

# Chapter 19

## Towards Predicting Financial Failure in Non- Profit Organisations

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### ABSTRACT

*Non-profit organisation financial failure has been a prevalent problem in developed and developing economies. Such incidences bring adverse effects to the reputation of the non-profit organisation in question and the third sector as a whole, especially if the organisation in question is significantly large in size, leading to possible knock-on effects such as disruption to society, litigation, loss of investor confidence in the economic environment, and a worsening of a country's ranking under the Corruption Perceptions Index. This chapter examines past financial failures amongst non-profits and reviews past literature on attempts to predict non-profit failures before they occur. Finally, it proposes an additional governance-related factor to be taken into consideration when considering potential financial distress amongst non-profit organisations. Suggestions for further research are made accordingly.*

### INTRODUCTION

Non-profit organisation failure has been a problem that has been plaguing developed countries. In 2008, a scholar of philanthropy and government predicted that more than 100,000 nonprofit groups in the US would fail within the next two years (Wasley, 2008), and a fifth of small charities in the UK were at the risk of closure, at the end of 2013, if their finances did not improve (Swinford, 2013). Such failures were attributed to the poor economy and the resulting fall in donation levels (Doward,

2012), lack of funding in general (Griesmann, 2012), increased competition for funding, even with for-profit organisations (Steuerle, 2007), lack of administrative capacity (Wasley, 2008), lack of transparency and risk management, inadequate resource planning and development, inadequate fiscal controls, failure to set and adhere to best practices, policies, procedures and standards (Griesmann, 2012), and theft and embezzlement (Snyder, 2013), amongst others.

A good number of financial failures have been noted amongst non-profit organisations in the

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Asian region, which is a worrying development. For example, in City Harvest Church Singapore, the senior pastor and four other church members were arrested and charged with conspiracy to commit criminal breach of trust for misusing over SGD\$50 million of church money (Channel News Asia Singapore, 2012). Also in Singapore, the founder and former chief executive of Ren Ci Hospital, Shi Ming Yi was found guilty of fraud, falsifying documents, misappropriating funds and giving false information to the Commissioner of Charities (Chan, 2009).

In the Calvary Church Kuala Lumpur, the senior pastor was accused of the following issues, amongst others: the rising construction costs of a church building project, transfer of substantial funds from the church into the accounts of a personal ministry headed by him without church members' knowledge and poor financial management. In fact, some of the members reacted by forming a governance group to demand for accountability and transparency over the use of church funds, and lodging a police report over the matter (Fernandez and Michael, (2009); Sunday Star, 2010). These members also decided to stop giving their financial support to the church (Calvary Today, n.d.).

Another Malaysian case involved the Anglican church of All Saints' Cathedral, at which the Diocesan Bishop was investigated for the alleged abuse of power and mismanagement of the Mission Fund. Some contentious issues included the purchase of a property in Thailand under the Bishop's personal name while using church funds and the execution of financial transactions without the prior approval of the church's Standing Committee (Daily Express, 2012). Based on anecdotal evidence, a significant number of members started taking an interest in governance issues, for example by demanding answers pertaining to noted irregularities, making complaints to the diocese's higher authority and even initiating legal action. Some members have also left the church as a response. As with the Calvary Church, some members have also

decided to withdraw their financial support (The Truth, 2013) as a result of the alleged governance irregularities.

On the non-church front, there are also many examples of financial irregularities. A recent example is from the UK, where the Charity Commission has opened a statutory inquiry into a charity that provides financial support and advice for other charities, called Catalyst Trust, after questioning the accuracy of the said charity's accounts (James, 2014). The commission received a complaint in October 2013 about the charity's finances, whereby the complainant wondered whether the trustees' acceptance of a gift of a property had been in the charity's best interests. An inspection of the charity carried out revealed unexplained transactions totaling more than £60,000. This raised concerns about the accuracy of the accounts because the charity had never declared an income of more than £25,000 in its annual return. However, a comment by a trustee of Catalyst Trust suggested that abuse in the charity sector was wide ranging: "There is so much abuse in the charity sector that to pick on me is unbelievable."

It is clear from the above that financial failures have occurred widely amongst non-profit organisations. Such incidences bring adverse effects to the reputation of the non-profit organisation in question and the third sector as a whole, especially if the organisation in question is significantly large in size. The financial sustainability of the third sector is of major concern because it is: very large and has been growing rapidly (Lyons and Hocking, 1998); a substantial employer; the provider of services which fill gaps in government services; an alternative delivery mode for public services, a rich source of diverse ideas and an avenue through which minority demands for public goods can be channelled (Douglas, 1987; Weisbrod, 1988); and an important expression of the pluralistic approach that underlies Western democracies. Knock-on effects could also include disruption to society, litigation, loss of investor

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