



ETHICS RESOURCE CENTER'S
NATIONAL NONPROFIT ETHICS SURVEYSM

AN INSIDE VIEW OF NONPROFIT SECTOR ETHICS

2007

Fourth in a longitudinal study of U.S. workplaces

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Founded in 1922, the Ethics Resource Center (ERC) is America's oldest nonprofit, nonpartisan organization devoted to independent research and the advancement of high ethical standards and practices in public and private institutions. For more than 85 years, ERC has been a resource for public and private institutions committed to a strong ethical culture. ERC's expertise also informs the public dialogue on ethics and ethical behavior. ERC researchers analyze current and emerging issues and produce new ideas and benchmarks that matter — for the public trust.

For more information about ERC, please visit our website at www.ethics.org.

Visit our website and sign up to receive additional reports in the National Workplace Ethics Study research series, including:

National Business Ethics Survey

National Government Ethics Survey

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The 2007 NNES is a part of the National Workplace Ethics Surveys, an ongoing research initiative of the Ethics Resource Center. All work in this effort is funded by charitable contributions. Additional donations from individuals, companies, and other organizations will enable ERC to expand its research and conduct further analysis on the data. For more information about how to support the National Workplace Ethics Surveys or other ERC research projects, please visit www.ethics.org.

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The findings and conclusions of this report are those of the Ethics Resource Center alone and do not represent the views of our sponsors.

ABOUT

the Ethics Resource Center's 2007 National Nonprofit Ethics SurveySM

The National Nonprofit Ethics Survey is a distinct and important part of the Ethics Resource Center's ongoing longitudinal survey work, the National Workplace Ethics Surveys¹. Since 1994, the Ethics Resource Center has fielded a nationally-representative poll of employees at all levels to understand how they view ethics and compliance at work. Previous reports presented aggregated findings from the business, government, and nonprofit sectors; 2007 marks the first time a separate nonprofit report has been issued. Henceforth, the findings of the National Workplace Ethics Surveys will be presented primarily through the National Business Ethics Survey, the National Government Ethics SurveySM, and the National Nonprofit Ethics Survey, as well as future web casts, white papers, and research briefs.

This research has become the national benchmark on organizational ethics. It is the country's most rigorous measurement of trends in workplace ethics and compliance, a snapshot of current behaviors and thinking, and a guide in identifying ethics risk and measures of program effectiveness. The 2007 survey is the fifth in the series and the fourth survey which includes nonprofit data.

Over the years, ERC has polled more than 13,500 employees through the National Workplace surveys, representing the U.S. workforce across all sectors. Since 2000, 1,418 employees working in the nonprofit sector have been surveyed. This study is the most exacting longitudinal research effort examining organizational ethics from the employee perspective. The long-term nature of the study is important because it provides context for national trends. The National Workplace research includes the only longitudinal study tracking the views of employees at all levels within organizations to reveal real-life views of what is happening within organizations and the ethics risks they face.

Across all three sectors in 2007, ERC polled a total of 3,452 employees. Responses from the 558 respondents in the nonprofit sector have been isolated and are presented here. A report detailing business findings was released in November 2007 and a similar report covering the government sector was released in January 2008.

Methodology

Participants in the 2007 NNEs were 18 years of age or older; currently employed at least 20 hours per week for their primary employer; and working for an organization that employs at least two people. They were randomly selected to attain a representative national distribution. All interviews were conducted via telephone, and participants were assured that their individual responses to all survey questions would be confidential.

Interviews were conducted from June 25 through August 15, 2007.

Survey questions and sampling methodology were established by ERC; data collection was managed by the Opinion Research Corporation². Analysis by ERC was based upon a framework provided by the Federal Sentencing Guidelines for Organizations and professional experience in defining elements of formal programs, ethical culture, risk, and outcomes.

The sampling error of the findings presented in this report is +/- 4.2 percent at the 95 percent confidence level.

For a detailed explanation of methodology and the methodological limitations of this report and demographic information on survey participants, visit www.ethics.org.

¹ The study was previously referred to as the National Business Ethics Survey®. As of 2007, the National Business Ethics Survey refers only to the report for the business sector.

² For additional information on the Opinion Research Corporation, please see page 32.

FOREWORD

Nonprofits are noble organizations — from their intended missions to their receipt and use of revenue — they exist to serve others. Without civil society organizations, many important social issues would go unaddressed. As a nonprofit ourselves, the Ethics Resource Center walks the same path of many of our nonprofit colleagues — endeavoring to fulfill our mission with the highest integrity possible.

Yet many of our nonprofit peers are in trouble. One would think that, freed from the pressure to generate and distribute profits to shareholders, nonprofit organizations would rise high above the myriad ethics and compliance issues that have plagued the public and private sectors over the years. Unfortunately, the 2007 National Nonprofit Ethics SurveySM (2007 NNESSM) paints a very different picture. The nonprofit sector that for so long enjoyed a better reputation with regard to its ethics now exhibits many of the shortcomings ERC found in its companion surveys of the public and private sectors.

Our goal in this research has been to gauge the views of employees across the country about ethics in their workplace. Our research is guided by the belief that a dedicated focus on ethics at all levels within nonprofits will enhance the good will of the public they serve, and the contributors who perpetuate their work. It is our hope that the 2007 NNES will empower and challenge nonprofit leaders to do a better job in guiding their organizations to operate with integrity. The data in this report proves that not only can it be done, but the results of certain proactive steps are significant.

The 2007 National Nonprofit Ethics Survey is the fourth in a benchmark series going back to 2000, offering perspectives of nonprofit sector by those who are closest to it: their employees. Based on employees' responses, we have created a tool for nonprofit leaders to juxtapose incidence of various types of misconduct with employee reporting. Misconduct that is most prevalent and least reported poses the greatest risk to nonprofit organizations. We look forward to sharing this new tool, ERC's Ethics Risk IndexSM, with organizations so they can benchmark their risk against relevant peers, and identify the specific areas that present the greatest vulnerability.

This NNES, like our surveys of the public and private sector ethics environments, offers good news along with the bad. It also quantifies the findings in a way that makes them applicable to nonprofits of all types and sizes.

The good news:

- When compared with for-profit businesses and government institutions, nonprofit organizations still exhibit stronger ethical cultures and a greater alignment of employees' personal values with the missions and values of their organizations.
- Nonprofit employees who demonstrate ethical courage and report misconduct they have observed are less likely to experience retaliation than employees in other sectors.
- The nonprofit sector provides the best possible example of the difference a well-implemented ethics program and strong culture can make. Where present, levels of misconduct drop to nearly 0 percent, and, when violations occur, 100 percent of employees report the situation to management.

The bad news:

- Conduct that violates the law or an organization's standards is on the rise, and in 2007 nonprofit violations have reached levels comparable to business and government organizations.
- Financial fraud is higher in nonprofit organizations than it is in business or government.
- Boards, while very important in shaping the perceptions of employees with regard to ethics, are not taking advantage of their influence to set clear ethics standards for their nonprofit organizations. Where boards have heavy influence, we also see high levels of misconduct.

By many indications in this research, what seems to matter most 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. A commitment to ethics that engages all employees at all levels and incorporates ethical considerations into operational decisions is critical to reducing misconduct and protecting the good will of the public towards charitable organizations.

The 2007 NNES would not be possible without the generous support of our benefactors. We wish to thank the public and private institutions who made the NNES possible through their financial contribution to ERC. We invite other organizations and individuals to join the effort to promote high ethical standards and conduct in public and private institutions by supporting our research. We also would like to thank the 2007 NNES Advisory Group (p. 31) for their insights and advice.

The Ethics Resource Center's 2007 National Nonprofit Ethics Survey provides much food for thought. It also offers a great deal of information and many insights that can be used by all who are interested in maintaining the integrity of the nonprofit sector. We look forward to continued exploration and quantification of these issues, to hearing from more employees in years to come, and to sharing the insights we gain along the way.



Patricia J. Harned, Ph.D.
President, Ethics Resource Center



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EXECUTIVE SUMMARY

Ethics Resource Center's 2007 National Nonprofit Ethics Survey

To Nonprofit Leadership: What the 2007 NNES Reveals

At present, nonprofit organizations have the strongest ethics standing over any other sector.



Nevertheless, integrity in the nonprofit sector is eroding. Misconduct is on the rise — especially financial fraud.



Governance makes a substantial difference, positively or negatively.



Size makes a difference when it comes to misconduct. Mid-sized organizations are at greatest risk.



Well-implemented programs have made the difference where misconduct has remained low in the nonprofit sector.



A near-perfect result can be achieved. A well-implemented program and a strong ethical culture essentially eliminate misconduct and increase reporting to 100 percent.

Nonprofits Have Strong Ethics, but They are Slipping

This research study looked at ethics in the workplace, from the perspective of employees. In particular, employees offered their perspectives of the standards of their organization, ethical culture, and its influence. The study also looked at ethics risk, defined as the incidence and reporting of misconduct.

Presently, nonprofits have the strongest ethics standing. Eleven percent of nonprofit organizations have a strong ethical culture, more prevalent than business or government sectors. In addition, close to a third of employees work in organizations with a well-implemented ethics and compliance program, higher than any other sector.

However, the high standards of nonprofits are eroding as the percentage of employees who observe misconduct continues to rise. For the first time since ERC began measuring in 2000, more than half of nonprofit employees observed at least one type of misconduct — growing close to levels reported in business and government. The most prevalent types of misconduct are conflicts of interest, lying to employees, abusive behavior, and misreporting hours worked. In addition, the strength of ethical cultures is on the decline.

More nonprofit organizations are midsized, and midsized organizations are experiencing the most misconduct. A shift is taking place in the size of nonprofits today. Roughly 8 percent fewer employees work in small nonprofit organizations in 2007 than in 2006. Seven percent more employees work in midsized organizations. In these larger organizations, misconduct is observed 23 percent more often.

When it comes to ethics, nonprofits have a governance problem. Nonprofit boards of directors have more influence on employees' perceptions of the workplace than directors in other sectors; but employees are least positive about their boards' ethics. Employees who believe their board of directors is the top management in their organizations are 21 percent more likely to observe misconduct and 22 percent less likely to say that they experience strong ethical leadership in their organizations.

Those nonprofit organizations that have kept ethics risk at bay have implemented an effective program. Where misconduct has remained low in the nonprofit sector, the common factor is the presence of a well-implemented ethics and compliance program.

Organizations that establish a well-implemented program and focus on building a strong ethical culture experience the greatest reduction in ethics risk. A strong ethical culture can virtually eliminate pressure to compromise ethics standards and retaliation for reporting. These initiatives also yield increased reporting to 100 percent, and lower observations of misconduct down to 17 percent.



KEY FINDINGS

from Ethics Resource Center's 2007 National Nonprofit Ethics Survey

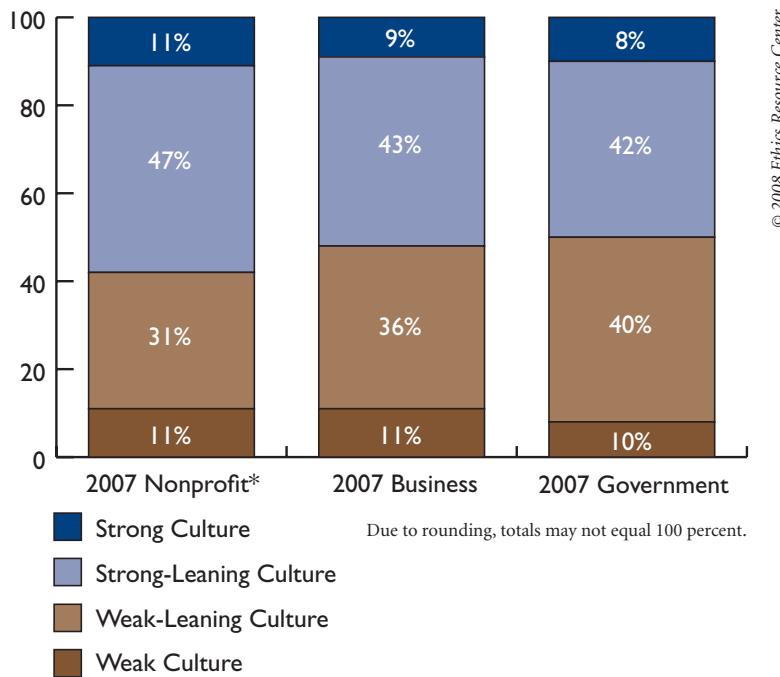
In this section, high-level findings on key ethics indicators are presented. Data shown here is based on the perceptions of nonprofit employees. Nonprofit employees can represent charitable organizations, religious organizations, educational institutions, and associations. Nonprofit employees are individuals who self-identified as employed in this sector.

Presently, Nonprofits Have the Highest Ethics Standing

Nonprofit organizations have a reputation for doing good work that other sectors cannot do. And true to form, the nonprofit sector has done so with high ethics standards.

- **Nonprofit organizations have stronger ethical cultures than any other sector.** Eleven percent of nonprofits have a strong ethical culture compared to 9 percent of businesses and 8 percent of government agencies. In addition, more nonprofits have a strong-leaning ethical culture than business or government. 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.

Strength of Ethical Culture in U.S. Organizations



*All data that follows comes from Ethics Resource Center's National Workplace Ethics Surveys

- ⇒ **Nonprofits are stronger than business and government on three types of peer and top management actions** — communicating about the importance of ethics, setting a good example of ethical behavior, and peer support for doing the right thing.

NOTE: The National Workplace Ethics Surveys are representative surveys of the American workforce. Participants in the surveys are representative of the business, government, and nonprofit sectors. In addition, ERC weights the data collected in accordance with findings from the U.S. Census bureau to further reflect the U.S. population. ERC, therefore, draws the conclusion that a significant portion of the workforce also represents a significant portion of organizations.

KEY FINDINGS

At A Glance

There Are Few Well-Implemented Ethics and Compliance Programs in the Nonprofit Sector

Well-implemented ethics and compliance programs should yield several positive outcomes:

Employees are willing to seek advice;

Employees receive positive feedback for ethical conduct;

Employees feel prepared to handle situations that invite misconduct;

Employees feel that they can question the decisions of management without fear of reprisal;

Employees are rewarded for following ethics standards;

Employees who achieve success through questionable means are not rewarded;

Employees feel positive about their organization's efforts to encourage ethical conduct; and

Employees feel that their organization is an ethical workplace.

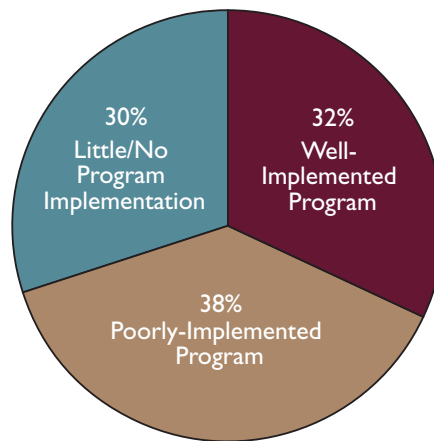
➤ **In addition, nonprofits are also stronger on a key supervisor action.** Nonprofits are only stronger than business and governments in one supervisor action — support for doing the right thing.

➤ **Nonprofits have the strongest embedded ethical values of the three sectors.** Twelve percent of employees in nonprofits work in organizations with strong embedded ethical values.

■ **Nonprofit employees are the most likely to have their values aligned with their jobs.** Forty-five percent of nonprofit employees believe their jobs never conflict with their personal values compared to 40 percent of business employees and just 36 percent of government employees. This is consistent with the image of the sector that people come to nonprofits for their missions of doing good.

■ **Employees in the nonprofit sector believe that their organization has implemented an effective ethics and compliance program.** More than a third (32 percent) of employees indicated that their organization not only has an ethics and compliance program in place, but also that the program is well-implemented. Only 25 percent of business and 17 percent of government employees indicated as such.

About a Third of Nonprofit Ethics Programs Are Well-Implemented



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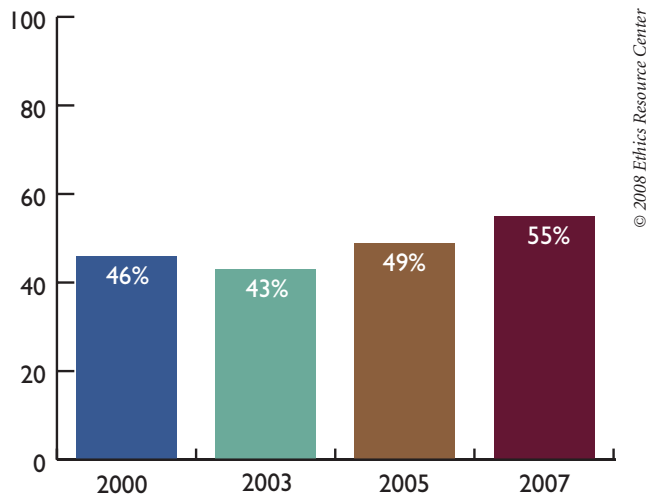
Nonprofits' High Ethics Standards Are Eroding — Valuable Lessons Can Be Learned From Their Decline

Historically, nonprofits have performed better than business and government on key ethics indicators. However, in the past few years, the situation has begun to change. Nonprofits' integrity is slowly weakening, but there are valuable lessons that can be learned from this situation to help prevent further deterioration.

■ **Historically, misconduct has been lower than other sectors, but it is now on the rise.** Rates of observed misconduct in nonprofit organizations are at the highest level since ERC began measuring in 2000. In 2007, more than half (55 percent) of employees observed one or more acts³ of misconduct in the previous year.

³ Note: The total number of acts of misconduct, as well as the types of misconduct, varied in each year (2000 = 11 different kinds of misconduct, 2003 = 9, 2005 = 16, and 2007 = 18). Additional analysis revealed that the average number of different kinds of misconduct observed, relative to the number asked about, has also increased.

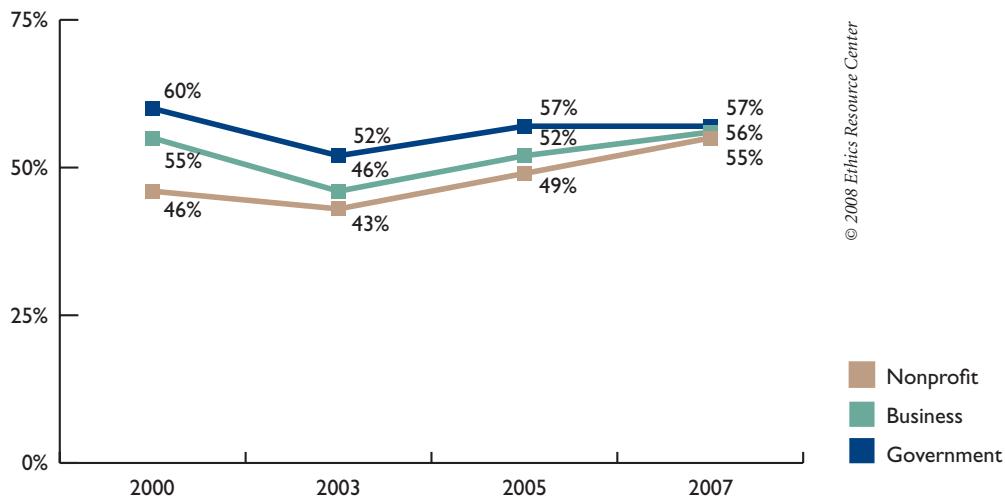
Misconduct Is at Highest Level



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- **Nonprofit misconduct has caught up to other sectors in 2007.** Before 2007, employees in nonprofit organizations observed less misconduct than any other sector, seeing the lowest sector average of 43 percent in 2003. However, this year the level of misconduct in nonprofits is comparable to both the business (56 percent) and government sectors (57 percent).

Nonprofits Historically Observed Less Misconduct, But Have Lost Their Advantage



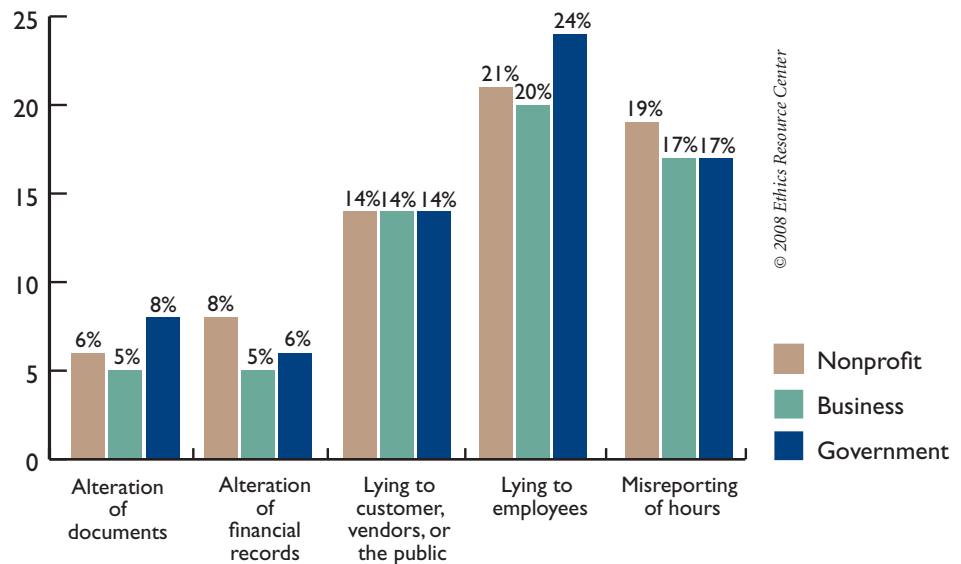
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- **Fraud is as prevalent in nonprofits as it is in business or government.** Nonprofit employees observe instances of fraud as much as employees in the business and government sectors. Fraud, in this study, consists of alteration of documents, alteration of financial records, lying to external stakeholders and employees, and the misreporting of hours.

KEY FINDINGS

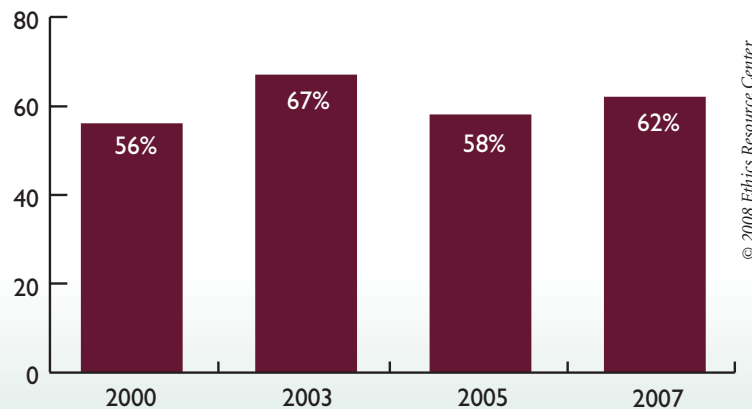
- **Significantly more employees in nonprofits observe financial fraud than in business.** Historically, nonprofits have been comparable to both the business and government sectors (approximately 5 percent in all three sectors) in observations of financial fraud. In 2007, the percentage of employees in nonprofit organizations that observed alteration of financial records jumped to 8 percent which is significantly more than business (5 percent in 2007).

Fraud as Common in Nonprofits as in Business or Government



- **Employee reporting of ethical problems has not improved much.** In general, nonprofit employees have not increased their ethical courage over recent years — nearly 2 out of 5 (38 percent) employees who saw some sort of misconduct remained silent, failing to report their observations to management.

Reporting Patterns Across Years in Nonprofits



- **The strength of ethical culture in nonprofit organizations is on the decline in 2007.** While there are slightly more nonprofits with a strong culture in 2007, more nonprofits also have a weak culture now than in past years. A strong ethical culture is found in organizations where top management leads with integrity, supervisors

At A Glance

Nonprofits Still Have High Standards For Ethics, But Their Prominence Is Slipping

Observations of misconduct have risen from a low of 43 percent in 2003 to a high of 55 percent in 2007.

Fraud is just as common in the nonprofit sector as it is in the private or public sectors.

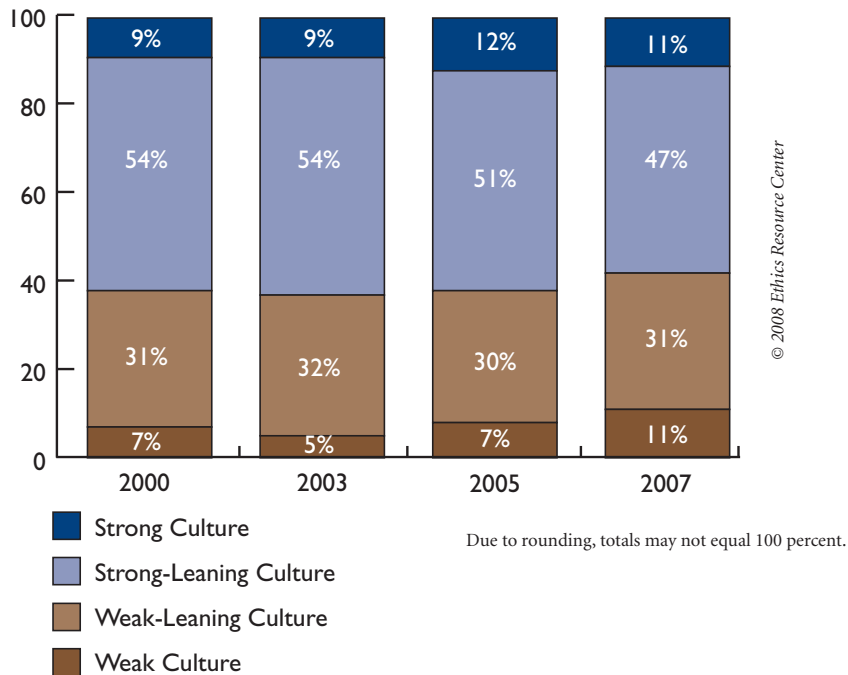
Just two in five employees report their observations of potential violations.

Nonprofits remain the sector with the strongest ethical culture, but it is on the decline. Organizations with weak ethical cultures rose from 7 percent in 2005 to 11 percent in 2007.

Employees in nonprofits are the least positive about the future of their organizations.

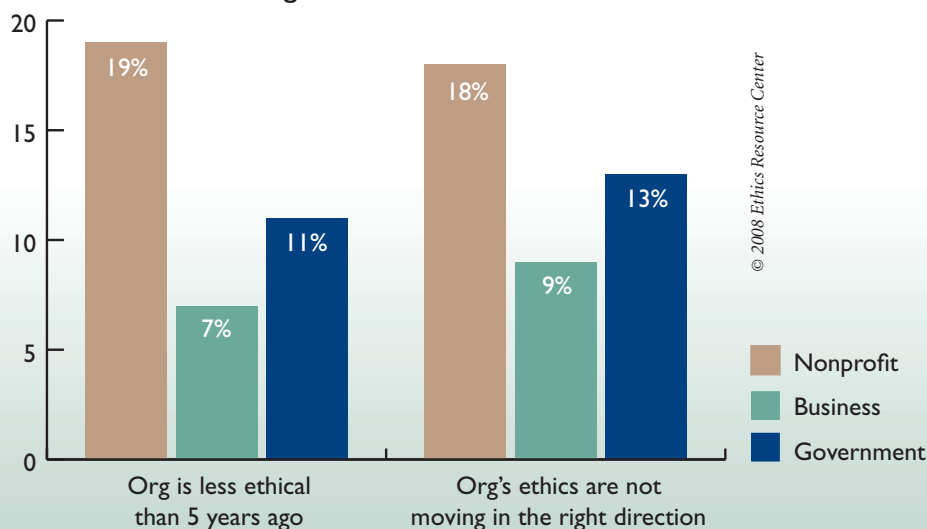
reinforce ethical conduct, peers display a commitment to ethics, and the values of the organization are embedded with decision-making.

Nonprofits Have Increasing Percentage of Weak Ethical Culture



- Nonprofit employees are the least positive of all sectors about the future of ethics in their organizations.** Nonprofit employees are most likely to believe that their organization has become less ethical in the past five years. Nonprofit employees are also less likely to agree that their organization's ethics are moving in the right direction.

More Nonprofit Employees Are Negative About Future of Ethics in Their Organizations Than Business or Government



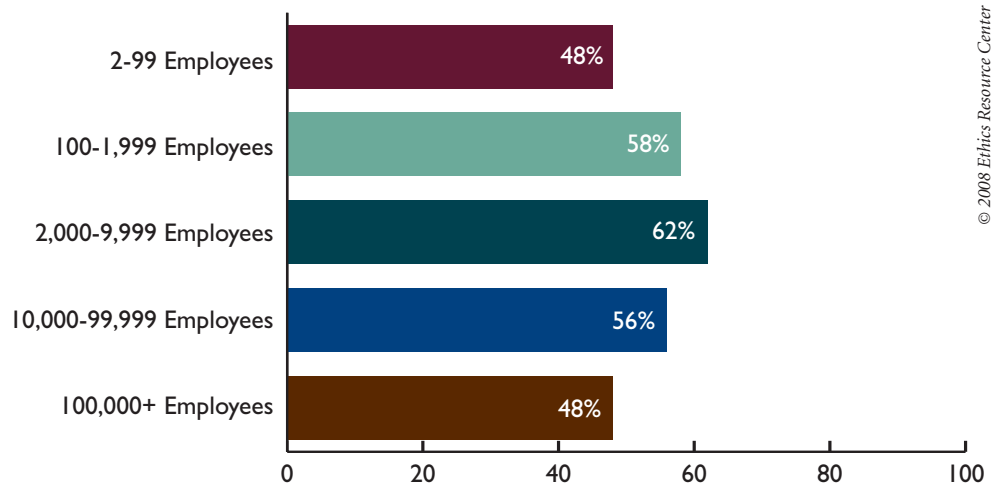
KEY FINDINGS

Ethics Are on the Decline Because of Governance and Growth

Governing bodies of nonprofit organizations have more influence over employees' perceptions of ethics at work than any other sector. This should be an asset to these organizations, especially because nonprofits, like many organizations in other sectors, are showing signs of growth in organizational size. Yet it appears that growth has not brought attention to ethics, especially by governing bodies. Where boards are strong, ethics are weakening.

- **Nonprofits are growing larger, but larger organizations are experiencing more misconduct.** In 2000, 34 percent of employees worked for small organizations of between 2 and 100 employees, and in 2007 just 28 percent of employees work in small organizations. This is compared to 57 percent of employees in 2000 worked for organizations with 100 to 10k employees, and in 2007 that percentage has increased to 61 percent. It is concerning that more nonprofit employees are working for mid-size organizations than in the past because employees of midsize organizations observe the most misconduct.

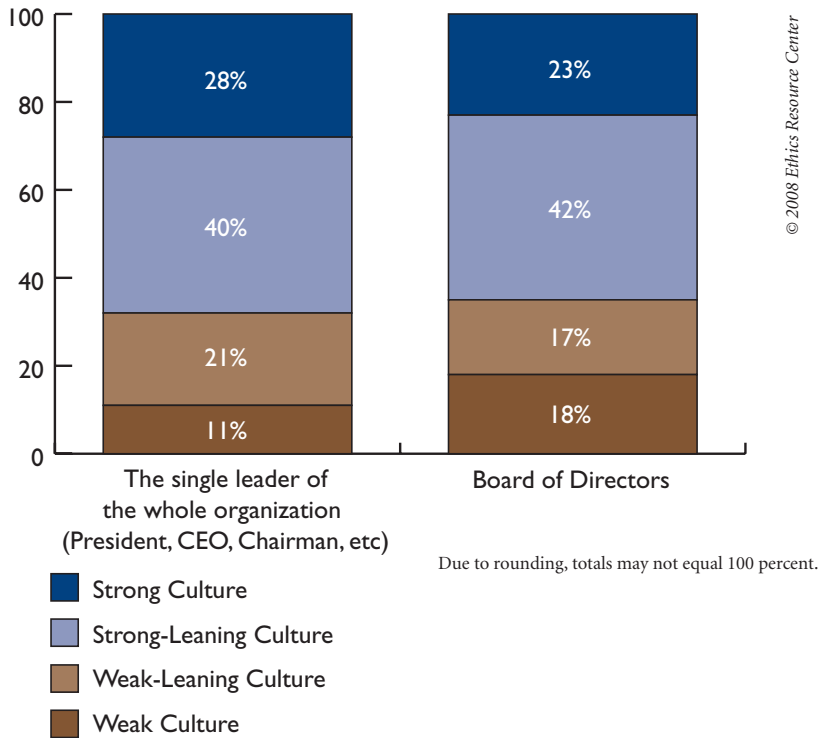
Mid-Size Nonprofit Organizations Observe Highest Rates of Misconduct



- **Employees in nonprofits are most likely to see their board of directors as setting the tone from the top.** Currently, nonprofits are not subject to many of the legislative and regulatory frameworks (such as Sarbanes-Oxley Act of 2002 and SEC and NASD regulations) that have highly influenced the private sector in ethics and compliance matters. The findings of the 2007 NNES, however, show that nonprofit employees have stronger views of the influence of their governing boards when it comes to ethics at work. Thirteen percent of nonprofit employees believe that their boards of directors are the top management who set the tone of their organizations which is higher than business (6 percent) or government (11 percent).
- **Where the board of directors sets the tone, perceptions of ethical leadership are lower.** Employees for whom the board is top management are 18 percent less likely to indicate that the organization has strong ethical leadership compared to employees for whom the president/executive director is top management.

In organizations where the board sets the tone, more employees believe that ethical leadership in the organization is weak.

Where the Board of Directors Sets the Tone Ethical Leadership is Weaker



These employees are less likely to:

- *Be satisfied with the information they receive from top management;*
- *Trust that top management will keep promises;*
- *Agree that top management talks about the importance of ethics;*
- *Think top management sets good examples;*
- *Believe top management is held accountable;*
- *Feel supported by top management in making right decisions;*
- *See considerations of society or employee well-being in organization decision-making;*
- *Question management without fear; and*
- *Believe that the compensation package for senior-most executive is appropriate.*

KEY FINDINGS

At A Glance

Growth in Size of Nonprofits and Governance Issues Contribute to Decline of Nonprofit Sector Ethics

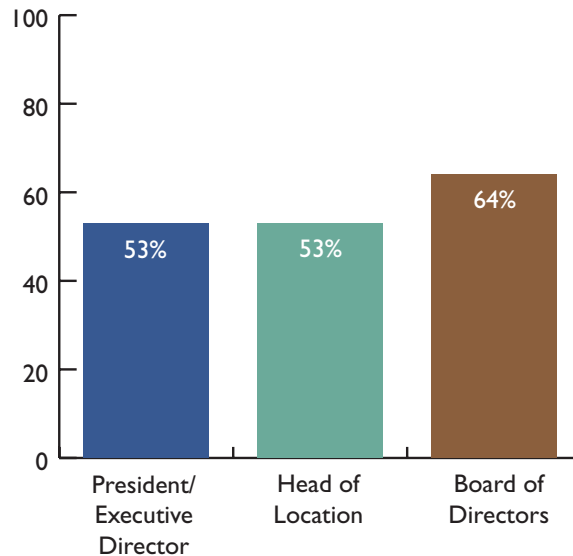
More nonprofit organizations are mid-sized than in the past, and these organizations are experiencing the most misconduct.

The governing boards of nonprofits have a stronger influence on employee perceptions than boards within the private or public sector.

Where boards are highly influential, there is more misconduct and more negative views about ethics of the organizations' leaders.

- **Where the board sets the tone, employees observe more misconduct.** This is compared to other nonprofit employees who believe top management is the president/executive director or the head of their locations.

Nonprofit Employees Who Believe Board is Top Management of Organization Observe Most Misconduct



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- **Paradoxically, those who think the board is top management are more likely to believe that their organization is moving in the right direction.** Over half (52 percent) of employees for whom the board is top management believe that their organizations are moving in the right direction.

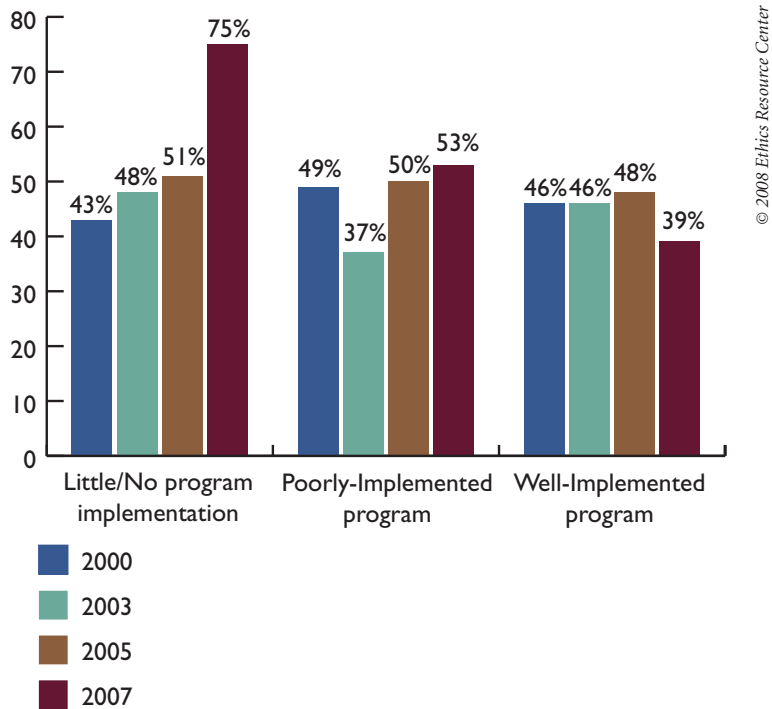
- **Nonprofit employees have the most negative views of the ethics of their governing body's decisions.** More nonprofit employees (7 percent) than business employees (5 percent) feel that the standards espoused by their workplace always conflict with their personal values. In addition, as many nonprofit employees as business or government feel that the compensation package for the senior-most executive in their organization is inappropriate (21 to 22 percent across the sectors).

Ethics Have Held Fast in Some Organizations

Despite the rise in observations of misconduct across the nonprofit sector, there are organizations that have been able to mitigate this rise. These organizations share important characteristics — the components of a well-implemented ethics and compliance program.

- **Nonprofits that have not seen a rise in misconduct have had well-implemented ethics and compliance programs.** Where observed misconduct has increased in nonprofit organizations, it has been within organizations with little to no ethics and compliance program. Organizations with well-implemented ethics and compliance programs have been able to avoid any increase in observations of misconduct through most of the past seven years and actually have seen a decrease in 2007. Having a well-implemented program mitigates the other factors that increase misconduct.

Nonprofits with Well-Implemented Ethics and Compliance Programs Are Able to Mitigate Rise in Misconduct



The Lesson to Learn — Ethics Risk Can Be Significantly Reduced in Nonprofits and Other Sectors

Despite discouraging trends, no other sector demonstrates the reduction of ethics risk as significantly as the nonprofit sector. Nonprofits' ethics risk is **virtually eliminated** when organizational leaders take steps to establish a well-implemented ethics and compliance program and adopt an organization-wide culture approach to ethics.

Well-Implemented Ethics & Compliance Program

+

Strong Ethical Culture

=

REDUCTION OF ETHICS RISK

KEY FINDINGS

At A Glance

Four Components of a Strong Enterprise-Wide Cultural Approach to Organizational Ethics

1. Ethical leadership: tone at the top and belief that leaders can be trusted to do the right thing.

2. Supervisor reinforcement: individuals directly above the employee in the organization's hierarchy set a good example and encourage ethical behavior.

3. Peer commitment to ethics: ethical actions of peers support employees who “do the right thing.”

4. Embedded ethical values: values promoted through informal communications channels are complementary and consistent with an organization's official values.

- **The near perfect result — when all four components of an ethical culture are in place in a nonprofit organization, ethics risk is eliminated.** An enterprise-wide cultural approach to organizational ethics creates an environment in which ethical behavior occurs for reasons beyond deterrence and sanctioning by authority. ERC has found that a strong culture features four major components: ethical leadership, supervisor reinforcement of ethics, peer commitment to ethics, and embedded ethical values.

When a strong ethical culture is present in a nonprofit:

- **No employees felt pressure to compromise standards,** compared to 47 percent of employees in weak ethical cultures.
 - **Just 17 percent of employees observed** misconduct compared to 100 percent of employees in weak ethical cultures.
 - **One hundred percent of employees reported their observations,** while just 35 percent of employees in a weak ethical cultures reported.
 - **No employees experienced retaliation** as a result of their report, but 47 percent of employees in weak ethical cultures experienced retaliation.
- **On their own, well-implemented ethics and compliance programs also significantly reduce ethics risk.** In organizations with little to no ethics and compliance program, 68 percent of employees observed two or more types of misconduct over the course of a year. This is significantly reduced in organizations with a well-implemented program to just 22 percent.
- **Well-implemented programs have a larger impact on certain types of misconduct.** The presence of a well-implemented program had the largest impact on the reduction of using competitors' inside information, sexual harassment, and provision of low quality goods and services.

- **Well-implemented programs and ethical culture go hand-in-hand.** Few nonprofit employees (1 percent) work in an organization with a weak ethical culture and well-implemented program, or an organization with little to no program and a strong ethical culture. In nonprofit organizations, more than in any other sector, well-implemented programs and strong ethical culture coexist.
- **The Ethics Resource Center has developed, from the perspective of employees at all levels, the ERC Ethics Risk IndexSM to identify the types of misconduct that pose the greatest risk to nonprofit organizations.** The ERC Ethics Risk Index exposes the likelihood that a particular kind of misconduct is occurring and is going unreported; it does not address the severity of each particular kind of misconduct and its potential impact on the organization.

$$\begin{array}{c} \text{Rate of Misconduct} \\ + \\ \text{Rate of Reporting} \\ = \\ \text{Level of Ethics Risk} \end{array}$$

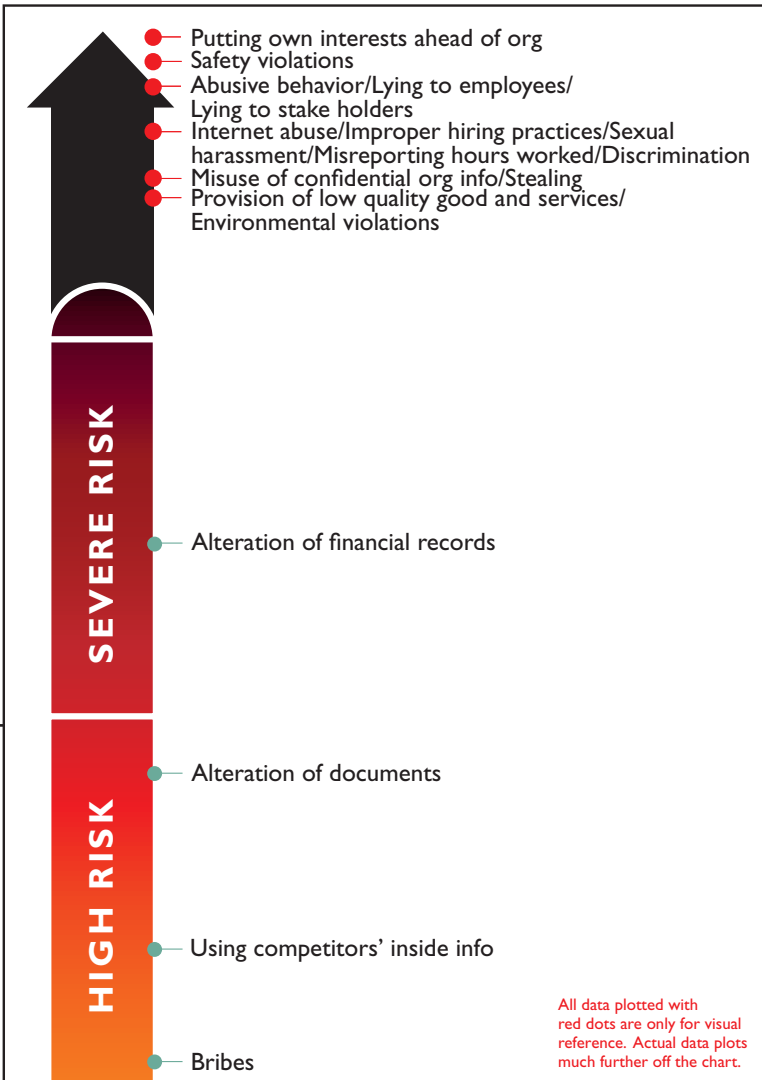
KEY FINDINGS

The ERC Ethics Risk Index presents data in a continuum, but the projected risk of various types of 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.
- An additional six types of misconduct pose **high risk** to the nonprofit sector:
 - Safety violations;
 - Lying to stakeholders;
 - Improper hiring;
 - Discrimination;
 - Sexual harassment; and
 - Misuse of confidential organizational information.
- **Organizations with both a well-implemented program and a strong ethical culture have no high or severe risks on the Ethics Risk Index.** Organizations with little to no program and a weak ethical culture have all their risk in the high and severe categories, with 14 out of 18 types of misconduct beyond the normal range for severe risk.



WEAK CULTURE & LITTLE/NO PROGRAM



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At A Glance

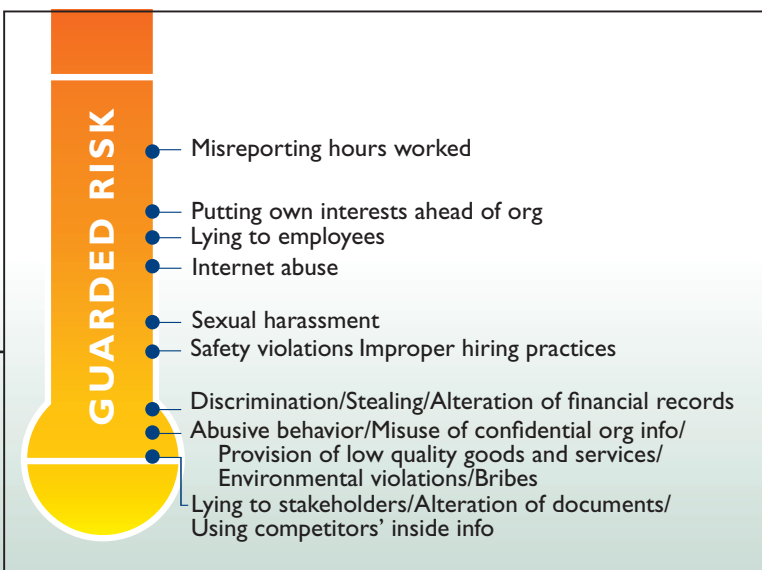
Ethics Risk Can Be Effectively Quantified from *Employee Perspective* — Allowing Nonprofits to Assess Funding Risks From the Inside

Nonprofits can learn about the ethics risk they face by assessing how often misconduct occurs and is reported.

Conflicts of interest, lying to employees, misreporting hours worked, abusive behavior, and Internet abuse pose the most severe risk to nonprofit organizations.

A well-implemented program and strong ethical culture reduce ethics risk to a negligible amount.

STRONG CULTURE & WELL-IMPLEMENTED PROGRAM



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ADDITIONAL FINDINGS:

an inside view of ethics in the nonprofit sector

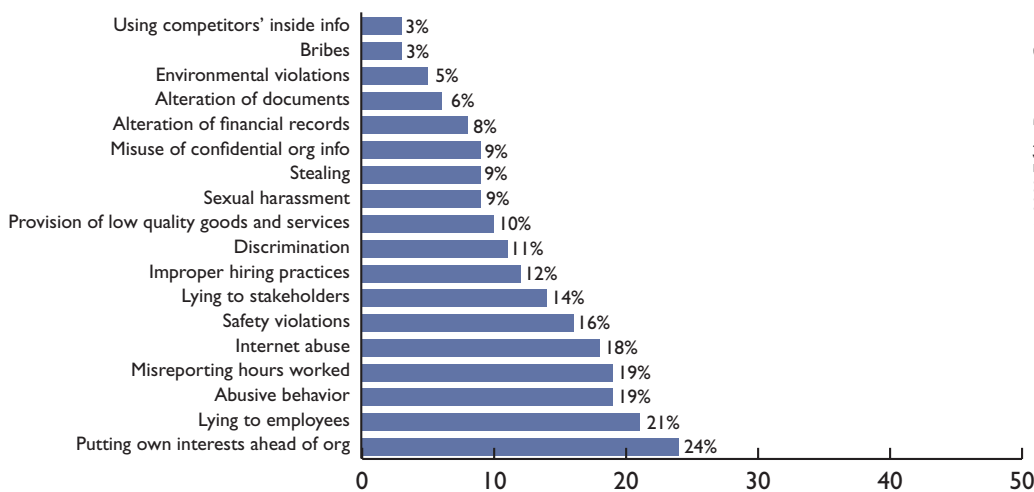
The 2007 NNES reveals a vast amount of information that can be useful to nonprofit executives, ethics and compliance practitioners, academic experts, and public policymakers. The following findings, presented in some detail, augment the key findings discussed in the previous section. They are included to help enable these groups to assess and enhance ethical activity in their organizations.

Nonprofits Are Challenged by the Same Types of Misconduct as Business & Government

The most prevalent types of misconduct observed in nonprofits echo the other sectors. In 2007 the following were observed by the highest percentage of nonprofit employees:

- *Putting own interests ahead of organization — 24 percent;*
- *Lying to employees — 21 percent;*
- *Abusive behavior — 19 percent; and*
- *Misreporting hours worked — 19 percent.*

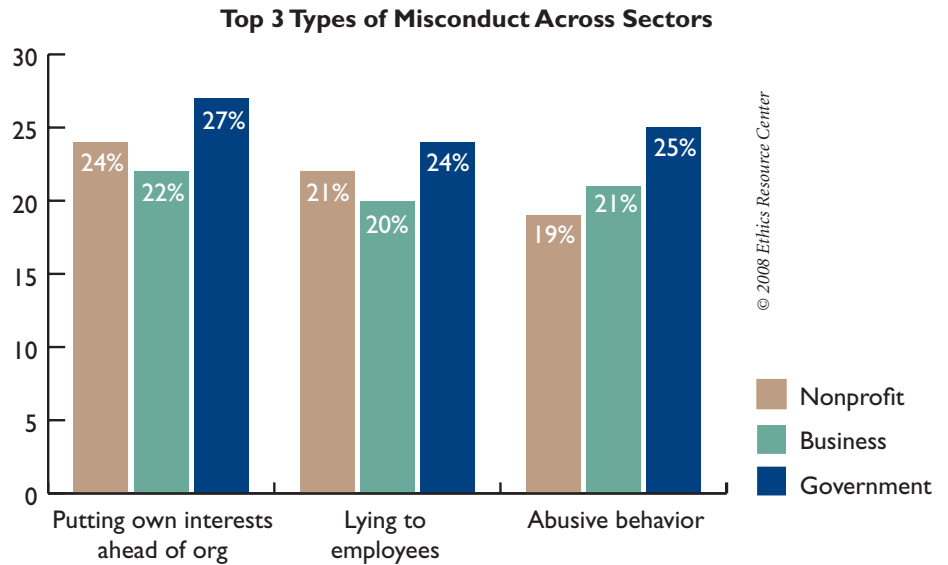
Conflicts of Interest Is the Most Observed Misconduct in Nonprofits in 2007



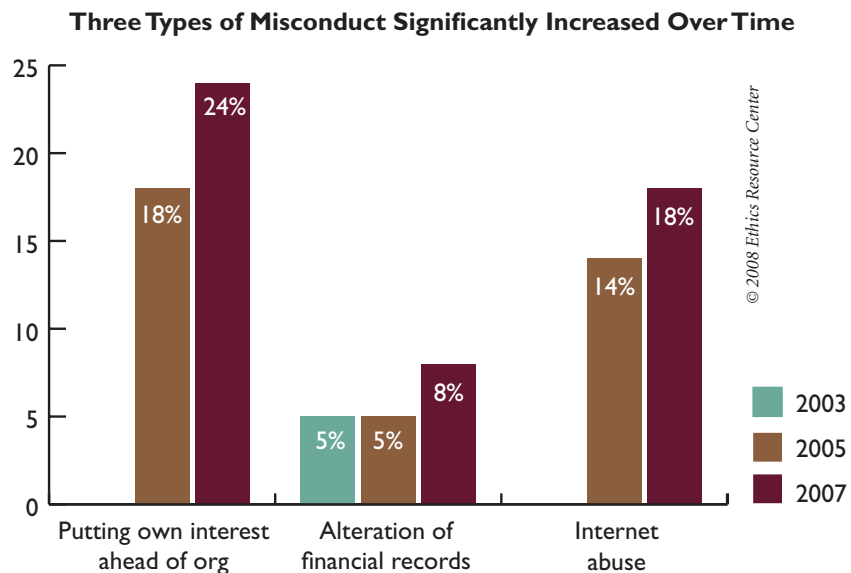
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- **Most frequently observed types of misconduct are comparable to other sectors.** In comparing the sectors, nonprofit organizations experience less misconduct than government agencies, and they are generally comparable in the amount of misconduct observed in for-profit companies.

ADDITIONAL FINDINGS



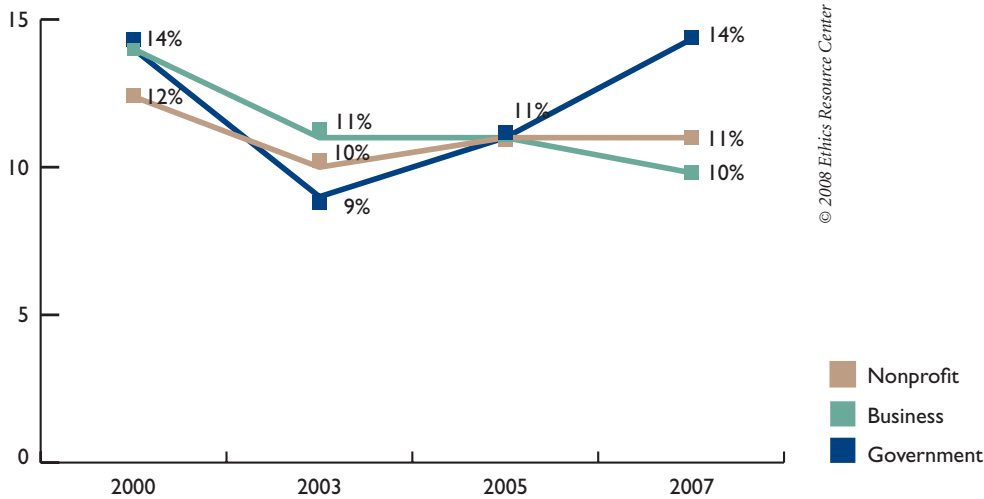
➤ **Since 2005, three types of misconduct stand out as having increased significantly in nonprofit organizations:** putting own interests ahead of the organization (conflicts of interest), Internet abuse, and alteration of financial records. One behavior has decreased over the past four years — environmental violations.



■ **Pressure has remained steady.** One key indicator of misconduct in an organization is the amount of employees who feel pressure to compromise the standards of the organization or the law. In nonprofits, 87 percent of employees who feel pressure also observe misconduct.

In the nonprofit sector, the amount of pressure to compromise the organization's standards has not changed much over the past four years in (11 percent reporting perceived pressure in 2007). However, pressure has been on the decline in business (10 percent in 2007) and is increasing in government (14 percent in 2007).

Pressure in Nonprofits Has Held Steady While Declining in Business and Increasing in Government



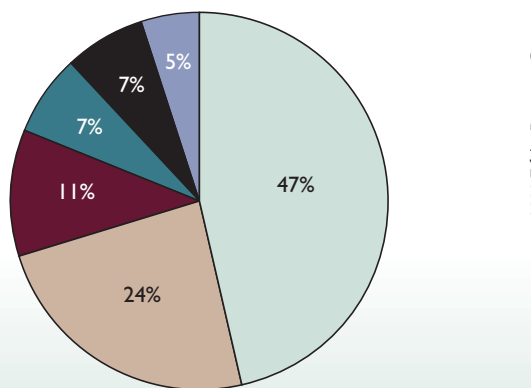
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Nonprofit Employees Primarily Report Misconduct to Supervisors, but Use Hotlines More than Any Other Sector

In any organization, employee reporting of misconduct is an essential part of an ethics and compliance program. If managers are not made aware of ethics and compliance issues when they arise, they cannot do anything to correct the problem.

- **Supervisors are the reporting method of choice, but nonprofit employees use hotlines more than business or government.** Aside from the encouragement of Federal Sentencing Guidelines, nonprofit organizations do not have the same level of regulatory or legislative emphasis as other sectors to implement anonymous or confidential hotlines for employee reporting of misconduct. Nevertheless, helplines are more widely used than they are in for-profit or governmental organizations where stronger regulations often exist.

Supervisors Are Reporting Method of Choice



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Chosen Method of Reporting:

- Supervisor
- Higher management
- Other responsible person (including ethics officer)
- Someone outside organization
- Hotline
- Other

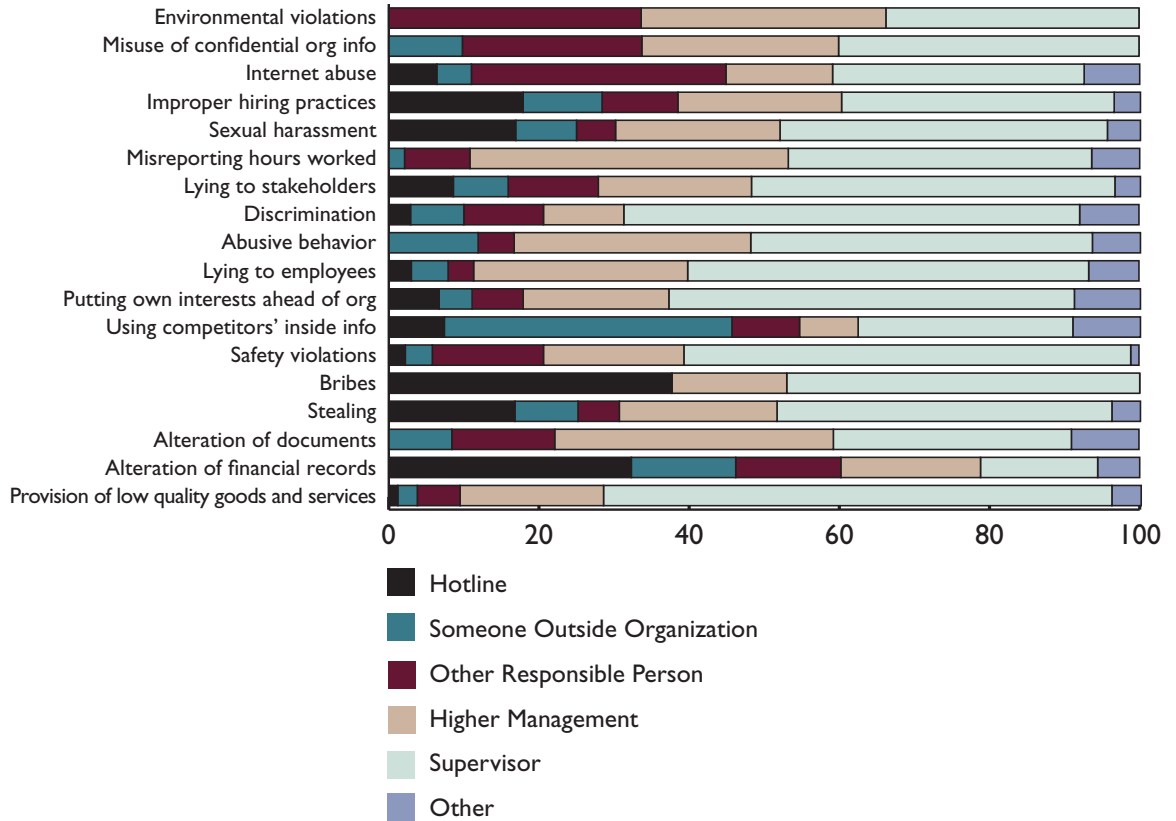
Due to rounding, totals may not equal 100 percent.

ADDITIONAL FINDINGS

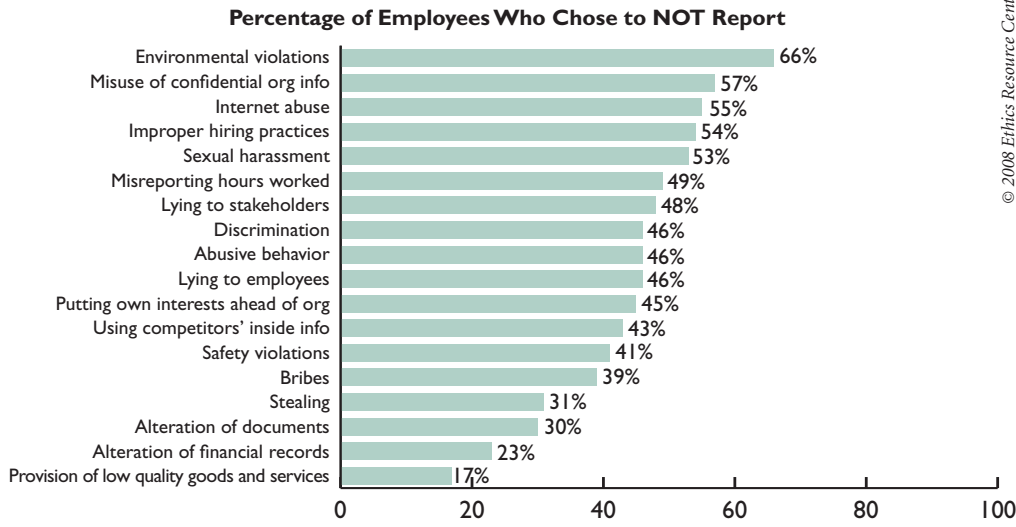
Nonprofit employees use the hotline more than both for-profit (3 percent) and public sector employees (1 percent). Nevertheless, almost half of all reports (47 percent) in nonprofit organizations go to supervisors, while just 7 percent go to hotlines. Nonprofit employees also tend to report their observations to someone outside the organization (7 percent) more than both business (3 percent) and government (5 percent).

➤ **Reporting methods in nonprofit organizations vary greatly by the specific type of misconduct observed.** While in general only 7 percent of reports went to the hotline, over a quarter of reports about bribes and alteration of financial records were reported to the hotline. In addition, a large percentage of observations of using competitors' inside information were reported to someone outside the organization.

Reporting Methods Vary Greatly by Type of Misconduct

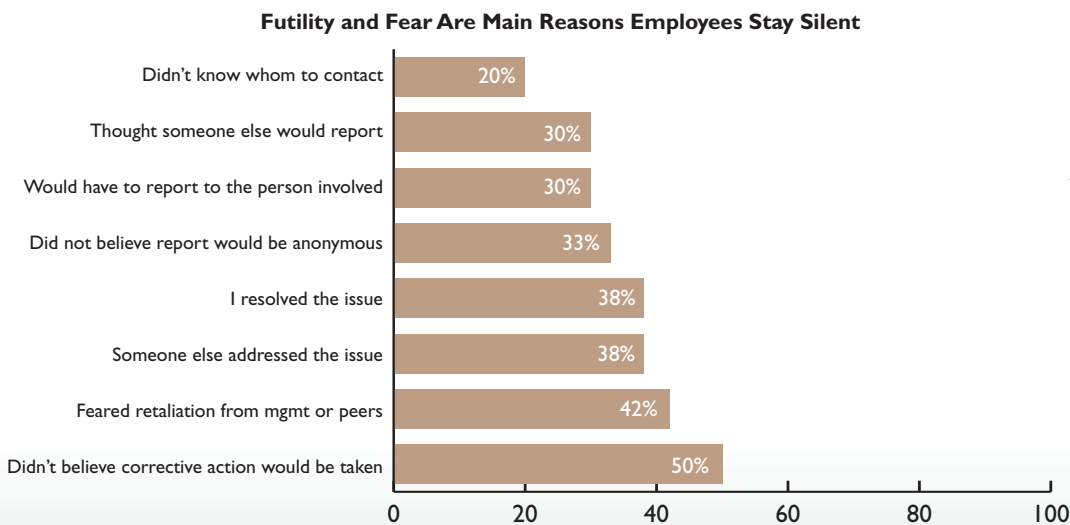


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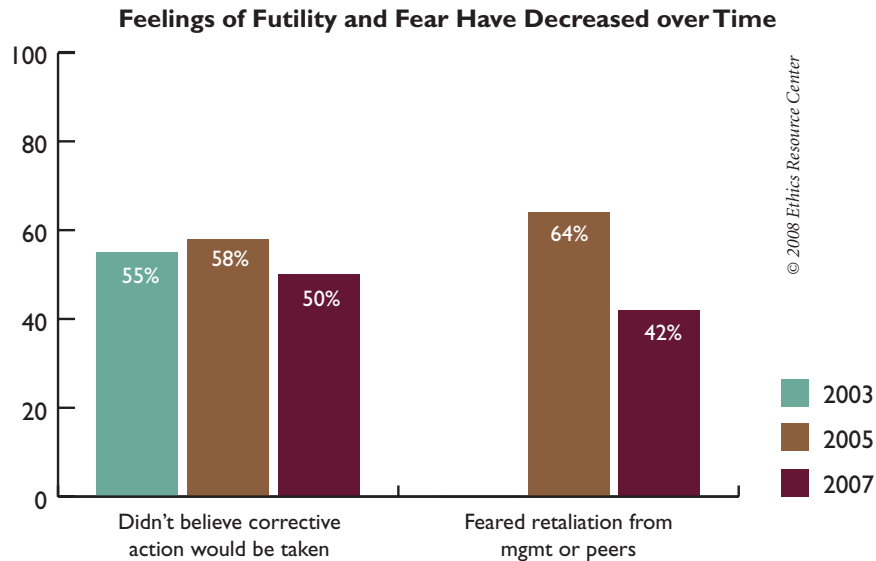


➤ **Some types of misconduct are reported less than others.** In particular, employees in nonprofits reported environmental violations the least; 66 percent of employees chose to stay silent when they observed environmental violations. Poor service and product quality were reported the most with 83 percent of all observers reporting.

■ **Employees remain silent because of fear and futility.** When deciding whether or not to report, nonprofit employees are driven by many considerations. The two leading reasons for non-reporting are the dominant beliefs that reporting will not lead to corrective action, or fear of retaliation.

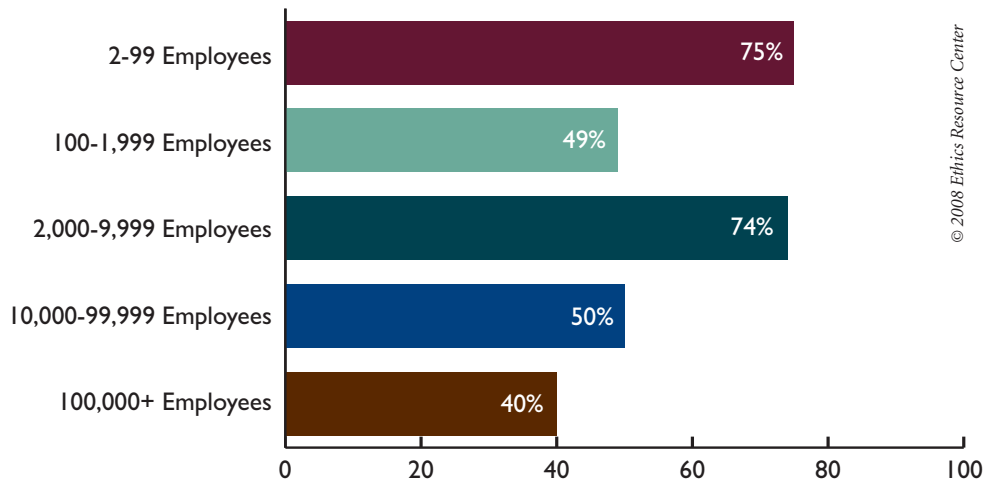


ADDITIONAL FINDINGS



- **Employees' feelings of fear have decreased significantly.** In 2005, 64 percent of those who observed misconduct but chose to remain silent feared retaliation, but that percentage has decreased significantly in 2007 to 42 percent. While there is some improvement in the percentage of employees feeling futility, the decrease is not significant.
- **Non-reporters who resolve the issue themselves do so out of fear.** Nearly 40 percent (38 percent) of employees did not report because they believed they resolved the issue themselves. Among these employees, the motivation to handle the situation personally is likely coming from perceptions about the negative consequences of reporting the behavior to management.
 - *Of those who resolved issue themselves 39 percent would have had to report the misconduct to the person involved.*
 - *These same employees also expressed fear of retaliation from management (36 percent) and fear of retaliation from peers (44 percent) if they were to make a report.*
- **Reporting is linked to organizational size.** Employees in the smallest organizations report misconduct the most, followed by those in organizations with 2000 to 10 thousand employees. Smaller mid-size organizations and the largest organizations report the least.
- **Retaliation is experienced less in nonprofits than in the government sector.** More than one in eight (13 percent) employees in nonprofits experienced retaliation as a result of their report of misconduct. This is comparable to the amount of retaliation experienced in business (12 percent), and less than government (17 percent).

Employees in Smallest and Mid-Size Organizations Report the Most

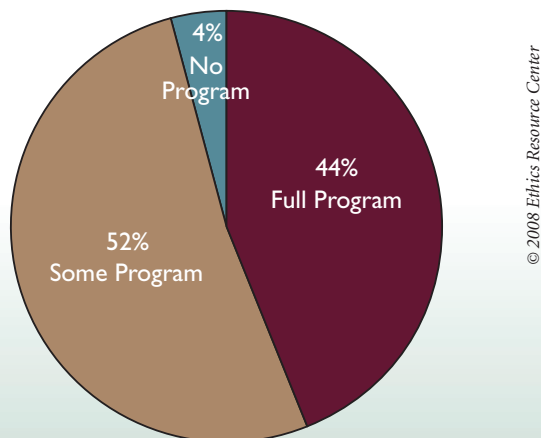


More Nonprofits Have Comprehensive Ethics Programs

Ethics and compliance programs have been shown in the 2007 NNES research to reduce misconduct by as much as 46 percent. The NNES measures six elements of an ethics and compliance program as defined by Federal Sentencing Guidelines⁴. Six elements are measured: written standards (code of conduct), training of employees on ethics issues, presence of a helpline for reporting, evaluation of employees based on ethical conduct, discipline for violations, and provision of resources to offer advice to employees with ethics questions.

- **A majority of employees (52 percent) work in organizations with only some elements of an ethics program.** Four in ten employees (44 percent) acknowledge that they work in organizations with complete ethics programs. Only 4 percent work in organizations with no ethics program.

Half of Nonprofit Employees Work in Organizations with only Some Ethics & Compliance Program Elements

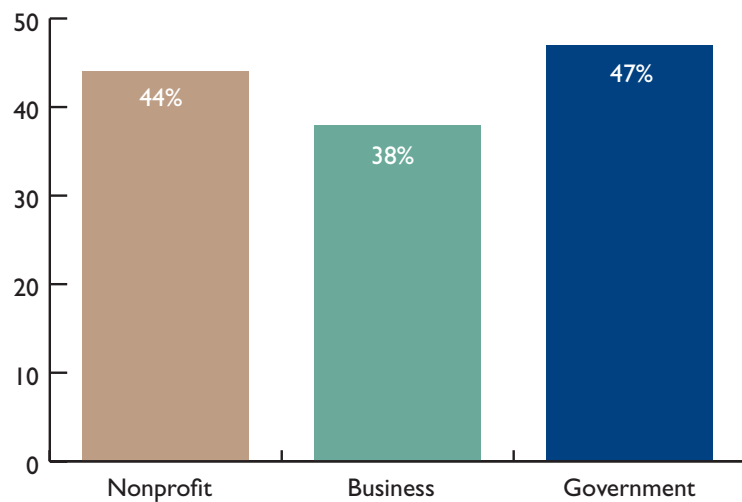


⁴ Respondents were only asked about elements that could be reasonably assumed to be known by all types of employees — e.g., it is not reasonable to assume that all levels of employees are knowledgeable of financial controls, so it is not asked.

ADDITIONAL FINDINGS

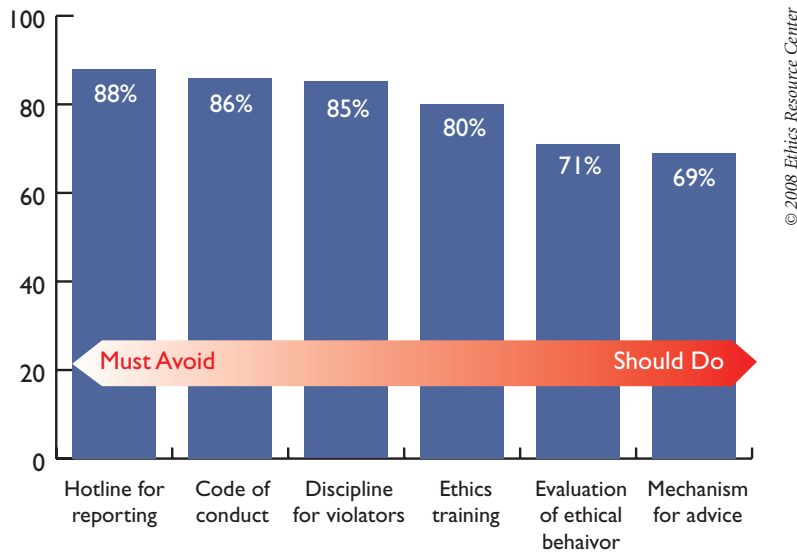
- **More nonprofit employees acknowledge full ethics and compliance programs than employees in for-profit businesses.** Nonprofit organizations are encouraged through Federal Sentencing Guidelines for Organizations (FSGO) to establish ethics and compliance programs. Businesses are also encouraged through FSGO, with many of these for-profit organizations mandated to implement certain elements of a program by listing agencies and other regulatory organizations. Nevertheless, more nonprofit employees recognize full programs than business employees. However, nonprofit organizations are behind government agencies.

Percentage of Employees Who Believe Their Organization Has Full Ethics & Compliance Programs



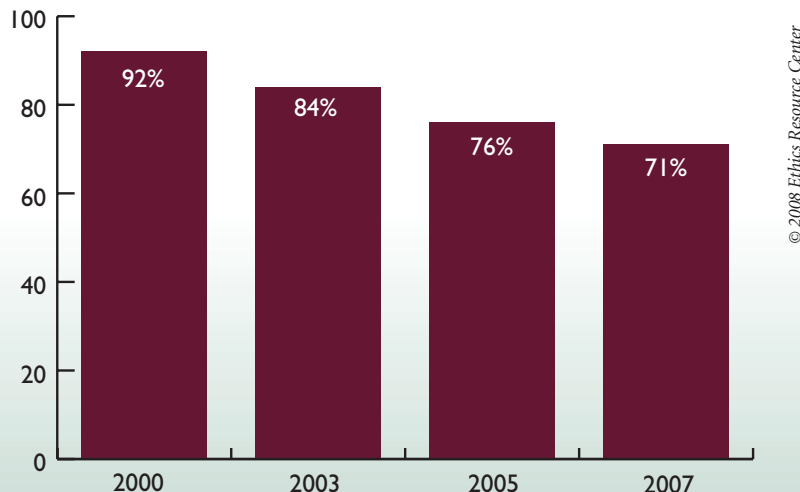
- **Most ethics and compliance programs are driven by legal and regulatory demands and designed in reaction to past mistakes;** as a result, they focus on teaching employees what they *must avoid*, rather than addressing what employees *should do*.
- **A code of conduct is the most prevalent element.** Nonprofits are most likely to have implemented written standards for ethics and compliance (88 percent) and least likely to have implemented a mechanism for employees to seek advice on ethics issues (69 percent).

More Nonprofits Implement Ethics & Compliance Program Elements Telling Employees What **MUST Be Avoided, Rather Than What **SHOULD** Be Done**



- ➔ **Four of the six elements of an ethics and compliance program are on the rise in nonprofit organizations.** The two exceptions are the presence of a code of conduct which has remained steady over the years, and the evaluation of ethical behavior during performance appraisals which has seen a steady decline.
- ➔ **The practice of evaluating employee ethical conduct is in decline.** Evaluation of ethical behavior during performance appraisals is a way to give employees an incentive to perform ethically. However, there has been a reduction of 23 percent 2000 to 2007 in the percentage of nonprofits with an evaluation element. The decline of this particular element shows how much ethics and compliance programs rely on punishment to change behavior and have decreased their attention on reinforcement of positive conduct.

Evaluation of Ethical Behavior in Nonprofits is on the Decline



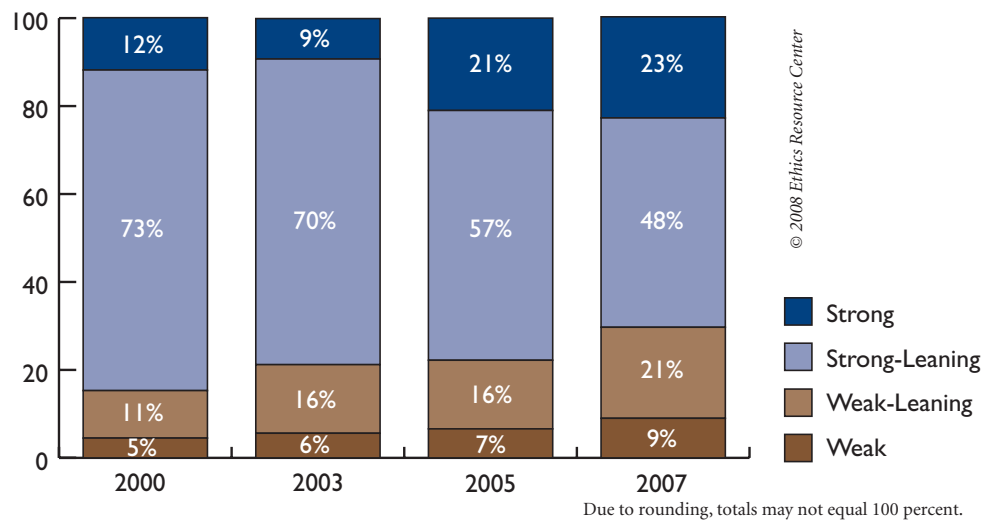
ADDITIONAL FINDINGS

Peers and Supervisors Contribute to the Decline of Ethical Culture

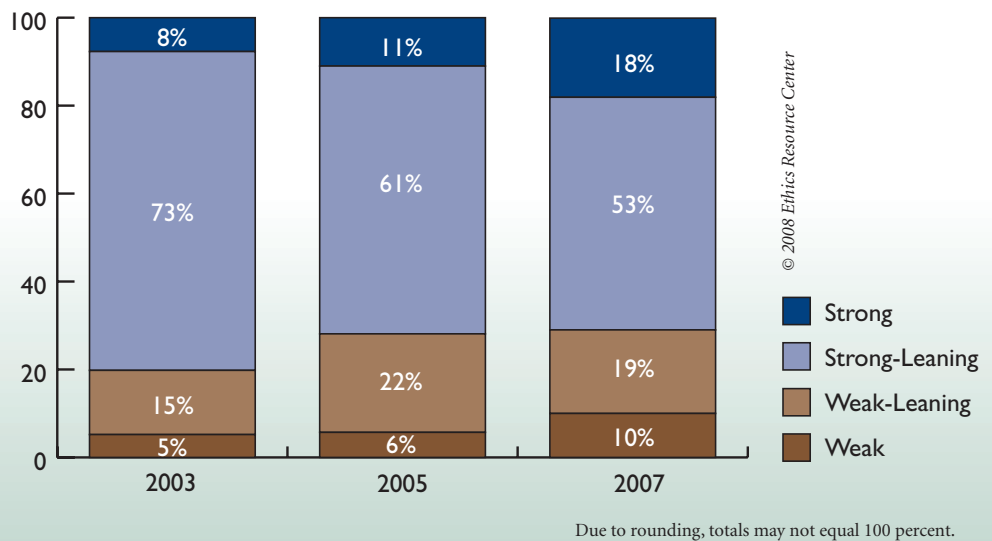
Nonprofits have historically had stronger ethical cultures than organizations in other sectors. In 2007, however, indications suggest this is beginning to change — cultures in nonprofits are weakening.

- Decline in culture seems to be attributable to supervisor reinforcement and peer commitment.** Peer commitment to ethics and supervisor reinforcement of ethics are both important to the reduction of misconduct. However, more organizations are moving to the ends of the spectrum — becoming strong or weak. The polarization of these two elements of ethical culture suggests that nonprofits that are seeing a rise in misconduct will continue with this trend unless they can address their ethical culture especially at the supervisor and peer levels.

Polarization Over Time for Supervisor Reinforcement



Increase in Strong Peer Commitment is Met with Increase in Weak Peer Commitment in 2007



CONCLUSION

Implications of the 2007 National Nonprofit Ethics Survey

Because nonprofits are not driven by a profit motive, the public assumes that employees of nonprofit organizations will, by nature, also face less pressure to engage in unethical practices, particularly in terms of their organizations' financial affairs. This is especially true of nonprofit organizations devoted to "the common good"— e.g., charities serving the needy, associations devoted to the cure of diseases, and the like. The expectation also applies to nonprofits created by for-profit entities — for example, the trade organizations that groups of companies form to advance their common interests.

This report reveals, however, that when it comes to malfeasance, nonprofits are not exempt. Ethical practice at the nation's nonprofit organizations is declining, edging closer to disturbing levels already seen in the for-profit and government sectors. And financial fraud, in particular, is on the upswing among nonprofit employees.

The ramifications are enormous. If the ethical standards of nonprofits continue to decline:

- The generosity of donors, members, and contributors will mirror the nonprofit ethics decline.
- The ability of civil society organizations, even those operating with the highest ethical standards, to benefit the public will be jeopardized for lack of trust.

The good news in this study is that these outcomes can be prevented. In no other sector have the interventions of strong ethical cultures and well-implemented programs had such a dramatic and positive effect. The solution is evident, but to mitigate the downward trend, two primary challenges now confront nonprofit leaders and policy makers:

- **Tailoring effective interventions to the nonprofit sector.** These organizations must enhance their accountability systems, particularly with regard to the use of funds and the reporting of financial information. Nevertheless, as evidenced in the private sector⁵, externally imposed internal controls often create only a compliance mentality that alone is not sufficient to uphold integrity at the highest levels. In the nonprofit sector, such a world view may have an unintended consequence — suppressing the mission-driven natures of these organizations (particularly small to mid-sized nonprofits). Balancing internal controls without suppressing organizations' inherent mission-driven focus will be central to the ability of nonprofit organizations to serve the public interest and the interest of their constituents.
- **Raising the priority of ethics in oversight.** Across the nonprofit sector, the tone is being set from the top, but it is not one that results in employee perceptions that ethical conduct is important. Directors and executives should have a strong influence over employees, but their influence must emphasize the values of the organization, financial integrity, and accountability for wrongdoing. A lack of focus in these areas results in employee cynicism, pressure to compromise standards, and misconduct.

⁵ See the 2007 National Business Ethics Survey for more discussion on compliance in the private sector.

CONCLUSION

Recommendations for Nonprofit Leaders and Boards of Directors

There are measures that nonprofit leaders and directors can take to begin addressing these challenges.

- **Make no assumptions — assess your organization.** The greatest threat to an organization is the assertion by its leaders that ethics issues “won’t happen here.” In fact, as revealed in this research, every reason exists to believe that not only can misconduct happen, it already has happened. Most alarming is the fact that the types of misconduct that have had devastating effects on private sector organizations over the past few years are now most prevalent in nonprofits. Nonprofit boards and executives should take steps to assess the present state of their organizations with regard to employee understanding of standards, perceptions of accountability, prevalence of misconduct, and strength of ethical culture. Ethics risk can and should be quantified.
- **Implement an ethics and compliance program with high-level oversight.** Having a well-implemented program is a vital first step in preventing future problems. Size of the nonprofit organization will determine how elaborate the ethics and compliance program can be. Key steps can be taken by organizations of all sizes to establish a values statement and/or a code of conduct that outline the standards of the organization. All organizations should provide training to their board of directors on ethics and the role of the board in oversight and a mechanism for employee reporting of misconduct. Appointing an ethics officer to oversee the ethics and compliance program can be done by smaller organizations if the individual divides time between ethics and another function. Nonprofit organizations can look to Federal Sentencing Guidelines for Organizations for detail on the elements of an effective program.
- **Implement internal controls to prevent financial fraud.** Particularly in smaller nonprofit organizations, survival is as much a concern as accomplishing the entity’s mission. Financial pressure can often result in short-sighted decisions. With these types of pressure — particularly in raising and managing funds — comes a high likelihood that misconduct will take place. Nonprofit organizations must focus on deterring fraud and other financial misconduct by putting in place effective internal controls. The complexity of controls should be proportionate to the size, risk, and infrastructure of each organization.
- **Grow your program and culture with your organization.** This survey revealed that misconduct is highest in mid-sized organizations, perhaps because efforts to address ethics and culture have not grown with the complexity of the nonprofits themselves. Standards and systems should parallel organizational growth. Attention to culture is equally necessary in organizations of all sizes, but, as organizations expand, leaders must assertively communicate the importance of integrity, reinforce that message through supervisors, and integrate values into daily activity.

Recommendations for Policymakers

Policymakers can encourage nonprofits to operate with the highest integrity by doing the following:

- **Take immediate steps to further understand the decline in ethical conduct in the nonprofit sector.** Despite considerable attention to financial reporting and issues related to taxation, misconduct in the nonprofit sector has continued to rise. In many cases, abuses extend beyond the areas of government scrutiny. The Administration and/or Congress should take steps to further understand the root of the problem and the solutions that can build momentum for positive change. The commissioning and funding of a task force to study this problem would benefit the entire nonprofit sector and could help the private and public sectors learn how to address their own ethics issues.
- **Emphasize attention to ethics in nonprofit governance.** Governing bodies in the nonprofit sector rightly address matters of public disclosure, compliance with tax laws, oversight of finance, and fundraising for their organizations. Yet ethics is the foundation of every one of these activities. Unfortunately, employees in nonprofit organizations with strong board influence are less positive about the ethics of the “top” of the organization. Boards should be encouraged to foster ethical cultures within their organizations, regularly assessing the status of their nonprofits. Governing bodies of nonprofits should therefore be regularly trained on matters of ethics for the nonprofit sector, and they should take steps to ensure that their organizations have systems in place to provide internal control.

Recommendations for the Nonprofit Sector

Nonprofit organizations can help each other by banding together and addressing ethics issues as a sector.

- **Encourage the creation of accountability systems.** Regulatory frameworks, such as the Federal Sentencing Guidelines for Organizations, do apply to nonprofit organizations. However, FSGO is relatively unknown in this sector. Additional efforts already underway to revise the IRS Form 990 and address donor violations may have a positive effect in encouraging nonprofit financial integrity. However, these efforts should be undertaken along with the implementation and growth of a well-implemented ethics and compliance program and a strong ethical culture. Nonprofit organizations with a well-implemented program and strong ethical culture have almost no misconduct, and when violations do occur, employees in these organizations are making leadership aware of the problems. Legislative and regulatory efforts that offer incentives to encourage the creation of such interventions — while allowing for self-regulation and the nonprofit distinction — would likely be very helpful.

CONCLUSION

- **Create a catalyst to inspire change.** There are lessons to be learned from the nonprofit sector, particularly with regard to their ability to grow strong ethical cultures that have such a positive impact. Furthermore, the public and private sectors also work to reduce their ethics risks, so government and business leaders also have important insights to share which might be of help to nonprofit executives. As the adage says, “iron sharpens iron.” It is time to bring leaders from across these sectors together to share ideas and create accountability mechanisms for one another.

Nonprofits play a fundamental role in our society and their success requires effective stewardship of donors’ contributions and maintenance of the public trust. The recent erosion of ethical behavior in this sector is very troubling, and the trend cannot be allowed to continue. It is our hope that by quantifying this emerging problem and offering proven solutions, this research will inspire nonprofit leaders to take immediate action to reinforce and rebuild their ethical structures.

We wish our nonprofit peers great success, and we look forward to being of assistance in that journey.

NEXT STEPS

for the Ethics Resource Center

The findings in this report represent only a portion of the National Workplace Ethics Study. In the coming months, ERC plans to undertake several additional research efforts to expand upon and complement the findings presented here:

- ➔ Replication of the nonprofit survey collecting additional demographic data to allow for deeper exploration of differences between types of nonprofits and the actions and influence of the board of directors.
- ➔ Development of enhancements to ERC Ethics Risk Index, including evaluation of the impact of specific kinds of misconduct on the organization.
- ➔ Further exploration of the relationship between ethical culture and ethics and compliance programs.

Please contact the Ethics Resource Center at ethics@ethics.org to find out more about how you can help support these research projects.



ADVISORY GROUP

for Ethics Resource Center's 2007 National Nonprofit Ethics Survey

The 2007 NNES Advisory Group includes nonprofit executives and board members, academics, and leading nonprofit management researchers. The NNES 2007 research team⁶ thanks the following individuals for their insight and collaborative support, which have been invaluable.

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The findings and conclusions of this report are those of the Ethics Resource Center alone and do not represent the views of our Advisory Group members or their organizations.

⁶ A list of the members of the NNES 2007 research team can be found on p. 32.

RESEARCH TEAM

for Ethics Resource Center's 2007 National Nonprofit Ethics Survey

The 2007 NNES benefits from the rich experience of a multi-faceted ERC research team.

A team of researchers and adjunct analysts developed the survey instrument, analyzed the data, and generated the report. This team included ERC staff members, as well as adjunct experts:

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Assistance with the question set development, analysis, and report creation was provided by several ERC staff members as well as adjunct experts:

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Additional findings, methodology, and demographic information
can be found at www.ethics.org.



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