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Nonprofit Organizations Show Stronger Ethical Cultures

The results of the National Nonprofit Ethics Survey (NNES) indicate that the ethical conduct of employees in nonprofit organizations in the United States compares favorably to the incidence of ethical misconduct reported in the business and government sectors. The NNES was conducted by the not-for-profit Ethics Resource Center (ERC), and the report marks the first time that survey results for employees of nonprofit organizations have been provided separately from the overall U.S. National Workplace. (This column covered results for the business sector in January 2008 and for government institutions in July 2008.) According to ERC President Patricia Harned, what seems to matter most in terms of ethical conduct "is the extent to which ethics is woven into the fabric of everyday work life and decision making, beginning at the top and moving throughout the organization."

The best news about nonprofit entities is that the ethical culture is rated as strong in more nonprofit organizations (11%) than in business (9%) and government institutions (8%). Nonprofits are also stronger in the four components of ethical culture: ethical leadership, supervisor reinforcement of ethics, peer commitment to ethics, and embedded ethical values. Employees at nonprofits also find a greater alignment of their personal values with the missions and values of their organizations, with 45% of nonprofit employees reporting they believe their jobs never conflict with their personal values—compared to 40% of business employees and 36% of government employees.

Additionally, 34% of employees indicated their organization not only had an ethics and compliance program in place but that the program was implemented well. This compares to only 25% of business and 17% of government employees who indicated an effective program was present in their organization.

Some bad news reported by the NNES study is that the rate of observed conduct that violates the law or an organization's standards is on the rise in nonprofits and has reached a level comparable to that found in business and government. In fact, financial fraud was found to be higher in nonprofit organizations than in business or government organizations. The NNES report concludes that boards of trustees aren't taking advantage of their influence to set clear ethics standards for their organizations.

The most important finding in the report is the analysis of observed misconduct within the varying context of a different strength of ethical culture. A strong ethical culture features four major components:

- *Ethical leadership* means an ethical tone at the top and belief that leaders can be trusted to do the right thing.
- *Supervisor reinforcement* requires that individuals directly above the employee in the organization's hierarchy set a good example and encourage ethical behavior.

◆ *Peer commitment to ethics* means that the ethical actions of peers support employees who "do the right thing."

◆ *Embedded ethical values* connotes the fact that the values promoted through informal communications channels are complementary and consistent with an organization's officially promoted values.

The NNES study found that when a strong ethical culture was present in a nonprofit organization:

◆ No employee felt pressured to compromise ethical standards, compared to 47% of employees in weak ethical cultures.

◆ Only 17% of employees observed misconduct, compared to 100% of employees who did so in organizations with weak ethical cultures.

◆ Every employee (100%) who observed a misdeed reported it, compared to 35% of employees who did so in a weak ethical culture.

◆ No employee experienced retaliation as a result of reporting a misdeed, while 47% of employees in weak ethical cultures experienced retaliation for their actions.

Another interesting finding of the study is the significant effect a well-implemented ethics and compliance program has on reducing ethics risks. In organizations with little to no ethics and compliance program in place, 68% of employees observed two or more types of misconduct over the course of a year. This is significantly reduced to just 22% in organizations that have a well-implemented program. Organizations with a well-implemented ethics and compliance program were found to also have a strong ethical culture.

The ERC has developed an Ethics Risk Index to identify the types of misconduct that present the greatest risk to nonprofit organizations. The projected risk from misconduct falls into three categories: severe risk (happens frequently and usually goes unreported), high risk (happens often and often goes unreported), and guarded risk (happens less frequently and may go unreported). On average, nonprofits face severe risk from a handful of behaviors: conflicts of interest, lying to employees, misreporting hours worked, abusive behavior, and Internet abuse.

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An additional six types of misconduct pose high risk to organizations in the nonprofit sector: safety violations, lying to stakeholders, improper hiring, discrimination, sexual harassment, and misuse of confidential organizational information.

The report concludes that nonprofit organizations now exhibit many of the same shortcomings that have plagued business and governmental organizations even though there's no pressure to earn and distribute profits to shareholders. Additionally, many of the same conclusions apply to all three types of organizations. Implementing and maintaining an effective ethics and compliance program along with a strong ethical culture is critical to avoiding fraud. Management accountants in all types of organizations need to heed this message.

New Research Shows Fraud Challenges Continue

Although the consequences of systemic financial risk seem to dominate the concerns of CEOs, CFOs, and management accountants, new research shows that fraud continues to be a major problem in corporate America. The *2008/2009 Kroll Global Fraud Report*, with research performed by the Economist Intelligence Unit (EIU), shows that fraud and the vulnerability to fraud, when measured according to a variety of metrics, are widespread and increasing. This second annual EIU fraud study surveyed 900 senior executives worldwide.

Average losses reported by companies increased 22% overall from the previous study, and the increase for smaller firms amounted to a 70% increase. Total incidence of fraud increased from 80% to 85% of the

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reporting companies. Only two of the 10 fraud categories showed declines—money laundering and procurement fraud. Increased occurrence was recorded in the categories where fraud was found to be most common: Theft of physical property increased from 34% to 37%, information theft increased from 22% to 27%, and regulatory and compliance breaches increased from 19% to 25%. The number of companies that consider themselves vulnerable to each category of fraud also increased. Seven in 10 respondents consider themselves exposed to information loss or attack, while more than half believe the same for the other three major fraud causes listed here.

The Kroll Report notes that the causes of the increased incidence and vulnerability to fraud include weakening internal controls and high staff turnover. Both of these factors induce much higher levels of fraud than other risks. See Table 1 for a breakdown of how these factors compare across all fraud categories.

The report concludes that money saved by inadequate controls and lower personnel costs resulting in higher turnover might well be lost many times over to fraudulent activity of various kinds. In the long run, fraud proves to be more costly than maintaining adequate control. ■

Table 1. Kroll Report Fraud Categories

	Overall	High Staff Turnover	Weaker Controls
Theft of physical assets	37%	49%	50%
Information theft/attack	27%	36%	36%
Management conflict of interest	26%	33%	41%
Regulatory/compliance breach	25%	31%	36%
Financial mismanagement	22%	26%	40%
Corruption/bribery	20%	23%	37%
Internal financial fraud/theft	19%	24%	34%
Vendor/procurement fraud	18%	23%	31%
IP theft/piracy	16%	18%	16%
Money laundering	4%	6%	6%

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