THE EFFECT OF COMMUNITY SOCIAL CAPITAL ON NON-PROFITS' GOVERNANCE AND DISCLOSURE QUALITY

by

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ABSTRACT

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Social capital is critical to the entities' disciplinary environment and the ability to produce high quality financial reports. Although prior literature on for-profit setting indicates that social capital impacts both governance (Ferris, et al., 2017) and financial reporting quality (Jha & Chen, 2015; Jha, 2019), this area has received less attention in non-profit literature. The purpose of this dissertation is to examine the impact of the social capital of a non-profit organization's (NPO) headquarter area (also known as community social capital) on the NPO governance and disclosure quality (i.e., the quality of Form 990).

The study hypothesizes and finds that the community social capital of an NPO headquarter area has a positive impact on its governance. The positive relationship suggests that NPO social capital and governance play a complementary role, where managers in high social capital face strong disciplinary environment and enjoy strong social connections and professional reputations and thus have fewer incentives to resist

the adoption of sound governance practices. Similarly, the study also hypothesizes and finds that the community social capital of an NPO headquarter area has a positive impact on its disclosure quality. This finding suggests that community social capital disciplines NPO self-interested managers' behavior to manipulate financial numbers in Form 990 disclosures.

My results are consistent with the social norms (Kohlberg, 1984) and structural theories (Bourdieu, 1989; Lin, 1999; Payne, et al., 2011) of social capital in that both norms and networks components of social capital discipline self-interested managers' behavior. The disciplinary forces from the community social capital complements internal governance. In addition, these disciplinary forces reduce the managerial self-interested motives to manipulate financial numbers in Form 990, and thus increase the quality of Form 990 disclosures (i.e., disclosure quality). This study complements and extends prior literature on NPO governance and disclosure quality. Finally, my paper also contributes to the research examining the effect of community social capital on entities' corporate policies. Overall, my study has implications to sound governance (Farazmand, 2012, 2017), agency (Jensen & Meckling 1976; Fama, 1980) and social capital (Putnam, 1993, 1995) theories.

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CHAPTER 1: INTRODUCTION

Social capital defined as the social networks that foster norms conducive behavior and constrains norm-deviant behavior (Fukuyama, 1997; Portes, 1998; Putnam, 2001) has been shown to impact societal (Brooks, 2005) and organizational behavior (Jha & Chen, 2015; Ferris, et al., 2017; Gupta, et al., 2018). The social capital of an area where the entity is located- is critical to the entity's disciplinary environment and the ability to produce high quality financial reports. Although prior research on for-profit literature indicates that social capital impacts both governance (Ferris, et al., 2017) and financial reporting quality (Jha & Chen, 2015; Bhandari et al., 2018), this area has received less attention in non-profit literature (hereafter, this study uses NPO to denote non-profit/non-profit's/non-profit organization/non-profit organization's). This study fills the void in the NPO literature by exploring the impact of social capital on NPO governance and disclosure quality (i.e., the quality of Form 990). [1]

[1] Based on Agency theory (Jensen & Meckling, 1976; Fama, 1980; Fama & Jensen, 1983), it can be argued that NPO managers are agents whose interest is to maximize their salaries, career prospect, and job security. Whereas the other stakeholders of NPOs (e.g. IRS, donors, grant-makers, regulators, creditors, watchdog agencies, and media) are the principals who want NPOs to maximize spending on charitable purposes and to be truthful about their financial reporting in Form 990. Governance studies in non-profit setting argue that NPO governance mechanisms such as appointing the independent board of directors, adopting a conflict of interest, whistleblower protection and document retention polices and having an independent financial audit provide proper monitoring to management and help align the interests of the NPO managers and other stakeholders (Yetman & Yetman, 2013).

The purpose of this dissertation is to examine the impact of the social capital of an NPO headquarter area (also known as community social capital) on its governance and disclosure quality (i.e., the quality of Form 990). The importance of above-stated questions originates from the contemporary community social capital research that treats social capital as a useful tool for business ethics and public administration (Spence, et al., 2003; Bhandari & Kohlbeck, 2018; Subedi & Farazmand, 2019) and examines how the community social capital of firm-headquarter area affects corporate policies and managerial practices (Gregory, 1999; Brooks, 2005; Saxton & Benson, 2005; Shim & Eom, 2009; Henry, et al., 2011; Jha & Chen, 2015; Subedi & Farazmand, 2019; Jha, 2019). The seminal work in social capital defines community social capital as dense networks over a long period that foster norms conducive behavior in society (Fukuyama, 1997; Portes,1998; Putnam, 2001). The predominant view that emerges from the prior studies in social capital is that community social capital, captured by shared common beliefs (i.e., social norms) and dense networks in a community, constrains norm-deviant behaviors and provides reputational capital (e.g., Lu, et al., 2016; Hasan, et al., 2017).

Consistent with the social norms theory (Kohlberg, 1984) and structural theorist view of social capital (Bourdieu, 1989; Lin, 1999; Payne, et al., 2011), this study argues that community social capital disciplines self-interested managers' behavior (e.g. Jha, 2019) and also provides reputational capital (Bhandari, et al., 2018) to these managers. Thus, managers in high community social capital NPOs have fewer incentives to behave entrenched and to resist the adoption of sound governance practices. Thus, the study predicts that community social capital has a positive association with NPO governance.

Alternatively, there is a possibility that community social capital may play a substitutive role in that it may replace the need for an NPO's investment in governance such as appointing a large number of independent directors, adopting whistleblower protection policy and hiring an independent external auditor. More specifically, if the disciplinary forces from the community social capital are suffice to organizational governance needs, then NPOs with high community social capital may need to invest less on internal monitoring mechanisms. Considering this substitutive role of community social capital, this study predicts a negative relationship between community social capital and NPO governance. Overall, the relationship between NPO community social capital and governance is an empirical question which this study seeks to investigate.

In line with the social norms theory (Kohlberg, 1984) and structural theorist view of social capital (Bourdieu, 1989; Lin, 1999; Payne, et al., 2011), the study argues that since managers in high community social capital NPOs are more disciplined and have higher reputational capital at stake, these managers are more likely to provide truthful disclosures.[2] Taken these arguments together, this study predicts that NPOs in high community social capital provide higher disclosure quality than NPOs in low community social capital.

To test the predictions, the study collects community social capital data at the US county-level from Rupasingha et al. (2006). The study includes all NPOs that file Form

[2] High social capital regions not only heighten the risk of reputation loss but also include several disciplinary instruments such as guilt, social isolation, gossip, and condescending stares from the members in the society (Bourdieu, 1986, 1989; Bourdieu & Wacquant 1992; Lin, 1999; Payne, et al., 2011; Javakhadze, et al., 2016; Bhandari, et al., 2018).

990 in the US. The study excludes religious NPOs because most religious NPOs are not required to file a Form 990. The study also excludes observations before 2013 for two reasons. First, Amazon Web Services (AWS), the main source of data used in this study, started collecting form 990 information starting year 2013. Second, Form 990 underwent significant changes in the year 2008 and it took a few years for all non-profits to disclose data consistent with the changes of Form 990.

The study uses six measures of NPO governance: *BoardSize* which is an indicator variable equal to 1 when the NPO board has more than five members but less than sixteen, and 0 otherwise; *BoardIndep* which is the number of independent directors divided by the total number of directors in the NPO board; *BoardReview* which equal to 1 if the NPO reports that it provided copies of the IRS 990 to the board before filing the form 990 with the IRS, and 0 otherwise; *BoardAuditCom* which equal to 1 if the NPO reports having an audit committee, and 0 otherwise; *AuditIndep* which equal to 1 if the NPO had its financial statements audited by an independent auditor, and 0 otherwise; *WrittenPolicy* which captures whether the NPO adopts written policies regarding conflict of interest, whistleblower protections, and document retention/destruction.[3]

This study uses four measures of NPO disclosure quality which proxy for NPO managers' propensity to inflate/manipulate charitable expenses. NPO managers have the incentive to manipulate and inflate charitable expenses because a high level of charitable expenses has been shown to be associated with more donations, increased compensation and job security of managers (Krishnan, et al., 2006; Keating, et al., 2008; Stewart &

[3] Section 3.2 explains the detailed construction of these governance measures. The summary definition of each of these governance attributes is provided in Appendix 1.

Diebold, 2017). Prior NPO literature documents that NPO managers inflate charitable expenses by understating fundraising and/or administrative expenses and misallocating these expenses as charitable expenses (Krishnan & Yetman, 2011; Yetman & Yetman, 2012). Following these prior studies, this study constructs four measure of NPO disclosure quality: *DQ1*, *DQ2*, *DQ3* and *DQ4*.[4]

The study follows Alexander and Weiner (1998), Brown (2005) and Blackwood et al. (2014) to construct a governance model which controls for NPO size, age, performance liquidity, industry and year. Similarly, the study follows Yetman & Yetman (2012) to construct a disclosure quality model which controls for NPO size, age, donation intensity, donation growth, liquidity, industry and year. Afterwards, the study utilizes multivariate analyses to test the expected relationships. To minimize the impact of invariant year and industry characteristics, all regression models include year and industry fixed effects and has robust standard errors.

Consistent with the first hypothesis (H1a), the study finds that the community social capital of an NPO has a positive and statistically significant association with its governance. The positive relationship indicates that NPO community social capital plays a complementary role to enhance the NPO governance. This finding suggests that NPO managers in high community social capital face social disciplinary forces and enjoy strong social connections and professional reputations and thus have fewer incentives to resist the adoption of sound governance practice. Alternatively, the second hypothesis

[4] The construction of these four disclosure quality measures is explained in the research design section 3.3. The summary definition of each of the four disclosure quality measures is provided in Appendix 1.

(H1b) predicts that the community social capital of an NPO has a negative association with the NPO governance. The study does not support this hypothesis and fails to confirm that the value relevance of community social capital is higher for NPOs with weak governance because the external disciplinary mechanisms provided by social capital substitute the need for internal investment on governance. Similarly, the third hypothesis (H2) predicts and finds that the community social capital of an NPO has a positive association with its disclosure quality. This finding suggests that community social capital disciplines NPO self-interested managers' behavior to manipulate financial numbers in Form 990 disclosures.

This study has several contributions to the literature. First, the study extends and complements the literature investigating the effects of various firm-specific factors affecting non-profit governance and disclosure quality (Cleverley, 1990; Farazmand, 2004; Farazmand, 2006; Van Puyvelde, et al., 2012; Cardinaels & Soderstrom, 2013; Dang & Owens, 2016). This study examines a critical but previously unaccounted firm-level qualitative characteristic, community social capital, and investigates whether it has a statistically and economically significant association with NPO governance and disclosure quality.

Second, this study also contributes to the new public administration research[5] (Helliwell, 2006; Farazmand, 2017; Subedi & Farazmand, 2020) in that Farazmand

[5] Similalry Helliwell (2006) points out the importance of social capital to understand and shape public policies and encourages public administration researchers to study more about social capital. More specifically, Helliwell (2006) argue that connections provide access to resources and control within the network and the individuals holding important network positions are able to drive their agendas in making public policy.

(2006, p.132) points out that while old public administration generally included only those working in the government agencies, the new multi-sectored public administration also encompasses non-profit communities. Since the primary purpose of the non-profit sector is to serve the public, non-profit research has become an important aspect of public administration research. This paper also responds to Farazmand's (2012, 2017) call for the governance-citizen relationship. More specifically, this study examines whether the societal relationships and networks with NPO has an impact on NPO governance and thus respond to Farazamnd's (2012, 2017) call for "sound governance" by engaging citizens in governance. Addtionally, Farazmand (2002) and Spence (2003) also discuss the importance of society for organizational ethics.[6]

Third, this paper contributes to the literature examining the effect of community social capital on organizational policies. To my knowledge, this is the first study that attempts to link an NPO social capital to its governance and disclosure quality. Gregory (1999), Brooks (2005), Saxton & Benson (2005), Jha & Cox (2015), Jha & Chen (2015), Cui et al. (2017), Hasan et al. (2017), Gupta et al. (2018) and Jha (2019) are the closest works to this study in this area. Gregory (1999) emphasizes that the concept of social capital is directly relevant to the task of bulilding and sustaining the ethical infrastructure of the public service. Saxton and Benson (2005) find that the social capital dimensions have a significant impact on county-level non-profit foundings. Similarly, Subedi and Farazmand (2019) provide evidence that the county level social capital is positively

[6] Farazmand (2002) argues that current public services should involve citizens in order to address the concern for accountability and ethics in public service. Farazmand (2009) highlights the importance of society and citizens for building a new administrative capacity.

associated with the growth of the non-profit sector in the county. Brooks (2005) finds that the community social capital enhances charitable giving behavior of the people residing in the community. Gupta et al. (2018) find that the community social capital of US state where a firm is headquartered is positively associated with the firm's valuation. Jha and Cox (2015) provide evidence that firms located in high community social capital counties practice more socially responsible activities.

Finally, this study has potential implications to practitioners and policies in that the results of this study can help auditors, regulators, donors, creditors, and other stakeholders of the NPOs. Since NPOs headquartered in high community social capital receive added disciplinary forces from the society and provide high disclosure quality, stakeholders such as auditors, regulators, donors and creditors may collect soft information about these NPOs trustworthiness and reputation. More specifically, the IRS may use community social capital as one of the factors that reduces the risk threshold for an NPO to be selected for a review of its returns.[7] Similarly, independent auditors may use NPO community social capital as a factor that reduces audit risk.[8] This practice not only saves government audit costs (i.e., IRS and local government audit costs for

[7] The IRS conducts two types of audits: Field Audit and Correspondence Audit (IRS 2019). The IRS agent actually visits the organization's premises for a field audit, whereas the IRS simply asks the organization to deliver documents to an IRS by mail for a correspondence audit.

[8] Prior studies in audit literature define audit risk as the risk that an auditor expresses a clean opinion when the financial statements are materially misstated and establish that high audit risks lead to auditors charging higher audit fees (Davis, et al., 1993; Bhandari, et al., 2018). When audit risk increases, the auditors are likely to exert greater audit effort to audit the clients' financial statements and, therefore charge higher audit fees to the clients (Radhakrishnan, 1999). If an auditor has a non-profit client which is headquartered in a high community social capital, the auditor, based on the findings of this study, may assess low audit risk and charge lower audit fees to the non-profit client.

reviewing NPOs Form 990) but also saves costs to the individual NPOs (i.e., audit fees paid to the independent auditors).[9]

Following this introduction, in Chapter 2, this study discusses prior literature relating to social capital, governance and disclosure quality and formulates the hypotheses. Chapter 3 discusses various proxies of the dependent and independent variables of interest and presents the research models to predict NPO governance and disclosure quality. Chapter 4 discusses the sample and results. Chapter 5 concludes with the findings and limitations of the study.

[9] Although there is no general requirement for NPOs to have an independent audit, many undergo audits voluntarily to attract funding and donations (Yetman & Yetman, 2012). However, NPOs that spend more than $750,000 in federal funds in a year are required to have an independent financial audit (National Council of Non-profits 2020). Similarly, many state and local governments request a copy of NPO audited financial statements when they register with the state for charitable fundraising purposes (National Council of Non-profits 2020). Sometimes banks may request an NPO to have an independent audit as a condition to receive a loan.

CHAPTER 2: LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Social Capital

Putnam (1993, 1995) is credited for simplifying and popularizing the concept of social capital. The author defines social capital as the features of social organizations such as social networks, social interactions, norms, and social trust that facilitate coordination and co-operation for mutual benefit. Woolcock (1998) further simplified the definition of social capital as the benefits linked to norms and networks among relationships.

In public administration research, Gregory (1999) argues that social capital is vital to the task of building and sustaining ethical infrastructure of public service. Subedi and Farazmand (2019) find that high social capital areas attract a larger number of NPOs. Their study suggests that community social capital is beneficial for NPOs because it increases the opportunity of volunteering and civic engagement. Schneider (2009) and Onder (2011) acknowledges the importance of social capital for NPOs survival and growth. Similalry, plenty of other research in public administration such as Erridge and Greer (2002), Brewer (2003), Henry, et al. (2011), Ganapati (2012), Andrews (2012), Bakiev & Kapucu (2012), and Andrews (2017) acknowledge the importance of social capital in public services and policies.

Javakhadze et al. (2016) aggregate the literature discussing social capital into two broad groups: cognitive and structural. Cognitive theories put forward by the collective

asset view of Putnam (1993) and the rational-choice theory of Coleman (1988) describe social capital as the control benefits provided by norms, values, attitudes, and beliefs in the social networks. Structural theories proposed by Bourdieu and Wacquant (1992) and Bourdieu (1986, 1989) and later expanded by Lin (1999) view social capital as the networks where the size of the networks represents reputational capital (Javakhadze, et al., 2016; Bhandari, et al., 2018). More specifically, the larger the network size of the individual's network, the higher the individual's reputational capital. Overall, although there have been numerous definitions of social capital (Coleman, 1988; Putnam, 1993, 1995; Fukuyama, 1995; Woolcock, 1998), it generally includes the norms and networks components which provide control (i.e., disciplinary) and reputational benefits to the networks' participants. The study further elaborates about the norms and networks below.

2.2 Social Capital as Norms and Networks

Some theorists view social capital from the perspective of social norms theory (Kohlberg, 1984) and relate social capital to norms, values, attitudes, and beliefs expected in a social group (Portes, 1998; Putnam, 1993). Consistent with this view, community social capital encourages morally acceptable behavior in the society and has implications for the organizations headquartered in the community in that it sets high ethical standards for the organizations (Pastoriza, et al., 2008; Jha & Cox, 2015; Jha, 2019; Subedi & Farazmand, 2019). Consistent with this view, Subedi & Farazmand (2019) suggest that NPOs headquartered in the high social capital counties attract a higher level of volunteerism. Jha & Cox (2015) find that firms in high community social capital practice a higher level of socially responsible activities. Similarly, Jha & Chen (2015) and Jha (2019) suggest that firms in high community social capital hold higher ethical standards.

Second, some theorists view social capital from the perspective of structural theory (e.g., Bourdieu, 1986, 1989; Bourdieu & Wacquant, 1992; Lin, 1999; Payne, et al., 2011) which focuses on the size of the network and argues that the large and dense networks in high social capital proxy for managerial reputational capital (Javakhadze, et al., 2016; Bhandari, et al., 2018). The large and dense network in a high social capital area may proxy for the network participants' reputations because the network participants in the high social capital area have a larger number of friends/connections/relationships to lose in the event of any breach of the public trust. In addition, information transfers quickly in such networks. All in all, high social capital heightens the loss of reputational capital because a network participant who violates public trust has to lose a larger number of friends (i.e., have a high reputational capital at stake) and also because the network size enables the quick transfer of any bad information related to the network participant. In regards to the public administration, Farazmand (1996, p.86) points out social capital as one of the structural forces that explain the growth of the public enterprises. Similarly, Liu (2015) finds that familiar relationships/connections among actors in the bond underwriting process play an important role in lowering the costs of borrowing. The study suggests that relationships among network participants help reduce information asymmetry.

Overall, the predominant view that emerges from both the norms and networks view of social capital is that community social capital, captured by shared common beliefs (i.e., social norms) and dense associational network in a community, encourages ethical behavior, facilitates quick information transfer and provides reputational capital to the network participants (Woolcock, 1998; Hasan, et al., 2017). In line with this view,

this study argues that network participants in the high community social capital area follow morally acceptable behavior not only because such behavior is encouraged but also because there are disciplinary instruments in case of violations.

2.3 Non-profit Governance

According to the agency theory (Jensen & Meckling, 1976; Fama, 1980; Fama & Jensen, 1983), all organizations face agency problems. More specifically, not everybody involved in an organization shares similar interests. In publicly traded corporations, the agency problem arises when managers' (i.e., agents) interests are not in alignment with shareholders' (i.e., principals) interests. Research in the for-profit setting agrees that corporate governance mechanisms such as appointing the board of directors, appointing the larger proportion of independent directors and having an independent audit – help mitigate agency problems between shareholders and managers.

In the non-profit setting, it can be argued that NPO managers are agents whereas the IRS, other regulators, donors, potential donors and other stakeholders who want the managers to maximize spending on charitable purposes and minimize expenses on administrative and fundraising purposes– are the principals. NPO managers, in the absence of appropriate governance mechanisms, may act in a way that maximizes their compensation and reduces the probability of their job turnover. More specifically, NPO managers may not discharge their fiduciary duties expected by the various stakeholders such as the IRS, donors, grant-makers, regulators, creditors, watchdog agencies, and media. Governance studies in non-profit setting agree that NPO governance mechanisms such as appointing a large proportion of independent directors and having an independent

financial audit- provide proper monitoring to management and help align the interests of managers and the stakeholders (Yetman & Yetman, 2012).

Agency theory suggests that managers are self-interested and may not always act in the best interests of stakeholders, which may include the resistance to the adoption of sound governance practices. The majority of prior NPO literature suggests that entrenched and self-interested managers resist the adoption of sound governance practices (Eldenburg & Vines, 2004; Roberts, 2005; Hopkins & Gross, 2009; Yetman & Yetman, 2012). Hopkins & Gross (2009), for example, argue that the adoption of conflict-of-interest policy in NPOs has become a staple for sound governance and that IRS has pushed NPOs to adopt these policies despite their resistance. Similalry, Eldenburg and Vines (2004), Roberts (2005) and Yetman and Yetman (2012) suggest that NPO managers practice expense misallocation in the absence of proper governance mechanisms.[10]

The concept of "governance" has been extensively used in the public administration literature (Osborne & Gaebler, 1992; Peters, 1996; Frederisckson, 1997; Farazmand, 1997). More recently, Farazmand (2012, 2017) introduced the concept of sound governance which involves citizens' participatory process in the governance. More specifically, Farazmand (2012) defines sound governance as "a participatory process of governing the social, economic, and political affairs of a country, state, or local community through structures and values that mirror a society" (p. 230). The mitigation of agency problems due to societal participation may lead to sound governance within an

[10] In the for-profit setting, McLean et al. (2012) and Ferris et al. (2017) suggest that entrenched managers resist adoption to sound governance practices in publicly traded companies.

organization. Citizens and governance relationship has always been a central issue of the historical evolution of civilizations since the ancient time (Farazmand, 2012). Some ways to engage citizens in governance process are meeting community leaders and people, creating advisory boards involving people from the community, collaboration and partnership building with the society, and digital governance. Farazmand (2012) begs a question that why have citizens become so important today in the process of governance? This study addresses a novel concept of sound governance with the engagement of societal norms and networks (i.e., 'engaged citizens'). Societal engagement is imperative in the age of increasing global complexities, challenges, threats, and opportunities that affect both citizens and organizations.

2.4 Hypothesis 1a and 1b: Social Capital and Non-profit Governance

First, consistent with the social norms theory (Kohlberg, 1984), this study argues that the norms component of community social capital disciplines NPOs self-interested managers behaviors by encouraging them to implement honest organizational policies and imposing several disciplinary instruments for practicing dishonest dealings and entrenched organizational policies (Kandori, 1992; McMillan & Woodruff, 2000; Jha & Chen, 2015; Javakhadze, et al., 2016; Gupta, et al., 2018). These disciplinary instruments include guilt, social isolation, gossip, and condescending stares. Thus, managers in high social capital NPOs have fewer incentives to resist the adoption of sound governance practices.

Second, consistent with the structural theory of the social capital, this study argues that the large and dense networks in high social capital proxy for managerial

reputational capital (Bourdieu, 1986, 1989; Bourdieu & Wacquant, 1992; Lin, 1999; Payne, et al., 2011). Prior studies have established a positive association between managerial reputation and sound governance practices (Fafchamps & Minten, 1999; Powell, 2003; Javkhadze, et al., 2016; Bhandari, et al., 2018). Javakhadze, et al., (2016) argue that social network size heightens the costs of reputation loss (e.g., Kandori, 1992) and, therefore reduces managerial incentives to misbehave. Powell (2003) argues that the costs of reputation loss is high in the social network setting because there is only a little separation between formal business status and personal social status. Fafchamps and Minten (1999) also provide evidence that the loss of the relationship with network participants serves as the self-disciplining role for the network participants. Since the costs of reputation loss is higher for managers in high social capital NPOs, the study expects that these managers are more likely to adopt sound governance practices than compared to managers in low social capital NPOs.

Combining the above norms and networks arguments, this study predicts a positive relationship between the NPO social capital and governance. The study posits the following hypothesis:

H1a: Community social capital has a positive effect on NPO governance.

Alternatively, there is a possibility that community social capital may play a substitutive role in that it may replace the need for an NPO investment in internal governance. More specifically, if the disciplinary forces from the community social capital are suffice to reduce organizational needs for internal monitoring, then organizations headquartered in high social capital regions may need to invest less on internal governance mechanisms such as appointing larger number of directors and hiring

independent audit. Considering the substitutive role of the community social capital, this study predicts a negative relationship between community social capital and NPO governance.

H1b: Community social capital has a negative effect on NPO governance.

2.5 Non-profit Disclosure Quality

Agency theory suggests that managers are self-interested and may not always act in the best interests of stakeholders such as the IRS, donors, and grant-makers. These self-interested actions of the mangers may include misreporting NPOs' financial numbers to serve their interests at the expense of the interests of the users of financial information (Jensen & Meckling, 1976; Fama, 1980; Fama & Jensen, 1983). The users of NPO financial information include the IRS, donors, grant-makers, regulators, creditors, watchdog agencies, media, State Attorney General, and local taxing authorities (Gordon, et al., 2007). Form 990 has become one of the primary sources of NPO financial reporting to these users. They rely on the financial numbers reported in Form 990 to make various decisions. From agency theory perspective, it can be argued that NPO managers are the agents and that these agents may not truthfully report Form 990 disclosures which negatively impacts the decision usefulness of Form 990.

The incentives to misreport financial disclosures arise due to many reasons that are ultimately tied to self-interested managerial motives to increase compensation and maintain job security. Callen (1994) and Yetman & Yetman (2012) suggest that NPOs that report high charitable expenses receive more donations than compared to the NPOs that report low charitable expenses. Thus, donors consider whether the managers are spending money on charitable purposes and they rely on Form 990 disclosure to

determine the amount of charitable expenses relative to the expenses in other categories such as fundraising and administrative. Krishnan et al. (2006), Keating et al. (2008) and Chen (2016) suggest that NPOs managers may misallocate expenses to inflate low charitable expenses in order to solicit donations. Simply, NPO managers may compromise the quality of Form 990 disclosures to receive more donations. Prior non-profit studies have linked donations to managerial job security (Brickley & Van Horn, 2002; Mano & Giannikis, 2013; Stewart & Diebold, 2017). These studies suggest that NPO managers may risk losing their jobs if they don't attract enough donations which provides another incentive for NPO mangers to inflate charitable expenses.

Similarly, Lagnando (2004) suggests that an NPO may lose its charitable status if it does not spend major portion of total expenses towards charitable purposes. Thus, the risk of the NPO losing the charitable status may also incentivize the NPO managers to inflate the charitable expenses by shifting a portion of administrative and /or fundraising expenses towards the charitable expenses category. Furthermore, prior studies argue that NPO managers reporting higher charitable expense ratio (charitable expenses divided by total expenses) get paid higher salaries (Baber, et al., 2002) which provides added incentives for the managers to inflate charitable expenses in Form 990. In addition, many non-profit CEOs are often evaluated on financial performance (Brickley &Van Horn, 2002). Therefore, these CEOs have incentives not to report losses, which might negatively impact managerial compensation, reputation, and career mobility (Hofmann & McSwain, 2013). Similarly, many NPOs finance capital expansion by borrowing loan from banks and other creditors (Leone & Van Horn, 2005) and managers in these NPOs

have incentives to smooth earnings to reduce the cost of the loan (Trueman & Titman, 1988).

2.6 Hypothesis 2: Social Capital and Non-profit Disclosure Quality

First, Agency theory (Jensen & Meckling, 1976) argues that managers in the NPOs may act opportunistically and have incentives to manipulate financial numbers. The incentives to misreport financial disclosures arise due to many reasons that are ultimately tied to self-interested managerial motives to increase compensation and maintain job security.

Second, consistent with the social norms theory (Kohlberg, 1984), this study argues that the community social capital disciplines NPO self-interested managers behaviors by encouraging them to practice honest dealings and imposing several disciplinary instruments for dishonest and self-interested dealings (Kandori, 1992; McMillan & Woodruff, 2000; Jha & Chen, 2015; Javakhadze, et al., 2016; Gupta, et al., 2018). These disciplinary instruments include guilt, social isolation, gossip, and condescending stares. Thus, managers in high social capital NPOs are less likely to manipulate financial figures in Form 990.

Third, consistent with the network size view (i.e., structural theory) of the social capital, this study argues that the large and dense networks in high social capital proxy for managerial reputational capital (Bourdieu, 1986, 1989; Bourdieu & Wacquant, 1992; Lin, 1999; Payne, et al., 2011). Prior studies in the for-profit setting have established a positive association between managerial reputation and financial reporting quality (Bhandari, et al., 2018). In addition, Javakhadze et al. (2016) argue that social network size heightens the costs of reputation loss (e.g., Kandori, 1992), and therefore reduces

managerial incentives to misbehave. Powell (2003) argues that the costs of reputaiton loss is high in the social network setting because there is only a little separation between formal business status and personal social status. Fafchamps & Minten (1999) also provide evidence that the loss of the relationship with network participants serves as the self-disciplining role for the network participants. Since the costs of reputation loss is higher for managers in high social capital NPOs, the study expects that these managers are less likely to manipulate financial numbers in the Form 990 disclosures.

Combining the above norms and networks arguments, this study argues norms and networks channels of social capital provide external disciplinary instruments to these managers which reduces their opportunistic behavior and promotes more truthful financial disclosures in Form 990. Hence this study predicts a positive relationship between social capital and financial dislcosure quality in NPOs. The study posits the following hypothesis:

H2: Community social capital has a positive effect on NPO disclsoure quality.

CHAPTER 3: RESEARCH DESIGN

This section presents the research design of the study. First, it discusses how the study operationalizes the key, i.e., social capital of the area where an NPO is headquartered. Second, it discusses the various measures of NPO governance used in this study. Third, it discusses various proxies for NPO disclosure quality. Finally, this section presents the governance and disclosure quality models.

3.1 Social Capital Measures

This study relies on Rupsingha et al. (2006) for the construction of social capital index at the county level. The dataset is availabe in the Northeast Regional Center for Rural Development (NERCRD) website. [11] The social capital index (*SocailCap1*) of Northeast Regional Center for Rural Development (NERCRD) at the US county-level is the first principal component from a principal component analysis based on four factors including the number of social organizations and associations in a county (*ASSN*), voter turnout (*PVOTE*), census response rate (*RESPN*), and the number of non-profit organizations excluding those without an international approach (*NCCS*).

Consistent with community social capital literature (Jha & Chen, 2015; Hoi, et al., 2016; Li, et al., 2018; Subedi & Farazmand, 2019; Jha, 2019), this study interpolates and extrapolates community social capital index to fill the missing years. Since social capital

[11] The full information about community social capital components can be found at https://aese.psu.edu/nercrd/community/social-capital-resources/social-capital-variables-for-2014/data-dictionary-social-capital-variables.

in a particular community remains relatively stable over time, interpolation and extrapolation biases are not the concerns in this setting. In later robustness tests (untabulated), the study also adds an alternative measure of community social capital which is an indicator varible *SocialCap_dum* which is equal to 1 if community social capital is above the median social capital index and 0 otherwise.[12]

3.2 NPO Governance Measures

This study uses six different measures of NPO governance. These six measures come from the revised IRS Form 990, which includes the new part Part VI: Governance, Management, and Disclosure. The first four measures are related to the board of directors' characteristics; the fifth measure is related to whether the NPO hires external auditor to audit its financial statements; and the sixth measure is related to whether the NPO adopts several written policies that increases the level of managerial accountability.

Board of Director Monitoring

The study uses four measures of a board's ability to monitor managerial decisions. The first measure of governance is number of board directors in an NPO (*BoardSize*). Large number of board of directors provide additional insights and eyes to monitor the management. However, the literature also discusses two main reasons why the continuous measure of the size of the board may not capture the governance. First, the increased problems of communication and coordination as group size increases, and second, the decreased ability of the board to control management, thereby leading to agency problems stemming from the separation of management and control (Jensen,

[12] The regression analyses using *SocialCap_dum* as an independent variable produces the results that are qualitatively similar to the main results. For the sake of brevity, these analyses are untabulated.

1993; Yermack, 1996; Eisenberg, et al.,1998). Therefore, the study follows Aggarwal et al. (2009) and define *BoardSize* as an indicator variable which is equal to 1 when the board has more than five members but less than sixteen and 0 otherwise. Similar to Aggarwal, et al., (2009), this measure captures governance attribute where board size matters in a way that it does not increase (decrease) the problems of communication and coordination (the ability to control the management).

The second governance measure captures the composition of the board members in an NPO. One way to ensure the best interest of the NPO is to have a large independent board. Board members are considered independent if they do not receive, directly or indirectly, material financial benefits from the organization or related organizations and are not related to anyone who does (Blackwood, et al., 2014). Part VI, line 1b of the revised Form 990 provides information about the number of independent voting members of the governing body. Prior researches in the for-profit setting provide evidence that the inclusion of independent members in the board is associated with better governance (Baysinger & Butler, 1985; Duchin, et al., 2010; Aggarwal, et al., 2009). Non-profit literature on board independence also supports the notion that independent directors provide better oversight and enhance board performance (O'Regan & Oster, 2005; Vermeer, et al., 2006; Yetman & Yetman, 2012; Blackwood, et al., 2014). Blackwood, et al. (2014) and O'Regan & Oster (2005) suggest that independent directors provide better oversight to NPO managers. Vermeer et al. (2006) also argue that the presence of independent directors enhances the monitoring and strengthens NPO governance. Following prior studies, this study defines *BoardIndep* as the proportion of the independent directors in the board.

The third measure of NPO governance is whether or not the board was provided with copies of the IRS 990 for review prior to the form being filed with the IRS (Yetman & Yetman, 2012). The study names this variable as *BoardReview* which equal to 1 if the NPO reported that it provided copies of the IRS 990 to the board before filing them with the IRS, and 0 otherwise.

The fourth measure of the board's characteristics is the presence of the audit committee (Yetman & Yetman, 2012; Blackwood, et al., 2014). The study names this variable *BoardAuditCom* which equal to 1 if the non-profit reported having an audit committee, and 0 otherwise.

Independent Audit

Prior NPO studies agree that having an independent accountant compile, review, or audit annual financial statements is considered a sound governance practice (Cornforth 2012; Blackwood, et al., 2014; Desai & Yetman, 2015; Chen, 2016). Cornforth (2012) argues that a broader concept of non-profit governance should include auditors that can place accountability requirements on an organization and its board. The notion that independent audit is related to sound governance practice comes from the auditors' ability to mitigate agency conflict between managers and the organizations (Watts, 1977; Watts & Zimmerman, 1978; Choi & Wong, 2007). Choi & Wong (2007) provide empirical evidence supporting the notion that independent auditors provide strong governance.

Taking all the above arguments into consideration, my fifth measure of NPO governance is equal to 1 if the non-profit had its financial statements audited by an independent auditor, and 0 otherwise. The study names this variable as *AuditIndep*. Part

XII, line 2b of the revised Form 990 provides information on whether the non-profit employs independent audit.

Written Policy

My sixth and final measure of NPO governance captures whether or not the NPOs have voluntarily adopted several written policies intended to mitigate opportunistic managerial behavior (Yetman & Yetman 2012; Blackwood, et al., 2014). Part VI, Section B, line 12, 13 and 14 of the revised Form 990 provides information on whether the NPOs adopt written policies regarding conflict of interest, whistleblower protections, and document retention/destruction. Yetman & Yetman (2012) and Blackwood, et al. (2014) argue that NPOs adopting the above stated written policies provide better governance as these written policies mitigate managerial incentives to act on their self-interests. The presence of each of these written policies is coded as one, and zero otherwise. In order to capture a single comprehensive measure of written policy, the study sums each of these three codes in that the aggregate value ranges from 0 to 3, where the aggregate value of 3 (0) indicates the presence (absence) of all three policies. The study names this final measure of NPO governance as *WrittenPolicy* where the higher values indicate stronger NPO governance.

3.3 Financial Disclosure Quality Measures

Prior studies including the IRS acknowledge the importance of NPO charitable expenses as one of the most important information to the users of Form 990 because it shows how much NPOs are actually spending on charitable purposes (Tinkelman & Mankaney, 2007). NPO managers have incentives to increase charitable expenses in order to show that the contributions to the NPOs are being spent on charitable purposes.

More specifically, prior studies argue that NPO managers reporting higher charitable expenses ratio (charitable expenses divided by total expenses) get paid higher salaries (Baber, et al., 2002), bring more donations (Callen, 1994; Yetman & Yetman, 2013) and are less likely to lose tax-exempt status (Lagnando, 2004). In addition, various charity watchdogs such as Better Business Bureau Wise Giving Alliance, National Charities Information Bureau, Charity Navigator, the American Institute of Philanthropy as well as various news sources such as Forbes[13], use the charitable ratio as one means of rating the non-profits.

Prior NPO literature documents that NPO managers inflate charitable expenses by understating fundraising and/or administrative expenses and misallocating these expenses as charitable expenses (Krishnan, et al., 2006; Ketating, et al., 2008; Krishnan & Yetman, 2011). This study follows Yetman & Yetman (2012) and construct **four measures of NPO disclosure quality** which are primarily based on the NPOs propensity to understate fundraising and administrative expenses. NPOs understating fundraising and administrative expenses are expected to channel and misallocate these expenses as charitable expenses and thus are not being truthful in their financial information available to the public via the Form 990.

Dichotomous zero／nonzero fundraising expenses

The first measure of NPO disclosure quality variable is based on Krishnan et al. (2006) and Yetman & Yetman (2012), who argue that a large proportion of NPOs who reasonably should be reporting some fundraising expenses actually report zero

[13] https://www.forbes.com/sites/williampbarrett/2016/12/14/how-to-evaluate-a-charity-2/#47cbd5853371

fundraising expenses. Based on this idea, this study defines the first measure of disclosure quality (*DQ1*) as an indicator variable equal to 1 when an NPO reports a nonzero fundraising expenses, and 0 when the NPO reports zero fundraising expenses (Yetman & Yetman, 2012). Similar to Yetman & Yetman (2012), this study argues that *DQ1* reflects disclosure quality because NPOs who report some amount as fundraising expenses are expected to be more truthful about their financial information (i.e., charitable expenses) than compared to NPOs who report zero fundraising expenses. All in all, those NPOs where *DQ1* equal to 1 (0) are the ones with higher (lower) charitable expense accuracy which translates into a higher (lower) level of disclosure quality.

Continuous understated fundraising expenses

The second measure of NPO disclosure quality is also based on Krishnan et al. (2006) and Yetman & Yetman (2012). More specifically, these studies document that NPOs that report fundraising expenses have a tendency to underreport these expenses. Consistent with this argument, Yetman & Yetman (2012) use Steinberg's (1986) theoretical link between fundraising expenses and donations and propose a model that predicts fundraising expenses. Afterwards, an error term for each observation is calculated where the increasing value of the error term represents higher disclosure quality (*DQ2*). More specifically, observations that generate positive (negative) residuals in model (1) are the ones who report more (less) fundraising expenses than the model actually predicts. Thus, the error term from model (1) represents the increasing value of disclosure quality (*DQ2*).

$$\textit{Fundraising Expenses}_{i,t} = \beta 0 + \beta 1\ \textit{Private Donations}_{i,t} + \beta 2\ \textit{Feeder Donations}_{i,t} + \beta 3\ \textit{Government Grants}_{i,t} + \text{Industry FE} + \text{Year FE} + \varepsilon_{i,t}\ , \quad (1)$$

where *Fundraising Expenses* are total fundraising expenses reported in the subsample of non-profits. The subsample is limited to NPOs that report some amount of fundraising expenses. *Private Donations* are contributions received from individuals, corporations, and foundations. *Feeder Donations* are contributions received from federated fundraising organizations such as the United Way. *Government Grants* are contributions received from local, state, or federal agencies. To minimize the impact of invariant year and industry characteristics, this study includes year and industry fixed effects.

Dichotomous zero/nonzero administrative expenses

The third measure of NPOs disclosure quality variable is based on Wing, et al. (2006) and Yetman & Yetman (2012), who argue that a large proportion of NPOs who reasonably should be reporting some administrative expenses actually report zero administrative expenses. In line with the same argument, Steinberg (1986) argues that it is nearly impossible to have a charitable output without incurring some level of administrative expenses. Based on these studies, my study defines a third measure of disclosure quality **(*DQ3*)** as an indicator variable equal to 1 when an NPO reports a nonzero administrative expenses, and 0 when the NPO reports zero administrative expenses. Similar to Yetman & Yetman (2012), this study argues that *DQ3* captures disclosure quality because NPOs who report some amount as administrative expenses are expected to be more truthful about their financial information (i.e., charitable expenses) than compared to NPOs who report zero administrative expenses. All in all, those NPOs where *DQ3* equal to 1 (0) are the ones with higher (lower) charitable expense accuracy which translates into a higher (lower) level of disclosure quality.

Continuous understated administrative expenses

My fourth and final measure of NPOs' disclosure quality is also based on Yetman & Yetman (2012) who use Wing, et al. (2006) and Steinberg's (1986) theoretical link between and administrative expenses and donations and propose a model that predicts administrative expenses. Afterwards, an error term for each observation is calculated where the increasing value of the error term indicates the higher disclosure quality **(*DQ4*).** More specifically, observations that generate positive (negative) residuals in model (2) are the ones who report more (less) administrative expenses than the model actually predicts. Thus, the error term from model (2) represents the increasing value of disclosure quality (*DQ4*).

$$\textit{Administrative Expenses}_{i,t} = \beta 0 + \beta 1\ \textit{Private Donations}_{i,t} + \beta 2\ \textit{Feeder Donations}_{i,t} + \beta 3\ \textit{Government Grants}_{i,t} + \text{Industry FE} + \text{Year FE} + \varepsilon_{i,t}\ , \quad (2)$$

where *Administrative Expenses* are total administrative expenses reported in the subsample of NPOs that disclose some amount of administrative expenses. Similar to model (1), model (2) includes *Private Donations*, *Feeder Donations*, *Government Grants*, year and industry fixed effects.

3.4 Empirical Models

The section presents the multivariate models used in the study to test the effect of the community social capital on NPO governance and disclosure quality. First this section explains the governance model used in this study. Afterwards, it discusses the disclosure quality model used in the study.

3.4.1 Governance Model

This study follows the discussions in Alexander and Weiner (1998), Brown (2005) and Blackwood et al. (2014) to construct a model that predicts NPO governance.

$$Governance_{i,t} = \beta 0 + \beta 1\ Social\ Capital_{i,t} + \beta 2\ Size_{i,t} + \beta 3\ Age_{i,t} + \beta 4\ ROA_{i,t} + \beta 5\ CurrentRat_{i,t} + \text{Industry FE} + \text{Year FE} + \varepsilon_{i,t}\ , \quad (3)$$

where the study replaces *Governance* with one of the six proxies of NPO governance discussed in section 4.2. The six proxies to capture NPO governance are: (1) *BoardSize* (2) *BoardIndep* (3) *BoardReview* (4) *BoardAuditCom* (5) *AuditIndep* (6) *WrittenPolicy.* The main independent variable of interest, *Social Capital*, is explained in detail in section 4.1. Consistent with the first set of hypotheses (H1a and H1b), this study expects a positive (negative) and significant coefficient on *Social Capital*, which would suggest that NPOs headquartered in high community social capital are associated with higher (lower) NPO governance. A positive (negative) association supports the notion that community social capital plays complementary (substitutive) role to NPO governance.

The model also controls for NPO size as prior literature documents that larger firms have more resources (Ohlson, 1980; Bruderl & Schussler, 1990) which they can use to invest in governance. Similarly, Alexander and Weiner (1998) and Blackwood et al. (2014) document that larger NPOs are more likely to adopt sound governance practices. Following prior studies such as Keating et al. (2005), this study measures an NPO size as the natural log of the total assets (*SIZE*). Similarly, Blackwood et al. (2014) provide evidence that older NPOs are more likely to adopt sound governance practices. Older NPOs have higher reputational capital and thus are likely to invest more in sound

governance practices (Weisbrod & Dominguez, 1986). Following these studies, the model also controls for an NPO age (*AGE*).

In addition, Alexander and Weiner (1998) document that organizational performance is positively associated with NPO sound governance practices. It can be argued that managers enjoying a strong organizational performance have fewer incentives to misbehave as if entrenched or to resist the adoption of sound governance practices. The model controls for two measures of organizational performance. The first measure is return of assets (*ROA*). Prior non-profit research includes ROA as a proxy for NPO financial health and sustainability (Bowman 2002; Keating et al. 2005; Ritchie & Kolodinsky, 2003; Laitinen & Suvas, 2016). The second measure of NPO performance is the current ratio (Beaver, 1966). The current ratio is calculated as the current assets divided by the current liabilities (*CurrentRat*). NPOs with higher values of the current ratio are in better financial health than compared to NPOs with lower values of the current ratio.

NPOs receiving government grants are more likely to adopt sound governance practices (Blackwood, et al., 2014). Thus, the model also controls for *GovernmentGrants* which is the contributions received from local, state, or federal agencies. To minimize the impact of invariant year and industry characteristics, the model also includes year and industry fixed effects.

3.4.2 Disclosure Quality Model

Numerous models have been developed over the years to explain NPO disclosure quality. To examine the relationship between community social capital and NPO

disclosure quality, this study uses the following model based on Yetman & Yetman (2012).

$$\textit{Disclosure Quality}_{i,t} = \beta 0 + \beta 1\ \textit{Social Capital}_{i,t} + \beta 2\ \textit{Size}_{i,t} + \beta 3\ \textit{DonIntensity}_{i,t} + \beta 4\ \textit{Age}_{i,t} + \beta 5\ \textit{DonGrwoth}_{i,t} + \beta 6\ \textit{CurrentRat}_{i,t} + \text{Industry FE} + \text{Year FE} + \varepsilon_{i,t}\ , \quad (4)$$

where the study replaces *Disclosure Quality* with one of the four proxies of disclosure quality discussed in section 4.3. The four proxies to capture NPO disclosure quality are: (1) *DQ1* (2) *DQ2* (3) *DQ3* and (4) *DQ4*. The main independent variable of interest, *Social Capital*, is explained in detail in section 4.1. Consistent with my third hypothesis, this study expects a positive and significant coefficient on *Social Capital*, which would suggest that NPOs headquartered in high community social capital are associated with higher disclosure quality.

The model controls for NPO size as larger NPOs are expected to have better information environment (Yetman & Yetman ,2012). In addition, prior NPO literature documents that larger firms have more resources (Ohlson, 1980; Bruderl & Schussler, 1990) which they can use to improve the disclosure quality. Larger NPOs, for example, can hire a large number of financial experts and CPAs in their accounting team which would increase the Form 990 disclosure quality. Following prior studies such as Keating et al. (2005) this study measures an NPO size as the natural log of the total assets (*SIZE*). Similarly, since NPOs that rely more on donations have greater incentives to manipulate financial numbers, the model controls for donation intensity which is the ratio of total donations to total revenues (*DonIntensity)*. The model also includes an NPO age (*AGE*) as a control for reputational capital as prior studies argue that NPOs with high reputational capital are less likely to manipulate their financial numbers and thus provide

higher disclosure quality (Weisbrod & Dominguez, 1986). In addition, Fernandez (2008) documents that younger NPOs are at greater risk of failure and thus have higher pressure to look financially better to the current and potential stakeholders.

Similarly, since prior studies (e.g. Loebbecke, et al., 1989) document that high growth firms are in greater pressure to manage financial numbers, the model controls for an NPO growth (*DonGrowth*). This study defines *DonGrowth* as the average growth in donations during the sample period (Yetman & Yetman, 2012). Prior studies such as Mercer (2004) argue that managers in distressed firms have greater incentives to manipulate financial disclosures and thus, this study also controls for the current ratio, which is calculated as the current assets divided by current liabilities (*CurrentRat*). NPOs with higher values of the current ratio are less distressed than compared to NPOs with lower values of the current ratio. To minimize the impact of invariant year and industry characteristics, the regression model also includes year and industry fixed effects.

CHAPTER 4: SAMPLE AND ANALYSES

For nonprofit governance and disclosure quality data, this study uses Form 990 data available in a machine-readable format through Amazon Web Services (AWS). The initial sample of the study covers seven years of sample period from 2013 to 2019. The initial sample period starts from year 2013 because AWS provides access to machine-readable data for electronic 990 forms from year 2013. The year 2013 is the start year for another reason in that Form 990 underwent major changes in year 2008 and it took a few years for many NPOs to adjust to these changes and have consistent disclosure format. The sample period ends in year 2018 because 2019 and onwards Form 990 data were not completely available at the time of data extraction. The source of National Taxonomy of Exempt Entities (NTEE) Code is NCCS database.[14] I eliminated non-profit firm year observations that belong to religion industry as many religious firms don't need to file Form 990. The final sample size includes 866,022 observations for the period 2013-2018.

The sample distribution by year is presented in Table 1. The year 2013 has the least percentage of sample observations as this period coincides with the year AWS started collecting NPO Form 990 information. The sample observations are fairly distributed for the period 2014-2018. The year 2018 has the largest number of observations which comprise 19.62 percent of the sample size.

< Insert Table 1 about here >

[14] https://nccs.urban.org/project/national-taxonomy-exempt-entities-ntee-codes

Table 2 reports distributions of the sample observations by NTTE classifications. It uses 10 industry classification for NPOs: 1) Arts, Culture, and Humanities, 2) Education, 3) Environment and Animals, 4) Health, 5) Human Services, 6) International and Foreign Affairs, 7) Public, Societal Benefit, 8) Religion Related, 9) Mutual/Membership Benefit and 10) Unknown/Unclassified. The industry classification in this study does not include 'Religion Related' because religious NPOs are not required to file Form 990 and the study has dropped observations in this classification. 'Public, Societal Benefit' industry has the largest number of observations overall. While 'International, Foreign Affairs' industry comprises only 1.60 percent of the sample size and has the lowest number of observations in classified industries, 'Unknown, Unclassified' industry have the lowest number of observations overall (0.12 percent of total sample observations).

< Insert Table 2 about here >

Table 3 presents the overall descriptive statistics of the variables used in my empirical analyses. The mean of *BoardSize* is 0.563, suggesting that around 56 percent of the sample observations have board size greater than five members but less than sixteen members. The mean of the ratio of independent directors to total directors is 0.856, indicating that the sample firms have on average 85 percent independent directors. Similarly, on average 32.60 percent of observations have their Form 990 reviewed by all member of the governing body before they file it to the Internal Revenue Service (IRS). Around 47.10 percent NPOs have audit committee to review the financial reporting process. 18.20 percent of NPOs have their financial statements audited by the independent auditors. The average *WrittenPolicy* is 1.584 which suggests that the sample

NPOs adopt at least half of the three written policies regarding conflict of interest, whistleblower protections, and document retention/destruction.

Regarding financial reporting quality measures, on average only 3.2 percent of my sample NPOs disclose non-zero fundraising expense and 84 percent of sample firms disclose non-zero administrative expense. Compared to private and feeder donations, the sample NPOs receive large portion of their contributions from governments. Average return on assets (ROA) in our sample NPOs is only 0.1 percent. Similarly, private donations only represent 0.2 percent of total revenue of sample NPOs.

< Insert Table 3 about here >

Tests for Hypothesis 1a and 1b: Table 4 reports the ordinary least square regression results for the relationship between social capital and governance as captured by four proxies of board of director monitoring. In Table 4 columns 1, 2, 3 and 4, I find that the coefficient estimate on *SocialCap* is positive and statistically significant at the one percent level (0.0144, p-value<0.01; 0.0135, p-value<0.01; 0.0294, p-value<0.01; 0.0025, p-value<0.01). This confirms my hypothesis 1a and suggests that social capital is positively associated with NPOs' governance. More specifically, this study confirms that social capital plays complementary role to enhance the NPO governance.

< Insert Table 4 about here >

Robustness Tests for Hypotheses 1a and 1b: Table 5 tests the first set of hypotheses and reports the ordinary least square regression results for the relationship between social capital and governance using an alternative proxy for governance. The measure of the governance used in this analysis is whether the NPO uses external

independent auditor to audit financial statements. In Table 5 column 1, I find that the coefficient estimate on *SocialCap* is positive and statistically significant at the one percent level (0.0207, p-value<0.01). This confirms the hypothesis 1a that social capital is positively associated with NPOs' governance. More specifically, the finding suggests that NPO community social capital plays a complementary role to enhance the NPO governance.

< Insert Table 5 about here >

Robustness Tests for Hypotheses 1a and 1b: Table 6 tests the first set of hypotheses using *WrittenPolicy* as a proxy for NPO governance. The measure ranges from 0 to 3 and indicates whether the NPO has voluntarily adopted three written policies: conflict of interest, whistleblower protections, and document retention/destruction. The presence of each of these written policies is coded as one, and zero otherwise. To capture a single comprehensive measure of written policy, I add these number in that the aggregate value ranges from 0 to 3, where the aggregate value of 3 (0) indicates the presence (absence) of all three policies. Table 6 column 1 reports the ordinary least square regression results for the relationship between social capital and governance which is captured by *WrittenPolicy*. In Table 6 column 1, I find that the coefficient estimate on *SocialCap* is positive and statistically significant at the one percent level (0.0303, p-value<0.01). This confirms the hypothesis 1a and suggests that social capital plays complementary role to NPO governance.

< Insert Table 6 about here >

Robustness Tests for Hypotheses 1a and 1b: In Table 7, the study tests the robustness of my results in Tables 4-6 using donation growth (*DonGrowth*) as an additional control variable. The original analyses in Tables 4-6 have not included donation growth because it requires lag by one-year values of donation which results in significant drop in my sample size. As seen in Table 7, the sample reduces to 521,530 after inclusion of donation growth in the original model.

In Table 7 columns 1-6, I use all six proxies of governance and find that the coefficient estimate on *SocialCap* is positive and statistically significant at the one percent level (0.0175, p-value<0.01; 088, p-value<0.01; 0.0298; p-value<0.01; 0.0211, p-value<0.01; 0.0246, p-value<0.01) when *BoardSize, BoardIndep, BoardReview, AuditIndep* and *WrittenPolicy* are used as dependent variables. However, *SocialCap* is not significant when *BoardAuditCom* is used as a dependent variable (-0.0010, p-value=0.118). Overall, Table 7 confirms the robustness of the findings presented in Tables 5-6 and confirms that the main finding prevails even in the presence of donation growth as an additional control variable.

< Insert Table 7 about here >

Robustness Tests for Hypotheses 1a and 1b: Four of the six dependent variables that are used to proxy for governance- are categorical variables. These four variables are: *BoardSize, BoardReview, BoardAuditCom* and *AuditIndep*. Since the data in question has binary output (1 or 0) for these analyses, it can be argued that logistic regression analyses should be used (Wooldridge, 2016). Thus, in Table 8 the study tests the robustness of these analysis by running logit regression analyses for these categorical dependent variables. As reported in columns 1-4 of Table 8, I still find a positive and

statistically significant association between *SocialCap* and the four proxies of governance (0.0604, p-value<0.01; 0.1306, p-value<0.01; 0.0092, p-value<0.01; 0.1196, p-value<0.01).

< Insert Table 8 about here >

Robustness Tests for Hypotheses 1a and 1b: One of the six dependent variables that is used to proxy for governance- is ordinal in nature. This dependent variable is: *WrittenPolicy*. Since the data in question has ordinal output (1, 2 or 3) for this analysis in Table 6, it can be argued that ordered logit regression analysis should be used (Wooldridge, 2016) for this dependent variable. Thus, in Table 9 I test the robustness of Table 6 analysis by running ordered logit regression model. As reported in column 1of Table 9, I still find a positive and statistically significant association between *SocialCap* and *WrittenPolicy* (0.0485, p-value<0.01).

< Insert Table 9 about here >

Tests for Hypothesis 2: Table 10 reports the ordinary least square (OLS) regression results for the relationship between *SocialCap* and NPO disclosure quality. Table 10 columns 1, 3 and 5 (columns 2, 4 and 6) use *DQ1* (*DQ2*) as direct proxies of NPO disclosure quality which are based on fundraising expense. In Table 10 columns 1-6, I find that the coefficient estimate on disclosure quality proxies is positive and statistically significant at the one percent level (0.0049, p-value<0.01; 0.2044, p-value<0.01; 0.0049, p-value<0.01; 0.2049, p-value<0.01; 0.0053, p-value<0.01, 0.1963, p-value<0.01). This confirms hypothesis 2 that community social capital has a positive effect on NPO disclosure quality.

< Insert Table 10 about here >

Robustness Tests for Hypothesis 2: Table 11 reports the ordinary least square (OLS) regression results for the relationship between *SocialCap* and NPO disclosure quality using two alternative proxies of NPO disclosure quality. Table 11 columns 1, 3 and 5 (columns 2, 4 and 6) use *DQ3* (*DQ4*) as direct proxies of NPO disclosure quality which are based on administrative expense. In Table 11 columns 1-4 and 6, I find that the coefficient estimate on disclosure quality proxies is positive and statistically significant at the ten percent level (0.0067, p-value<0.01; 8.4568, p-value<0.1; 0.0067, p-value<0.01; 9.3461, p-value<0.05; 8.9956, p-value<0.1). Overall, this confirms my hypothesis 2 that community social capital has a positive effect on NPO disclosure quality.

< Insert Table 11 about here >

Robustness Tests for Hypothesis 2: Two of the four dependent variables that are used to proxy for NPO disclosure quality- are categorical variables. These two variables are: *DQ1* and *DQ3*. Since the data in question has binary output (1 or 0) for these analyses, it can be argued that logistic regression analyses should be used (Wooldridge, 2016). Thus, in Table 12 this study test the robustness of these analyses by running logit regression analyses for these categorical dependent variables. As reported in columns 1-6 of Table 12, the study still find a positive and statistically significant association between *SocialCap* and the two binary proxies of NPO disclosure quality.

< Insert Table 12 about here >

Robustness Tests for Hypotheses 1 and 2: This study also controls for fundraising expense as a control variable in disclosure quality models that are derived

from fundraising expense (i.e., DQ1 and DQ2 models which are based on fundraising expense). Similarly, following the same logic, I control for administrative expense in DQ3 and DQ4 models which are based on administrative expense. The study finds that main results remain consistent; however, the R-square and adjusted R-square values in these are much higher than those reported in the main tables. Similarly, I added fundraising expense and administrative expense as additional controls in the governance models. R-square and adjusted-R-square values improve slightly. The summarized version of these analyses is presented in Table 13 Panels A, B and C.

< Insert Table 13 about here >

CHAPTER 5: CONCLUSION, LIMITATIONS AND FUTURE RESEARCH

Social capital is critical to the entities' governance (i.e., disciplinary instruments placed inside the organization) and their ability to report/disclose high quality financial information. Although prior literature on for-profit sector indicates that social capital impacts both governance (Ferris, et al., 2017) and financial reporting quality (Jha & Chen, 2015; Jha, 2019), this area has received less attention in non-profit literature. The purpose of this dissertation is to examine the impact of the social capital of a non-profit organization's (NPO) headquarter area (also known as community social capital) on the NPO governance and disclosure quality (i.e., the quality of Form 990).

The importance of above-stated questions originates from the contemporary sound governance (Farazmand, 2012, 2017), agency (Jensen & Meckling, 1976; Fama, 1980) and community social capital (Putnam, 1993, 1995) researches that treats social capital as a useful tool for business ethics and public administration (Spence, et al., 2003; Subedi & Farazmand, 2019;) and examines how the community social capital of firm-headquarter area affects corporate policies and managerial practices (Gregory, 1999; Brooks, 2005; Saxton & Benson, 2005; Shim & Eom, 2009; Henry, et al., 2011; Jha & Chen, 2015; Subedi & Farazmand, 2019; Jha, 2019). The below three consecutive paragraphs elaborate on theoretical framework used in this study by discussing sound governance, agency and social capital theories.

The seminal work in sound governance (Farazmand, 2012) defines sound governance as "a participatory process of governing the social, economic, and political affairs of a country, state, or local community through structures and values that mirror a society" (p. 230). Thus, the concept of sound governance encourages the citizens participatory process in the governance. Citizens and governance relationship has always been a central issue of historical evolution of civilizations since the ancient time (Farazmand, 2012). Farazmand (2012) recommends the following approaches to engage citizens in governance process: meeting community leaders and people, creating advisory boards involving people from community, collaboration and partnership building with the society, and digital governance. This study has implications to sound governance theory in that it responds to the call by Farazmand (2012) that begs a question that why citizens have become so important today in the process of governance now? This study addresses a novel concept of sound governance with engagement of societal norms and networks (i.e., 'engaged citizens'). Societal engagement is imperative in the age of increasing global complexities, challenges, threats, and opportunities that affect both citizens and organizations.

This study also relies on agency theory (Jensen & Meckling, 1976; Fama, 1980; Fama & Jensen, 1983) in that agency theory suggests that self-interested managers in NPOs may not always act in the best interests of stakeholders, which may include the resistance to the adoption of sound governance practices or manipulation of financial numbers in the Form 990. NPO managers, in the absence of appropriate governance mechanisms, may act in a way that maximizes their compensation and reduces the probability of their job turnover. More specifically, NPO managers may not discharge

their fiduciary duties expected by the various stakeholders such as the IRS, donors, grant-makers, regulators, creditors, watchdog agencies, and media. The study argues that the norms (Kohlberg, 1984) and networks (Bourdieu, 1986, 1989) components of the community social capital mitigates these agency issues, thereby encouraging the organizations to adopt sound governance practices and to make more truthful disclosures in Form 990.

The study relies on social capital theory (Putnam, 1993, 1995) in that the main premise of the study is based on norms and networks views presented by social capital theory. Norms and networks views of social capital are supported by norms (Kohlberg, 1984) and structural (Bourdieu, 1989; Lin, 1999; Payne, et al., 2011) sub-theories of social capital. The predominant view that emerges from prior studies in social capital is that community social capital, captured by shared common beliefs (i.e., social norms) and dense networks in a community, constrains norm-deviant behaviors and provides reputational capital (e.g., Lu, et al., 2016; Hasan, et al., 2017). More specifically, this study relies on the norms and structural theories of social capital and argue that both norms and networks components of social capital discipline self-interested managers' behavior. The disciplinary forces from the community social capital complements internal governance. In addition, these disciplinary forces reduce the managerial self-interested motives to manipulate financial numbers in Form 990, and thus increase the quality of Form 990 disclosures (i.e., disclosure quality).

Motivated by the social norms and structural theories of social capital (Putnam 1993, 1995), sound governance theory (Farazmand, 2012, 2017) and agency theory (Jensen & Meckling, 1976; Fama, 1980), this study examines whether the community

social capital of an NPO headquarter-area influences the NPO governance and disclosure quality. Prior public administration literature has shown that social capital is important not only to understand public policy but also important to shape public policies (Helliwell, 2006). More specifically, Helliwell (2006) argues that connections provide access to valuable resources within the network and the individuals holding important network positions are able to drive their agendas in making public policy.

The study hypothesizes and finds that the community social capital of an NPO headquarter area has a positive impact on its governance. The positive relationship suggests that NPO social capital and governance play a complementary role, where managers in high social capital face a strong disciplinary environment and enjoy strong social connections and professional reputations and thus have fewer incentives to resist the adoption of sound governance practices. The study does not find the negative relationship between social capital and NPO governance and thus fails to support the assertion that the value relevance of social capital is higher for NPOs with weak governance because the external disciplinary mechanisms provided by social capital substitute the need for NPO investment on governance. Similarly, the study also hypothesizes and finds that the community social capital of an NPO headquarter area has a positive impact on its disclosure quality. This finding suggests that community social capital disciplines NPO self-interested managers' behavior to manipulate financial numbers in Form 990 disclosures.

This study is subject to limitations. First, the county level proxy for community social capital may not capture social capital rather some other county-level characteristics. Although prior researches in social capital extensively use county level

Rupsingha, et al. (2006) social capital index (e.g., Jha & Chen, 2015; Jha, 2019 and Subedi & Farazmand 2019), this study uses an alternative measure of social capital and find the similar results. Similarly, the main results may suffer from reverse causality bias in that one may argue that NPO governance (and disclosure quality) actually determines the social capital. However, community social capital preexists the sample firms used in this study and, thus the effect of social capital is fairly exogenous to reverse causality bias. Although the sample period of social capital used in this study is from 2013 to 2018, I argue that social capital overall pre-exists the financial information studied during the sample because prior studies confirm that there is a less year to year variation in social capital in a county and avoid using firm fixed effects model. In addition, the study uses lag by one-year measures of independent variables of interest and find the qualitatively similar results (untabulated).

The study could suffer from autocorrelation and multicollinearity issues. More specifically, the research design could suffer from autocorrelation within non-profit organizations over years. To address this issue, the regression analyses were conducted with clustering by unique organizational id (untabulated). The main results are consistent to those reported in our main analyses. Thus, the serial autocorrelation does not seem to be an issue in the research design of this study. Additionally, the regression analyses may suffer from multicollinearity issue. This study separately examines the variance inflation factors (VIFs) on the independent variables in each of the major estimations to alleviate potential concerns about multicollinearity and find that all the variables have a VIF less than 2, suggesting that multicollinearity is not an issue the models. Multicollinearity is

usually considered high (very high) when the variance-inflation-factors (VIFs) exceed 10 (20) (Bhandari & Kohlbeck 2018).

APPENDIX

Appendix 1: Variable Definitions

Governance Measures		
BoardSize	=	1 when the board has more than five members but less than sixteen, and 0 otherwise. Large number of board of directors provide additional insights and eyes to monitor the management. However, the literature also discusses two main reasons why the continuous measure of the size of the board may not capture governance. First, the increased problems of communication and coordination as group size increases, and second, the decreased ability of the board to control management, thereby leading to agency problems stemming from the separation of management and control (Jensen, 1993; Yermack, 1996; Eisenberg et al.1998). Therefore this study follows Aggarwal et al. (2009) and defines BoardSize as an indicator variable which equal to 1 when the board has more than five members but less than sixteen and 0 otherwise. Similar to Aggarwal et al. (2009), this measure captures governance attribute where board size matters in a way that it does not increase the problems of communication, coordination and control;
BoardIndep	=	proportion of the independent directors in the board calculated as the total number of independent directors divided by the total number of directors in the board. Board members are considered independent if they do not receive, directly or indirectly, material financial benefits from the organization or related organizations and are not related to anyone who does (Blackwood et al. 2014);
BoardReview	=	1 when the non-profit chooses to provide a copy of their IRS 990s to the board of directors for review prior to filing it, and 0 otherwise;
BoardAuditCom	=	1 if the non-profit has audit committee, and 0 otherwise;
AuditIndep	=	1 if the non-profit has its financial statements audited by an independent auditor;

WrittenPolicy	=	a measure that ranges from 0 to 3 and indicates whether the NPO has voluntarily adopted three written policies (conflict of interest, whistleblower protections, and document retention/destruction). The presence of each of these written policy is coded as one, and zero otherwise. In order to capture a single comprehensive measure of written policy, the study sums these three codes in that the aggregate value ranges from 0 to 3, where the aggregate value of 3 (0) indicates the presence (absence) of all three policies;

Disclosure Quality Measures

DQ1	=	1 when the NPO reports a nonzero fundraising expenses, and 0 when the NPO reports zero fundraising expenses;
DQ2	=	the error terms from model (1) where the increasing value of the error terms indicate the higher value of disclosure quality. More specifically, observations that generate positive (negative) residuals in model (1) are the ones who report more (less) fundraising expenses than the model actually predicts. NPO managers have incentives to report less fundraising expenses so that they can misallocate fundraising expenses as charitable expenses. The negative error terms from model (1) capture NPOs who report less fundraising expenses and thus have manipulated the financial information. Therefore, the increasing value of error term from negative to positive represents the increasing value of disclosure quality (DQ2);
DQ3	=	1 when the NPO reports a nonzero administrative expenses, and 0 when the NPO reports zero administrative expenses;
DQ4	=	the error terms from model (2) where the increasing value of the error terms indicate the higher value of disclosure quality. More specifically, observations that generate positive (negative) residuals in model (2) are the ones who report more (less) administrative expenses than the model actually predicts. NPO managers have incentives to report less administrative expenses so that they can misallocate administrative expenses as charitable expenses. The negative error terms from model (2) capture NPOs who report less administrative expenses and thus have manipulated the financial information. Therefore, the increasing value of error term from negative to positive represents the increasing value of disclosure quality (DQ4);

Social Capital Measure

SocialCap	=	Social capital index of Northeast Regional Center for Rural Development (NRCRD) at the US county level;

Other Variables

SIZE	=	the natural logarithm of total assets;
AGE	=	the number of years the organization has been a registered non-profit organization;
ROA	=	return on assets calculated as the net income divided by the total assets at the end of the year;
CurrentRat	=	current ratio calculated as the current assets divided by the current liabilities;
DonIntensity	=	the ratio of total donations to total revenues;
DonGrowth	=	the average growth in the NPO's donations during the sample period;
Fundraising expenses	=	total fundraising expenses;
Administrative expenses	=	total administrative expenses;
Private Donations	=	contributions received from individuals, corporations, and foundations;
Feeder Donations	=	contributions received from federated fundraising organizations;
Government Grants	=	the contributions received from local, state, or federal agencies;

Table 1 Sample Distribution by Year

Frequency Distribution by Year		
Fyear	**Freq.**	**Percent**
2013	66325	7.66
2014	144326	16.67
2015	155441	17.95
2016	162512	18.77
2017	167539	19.35
2018	169,879	19.62
Total=	866,022	100

Notes: Table 1 presents sample distribution by year.

Table 2 Sample Distribution by Industry

	Industry	Freq.	Percent
1	Arts, Culture and Humanities	67070	7.74
2	Education	108426	12.52
3	Environment and Animals	34260	3.96
4	Health	127189	14.69
5	Human Services	326589	37.71
6	International, Foreign Affairs	13891	1.6
7	Mutual/Membership Benefit	21872	2.53
8	Public, Societal Benefit	165692	19.13
9	Unknown, Unclassified	1033	0.12
	Total=	866,022	100

Notes: Table 2 presents sample distribution by industry. The industry classification is based on National Taxonomy of Exempt Entities (NTEE) Code Classification, where the first digit of the code is used to identify an industry. Religion industry is not included in this sample.

Table 3 Sample Descriptive Statistics

Variable	Mean	SD	Q1	Median	Q3
BoardSize	0.563	0.496	0	1	1
BoardIndep	0.856	0.312	0.929	1	1
BoardReview	0.326	0.469	0	0	1
BoardAuditCom	0.471	0.499	0	0	1
AuditIndep	0.182	0.386	0	0	0
WrittenPolicy	1.584	1.312	0	2	3
Fundraising Expense ($ 000)	0.978	6.819	0	0	0
DQ1	0.032	0.176	0	0	0
DQ2	0	8.43	-1.365	-1.106	-1.06
Administrative Expense ($ 000)	521.13	1962.2	4.225	43.293	183.321
DQ3	0.84	0.367	1	1	1
DQ4	0	2470.31	-566	-507.69	-363.9
SocialCap	-0.212	0.914	-0.74	-0.318	0.14
SIZE	13.567	2.640	12.294	13.570	14.990
AGE	3.251	0.891	2.708	3.332	3.871
ROA	0.001	0.409	-0.036	0.019	0.104
DonIntensity	0.002	0.018	0	0	0
CurrentRatio	46.206	192.444	0.629	2.331	12.075
DonGrowth	0.41	2.031	-0.187	0.018	0.269
Private Donations ($ 000)	1.345	11.792	0	0	0
Feeder Donations ($ 000)	1.629	10.964	0	0	0
Government Grants ($ 000)	1447.84	4035.98	40.568	187.4	826.114

Notes: Table 3 presents sample descriptive statistics of the variables used in this study.

Table 4 Social Capital and Board of Director Monitoring as Governance

Dependent Var=	BoardSize	BoardIndep	BoardReview	BoardAuditCom
	(1)	**(2)**	**(3)**	**(4)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0144***	0.0135***	0.0294***	0.0025***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
SIZE	-0.0082***	0.0030***	0.0442***	0.0963***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
AGE	0.0023***	0.0209***	-0.0202***	-0.0007
	(0.0006)	(0.0000)	(0.0000)	(0.2660)
ROA	0.0327***	0.0246***	-0.0341***	-0.0539***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
CurrentRatio	0.0000***	-0.0001***	-0.0001***	-0.0002***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
DonIntensity	-0.3360***	0.1106***	2.0891***	-0.2315***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Constant	0.6882***	0.7650***	-0.1861***	-0.8015***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
R^2	0.068	0.021	0.047	0.193
Adjusted-R^2	0.068	0.020	0.047	0.193
N	866,022	866,022	866,022	866,022

Notes: Table 4 presents ordinary least square (OLS) regression analyses of social capital (*SocialCap*) on four proxies of board of director monitoring. The OLS regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 5 Social Capital and Independent Auditor as Governance

Dependent Var=	AuditIndep
	(1)
Variable	**Coeff.**
SocialCap	0.0207***
	(0.0000)
SIZE	0.0459***
	(0.0000)
AGE	-0.0070***
	(0.0000)
ROA	-0.0093***
	(0.0000)
CurrentRatio	-0.0001***
	(0.0000)
DonIntensity	0.4000***
	(0.0000)
Constant	-0.3907***
	(0.0000)
Year FE	Yes
Industry FE	Yes
R^2	0.061
Adjusted-R^2	0.061
N	866,022

Notes: Table 5 presents ordinary least square (OLS) regression analysis of social capital (*SocialCap*) on AuditIndep which a proxy of monitoring by auditor. The OLS regression model includes year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 6 Social Capital and Written Policy as Governance

Dependent Var=	WrittenPolicy
	(1)
Variable	**Coeff.**
SocialCap	0.0303***
	(0.0000)
SIZE	0.2219***
	(0.0000)
AGE	-0.0775***
	(0.0000)
ROA	-0.1632***
	(0.0000)
CurrentRatio	-0.0005***
	(0.0000)
DonIntensity	1.7739***
	(0.0000)
Constant	-1.1158***
	(0.0000)
Year FE	Yes
Industry FE	Yes
R^2	0.1623
Adjusted-R^2	0.1623
N	866,022

Notes: Table 6 presents ordinary least square (OLS) regression analyses of social capital (*SocialCap*) on WrittenPolicy which is a proxy of governance instrument. The OLS regression models includes year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 7 Robustness tests for governance model by using donation growth as an additional control

Dependent Var=	BoardSize	BoardIndep	BoardReview	BoardAuditCom	AuditIndep	WrittenPolicy
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0175***	0.0088***	0.0298***	-0.0010	0.0211***	0.0246***
	(0.0000)	(0.0000)	(0.0000)	(0.1189)	(0.0000)	(0.0000)
SIZE	-0.0218***	0.0044***	0.0506***	0.1038***	0.0489***	0.2357***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
AGE	-0.0242***	0.0195***	-0.0250***	0.0031***	-0.0110***	-0.0767***
	(0.0000)	(0.0000)	(0.0000)	(0.0001)	(0.0000)	(0.0000)
ROA	0.0422***	0.0165***	-0.0397***	-0.0469***	-0.0096***	-0.1493***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
CurrentRatio	0.0000	-0.0000***	-0.0001***	-0.0002***	-0.0001***	-0.0005***
	(0.5307)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
DonIntensity	-0.4272***	0.0078	1.9285***	-0.2998***	0.2989***	1.4654***
	(0.0000)	(0.6183)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
DonGrowth	0.0014***	-0.0024***	-0.0006*	-0.0059***	-0.0048***	-0.0152***
	(0.0001)	(0.0000)	(0.0659)	(0.0000)	(0.0000)	(0.0000)
Constant	0.9677***	0.7757***	-0.2527***	-0.8928***	-0.4102***	-1.2015***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.0196	0.0146	0.0568	0.2154	0.0655	0.1759
Adjusted-R^2	0.0196	0.0146	0.0568	0.2154	0.0655	0.1759
N	521,530	521,530	521,530	521,530	521,530	521,530

Notes: Table 7 conducts robustness tests of the governance results presented in Tables 4-6. More specifically it controls for donation growth as an additional control variable and presents ordinary least square (OLS) regression analyses of social capital (*SocialCap*) on all six proxies of board of director monitoring. The OLS regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed

tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 8 Robustness tests using logit regressions for indicator governance variables

Dependent Var=	BoardSize	BoardReview	BoardAuditCom	AuditIndep
	(1)	**(2)**	**(3)**	**(4)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0604***	0.1306***	0.0092***	0.1196***
	(0.0000)	(0.0000)	(0.0006)	(0.0000)
SIZE	-0.0341***	0.1963***	0.5226***	0.2595***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
AGE	0.0093***	-0.0900***	-0.0035	-0.0406***
	(0.0007)	(0.0000)	(0.2538)	(0.0000)
ROA	0.1351***	-0.1517***	-0.3010***	0.0106
	(0.0000)	(0.0000)	(0.0000)	(0.2006)
CurrentRatio	0.0001***	-0.0003***	-0.0010***	-0.0009***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
DonIntensity	-1.3700***	9.2155***	-0.7817***	2.0370***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Constant	0.5951***	-3.0462***	-7.2903***	-4.8611***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Pseudo-R^2	0.05	0.365	0.162	0.057
N	866,022	866,022	866,022	866,022

Notes: Table 8 conducts robustness tests of the governance results presented in Tables 4-6. More specifically it presents logit regression analyses (instead of OLS analyses) for governance models where indicator variables are used as dependent variables. The logistic regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of z-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 9 Robustness test using ordered logit regression analysis for WrittenPolicy variable

Dependent Var=	WrittenPolicy
	(1)
Variable	**Coeff.**
SocialCap	0.0485***
	(0.0000)
SIZE	0.3901***
	(0.0000)
AGE	-0.1377***
	(0.0000)
ROA	-0.2933***
	(0.0000)
CurrentRatio	-0.0008***
	(0.0000)
DonIntensity	3.3162***
	(0.0000)
Year FE	Yes
Industry FE	Yes
Pseudo-R^2	0.0741
N	866,022

Notes: Table 9 conducts robustness tests of governance results presented in Table 6 where WrittenPolicy ordinal variable is used. More specifically this table presents ordered logit regression analysis (instead of OLS analysis) for governance models where ordinal variables are used as dependent variables. The ordered logit regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of z-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 10 Disclosure Quality Models Based on Fundraising Expense

Dependent Var=	DQ1	DQ2	DQ1	DQ2	DQ1	DQ2
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0049***	0.2044***	0.0049***	0.2049***	0.0053***	0.1963***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
SIZE	0.0093***	0.7638***	0.0095***	0.7751***	0.0142***	0.7986***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
AGE	0.0002	0.4186***	0.0001	0.4072***	-0.0009**	0.4564***
	(0.4851)	(0.0000)	(0.7199)	(0.0000)	(0.0286)	(0.0000)
DonIntensity	0.5141***	2.9620***	0.5146***	2.9607***	0.4574***	2.8531***
	(0.0000)	(0.0002)	(0.0000)	(0.0002)	(0.0000)	(0.0025)
CurrentRatio	-0.0000***	-0.0001	-0.0000***	-0.0000	-0.0000***	-0.0001
	(0.0000)	(0.2680)	(0.0000)	(0.5917)	(0.0000)	(0.1005)
ROA			-0.0031***	-0.3111***		
			(0.0000)	(0.0000)		
DonGrowth					-0.0010***	-0.0378***
					(0.0000)	(0.0001)
Constant	-0.0914***	-11.9988***	-0.0935***	-12.1201***	-0.1421***	-12.6170***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.0191	0.0458	0.0192	0.0460	0.0242	0.0471
Adjusted-R^2	0.0191	0.0457	0.0192	0.0459	0.242	0.047
N	866,022	866,022	866,022	866,022	521,530	521,530

Notes: Table 10 presents ordinary least square (OLS) regression analyses of social capital (SocialCap) on two proxies of disclosure quality (*DQ1* and *DQ2*) that are based on fundraising expense. The OLS regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 11 Disclosure Quality Models Based on Administrative Expense

Dependent Var=	DQ3	DQ4	DQ3	DQ4	DQ3	DQ4
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0067***	8.4568*	0.0067***	9.3461**	0.0005	8.9956*
	(0.0000)	(0.0574)	(0.0000)	(0.0351)	(0.1796)	(0.0798)
SIZE	0.0109***	568.6932***	0.0110***	585.1023***	0.0173***	591.5922***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
AGE	-0.0170***	199.9159***	-0.0170***	182.1272***	-0.0167***	238.7852***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
DonIntensity	-0.1011***	-2360.9804***	-0.0996***	-2350.9460***	-0.2768***	-2640.2873***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
CurrentRatio	-0.0000***	-0.0213	-0.0000***	0.0495***	-0.0000***	-0.0091
	(0.0000)	(0.1339)	(0.0000)	(0.0007)	(0.0000)	(0.5891)
ROA			-0.0036***	-538.7947***		
			(0.0002)	(0.0000)		
DonGrowth					-0.0021***	4.2421
					(0.0000)	(0.2503)
Constant	0.7630***	-8573.6494***	0.7620***	-8746.0738***	0.7272***	-9050.8116***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.0307	0.3210	0.0307	0.3268	0.0327	0.3343
Adjusted-R^2	0.0307	0.3219	0.0307	0.3268	0.0323	0.3317
N	866,022	866,022	866,022	866,022	521,530	521,530

Notes: Table 11 presents ordinary least square (OLS) regression analyses of social capital (SocialCap) on two proxies of disclosure quality (*DQ3* and *DQ4*) that are based on administrative expense. The OLS regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. Variables are defined in Appendix 1.

Table 12 Robustness tests using logit regressions for indicator disclosure quality variables

Dependent Var=	DQ1	DQ3	DQ1	DQ3	DQ1	DQ3
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.1176***	0.0668***	0.1177***	0.0668***	0.1071***	0.0056
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.3229)
SIZE	0.2492***	0.1028***	0.2495***	0.1043***	0.2958***	0.2544***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
AGE	-0.0162**	-0.1553***	-0.0165**	-0.1557***	-0.0404***	-0.2177***
	(0.0245)	(0.0000)	(0.0229)	(0.0000)	(0.0000)	(0.0000)
DonIntensity	7.2511***	-0.9729***	7.2524***	-0.9587***	5.7915***	-3.2537***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
CurrentRatio	-0.0003***	-0.0002***	-0.0003***	-0.0002***	-0.0003***	-0.0004***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
ROA			-0.0133	-0.0375***		
			(0.6336)	(0.0000)		
DonGrowth					-0.0217***	-0.0265***
					(0.0000)	(0.0000)
Constant	-6.1502***	1.6717***	-6.1529***	1.6525***	-6.6119***	0.2290***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Pseudo-R^2	0.0549	0.0399	0.0549	0.0399	0.0586	0.0599
N	866,022	866,022	866,022	866,022	521,530	521,530

Notes: Table 12 conducts robustness tests of disclosure quality analyses presented in Tables 10-11. More specifically it presents logit regression analyses (instead of OLS analyses) for disclosure quality models where indicator variables (*DQ1* and *DQ3*) are used as dependent variables. The logistic regression models include year (tax filing year of Form 990) and industry fixed effects (NTEE industry classification). The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for one-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates.

Variables are defined in Appendix 1.

Table 13 Robustness tests after controlling for fundraising and/or administrative expense

Panel A:

Dependent Var=	BoardSize	BoardIndep	BoardReview	AuditIndep	WrittenPolicy
	(1)	**(2)**	**(3)**	**(4)**	**(5)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0201***	0.0083***	0.0293***	0.0203***	0.0219***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
CONTROLS	YES	YES	YES	YES	YES
Constant	0.8976***	0.6857***	-0.3511***	-0.6122***	-1.2604***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
R^2	0.0231	0.0241	0.0646	0.0806	0.1772
Adjusted-R^2	0.0230	0.0241	0.0646	0.0805	0.1772
N	521,530	521,530	521,530	521,530	521,530

Notes: This panel conducts robustness tests of the governance results. The OLS regression models include year and industry fixed effects. The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for two-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. CONTROLS include control variables: SIZE, AGE, ROA, CurrentRatio, DonIntensity, DonGrowth, Fundraising and Administrative Expense.

Panel B:

Dependent Var=	DQ1	DQ2	DQ1	DQ2	DQ1	DQ2
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0045***	0.1867***	0.0045***	0.1871***	0.0049***	0.1783***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
CONTROLS	YES	YES	YES	YES	YES	YES
Constant	-0.0775***	-10.6871***	-0.0793***	-10.7891***	-0.1225***	-11.2495***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.0581	0.1036	0.0581	0.1037	0.0625	0.1038
Adjusted-R^2	0.058	0.1035	0.0581	0.1037	0.0625	0.1037
N	866,022	866,022	866,022	866,022	521,530	521,530

Notes: This panel presents ordinary least square (OLS) regression analyses of social capital (SocialCap) on two proxies of disclosure quality (DQ1 and DQ2) that are based on fundraising expense. The OLS regression models include year and industry fixed effects. The main independent variable of interest is SocialCap. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for two-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. CONTROLS in Column 1 and 2 include control variables: SIZE, AGE, DonIntensity, CurrentRatio, and Fundraising Exp. Column 3 and 4 add ROA as an additional control whereas Column 5 and 6 add DonGrowth as an additional control.

Panel C:

Dependent Var=	DQ3	DQ4	DQ3	DQ4	DQ3	DQ4
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**
Variable	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**	**Coeff.**
SocialCap	0.0056***	0.0284***	0.0056***	0.0283***	0.0001	0.0288***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.7685)	(0.0000)
CONTROLS	YES	YES	YES	YES	YES	YES
Constant	0.8933***	0.6861***	0.8976***	0.7005***	0.7497***	0.7287***
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.0598	0.8666	0.0598	0.8666	0.0408	0.8659
Adjusted-R^2	0.0598	0.8666	0.0598	0.8666	0.0408	0.8659
N	866,022	866,022	866,022	866,022	521,530	521,530

Notes: This panel presents ordinary least square (OLS) regression analyses of social capital (SocialCap) on two proxies of disclosure quality (*DQ3* and *DQ4*) that are based on administrative expense. The OLS regression models include year and industry fixed effects. The main independent variable of interest is *SocialCap*. The standard errors are robust. *, **, and *** indicate significance levels at the 0.10, 0.05, and 0.01 level for two-tailed tests. The p-values of t-statistics are presented in parentheses under the coefficient estimates. SIZE, AGE, DonIntensity, CurrentRatio, and Administrative Exp. Column 3 and 4 add ROA as an additional control whereas Columns 5 and 6 add DonGrowth as an additional control.

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