

Improving Charity Accountability: Lessons from the Scottish Experience

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Abstract

This paper examines the relevance and effectiveness of a charity accountability monitoring program in Scotland. The Scottish charity sector is vibrant and growing but the regulatory regime is in flux. Drawing upon a novel panel dataset of 21,322 observations on 5,124 organizations for the period 2007-2013, this study examines charity accountability from the perspective of the regulator and analyzes its attempts to encourage acceptable norms and practices in the sector. The results reveal that a majority of these charities trigger accountability concerns and a minority do so persistently; however, this study finds no link between these concerns and negative organizational outcomes such as public complaints, regulatory intervention or charity dissolution. The paper suggests that Scotland's regulatory body should collaborate with the charity sector to reconsider the program's intended impact and priorities, and reflects on alternative indicators of accountability.

Keywords: performance accountability, nonprofit regulation, public confidence, charity accountability, financial accountability

Introduction

Concerns have long been raised about the accountability of charitable organizations, particularly the adequacy of current reporting and oversight mechanisms (Acar, Guo & Yang, 2008; Keating & Frumkin, 2003; Saxton & Guo, 2011). Among the panoply of concerns, various stakeholders have questioned the amount spent by these organizations on their charitable activities, the provision of private benefit to trustees and senior management, and the manner in which they raise their funds (Charity Commission, 2016). These misgivings are particularly salient in an era of increasing public scrutiny and accountability of institutions in general (Power, 2009; Rothstein, Huber & Gaskell, 2006). Consequently, charities and those tasked with their oversight are under increasing pressure to demonstrate their legitimacy and sustain and enhance public confidence in the sector.

In response to calls for greater accountability “there have been several recent initiatives, both regulatory and voluntary, to encourage and promote UK charity accountability (accountability being the requirement to be answerable for one’s conduct and responsibilities) through information communication.” (Connolly & Hyndman, 2013a, pp. 946) In Scotland, the Office of the Scottish Charity Regulator (OSCR) now publishes links to charity accounts on their website and organizations are required to contact OSCR regarding what are known as ‘notifiable events’ (e.g. instances of theft or fraud). OSCR also implements a program of accountability aimed at unearthing potential vulnerabilities in the sector. Examining this program can help address some theoretical and empirical gaps in our understanding of charity accountability: how is accountability conceptualised and operationalised by those overseeing the sector? What factors account for the triggering of accountability concerns? How successful are regulatory attempts at promoting accountability? In this article, I answer these questions in reporting the results of the first systematic, UK study of a regulatory program aimed at monitoring charity accountability. The paper is structured as follows. The charity

accountability and regulation literatures are synthesised to provide a conceptual framework for the research topic. This is followed by a description of the Scottish charity sector and efforts to monitor accountability concerns. A delineation of the data and methods is then provided, followed by the presentation of empirical results. The paper concludes with a discussion of the theoretical and practical implications of the study.

Literature

Despite their public benefit requirement and production of beneficial externalities, “in recent years nonprofit organizations are required to prove that their public interest orientation still remains the case.” (Valentinov, 2011, pp. 32) It is often argued that the continued success of the charity sector depends not only on its economic and social activities but also on its ability to demonstrate accountability and transparency, which in turn can protect and enhance public confidence (Connolly & Hyndman, 2013b; Cordery & Morgan, 2013; Keating & Frumkin, 2003; Morgan, 2012). Bovens (2007, pp. 452) defines accountability as “a relationship between an actor and a forum in which the actor is obliged to explain and justify his conduct; the forum can pose questions; pass judgment; and the actor may face consequences.”

Valentinov (2011) contends that charity accountability is contingent on addressing two major questions: accountability to whom; and accountability for what. With respect to the second question, Taylor and Rosair (2000), Behn (2001), Brody (2002), Goodin (2003), and Connolly and Hyndman (2004) have made substantial contributions, with their work converging on the need for charities to discharge two dimensions of accountability: fiduciary and performance. Traditionally, charities have discharged accountability through the disclosure of financial information and efficiency metrics in annual accounts and reports submitted to the relevant oversight body. However, there are increasing calls for these organizations to discharge accountability through the provision of alternative, non-financial narratives of performance (Britton, 2008; Connolly, Hyndman & McConville, 2013; Keating

& Frumkin, 2003; Philips, 2013). Considerable research has also been conducted on to whom charities should be accountable. Prominent in the literature is work examining the manner and content of accountability to beneficiaries (e.g. Wellens & Jegers, 2016) and the public (e.g. Morgan & Fletcher, 2013), particularly in the context of voluntary disclosures of financial information (e.g. Saxton, Kuo & Ho, 2012).

The growth and importance of the charity sector globally in recent years, particularly in terms of public service provision, has placed a spotlight on the role and effectiveness of regulation (Johnson, Jenkinson, Kendall, Bradshaw & Blackmore 1998; Rutherford, 2015). Regulators have an important role to play in promoting transparency and accountability, which in turn may have tangible reputational benefits for the sector (Cordery & Morgan, 2013; see also Philips, 2013; Thompson & Williams, 2014). There are convincing rationales for the regulation of charities: the need to address perceived or actual transparency issues by reducing information asymmetry in the sector; the privileged tax exempt status of charities; the importance of public confidence to the health of the sector; the desire for competition among charities through transparency and open data initiatives; and to ensure an appropriate distribution of scarce resources (Cordery, 2013). Not all of the above rationales are present in every regulatory regime but the importance of protecting and facilitating public confidence in the sector cannot be overstated (Cordery & Morgan, 2013). One of the primary mechanisms through which regulators oversee the sector, and thus achieve their primary aim of protecting public confidence, is through the requirement of good accounting and reporting practices by charities (Hyndman & McMahon, 2011; Reheul, Van Caneghem & Verbruggen, 2014).

The use of regulation to encourage and enhance accountability in the charity sector is not without consequences, intended or otherwise (Irvin, 2005). Corry (2010, pp.11) argues that charities cannot be regulated without imposing some cost on organizations and the sector as a whole: “Unlike the state and the market economy, it is something that can scarcely be

subjected to detailed planning or regulated without it losing some of its...qualities such as voluntary participation, value-based motivation, and independence from more institutionalized power structures.” In his analysis of philanthropic foundations in the US, Frumkin (1998) argues that a regulatory development (Tax Reform Act of 1969) led to the emergence of highly staffed bureaucratic foundations, which in turn had two significant consequences for the sector: increased isomorphism and the dominance of a short-term, targeted form of funding. Neely (2011, pp. 123) also examined the effectiveness of nonprofit regulation in the US and found that the Nonprofit Integrity Act (NIA) of 2004 had the “effect of increasing accounting fees, while providing limited improvement in financial reporting quality in the first year of implementing the Act.” Hyndman and McDonnell (2009; see also Cordery, 2013) posit that charities may become more accountable to the regulator at the expense of their donors and beneficiaries. Onerous reporting requirements can force charities to divert time and resources away from achieving objectives (Szper & Prakash, 2011) and discourage innovation (Johnson et al., 1998). In order to address these undesirable implications there have been calls for a differentiated approach to regulation and the rejection of a narrow conceptualization of accountability that privileges external oversight (Cordery, Sim & van Zijl, 2015; Ebrahim, 2003).

Despite the proliferation of credible work in this area, our understanding of the nature, extent, determinants and outcomes of accountability concerns is limited (Prakash & Gugerty, 2010).

Contributing to the literature on charity accountability I address three research questions:

1. What is the nature and extent of accountability concerns in the Scottish charity sector?
2. What factors account for variation in the triggering of these concerns?
3. Is there a link between accountability concerns and negative organizational outcomes?

To answer these questions I employ factors derived from institutional theory that are common in studies of charity accountability to serve as the conceptual framework for the study.

Organisation size, age, type, strategy and revenue concentration have all been found to be associated with variation in the accountability behaviour of charities (Saxton & Guo, 2011; Saxton et al., 2012; Tremblay-Boire & Prakash, 2015). The operationalization of this framework is outlined in the Method section of the paper; the next section describes the Scottish charity sector and the accountability monitoring program that is the subject of this study.

The Scottish Charity Sector

In Scotland, a charity is defined (under statute) as an organization that is listed on the Charity Register maintained by OSCR; unlike the rest of the UK, all charities are required to register with OSCR and thus the Charity Register is a complete accounting of these organizations in Scotland. To register, an organization must demonstrate that it passes the charity test: it must have only charitable purposes; the organization must or intend to provide some form of public benefit; it must not allow its assets to be used for non-charitable purposes; it cannot be governed or directed by government Ministers; and it cannot be a political party (Office of the Scottish Charity Regulator, n.d). Charities are subject to regulation by OSCR, which was established in 2003 as an Executive Agency and took up its full powers when the Charities and Trustee Investment (Scotland) Act 2005 came into force in April 2006. Its responsibilities include the following: keep a public register of charities in Scotland; determine whether an organization can be a charity; encourage, assist and monitor compliance with regulation; identify and investigate apparent misconduct and protect charity assets; give advice or make proposals to ministers about charity regulation. The rationale underpinning these responsibilities is common to many charity regulatory regimes: protect public confidence and trust in the sector. In order to achieve this aim OSCR has shifted

towards a risk-based regulatory approach, examining charities “as a whole rather than charitable status alone, checking on all the issues we know can threaten charitable assets or a charity’s reputation and cause concern to the public” (Office of the Scottish Charity Regulator, n.d., pp. 6). Risk-based regulation is commonly defined as a particular strategy or set of strategies that regulators use to target their resources at those sites and activities that present threats to their ability to achieve their objectives (Black & Baldwin, 2012; see also Hutter, 2006; Rothstein et al., 2006; Sparrow, 2000).

Monitoring Accountability Concerns

In order to identify and monitor accountability concerns in the sector, OSCR implements a financial “exceptions” program that establishes standards and identifies vulnerabilities (e.g. errors, transgressions and risks) which then activate closer investigation. This exception approach differs from OSCR’s interventionist, enforcement activities in that the focus is on establishing standards and identifying vulnerabilities in a charity’s financial profile rather than investigating misconduct or noncompliance. The program examines 32 aspects of a charity’s financial status that may be indicative of accountability concerns, with a particular focus on fundraising, governance and compliance with regulation. The financial exceptions are grouped under six headings: large charity or major fundraiser; sudden growth or contraction; possible failure to apply funds for charitable purposes (including fundraising issues); poor liquidity, low reserves, threats to viability; adequacy of governing board; and transactions with trustees (see Table A1 for a detailed list of the exceptions in each group). Exceptions are triggered automatically during the submission of a charity’s annual accounts; if this occurs the organization is immediately informed and offered the opportunity to provide an explanation. OSCR then decides whether this explanation is valid and – in tandem with a fuller review of the charity’s accounts and annual report – if the exception requires further investigation. The financial exceptions program does not apply to charities with an annual

gross income less than £25,000, Registered Social Landlords and Cross Border charities (these organizations are primarily subject to regulation by the Scottish Housing Regulator and the Charity Commission for England & Wales respectively).

Method

To investigate the prevalence, determinants and predictive ability of accountability concerns, I utilise administrative panel data derived from OSCR for the period 2007-2013. Charities must submit an annual return form and set of financial accounts for each accounting year. The dataset utilised for this research is constructed from two sources: financial exceptions data and annual returns information. The first data source captures instances where a charity's annual accounts trigger one or more exception codes; the second source contains detailed organizational and financial attributes of charities. Table 1 summarises the sample selection process.

[Table 1 here]

The median organisation in the sample does not receive any income from government funding or trading activities, spends £230,391 on conducting its charitable activities and £4,200 on governance costs, has £129,909 in unrestricted funds (reserves), and has been in existence for 21 years. In contrast the mean charity receives £1,039,762 and £135,133 in income from government funding and trading activities respectively, spends £2,044,046 on conducting its charitable activities and £17,306 on governance costs, has £2,056,464 in reserves, and has been in existence for 31 years. These figures point to a sector that is skewed by large, well-established charities that possess greater resources than their peers; the heterogeneous nature of the sector is a fact that readers should keep in mind during the presentation and discussion of the empirical analysis.

Dependent and Independent Variables

For the descriptive analysis six binary indicator variables are examined (one for each of the exception groups: a value of 1 indicates that an observation experienced this exception and 0 if it did not. Tabulations and sequence analysis techniques are employed to analyse trends over time for the exception groups. For the multivariate analysis, two of the exception groups are employed as the dependent variables in a logistic regression random effects model: (i) possible failure to apply funds for charitable purposes and (ii) poor liquidity, low reserves, threats to viability. This is for statistical reasons as well as substantive: they are the most common exception groups and of most concern to the regulator with regards to public confidence. For the regression models the reference category of the indicator variables is altered slightly: a value of 1 indicates that an observation experienced this exception and 0 represents an observation that never triggered an exception of any type, and thus the sample sizes in the models are reduced. In order to leverage the longitudinal nature of the data, a random effects logistic regression model was specified.¹

Drawing on the reviewed literature, I operationalise seven independent variables for the statistical models: six organizational and one financial (see Table 2). As many of the exceptions are derived by computing ratios of numerous financial attributes, it would be unwise to include more financial variables for multicollinearity and causal reasons. Though theoretical models of the determinants of accountability exist (see Saxton & Guo, 2011; Saxton et al., 2012), they seek to explain *voluntary* disclosure by nonprofits and thus are not considered appropriate for this analysis; it is also not possible to employ these models as intended due to the absence of appropriate measures in the dataset (e.g. board size).

[Table 2 here]

The sample generated for this research has some limitations. Observations apply only to charities that meet a specified income threshold (see Table 1) and thus some occurrences of financial exceptions are not included in the analysis: for example, some instances of exceptions relating to fundraising and governance in smaller organizations are excluded. There are also issues inherent in using charity accounts for research purposes, such as missing data, incomparability between organizations due to the adoption of different accounting standards, significant lags in reporting, and measurement changes over time (Bingham & Walters, 2013; Morgan, 2011). With respect to the topic at hand, this research only examines one interorganizational relation – that of the regulator and charity. As Ebrahim (2005: pp. 82) cautions:

Policy discussions about improving accountability through increased oversight may be myopic if they rely on and privilege upward, rather than downward and internal, means and actors. This is not to say that upward accountability or oversight is unnecessary – certainly it plays a crucial and legitimate role, for example, in preventing fraudulent use of funds by organizations – but it is only one dimension of multiple accountability relationships.

Results

61 percent of charities (42 percent of observations) in the sample triggered at least one financial exception over the period 2007-2013. For organizations that experienced an exception, it is likely that they will trigger more than one over the whole period: the mean number of exceptions is 9 (SD 10) and the median is 8. However, charities that do experience exceptions tend to trigger only a small number per annum: the mean number of exceptions is 2 (SD 1) and the median is 1.

Trends over Time

Table 3 displays the distribution of exception groups over time. A possible failure to apply funds for charitable purposes is the most common exception group: the majority of the 22 percent of observations that experienced this exception triggered concerns relating to the cost of raising funds and expenditure on charitable activities (codes 5 and 8 respectively). There is some evidence of financial vulnerability in the sector, with at least 13 percent of charities in any particular year triggering exception codes relating to poor liquidity, low reserves, and threats to viability; there is a more even distribution of exception codes in this category, with concerns relating to debtors and creditors (codes 13 and 14 respectively) being slightly more common than other exceptions. There appears to be no association between each type of exception and the year in which it occurred ($\gamma < 0.1$): the proportion of charities triggering each exception group does not vary substantially over time or from the average for the whole period. The increases for 2012 and 2013 across some of the exception groups are accounted for by a change in the denominator (that is, a reduction in the number of organizations completing the detailed financial information section of the supplementary monitoring form).

[Table 3 here]

Table 4 presents the distribution of the number of times a charity experienced each exception group, only for those organizations that triggered the respective exception at least once. The results suggest that there is some degree of repetition. For instance, twenty percent of charities that trigger concerns relating to a possible failure to apply funds for charitable purposes do so in four or more years; similar distributions are found for the other exception groups besides sudden growth or contraction.

[Table 4 here]

For the sector as a whole it appears that exceptions persist over time. Adopting a repeated cross-sectional perspective is limited however, as it does not reveal whether the same charities are triggering these exceptions over time. In order to examine persistence and transitions I examine only those charities that submitted an annual return for each year ($n=1,398$). Figures 1 and 2 display the results of a sequence analysis for the two most common exception groups. To make the sequences clearer, charities that never trigger these exception groups are excluded. The figures show that a small proportion of charities repeatedly trigger these accountability concerns (about five percent of the sample) – as evidenced by a continuous dark line across every time period – and exception sequences are somewhat turbulent (i.e. varying between states over time). Examining the transition matrices for these exception groups also reveal an element of dependency in the triggering of an accountability concern (Table 5). The likeliest transition is dependent on a charity's current exception status: if it has not triggered an exception at time t then it most likely will not experience the exception at time $t+1$ and vice versa. For example, there is a 61 percent probability that a charity, having triggered a concern relating to poor liquidity, low reserves and threats to viability at time t , will trigger the same exception at time $t+1$. This is true for all groups with the understandable exception of triggering concerns relating to sudden growth or contraction, where the likeliest transition is to not experiencing this exception. In conclusion, it appears that a small minority of charities repeatedly trigger exceptions and there is evidence of path dependency. The posited determinants of triggering accountability concerns are modelled in the next section.

[Figure 1 here]

[Figure 2 here]

[Table 5 here]

Patterns in Exceptions: Relationship with Covariates

Before turning to the multivariate results, Tables A2 and A3 in the appendices contain descriptive statistics for each of the dependent variables in the analysis. For exceptions relating to the possible failure to apply funds for charitable purposes, the average charity appears to be slightly bigger, younger, more likely to discharge grants, more likely to operate overseas and less likely to be a religious organization. For exceptions relating to poor liquidity, low reserves and threats to viability, the average charity appears to be slightly bigger, younger, and more likely to operate both overseas and locally. The presence of multicollinearity among the independent variables was examined for each model by calculating the variance inflation factors (VIF). For both models, the VIF for each independent variable is less than 1.5 and the mean VIF is less than 1.2, below the thresholds at which Allison (1999) suggests multicollinearity is problematic.

I report the odds ratios (exponentiated coefficients) rather than the log odds as they approximate the relative risk of triggering each exception.² This is appropriate not only for ease of interpretation but because the absolute chance of triggering an exception is low (i.e. it is better to know which charities are more likely relative to their peers). The results of the regression models are presented in Table 6. I examine the financial independent variable first. For both dependent variables, the odds of triggering an exception are lower for organizations with greater revenue diversity, though the effect is only statistically significant in the first model. The effect of age is similar across both models: as charities get older their odds of triggering these exceptions reduce significantly. This may suggest some form of organizational learning whereby charities develop better practices over time across a range of domains (e.g. reporting and accounting). The effect of size is also consistent across both models: an increase in annual gross income is associated with a significant increase in the odds of triggering concerns. This stands in contrast to the interpretation of the effect of age:

charities develop over time but they may become exposed to different pressures and situations that relate to exceptions as they grow. It also appears that the other independent variables matter, though their effect and significance varies across the models. For example, grant-making charities have higher odds of triggering exceptions relating to the use of charitable assets but lower odds for those relating to financial vulnerability. Finally, the rho statistic reveals that a large proportion of the variance of the error term in the models is accounted for by unobserved differences between charities. This suggests that the idiosyncrasies of these organizations contribute to their likelihood of triggering exceptions.

[Table 6 here]

The analysis concludes with an assessment of the association between the exceptions program and a suite of negative outcomes in the sector: late submission of annual returns and accounts; complaint about the conduct of an organization; regulatory intervention arising as a result of a complaint; and removal from the Charity Register. Table 7 below presents the higher-order correlations between each exception group and the four outcomes, controlling for the independent variables utilised in the regression models. The results show that the exception groups are not associated with any of the outcomes, with the correlations below the threshold at which they are typically considered weak (0.1). This is especially surprising for exceptions relating to sudden growth/contraction or threats to viability, as it is plausible that they should be associated with organizational demise. In sum, though accountability concerns may be important to monitor in their own right, in general they do not seem to lead to other, arguably more serious organizational outcomes.

[Table 7 here]

Discussion and Conclusion

Monitoring accountability concerns is an acknowledgement of charity law being an “incomplete solution to nonprofit governance and the protection of the public interest.” (Brody, 2006, pp. 243) OSCR’s aim of encouraging good practice is laudable and clearly grounded in the belief that “accountability as a marker sets the stage for accountability as a modifier” (Acar et al., 2008, pp. 13). However, the absence of any statistical association between the accountability concerns measured by OSCR and tangible outcomes such as dissolution and regulatory intervention raises questions about the effectiveness of this monitoring program. In essence, the program’s normative aims appear to lead to symbolic or negligible impact on charity behaviour.

This study contributes to the burgeoning charity accountability literature in a number of important ways. First, by describing patterns in the occurrence and persistence of accountability concerns the study makes a contribution to the evidence base from the under-researched UK perspective (Clifford & Mohan, 2016). The proportion of charities triggering financial exceptions is consistent across the study period and there is evidence of repetition and path dependency also. However, Figures 1 and 2 reveal that there is still a degree of variability in the triggering of exceptions and it does not appear that the consistent proportions of exceptions over time are fully accounted for by the same group of charities. This suggests that the accountability concerns monitored by OSCR are somewhat an inherent feature of the sector, at least for the sample of large charities in this study. The multivariate work highlights the salience of core institutional factors in understanding the locus of accountability concerns in the charity sector. The finding that older charities are less likely to trigger accountability concerns while larger organizations are more likely, may be indicative of a tension in the development cycle of charities: age brings experience and learning but size engenders new and significant challenges with respect to financial reporting and performance. Finally, the descriptive and multivariate work combined offer an alternative

perspective to the extant literature by focusing on involuntary, performance-related information disclosures rather than voluntary disclosure of (primarily) financial information (Connolly & Hyndman, 2013a; Connolly et al., 2013; Hyndman, 1990, 1991; Gandia, 2011; Gordon, Fischer, Malone & Tower, 2002; Saxton & Guo, 2011; Saxton et al., 2012).

The results of this analysis also have considerable practical implications for OSCR and other institutions operating under the rubric of risk-based regulation. OSCR aims to discharge its regulatory function in a progressive, proportionate and preventative manner, and the efficient and effective distribution of its resources is critical in achieving this. In light of the evidence provided in this study OSCR may need to reflect on the utility of its accountability program. It could be argued that the exceptions monitoring program is retrospective, tangentially linked to public confidence, and focused on technical compliance with accounting requirements and not enough on core concerns such as fundraising, governance and sound financial practices. The issue of regulatory burden should also be a consideration for OSCR; the absence of a link between the financial exceptions and negative organizational outcomes (Table 7) calls into question whether the costs imposed on charities by the need to respond to the triggering of a concern are justified. A useful exercise for OSCR would be to re-evaluate its own interest, intensity and investment in this program. Improvements to the monitoring program could be made by adopting simpler, alternative measures of accountability: ones that are at least moderately linked with demise and misconduct (Breen, 2013), and whose effect on public confidence is more plausible (e.g. senior management pay).³ If the focus is entirely on accountability concerns that may impact public confidence, many of these measures could be derived from the multitude of surveys exploring public trust in, and issues with, charities (see National Council for Voluntary Organizations, 2015 for an overview). Finally, OSCR could collaborate with charities themselves to better understand and measure the operational vulnerabilities of these organizations.

The counter argument is that the effect of the mere existence of this program – whatever its capacity to affect behaviour change and prevent negative outcomes – on public confidence in the sector should not be discounted; donors, beneficiaries, funders and the public may derive reassurance from the activities of OSCR to monitor vulnerabilities and dissuade undesirable behaviours. It is plausible that certain exception codes do relate to public confidence and thus are worth monitoring: for example, transactions with trustees could constitute excess private benefit which would contravene elements of the charity test. It would also be remiss to suggest that charities do not derive any utility from the triggering of exceptions: it is plausible that some organizations improve their accounting, reporting and financial practices in response to an exception being triggered.

Reflecting on the discussion above, there is a number of fruitful avenues for research in this area. There is a dearth of evidence on charities' understanding of and response to accountability concerns (Acar, Guo & Yang, 2012), which could be addressed by a program of longitudinal, qualitative research. Research could also focus on regulatory regimes – charity or otherwise – that are successful in dissuading undesirable behaviours and preventing negative outcomes. Specific to the Scottish context, it would be interesting to investigate charities' prior knowledge of the exceptions, whether tactics are employed to avoid triggering these concerns, and any resulting organizational learning or behavioural changes. In the UK, the existence of three broadly similar regulatory regimes (Scotland, England and Wales, and Northern Ireland) offers the potential for detailed comparative work (e.g. natural experiments) to be conducted on the impact of different reporting thresholds and requirements on accountability. Finally, alternative data sources – such as the Trustee Annual Report (TAR) – could be mined for a wider, more specific suite of independent variables and performance-related information.

Appendices

[Table A1 here]

[Table A2 here]

[Table A3 here]

Endnotes

1. Other possible model specifications include fixed effects and pooled logistic regression. A random effects model is chosen over pooled logit as the Hausman test is statistically significant ($X^2=69.59***$) and due to the size of the rho coefficient; ignoring this level of unobserved heterogeneity would lead to incorrect interpretation of model coefficients. A fixed effects model is rejected as it excludes time-invariant independent variables that are of substantive interest (they are absorbed by the model's intercept or constant). For example, ICNPO category does not vary over time and thus would be omitted in the estimation of a fixed effects model, despite interest in exploring whether this variable affects the outcome.
2. Values greater than one indicate higher odds of the outcome occurring compared to the reference category; less than one indicate lower odds; and one represents the same odds.
3. As part of its *targeted regulation* approach, OSCR is reviewing the accountability monitoring program; though the changes have not been made public, it appears that fewer exceptions will be monitored and new ones derived from questions on the amended annual return form introduced in April 2016. It is too early to evaluate the impact of these changes but fewer, better measures of vulnerability are to be welcomed.

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Tables and Figures

Table A1. Financial exception codes

Exception code	Description
Large charity or major fundraiser	
1	Total incoming resources are over £10M.
2	Total donations gifts and legacies received over £1M.
Sudden growth or contraction	
3	Total incoming resources are over £250,000 and over five times the previous year's.
4	Total incoming resources previous year were over £250,000 and this year's are under one fifth.
Possible failure to apply funds for charitable purposes	
5	Cost of generating voluntary funds is over 50% of donations plus legacies.
6	Cost of trading in order to raise funds exceeds income from trading in order to raise funds.
8	Total resources expended are under 67% of total incoming resources.
9	Governance costs are over 25% of total resources expended.
10	"Other" is more than 50% of resources expended.
Poor liquidity, low reserves, threats to viability	
11	Total resources expended are over 150% of total incoming resources.
12	Negative total net assets.
13	Debtors more than 30% of total incoming resources.
14	Creditors payable within one year more than 50% of total resources expended.
15	Negative net current assets (ie net current liabilities) more than 20% of total incoming resources.
16	Unrestricted fund negative and more than 1% of total incoming resources.
Fundraising issues (also 5 and 6)	
17	Unauthorised fundraising answered yes.
Adequacy of governing board	
18	Two or fewer trustees and either total incoming resources over £1M or total net assets over £1M.
19	No trustees normally residing in Scotland.
Transactions with trustees	
20	Payments to trustees settling outlays greater than £50,000.
21	Payments to Trustees for professional services to the charity greater than £50,000.
22	Payments to Trustees for professional services greater than 30% of total resources expended.
23	Payments to Trustees for any other work done for the charity is greater than £50,000.
24	Payments to Trustees for any other work done for the charity is over 30% of total resources expended.
25	Payment to Trustees for any other reason over £50,000.

26	Payments to Trustees for any other reason over 30% of total resources expended.
27	Payments to trustees for professional services, work done or “other”, and no specific authority in constitution.
28	Money owed by Trustee at any time greater than £5,000.
29	Sales of properties to Trustees greater than £50,000.
30	Property gifted to trustee(s) value over £500.
31	Purchase of properties from Trustees greater than £50,000.
32	Charity occupied property belonging to a trustee and paid more than £20,000.
33	Services made available to one or more trustees.

Table 1. Sample selection

Sample selection	Observations
Initial sample	155,416 (28,093 charities)
Removal of observations that did not provide a detailed financial breakdown in the supplementary monitoring form in a particular year – those with annual gross income less than £250,000 (£100,000 prior to 2012)	129,708
Removal of observations not included in analysis period	808
Removal of observations listed as Cross Border or Registered Social Landlords	4,231
Final sample	21,322 (5,124 charities)

Table 2. Conceptual framework

Factor	Variable	Operationalization
Financial	Concentration	Revenue concentration of a charity. Herfindahl-Hirschman index (HHI) on a scale of 0-1; 0 is more concentrated, 1 is less.
Organizational	Size	Natural log of annual gross income
	Age	Natural log of the number of years a charity has existed (most recent annual return year – registration year)
	Grant	1 = Disburses grants to other organisations 0 = Carries out charitable activities itself or a combination of functions
	Field	International Classification of Non-profit Organisations (e.g. Social Services). Nominal variable with 12 categories (see Mohan & Barnard, 2013 for how these categories were assigned)
	Geography	Geographical scope of a charity's operations (e.g. Local). Nominal variable with 8 categories.
	Form	Constitutional form of a charity (e.g. Trust). Nominal variable with 9 categories.

Table 3. Distribution of financial exceptions 2007-2013

Type of exception	% of charities							Overall
	2007	2008	2009	2010	2011	2012	2013	
Possible failure to apply funds for charitable purposes	25	22	20	21	21	22	23	22
Poor liquidity, low reserves, threats to viability	15	13	14	14	14	16	16	14
Transactions with trustees	10	10	10	10	9	12	10	10
Large charity or major fundraiser	6	6	6	6	6	13	12	7
Sudden growth or contraction	1	1	1	1	2	3	4	2
Adequacy of governing board	2	1	1	1	2	1	1	1
Total	100 (3,386)	100 (3,563)	100 (3,491)	100 (3,496)	100 (3,604)	100 (1,872)	100 (1,910)	100 (21,322)

Note: Percentages rounded to the nearest whole number and thus columns may not sum to 100.

Table 4. Distribution of the number of instances of exception groups

Number of instances	% of charities					
	Large charity or major fundraiser	Sudden growth or contraction	Possible failure to apply funds for charitable purposes	Poor liquidity, low reserves, threats to viability	Adequacy of governing board	Transactions with trustees
1	28	83	45	43	57	35
2	10	16	23	23	13	15
3	6	1	13	13	8	8
4	6	-	10	7	9	9
5	7	-	6	6	4	11
6	8	-	2	4	3	9
7	35	-	2	4	7	13
Total	100 (1,876)	100 (336)	100 (5,054)	100 (3,486)	100 (371)	100 (2,401)

Note: Percentages rounded to the nearest whole number and thus columns may not sum to 100.

Table 5. Probability of transitioning to triggering an exception

Triggered exception at t	Probability of triggering exception at $t+1$ (%)					
	Large charity or major fundraiser	Sudden growth or contraction	Possible failure to apply funds for charitable purposes	Poor liquidity, low reserves, threats to viability	Adequacy of governing board	Transactions with trustees
No	25	15	26	25	16	23
Yes	89	18	55	61	63	80

Note: Percentages rounded to the nearest whole number.

Table A2. Descriptive statistics for possible failure to apply funds for charitable purposes

Variables	Triggered (N=1,807)		Not triggered (N=2,850)		Whole sample (N=4,657)	
	M	SD	M	SD	M	SD
Size	13.81	1.74	12.76	1.00	13.17	1.43
Age	3.07	.88	3.19	.79	3.14	.83
Concentration	.29	.22	.31	.22	.30	.22
Grant	.40	.49	.27	.44	.32	.47
Company (%)	52.41	-	54.74	-	53.83	-
Trust (%)	19.37	-	12.07	-	14.90	-
Unincorporated association (%)	17.10	-	25.96	-	22.53	-
Operate widely (%)	16.05	-	26.35	-	22.35	-
Operate locally (%)	23.02	-	26.04	-	24.87	-
Operate overseas (%)	22.75	-	13.02	-	16.81	-
Social services (%)	13.09	-	23.98	-	19.77	-
Religion (%)	18.51	-	22.04	-	20.68	-
Culture & recreation (%)	17.71	-	14.06	-	15.47	-
Education & research (%)	17.49	-	6.76	-	10.90	-
Development & housing (%)	14.00	-	11.43	-	12.43	-
Health (%)	3.60	-	7.23	-	5.83	-

Note: Figures rounded to two decimal places. Only selected categories from the nominal variables are included for the purpose of brevity.

Table A3. Descriptive statistics for poor liquidity, low reserves, threats to viability

Variables	Triggered (N=1,408)		Not triggered (N=1,632)		Whole sample (N=3,040)	
	M	SD	M	SD	M	SD
Size	13.54	1.51	12.89	1.05	13.19	1.32
Age	3.01	.83	3.09	.77	3.05	.80
Revenue concentration	.28	.22	.28	.23	.28	.22
Grant	.39	.49	.37	.48	.38	.48
Company (%)	58.10	-	62.25	-	60.33	-
Trust (%)	20.03	-	18.87	-	19.41	-
Unincorporated association (%)	13.99	-	13.48	-	13.72	-
Operate widely (%)	18.82	-	25.98	-	22.66	-
Operate locally (%)	21.16	-	17.40	-	19.14	-
Operate overseas (%)	20.60	-	12.87	-	16.45	-
Social services (%)	12.94	-	17.02	-	15.14	-
Religion (%)	15.29	-	13.69	-	14.43	-
Culture and recreation (%)	22.21	-	20.48	-	21.27	-
Education & research (%)	15.59	-	14.57	-	15.14	-
Development & housing (%)	16.03	-	10.11	-	12.84	-
Health (%)	2.50	-	4.40	-	3.52	-

Note: Figures rounded to two decimal places. Only selected categories from the nominal variables are included for the purpose of brevity.

Table 6. Regression models results

	Possible failure to apply funds for charitable purposes		Poor liquidity, low reserves, threats to viability	
	Odds ratio	SE	Odds ratio	SE
Financial				
Concentration	.30***	.09	.79	.28
Organizational				
Size	2.94***	.22	2.34***	.19
Age	.61***	.07	.62***	.08
Grant	1.87**	.36	.86	.18
Form (base = Company)				
Trust	2.14**	.53	1.93*	.52
Unincorporated	1.10	.27	2.63**	.87
Geography (base = Wide)				
Operate locally	1.91**	.45	2.75***	.76
Operate overseas	2.04*	.59	5.77***	1.88
ICNPO (base = Social)				
Religion	3.45***	1.03	1.60	.58
Culture & recreation	3.87***	1.07	1.38	.41
Education & research	3.27***	1.07	.92	.31
Development & housing	3.53***	1.04	3.43***	1.15
Health	.77	.29	.39	.20
Observations	4,522		2,949	
Log-likelihood	-2301.03		-1672.65	
LR test (X^2)	302.47***		161.14***	
rho	.65		.59	

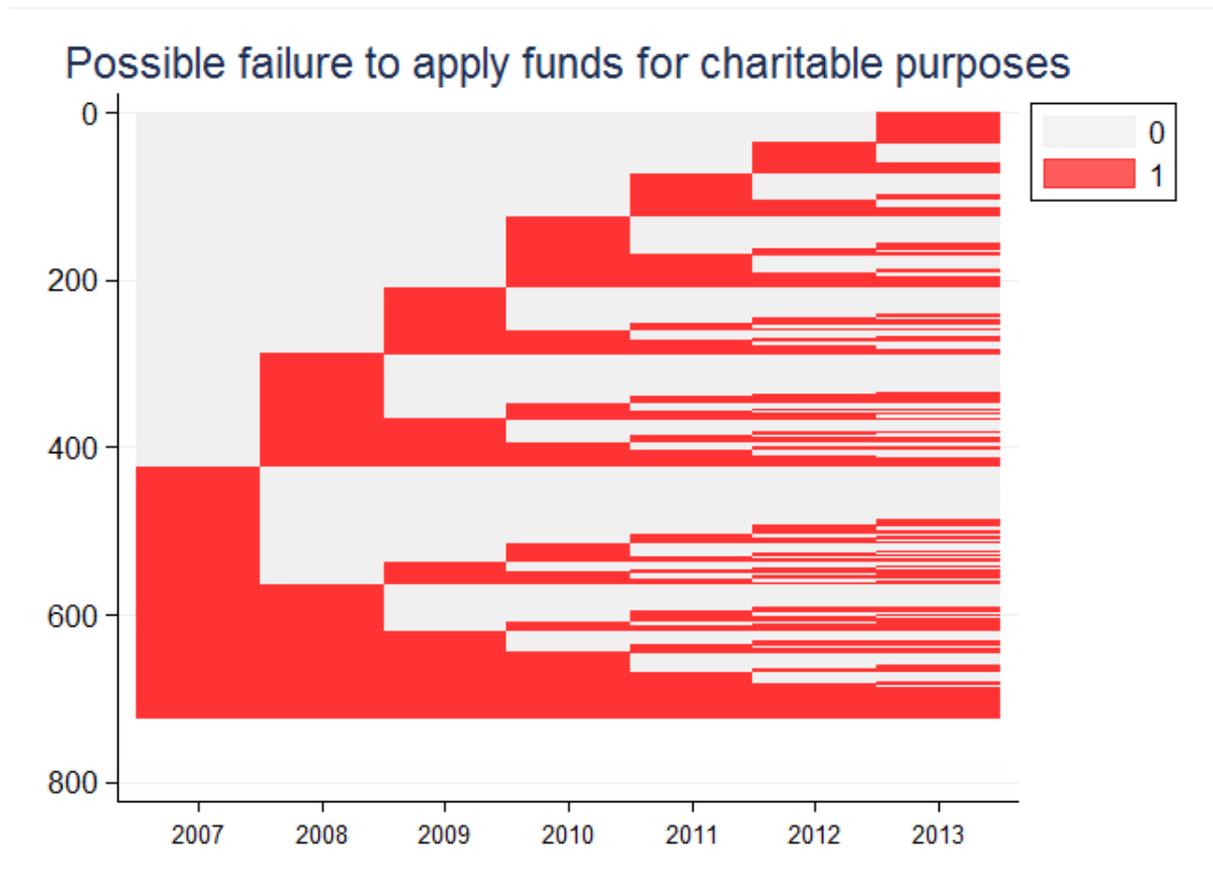
Note: Figures rounded to two decimal places. The reference groups are the largest categories for each independent variable. Only selected categories from the nominal variables are included for the purpose of brevity. Constant is omitted. * $p < .05$. ** $p < .01$. *** $p < .001$.

Table 7. Correlation between accountability concerns and negative outcomes

Exception group	Late submission	Complaint	Regulatory intervention	Removal from Charity Register
Large charity or major fundraiser	.03***	.05***	.03***	.06***
Sudden growth or contraction	.02**	-.01	.01	-.02***
Possible failure to apply funds for charitable purposes	.04***	-.01	.01	-.03***
Poor liquidity, low reserves, threats to viability	.05***	-.01	.00	.02**
Adequacy of governing board	.01*	-.00	.01	.01
Transactions with trustees	.04***	.00	.03***	.04***

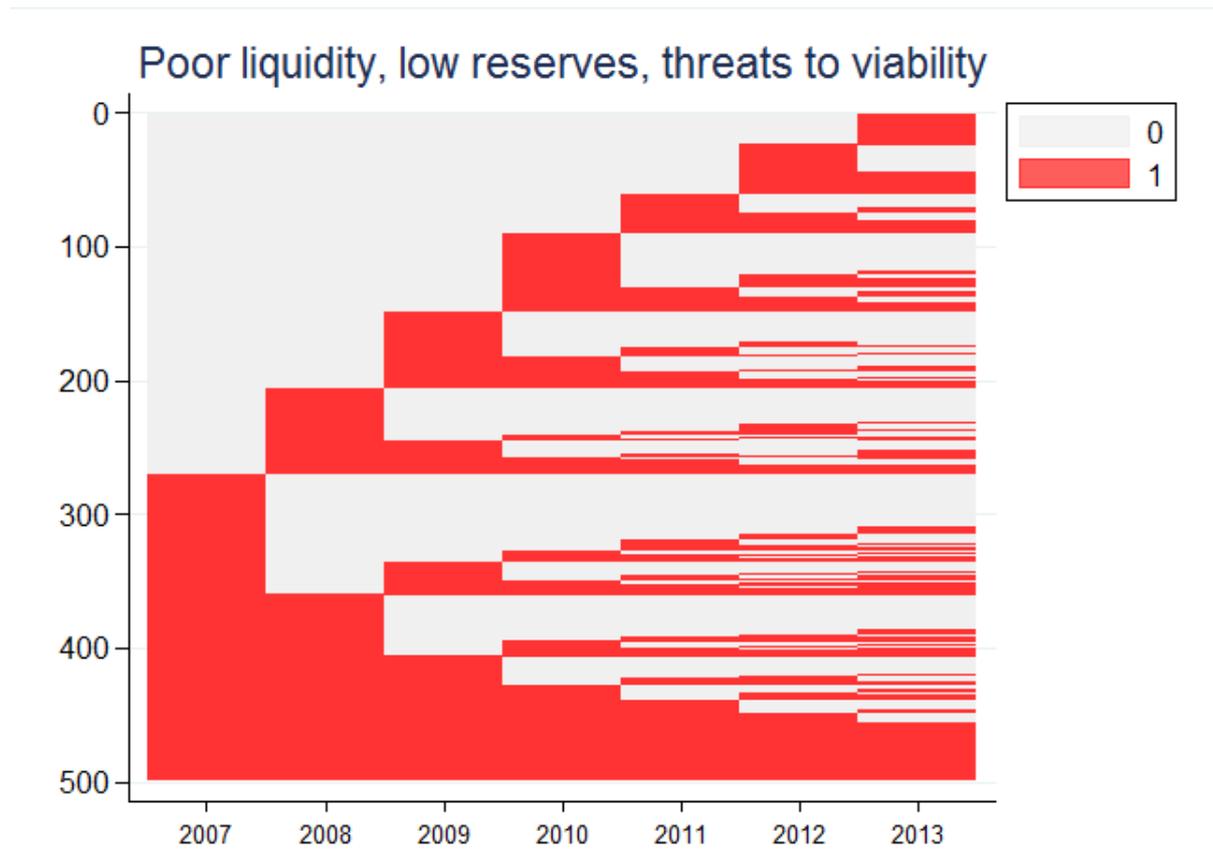
Note: Pearson's r correlations are reported. Figures rounded to two decimal places. Based on 20,180 observations. * $p < .05$. ** $p < .01$. *** $p < .001$.

Figure 1. Sequence index plot of the possible failure to apply funds for charitable purposes



Note: The Y axis represents the individual sequences of the 722 charities that triggered this exception at least once and is ordered by exception status in 2007.

Figure 2. Sequence index plot of poor liquidity, low reserves, threats to viability



Note: The Y axis represents the individual sequences of the 498 charities that triggered this exception at least once and is ordered by exception status in 2007.