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An Analysis of Rating Systems Used by Watchdog Organizations for Nonprofit Charities in the Health and Human Services Sector

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THESIS SUMMARY

In the United State, lack of trust and accountability are developing trends among donors in regard to charitable nonprofits in the health and human services sector. Watchdog organizations are working diligently to provide useful data to donors to combat this growing issue. While some watchdog organizations focus on quality of statistics, others focus largely on quantity of metrics. Additionally, some rating systems are solely based on financial data, while others consider nonfinancial data as well. Although different methodologies concentrate on varying metrics, this thesis seeks to find a comprehensive, yet easy-to-use rating system that allows users to understand both financial and nonfinancial data. In comparing this proposed system with current methodologies for specific charities, overall ratings did not differ as greatly as hypothesized. Because managerial decisions and financial health correlate so closely, the focus on financial versus nonfinancial data in rating systems created little difference in overall grades. Additionally, the focus on quality over quantity, and vice versa, seemed to create almost no difference in ratings. Although this difference in ratings was not large for different ratings systems, using portions of certain rating systems can benefit individuals if they have more concerns in one area of a charity's business than another. Through this research and analysis, it can be concluded that individuals can trust current watchdog organizations in regard to overall ratings. However, discretion is still advised, and this thesis recommends verifying the accuracy of scores on published websites before donating to charities in the health and human services sector.

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SECTION 1

INTRODUCTION

According to the Merriam-Webster dictionary (*Merriam-Webster Online*), a charity is "an institution engaged in relief of the poor." In this case, poor may refer to one being economically disadvantaged, mentally disabled, physically unhealthy, or restricted in a plethora of other ways. Tthis thesis will focus specifically on those that are bound by physical sickness. The purpose of health and human services sector charities is to lessen the burden of those that have become permanently or temporarily ill by assisting with medical bills, providing sought-after treatments, or simply by brightening one's day. The American Red Cross ("Mission & Values," 2018, para. 1) defines its own purpose through its mission statement, which declares "The American Red Cross prevents and alleviates human suffering in the face of emergencies by mobilizing the power of volunteers and the generosity of donors." While this mission pulls at the heartstrings of citizens across America, a tugging question still bothers many who are considering involvement with these organizations: are health and human services sector charities *actually* helping others? This broad question can have polar opposite answers, depending on which measures are used to quantify "help." Are these organizations giving appropriate financial support? Are they advocating for a cause? Are they finding answers to difficult medical questions through research? Perceptions are largely in the eye of the beholder, which makes this tough question almost impossible to answer decisively. As a way to combat these troubling questions, organizations that rate charities have developed over the years; these use point and grade systems to characterize a charity's success. In the following analysis of health and human services sector nonprofit charities, this paper will explore the ways in which charities manage and use financial resources. In addition, it will explore

managerial capabilities of executives, and citizens' perceptions of the nonprofit organizations. By comparing these three measures to the relative ratings organizations have awarded to several charities, readers will have greater evidence on the usefulness of the published ratings of health and human services sector charities. There is not currently, nor will there ever be, a perfect way to analyze the work of charities in America. However, human intuition, financial analysis, and managerial effectiveness have been proven over many years and platforms to be helpful in making important decisions. Though many Americans rely on easily available charity ratings by organizations such as Charity Navigator and CharityWatch, these published ratings may not accurately depict the managerial success, public opinions, and financial viability of charities in the health and human services sector; this may result in misinformed donation decisions by citizens across the country.

SECTION 2

OVERVIEW OF NONPROFITS

In order to understand the complexities of nonprofit charity ratings, one must first understand nonprofits in general, including the ways they are classified and the purpose of their organization. According to the *Wex legal dictionary and encyclopedia (“*Nonprofit organization,” 2007, para. 1), “A non-profit organization is a group organized for purposes other than generating profit and in which no part of the organization's income is distributed to its members, directors, or officers.” Although this definition may seem obvious and quite broad, it is intended to be high level.

In general, a company is either a nonprofit or for-profit entity. Whereas nonprofit organizations are not created to make a profit, both public and private companies exist mostly, if not solely, to make a profit to later distribute to their public shareholders or private investors. Although this purpose of for-profit entities, contrasts with that of nonprofits, the Journal of Accountancy found one similarity worth noting. According to the Journal of Accountancy (“Nonprofits,” 2011, para. 3), “nonprofits…are more similar to public entities because of the public accountability created via donations and tax exemptions.” In for-profit organizations, investors and creditors use the annual or quarterly financial statements to assess the viability and financial health of said companies. In nonprofit organizations, donors use the financial statements or other financial reports to analyze the probable future use of donations by the company. Although nonprofit and for-profit companies operate for differing reasons, each attempts to raise funds in order to carry out the mission of the organization, whether that is through investors or donations. The key difference between for-profit and nonprofit

organizations that will be emphasized in this writing is the ways in which the organizations use the funds they raise.

In the United States, nonprofits are generally understood by average citizens to be tax-exempt or not tax-exempt. According to the Internal Revenue Service (IRS) publication 557 (2018, pg. 67-68), taxpayers, in general, receive a tax deduction for contributions to organizations that fall under sections 501(c)(1), 501(c)(3), 501(c)(8), 501(c)(10), and 501(c)(13). For the purposes of this paper, focus will be put only on section 501(c)(3) organizations, which are nonprofits with a charitable purpose. According to the Internal Revenue Code ("'Charitable' Purposes," para. 1),

> The term charitable…includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

If an organization does not fall under the IRS sections listed above and does not have a charitable purpose, taxpayers generally do not receive a tax deduction for contributions made to those organizations, whether the organization is for-profit or nonprofit. Some examples of nonprofit organizations that are not tax-exempt are social and recreational clubs and political organizations (Internal Revenue Service, 2018, pg. 67-68). Although these organizations do not operate to profit, they also do not operate to serve any of the problems listed above under the definition of "charitable purpose." An example of a nonprofit that is not tax exempt under section 501(c)(3) is the organization, TIAA. Instead of contributing its earnings to a charitable cause, "any profits the

not-for-profit group earns are returned to its participants in the form of higher dividends on their annuities." Although this action still classifies TIAA as a nonprofit organization, it disallows them from being tax-exempt since 1997 (Abelson, 1997, para. 2). While these classifications may seem confusing, it can all be simplified by asking two questions: Does the organization operate for a purpose other than raising profits? Does the organization serve a charitable purpose? If the answer to both of these questions is affirmative, the entity will generally be classified under section 501(c)(3) in the Internal Revenue Code and will be included in the group that is the main topic of this paper.

As this paper focuses primarily on 501(c)(3) nonprofits, it is important to further discuss the many types of nonprofits with a charitable purpose as well. Not only are they placed into the 501(c)(3) "bucket," but they are further subcategorized. According to Emily Barman (2013, pg. 107), the most commonly used method to categorize nonprofits is the National Taxonomy of Exempt Entities (NTEE), which was developed by the National Center for Charitable Statistics (Lampkin, Romeo & Finnin, 2001, pg. 781). Although many debate the accuracy in dataset formation with the use of the NTEE classifications, the Independent Sector's Research Committee suggests that "Without the development of a common language, it is difficult to build a body of statistics or to encourage further theoretical and policy research on the sector," leading to the consistent use of the NTEE in the United States (Barman, 2013, pg. 123). Not only do policymakers utilize the NTEE, but the IRS uses this classification system to divide nonprofit organizations into hundreds of separate categories, each with specific criteria for entry, under section code 501(c)(3). Organizations from credit unions to fraternal societies to support services each have their own subcategory, showing the wide variety of charitable nonprofits in the United States (Internal Revenue Service, 2010, pg. 7).

As mentioned above, one characteristic that distinguishes nonprofits not only from for-profit organizations but also from each other is purpose. The NTEE classification utilize this idea by subcategorizing nonprofits based on purpose and services (Barman, 2013, pg. 128). Kirsten Gronbjerg (1994, pg. 302-303 makes this comment when discussing the NTEE:

> The focus on purpose, rather than just economic activities, captures a fundamental distinction between non-profit organizations and their for-profit counterparts…It is purpose (for example, serving minority communities or improving the environment), not a particular economic activity (for example, operating a pre-school or a publishing house), which gives non-profits their moral appeal.

Although hundreds of different charitable nonprofits exist, the NTEE classification system makes it easier for American to narrow down their search for specific types of charities. To illustrate specifics of the coding system, one can look at Ronald McDonald House Charities (RMHC) as an example. The IRS classifies RHMC by using code E86. In this case the letter “E” represents the general category “Health – General and Rehabilitative” and the number “86” represents the specific subsection “Patient Services – Entertainment, Recreation” (Internal Revenue Service, 2010, pg. 18). The purpose of Ronald McDonald House Charities, as defined by its vision, is to create “a world where all children have access to medical care, and their families are supported and actively involved in their children's care.” Clearly, Ronald McDonald House Charities fits under the health category, as it deals with the children and families of unhealthy children. In addition, it provides entertainment and recreation, the title of the subcategory, by allowing families to be close to their children at the Ronald McDonald Houses and by creating areas for children to play in the Ronald McDonald Family Rooms (“Ronald McDonald House,” 2018, para. 1). If someone is interested in donating to a specific type of

organization, a good place to begin this search is by looking at organizations that fall under certain NTEE categories.

Since the definition, nature, and categorization of nonprofits with a charitable purpose is now clear, it is also imperative to review the outcomes that can be achieved by nonprofits in the health and human services sector and the impact that said organizations can have on the surrounding communities. For example, consider St. Jude Children's Research Hospital in Memphis, Tennessee. Not only do "families never receive a bill from St. Jude for treatment, travel, housing or food," but also "treatments invented at St. Jude have helped push the overall childhood cancer survival rate from 20% to more than 80%" ("Meet Abi," 2018, para. 14). For one child, this could mean the difference between life and death. Ashley, who was diagnosed with acute lymphoblastic leukemia shortly after her second birthday, was sent to St. Jude Children's Research Hospital, where she received treatment and has been in remission for four years ("Together for Ashley," 2018, para. 1-3). Not only can nonprofits in the health and human services sector help patients, but they can also greatly impact the lives of others involved. William, who was diagnosed with a congenital heart defect, was granted a wish of his choice by Make-a-Wish America. His dream was to be an American Airlines pilot and this organization made his dream a reality. However, he was not the only person to benefit from this experience. Jim, a senior manager and pilot at American Airlines, "counts his three days with William as the 'the coolest thing I've done in my 26 years at American Airlines'" ("American Airlines Transforms Wish Kid from Patient to Pilot," para. 3-4, 19). Health and human service organizations are created to improve social welfare and help those suffering from illness or misfortune. One can clearly see that these two example organizations above are helping people and showing others how to make an impact on the greater community. The purpose of this paper

is not to place judgment on organizations or encourage donations to one specific nonprofit charity. It intends to help others understand the factors that contribute to organizational success. Success can come in many forms, especially in the context of the nonprofit sector. Does success mean high donations? Does it mean low managerial expenses and executive compensation? Does it mean positive news articles? Although success may mean different things for different people, the goal of this paper is to provide tools that people can use to make decisions about nonprofit charities in the health and human services sector in America.

SECTION 3

OVERVIEW OF CHARITY RATING ORGANIZATIONS

Over the course of United States history, philanthropy has become a major part of society, with billions of dollars donated each year to various organizations. According to CNBC (Frank, 2017, para. 1), "American charitable giving in 2016 jumped nearly 3 percent from 2015 to $390 billion." Not only do Americans donate money, but they also donate blood, organs, food, and time to meaningful charities. Although one can see that charitable donations are at a high, why do American citizens donate? The answer could include tax deductions, empathetic feelings, religious purposes, or a combination of these. Although no research study fully answers this question, one reason that people do not donate to charities has been clearly established in the literature: lack of trust and accountability. PwC employees, Jill Halford and Neil Sherlock (2017, pg. 1), point out that "public polling for the Charity Commission showed that the overall level of trust and confidence in charities fell from 6.7 out of 10 in 2012 and 2014 to 5.7 in 2016." Research shows a direct correlation between trust in a charity and donations to that charity. According to research done by Alhidari, Veludo-de-Oliveira, Tousafzai, & Yani-de-Soriano (2018, pg. 639), "trust in COs determines individuals' intention to donate money to COs, and trust in COs determines future monetary donations to COs," where COs are charitable organizations. Over time, the lack of trust in charities will result in a lack of donations. Although not an immediate effect, this trend could seriously damage the successes of charities in the long run.

In order to combat the growing concerns of trustworthiness in charities across the country, organizations have been developed specifically to target this growing issue. According to Cordery and Baskerville (2011, pg. 199), "Increased government oversight, watchdog

agencies and ethical codes are responses to donor trust reduction resulting from NGOs' [non-governmental organizations] governance failures (Gibelman and Gelman 2004).” This paper focuses on watchdog agencies, with a particular concentration on Charity Navigator and CharityWatch, which are actually nonprofits themselves. Since, “trust is considered a fundamental prerequisite of effective human interaction and meaningful, constructive relationships” (Halford, J., & Sherlock, N., 2017, pg. 2), charitable organizations try to prove their trustworthiness by applying to be rated on these watchdog websites. In doing so, the organizations hope to gain trust and build essential relationships with donation-providing constituents. This paper will explore the effectiveness of such charity-rating organizations, but in order to do so, one must first understand the nature, missions, and methods of these watchdog organizations.

While watchdog organizations compete for the most users, the two that will be explored in this writing, CharityWatch and Charity Navigator, have similar missions. CharityWatch (“Mission & Goals,” 2018, para. 1) claims that its mission is to “maximize the effectiveness of every dollar contributed to charity by providing donors with the information they need to make more informed giving decisions.” This mission mentions one very important aspect in regard to philanthropic giving: improved decision-making. As mentioned above, these organizations were created in order to improve transparency and increase trust across the American population. Because these watchdog organizations are believed to be impartial, citizens tend to inherently trust the information presented. This allows the citizens to make their donation decisions based on information they trust. If these charity-rating organizations are truly providing valuable, relevant, and accurate information, the decision-making of potential donors will be positively affected by the work of CharityWatch.

While this organization has a very specific mission, Charity Navigator ("Mission, Vision, and Goals," 2018, para.1) takes a slightly boarder approach by seeking to "make impactful philanthropy easier for all." The ways in which this organization does so is unclear based on published goals, but this mission implies helping average citizens in decision-making about giving to charitable nonprofits. However, an important question remains: how do these watchdog organizations fulfil the duty of providing trustworthy information, leading to improved decisions by potential donors? The simple answer is that these organizations provide easy-to-understand ratings that are backed by relevant information. However, little research has been done to analyze the ratings or determine if these organizations are truly looking out for the best interests of ratings users. This paper seeks to determine whether the information that underlies these ratings is truly comprehensive and relevant.

In order to analyze the accuracy of the reported information, one must first understand ways in which these watchdog organizations rate charitable nonprofits. When average citizens discuss effectiveness of charities, they often discuss program expenses and executive compensation. Although these two metrics are essential in analyzing a charity's success, more financial and managerial factors can impact the accomplishments of a charity. While CharityWatch and Charity Navigator are only two of the charity rating agencies, they are representative of the watchdog industry as a whole. According to Oregon Attorney General's Nonprofit Profiles 2006 ("Praise," 2018, para. 14), "CharityWatch 'rating standards are generally considered the sector's most stringent.'" While CharityWatch is known to be strict with its ratings, "Charity Navigator is the easiest to use," according to The New York Times writer, John F. Wasik (2013, para. 19). Whether Americans prefer stringent or user-friendly, an analysis of

these watchdog organizations will give readers a better understanding of different considerations that could go into the evaluation of a charitable nonprofit.

Firstly, this paper will explore the rating methods of CharityWatch, which has the more rigorous methodology. The most unusual aspect of this methodology is that CharityWatch only uses two metrics to determine its grading: program percentage and cost to raise 100 dollars ("Criteria & Methodology," 2018, para. 2-3). Although much research goes into the calculation of each statistic, it is surprising to learn that the strictest watchdog organization bases its judgments on only two dimensions. The simple formula to calculate program percentage is program expenses divided by total expenses, where program expenses are "total expenses a charity spent on its programs in the year analyzed" ("Criteria & Methodology," 2018, para. 2). The formula to calculate the cost to raise 100 dollars is fundraising expenses divided by related contributions ("Criteria & Methodology," 2018, para. 3). Although this may seem simple, CharityWatch is different from many other watchdog organizations, in that the employees perform an "in-depth financial analysis…and any necessary adjustments…to a charity's reported figures" ("Criteria & Methodology," 2018, para. 14). CharityWatch does not report the methods it uses in detail to conduct this analysis, but it does discuss its analysis of three specific line items: non-cash donations, joint costs, and high assets. According to CharityWatch, these metrics are inconsistently reported among charities, as the guidelines for financial reporting are not clear for these items ("Criteria & Methodology," 2018, para. 17). According to Brenner ("Gifts-in-kind: What are they worth?" 2013, para. 6), noncash donations, for example, are supposed to be valued at fair value, which is "difficult and includes professional judgment." In order to combat this first issue, CharityWatch simply eliminates all noncash donations from related contributions in the cost to raise 100 dollars calculation. In addition, it eliminates any related expenses, such as

the value of the non-cash donations that are distributed in that year, from both program expense and total expense in the program percentage calculation (“Criteria & Methodology,” 2018, para. 23). In regard to the second issue noted by CharityWatch, joint costs are expenses incurred when a charity includes an educational piece of information in its solicitation or telemarketing efforts. The “joint” purpose of this action is educating the public on an issue, while also soliciting donations. Because “CharityWatch believes that most donors do not consider a charity's joint solicitation/educational activities to be equivalent to the purely programmatic activities,” they eliminate these expenses from program expenses and include them in fundraising expenses (“Criteria & Methodology,” 2018, para. 25). Finally, CharityWatch adjusts a charity’s ratings based on the value of any assets a charity holds in reserve for future use, since it believes benefactors want their donations used on current projects. In order to calculate these reserve assets, they first perform a simple calculation by dividing net fund balance by total operating budget. In addition, CharityWatch (“Criteria & Methodology,” 2018, para. 30) employees:

> conduct a review of a charity's tax Form 990 and Audit balance sheets and …subtract out items such as the equity in Land, Buildings, and Equipment used in operations; Construction in Progress; Permanently Restricted Funds; Accounts Receivable due in greater than five years, and assets that a charity is prohibited by an outside party from using.

In addition, the employees analyze the notes to the financial statements, looking for indications of future large projects or large donations that are unlikely to be spent in the coming year, which would then be subtracted as well. Once the adjusted reserve assets have been calculated, CharityWatch multiplies the charity’s annual expenditures by three to determine the assets necessary to hold in reserve for the coming three years, which is length of time recommended in

the industry. If the adjusted reserve assets are greater than necessary for the next three years but less than necessary for the next four years, CharityWatch subtracts one letter grade from its overall rating (See Appendix E), which will be discussed later in this paper. However, if the adjusted reserve assets are greater than necessary for the next five years, the charity automatically receives a failing grade of "F" because this is considered an extremely high amount of reserve assets ("Criteria & Methodology," 2018, para. 27-30). For purposes of this paper, it will be assumed that these line items are the only totals adjusted by CharityWatch in its analysis when calculating program percentage and cost to raise 100 dollars. Once these calculations are determined as mentioned above, CharityWatch will assign a letter grade between A+ and F, similar to grades given in intermediate school (See Appendix E), but it is unclear how the grade for each statistic are averaged together to achieve an overall grade. CharityWatch does not go into detail about this process. According to its website, "CharityWatch considers a charity to be highly efficient when our end calculations produce a Program Percentage of 75% or greater and a Cost to Raise $100 of $25 or less" ("Criteria & Methodology," 2018, para. 4). As previously mentioned, CharityWatch only has two main calculations that contribute to its ratings, but this organization is also considered the toughest critic of charities. This paper compares CharityWatch's rating techniques to others to determine if these are the most effective in assisting donors in donation decision-making.

In addition to CharityWatch, this paper analyzes the methodology of Charity Navigator, which is said to utilize a rating system that is the easiest to use. Unlike CharityWatch, Charity Navigator uses several metrics in order to determine ratings of charitable nonprofits based on financial health, accountability, and transparency. Specifically, Charity Navigator calculates seven metrics in relation to financial health, twelve metrics in relation to accountability, and five

metrics in relation to transparency (Appendices A, B, and C). In doing so, this watchdog organization believes it is giving readers a more comprehensive look at the charities' activities, as compared to CharityWatch. Another major difference that separates Charity Navigator from CharityWatch is the resources it uses to gather information for its calculations. While CharityWatch adjusts the data from the IRS Form 990, financial statements, and other various sources, Charity Navigator uses the financial and nonfinancial information that each charitable nonprofit provides on the IRS Form 990 and their website ("Charity Navigator's Methodology," 2018, para. 11). In order to determine ratings, Charity Navigator splits up the metrics into two categories. The financial health metrics make up one category, while the accountability and transparency metrics are combined into one category ("Charity Navigator's Methodology," 2018, para. 11). In regard to the financial health category, points are assigned to the charity based on the values of the metrics relative to Charity Navigator's thresholds (Appendix A). Once all of the points are assigned, Charity Navigator adds 30 points to the charity's score to convert the scores to a 100-point scale and determines the number of stars to assign as a rating based on another series of thresholds (Appendix D). In regard to the accountability and transparency category, each charitable nonprofit begins with 100 points and loses points based on nonfinancial information that is or is not provided on the on IRS Form 990 and nonprofit's website (Appendices A and B). After deducting all necessary points, the star rating is assigned to this category based on the same thresholds as the financial health category (Appendix D). For ease of use, Charity Navigator not only assigns stars to each category, but it determines an overall star rating for each charitable nonprofit as well. By using a formula determined by Charity Navigator, as well as the same star thresholds used to determine the stars for each category, Charity

navigator inserts the previously determined points scores into this formula to determine the overall score:

$100-\sqrt{\frac{(100-Financial\ Score)^2+(100-A\&T\ Score)^2}{2}}$ (“Charity Navigator’s Methodology,” 2018, para. 13). As one can see, this entire process is based largely on Charity Navigator’s judgment, as it determines the metrics, the thresholds, the points, and the scoring formula. However, Charity Navigator does consider many characteristics of a charitable nonprofit, which could be beneficial to readers. An important question when comparing watchdog organizations still remains: Is quality or quantity more important? Whereas CharityWatch falls on the quality side of the spectrum because of its stringency, Charity Navigator falls on the quantity side because of its large amount of metrics. While some may have a preferred methodology, this paper seeks to find a method that is more productive than either one presented thus far, and to determine if these watchdog organizations are consistent in their ratings holistically.

SECTION 4

HOW SHOULD NONPROFITS BE RATED?

As mentioned above, charity watchdog organizations strive to help average citizens understand the success and work of charitable nonprofits in the health and human services sector, as well as other sectors not included in this study. With the public's trust in nonprofits wavering as a whole, this paper seeks to find a way to regain that trust by proposing an alternative rating system. In using the alternative system, users will be able to obtain a more complete understanding of a charity, including components such as management performance, general public opinions, and financial health. While Charity Navigator includes some of these components in its ratings, CharityWatch focuses solely on financial health. Are public opinions and management performance relevant when deciding to donate to a given charity? While little research has been done to specifically answer this question, this thesis will analyze the importance of all three components to create a comprehensive methodology usable by a majority of Americans.

In regard to management of charitable nonprofits, one must realize that the managers, including Chief Executive Officers and other C-suite officers, are in charge of producing relevant and accurate financial statements. While auditors ensure these financial statements are free from material misstatement, managers and accounting professionals within the organization are ultimately responsible for any inaccuracy in reporting. This begs an important question: Are managers and auditors for not-for-profits qualified to produce and audit financial measures that are used in ratings? For the purposes on this paper, an accounting professional will be considered competent to produce and audit financial statements if he/she is a certified public accountant (CPA). While an auditor is required to be a CPA in order to sign off on audited financial

statements, this certification is not required in order to become a top manager of a charitable nonprofit. To make matters worse, certain nonprofits are not even required to have an auditor examine the financial statements for material misstatements. For example, as of July 1, 2017, the New York Revitalization Act lessened the requirements for nonprofit audits by increasing the annual revenue threshold to $250,000, meaning that nonprofits with an annual revenue of less than $250,000 are not required to produce audited financial statements at all (Kahn, 2014, pg. 47). Consequently, financial measures for low revenue-producing nonprofits that are used by current watchdog organizations could be affected by the capabilities and incentives of managers. Since these managers do not necessarily have accounting experience, this regulation and many others like it can be problematic to say the least. In addition, while some charitable organizations that are not required to have an audit choose to do so anyway, they are not required to use highly qualified auditors to review their financial statements. According to Reeve (1965, pg. 63), who conducted a study of 14 charitable organizations, "None of the ten unsatisfactory audit reports gave the scope of the audit, nor the qualifications of the auditor. By this I mean that the persons who performed the audits were not known to me or could not be located in the directory of CPAs or registered public accountants." Reeve (1965, pg. 65) furthers his argument for quality audits by stating that "an audit by a nonqualified layman is really worse than no audit at all, because it creates a feeling of false security…in the minds of the public." Other researchers also push for high quality audits of nonprofit organizations in order to boost accountability and increase public trust. For example, Baumuller (2013, pg. 163) simply defines quality of a nonprofit audit by stating that "Quality(*Audit)* = Skills*(Auditor)* + Independence*(Auditor).*" As one can see, the effectiveness of an audit is directly correlated with the abilities of the auditor. If an auditor is unable to identify issues or misstatements in the financial statements of a charitable nonprofit,

the financial measures of the organization will be useless to the public and watchdog organizations. In order to ensure the accuracy of financial statistics, this thesis proposes that the Chief Financial Officer or equivalent of the nonprofit organization should be a CPA, as well as the auditor, whether the audit is required or not. Since the quality of financial management and auditing is of utmost importance, this idea will be included in the recommended rating system of watchdog organizations (Appendix F). If an audit is not completed, points will be deducted, but not to the extent that an organization uses an unqualified auditor. For watchdog organizations and donors alike, it is important to be skeptical of charitable organizations and research management qualifications for specific charities of interest.

Not only should managers of a nonprofit organization be financially savvy, but they also need to be efficient and effective in running the logistics of the charity. According to Bryce (2016, para. 37),

> When donors make a gift, unless they specify a purpose for which the gift is to be used, they are presumed by law and accounting procedures (FASB 116) to be making a gift to the general fund of the organization—i.e., an unrestricted gift. The use of the gift is at management's discretion. In this case, trust is vested in that discretion…This kind of trust is highly permissive.

Since managers have such unlimited power, it is assumed by donors that they are capable of managing resources and allocating donations appropriately. With this power comes an unusually large amount of trust. Since donors are putting trust in top management to allocate the resources provided to appropriate program expenses, it is imperative that managers of charitable nonprofits understand the magnitude of their power, as "custodial trust can also be impaired because management is inactive, incompetent, uninformed, or uninvolved," according to Bryce, (2016,

para. 52). Essentially, these qualities boil down to two major components: experience and ethical record. Although it is difficult to quantify all of these characteristics, the rating system of a watchdog organization should be as comprehensive as possible.

In order to analyze management performance, a listing of managers must be provided on IRS Form 990. If this listing it not provided, many other assessments within the system will not be possible, so excluding this list would result in a major reduction in the rating (Appendix F). After ensuring the list of key employees is provided, it is important to successfully appraise the experience and ethical record of managers. When evaluating experience, this can be broken down further into two categories, education and industry knowledge, which must be incorporated into the new rating system. In order to do so, this thesis proposes that one rating criterion should be that the CEO or equivalent of the organization has a graduate degree in a business discipline. In addition, at least 75% of other key employees and highly compensated employees listed on IRS Form 990 should have at least an undergraduate diploma in an appropriate discipline. Because a large number of key employees may be listed, it is unrealistic that a watchdog organization would be able to find the education information on every employee, hence the 75% threshold. This threshold is added out of convenience to users. Industry knowledge is often correlated with years of experience in the same or similar industries. In order to judge industry knowledge, this thesis proposes that at least 75% of all key and highly compensated employees listed on the IRS Form 990 should have at least 5 years experiences in relevant roles. Similarly to the last criterion, the 75% threshold is for the convenience of users and watchdog organizations. With the addition of the four criteria described above, the proposed rating system develops an understanding of management abilities as a whole, which is an essential component of any rating system.

In addition to experience, it is essential that managers have a clean ethical record, which directly correlates to the ethical culture of the organization. According to LaMontagne (2016, pg. 10), “a person’s level of moral cognition can either continue to develop or regress, depending on the person’s job and the organizational culture.” Managers establish a tone at the top of the organization, which has an effect on the employees in the organization. This means that an unethical manager can create more unethical behaviors in the organization as a whole, leading to fraud, corruption, or misstatements. In order to ensure that managers are acting ethically both personally and professionally, the proposed rating system will investigate key and highly compensated employees for past convictions of any crimes, excluding traffic violations. Although it is not included on the IRS Form 990 or financial statements, these criminal records are public information, so it is key that this extra piece of information be included in the rating. Additionally, a manager’s ethical decision-making can be shown through the policies of the organization, since management is responsible for enacting guidelines that dictate employee behavior. If certain policies are excluded, it can be assumed that the managers are acting inappropriately in ensuring the ethical management of the organization. According to Mitzen (1998, para. 14), “Ethical behavior of an organization begins with ethical behavior toward its own employees, which means communication and a supportive environment that supports even whistle blowing, with all its potential for conflict.” In order to incorporate the importance of whistleblowing, which is defined as “the act of telling the authorities or the public that the organization you work for is doing something immoral or illegal” (*Collins English Dictionary)*, the proposed rating system will verify that the organization has a written whistleblower policy by inspecting IRS Form 990, which has a line item specifically for this purpose. In addition to a whistleblowing policy as a preventative measure for illegal activities, it is important to also have

a conflict of interest policy. In order to incorporate this idea into the rating system, it is suggested that watchdog organizations make sure that nonprofit charities have a written conflict of interest policy, as shown on the IRS Form 990 as well. Finally, the last section to be utilized on the IRS Form 990 (2017, pg. 6) that relates to ethical behavior within the organization is Part 6, Section a, Line 5: "Did the organization become aware during the year of a significant diversion of the organization's assets?" Diversion of assets is defined as "the use or conversion of charitable assets for unauthorized purposes. Practically speaking, asset diversions are a type of fraud commonly referred to as asset misappropriations" (Harris, Petrovits, & Yetman, 2017, pg. 149). Fraud and theft are the most basic examples of unethical behavior for both managers and employees. If a nonprofit has had a significant diversion of assets within the last year, it is proof that the policies and controls put in place are not sufficient in preventing unethical decisions, which should be reflected in the rating of that organization. Although it may seem overly ambitious to include all of these criteria in just one section of the proposed rating system, the Journal of Accountancy ("Nonprofits," 2011, para. 4) states that "board members or trustees of nonprofits have a special role in ensuring public accountability," so it is important to consider their effect on the logistical management of the organization as a whole in the watchdog ratings of these charitable nonprofits.

In regard to the three components of the proposed rating system, the public opinions portion is the most challenging to measure accurately. In order to understand how to include this component in the new rating system, it is first important to understand how public opinions are created. According to a study by Matthew Hale (2007, pg. 465), "…the media can tell us not only what to think about but also what to think," meaning that a reader's perceptions can turn into that of the writer of news sources. Not only do media sources affect public opinions, but

friends and family members can also play a role in developing opinions. According to Hoffman (2012, pg. 479), her study "…provides further evidence for the role of interpersonal discussion in the development of public opinion, suggesting that discussion at the individual level interacts with media content at the contextual level to fuel perceptions of social reality." Essentially, other citizens in one's community may develop opinions based off of a newspaper article and share this information with another; this cycle could continue with repeated distortions to the original information, leading to inaccurate information about the original topic. In the case of this thesis, it could be information in regard to a charity's work in the community. This begs the question: are public opinions an accurate depiction of charity effectiveness? Not only are public opinions potentially skewed based on the reporting choices of major media outlets and misinformation during interpersonal conversations, but they are also extremely difficult to measure accurately without the use of mass surveying nationwide. As charity watchdog organizations often operate on small budgets themselves, it is unrealistic to expect them to conduct such extensive research in order to rate the nonprofits. Because of this potential inaccuracy, public opinions should have a significantly less impact on rating, as they are not based on empirical data. However, it is still possible to incorporate these opinions into the rating system, which is important because users of the watchdog ratings often want to know others' opinions on charity performance. It is a similar idea to reading reviews on a website before buying a product. Since media opinions directly correlate with public opinions as mentioned above, this can be used as a means to measure public opinions in the rating system. If the charity is a national organization, watchdog organizations can rate a charity based on the amount of times a charity appears in a negative and the amount of times a charity appears in a positive context in the last year in one of the top ten major news sources (Appendix G). If the charity is a local organization, they can be rated based on the

amount of times they appear in a negative context and the amount of times a charity appears in a positive context in the last year in the main local news source. Fortunately, and surprisingly, negative news articles in regard to nonprofit charities are actually uncommon. As cited by Hale (2007, pg. 470),

> Deacon (1999) found that just 1% of all news stories in his study of nonprofits in the British media focused on what he broadly describes as “maladministration/inefficiency” …In addition, two studies focused on the United States (Gould et al., 2003; Martens, 1996) also describe media stories about nonprofits as generally more “positive” than “negative” in tone.

In most cases, these rating components will only help charities by buffering any other areas where they might be struggling. However, as mentioned, it is an important component that could potentially sway or dissuade certain individuals from getting involved with a particular charity.

In regard to financial health, an important question arises about nonprofits: Do nonprofit charities function the same as for-profit companies when discussing financial operations? Although the need for accountability is the same for for-profit and nonprofit organizations as mentioned above, the same is not true for financial criteria. Charities often do not operate in similar fashions to for-profit entities, especially in regard to financial decisions. In fact, donors do not necessarily want them to function as for-profit organizations. According to Lee, Bolton, and Winterich (2017, pg. 869), “As companies make profit, people won’t donate: the pattern of results provides support for our theorizing that consumers believe profits come at the expense of social impact, which drives greed perceptions and undermines organizational support.” Although it is unrealistic to have donations and other revenues match program and operational expenses exactly, donors associate a minimal profit with higher amounts of money spent on program

expenses. However, this may certainly not be the case because charities could raise operational expenses, such as salary and marketing expenses, to obtain the same result. In order to ensure that charities are not simply increasing operational expenses, the proposed rating system for watchdog organizations will look at the program expense ratio (total program expenses/total expenses), as donors are anticipating high program expenses, not operational expenses, when profit does not exist. Not only is it important to ensure that program expenses account for the majority of total expenses, but Principle 24 of the *Principles for Good Governance and Ethical Practice a Guide for Charities and Foundations* (2015, pg. 35) also recommends that “A charitable organization should spend a significant amount of its annual budget on programs that pursue its mission while ensuring that the organization has sufficient administrative and fundraising capacity to deliver those programs responsibly and effectively.” In order to evaluate a charity’s success in doing so through the proposed rating system, CPAs Lang, Eisig, Klumpp, and Ricciardella (2017, pg. 224) recommend the use of a net margin ratio ((Total Revenue - Total Expenses)/Total Revenue) to decide “whether the organization is (1) living within its means or (2) maximizing its program expense.” In doing so, the rating system ensures that the charity is not on the verge of failure, while also verifying that the charity is using its program expenses appropriately. Because appropriate expense management is so important to donors, multiple ratios must be used in order to rate the charities in regard to expenses. Although the program expense ratio ensures that program expenses account for a majority of expenses, executive compensation is of particular interest to donors as well. According to the 2016 Nonprofit Executive Compensation Report (2016, pg. 5), above average executive salaries were reported in 2015, with the health sector average at $118,168 per year. Thus, the proposed rating system will include a compensation expense ratio (Total salary expense/Total expenses) to

encourage charities to be cautious in increasing salaries. The final ratio in relation to expenses that must be included in the rating system is the fundraising expense ratio (Total Fundraising Expenses/Total Contributions). According to the Better Business Bureau's Standards for Charity Accountability (2003, pg. 2), charities should "spend no more than 35% of related contributions on fund raising. Related contributions include donations, legacies and other gifts received as a result of fund raising efforts." Although it definitely requires money in order to make more money, ultimately, the contributions by donors are intended to go directly to program expenses, so fundraising expenses should be kept to a minimum. With the addition of this ratio, the proposed rating system will ensure that monetary contributions are going to the intended cause, as opposed to operational expenses, executive salary, and fundraising. In order to calculate the aforementioned ratios, it was assumed that the company provided financial data on either the IRS Form 990 or some other published financial statements that are posted on their website. According to the AICPA ("NFP Governance and Management FAQs," para. 11), "There is no federal requirement to provide your financial information on your website...In the interest of transparency, it is considered a good industry practice to post both the IRS Form 990 and the NFP's annual financial statements." Because it is impossible to calculate financial statistics without this information, excluding this information would result in a major reduction in the rating. Another financial measure that is included in the proposed rating system is the amount of accumulated contributions. Although CharityWatch uses a very similar version of this metric, it multiplies the annual expenditures by three to determine the necessary assets for the coming three years. Similarly, the Better Business Bureau's Standards for Charity Accountability (2003, pg. 2) recommend charities "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 higher." These standards incorporate the past expenses instead of just expected future expenditures, which better accounts for fluctuations in expenses. Since expenses for a charity should generally correlate with donations, which are assets, this proposed addition to the rating system is more specific in measuring the organization's effectiveness in achieving its mission.

In order to recommend a complete rating system, it is important to be able to take these metrics, both quantitative and qualitative, and convert them into a comprehensive score. Because simplicity is key in this proposed rating system for watchdog organizations, it is suggested that users employ a simple percentage by dividing the points earned by total points, which would be correlated with a certain grade (Appendix H). For example, if a charity earned 125 points out of 165 total points based on the rating system (Appendix F), the simple percentage would be 76% after rounding, which would translate to a grade of C. By calculating a simple percentage, this system does not equally weight the management, public opinion, and financial categories. In my opinion, the categories do not need to be weighted equally because each metric is chosen for its own intrinsic value. Essentially, each additional measure is important and receives weight equal to all other categories with more measures in one category naturally receiving more weight. In addition, I recommend using a very traditional grading system, typically seen in secondary and post-secondary educational institutions ("How to Convert Your GPA to a 4.0 Scale," 2018). Because this system is common in the United States, it is more user-friendly and understandable to typical users, as compared to a star-based system.

In creating a new rating system, I sought to create a methodology that is both comprehensive and easy-to-understand (Appendix F). Based on the research conducted, each of

the eighteen criterion that was chosen to be incorporated was either necessary based on underlying facts or directly mentioned by experts in the field of nonprofits. While the other two rating systems discussed in this paper incorporate other metrics for various reasons, some of which are disclosed and some of which are not, the goal of this thesis was to simply suggest a new system that seeks to more accurately depict the true actions of charities in the United States. While Charity Navigator has a large quantity of measures and CharityWatch strives for quality measures, I sought to provide a middle ground that would satisfy all user needs.

SECTION 5

ANALYSIS OF THE AMERICAN RED CROSS AND ALZHEIMER'S ASSOCIATION

This study will focus on two specific health and human services sector section 501(c)(3) nonprofits: the American Red Cross and Alzheimer's Association. In order to fully understand the proposed rating system and analyze its effectiveness, I will compare the rating under the new methodology with the ratings of Charity Navigator and CharityWatch for two charities. Since this thesis is focused solely on charities within the health and human services sector, it is necessary to validate that the American Red Cross fits into this category. According to IRS data (Internal Revenue Service, 2010, pg. 22), the American Red Cross NTEE code is P21, placing it in the Human Services – Multipurpose and Other category (P). Because this charity is so large, it has its own subcategory, denoted with the 21. In fact, Forbes ("The 100 Largest U.S. Charities," 2017) ranks the American Red Cross as the twentieth largest charity in the United States. In choosing a charity to analyze using the new system, the American Red Cross was chosen because of its high donor dependency. According to Forbes ("The 100 Largest U.S. Charities," 2017), the American Red Cross's donor dependency is 204%, meaning that the American Red Cross receives more than twice the amount of contributions as it has expenses. Although this may seem good at first glance, many donors want to know if the high amounts of contributions are going towards the assumed cost areas, specifically program costs. The question remains: Is the management of the American Red Cross spending these donations appropriately?

According to CharityWatch ("American Red Cross," 2018), the American Red Cross is doing a "good" job of managing resources, with a overall score of B+, a program percentage of

89%, and a cost to raise $100 of $31. Similarly, Charity Navigator ("American Red Cross," 2018) awarded the American Red Cross 84.09 points, which translates to three stars overall. In the views of Charity Navigator, this is a good rating that means the charity "exceeds or meets industry standards and performs as well as or better than most charities in its Cause" (Appendix D). Broken down even further, the American Red Cross received 77.5 points or two stars in the financial category and 100 points or four stars in the accountability and transparency category from Charity Navigator ("American Red Cross," 2018). Using the proposed rating system that was hypothesized in this thesis, the American Red Cross was awarded 135 points out of 165 points, which translates to 81.8% or a grade of B- (Appendix I).

In addition to the American Red Cross, I analyzed the Alzheimer's Association for charity success using the proposed rating system. According to the IRS (Internal Revenue Service, 2010, pg. 19), this organization has an NTEE code of G83, where the G represents the Diseases, Disorders, Medical Disciplines category and the 83 denotes organizations that deal with Alzheimer's disease. Although not as high as the American Red Cross, the Alzheimer's Association has a donor dependency of 95% and ranks fiftieth in the United States' largest charities, according to Forbes ("The 100 Largest U.S. Charities," 2017). Just as any other organization that serves to eradicate disease from the world, the Alzheimer's Association ("About," 2018, para. 1) works to "eliminate Alzheimer's disease through the advancement of research; to provide and enhance care and support for all affected; and to reduce the risk of dementia through the promotion of brain health." In order to achieve this mission, this charity relies on donors that have personal interest in this disease, whether that be because of family members with the disease or empathy for those suffering.

According to CharityWatch ("Alzheimer's Association (National Office)," 2018), the Alzheimer's Association receives the same rating as the American Red Cross with an overall grade of B+. In order to calculate this overall grade, CharityWatch calculated a program percentage of 73% and a cost to raise $100 of $22. Consistent with this rating, Charity Navigator ("Alzheimer's Association," 2018) gave the Alzheimer's Association 89 points overall, equaling a rating of three stars. Although the Alzheimer's Association received a lower score in the accountability and transparency category with 96 points or four stars as compared to the American Red Cross, it received a higher score in the financial category with a score of 84.97 or three stars ("Alzheimer's Association," 2018). After applying the proposed rating system to the Alzheimer's Association, this nonprofit charity was given a total of 125 out of 165 points, which results in an 75.8% or C (Appendix J).

Although this thesis hypothesized that a large difference would exist between the ratings of current watchdog organizations and the proposed rating methodology, the ratings are essentially the same. Therefore, several questions remain. Are stringent methodologies or user-friendly methodologies more appropriate for donors? Should rating systems focus more on managerial success, public opinions, or financial effectiveness? Due to the lack of differences in the rating systems scores, it seems that all rating systems presented fall within the range of consensus for charity effectiveness. Whether the system is simple, stringent, easy-to-use, financially based, etc., the results in ratings appear to be similar for these two charities. This conclusion was surprising at first, but upon further thought, it is actually logical. A strong correlation exists between managerial effectiveness and financial success. Because managers generally make decisions about financial resources, educated, experienced managers will generally be better at allocating these resources than inexperienced managers. They are more

equipped to understand donor demands, minimize unnecessary expenses, and focus on the mission of the organization. Because of this correlation, a rating system can focus on either the managerial effectiveness or financial success of an organization, as the results would likely lead to the same conclusion.

In comparing simplistic rating systems, complex methodologies, and everything in between, the overall scores may be similar; however, donors may have more trust in watchdog organizations that utilize a stringent approach. Where the metrics in a simple rating system, like the new one proposed by this thesis, may be easily duplicated by users to verify accuracy, the metrics used in a complex system, such as the one used by CharityWatch, are not as clear cut, making it more difficult for average donors to verify the ratings. As a result, the donors that choose to use this rating system would have to trust that the watchdog organization calculated all of the metrics accurately. In addition, a simpler rating system can have an added advantage of being customizable. A simple methodology allows users to eliminate metrics and add other metrics that have specific importance to them personally. Although this may or may not change the overall score, it could give users peace of mind in knowing that they observed every possible metric that could affect their donation.

Although it is surprising that all ratings presented fall within the range of consensus, this conclusion could lead to more research in the field of nonprofit charities. Is there another missing piece that could be contributing to charity success and failure? Should watchdog organizations be rating charities or providing means for donors to analyze on a more personal level? Although answers to these questions may not be available for years to come, given results of the analysis of the American Red Cross and Alzheimer’s Association, it appears as if current watchdog

organizations, as well as to an alternative proposed method, are concluding similarly to each other and are all falling within the range of consensus for charity effectiveness.

SECTION 6

CONCLUSIONS

In researching charitable nonprofits, watchdog organizations, and the ways in which these work with and for each other, some surprising conclusions have become evident. As mentioned above, the differing focus of the different rating systems on financial versus nonfinancial data and quantity versus quality of metrics created little difference in overall grades. However, skepticism is still important for donors when using various rating systems, including the one proposed in this thesis. In order to achieve desired results with their contributions, donors should use these rating systems to narrow down the search for a deserving charity, but it should not be the sole decision-maker for users. It is recommended that donors use portions of various rating systems that focus more heavily on the concerns of that individual. According to Rick Cohen (2013, para. 6), “With such a mixed message about a charity…, a donor has no other choice than to be an informed consumer and to pick a charitable recipient thoughtfully.” Consistent with Cohen’s suggestion, this thesis recommends that a donor make a thoughtful choice by informing him/herself on specific metrics that are relevant to them. Additionally, it is recommended that donors use a multidimensional approach in the analysis of charitable nonprofits. Although correlation between financial health, public opinion, and managerial efficiency exists in the long term, results for one dimension could be skewed depending on the year and charity. For example, if a charity suffers financially in one year because of outside market factors, the rating may be very poor for a system that focuses solely on finances, even though it is not necessarily deserved. Finally, this thesis recommends that judgment is used when analyzing metrics, especially in regard to financial metrics. Although percentages are recommended as thresholds of success and failure, outlying factors may be relevant and should

be considered if the metrics fall close to the thresholds. The same could also be true for nonfinancial data. For example, some key employees may not be formally educated but have obtained enough training that this satisfies the need for educated managers. It is important for donors to recognize that these metrics should be based on substance over form. Because it is impossible to determine if watchdog organizations are using judgment in their rating system, it is important to reiterate that users should develop their own rating systems based on a published system. Although the overall conclusion was different than hypothesized, several important recommendations and realizations came from the necessary and extensive research in this field.

In addition to these conclusions and recommendations, it is important to discuss scope limitations of this research. Firstly, this study was focused solely on the health and human services sector. Although unlikely, it is important to note that differing results may have occurred in other nonprofit sectors. Secondly, this thesis only analyzed the ratings for two different charities. Although they both produced the same result, a thorough study should be conducted with a large random sample in order to prove valid results. More accurate and consistent results will come from larger samples and more extensive research. Lastly, all ratings are subject to human error, both published ratings and the proposed ratings. The results of this thesis are based on the accurate calculation of these ratings, and it was assumed that all scores were calculated appropriately. With these scope limitations, discretion is advised when referencing the results of this research and it is again recommended that users verifying the accuracy of all scores given on both published websites and the proposed rating system.

In order to conclude, it is imperative to discuss potential future research in this field. Firstly, in further research, it would be beneficial to interview representatives and users of watchdog organizations in order to gain further insights on the positives and negatives of rating

systems. Since CharityWatch does not explain the process for determining overall score, this could also be beneficial to gain a better understanding of the scoring process as a whole. Secondly, it would be beneficial to research more effective ways to incorporate public opinions into the ratings. Because public opinions are skewed so heavily by family, friends, and media, it was difficult to incorporate this into the proposed rating. With further research, it may be possible to include a more research-based metric into the public opinion category. Thirdly, as mentioned above, it is recommended in future research to conduct a more expansive study that analyzes a large sample of charitable nonprofits in the health and human services sector. Additionally, it would be advantageous to conduct hypothesis tests in order to gauge whether the differences in ratings are actually statistically significant. Lastly, future researchers could conduct similar studies for charitable nonprofits outside of the health and human services sector in order to build a larger platform for analysis. Because nonprofit watchdog organizations are a relatively new medium of critique, little research has been conducted in comparison to other topics within the nonprofit field. With more research, watchdog organizations will be able to improve their processes, ultimately benefitting all donors in the United States. After completing this thesis and the included research, one question remains: do you trust your favorite charity?

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APPENDIX A[1]

CHARITY NAVIGATOR'S FINANCIAL METRICS

Metric Number	Metric Name	Metric Formula	Point Determinant	Points
1	Program expense percentage	Average program expense ÷ average total expense	< 33%	0 points and 0 stars
			33.3 - 50%	0 points
			50 - 85%	10*(Raw Score-0.5)/0.35 equals the points
			> 85%	10 points
2	Administrative expense percentage	Average administrative expenses ÷ average total expenses	0 - 15%	10 points
			15 - 20%	7.5 points
			20 - 25%	5 points
			25 - 30%	2.5 points
			> 30%	0 points
3	Fundraising expense percentage	average fundraising expense ÷ average total expenses	0 - 10%	10 points
			10 - 15%	7.5 points
			15 - 20%	5 points
			20 - 25%	2.5 points
			> 25%	0 points
4	Fundraising efficiency	Average fundraising expense ÷ average total contributions	$0.00 - 0.10	10 points
			$0.10 - 0.20	7.5 points
			$0.20 - 0.35	5 points
			$0.35 - 0.50	2.5 points
			> $0.50	0 points

[1] Charity Navigator. (2018). Charity Navigator's Methodology. Retrieved September 13, 2018 from https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=5593#rating.

5	Program expenses growth	(Program expenses in most recent interval year ÷ program expenses in oldest interval year) ^ (1 ÷ number of interval years) - 1	Score * 100	Generally, for health and human services, the points are calculated by the formula: converted raw score + 1
6	Working capital ratio	Working capital ÷ average total expense	> 1.0	10 points
			1.0-0.5	7.5 points
			0.5-0.25	5 points
			0.25-0.0	2.5 points
			<0.0	0 points
7	Liabilities to assets ratio	Total liabilities ÷ total assets	0-5%	10 points
			5-20%	7.5 points
			20-40%	5 points
			40-99.9%	2.5 points
			100%+	0 points

APPENDIX B[2]

CHARITY NAVIGATOR'S ACCOUNTABILITY METRICS (IRS FORM 990)

Metric Number	Metric Name	Decision Determinant	Points Deducted
1	Independent Board	Has independent board members with a voting majority and at least five members	0 points deducted
		Does not have an independent board with a voting majority and/or has less than five members	15 points deducted
2	Material diversion of assets	No diversion of assets in the last two years	0 points deducted
		Diversion of assets with a corrective action stated	7 points deducted
		Diversion of assets with no explanation	15 points deducted
3	Audited financials	Audited financials prepared by an independent accountant with an audit oversight committee	0 points deducted
		Audited financials prepared by an independent accountant but did not have an audit oversight committee	7 points deducted
		Did not have its audited financials prepared by an independent accountant	15 points deducted
4	Loans to or from related parties	Does not have loans with related parties	0 points deducted
		Has loans with related parties	4 points deducted
5	Documents Board meeting minutes	Documents and discloses minutes	0 points deducted
		Does not document and/or disclose minutes	4 points deducted
6	Provided copy of Form 990 to	Does provide copy	0 points deducted

[2] Charity Navigator. (2018). Charity Navigator's Methodology. Retrieved September 13, 2018 from https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=5593#rating.

	organization's governing body in advance of filing	Does not provide copy	4 points deducted
7	Conflict of interest policy	Has a policy	0 points deducted
		Does not have a policy	4 points deducted
8	Whistleblower policy	Has a policy	0 points deducted
		Does not have a policy	4 points deducted
9	Records retention and destruction policy	Has a policy	0 points deducted
		Does not have a policy	4 points deducted
10	CEO listed with salary	Does report	0 points deducted
		Does not report	4 points deducted
11	Process for determining CEO compensation	Does report	0 points deducted
		Does not report	4 points deducted
12	Board listed/board members not compensated	Listed and not compensated	0 points deducted
		Not listed and/or compensated	4 points deducted

APPENDIX C[3]

CHARITY NAVIGATOR'S TRANSPARENCY METRICS

Metric Number	Metric Name	Decision Determinant	Points Deducted
1	Board members listed	Publishes	0 points deducted
		Does not publish	4 points deducted
2	Key staff listed	Publishes	0 points deducted
		Does not publish	3 points deducted
3	Audited financials	Publishes	0 points deducted
		Does not publish	4 points deducted
4	Form 990	Publishes	0 points deducted
		Does not publish	3 points deducted
5	Privacy Policy	Has policy	0 points deducted
		Does not have policy	4 points deducted
		Opt-out policy	3 points deducted

[3] Charity Navigator. (2018). Charity Navigator's Methodology. Retrieved September 13, 2018 from https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=5593#rating.

APPENDIX D[4]

CHARITY NAVIGATOR'S GRADING

Points	Number of stars	Qualitative rating	Description
< 55 points	0 star	Exceptionally poor	Performs far below industry standards and below nearly all charities in its Cause
55 - 70 points	1 star	Poor	Fails to meet industry standards and performs well below most charities in its Cause
70 - 80 points	2 stars	Needs improvement	Meets or nearly meets industry standards but underperforms most charities in its Cause
80 - 90 points	3 stars	Good	Exceeds or meets industry standards and performs as well as or better than most charities in its Cause
> 90 points	4 stars	Exceptional	Exceeds industry standards and outperforms most charities in its Cause

[4] Charity Navigator. (2018). Charity Navigator's Methodology. Retrieved September 13, 2018 from https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=5593#rating.

APPENDIX E[5]

CHARITYWATCH'S GRADING

Program Percentage	Cost to Raise 100 Dollars	Grade	Grade Meaning
90-100%	$0-4	A+	Excellent
80-89%	$5-11	A	Excellent
75-79%	$12-15	A-	Excellent
72-74%	$16-19	B+	Good
68-71%	$20-26	B	Good
65-67%	$27-30	B-	Good
61-64%	$31-33	C+	Average
56-60%	$34-37	C	Average
50-55%	$38-40	C-	Average
36-49%	$41-59	D	Poor
0-35%	$60-100	F	Failing

[5] CharityWatch. (2018). Criteria & Methodology. Retrieved September 13, 2018 from https://www.charitywatch.org/about-charitywatch/criteria-methodology/3113/3147.

APPENDIX F

PROPOSED RATING SYSTEM METRICS

Metric Number	Category of Metric	Metric Name	Metric Formula/Decision Determinant	Possible Source of Determinant	Points Determinant	Points Awarded
1*	Management	CFO Qualifications	Is their CFO or equivalent a CPA?	Charity Website, LinkedIn, or Financial Statements	Yes	10 Points
					No	0 points
2*	Management	Auditor Qualifications	Is the auditor a CPA?	Financial Statements	Yes	10 points
					No audit	5 points
					No	0 points
3	Management	Employee Disclosure	Are the key and highly compensated employees listed on IRS Form 990?	IRS Form 990	Yes	10 points
					No	Deduct 50 points
4*	Management	CEO Qualifications	Does the CEO have a graduate degree in a business discipline?	Charity Website or LinkedIn	Yes	10 points
					No	0 points
					N/A	0 points
5*	Management	Employee Education Qualifications	Do at least 75% of the key and highly compensated employees have an undergraduate degree in an applicable discipline?	Charity Website or LinkedIn	Yes	10 points
					No	0 points
					N/A	0 points
6*	Management	Employee Industry Knowledge Qualifications	Do at least 75% of the key and highly compensated employees have at least 5 years of work experience?	Charity Website or LinkedIn	Yes	10 points
					No	0 points
					N/A	0 points
7*	Management	Employee Criminal Records	Have any key employees or highly compensated employees been convicted of any crimes, excluding traffic violations?	Public Record	Yes	0 points
					No	5 points
					NA	0 points
8	Management	Whistleblower Policy	Did the organization have a written whistleblower policy?	IRS Form 990: Part VI Section B Line 13	Yes	10 points
					No	0 points

9	Management	Conflict of Interest Policy	Did the organization have a written conflict of interest policy? If so, was disclosure of conflicts required and was this policy monitored for compliance?	IRS Form 990: Part VI Section B Line 12a, b, and c	Yes	10 points
					No	0 points
10	Management	Diversion of Assets	Did the organization become aware during the year of a significant diversion of the organization's assets?	IRS Form 990: Part VI Section A Line 5	Yes	0 points
					No	5 points
11 (a)*	Public Opinions	Negative Media Attention	If the charity is a national organization, did the charity appear in a negative context in the last year in one of the top ten major news sources?	Internet Search	0 - 1 times	5 points
					2 - 5 times	2.5 points
					> 5 times	0 points
					NA	NA
11 (b)*	Public Opinions	Negative Media Attention	If the charity is a local organization, did the charity appear in a negative context in the last year in the main local news source?	Internet Search	0-1 times	5 points
					2-5 times	2.5 points
					>5 times	0 points
					NA	NA
12 (a)*	Public Opinions	Positive Media Attention	If the charity is a national organization, did the charity appear in a positive context in the last year in one of the top ten major news sources?	Internet Search	0-1 times	0 points
					2-5 times	5 points
					>5 times	10 points
					NA	NA
12 (b)*	Public Opinions	Positive Media Attention	If the charity is a local organization, did the charity appear in a positive context in the last year in the main local news source?	Internet Search	0-1 times	0 points
					2-5 times	5 points
					>5 times	10 points
					NA	NA
13	Financial	Program Expense Ratio	Total program expenses/Total Expenses	Financial Statements or IRS Form 990	> 65%	10 points
					< 65%	0 points
					NA	0 points
14*	Financial	Net Margin	(Total Revenue - Total Expenses)/Total Revenue	Financial Statements or IRS Form 990	> 66%	0 points
					33% < x < 66%	10 points
					< 33%	0 points
					NA	0 points

15*	Financial	Compensation Expense Ratio	Total salary expense / Total Expenses	Financial Statements or IRS Form 990	< 25%	10 points
					25% < x < 50%	5 points
					> 50%	0 points
16	Financial	Fundraising Expense Ratio	Total Fundraising Expenses/Total Contributions	Financial Statements or IRS Form 990	< 35%	10 points
					> 35%	0 points
					NA	0 points
17	Financial	Financial Information Disclosure	Is the IRS Form 990 or published financial statements provided on the website?	Charity's Website or IRS Form 990 Part VI Section C Line 18	On Charity's Website	10 points
					On Another Website	5 points
					Not on any Website	Deduct 50 points
18*	Financial	Large Amounts of Unrestricted Assets	Are the unrestricted net assets more than three times the size of the past year's expenses or the size of the current year's budget, whichever is higher?	Financial Statements or IRS Form 990	> 3 times	0 points
					< 3 times	10 points

* Not included in CharityWatch or Charity Navigator's rating systems

APPENDIX G[6]

TOP TEN MAJOR NEWS SOURCES

1. The New York Times
2. Washington Post
3. USA Today
4. Houston Chronicle
5. The Wall Street Journal
6. Chicago Tribune
7. Los Angeles Times
8. New York Post
9. Newsday
10. The Seattle Times

[6] Agility PR Solutions. (2018). Top 15 U.S. Newspapers by Circulation. Retreived November 11, 2018 from https://www.agilitypr.com/resources/top-media-outlets/top-15-daily-american-newspapers/.

Appendix H

Proposed Rating Grading

Points	Grade	Qualitative rating
97-100 points	A+	Excellent
93-96 points	A	Excellent
90-92 points	A-	Excellent
87-89 points	B+	Good
83-86 points	B	Good
80-82 points	B-	Good
77-79 points	C+	Satisfactory
73-76 points	C	Satisfactory
70-72 points	C-	Satisfactory
67-69 points	D+	Poor
65-66 points	D	Poor
<65 points	F	Failure

APPENDIX I

AMERICAN RED CROSS – PROPOSED RATING SYSTEM

Metric Number	Category of Metric	Metric Name	Metric Formula/Decision Determinant	Points Determinant	Points Awarded
1	Management	CFO Qualifications	Is their CFO or equivalent a CPA?	Yes[7] [8]	10 Points
2	Management	Auditor Qualifications	Is the auditor a CPA, if an audit is required?	Yes[9]	10 points
3	Management	Employee Disclosure	Are the key and highly compensated employees listed on IRS Form 990?	Yes[7]	10 points
4	Management	CEO Qualifications	Does the CEO have a graduate degree in a business discipline?	Yes[7] [10]	10 points

[7] Internal Revenue Service. (2017). *Form 990: Return of Organization Exempt from Income Tax: American Red Cross.* Retrieved November 23, 2018 from https://www.redcross.org/content/dam/redcross/enterprise-assets/pdfs/FY-2017-Form-990.pdf.

[8] Rhoa, B. (2018) Posts [LinkedIn page]. Retrieved November 23, 2018 from https://www.linkedin.com/in/brian-rhoa-2b57814/

[9] American Red Cross. (2016) *The American Red Cross Consolidated Financial Statements.* Retrieved November 23, 2018 from https://www.redcross.org/content/dam/redcross/enterprise-assets/pdfs/2016_TheAmericanRedCross_CFS.pdf

[10] American Red Cross. (2018). Gail McGovern. Retrieved November 23, 2018 from https://www.redcross.org/about-us/who-we-are/leadership/gail-j-mcgovern.html

5	Management	Employee Education Qualifications	Do at least 75% of the key and highly compensated employees have an undergraduate degree in an applicable discipline?	Yes[7 8 10 11 12 13 14 15 16 17 18 19 20 21]	10 points
6	Management	Employee Industry Knowledge Qualifications	Do at least 75% of the key and highly compensated employees have at least 5 years of work experience?	No[7 8 10 11 12 13 14 15 16 17 18 19 20]	0 points
7	Management	Employee Criminal Records	Have any key employees or highly compensated employees been convicted of any crimes, excluding traffic violations?	No	5 points
8	Management	Whistleblower Policy	Did the organization have a written whistleblower policy?	Yes[7]	10 points
9	Management	Conflict of Interest Policy	Did the organization have a written conflict of interest policy? If so, was disclosure of conflicts required and was this policy monitored for compliance?	Yes[7]	10 points
10	Management	Diversion of Assets	Did the organization become aware during the year of a significant diversion of the organization's assets?	No[7]	5 points

[11] Meltzer, D. (2018) Posts [LinkedIn page]. Retrieved November 23, 2018 from https://www.linkedin.com/in/david-meltzer-967350b/
[12] Hawkins, J. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/jennifer-hawkins-3b5aba5/
[13] Hurst, M. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/melissa-hurst-1b24989/
[14] Holtz, C. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/cliff-holtz-74769360/
[15] Gilmore, S. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/shaun-gilmore-a29358/
[16] Hrouda, C. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/chrishrouda/
[17] Litvack, N. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/neal-litvack-143625150/
[18] Williamson, G. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/gregtwilliamson/
[19] Waldman, K. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/kathryn-waldman-7601197/
[20] DeFrancis, S. (2018) Posts [LinkedIn page]. Retrieved November 24, 2018 from https://www.linkedin.com/in/kathryn-waldman-7601197/
[21] Bonnett, J. (2013). American Red Cross acquires Delta Blood Bank, will make no changes. Retrieved November 24, 2018, from https://www.lodinews.com/news/article_9fa7e1d2-0ab0-11e3-b344-0019bb2963f4.html

11 (a)	Public Opinions	Negative Media Attention	If the charity is a national organization, did the charity appear in a negative context in the last year in one of the top ten major news sources?	0 - 1 times[22]	5 points
11 (b)	Public Opinions	Negative Media Attention	If the charity is a local organization, did the charity appear in a negative context in the last year in the main local news source?	NA	NA
12 (a)	Public Opinions	Positive Media Attention	If the charity is a national organization, did the charity appear in a positive context in the last year in one of the top ten major news sources?	2-5 times[23] [24]	5 points
12 (b)	Public Opinions	Positive Media Attention	If the charity is a local organization, did the charity appear in a positive context in the last year in the main local news source?	NA	NA
13	Financial	Program Expense Ratio	Total program expenses/Total Expenses	> 65%[7]	10 points
14	Financial	Net Margin	(Total Revenue - Total Expenses)/Total Revenue	< 33%[7]	0 points
15	Financial	Compensation Expense Ratio	Total salary expense / Total Expenses	25% < x < 55%[7]	5 points
16	Financial	Fundraising Expense Ratio	Total Fundraising Expenses/Total Contributions	< 35%[9]	10 points
17	Financial	Financial Information Disclosure	Is the IRS Form 990 or published financial statements provided on the website?	On Charity's Website[7]	10 points
18	Financial	Large Amounts of Unrestricted Assets	Are the unrestricted net assets more than three times the size of the past year's expenses or the size of the current year's budget, whichever is higher?	< 3 times[7] [9]	10 points

[22] Sean Rossman, Eleanor Dearman, John C Moritz, & USA TODAY. (n.d.). Red Cross floundered in its Harvey response. *USA Today*. Retrieved from https://login.pallas2.tcl.sc.edu/login?url=http://search.ebscohost.com/login.aspx?direct=true&db=a9h&AN=J0E069536039317&site=ehost-live

[23] ROMERO, S. (2018, November 19). California Fire Evacuees Find Refuge, if Not Solace, in Tent City by Walmart. New York Times, p. A12. Retrieved from https://login.pallas2.tcl.sc.edu/login?url=http://search.ebscohost.com/login.aspx?direct=true&db=a9h&AN=133079970&site=ehost-live

[24] Garnett, R. R. (2018, July 7). A Lost Love Gave Us Hemingway's Spare Prose. Wall Street Journal - Online Edition, p. 1. Retrieved from https://login.pallas2.tcl.sc.edu/login?url=http://search.ebscohost.com/login.aspx?direct=true&db=a9h&AN=130581378&site=ehost-live

APPENDIX J
ALZHEIMER'S ASSOCIATION – PROPOSED RATING SYSTEM

Metric Number	Category of Metric	Metric Name	Metric Formula/Decision Determinant	Points Determinant	Points Awarded
1	Management	CFO Qualifications	Is their CFO or equivalent a CPA?	Yes[25 26]	10 Points
2	Management	Auditor Qualifications	Is the auditor a CPA, if an audit is required?	Yes[27]	10 points
3	Management	Employee Disclosure	Are the key and highly compensated employees listed on IRS Form 990?	Yes[25]	10 points
4	Management	CEO Qualifications	Does the CEO have a graduate degree in a business discipline?	Yes[25 28]	10 points
5	Management	Employee Education Qualifications	Do at least 75% of the key and highly compensated employees have an undergraduate degree in an applicable discipline?	Yes[25 26 28 29 30 31 32 33 34]	10 points

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[25] Internal Revenue Service. (2017). *Form 990: Return of Organization Exempt from Income Tax: Alzheimer's Association*. Retrieved November 25, 2018 from https://www.alz.org/media/Documents/form-990-fy-2017.pdf

[26] Hovland, R. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/richard-hovland-50032612/

[27] Alzheimer's Association. (2017) *Consolidated Financial Statements and Report of Independent Certified Public Accountants Alzheimer's Association*. Retrieved November 25, 2018 from https://www.alz.org/media/Documents/audited-financial-statements-fy2017.pdf

[28] Bloomberg. (2018). Harry Johns. Retrieved November 25, 2018 from https://www.bloomberg.com/research/stocks/private/person.asp?personId=23627246&privcapId=22709156&previousCapId=22709156&previousTitle=Alzheimer%20Association

[29] Carrillo, M. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/maria-carrillo-baaa112/

[30] McCullough, D. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/donna-mccullough-8802672b/

[31] Gardner, S. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/scott-gardner-90a8a372/

[32] Carson, M. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/michaelkcarson/

[33] Foh, C. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/christine-foh-307a4b8/

[34] Geiger, A. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/angela-timashenka-geiger-35654623/

6	Management	Employee Industry Knowledge Qualifications	Do at least 75% of the key and highly compensated employees have at least 5 years of work experience?	Yes[25 26 28 29 30 31 32 33 34 35]	10 points
7	Management	Employee Criminal Records	Have any key employees or highly compensated employees been convicted of any crimes, excluding traffic violations?	No	5 points
8	Management	Whistleblower Policy	Did the organization have a written whistleblower policy?	Yes[25]	10 points
9	Management	Conflict of Interest Policy	Did the organization have a written conflict of interest policy? If so, was disclosure of conflicts required and was this policy monitored for compliance?	Yes[25]	10 points
10	Management	Diversion of Assets	Did the organization become aware during the year of a significant diversion of the organization's assets?	No[25]	5 points
11 (a)	Public Opinions	Negative Media Attention	If the charity is a national organization, did the charity appear in a negative context in the last year in one of the top ten major news sources?	0 - 1 times	5 points
11 (b)	Public Opinions	Negative Media Attention	If the charity is a local organization, did the charity appear in a negative context in the last year in the main local news source?	NA	0 points
12 (a)	Public Opinions	Positive Media Attention	If the charity is a national organization, did the charity appear in a positive context in the last year in one of the top ten major news sources?	0-1 times	0 points
12 (b)	Public Opinions	Positive Media Attention	If the charity is a local organization, did the charity appear in a positive context in the last year in the main local news source?	NA	NA

[35] Egge, R. (2018) Posts [LinkedIn page]. Retrieved November 25, 2018 from https://www.linkedin.com/in/robertegge/

13	Financial	Program Expense Ratio	Total program expenses/Total Expenses	> 65%[25]	10 points
14	Financial	Net Margin	(Total Revenue - Total Expenses)/Total Revenue	< 33%[25]	0 points
15	Financial	Compensation Expense Ratio	Total salary expense / Total Expenses	25% < x < 55%[25]	5 points
16	Financial	Fundraising Expense Ratio	Total Fundraising Expenses/Total Contributions	< 35%[27]	10 points
17	Financial	Financial Information Disclosure	Is the IRS Form 990 or published financial statements provided on the website?	On Another Website[25]	5 points
18	Financial	Large Amounts of Unrestricted Assets	Are the unrestricted net assets more than three times the size of the past year's expenses or the size of the current year's budget, whichever is higher?	> 3 times[25, 27]	0 points