

Encompass Rating System Beta V3

Methodology Documentation



February 2021

Table of Contents

Introduction	3
Methodology Brief 1: Culture & Community Beacon v1 - Constituent Feedback Practices	4
Methodology Brief 2: Finance & Accountability Beacon v2	7
Beacon Weighting for Encompass Rating Beta V3	10

Note: User testing documentation for V3 can be found here:

[User Testing Documentation for V3](#)

Introduction

Charity Navigator began evaluating nonprofits in 2002. The evaluation methodology has evolved over the years as we have edited and added to the original set of metrics. Our goal was to always add to the evaluation so that we can cover more and more aspects of nonprofit operations. Our original star rating system was built around assessing medium to large size, well established organizations who are primarily funded by direct donations from the general public. We also primarily used publicly available data which comes from the IRS Form 990 and a charity's own website.

Encompass Rating Beta V1

In order to scale the overall number of nonprofit organizations evaluated, Charity Navigator launched the Encompass rating system in July of 2020 which allowed our ratings to include over 160,000 nonprofits. The only criteria to be considered for an Encompass rating at this time is that the charity regularly electronically files the Form 990 (990EZ or 990N does not qualify). This automated system allows Charity Navigator to evaluate nonprofit organizations of many sizes, structures and funding models.

Encompass V1 uses data solely from the IRS Form 990 to evaluate Finance & Accountability metrics, but over time has already and will continue to use data points that go beyond the Form 990. The overall goal is to evaluate nonprofits using four core domains (called Beacons) that comprise an overall Encompass score on a 100 point scale..

Encompass Rating Beta V2

In October 2020, Charity Navigator announced the acquisition of ImpactMatters and launched the Impact & Results beacon utilizing the ImpactMatters methodology and data acquired.

Encompass Rating Beta V3

This document explains the methodological choices included in V3 including the first version of the Culture & Community beacon focusing on Constituent Feedback practices and the next version of the Finance & Accountability beacon.

Methodology Brief 1: Culture & Community Beacon v1 - Constituent Feedback Practices

Charity Navigator believes that an organization's culture and commitment to fostering strong connections within their community, including program beneficiaries, staff, board, donors, volunteers and other constituents, can play a key role in helping the organization succeed in its mission.

The Culture & Community beacon will ultimately evaluate several factors related to community connectedness (i.e. the extent to which an organization is engaged with and responsive to their community, both internally and externally) and the health of the organization's culture (i.e. the institutionally held values and beliefs which shape organizational decisions/actions as well as employee perceptions/behaviors). This document will include the methodology for scoring, adjusting, and weighting each domain and details underlying metrics. The first version of the beacon will be based on Constituent Feedback practices.

Domain

1. **Constituent Feedback** - An increasing network of experts are finding through their research and practice that organizations that collect feedback from their beneficiaries and utilize what they learn in their decision-making process may be more effective in pursuit of their stated mission and goals. Feedback practices have been shown to improve program delivery and positively affect Diversity, Equity, and Inclusion outcomes, a domain that that Culture & Community beacon will address as we continue development. Moreover, our partners at Feedback Labs have documented several [studies](#) suggesting that beyond achieving organizational goals, nonprofits that are attentive and responsive to concerns raised by beneficiaries establish stronger relationships with the people they serve, promote greater equity and empower constituents in ways that can help to ensure better long-term outcomes.

Charity Navigator partnered with Feedback Labs, Candid, Global Giving, Fund for Shared Insight, and Keystone Accountability to develop a tool for learning more about how nonprofits are collecting feedback, and how they are listening to their constituents. How We Listen (HWL), the initiative that emerged from this collaboration, is a feedback self-reflection that invites nonprofits to share their listening and feedback practices. Nonprofits answer questions about their listening and feedback practices on GuideStar by Candid, and their responses are summarized on their GuideStar by Candid and Charity Navigator profiles.

The questions for the current HWL (version 1.0) are [here](#). Between October 2019 and October 2020, more than 6,700 nonprofits filled out How We Listen version 1.0. Their responses are live on their GuideStar and Charity Navigator profiles. How We Listen will be updated to version 2.0, which contains two additional questions about high-quality feedback practices, in early January 2021. The HWL version 2.0 questions [are here](#).

- **Metrics and Scoring:**

- **V1:** This is a light touch measure intended to encourage nonprofits to begin collecting feedback, if they don't already, or reflect on their current feedback practices as a means of advancing or improving their practices. Participation is voluntary, however organizations that complete the survey will be rewarded with a full 100 point score for sharing their information publicly. Organizations that do not collect feedback or do not submit their data to Candid will not be penalized. In this way, we believe thousands of nonprofits will be incentivized to develop a feedback practice and to voluntarily submit feedback data to CN/Candid, which we hope will encourage organizations to more readily submit other forms of data to Charity Navigator in the future.

Nonprofits will receive full 100 'points' on the Charity Navigator metric if they:

- respond 'yes' to question 1 of How We Listen, (*"Does your organization collect feedback (i.e., perceptions, opinions, ideas, concerns) from the people you serve?"*)
 - **and** complete all questions 1-6 in [HWL 1.0](#) or questions 1-8 in [HWL 2.0](#)
- **V2:** A second constituent voice metric for inclusion in this beacon will assess the quality of a nonprofit's listening and feedback practices using a 'Net Promoter System' (NPS) approach (e.g. how likely are you to recommend this organization?). This robust quality measure will put more rigor into our evaluation and will likely include a 3rd party validator.

- **Adjustments:**

In some cases, Charity Navigator may find certain variables are only partially applicable or entirely inapplicable to a subset of nonprofits. In order to ensure the assessment is fairly calibrated, when necessary,

adjustments may be made to include/exclude a metric(s) from the evaluation of a subset of organizations. In addition, demographic factors, such as the needs addressed, nonprofit's age, revenue, geographic location, etc., may render some metrics more relevant when evaluating the organization's effectiveness than others. For example, volunteer engagement may be an important indicator for nonprofits that provide direct services, and yet insignificant to the success of grantmaking organizations. Changes to scoring based on cause category and/or operating model will be well documented.

With respect to Constituent Feedback, various factors taken into consideration led to the determination that no adjustments need to be made to this metric at this time.

- Additional analysis of the nonprofits submitting data may lead to greater understanding about the nonprofits that do/do not submit data - e.g. geographical differences, variations based on revenue, cause areas, etc. - which might necessitate some adjustments in future iterations.
 - V2 will include a NPS/validator measure, which might necessitate some adjustments.
 - Since there is no risk of penalty to any nonprofit, and there is no intent to rate responses based on quality or right/wrong, there are no adjustments necessary for V1.
- **Weights:**
 - As this is the first measure released in this beacon, weighting the metric itself may not be as essential as determining how to weight the beacon relative to the other beacons. That said, the first version of this metric will be worth 100% of the beacon upon launch. As additional metrics are introduced in this beacon, the relative value of the Constituent Feedback metric will decrease and thus carry a lower weight relative to other measures within the Culture & Community beacon.

Future Beacon Directions

Future domains being explored for this beacon include:

- Diversity, Equity, Inclusion (DEI)
- People Operations/HR including Staff Engagement/Retention
- Volunteer Base/Engagement
- Net Promoter Metric -- Crowd Sourced Reviews
- Social Sentiment/Media

Methodology Brief 2: Finance & Accountability Beacon v2

The star rating system, which uses our 2.1 methodology, covers over 9,000 nonprofits. These organizations must meet seven criteria to be considered for a star rating which limits the universe. The methodology covers both Finance and Accountability & Transparency metrics. Charity Navigator leverages its historical expertise in these domains to build the Finance & Accountability beacon in Encompass.

Below is a description of the metrics and methodology used in the current version of the Encompass Finance & Accountability beacon, along with reasoning as to why each metric was chosen.

METRICS:

- 1. Program Expense Ratio:** 70% or more passes (85% of charities pass)
 - a. If a charity fails to have 50% or higher then both financial meters are zeroed out.

---Nonprofit organizations exist to provide programs and services. Charity Navigator believes that while charitable organizations will always have to account and spend funds on fundraising and administrative expenses, they fulfill their mission and meet the expectations of donors when they allocate most of their budgets towards their programs. Nonprofits that consistently underspend on their programs and services do not have as strong an impact on their mission. The data set we reviewed showed that the average and median program spend was 83.6% and 86.10% respectively. Therefore, we believe that setting the requirement at 70% is a fair marker to display that an organization is meeting industry standards. It is also an important metric to donors who want to ensure that the majority of a charity's budget is allocated to its mission.

- 2. Liabilities to Assets (LTA) Ratio:** <50% passes (82% of charities pass)

---Nonprofits must be mindful of their management of their total liabilities in relation to their total assets. A high LTA ratio can signal potential risks of solvency and sustainability. This includes the issue of financial resources being allocated to debt payments and other obligations that may not be properly funded. This metric displays how well a charity is managing this balance between their outstanding liabilities and their assets on hand. The data set we reviewed displayed that the average LTA ratio for the nonprofits reviewed was 77%. Therefore we believe that

setting the requirement at 50% will show that when charity's liabilities are more than half of assets they are not only outside the norm of most charities analyzed but may be financially vulnerable.

3. Website URL Listed on 990: Straight Yes or No, Yes Passes (72% of charities pass)

---We expect most nonprofits to have some kind of online presence. The IRS Form 990 has a field for the charity to enter their website URL. A Facebook page address is acceptable as well. We believe having an online presence and sharing the charity's URL is a sign of transparency as we hope the website or Facebook page will include other key information and data points about a nonprofit.

4. Audited Financials, Review/Compilation: Yes to either of the two related 990 questions passes (51% of charities pass)

- a. Charities with \$1mil+ in Total Revenue must have Audit (Possibly use [U.S. state requirements](#) as our guide)
- b. This indicator will not apply to very small Charities (under \$250K Total Revenue). Scored as N/A for those.

---Charity Navigator believes that it is good governance for a nonprofit to have their financial statements either audited, reviewed or compiled by an independent accountant. We understand the costs associated with this work and so we have scaled this metric by size. Using current state by state requirements as a guide, we set our guidelines for this metric so if a nonprofit has over \$1million in total revenue then the full audit is expected. And if the nonprofit has under \$250,000 in total revenue this metric is not applied. Nonprofits that fall between those two revenue thresholds are expected to have either the review or compilation completed.

5. Independent Board of Directors: >51% independence passes (89% of charities pass)

- a. Must have at minimum 3 total board members

---The presence of an independent governing body is strongly recommended to allow for a full deliberation and diversity of thinking on governance and other organizational matters. Per the IRS, a best practice when establishing a nonprofit is that it begins its operation with at least a total of three board members. For this metric we look to see that there are three total board members at minimum and that more than 51% of the board is made up of independent members.

6. Documents board meeting minutes:

- a. No exceptions

-- An official record of the events that take place during a board meeting ensures that a contemporaneous document exists for future reference. For this metric, we are checking to see if the organization reports on their Form 990 that it does document board meeting minutes.

7. Whistleblower policy:

- a. No exceptions

-- A whistleblower policy outlines procedures for handling employee complaints, as well as a confidential way for employees to report any financial mismanagement. Here we are reporting on the existence of a policy as reported by the charity on its Form 990.

8. Conflict of interest policy:

- a. No exceptions

-- A conflict of interest policy protects the organization, and by extension those it serves, when it is considering entering into a transaction that may benefit the private interests of an officer or director of the organization. For this metric, we are checking to see if the organization reports on their Form 990 that they have this policy in place.

9. Records retention and destruction policy:

- a. No exceptions

-- A records retention and destruction policy establishes guidelines for handling, backing up, archiving and destruction of documents. These guidelines foster good record keeping procedures that promote data integrity. We are reporting the existence of this policy as reported by the nonprofit on its Form 990.

Beacon Weighting for Encompass Rating Beta V3

The first version of Community & Culture beacon is lightweight with a low barrier to entry. In order to encourage broad adoption, we are giving full credit for participating in Constituent Feedback practice and submitting a brief survey. As such, our initial weight for the beacon is a low 5%. Furthermore, we will not give an overall Encompass Rating for only having Constituent Feedback data. The following weights will be assigned for V3:

All Three Beacons Evaluated

Impact & Results	60%
Finance & Accountability	35%
Culture & Community	5%

Two Beacons Evaluated

Impact & Results	60%
Finance & Accountability	40%
-or-	
Impact & Results	95%
Culture & Community	5%
-or-	
Finance & Accountability	95%
Culture & Community	5%

One Beacon Evaluated

Finance & Accountability	100% of overall rating
Impact & Results	100% of overall rating
Culture & Community	will not receive an overall rating,