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NONPROFIT FRAUD AND ORGANIZATIONAL DEMISE: THE ROLE OF GOVERNANCE IN TIMES OF CRISIS

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Abstract

This study investigates how organizational fraud impacts the decline of nonprofit organizations, focusing on the role of governance structures during crises, including the COVID-19 pandemic. Analyzing U.S. nonprofits that reported fraud between 2017 and 2019, the results show that 34% of these organizations shut down within three years, compared to only 4.3% of those that did not report fraud. The study highlights key governance factors, such as internal control systems and board oversight, that significantly influence the likelihood of organizational closure. Strong internal controls were linked to a lower risk of shutdown, emphasizing their protective effect during times of increased uncertainty. Additionally, larger boards were associated with better oversight, which may help prevent organizational failure. The research also emphasizes the impact of organizational size and external funding, with larger nonprofits and those receiving government grants being less likely to close. Overall, the findings underscore the essential role of governance and financial support in helping nonprofits endure fraud-related challenges during crises like the COVID-19 pandemic.

Keywords: nonprofit fraud, organizational demise, fraud triangle, governance, COVID-19.

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1. Introduction

Nonprofit organizations in the United States depend highly on donations and grants for operational funding (Young, 1983). For these organizations, trust is a cornerstone of their success, as they rely on external stakeholders, such as donors, foundations, and government agencies, to secure financial resources (Hager *et al*., 1996). However, nonprofits face unique organizational challenges that often compromise their ability to maintain this trust. Loosely structured frameworks, insufficient oversight, and weak internal controls are common issues within many nonprofits (Archambeault, Webber and Greenlee, 2015). As a result, these organizations are particularly vulnerable to fraudulent activities, which can lead to significant financial and reputational damage, undermining the trust they have carefully cultivated.

The impact of fraud in nonprofit organizations has been well-documented across various studies, with evidence showing that fraud can result in financial loss, damaged reputation, and decreased donor confidence (Archambeault, Webber and Greenlee, 2015; Bottan and Perez-Truglia, 2015; Gallagher and Radcliffe, 2002). However, there is a gap in the literature regarding the direct relationship between fraud and organizational demise. While numerous studies have explored the consequences of fraud within nonprofits, few have investigated how fraudulent activities may contribute to these organizations' eventual closure or dissolution. This gap is significant, as understanding the link between fraud and nonprofit demise can offer crucial insights into how organizations can better protect themselves and mitigate such risks.

In response to rising concerns about fraud and financial mismanagement, nonprofit organizations in the U.S. have been encouraged since 2008 to implement comprehensive governance systems (IRS, 2024; Harris, Petrovits and Yetman, 2017). These systems are designed to enhance transparency, accountability, and oversight and reduce the likelihood of fraudulent activities (IRS, 2024). Yet, the question remains: Do these internal controls truly minimize the impact of fraud on the survival of nonprofits, or do organizations with stronger internal controls still face significant risks of demise due to fraud?

This study addresses critical questions by examining the relationship between organizational fraud, demise, and governance in U.S. nonprofit organizations during periods of crisis such as the COVID-19 pandemic. Specifically, it explores whether reporting fraudulent activities leads to organizational closure and whether the presence of an internal control system mitigates this effect. Utilizing a dataset of U.S. nonprofits that have reported fraud, this research aims to answer two key questions: First, does reporting fraud lead to the demise of nonprofit organizations? Second, does the organizational governance system influence the relationship between fraud reporting and organizational demise? By answering these questions, this study contributes to understanding how internal controls, particularly governance structures, influence the resilience of nonprofits in the face of fraud and broader challenges posed by crises such as COVID-19.

The structure of this manuscript is as follows: the second section reviews the relevant literature and develops the research hypotheses. The third section outlines the research

design and empirical context. The fourth section presents the study's findings, followed by a discussion and conclusion in the fifth section, which addresses the theoretical and practical implications of the results.

2. Background and hypotheses

2.1. Nonprofit fraud

Nonprofit fraud typically refers to intentional acts of dishonesty or misrepresentation within a nonprofit organization, usually for personal gain or to benefit another party (Archambeault Webber and Greenlee, 2015). It often involves misusing the organization's resources or assets and violating legal or ethical standards (Archambeault and Webber, 2018). While there is no universally accepted definition of nonprofit fraud, existing literature categorizes it into three main types: (1) asset misappropriation, which involves the theft or embezzlement of organizational assets; (2) corruption, which refers to the unethical manipulation of business transactions for personal benefit; and (3) financial statement fraud, which entails the deliberate falsification of financial information (Harris, Petrovits and Yetman, 2017; Wells, 2005). Each form can profoundly impact an organization's financial integrity, accountability, and public trust.

Among these types, asset misappropriation is the most prevalent form of fraud in nonprofit organizations (ACFE, 2021). The Internal Revenue Service (IRS) defines it as the unauthorized conversion or use of organizational assets for purposes not approved by the organization. Asset misappropriation includes, but is not limited to, embezzlement, theft, and other fraudulent financial transactions (IRS, 2024). The Association of Certified Fraud Examiners (ACFE) reports that nearly 40% of all reported fraud cases in nonprofit organizations involve asset misappropriation (ACFE, 2021). Despite its high incidence, literature specifically addressing asset misappropriation is still limited. One reason for this gap is the challenge of obtaining reliable and comprehensive data on such incidents, as they are often underreported or concealed, particularly in smaller organizations with limited oversight and internal controls (Harris, Petrovits and Yetman, 2017).

In response to these concerns, the IRS introduced regulatory measures to enhance transparency and prevent such fraud from going unnoticed. Since 2008, U.S. law has mandated nonprofit organizations to disclose any instances of significant asset misappropriation (IRS, 2024). This requirement is part of a broader effort to ensure accountability and improve financial oversight within the nonprofit sector. Charitable organizations are now legally obligated to report whether they have identified significant instances of asset misappropriation during the year, creating a framework that promotes proactive detection and reporting of fraudulent activities.

The IRS Form 990, the primary public source of financial information about nonprofit organizations, plays a central role in this process (Harris, Petrovits and Yetman, 2017; Harris, Petrovits and Yetman, 2015). Specifically, Part VI of the form mandates the disclosure of asset diversion, which is defined as any unauthorized use or conversion of the

organization's assets for purposes other than its intended mission. This includes theft, embezzlement, and similar fraudulent activities (IRS, 2024). To ensure that such disclosures are meaningful, the IRS sets specific thresholds for when asset diversion must be reported. An asset diversion is deemed significant if its value exceeds any of the following benchmarks: (1) 5% of the organization's total income for the tax year, (2) 5% of the organization's total assets at the end of the tax year, or (3) $250,000 or more. These requirements ensure that nonprofits are transparent about significant financial discrepancies and take responsibility for addressing them (Harris, Christine and Michelle, 2017).

2.2. The effects of nonprofit fraud and nonprofit demise

Fraud within organizations can have immediate and long-lasting effects, primarily impacting their financial health, reputation, and ability to fulfill their mission (Alexander, 1999). One of the most direct consequences of fraud is financial loss, often due to embezzlement or theft of funds, which severely hinders the organization's ability to continue operations. The literature consistently shows that these financial losses often result in downsizing, reduced program effectiveness, and an inability to meet organizational goals (Lamothe *et al*., 2022).

However, reputational damage is often one of the most harmful and lasting consequences (Trussel and Parsons, 2007). Nonprofits depend heavily on public trust and donor confidence, and fraud can undermine this trust, resulting in a decline in donor support (Newton, 2015). Research indicates that organizations facing fraud are more likely to experience a substantial reduction in donations, which can ultimately lead to operational shutdown (Petrovits, Shakespeare and Shih, 2010). Donor behavior is especially sensitive to fraud; even the mere perception of fraud can trigger a decrease in contributions (Bottan and Perez-Truglia, 2015; Burt, 2014).

Additionally, fraud can trigger legal and regulatory consequences. Nonprofits found guilty of fraudulent activities may face legal actions, fines, or the loss of tax-exempt status, further straining their financial situation and potentially leading to closure (Archambeault and Webber, 2018; Hager and Searing, 2014). Internal fraud cases also increase the likelihood of compliance violations, which can result in the loss of public funding or forced closure.

Fraud often leads to the demise of organizations (Archambeault and Webber, 2018). Despite the extensive body of research examining the causes of nonprofit demise, which includes organizational and socio-environmental factors, studies that explicitly link fraud to nonprofit closure remain relatively limited (Twombly, 2003). Most research has focused on factors such as financial mismanagement, leadership issues, and external pressures like changes in funding or regulation; however, the specific impact of fraud on nonprofit closure has not been sufficiently explored (Lu, Shon and Zhang, 2020; Mayer, 2022; Park, Shon and Lu, 2022). This gap in the literature is particularly noteworthy given the growing evidence that fraud significantly contributes to financial instability and reputational damage, both of which are critical drivers of nonprofit demise. Based on the discussion above,

the following hypotheses are proposed:

Hypothesis 1: Nonprofit organizations that experience significant fraud are more likely to face organizational demise during times of crisis.

2.3. Fraud triangle theory and nonprofit governance

The fraud triangle theory provides a theoretical framework for understanding the factors that contribute to the occurrence of fraud within organizations. It identifies three key elements that increase the likelihood of fraudulent behavior: pressure, opportunity, and rationalization (Cressey, 2017). Nonprofit organizations, like for-profit entities, are vulnerable to these factors, and understanding how governance structures influence these elements is critical in preventing fraud (Abu Khadra and Delen, 2020).

Pressure in nonprofit organizations often stems from financial difficulties, resource constraints, or the need to meet performance targets (Cressey, 2017). A decline in donations or a lack of funding for critical programs can create financial stress, particularly among staff and leadership. This pressure may tempt individuals to engage in unethical practices, such as embezzling funds or inflating financial reports to meet goals or expectations (Abdullahi and Mansor, 2015). Nonprofits can alleviate such pressures by establishing clear financial management policies and robust fundraising strategies (Chang and Tuckman, 1991). Transparent financial reporting and a diversified funding base can help reduce the financial strain on an organization (Harris, Petrovits and Yetman, 2015). By creating an environment in which financial performance is monitored and donors are kept informed, nonprofits can reduce the temptation to engage in fraudulent behavior due to financial stress.

The opportunity arises when there are gaps in internal controls, oversight, or financial systems (Cressey, 2017). Nonprofits often face resource limitations, which may lead to insufficient monitoring of financial transactions and inadequate segregation of duties. These weaknesses can allow individuals to misuse organizational assets or manipulate financial information (Harris, Petrovits and Yetman, 2015). To reduce opportunities for fraud, nonprofits must implement strong internal controls, such as regular independent audits, clear approval processes for financial transactions, and robust financial reporting systems. Clear policies on using organizational assets and a system of checks and balances will limit the potential for fraudulent behavior (Lamothe *et al.,* 2022). Nonprofits must also ensure that oversight mechanisms, such as independent audits or external reviews, are in place to identify and address potential weaknesses in their financial systems.

Rationalization occurs when individuals justify their fraudulent actions (Cressey, 2017). In nonprofit organizations, employees or executives may rationalize their behavior by telling themselves that they are helping the organization or that their actions are a temporary solution to financial difficulties. This mindset can enable fraudulent behavior to persist without the individuals feeling guilty or accountable. A strong ethical culture and clear policies are crucial in preventing rationalization. Nonprofits should cultivate a

culture of integrity and transparency, where all staff members know the consequences of fraudulent actions (Cornforth, 2012). By developing a code of ethics and providing regular training on ethical conduct, nonprofits can ensure that employees understand their responsibilities and are less likely to rationalize fraudulent actions. Furthermore, clear enforcement of ethical standards and an anonymous whistleblower system can provide employees with a safe way to report unethical behavior without fear of retaliation.

In the nonprofit sector, governance plays a crucial role in managing the fraud triangle factors – pressure, opportunity, and rationalization (Abu Khadra and Delen, 2020). Strong governance systems, including effective internal controls, transparency, and a culture of ethics, are essential for reducing the risk of fraud (Cornforth, 2012). When nonprofits actively address these three elements, they can prevent fraudulent activities, protect donor trust, and ensure the sustainability of their operations. Properly addressing the fraud triangle within nonprofit governance helps safeguard against financial loss and strengthens the organization's ability to fulfill its mission effectively and with integrity (Abu Khadra and Delen, 2020; Lamothe *et al*., 2022). By doing so, nonprofits can minimize the risk of failure due to fraud and foster long-term sustainability. Thus, the following hypothesis is proposed.

Hypothesis 2: Nonprofit organizations with effective governance structures are likely to face a lower risk of organizational failure due to fraud during crises.

3. Empirical methods

3.1. Data and sample

This study examines the connection between fraud reporting and organizational demise in nonprofits, focusing on governance. The analysis centers on U.S. nonprofit organizations that reported fraud between 2017 and 2019. Data for this study were collected from IRS Form 990, which serves as the primary source of public financial information for nonprofit organizations in the United States. The IRS provides these tax filings in XML file format, including detailed financial data, governance information, and disclosures about any fraud (IRS, 2024). Given the structured nature of this data, I employed a custom Python script to extract and analyze relevant information, facilitating a comprehensive assessment of fraud reports and their potential correlation with organizational demise.

To identify organizational demise, I used the IRS Automatic Revocation List, specifically referencing revocations recorded from 2020 through 2025 to capture post-reporting outcomes for the 2017–2019 fraud-reporting cohort. This list includes nonprofit organizations that have lost their tax-exempt status for failing to file tax returns for three consecutive years. By comparing the organizations reported for fraud with the Automatic Revocation List, we can determine whether they faced demise, as evidenced by the revocation of their tax-exempt status.

3.2. Measurements

3.2.1. Nonprofit fraud

The IRS requires nonprofit organizations to report significant asset diversion in Form 990 filings (IRS, 2024). The specific question about asset diversion in Part VI, Section A, Question 5 of Form 990 asks: 'Did the organization become aware during the year of a significant diversion of the organization's assets?'. This question is designed to capture instances of significant asset diversion, such as fraud, that may have occurred during the reporting year. When nonprofit organizations answer 'Yes' to this question, they acknowledge substantial fraud within the organization. Therefore, organizations that answer 'Yes' to this question are considered to have reported fraud for this study.

3.2.2. Nonprofit demise

The demise of a nonprofit organization refers to its closure, dissolution, or cessation of operations (Hager and Searing, 2014; Lu, Shon and Zhang, 2020). This demise can occur for various reasons, including financial difficulties, failure to achieve mission objectives, leadership challenges, or changes in the regulatory environment (Twombly, 2003). From an academic perspective, a nonprofit is considered to have 'demised' if it fails to submit the IRS Form 990 for three consecutive years (Lu, Shon and Zhang, 2020; Park, Shon and Lu, 2022). When a nonprofit organization experiences demise, it automatically loses its tax-exempt status. The loss of tax-exempt status is considered to have occurred two years before the organization lost its status (Lu, Shon and Zhang, 2020; Mayer, 2022; Park, Shon and Lu, 2022). For example, if an organization loses its tax-exempt status in 2024, it is deemed demised in 2022. In this study, examining the automatic revocation of tax-exempt status in 2024 allows for identifying nonprofit organizations that ceased operations by 2022.

3.2.3. Nonprofit governance

The IRS mandates nonprofit organizations report on their governance policies and systems through Form 990. These governance practices are categorized into internal, board, and external controls (Harris, Petrovits and Yetman, 2015).

Internal control practices include: (1) Form 990 Transparency: Providing the governing body with a complete copy of Form 990 prior to filing. (2) Conflict of Interest Policy: Implementing a written policy to address conflicts of interest. (3) Annual Disclosure of Conflicts: Requiring officers, directors, and key employees to disclose potential conflicts annually. (4) Policy Monitoring and Enforcement: Regularly monitoring and enforcing compliance with policies. (5) Whistleblower Policy: Establishing a written whistleblower policy. (6) Document Retention and Destruction Policy: Creating a policy for document retention and destruction. (7) Compensation Process for Key Individuals: Reviewing compensation for top executives with independent approval and comparability data. (8) Compensation Process for Other Key Employees: Similarly, compensation for other officers is reviewed and approved. These practices, documented in Part 6 of Form 990, reflect a well-structured internal governance system.

Another significant factor influencing governance, as highlighted in previous research, is the degree of board control. To measure this, the study incorporates two key control variables: board size and independence. Board size refers to the total number of members on the board. In contrast, board independence is the proportion of independent board members in their voting and decision-making processes. These factors are critical in evaluating the board's governance capacity, as larger boards may offer more diverse perspectives. In contrast, more independent members may mitigate conflicts of interest and enhance the organization's accountability (Boland *et al*., 2020).

On the other hand, external control practices focus on financial management and reporting, which include: (1) Independent Compilation or Review: Having financial statements compiled or reviewed by an independent accountant. (2) Independent Audit: Conducting audits of financial statements by an independent accountant. (3) Audit Oversight Committee: Establishing a committee responsible for overseeing the financial statement audit and selecting an independent accountant. These practices, detailed in Part 12 of Form 990, reflect transparency in financial management and signal accountability.

3.2.4. Explanatory variables

This study includes several organizational characteristics as control variables to better understand the demise of nonprofits. Organizational size and age are key factors, as larger and older organizations often have more resources, stability, and established reputations, making them less likely to close (Chang and Tuckman, 1991). Employee count reflects an organization's operational capacity; larger workforces typically provide greater oversight, reducing the risk of fraud and closure.

Financial indicators are also crucial. Government grants provide financial stability and external oversight, often reducing the risk of fraud and increasing nonprofit longevity (Chang and Tuckman, 1991; Trussel and Parsons, 2007). Donative dependence, or the extent to which an organization relies on donations, affects financial stability, as organizations dependent on donations may be more vulnerable to donor fluctuations (Lecy and Van Slyke, 2013). Lastly, the debt ratio measures financial health; nonprofits with high debt levels face greater financial pressures, especially during crises (Chang and Tuckman, 1991).

3.3. Analysis

To address the first research question concerning the demise of organizations that reported fraud, this study begins by analyzing IRS Form 990 data from 2017 to 2019 and extracting organizations that reported 'asset diversion'. Next, the extracted organizations are matched with the Automatic Revocation List to determine whether they ceased operations between 2020 and 2022. This allows us to identify whether organizations that reported fraud reached organizational demise within three years.

A logistic regression analysis is conducted to answer the second research question, which examines the influence of governance on the relationship between fraud reporting

and organizational demise. The dependent variable is binary: organizations that have ceased operations are coded 1, while those still operational are coded 0. This binary outcome facilitates the analysis of factors influencing the demise of nonprofits. The model examines how key independent variables, particularly governance factors and other organizational characteristics, affect the likelihood of organizational closure.

$$logit\ (P(Y=1)) = ln\ (\frac{P\ (Y=1)}{1-P(Y=1)}) = \beta_0 + \beta_1 \cdot X_1 + \beta_2 \cdot X_2 + \cdots + \beta_k \cdot X_k$$

where *P(Y=1)* is the probability of nonprofit demise, and the vector X represents the independent variables, which in this case would include factors such as governance (e.g., internal governance, external governance, board size, board independence), organizational size, age, employee count, and government grants.

Table 1: Descriptive statistics

Variable	Description	Source
Nonprofit Fraud	Did the organization become aware during the year of a significant diversion of the organization's assets?	IRS Form 990 Part VI Section A Q 5
Nonprofit Demise	Demise = 1, Survivor = 0	IRS Automatic Revocation List
Internal Governance	Sum of internal governance	IRS Form 990
• *Form 990 transparency*	Provide a complete copy of Form 990 to its governing body?	Part VI Section B Q11a
• *Conflict of interest policy*	Have a written conflict of interest policy?	Part VI Section B Q12a
• *Annual Disclosure of Conflicts*	Annually disclose interests that could give rise to conflicts of interest?	Part VI Section B Q12b
• *Policy Monitoring and Enforcement*	Regularly monitors and enforces compliance with its policies.	Part VI Section B Q12c
• *Whistleblower Policy*	Does the organization have a written policy for whistleblowing?	Part VI Section B Q13
• *Document Retention and Destruction*	Does the organization have a written policy for document retention and destruction?	Part VI Section B Q14
• *Compensation Process for CEO*	Top executive compensation approved	Part VI Section B Q15a
• *Compensation Process for Other*	Other key personnel compensation approved	Part VI Section B Q15b
Board Governance		IRS Form 990
• *Board Independence*	Total independent voting members/ Total voting members	Part I Q3, Q4
• *Board Size*	Total number of voting members	Part I Q3
External Governance	Sum of external governance	IRS Form 990
• *Independent Compilation or Review*	Financial statements compiled or reviewed by an independent accountant	Part XII Q2a
• *Independent Audit*	Financial statements audited by an independent accountant	Part XII Q2b
• *Audit Oversight Committee*	The organization has an audit committee	Part XII Q2c

Variable	Description	Source
Control Variables		IRS Form 990
• *Org Size*	Total net asset (logged)	
• *Org Age*	Age of the organization as of 2022	NCCS Core File
• *Employee*	Fundraising expense / Total expense	Part I Q5
• *Government Grant*	Government Grant > 0, 1 other 0	Part VIII Q1e
• *Donative Org.*	If Total contribution / Total revenue > 0.5, 1 other 0	Part I Q8
• *Debt Ratio*	Total liability / Total revenue	Part I Q21

Source: Author's own analysis

4. Findings

4.1. Nonprofit fraud and demise

The first research question of this study examines whether nonprofit organizations that report fraud are more likely to experience organizational demise. To address this question, the study analyzes nonprofit organizations that reported fraud between 2017 and 2019 and investigates their status over the subsequent three years. Specifically, 545 nonprofit organizations that reported fraud during this period were identified. By matching these organizations with the IRS Automatic Revocation List, which identifies organizations that lose their tax-exempt status for failing to file tax returns for three consecutive years, the study assesses whether these organizations experienced a decline in their status.

Table 2 revealed that 183 of the 545 fraud-reporting organizations (approximately 34%) experienced organizational demise within the following three years. This breakdown is as follows: 100 organizations ceased operations in the first year (2020), 49 organizations dissolved in the second year (2021), and 34 organizations shut down in the third year (2022). These findings suggest that fraud reporting significantly increases the likelihood of organizational demise, with a substantial proportion of these organizations ceasing to operate within a relatively short time frame.

To further understand the significance of these results, Table 2 compares the demise rate of fraud-reporting organizations with that of those that did not report fraud. According to the data, 272,478 nonprofit organizations did not report fraud during the same period. When these organizations were matched with the IRS Automatic Revocation List, it was found that only 11,604 organizations (approximately 4.3%) ceased operations by 2022. This contrasts sharply with the 34% demise rate observed among organizations that reported fraud, highlighting the significantly higher likelihood of demise for nonprofits that report fraud. These findings underscore the severe impact of fraud on nonprofit sustainability, suggesting that reporting fraud may not only result in immediate financial losses but also lead to long-term consequences, such as reputational damage and loss of donor support, ultimately increasing the likelihood of closure.

However, it is essential to recognize that relying on IRS Form 990 disclosures of 'asset diversion' presents significant measurement challenges. Research indicates that these disclosures capture only a fraction of actual fraud events (Archambeault, Webber and Greenlee, 2015). As a result, the 'no fraud' group in our dataset almost certainly includes many nonprofits that did experience fraud but chose not to disclose it. This contamination implies that our control group is not a pure 'fraud-free' comparison but rather a mixture of non-fraud and unreported-fraud cases. This bias likely dampens the true magnitude of the effect of fraud on organizational demise. Therefore, our estimates are best understood as conservative lower bounds of the reported fraud.

Table 2: Comparison of organizational demise rates between fraud-reported and non-fraud-reported nonprofits

	Demise (%)	Non-demise (%)	Total (%)
Fraud reported nonprofits	183* (34%)	363 (66%)	545 (100%)
Non-fraud reported nonprofits	11,604 (4.3%)	260,824 (95.7%)	272,428 (100%)

Note: * 100 (2020), 49 (2021), 34 (2022)

Source: Author's own analysis

Table 3 compares governance and organizational characteristics between nonprofits that reported fraud and those that did not. Fraud-reported organizations tend to have

Table 3: Comparison of governance and organizational characteristics between fraud-reported and non-fraud-reported nonprofits

Nonprofits	Demise (n=183)	Non-demise (n=362)	Total (n=545)
Internal Governance	5.60	6.00	5.79
• *Form 990 transparency*	0.79	0.75	0.76
• *Conflict of interest policy*	0.61	0.69	0.66
• *Annual Disclosure of Conflicts*	0.83	0.88	0.86
• *Policy Monitoring and Enforcement*	0.81	0.82	0.82
• *Whistleblower Policy*	0.46	0.48	0.48
• *Document Retention and Destruction*	0.50	0.52	0.52
• *Compensation Process for CEO*	0.42	0.55	0.50
• *Compensation Process for Other*	0.29	0.38	0.35
External Governance	2.05	2.06	2.06
• *Independent Compilation or Review*	0.16	0.11	0.13
• *Independent Audit*	0.31	0.47	0.42
• *Audit Oversight Committee*	0.81	0.83	0.83
Board Size	2.15	2.36	2.29
Board Independence	0.77	0.77	0.77
Org. Age (avg.)	28.0	33.4	31.70
Org. Size (avg.)	$ 455,411	$ 39,155,665	$ 26,160,901

Source: Author's own analysis

lower internal governance scores, smaller boards, and fewer governance policies, including those related to conflict of interest and whistleblower protection. External governance is similar across both groups, with nonprofits that report fraud being less likely to have independent audits. Fraud-reported nonprofits are also younger and smaller, with average assets significantly lower than those of non-fraud-reported organizations. These findings suggest that nonprofits reported for fraud generally have weaker governance and fewer resources.

4.2. Nonprofit fraud, demise, and governance

The second research question examines the impact of governance on the relationship between fraud reporting and the demise of nonprofit organizations. Table 4 represents the results of the logistic regression models examining the factors associated with nonprofit demise. Two models are analyzed: Model 1 focuses on the relationships between governance and nonprofit demise, while Model 2 incorporates additional organizational factors.

Both models show a significant negative association between internal governance and nonprofit demise. In Model 1, the coefficient for internal governance is -0.217 ($p < 0.01$), indicating that stronger internal governance is associated with a lower likelihood of organizational demise. The odds ratio of 0.805 further suggests that each unit increase in internal governance decreases the odds of demise by approximately 19.5%. Similarly, Model 2 yields a coefficient of -0.185 ($p < 0.01$) and an odds ratio of 0.831, reinforcing the protective effect of strong governance. This consistent finding across both models indicates that robust internal governance significantly reduces the risk of nonprofit closure.

The analysis of board-related variables provides mixed results. In Model 1, board size has a significant negative effect on nonprofit demise (coefficient = -0.512, $p < 0.01$), with an odds ratio of 0.599, indicating that larger boards are associated with a lower risk of organizational closure. Board independence, on the other hand, shows a positive association with nonprofit demise in both models. In Model 1, the coefficient for board independence is 0.543, and in Model 2, it increases to 0.799, with corresponding odds ratios of 1.721 and 2.223. These findings suggest that more independent boards may be associated with a higher likelihood of nonprofit demise. However, the relationship is not immediately intuitive and may warrant further investigation into the role of board independence in nonprofit governance.

The impact of external governance on nonprofit demise appears less clear. In Model 1, the coefficient for external governance is positive (0.271), but it is not statistically significant. Similarly, Model 2 shows a coefficient of 0.607, with an odds ratio of 1.835, but it does not reach statistical significance. These results suggest that, in contrast to internal governance, external governance may not be a strong predictor of organizational demise in this sample of nonprofits.

Additional organizational factors, introduced in Model 2, provide further insights. Organizational size, measured by total assets, is strongly negatively associated with nonprofit demise (coefficient = -0.390, $p < 0.001$, odds ratio = 0.677). This indicates that larger organizations are less likely to experience closure. Organizational age is not significantly related to demise (coefficient = 0.016), suggesting that older organizations are not necessarily more

resilient to closure. The number of employees does not show a significant effect (coefficient = 0.087). However, government grants are significantly associated with a reduced risk of demise (coefficient = -0.826, $p < 0.05$, odds ratio = 0.438), suggesting that organizations receiving government funding may be better positioned to avoid closure. Regarding financial health, the debt ratio does not appear to significantly impact nonprofit demise, with an odds ratio of 2.276, but a high standard error suggests instability in this predictor's estimate. Finally, donor-dependent organizations, which rely heavily on donations, are not significantly associated with nonprofit closure in either model (coefficient = -0.195), indicating that reliance on donations alone does not influence the likelihood of demise.

Table 4: Logistic regression results: Factors influencing nonprofit demise

Nonprofit Demise	Model 1		Model 2	
	Coef.	Odds ratio	Coef.	Odds ratio
Internal Governance	-0.217**	0.805**	-0.185**	0.831**
	(0.086)	(0.069)	(0.110)	(0.091)
External Governance	0.271	1.311	0.607	1.835
	(0.245)	(0.321)	(0.331)	(0.607)
Board Independence	0.543	1.721	0.799	2.223
	(0.392)	(0.674)	(0.516)	(1.148)
Board Size	-0.512**	0.599**	-0.427**	0.652**
	(0.203)	(0.121)	(0.278)	(0.181)
Org. Size			-0.390***	0.677***
			(0.136)	(0.092)
Org. Age			0.016	1.017
			(0.011)	(0.011)
Employee			0.087	1.091
			(0.160)	(0.174)
Government Grant			-0.826*	0.438*
			(0.457)	(0.200)
Donative Organization			-0.195	0.823
			(0.459)	(0.378)
Debt Ratio			0.822	2.276
			(0.700)	(1.593)
Constant	0.536	1.709	4.276**	71.928**
	(0.706)	(1.206)	(1.671)	(120.188)
LR $\chi 2$ (df)	13.89		32.92	
Log likelihood	-124.46		-85.33	
Pseudo-R^2	0.053		0.162	
Observations	545	545	545	545

Note: *** p<0.01, ** p<0.05, * p<0.1

Source: Author's own analysis

Since an aggregated index assumes all governance practices have equal weight, which can hide the effects of specific mechanisms, I conducted a disaggregated analysis to examine each governance component separately. Table 5 displays these results, providing more detailed insights into how individual governance practices influence outcomes. The findings show that not all internal controls impact an organization's survival equally. Specifically, having a formal conflict of interest policy and an independent process for reviewing CEO compensation significantly reduces the risk of organizational failure (see Table 5, Conflict of Interest Policy; Compensation Process for CEO), emphasizing their importance as high-impact governance tools. Conversely, procedural transparency measures, such as

Table 5. Logistic regression results: Specific factors influencing nonprofit demise

Nonprofit Demise	Model 1.		Model 2.	
	Coef.	Odds ratio	Coef.	Odds ratio
Internal Governance				
Form 990 transparency	1.528**	4.610**	2.134**	8.445**
	(0.636)	(2.935)	(0.992)	(8.376)
Conflict of interest policy	-1.751***	0.174***	-4.609***	0.010***
	(0.951)	(0.165)	(1.721)	(0.017)
Annual Disclosure of Conflicts	-0.811	0.445	-0.895	0.409
	(0.600)	(0.266)	(0.894)	(0.365)
Policy Monitoring and Enforcement	0.885	2.423	1.279	3.594
	(0.652)	(1.580)	(0.953)	(3.425)
Whistleblower Policy	-0.348	0.706	-0.314	0.730
	(0.551)	(0.389)	(0.697)	(0.509)
Document Retention and Destruction	0.353	1.424	0.640	1.896
	(0.533)	(0.759)	(0.645)	(1.222)
Compensation Process for CEO	-0.510*	0.600*	-0.052*	0.349*
	(0.434)	(0.260)	(0.621)	(0.217)
Compensation Process for Other	-0.300	0.740	0.363	1.438
	(0.391)	(0.289)	(0.520)	(0.748)
External Governance				
Independent Compilation or Review	0.993*	2.699*	0.526*	1.692*
	(0.551)	(1.486)	(0.883)	(1.494)
Independent Audit	0.338	1.402	0.829	2.292
	(0.608)	(0.852)	(0.989)	(2.266)
Audit Oversight Committee	0.271	1.311	1.402	4.064
	(0.480)	(0.629)	(0.729)	(2.961)
Board Independence			1.031*	2.804*
			(0.584)	(1.638)
Board Size			-0.380	0.684
			(0.315)	(0.215)
Org. Size			-0.519***	0.595***
			(0.151)	(0.090)

Nonprofit Demise	Model 1.		Model 2.	
	Coef.	Odds ratio	Coef.	Odds ratio
Org. Age			0.013	1.014
			(0.011)	(0.011)
Employee			0.129	1.138
			(0.169)	(0.193)
Government Grant			-0.879*	0.415*
			(0.495)	(0.205)
Donative Organization			-0.227	0.797
			(0.528)	(0.421)
Debt Ratio			1.146	3.146
			(0.829)	(2.607)
Constant	-1.003	0.367	6.401***	602.63***
	(0.831)	(0.305)	(2.190)	(1319.96)
LR $\chi 2$ (df)	22.46 (11)	22.46 (11)	52.40 (19)	52.40 (19)
Log likelihood	-126.70	-126.70	-77.27	-77.27
Pseudo-R^2	0.081	0.081	0.253	0.253
Observations	545	545	545	545

Note: *** p<0.01, ** p<0.05, * p<0.1

Source: Author's own analysis

providing the governing body with a copy of Form 990 or relying on independent compilations or reviews of financial statements, are linked with a higher risk of closure (see Table 5, Form 990 transparency; Independent Compilation or Review). These results suggest that symbolic compliance measures may offer limited protection and, in some cases, could create unintended vulnerabilities.

Board-level characteristics also reveal complex patterns. While larger boards generally strengthen resilience, board independence was unexpectedly associated with a greater risk of demise. This result challenges conventional governance theory and is more consistent with a contingency perspective: in times of crisis, independent directors may lack embedded resource ties or prioritize stricter compliance and risk-avoidance strategies, which can accelerate closure decisions. Taken together, these findings highlight that governance mechanisms are not uniformly beneficial; their effectiveness depends on both the substance of specific practices and the organizational context in which they operate.

5. Discussion and conclusion

This study investigated how fraud reporting and governance structures affect the likelihood of nonprofit failure during crisis periods, including the COVID-19 pandemic. The analysis reveals that organizations reporting fraud were significantly more likely to close

(34%) compared to those not reporting fraud (4.3%). At the same time, strong internal governance systems – particularly comprehensive internal controls – were consistently associated with a lower risk of failure, emphasizing the protective role of good governance. Larger boards also decreased the odds of closure, indicating that board size can provide resilience during crises. Conversely, a higher proportion of independent board members was linked to an increased likelihood of failure, a finding that challenges traditional governance assumptions and calls for further investigation. Additionally, financial factors such as organizational size and receipt of government grants enhanced survival prospects, highlighting the importance of resource endowments for organizational resilience.

These findings deepen our understanding of various governance and organizational theories. Resource dependency theory is supported by evidence that larger boards enhance survival chances by offering diverse expertise, wider fundraising networks, and better oversight capabilities. During crises, these resources appear to outweigh the agility benefits of smaller boards. The findings also support the fraud triangle framework: organizations with stronger internal controls reduce opportunities for fraud, thereby increasing resilience after an incident. At the same time, the strong link between fraud and failure demonstrates how financial pressures and reputational damage (the 'pressure' dimension) increase organizational vulnerability. Lastly, the surprising connection between board independence and higher failure risk underscores the importance of the contingency theory of governance. While independence can improve monitoring in stable environments, in crises, it may weaken embedded resource ties and result in more aggressive loss-cutting decisions, raising the risk of closure. Overall, these insights show that the effectiveness of governance mechanisms depends on organizational context and environmental shocks.

Our dependence on self-reported fraud data, however, carries an important caveat. Form 990 disclosures likely underestimate the true extent of fraud due to reputational, legal, and donor-related disincentives to report such incidents. Prior research shows that only a small fraction of organizations experiencing fraud report asset diversions on their filings (Archambeault, Webber and Greenlee, 2015). This underreporting directly affects how we interpret our findings: the 'no fraud' group in our dataset almost certainly includes organizations that committed fraud but did not disclose it. Importantly, this contamination biases our estimates in a conservative manner, since unreported fraud cases artificially raise the control group's demise rate. Thus, the observed 7–8 times higher risk of demise among fraud-reporting organizations is probably a lower-bound estimate of the actual impact. Although self-reported Form 990 data are imperfect, they remain one of the few systematic and comprehensive sources available and are widely used in past nonprofit fraud research.

Additionally, our research design rests on features that are unusually specific to the U.S. reporting environment. IRS Form 990 – most notably Part VI, 'Governance' – can be linked to the IRS Automatic Revocation List, which records an administratively imposed termination after three consecutive non-filings. That pairing allows governance-relevant disclosures to be aligned with an externally administered endpoint within a single,

linkable microdata system. Roughly comparable regimes exist elsewhere, but they differ in scope, linkability, and materiality triggers. In the United Kingdom, for example, the Charity Commission's Annual Return and Serious Incident reporting provide event-level transparency, yet there is no unified public micro-dataset that both standardizes fraud-type disclosures at a fixed threshold and ties them directly to deregistration in the way the U.S. revocation process does. Canada (T3010 filings and revocation lists), Australia (ACNC Annual Information Statements and enforcement notices), and New Zealand (Charities Services registers) also publish rich information; however, audit requirements are typically revenue-threshold based, governance policy disclosures (e.g., whistleblower, conflict-of-interest, compensation review) are less uniformly reported, and fraud items are not consistently captured in a binary, materiality-screened format.

These institutional differences have two implications. First, our U.S. 'demise' proxy – automatic revocation after three consecutive non-filings – has no exact analogue in settings where removal from a register may reflect mergers, voluntary wind-ups, or broader compliance actions. Replication will therefore require careful mapping of local exit codes to isolate compliance-driven terminations and sensitivity checks across alternative outcome definitions. Second, while we expect the direction of governance effects to travel (stronger internal controls generally accompany greater resilience), magnitudes are likely to vary with oversight intensity, disclosure design, and data accessibility. A pragmatic reading is thus appropriate: the mechanisms we document – namely, that stronger internal controls tend to accompany greater organizational resilience – are likely to generalize in direction but not necessarily in size. For research outside the U.S., a disciplined approach is to (1) define 'fraud/asset diversion' and 'demise' with jurisdiction-specific coding rules, (2) report sensitivity analyses across plausible outcome definitions (e.g., excluding mergers/voluntary wind-ups), and (3) document non-equivalences in reporting items and materiality thresholds. Framed this way, the U.S. case serves as a benchmark for mechanism testing, while comparative studies can identify which regulatory ingredients – standardized disclosures, linkable registers, or enforcement posture – most strongly moderate governance–resilience relationships.

In conclusion, the evidence positions governance not as a compliance box but as a core survival strategy. Boards should prioritize high-impact internal controls that both prevent fraud and mitigate its consequences. A pragmatic implementation checklist is: (1) segregation of duties, ensuring no single individual controls authorization, custody, and recordkeeping; (2) adopt and publicly communicate a whistleblower policy to encourage early detection; (3) conduct regular independent audits with an explicit fraud-risk and governance review; (4) optimize board composition by balancing independence with embedded resources – recruiting formally independent members who also bring sector expertise and donor/policy networks; and (5) establish crisis-ready finance/audit committees that can act quickly while maintaining oversight. Implemented as a bundle, these practices reinforce accountability, sustain donor trust, and build resilience to financial and reputational shocks.

Building on these practical implications, our results also underscore that the impact of fraud is mediated by governance design. Larger boards and stronger internal controls emerge as consistent protective factors, whereas the unexpected association between independence and higher failure risk highlights the need for context-aware governance – what works in stable periods may not hold in crises. Accordingly, governance should be managed as a strategic asset: tracked with clear targets (e.g., duty-segregation coverage, whistleblower uptake, audit timeliness) and periodically stress-tested against crisis scenarios. Future research should triangulate Form 990 with press reports, litigation records, administrative enforcement data, and surveys to detect under-reported fraud, and examine how governance mechanisms interact with institutional context (regulatory intensity, disclosure design, funding mix) to shape nonprofit longevity.

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Appendices

A. Correlation matrix

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1) Org. Demise	1.000										
(2) Internal Governance	-0.044	1.000									
(3) External Governance	-0.010	0.393***	1.000								
(4) Board Independence	0.006	0.046	0.042	1.000							
(5) Board Size	-0.114***	0.140***	0.177***	0.122***	1.000						
(6) Org. Size	-0.241***	0.384***	0.374***	-0.027	0.252***	1.000					
(7) Org. Age	-0.023	0.097*	0.133**	0.000	0.331***	0.369***	1.000				
(8) Employee	-0.179***	0.401***	0.441***	-0.040	0.229***	0.761***	0.378***	1.000			
(9) Government Grant	-0.140***	0.219***	0.338***	0.065	0.138***	0.284***	0.091**	0.431***	1.000		
(10) Donative Org.	-0.023	-0.063	-0.073	-0.055	-0.095**	-0.201***	-0.222***	-0.243***	-0.153***	1.000	
(11) Debt Ratio	0.020	0.158***	0.191***	-0.038	0.015	0.385***	0.145***	0.231***	0.109**	-0.050	1.000

Note: *** $p<0.01$, ** $p<0.05$, * $p<0.1$

B. Descriptive statistics

Variable	Obs.	Mean	S.D.	Min	Max
Org. Demise	545	0.34	0.47	0	1
Internal Governance	545	5.79	2.11	0	8
– Form 990 transparency	545	0.76	0.43	0	1
– Conflict of interest policy	545	0.66	0.47	0	1
– Annual Disclosure of Conflicts	545	0.86	0.34	0	1
– Policy Monitoring and Enforcement	545	0.82	0.38	0	1
– Whistleblower Policy	545	0.48	0.50	0	1
– Document Retention and Destruction	545	0.52	0.50	0	1
– Compensation Process for CEO	545	0.50	0.50	0	1
– Compensation Process for Other	545	0.35	0.48	0	1
External Governance	545	2.07	0.73	0	3
– Independent Compilation or Review	545	0.13	0.33	0	1
– Independent Audit	545	0.42	0.49	0	1
– Audit Oversight Committee	545	0.83	0.38	0	1
Board Independence	545	0.77	0.42	0	1
Board Size (logged)	545	2.29	0.87	0	6.91
Org. Size (logged)	545	13.97	2.76	6.56	24.69
Org. Age	545	31.02	21.98	0	93
Employee	545	3.20	2.22	0	11.38
Government Grant	545	0.27	0.45	0	1
Donative Org.	545	0.35	0.48	0	1
Debt Ratio	545	0.28	0.36	0	1