

# **Strategic Modeling: The Ethics Audit for Non-Profit Organizations**

by

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When a charity violates the public trust or does not adhere to its own principles, often there is disillusionment coupled with anger. Not-for-profit institutions are created, given tax benefits, and funded with the expressed purpose of supporting perceived community values such as religion, art, public welfare, and education. The contributors, board members, officers, employees, and volunteers willingly participate in the non-profit institution's activities because they advocate the same values of the nonprofit organization. In addition to the attainment of the charitable goals, there is a public perception that non-profit institutions will honor the public faith placed in them by managing their endeavors with a high level of integrity.

When there is a distance between the charity's public face and its private functioning, it produces disenchantment for its supporters. Contributors become disappointed when their money is used inappropriately or when an institution lacks trustworthiness. Volunteers and employees for organizations that are viewed as lacking virtue can exhibit frustration, and even hostility, as they believe their goodwill, time, effort, and reputation have been abused. Ultimately, the effectiveness of the enterprise and its ability to attain its charitable purpose can be undermined by this discord.

Accordingly, the inner workings of an institution require monitoring to insure that there is a mirroring of its publicly known values. However, most organizations do not take time to discuss the need for consistency in words and deeds. Moreover, there is virtually no mechanism designed for this type of review. To begin to fill this gap, this article contains an ethics audit that has been specifically drafted for the not-for-profit institution focusing on common core values such as social responsibility, open communication, treatment of employees, confidentiality and leadership. The audit does not set forth an objective standard but uses the institutions own values to create a criterion with which its actual practices are compared. Ethics is not a matter of right or wrong in many cases, rather it is a process by which an organization evaluates decisions being made. If the organization's core values agree with the values being promoted in its choices, then there is ethical consistency. Yet, if its actions and motives seem to send a different message than its core values would suggest, it begins to sink into ethical chaos and becomes uncontrollable. It was this lack of direction that the ethics education revolution sought to curtail.

## **Current tools of codes of ethics and decision models are insufficient**

With the closing of the 1980's, many individuals in our society reach sobering conclusions regarding our ethical choices. Chief among these reflect perspectives hinged on the dismay and subsequent need for more ethical scrutiny and practices in profit oriented business. As a result ethical programs have proliferated. Both universities and corporations have gotten 'on the bandwagon,' eagerly sponsoring a vast array of speakers, conferences, courses and approaches. The goal was to equip business people with the proper tools (e.g., codes of ethics) and decision making procedures (e.g., stockholder analysis) to deal with ethical dilemmas. Non-profit institutions either slowly followed this trend by adopting codes of ethics or ignored the whole problem by believing that issues of business ethics had no relevance for charitable entities. One thing is clear, they are in desperate need of an ethics audit.

Beyond the positive effects of any institution living in an ethical climate, non-profit institutions are expected to justify the public trust and carry a greater obligation to be ethical than a privately owned corporation. The 1997

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Internal Revenue Service regulations offer the classification for tax exempt organizations in section 501(c)(3). The definition for an exempt organization is: "Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals."<sup>3</sup> Clearly, the purpose of the exemption from taxes subsidizes organizations that benefit the community and society at large. In addition, the establishment of a nonprofit organization is the quintessential idea of this obligation to the community.

However, with the passage of time, one fact has become extremely visible: it is not easy to raise the ethical consciousness of an organization-- whether profit or not for profit. Even companies with the best codes of conduct and histories of ethical behavior can sometimes behave in an unethical manner. For example, Johnson & Johnson is famous for its swift response when Tylenol painkillers poisoned eight people in the 1980's. But in January 1995, the same company was forced to pay \$7.5 million after revealing that one of its companies shredded evidence in a Federal investigation.<sup>4</sup> Ethic-enhancing tools, while helpful, did not act as the "cure-all" for ethical problems which was hoped they would. While tools like corporate codes of ethics could function as a good first step towards raising some ethical issues, when used alone they were proven to be totally insufficient in ensuring that the ethical standards of the organization were followed. In some cases, these tools could actually be detrimental to an organization. Tools that were thought to help resolve and encourage ethical behavior, provided frustration and confusion for managers of organizations. If the leadership of the organization produces a corporate credo and does not actively and visibly follow it, the remainder of the company will become equally indifferent; worse, if the leadership violates such a credo, those below them will feel they also have no need to obey the rules.<sup>5</sup>

Yet, the mere fact that the current tools have not been as effective as hoped does not undermine the basic fact that ethical considerations are critical for profit and non-profit institutions. As ethics is becoming more popular in the work place, the benefits of acting ethical are becoming more obvious to corporations, both in the private sector and in nonprofit organizations. Because of the free market forces which drive companies to perform at optimum levels of efficiency and customer satisfaction, ethics plays a large role in how successful the organization will be. Diane J. Duca, in Nonprofit Boards: Roles, Responsibilities, and Performance, supports this view, "Business and nonprofit organizations are increasingly aware that actively promoting ethical behavior and practices not only makes sense from a customer-relations standpoint, but also represents a better way to run a business."<sup>6</sup> Not only are clients pleased when they view an organization as acting in an ethical manner, but also the employees are more satisfied. One can easily see the benefits that would result in higher employee productivity when the employees observe the company acting ethically with them and its customers.

Moreover, it is clear that unethical conduct creates many negative effects. Unethical behavior not only affects clients, and employees, but also upper management and the overall organization's sense of value as a business. In psychology and marketing, the term cognitive dissonance is used to express the uneasiness that one feels when he or she does not act in accordance with his or her values and beliefs.<sup>7</sup> This is a dangerous situation for an organization because the goal of the organization is lost in as much as it is not following the values for which it was established. The purpose of the organization is compromised because of the unethical behavior. This could result in one of two actions. A positive effect of the cognitive dissonance would be the elimination of the unethical behavior. Guilt could change the way the individual or organization acts in the future. Another, not so positive, effect could lead to a change in the organization's values, thus making the unethical behavior consistent with the values held by the individual or organization, and ultimately undermining the sole purpose of a nonprofit organization. An organization and its directors should lead by example. Once clients or employees observe unethical behavior by the organization, they will no longer offer their support and loyalty. It is imperative that an

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<sup>3</sup>1997 IRS Tax Code

<sup>4</sup>April 8 1995, "Good Grief," *The Economist*. p. 57. Reprinted in 1996/1997 Annual Edition: *Business Ethics*, p. 26

<sup>5</sup> January 1995, "The Ethics of Business: Improving or Deteriorating?" *Business Horizons*, p. 39-47

Donaldson, T. : September-October 1996, "Values in Tension: Ethics Away From Home" *Harvard Business Review*, p.48-62

<sup>6</sup>Diane J. Duca, *Nonprofit Boards: Roles, Responsibilities, and Performance* (New York: John Wiley & Sons, Inc, 1996) 29.

<sup>7</sup>Robert A. Baron, *Psychology* (Boston: Simon & Shuster Co., 1995) 638.

organization examine its values and, if its actions are in accordance with those values this will ensure that the modus operandi of the organization is reached to the organization's potential, thus upholding the reasons of why it was founded.

### **The need for Ethics Audits for Non-Profit Entities**

While valiant activities such as creation of corporate conduct codes, ethics training, imposed legal inspections and consistent reaction to ethical violations all have their place in ensuring ethical practices and policy development, they still have serious shortcomings. First, these typical measures are reactive, not proactive measures. Second, utilized as typical managerial control systems, they emphasize the short term and obvious. Third, their very nature is either descriptive or prescriptive, lacking in the area of self-reflection; rarely do organizations have a bona fide, agreed upon and accepted system that allows the organization to consistently focus and re-focus on whether or not it embodies the values it professes. There is no difference between what individuals and organizations have grave difficulty doing, namely holistic self-examination. Clarence Walton, a pioneer in the areas of organizational ethics, thoroughly understands and supports the need for ethics audits in his book, *The Moral Manager*:

*"....few organizations step back often enough to assess the character of the workplace. The assessments, properly and objectively made could be revealing. The pulse-taking and analysis is probably the most serious exercise an organization will ever make."*<sup>8</sup> □

Furthermore, many of the current tools focus on helping the individual make a decision separate from the context of the non-profit institution's core values in which they function. Much of what we know and use in ethical training and consulting is based almost wholly upon research and theory that is based on the notion of the individual. Areas such as moral reasoning, personal values, decision styles, or moral philosophies, which reflect an intense individual grounding, are used consistently to describe and prescribe ethical practices and policies. While there is significant merit to this approach, it is severely limited in the sense that it defies the reality of how and why ethical behavior occurs in organizations. People will act according to how they perceive the culture of the organization as a whole. While a company may possess a detailed code of ethics, it will be the behavior that the company rewards, either ethical or unethical, that the individuals will continue to perform.<sup>9</sup> □ By adopting the ethics of the individual as the basis for our understanding and rectifying the ethical ills in the organization, we severely limit consideration of a fuller range of ethical behaviors and issues. SHOULD PROVIDE AN EXAMPLE HERE, I COULD NOT THINK OF ONE.

Finally, tools that are developed to help the individual and institution review their ethical climate must be 'user friendly' and aimed at changing the corporate culture. In an excellent article that appeared in the May/June 1993 edition of the *Harvard Business Review*, Andrew Stark expresses the reality and subsequent impressions that business people face in relation to ethics in organizations. He states:

*"I suspect that the field of business ethics is largely irrelevant for most managers. It's not that they are hostile to the idea of business ethics. Recent surveys suggest that over three-quarters of America's major corporations are actively trying to build ethics into their organizations... the problem is that the discipline of business ethics has yet to provide much concrete help to managers... what is called for (by recent ethicists) are fundamental changes in the way the enterprise of business ethics is conducted."*<sup>10</sup> □

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<sup>8</sup>Walton, C.: 1988, 'The Moral Manager' Ballinger Publishing Company

<sup>9</sup>Spring 1997, "Federal Sentencing Guidelines for Organizations: Legal, Ethical, and Public Policy Issues for International Marketing" *Journal of Public Policy & Marketing*

<sup>10</sup>Stark, A.: 1993, 'What's the Matter with Business Ethics?' *Harvard Business Review* (Volume 71, No. 3), May/June 1993, p. 38.

While there are a myriad of organizations today that have adopted an ethics audit approach to understanding and rectifying ethical issues, many fall short of providing what Stark refers to as “concrete help for managers.”<sup>11</sup> □ Although such a step as an ethics audit is commendable, we feel that many of these organizations are very limited in their scope, and thus their effectiveness. It is imperative that organizations utilize audits that combine the context of individually based ethics and the social systems in which individuals operate. We need to remember that people do not exist and make decisions in isolation. It is apparent that any audit that purports to examine ethics inside an organization (e.g., open communication, leadership) must look outside the organization (e.g., social responsibility, ecology) as well. Situational and environmental factors have a significant impact upon the ethical behaviors and subsequent policies of an organization. Clearly, an ethics audit is needed to go beyond individually based ethical theory, to include the dimensions of the organization, the social system and milieu in which the company operates.

### **Internal Auditors and Public Accounts can assist in Raising Ethical Consciousness**

The accounting profession is in a unique position to both facilitate and implement the infusion of ethics programs into the general corporate culture. Accountants have the opportunity, the ability and the mission to influence the business community's ethical growth. Since virtually every business organization is advised by accountants, there is ample opportunity by accountants to educate and introduce effective ethical programs. Moreover, this opportunity for review and advice is ever more enhanced during the audit process.

An ethics audit is an activity that needs to be done with some degree of consistency; it cannot simply be a one-time event. Much like a financial audit, in order to be truly effective, an ethics audit must be used with some degree of regularity, so that an organization can close the gap between values (which is what I say I believe) and ethics (which is how I actually behave). By combining the actions involved in performing financial and ethics audits, the accounting profession would be in a position to ensure frequent ethics audits, and also to maintain the well-being of both sections of any business they would be involved with.

The accounting profession, more than any other profession, has the ability to monitor internal corporate effectiveness. Just as accountants monitor the internal controls, so could they monitor the ethical climate of a business. As they are developing mechanisms to establish quality controls for the business organizations, they can review the quality of a company's ethical programs. Finally, the teaching and monitoring of the ethics programs are clearly within an accounting mission of reducing corporate corruption. As good internal controls are essential to reduce employee theft, so accountants should stress that strong ethics program contributes to the prevention of corruption and the reduction of internal control costs within the business institution.<sup>12</sup> □ The accounting profession is a powerful institution that can create change. When the Foreign Corrupt Practices Act became law, it was the accounting profession that helped companies understand its impact and monitor its application. The accounting profession is in a key position to become proactive in the introduction of programs that will create a more ethical corporate culture.

### **Conclusion**

Organizations place too much emphasis upon individually based theory to understand organizational concerns. This emphasis can be found in most of the ethics audits developed to date. We believe that an audit which goes far beyond the standard ethics audit is needed. Reynolds concurs with this and goes on to state that an ethics audit like this could be regarded as “a corporate wellness tool.”<sup>13</sup> □

We would take it one step further and see the creation of such an audit as a corporate system of awareness, a self-assessment and self-regulation tool. This tool would raise the self-consciousness of unethical behavior for boards, officers and workers and thereby help to heighten ethical actions and prevent corruption within the institution. When the audit is used by a institution, such as the accounting profession which has a great deal of authority within the corporate culture, it can become a very powerful force for change in a company.

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<sup>11</sup>Stark, A.: op. cit., p. 38

<sup>12</sup>April 1994, “Ethics Policies Help Reduce Internal Control Costs” Journal of Accountancy, p. 14 Murphy, K. : 1993, Honest in the Workplace

<sup>13</sup>Reynolds, L.: 1991, ‘The Ethics Audit’ Business Ethics 5(4) p. 20

We believe this audit must include and combine key factors as the areas of social responsibility, open communication, support to the community, leadership by example, human investment, ecology and maintaining the dignity of employees if it is to truly serve the purpose of a more complete system of self-examination. In doing so, organizations may actually become better at planning for unethical activities. It is our contention that this would also make a dramatic contribution to the successful development of an organization's overall strategic planning process. An organization should plan for ethical issues as they would for strategic goals.

**SAMPLE ETHICS AUDIT**

by  
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This sample Ethics Audit is an attempt to help raise various ethical issues to the multi faceted aspects of non-profit organizations. The theoretical basis for this audit is a simple stimulus-response model. The model itself raises questions and acts as the stimulus prompting the responses. In the process of responding to the questions, those performing the audit become aware of the issues and are in a position to formulate suggestions for improvements.

This audit recognizes that there are literally hundred of ethical issues which may be relevant to a given non-profit organization. However, it is feasible to focus on a limited number of issues with this instrument.

Please note that this ethical audit has been made for general application and that some of the specific questions may not be applicable to your particular situations. Moreover, you may need to increase areas of investigation to help ensure that significant ethical issues at your non-profit organization are properly addressed.

Since it is our hope to continually improve this ethics audit, please take a few moments to write us with your comments and any additional questions or areas of investigation that you found to be helpful.

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**COMMUNITY ADVOCACY - an ardently advocating ethical values within the non-profit organization and the community**

Does the non-profit organization support and encourage staff to be involved in community activities?

Insufficiently 1 2 3 4 5 sufficiently

Comments:

Does the non-profit organization's community advocacy program reflect the priority of the members?

Insufficiently 1 2 3 4 5 sufficiently

Comments:

Does the non-profit organization take public stands and contribute its resources to public issues?

Insufficiently 1 2 3 4 5 sufficiently

Comments:

Is the organization efficient when contributing its resources to public causes?

Insufficiently 1 2 3 4 5 sufficiently

Comments:

Is the organization known as leader in issues of social concern?

Insufficiently 1 2 3 4 5 sufficiently

Comments:

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**OPEN COMMUNICATION - keep membership informed honestly as to all relevant matters**

Are board decisions made in an open and honest manner with an opportunity for input from all relevant sources?

To what extent does the Board of Trustees (or Executive Committee) view its responsibility of representing the entire organization?

To what extent does the non-profit organization honestly represent its programs and activities in its publications?

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**FAIR TREATMENT FOR ALL MEMBERS - safeguard the ability to exercise independent judgment on all matters by avoiding undue influences and conflicts of interest**

To what extent do all staff members feel that they have equal access to leadership?

Are leadership positions open to all members regardless of financial status or other considerations?

Do the professional staff provide services equally to all members regardless of financial or board status?

Are all employees treated with respect?

If the non-profit association engages in business relationships with its members, to what extent does it have a uniform policy which provides for full disclosure?

If the non-profit association engages in business relationships with its members, to what extent does it have a uniform policy which provides for competitive bids?

To what extent are safeguards used to prevent board members from unjustly profiting from their position in the organization?

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**CONFIDENTIALITY AND RESPECT FOR ALL MEMBERS - avoidance of gossip, cliques and the protecting of information gained in confidence**

To what extent is private information about non-profit staff members (emotional stability, marriage and financial status, etc.) kept in confidentiality?

Are the employees treated with dignity?

Are the people that are receiving help from the organization treated with dignity?

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**LEADERSHIP BY EXAMPLE - engaging in exemplary ethical conduct which will be a model for the non-profit organization's staff and the community**

To what extent do non-profit organization leaders take seriously their roles as leaders in the community who must set an example for others?

To what extent are non-profit association ethics actively taught as an important aspect of program curriculums?

To what extent does the organization have an established ethics committee or other channels which allow for the raising and discussing of ethical issues?

To what extent does the non-profit organization make available tax deductions which are illegal and not in the spirit of the law?

To what extent does the organization honor its written and oral agreements?

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**HUMAN INVESTMENT - the provision for the physical, psychological and economic welfare of present, potential, and former (retired) employees**

How does the non-profit organization provide for fair benefits (pension, social security, medical, etc.) for all of its employees?

To what extent does the non-profit association have an employee handbook which sets out clearly its policies for vacation, sick days, maternity, paternity, disability, etc.?

To what extent does the organization meet its financial obligations to all employees in an ethical manner?

To what extent does the non-profit organization treat its support and part-time staff in as fair a manner as its professional staff?

Does the organization address contract negotiations in an honest and ethical manner?

**To what extent does the organization treat its support and part-time staff in as fair a manner as its professional staff?**

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**ECOLOGY - the efforts to minimize the negative impact of its operations on the natural environment**

**To what extent does the non-profit organization attempt to support energy conservation and re-cycling activities?**