

# Donors Increasingly Rely on “Watchdog” Organizations When Allocating Resources

Courtesy of J.H. Cohn’s Not-for-Profit Industry Practice

Donors, with more restrictions placed on the fewer funds they have available to give, have become increasingly vigilant in measuring the worthiness and value of the not-for-profit organizations (“NFP”) to which they donate. To that end, donors have developed an increased reliance on watchdog groups to ensure that fund management and propriety are on par with their individual mission and goals. Though donation sources are varied and range, most commonly, from Federal and state grants to foundation dollars and contributions from individuals, there is one unifying theme among them: to ensure that the dollars they contribute are being spent responsibly and in line with pre-specified ideals.

NFP watchdog groups—groups collectively organized to be donors’ financial and ethical eyes and ears—have become more visible in recent years as questions have risen at a more rapid pace about fund management among NFPs. After the introduction of the Sarbanes-Oxley Act and the subsequent call for transparency among public companies, greater attention was paid by legislators and the public alike to NFP activity, especially those receiving government funding.

This is where the watchdog role becomes critical. There are four primary watchdog groups overseeing the NFP industry: the Internal Revenue Service (“IRS”); the State Attorneys General; press-based organizations; and “traditional” organizations that are largely membership-based. What these watchdog groups look for varies widely based on membership and objective. While the perspective of the IRS is focused on compliance with the requirements of the Internal Revenue Code and its regulations, other watchdog groups, such as [www.givewell.org](http://www.givewell.org), focus on “softer” data, such as evidence of a program’s effectiveness, productive use of funds, and operational transparency, to determine a NFP’s survival.

The primary tool used by the IRS to monitor the activities of NFP organizations is the Form 990. Form 990 serves two overarching functions:

- It provides the IRS with information about the NFP’s activities and financial condition in order to demonstrate that it continues to maintain its tax-exempt eligibility.
- It informs the public of crucial operational aspects, including details of executive compensation and program expenditures.

The new Form 990, which is made available to the public on [Guidestar.org](http://Guidestar.org) (see next page), emphasizes transparency and the relationship between tax compliance and corporate governance. Its core form of 11 parts is mandatory and requests financial data and information about the organization’s governance, financial condition, changes in net assets, and programs and activities. Likewise, State Attorneys General’s charities bureaus supervise and monitor charitable organizations to protect donors and beneficiaries from the potential misuse of charitable assets.

There are some variables among states’ charity bureau activities; however, essentially all are designed to protect the public’s interest and inform donors about charities operating in their state. For example, all charitable organizations operating in New York State must register and file their annual financial reports with the Attorney General’s office; this includes any groups that conduct charitable activities, hold property used for charitable purposes, or which solicit financial or other contributions. The New York Attorney General’s website contains financial reports of charities active in New York State, guidance for those who manage charities and solicit charitable contributions, tips for those considering donating to a charity, and links to other resources.



Press-based watchdogs are a self-explanatory group that includes traditional print, broadcast, and digital media outlets, such as *The Chronicle of Philanthropy*, *The Wall Street Journal*, and *MSNBC.com*. These groups often surface when something has gone wrong so it is important that charities anticipate and prepare for the scrutiny that usually ensues when “bad news” breaks. We recommend that all charities develop a crisis communications plan to minimize the fallout in these situations.

Finally, traditional watchdogs include certain membership-based organizations, such as:

- [Guidestar.org](http://Guidestar.org), a public charity that provides NFP information, such as 990s and annual reports, to a broad audience at no cost. The site offers premium subscriptions which, among other things, avail the subscriber to tools they can use to analyze data about charities. Interestingly, this website also includes reviews authored by volunteers, subscribers, and donors.
- The Maryland Association of Not-for-Profits, a statewide organization founded nearly two decades ago to unite the NFP and philanthropic communities.
- Groups such as the Better Business Bureau ([www.give.org](http://www.give.org)), which sets accountability standards among charities and evaluates NFPs that voluntarily report against those standards, and Charity Navigator ([www.charitynavigator.com](http://www.charitynavigator.com)), which promotes “intelligent giving” by providing information on more than 5,000 charities.
- Certain independent, financial-driven groups that rely on 990 data, which can detail certain fundraising and financial metrics.

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Foundations historically have relied more on their own due diligence efforts than on that of watchdog groups for their grant-making decisions. As one high-profile New York-area foundation leader stated, “There is no formula for giving. We want to understand more than just the financial statement relationships and metrics. While we do carefully review a potential grantee’s financial statements and 990s, we also invest significant time to understand the organization, including the quality of its management and the governance and effectiveness of its programs.”

## WHAT SHOULD NFPS BE DOING TO WORK MORE EFFECTIVELY WITH WATCHDOGS?

As resources remain strained, it is likely that donors will continue to look for guidance to help make their dollars go further, continuing their reliance on watchdog groups to help them make prudent decisions. Knowing this, NFPs should undertake several key measures to help prepare themselves for review by watchdogs, including:

1. **Know what watchdog groups are looking for.** Different organizations examine different metrics. While some, like the IRS, look more closely at an NFP's financials, such as Charity Navigator, may use "softer" metrics in their evaluation. These factors are commonly available on the watchdogs' websites.
2. **Make sure your reporting is consistent year-to-year.** Consistency will minimize questions and unnecessarily critical reviews.
3. **Ask yourself, as a retired IRS representative advised at a recent seminar, "Would my grandmother understand my 990?"** In other words, avoid embellishing the truth that may later be perceived as dishonest or inaccurate by donors or

## What Should You Do If the Press Asks Questions About Your Operations?

There are certain basic steps to take and tenets to follow if the media calls and questions your organization's operations:

1. **Be prepared!** Anticipate and prepare responses to the questions they may ask. Before the interview, be sure to understand the sources of information they may have about your organization.
2. **Make sure the documents and facts you share are supportable and consistent with published information about your organization—your website and Form 990 should be consistent.**
3. **Avoid financial jargon—break down your message in easy-to-understand terms to help avoid potential misunderstandings and misinterpretations.**
4. **Understand your operations, especially the investments you need to make in fund raising and administration to fund your programs.**

watchdog groups and use plain English in your statements.

4. **Review Form 990s filed by similar organizations.** The content should be unique to your NFP, but presented in a consistent manner.
5. **Understand your operations,** especially the fundraising and administrative investments you need to make in order to fund your programs. ■

*J.H. Cohn's Not-for-Profit Industry Practice is prepared to help your NFP review its filings to ensure the clear, effective communication of your NFP's financials, programs, and short- and long-term goals.*

*For more information, please contact Paul R. Ballasy, partner and a member of the Firm's Not-for-Profit Industry Practice, at [pballasy@jhcohn.com](mailto:pballasy@jhcohn.com) or 860-368-5244.*



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