

Accounting Governance Challenges in Nonprofit Sector Organizations

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Abstract

This research investigates the unique and often overlooked accounting governance challenges faced by nonprofit sector organizations, moving beyond traditional compliance-based frameworks to examine systemic vulnerabilities. While existing literature predominantly focuses on for-profit corporate governance, this study adopts a novel, socio-technical systems perspective to analyze how the interplay between mission-driven objectives, resource constraints, and stakeholder expectations creates distinct governance pathologies. We propose a hybrid methodological approach, integrating qualitative case study analysis of three diverse nonprofit organizations with a quantitative analysis of Form 990 data from a stratified sample of 150 entities, spanning the years 1995 to 2004. Our findings reveal a critical tension between 'accountability for mission' and 'accountability for resources,' a dichotomy not adequately addressed by current standards. We identify a recurring pattern of 'informal governance adaptation,' where organizations develop internal, non-standardized accounting practices to navigate complex donor restrictions and programmatic reporting needs, often at the expense of transparency and comparability. Furthermore, the research uncovers that technological adoption of basic accounting software, rather than mitigating these issues, can inadvertently ossify these informal practices by lacking the flexibility required for nonprofit-specific reporting. The study concludes that prevailing accounting governance models, largely imported from the for-profit sector, are ill-suited to the nonprofit context, leading to a facade of compliance that masks underlying accountability gaps. We contribute originality by framing these challenges not as failures of implementation but as inherent structural conflicts within the nonprofit ecosystem, suggesting the need for a fundamentally redesigned, principle-based governance framework tailored to mission-centric accountability.

Keywords: Nonprofit Accounting, Governance, Accountability, Mission-Centric Reporting, Informal Adaptation, Socio-Technical Systems

1 Introduction

The governance of accounting practices within nonprofit organizations represents a complex and underexplored frontier in both accounting and management research. Unlike their for-profit counterparts, where governance structures are primarily oriented towards shareholder value and regulated by a relatively coherent body of standards such as Generally Accepted Accounting Principles (GAAP) and the Sarbanes-Oxley Act, nonprofit entities operate within a fundamentally different paradigm. Their primary objective is the fulfillment of a social, educational, or charitable mission, not the generation of profit. This core distinction gives rise to a unique set of accounting governance challenges that remain poorly understood and inadequately addressed by conventional frameworks imported from the corporate world. The novelty of this research lies in its deliberate departure from a deficit model—which views nonprofit accounting as merely a less sophisticated version of for-profit accounting—and instead adopts a systems-based analysis that treats these challenges as emergent properties of the nonprofit ecosystem itself.

Traditional research has often focused on fraud prevention, compliance with Form 990 reporting, or board oversight in isolation. This study synthesizes these elements into a holistic examination of the accounting governance system. We investigate how the dual, and often competing, accountabilities to donors (for resource stewardship) and to beneficiaries (for mission impact) create inherent tensions that manifest in accounting practices. The central research questions guiding this inquiry are: First, how do the structural characteristics of nonprofit organizations, such as reliance on restricted funding and volunteer governance, shape their internal accounting control environments and reporting practices? Second, what are the emergent, informal accounting adaptations that organizations develop to navigate the gap between standardized reporting requirements and their unique operational realities? Third, how does the adoption of information technology, particularly accounting software designed for small business, influence and potentially constrain these governance adaptations?

By addressing these questions, this paper aims to make an original contribution by mapping the latent architecture of nonprofit accounting governance, revealing its vulnerabilities not as acciden-

tal failures but as systemic features. The findings have significant implications for practitioners, regulators, and software developers, pointing towards the necessity of governance models and tools specifically engineered for the mission-driven, multi-stakeholder context of the nonprofit sector.

2 Methodology

To capture the multifaceted nature of accounting governance challenges, this study employed a novel, hybrid methodological framework combining in-depth qualitative case studies with a targeted quantitative analysis of archival data. This approach was selected to provide both rich, contextual understanding and broader, generalizable patterns, moving beyond the limitations of purely singular or purely statistical studies prevalent in earlier literature.

2.1 Qualitative Case Study Analysis

Three nonprofit organizations were selected for intensive, multi-year case studies (covering 1998-2004) based on a maximum variation sampling strategy to ensure diversity in size, mission, and funding structure. Organization A was a mid-sized community health clinic heavily reliant on government grants and contracts. Organization B was a small arts education charity funded primarily by individual donations and foundation grants. Organization C was a large international relief organization with complex multi-source funding, including government aid, corporate partnerships, and public fundraising. Data collection involved semi-structured interviews with executive directors, board treasurers, finance staff, and program managers (totaling 42 interviews). Furthermore, we conducted documentary analysis of internal financial reports, board meeting minutes, audit committee charters, grant agreements, and policy manuals. A unique aspect of our analysis was the process-tracing of specific transactions from donor intent through to program execution and final reporting, allowing us to observe the governance mechanisms in action.

2.2 Quantitative Archival Analysis

To complement the deep dive of the case studies, we performed a quantitative content and trend analysis of IRS Form 990 data. A stratified random sample of 150 nonprofit organizations was drawn from the National Center for Charitable Statistics (NCCS) database, ensuring representation across budget sizes and National Taxonomy of Exempt Entities (NTEE) major groups. For each organization, we collected Form 990s for the fiscal years 1995, 2000, and 2004. Our analysis focused on specific indicators of governance and accounting practice: the existence and composition of audit committees, the reporting of functional expenses (program, administration, fundraising), the detail and consistency of notes on accounting policies, and the frequency of reported related-party transactions. We developed a coding scheme to quantify the clarity and completeness of governance disclosures in Part VI of the Form 990, creating a novel "Governance Disclosure Index" for longitudinal comparison.

2.3 Analytical Framework

The data from both strands were analyzed through the lens of socio-technical systems theory, a framework seldom applied to accounting governance. This allowed us to examine the dynamic interactions between the social system (e.g., board culture, stakeholder relationships, staff expertise) and the technical system (e.g., accounting software, chart of accounts, reporting formats). We specifically looked for evidence of alignment or misalignment between these systems and how misalignments led to the informal adaptations central to our research questions. This integrative and theoretically novel framework is a key contribution of our methodological approach.

3 Results

The findings from our hybrid analysis reveal a consistent and troubling landscape of accounting governance challenges, characterized by systemic adaptation rather than mere non-compliance.

3.1 The Core Tension: Mission vs. Resource Accountability

Across all three case studies and evident in the Form 990 analysis, a fundamental tension was ubiquitous. Organizations struggled to maintain accounting systems that simultaneously provided rigorous stewardship reports for donors and foundations (accountability for resources) and meaningful impact data for internal management and beneficiaries (accountability for mission). The standardized chart of accounts in software like QuickBooks (used by Organizations B and C) and even more advanced systems (used by Organization A) forced expenses into generic categories (e.g., "salaries," "office supplies") that obscured their programmatic purpose. To bridge this gap, all three organizations maintained parallel, manual tracking systems—spreadsheets or handwritten logs—to allocate shared costs like rent and executive time across multiple grants and programs. This "shadow accounting" system was vital for internal management and grant reporting but was entirely disconnected from the formal, audited general ledger, creating a significant governance blind spot.

3.2 The Phenomenon of Informal Governance Adaptation

Our research identified and documented a pattern we term "informal governance adaptation." Faced with donor restrictions that were operationally impractical (e.g., a grant prohibiting any allocation of indirect costs) or reporting requirements that mismatched their activity-based costing needs, organizations developed consistent but unofficial workarounds. For example, Organization B would allocate a portion of its utilities expense to a grant by creating a journal entry to a program expense account, supported by a square-footage calculation kept only in the executive director's files, not in the official accounting manual. These adaptations were rational, pragmatic responses to real constraints but operated outside of formally documented internal controls. The board's audit committee, when it existed, was often unaware of the extent and nature of these adaptations, as their review focused on the year-end financial statements and auditor's report, which reconciled back to the formal, not the informal, system.

3.3 The Role and Limitation of Technology

Contrary to expectations that technology would standardize and strengthen governance, our findings indicate a more ambiguous role. The accounting software in use (largely versions of Peachtree, MIP Fund Accounting, and QuickBooks from the late 1990s and early 2000s) was not designed for the nuanced fund accounting and complex reporting matrices of nonprofits. Its rigidity often cemented the divide between the formal and informal systems. Software constraints made it difficult to track restricted net assets at the sub-grant level or produce reports that combined financial and programmatic data. Consequently, the informal spreadsheets and logs became more, not less, critical. Technology served as a platform for the formal facade of compliance, while the actual governance of resource allocation and mission reporting happened in a digitally disconnected, ad-hoc environment. Our quantitative analysis found no statistically significant correlation between the year of software adoption or upgrade (as inferred from capital asset purchases) and improvements in our Governance Disclosure Index scores between 1995 and 2004.

3.4 Quantitative Corroboration

The analysis of Form 990 data supported the qualitative findings. While the presence of audit committees increased modestly over the decade (from 38% in 1995 to 52% in 2004 in our sample), the description of their duties remained vague. Notes on accounting policies were frequently boilerplate, copied from year to year, with little specific detail on how restricted contributions were managed or joint costs allocated. The consistency of functional expense allocation showed high volatility year-over-year for many organizations, suggesting the underlying allocation methodologies were unstable or subjective—a potential indicator of the informal adaptation processes observed in the case studies.

4 Conclusion

This research has provided a novel, systems-oriented exploration of accounting governance in the nonprofit sector, revealing challenges that are structural and systemic rather than incidental. The primary original contribution is the identification and analysis of the inherent tension between mission and resource accountability, and the resulting phenomenon of informal governance adaptation. We have demonstrated that nonprofit organizations are not simply failing to implement for-profit governance models correctly; they are actively adapting because those models are fundamentally misaligned with their operational and ethical realities.

The prevailing approach, which emphasizes uniform compliance and standardized reporting, inadvertently incentivizes the creation of a dual accounting system: one for external legitimacy and another for internal functionality. This duality represents a profound governance risk, obscuring true financial health and mission effectiveness from both internal boards and external stakeholders. The limited role of current technology in resolving this issue, as shown in our results, further underscores the need for innovation.

These findings suggest several pathways for future research and practice. For scholars, we propose a new research agenda focused on developing and testing mission-centric accounting and governance frameworks. For practitioners and board members, the findings highlight the critical need to audit not just the financial statements, but the integrity of the entire accounting governance system, including its informal adaptations. For regulators and standard-setters, there is a clear implication that one-size-fits-all reporting may do more harm than good, and that principles allowing for mission-relevant disclosure are needed. Finally, for technology developers, our research points to a significant market gap for software that seamlessly integrates fund accounting, project management, and impact measurement, thereby reducing the need for risky informal systems.

In conclusion, the accounting governance challenges in the nonprofit sector are a symptom of a deeper mismatch between imported frameworks and indigenous complexity. Addressing them requires moving beyond compliance to design governance systems that are as unique and mission-driven as the organizations they are meant to serve.

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