campaign (e.g., the month of October)

3. any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of $200,000)

respond promptly to and act on complaints brought to its attention by the BBB Wise Giving Alliance and/or local BBBs about fund-raising practices, privacy policy violations, and/or other issues

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Note: Information gathered directly from www.giving.org where more detailed information on each criterion can also be obtained.
Notes

1. The concept of information asymmetry derives from economic literature, primarily transaction theory as developed by Oliver E. Williamson (1975), and is a component of principal–agent theory discussions (see Alchian & Demsetz, 1972). Within this theory, one party or person derives an advantage over another party by having or obtaining more and better information than the other party; therefore, the information bearer gains more power.

2. According to the 2001 Wise Giving Alliance Survey, when presented with a list of seven potential sources of information about charities they might use when making decisions about giving, Americans put charities themselves at the top of the list (50% “very likely” to use), followed by friends and family (47%). The Better Business Bureau (BBB) emerges as the top choice among outside sources (42% “very likely” to use), outscoring Web sites of Internet-based research organizations (31%), the media (25%), and the government (24%) by wide margins. Young adults aged 18 to 29 are the segment of the population most likely to use an Internet Web site (47% “very likely”).

3. Several other organizations including the Evangelical Council for Financial Accountability and Tzedakah, Inc., review organizations and provide information to the public but do not offer a scale for assessment as the rating organizations do.

4. The term philanthropic marketplace is a phrase gaining popularity to underscore the increasing pressures for the third sector to behave more like the market for survival. Largely, the term is meant to indicate the movement of capital between donors and charities and the management of assets by charitable organizations. In some cases, users of the phrase also indicate the competition for resources among charities and the importance of leveraging assets for growth and stability of the sector. The concept considers donors as philanthropic investors who donate to a charity with the expectation of a social return. See the following for more information and examples of usage: http://www.givingnet.net, http://www.philanthropicconsultingservices.com, or Lucy Bernholz’s (2004) Creating Philanthropic Capital Markets: The Deliberate Evolution.

5. Organization theory and finance literature both document the effect of information asymmetry on strategic behavior on an individual and organizational basis.

6. With regard to information asymmetry, the 2001 Wise Giving Alliance survey also finds “The better educated seem as challenged as the less well educated. College graduates are as likely as the less well educated to say they have problems verifying a charity’s legitimacy (69% vs. 70%). When they need information to make decisions about giving, only half of all adults (49%) say it is easy to find what they are looking for.”

7. Citing the Wise Giving Alliance study, Ministry Watch writes, “Americans want to hold charities accountable for their use of funds, but inability to access information often stands in the way. The findings of a national survey sponsored by the BBB Wise Giving Alliance describe the frustrations average citizens face in deciding where to spend their charitable dollars. Most people say it is difficult to tell whether a charity soliciting their contribution is legitimate and to choose between organizations that raise money for similar causes. Americans rely most on charities themselves to provide information to guide their giving decisions, but charities get mixed reviews, at best, for their performance in delivering the relevant facts and figures. Close to half the public believes that charities do not divulge enough information about their activities that prospective donors need to make wise choices.”

8. The number of organizations in the data set makes it unfeasible to gather fund-raising information from the organizations’ annual reports, which would be preferable to the 990 data. Although the fund-raising variable, as constructed, works for the current model in assessing ratings, we would not want to rely on this model to assess the effect of fund-raising costs on total contributions.

9. The undetermined rating is not meant to imply good or ill behavior, only that the Wise Giving Alliance was “unable to determine whether the organization met the . . . standard listed” according to their Web site.

10. The model was also run with 22 outliers removed according to Cook’s D procedure with no effect on the significance of any of the variables involved aside from a change in the magnitude of the coefficients.
11. The model was run with and without a lobbying variable with no effect on the statistical significance of the variables. Total variance on the lobbying mean was 0.193563493 between rated and unrated organizations. Although the lobbying variable is significant without a robust estimation, this significance disappears when controlling for heteroskedasticity. The lobbying variable included the expenses for lobbying to influence public opinion and to influence a legislative body. The reporting of lobbying expenses by a charity is subject to the 5% rule, which states that if a charity does not exceed 5% of its expenses on lobbying costs, the organization can omit reporting the expense. Only 42 of the organizations in this study claimed lobbying expenses. The did not pass coefficient was negative, although still nonsignificant, when the model includes a lobbying variable.

12. The Wise Giving Alliance’s 2001 survey found that donors found the seal a helpful tool, stating, “eight in 10 (84%) adults say it would be at least somewhat helpful to potential donors—including four in 10 (43%) who say it would be very helpful—if an independent organization evaluated charities and awarded a seal to those meeting certain ethical and accountability standards. Subgroups who find the idea of a seal particularly attractive include those inclined to consult the Better Business Bureau for information about charities.” Along with the Wise Giving Alliance, the Evangelical Council for Financial Accountability also allows passing organizations to use a seal on publications.

References


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