

**NON-PROFIT ORGANIZATIONS SHOULD PRIORITIZE
GOVERNANCE IN BOARD SELECTION DECISIONS—
THOSE THAT PRIORITIZE MONEY MAY PAY TOO MUCH**

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ABSTRACT

Non-profit corporations must comply with federal tax laws, and their governing bodies must satisfy corporation law-based duties, but they are not subject to the regulatory requirements of publicly traded corporations. This discrepancy should be troubling, because the stakeholders of non-profit organizations are far more vulnerable than the typical investor. Accordingly, non-profit boards have a particularly strong need for good governance. However, our research shows that non-profit board members believe that board selection procedures prioritize giving over the ability to attract and retain members with attributes commonly associated with good governance. To address this problem, we argue that laws should require non-profit organizations to identify directors making contributions and the amounts of those contributions, as well as certify that quality governance is the top priority of the organizations in selecting governing board members. To do otherwise improperly validates the decisions of organizations to accept money in exchange for influence at the expense of their duties to stakeholders.

TABLE OF CONTENTS

INTRODUCTION	445
I. BACKGROUND.....	446
A. Non-Profit Reporting Requirements Under the I.R.C. and Board Member Contributions.....	447
B. Non-Profit Governance and Board Duties.....	449
C. Legal Framework.....	450
II. REVIEW OF THE STUDY.....	456
A. Motivation for the Study	456

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B. Methodology.....456

C. Data.....456

D. Analysis.....459

E. Results.....459

III. DISCUSSION467

 A. Risks of Loss at Non-Profits due to Malfeasance468

 B. Undisclosed Contributions of Directors472

 C. Potential Solutions.....474

CONCLUSION.....476

Another frequent error of non-profit boards is inviting new members because of their marquee name within a certain field of endeavor (e.g., a famous dancer on the board of a dance organization) or their means and inclination to donate, without due consideration to the person's ability and availability to fulfill fiduciary duties, providing the critical oversight function. The governing body of a non-profit must be made up entirely of people in a position to govern it—setting the strategic direction of the organization and overseeing management's execution of the mission.

- *Lesley Rosenthal*, Counsel
Lincoln Center for the Performing Arts¹

INTRODUCTION

Non-profit stakeholders deserve special protection because they exist to serve public purposes at public expense, but they lack the power and options held by the stockholders of for-profit corporations. Thus, it is all the more essential that non-profits benefit from good governance. This study was motivated by the concern that non-profits may be trading good governance for the ability of directors to contribute funds to the organizations. The research performed shows the non-profit leaders surveyed report that their boards *do* prioritize the ability to give financially when recruiting and retaining board members. They also divulged that this practice negatively affects the organizations' ability to attract and retain diverse skillsets and engaged board members. Compounding this troubling finding is that, in the United States, the current disclosure regime for non-profit governance does not require disclosure of board member contributions and does not sufficiently require boards to prioritize governance in board selection procedures. To begin to address this problem, the government should enact laws that require non-profits to disclose the names of directors making contributions and certify that quality governance is the first priority of the organization in selecting persons to serve on its governing body. To do

1. Lesley Rosenthal, *Nonprofit Corporate Governance: The Board's Role*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 15, 2012), <https://corpgov.law.harvard.edu/2012/04/15/nonprofit-corporate-governance-the-boards-role/> [<https://perma.cc/DH8X-UR83>].

otherwise improperly validates the decisions of organizations to accept money in exchange for influence at the expense of their duties to stakeholders.

I. BACKGROUND

In the United States, publicly traded companies are subject to federal securities laws,² Securities and Exchange Commission (SEC) regulations,³ and exchange rules.⁴ These provisions protect the integrity of markets, ensure that stockholders are provided with information material to their investment decisions, and support well-developed governance frameworks.⁵ Unfortunately, these regulations are largely absent in the non-profit context.⁶ As Ira Millstein explained while testifying before the U.S. Senate about the importance of non-profit governance:

The same mechanisms by which for-profit officers and directors are held accountable for their actions are missing in the nonprofit context. Once a nonprofit organization receives a contribution there is no one to hold the organization accountable for how that money is spent. Indeed, while officers and directors have a fiduciary duty to fulfill the mission of their organization, that mission cannot hold them

2. U.S. Sec. & Exch. Comm'n, *The Laws that Govern the Securities Industry*, INVESTOR, <https://www.investor.gov/introduction-investing/investing-basics/role-sec/laws-govern-securities-industry> [<https://perma.cc/YV3L-S3CU>] (last visited Jan. 20, 2022) (identifying and describing laws that public companies must follow).

3. *Rules and Regulations for the Securities and Exchange Commission and Major Securities Laws*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/about/laws/secrulesregs.htm> [<https://perma.cc/7PPX-EBY7>] (last visited Jan. 20, 2022).

4. See, e.g., N.Y. STOCK EXCH., NYSE LISTED COMPANY MANUAL: SECTION 303A CORPORATE GOVERNANCE STANDARDS FREQUENTLY ASKED QUESTIONS, https://www.nyse.com/publicdocs/nyse/regulation/nyse/FAQ_NYSE_Listed_Company_Manual_Section_303A_7_28_2021.pdf [<https://perma.cc/SL2X-HVYM>] (last visited Jan. 20, 2022).

5. See *About the SEC*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/about.shtml> [<https://perma.cc/HW6U-6HSN>] (last visited Apr. 10, 2022). See generally U.S. Sec. & Exch. Comm'n, *supra* note 2.

6. See generally *The Tax Code and Land Conservation: Report on Investigations and Proposals for Reform: Hearing Before the Comm. on Fin.*, 109th Cong. 3 (2005) [hereinafter *Hearing*] (statement of Ira M. Millstein of Weil, Gotshal & Manges LLP).

accountable in the same way that shareholders can in the for-profit world.⁷

In other words, although non-profit corporations must comply with federal tax laws, and their governing bodies must satisfy corporation law-based duties, they are not subject to the regulatory requirements of publicly traded corporations. This discrepancy is distressing because the stakeholders of non-profit organizations are far more vulnerable than the typical investor, let alone the institutional investors that collectively manage hundreds of trillions of dollars.⁸ Additionally, for-profit shareholders who believe that their organization is nonresponsive can sell their stock, vote for the removal of directors, and even commence shareholder derivative actions alleging a breach of fiduciary duties. However, generally, non-profits lack these vital safeguards.

A. NON-PROFIT REPORTING REQUIREMENTS UNDER THE I.R.C. AND BOARD MEMBER CONTRIBUTIONS

Non-profit organizations deserve special protection because they exist to serve public welfare purposes but do so at public expense because they do not pay taxes. Among the most salient differences between for-profit and non-profit corporations is the requirement that non-profits organize around social welfare-based missions.⁹ Those missions require protection and oversight by well-functioning boards, and their governance should not be undermined by pay-to-play clubs. Furthermore, it is unclear how much money organizations get in return for selecting such board members. Internal Revenue Code (I.R.C.) Sections 6104(b) and 170(b)(1)(A) do not require board members to disclose their contributions; hence, most organizations do not.¹⁰ Even a relatively small sum from the perspective of a large organization may still be a

7. *Id.*

8. *Id.* See also Record 631 *Institutional Investors Managing More than \$37 Trillion in Assets Urge Governments to Step up Ambition to Tackle Global Climate Crisis*, CERES (Dec. 9, 2019), <https://www.ceres.org/news-center/press-releases/record-631-institutional-investors-managing-more-37-trillion-assets-urge> [<https://perma.cc/C2F8-QR8K>]; Nick Price, *Who Governs Nonprofit Organizations?*, BD. EFFECT (Feb. 21, 2018), <https://www.boardeffect.com/blog/governs-nonprofit-organizations/> [<https://perma.cc/WDR9-H7YW>].

9. See generally Erica Harris et al., *The Effect of Nonprofit Governance on Donations: Evidence from the Revised Form 990*, 90 ACCT. REV. 579 (2015).

10. I.R.C. §§ 6104(b), 170(b)(1)(A).

prohibitively high figure to ask of otherwise qualified prospective board members. To demonstrate this point, imagine that the board of a large non-profit organization requests that a university professor who specializes in employment law serve on its board, accompanied by an ask for a \$10,000 donation. Although the professor would make an excellent addition to the board with her talents, she makes \$100,000 per year and declines to serve because she cannot afford the donation. In that example, the board lost a significant benefit—improved governance. The board should have accepted her and not prioritized a donation over its governance. It could have commemorated any such donation by conferring naming rights, creating an honorary or advisory board, awarding an honorary doctorate, or providing another honor that would not harm the organization's ability to govern its affairs.

There is a strong and developing line of research that uses publicly available data from Internal Revenue Service (IRS) Form 990, which non-profits are required to file, to demonstrate strong positive relationships between good governance and organization performance. For example, researchers created a matrix from IRS Form 990 disclosures that ranked organizations based on their governance practices and found that donations and grant levels correlate positively with their governance measures.¹¹ Other studies have similarly found that increased transparency correlates positively with organizational performance.¹² If good governance practices trend positively with organization performance, it is reasonable to assume that those practices would associate negatively with fraud and diversion of organization assets. Additional research has borne this hypothesis out.¹³

These studies, however, are stunted by the limited transparency of non-profits that decline to disclose the identities of their contributors or the amounts of their contributions. Accordingly, neither rating entities nor non-profit stakeholders can assess whether those non-profits prioritize the selection of directors based on their ability to give. Consequently, researchers cannot know whether such practices interfere with the non-profit's ability to select board members with the skills

11. Harris et al., *supra* note 9, at 591-95.

12. Erica E. Harris & Daniel Neely, *Determinants and Consequences of Nonprofit Transparency*, 36 J. ACCT., AUDITING & FIN. 195, 196 (2021).

13. Erica Harris et al., *Why Bad Things Happen to Good Organizations: The Link Between Governance and Asset Diversions in Public Charities*, 146 J. BUS. ETHICS 149, 164 (2017).

necessary to govern the organization. Moreover, they do not know whether the level of giving rises to such a level that it could be reasonable to claim that the contribution was worth the loss in good governance.

B. NON-PROFIT GOVERNANCE AND BOARD DUTIES

Non-profit organizations perform necessary social services that the state either does not provide at all or cannot perform to the level that meets the needs of society. Recently, the burden of providing social services to members of our society who are most in need shifted toward non-profit organizations.¹⁴ Given their role, diligent oversight by regulatory authorities and skilled internal governance are essential to making sure that organizations fulfill their essential missions. A study analyzing the effect of non-profit governance on donations defined non-profit governance as “the set of internal and external mechanisms designed to ensure that managers are working to fulfill their organization’s charitable mission and fiduciary responsibilities and, in turn, to minimize the misuse of charitable assets.”¹⁵ Likewise, during his testimony before the U.S. Senate Finance Committee, Millstein explained that the role of the board in our non-profit system is to provide such protection, explaining that its purposes include:

[C]ontinuously reviewing, adapting and strengthening its oversight responsibilities to meet the changing needs of the organization. Increasing transparency, adopting conflict of interest policies and whistleblower procedures, and recruiting individuals with financial or other skills necessary for the organization are all important, but underlying such reforms is a fundamental need to make boards understand their role.¹⁶

As a result, directors need to focus on oversight, mission, transparency, adoption of policies, and identification and selection of the officers who will run the organization. These are critical roles that should be held by well-suited individuals, not simply those who can contribute money.

14. Ann Goggins Gregory & Don Howard, *The Nonprofit Starvation Cycle*, STAN. SOC. INNOVATION REV. 49, 50 (2009).

15. Harris et al., *supra* note 9, at 580.

16. *Hearing*, *supra* note 6, at 3-4.

C. LEGAL FRAMEWORK

Although a complete review of the laws that govern the operations of organizations is beyond the scope of this Article, this section provides an overview of the basic legal framework. The purpose here is to show the importance of board selection procedures and how they are designed to produce boards with the appropriate and necessary skills to govern the organization, and to demonstrate how current practices and policies fail to meet the reasonable expectations of non-profit stakeholders.¹⁷

The main legal distinction between non-profit and for-profit corporations is that the focus of the former is social welfare or charitable missions, whereas the focus of the latter is accumulation of profit.¹⁸ Because of their beneficent nature, non-profits are afforded different rules that may be interpreted as more lenient than the rules for for-profit organizations.¹⁹ Accordingly, laws exist to ensure that each type of corporation properly pursues those purposes.²⁰ These statutory controls come from the I.R.C., which gives non-profit organizations life and tax-exempt status.²¹ Most non-profits organize pursuant to the I.R.C.

17. Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance: A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 352, 355-56, 399-402 (2012). See also Michael L. Fassler & Jennifer Pendergast, *Selecting Board Members: Guidelines for an Effective Nominating Process*, FAM. BUS. CONSULTING GRP. (Dec. 4, 2017), <https://www.thefbcg.com/resource/selecting-board-members-guidelines-for-an-effective-nominating-process/#:~:text=Importance%20of%20process&text=Selecting%20them%20is%20not%20a,is%20your%20roadmap%20and%20guide> [https://perma.cc/8PU5-J437].

18. *Non Profit vs For Profit: Everything You Need to Know*, UPCOUNSEL, <https://www.upcounsel.com/non-profit-vs-for-profit> [https://perma.cc/2YRU-3PG4] (last visited Apr. 10, 2022).

19. Emily Heaslip, *Nonprofit vs. Not-for-Profit vs. For-Profit: What's the Difference?*, U.S. CHAMBER, <https://www.uschamber.com/co/start/strategy/nonprofit-vs-not-for-profit-vs-for-profit#:~:text=%E2%80%9CA%20for%2Dprofit%20can%20raise,from%20individuals%2C%20foundations%20and%20corporations> [https://perma.cc/TM8T-KB3F] (last visited Apr. 10, 2022). See also Shoshanna Delventhal, *The Pros and Cons of Being a Nonprofit*, INVESTOPEDIA, <https://www.investopedia.com/articles/investing/110215/pros-and-cons-being-nonprofit.asp> [https://perma.cc/VQN5-MTW8] (last updated July 13, 2020).

20. I.R.C. §§ 501(c)(3)-(4), 527.

21. *Id.*

501(c)(3),²² but others, particularly those whose main purpose is to engage in political activities, organize under § 527.²³ Other social welfare groups organize under § 501(c)(4), which permits them to engage in some political activities so long as it is not their main purpose.²⁴ That said, most non-profit organizations do not have to disclose the identities of their donors.²⁵ The disclosure requirements stem from I.R.C. § 6104(b), which provides for the inspection of “the information required to be furnished” in the tax returns of non-profits, but then claws back the requirement to disclose “the name or address of any contributor . . . (other than . . . a political organization exempt from taxation under section 527)” or a private foundation.²⁶ Accordingly, non-profits organized under § 501(c)(3) do not have to disclose their donors. That includes donors who are also board members. In the absence of knowledge about donations, it is difficult to determine whether decisions to prioritize contributions harm board performance. If non-profits engage in for-profit activities²⁷ or fail to file their tax returns (IRS Form 990),²⁸ the IRS, state, or local authorities may strip them of their tax-exempt status and treat them as

22. I.R.C. § 501(c)(3). Non-profits are also statutorily required to be “operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes.” *Id.*

23. I.R.C. § 527.

24. Otherwise, the IRS may reclassify § 501(c)(4) organizations that do not operate as social welfare organizations as I.R.C. § 527 organizations, which must disclose the identities of their donors to the IRS. Rick Cohen, *IRS Strips Electoral Group of 501(c)(4) Status; Will Widespread Crackdown Follow?*, NONPROFIT Q. (June 11, 2012), <https://nonprofitquarterly.org/irs-strips-electoral-group-of-501c4-status-will-widespread-crackdown-follow/> [https://perma.cc/MSG6-3HRF].

25. I.R.C. § 6104(b).

26. I.R.C. § 170(b)(1)(A) sets forth the exception. I.R.C. § 6104(b).

27. See I.R.S. Gen. Couns. Mem. 39,498 (Jan. 28, 1986). *But see* Marni Jameson Carey, *How Nonprofit Hospitals Get Away with the Biggest Rip Off in America*, MED. ECON. (Jan. 17, 2020), <https://www.medicaleconomics.com/med-ec-blog/how-nonprofit-hospitals-get-away-biggest-rip-america/> [https://perma.cc/V9YJ-AAFT].

28. See, e.g., Charlie Kratovil, *IRS Strips Tax-Exempt Status from Brunswick-Based Police Agency*, NEW BRUNSWICK TODAY (Feb. 19, 2017), <https://newbrunswicktoday.com/2017/02/19/irs-strips-tax-exempt-status-from-brunswick-based-police-agency/> [https://perma.cc/8Y5Y-JXEX]. See also Emily Schultheis, *IRS Strips Richard Spencer’s Nonprofit of its Tax-Exempt Status*, CBS NEWS (Mar. 14, 2017, 11:38 AM), <https://www.cbsnews.com/news/irs-strips-richard-spencer-nonprofit-of-its-tax-exempt-status/> [https://perma.cc/4KTE-7NXW].

for-profit entities.²⁹ State attorneys general may also sue non-profit organizations that are believed to be violating the law to recover assets wasted by the organization or obtain orders withdrawing their charters.³⁰ It is therefore essential that boards have procedures in place to ensure that their organizations are complying with applicable laws in order to remain focused on their missions and maintain their preferable status.³¹

In contrast to the disclosure-based framework of the IRS, which requires non-profits to make certain disclosures, for-profit organizations are governed by explicit laws and stock exchange rules that require certain conduct.³² For example, New York Stock Exchange (NYSE) rules require listed companies to perform a host of activities, such as self-evaluations to determine the extent to which their boards and committees (including any nominating committees) are performing their responsibilities. Those rules and common practices include requirements that a public company:

- Performs an annual self-evaluation to determine whether its nomination committee (or the group performing similar functions) is “functioning effectively”;³³

29. *Instructions for Form 990 Return of Organization Exempt from Income Tax* (2021), IRS (Dec. 16, 2021), https://www.irs.gov/instructions/i990#en_US_2021_publiclink11283jd0e1650 [<https://perma.cc/QFH4-A868>]. *See generally*, Int’l Sch. Servs., Inc. v. W. Windsor Twp., 991 A.2d 848 (N.J. Super. Ct. App. Div. 2010) (denying tax exempt status of organization for using its property for profit). *See also* Andrew Kitchenman, *Deal Strips Morristown Medical Center of Some of Its Tax-Exempt Status*, NJ SPOTLIGHT NEWS (Nov. 12, 2015), <https://www.njspotlight.com/2015/11/15-11-11-agreement-strips-morristown-medical-center-of-some-of-its-tax-exempt-status/> [<https://perma.cc/ZS69-9TR7>].

30. *See, e.g., AG Racine Sues Failed Nonprofit Related to U.S. Pavilion at World’s Fair for Improperly Paying Founds More Than \$360K in Charitable Funds*, OFF. ATT’Y GEN. FOR D.C. (June 8, 2021), <https://oag.dc.gov/release/ag-racine-sues-failed-nonprofit-related-us> [<https://perma.cc/7LCF-9BAC>].

31. Harvey J. Goldschmid, *The Fiduciary Duties of Nonprofit Directors and Officers: Paradoxes, Problems, and Proposed Reforms*, 23 J. CORP. L. 631, 633 (1998).

32. Erica Harris et al., *supra* note 9, at 581.

33. Corporate Governance Guidelines, § 303A.09 N.Y.S.E. Listed Co. Manual (CCH) (amended Nov. 25, 2009), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-77 [<https://perma.cc/2VSQ-6QN3>].

- “[Makes] its corporate governance guidelines available on or through its website”;³⁴
- “[Has] a nominating/corporate governance committee composed entirely of independent directors”;³⁵
- Adopts a written charter for its nominating committee;³⁶
- “[Identifies] individuals qualified to become board members, consistent with criteria approved by the board”;³⁷
- Has a charter that addresses “an annual performance evaluation of the committee”;³⁸
- “[Makes] its nominating/corporate governance committee charter available on or through its website”;³⁹
- Discloses “[a] description of . . . any specific, minimum qualifications that the nominating committee believes must be met by a nominee in

34. *Id.*

35. Nominating/Corporate Governance Committee, 303A.04(a) N.Y.S.E. Listed Co. Manual (CCH) (amended Nov. 25, 2009), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-72 [<https://perma.cc/W48K-7ZUL>].

36. Nominating/Corporate Governance Committee, 303A.04(b) N.Y.S.E. Listed Co. Manual (CCH) (amended Nov. 25, 2009), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-72 [<https://perma.cc/PBH6-AE5N>].

37. Nominating/Corporate Governance Committee, 303A.04(b)(i) N.Y.S.E. Listed Co. Manual (CCH) (amended Nov. 25, 2009), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-72 [<https://perma.cc/T6NF-E9P4>].

38. Nominating/Corporate Governance Committee, 303A.04(b)(ii) N.Y.S.E. Listed Co. Manual (CCH) (amended Nov. 25, 2009), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-72 [<https://perma.cc/A8MH-FLT2>].

39. *Id.*

order to be considered for nomination by the committee to the company's board of directors;⁴⁰

- Discloses “any specific qualities or skills that the nominating committee believes are necessary for one or more of the company's directors to possess”;⁴¹
- Discloses “processes for identifying and evaluating director nominees”;⁴² and
- Discloses whether they pay a third party or parties “to identify or evaluate or assist in identifying or evaluating potential nominees, the function performed by each such third party.”⁴³

Non-profits do not face these explicit requirements for good governance. This is an unfortunate revelation given that their stakeholders are among the most vulnerable and underserved. Non-profit stakeholders lack the protections of securities laws.⁴⁴ Further, their boards are volunteers, and they are not subject to extensive regulatory oversight.⁴⁵ As such, it is all the more essential for them to select board members based on their ability to govern, and not prioritize their capacity to donate money as a prerequisite to service in a way that will interfere with that preeminent responsibility.

In general, state corporation laws provide that “the business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors [As they are corporations, non-profit organizations] are governed by boards of directors (or trustees).”⁴⁶ Like their for-profit counterparts, directors of non-profit organizations own

40. *SEC Adopts Final Rules Regarding Nominating Committee Functions and Communications Between Security Holders and Board of Directors*, FINDLAW, <https://corporate.findlaw.com/corporate-governance/sec-adopts-final-rules-regarding-nominating-committee-functions.html> [<https://perma.cc/Q8ME-RYHH>] (last updated Mar. 26, 2008).

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Can Board Members Be Paid?*, NAT'L COUNCIL NONPROFITS, <https://www.councilofnonprofits.org/tools-resources/can-board-members-be-paid> [<https://perma.cc/5T6F-ZEWJ>] (last visited Apr. 10, 2022). *See also* Price, *supra* note 8.

46. DEL. CODE ANN. tit. 8 § 141(a) (2020).

duties of care, loyalty, and good faith.⁴⁷ The duty of care requires directors adhere to reasonable standard of care and make informed decisions.⁴⁸ Duty of loyalty issues arise where a director puts his interests above that of the organization or its stakeholders.⁴⁹ This duty requires that, in making a decision for the organization, directors act for its benefit, and not to benefit themselves or an outside interest at the organization's expense.⁵⁰ The Third Circuit Court of Appeals explained that "[t]he duty of loyalty . . . requires that corporate officers devote themselves to the corporate affairs with a view to promote the common interests and not their own."⁵¹ As a result, under both the duty of care and the duty of loyalty, board members must act in good faith.⁵² Similarly, directors and their boards must maintain the "good faith belief [that they are] acting in the corporation's best interest."⁵³ Although the business judgment rule presumes that directors act in good faith, the presumption may be rebutted where the directors have "knowledge concerning the matter in question that would cause [their] reliance to be unwarranted"⁵⁴ or where there is evidence of self-dealing.⁵⁵

Non-profit boards also have an additional obligation that derives from the condition that non-profits further a social welfare mission: the duty of obedience.⁵⁶ "The duty of obedience . . . describe[s] the board's obligation to remain faithful to the organization's purpose and mission."⁵⁷ As a result of these duties, non-profit organizations need protection by boards that focus on governance.

47. See, e.g., *In re Lemington Home for the Aged*, 777 F.3d 620, 626-28 (3d Cir. 2015).

48. See Hazen & Hazen, *supra* note 17, at 356.

49. *Id.*

50. *Id.* at 381.

51. *In re Lemington Home*, 777 F.3d at 626 (internal citations and quotations omitted).

52. *Id.*

53. See Hazen & Hazen, *supra* note 17, at 375.

54. 15 PA. CONS. STAT. § 5712(b) (2021).

55. Adam Hayes, *Business Judgment Rule*, INVESTOPEDIA, <https://www.investopedia.com/terms/b/businessjudgmentrule.asp#:~:text=A%20legal%20staple%20in%20common,care%20directors%20owe%20to%20stakeholders> [https://perma.cc/DPQ3-ZMWA] (last updated Apr. 27, 2022).

56. See Hazen & Hazen, *supra* note 17, at 386-87.

57. *Id.* at 356.

II. REVIEW OF THE STUDY

A. MOTIVATION FOR THE STUDY

The motivation for this Study was prompted by a concern that non-profit boards are prioritizing the ability to contribute funds over the ability to contribute to good governance. The purpose of this Study is to empirically test whether non-profit management believes that their boards prioritize the ability to contribute money in board selection and retention procedures. It also measured whether non-profit leadership felt that any such procedures compromised organizational outcomes.

B. METHODOLOGY

This Study seeks to answer two primary research questions related to non-profit board membership and governance: 1) Do non-profit executive officers report that their organization prioritizes board membership based on an individual's ability to give?; and 2) Do they report that prioritizing a board member's ability to give financially affects the organization's capacity to attract and retain board members with diverse skillsets, which ensures organizational success?

C. DATA

We surveyed 620 executive officers of non-profit organizations about their board selection practices. We purchased access to an opt-in survey panel of professionals through the market research firm Opinions 4 Good (Op4G).⁵⁸ Our team, including a lawyer specializing in business ethics and survey research experts from Temple University's Institute for Survey Research, an academic survey research center, drafted the questionnaire by drawing on literature concerning non-profit management. After several months of reviewing, refining, and pilot testing the instrument, the questionnaire was programmed into Qualtrics, (Qualtrics) a powerful online survey tool,⁵⁹ and survey links were sent to

58. *About*, OPINIONS4GOOD, <https://opinions4good.com/about/> [<https://perma.cc/Q2RK-NX72>] (last visited Apr. 21, 2022).

59. *Build Technology that Closes Experience Gaps*, QUALTRICS, <https://www.qualtrics.com/about/> [<https://perma.cc/Z2EY-9SXB>] (last visited Apr. 21, 2022).

Op4G for distribution to their large, professional network of non-profit executives.

The first question on the survey screened for non-profit senior leaders, such as Chief Executive Officers (CEOs), Chief Financial Officers (CFOs), Chief Operating Officers (COOs), Executive Directors, and Directors of Development. These senior leaders were subsequently asked a series of questions about board selection practices, including their opinions on whether those practices were effective in attracting and retaining a board with diverse skillsets, and opinions about whether they personally believed that prioritizing board member giving resulted in good board governance and organizational success. The non-profit leaders were also asked about the size of their organization and whether there were explicit expectations of board giving and amounts expected.

Op4G deployed the survey to a very large panel of professionals recruited through various trade associations and professional memberships. The sample selection criteria included high-level executives of non-profit organizations with an annual budget larger than \$100,000. We used quota sampling to ensure responses from non-profit organizations with annual budgets within five ranges: \$100,000 to \$499,999; \$500,000 to \$999,999; \$1,000,000 to \$4,999,999; \$5,000,000 to \$9,999,999; and \$10,000,000 or more.⁶⁰ The goal was to have 40 respondents in each group for an initial total sample size of n=200. Table 1 indicates the distribution of respondents by annual organizational budget size⁶¹ and Table 2 shows the distribution of size of the organization by number of employees.⁶²

60. Quota sampling is a type of non-probability sampling method. This means that elements from the population are chosen on a non-random basis, and all members of the population do not have an equal chance of being selected to be a part of the sample group. However, it does ensure representativeness across an *a priori* set of strata, here organizational sizes. The goal is to eliminate post-stratification weighting of the data.

61. See *infra* Table 1.

62. See *infra* Table 2.

Table 1. Respondents by Annual Budget Size of the Organization

Annual Budget of Organization	n	Percent
\$100,000 - \$499,999	124	20
\$500,000 - \$999,999	127	21
\$1,000,000 - 4,999,999	120	19
\$5,000,000 - 9,999,999	126	20
\$10,000,000+	123	20

There is an equal distribution across budget sizes because we used quota sampling to ensure representation of this organizational trait. The number of employees working at each organization is set forth in Table 2.

Table 2. Respondents by Number of Employees Working at the Organization

Number of Employees	n	Percent
0-10	117	19
11-50	189	31
51-100	139	22
101-500	125	20
500+	50	8
Total	620	100

The distribution of respondents by total number of organizational employees indicates that percentage of respondents is slightly higher (31 percent) in the 11-50 category and much smaller (8 percent) in the largest category of 500 employees and above, which is representative of the overall numbers of these types of organizations. Op4G provided unique identifiers for each respondent, as well as IDs for any non-eligible respondents (“non-eligibles”) due to the quota sampling.⁶³ The data were

63. A respondent becomes non-eligible to be included in the study sample if he or she meets the qualifications to be included, but the desired total number of respondents in a particular strata (here, organizational budget size) has already been reached.

uploaded to Statistical Package for the Social Science (SPSS) for analysis.⁶⁴

D. ANALYSIS

We conducted statistical analyses of all three data extracts separately to satisfy any concerns that there were statistical differences among the samples. Responses and patterns were consistent across all three samples, so we analyzed a final data extract of the full dataset. Analyses included univariate descriptive statistics,⁶⁵ as well as bivariate crosstabs,⁶⁶ and Chi-square tests⁶⁷ to determine statistical significance of any observed associations. We used a significance threshold (the “p-value”) of .05, and, to manage any issues of multiple testing, we tested only those hypotheses that would provide evidence for or against the three main research questions.

E. RESULTS

To answer the first research question, “[d]o non-profit executive officers report that their organization prioritizes board membership based on an individual’s ability to give?,” we analyzed a series of Likert-type questions where executives were asked “to what extent to you agree or disagree” with a series of statements about their organization.⁶⁸ The

64. *SPSS – Statistical Package for Social Sciences*, STAT. SOLS., <https://www.statisticssolutions.com/spss-statisticalpackageforsocialsciences/> [<https://perma.cc/9R5L-JAYG>] (last visited Apr. 21, 2022).

65. Univariate descriptive statistics imply the calculation of the preferred estimate (mean, proportion) on each question (variable) individually.

66. Bivariate descriptive statistics include analyses of two variables at once. For example, a cross-tabulation of a perception of board’s ability to attract and retain diverse skillsets alongside organizational size. This allows the researcher the ability to detect differences in non-profit leaders’ opinions or perceptions across organizational sizes.

67. Chi-square tests are used to determine whether or not the differences or trends detected in the cross-tabulation are statistically significant given the sample size, and type-I error rate. The formula is $C^2 = \sum (O_i - E_i)^2 / E_i$, where O_i = Observed Value and E_i = Expected Value. The statistic is a measure of the difference between the observed and expected frequencies of the outcomes. It is useful for analyzing differences among categorical/nominal variables.

68. A Likert scale is a type of psychometric response scale in which respondents specify their level of agreement to a statement, typically in five points: 1) Strongly disagree; 2) Disagree; 3) Neither agree or disagree; 4) Agree; 5) Strongly agree.

response category included a five-point scale from “strongly agree” to “strongly disagree.” Table 3 below shows that 69 percent of executives “agreed” or “strongly agreed” that “a prospective board member’s ability to give financially to the organization influences the likelihood that a person will be selected as a board member.”

Table 3. Management’s Perceptions of Likelihood that Board Member’s Ability to Give Affects Likelihood She is Selected to the Board

Percent of Management’s Agreement with the Following Statement:
A Prospective Board Member’s Ability to Give Financially Influences
the Likelihood that a Person will be Selected to the Board

	n	Percent
Strongly Agree	92	15
Agree	337	54
Neither Disagree or Agree	133	22
Disagree	43	7
Strongly Disagree	15	2
Total	620	100

Additionally, an overwhelming majority—81 percent—responded “very” or “somewhat” to the question “[t]o what extent does your organization prioritize the selection of board members based on their ability to contribute money to the organization?,” with 38 percent reporting “very” and 43 percent reporting “somewhat.” Clearly, a large majority of respondents in this sample believe that non-profit boards prioritize financial giving, and that giving influences the likelihood of someone being selected to join the board. Moreover, this pattern is consistent across organizational budget sizes.⁶⁹ For organizations whose budgets are \$100,000 to \$500,000, 14 percent reported that the ability to give was prioritized “very little” in board selection, whereas 86 percent say they prioritize giving ability “somewhat” or “very much.” That pattern is similar across budget sizes. The Chi-Square test suggests that organization size and budget have no influence on the distribution of how much an organization prioritizes board members’ ability to give. The majority of organizations do prioritize it—and it does not matter what size organization they are in. And this finding is statistically significant.

69. See *infra* Table 4.

Table 4. Management Perception of Prioritizing Board Giving by Organizational Budget Size							
		\$100,000	\$500,000	\$1,000,000	\$5,000,000	\$10,000,000	Total
		-	-	-	-	+	
		\$499,999	\$999,999	\$4,999,999	\$9,999,999		
Prioritize Giving:							
Not at all,	n	17	27	26	26	24	120
A Little							
	Percent	13.7	21.3	21.7	20.6	19.5	
Somewhat,	n	107	100	94	100	99	500
Very Much							
	Percent	86.3	78.7	78.3	79.4	80.5	

*(Chi Sq = 3.37, d.f.=4, p=0.49)

We also asked executive officers “[h]ow much money are board members expected to give to the organization each year?” Table 5 presents the number and percent of organizations with expected giving amounts.

Table 5. Expected Giving Amount		
How Much Money are Board Members Expected to Give	n	percent
\$0-\$100	9	2
\$101-\$250	30	5
\$251-\$500	99	16
\$501-\$1,000	204	33
\$1,001-\$5,000	149	24
Over \$5,000	62	10
Missing	67	11
Total	620	

The chart reflects that 67 percent of the 553 executives who responded to this question reported that directors are expected to give over \$501 each year with 24 percent reporting that directors are expected to give between \$1,001 and \$5,000, and 11 percent expected directors to give in excess of \$5,000.

We then examined whether the amount of expected giving is associated with the extent to which organizations prioritize giving in board selection decisions.

Table 6. Extent to Which Organizations Prioritize Giving by Expected Giving Amounts								
		\$0- \$100	\$101- \$250	\$251- \$500	\$501- \$1,000	\$1,001 - \$5,000	\$5,001+	Total
Prioritize Giving	n	4	4	12	34	22	5	81
Not at all, A Little	Percent	4.9	4.9	14.8	42.0	27.2	6.2	100
Somewhat, Very Much	n	5	26	87	170	127	57	472
	Percent	1.1	5.5	18.4	36	26.9	12.1	100

*(Chi Sq = 9.75, d.f.=5, p=0.08)

We found that there is no statistically significant association between the amount board members are expected to give to organizations and the extent to which boards prioritize giving. However, there are slight differences in the tails of the distribution. For example, of those boards that prioritize giving “somewhat” or “very much,” 12 percent expect their board members to give over \$5,000, whereas only 6 percent of boards that do not prioritize, or prioritize a little, are expected to give over \$5,000.

We then proceeded to answer the second research question, “[d]o executives report that prioritizing a board member’s ability to give affects the organization’s ability to attract and retain board members with diverse skillsets that help ensure organizational success?” To operationalize “diverse skillsets” we asked executive officers the extent to which they agree or disagree with a series of statements. Table 7 shows a subset that relates to the prioritization of attracting board members who have extensive experience relevant to the organization, sufficient time to satisfy their board responsibilities, and who will be engaged, attentive, and willing to spend the necessary energy.

Table 7. Percent of Executive Officers Who Believe Prioritizing the Ability to Give Affects the Organization’s Ability to <i>Attract</i> Board Members with Diverse Skillsets that Help Ensure Organizational Success						
When our organization prioritizes the selection of board members based on their ability to contribute money, it affects the organization’s ability to attract people who:	Percent Strongly Agree	Percent Agree	Percent Neither Agree or Disagree	Percent Disagree	Percent Strongly Disagree	Percent Total
Have extensive experience relevant to the organization	11.2	54.3	31.4	2.9	0.2	100
Have sufficient time to satisfy their responsibilities as board members	26.5	47.7	18	1.9	5.8	100
Will be engaged board members	23.6	54	18	1.5	2.9	100
Will be attentive board members	29.4	49.9	19.2	1	0.5	100
Will be willing to expend the energy necessary to satisfy their responsibilities as board members	29	52.1	17.3	1	0.7	100

Table 7 indicates that the vast majority of executive officers “agree” or “strongly agree” that prioritizing board members’ ability to give negatively affects the organization’s ability to *attract* people who have the skillsets needed for organizational success. Furthermore, there is no statistically significant relationship between the extent to which a board prioritizes giving and the pattern of agreement across the effect on board members’ experience, willing time commitment, engagement, attentiveness, and energy. That is to say, across the board, leadership

agrees that prioritizing giving negatively affects these attributes of board members.

We then analyzed the same series of questions as it related to retaining board members with diverse skillsets. Table 8 shows a different set of responses concerning the retention of board members.

Table 8. Percent of Executive Officers who Believe Prioritizing the Ability to Give Affects the Organization’s Ability to *Retain* Board Members with Diverse Skillsets that Help Ensure Organizational Success

When our organization prioritizes the selection of board members based on their ability to contribute money, it affects the organization’s ability to attract people who:	Percent Strongly Agree	Percent Agree	Percent Neither Agree or Disagree	Percent Disagree	Percent Strongly Disagree	Percent Total
Have extensive experience relevant to the organization	19	58.2	20	1.9	1	100
Have sufficient time to satisfy their responsibilities as board members	25.5	49.4	21.1	1.5	2.4	100
Will be engaged board members	28.7	49.1	19.5	1.5	1.2	100
Will be attentive board members	29.9	45.5	20.9	1.9	1.7	100
Will be willing to expend the energy necessary to satisfy their responsibilities as board members	29.4	49.6	19	0.7	1.2	100

Table 8 confirms that an overwhelming majority of executive officers of non-profit organizations “agree” or “strongly agree” that prioritizing giving affects their ability to retain people who have the diverse skillsets needed for organizational success.⁷⁰ The majority of

70. As compared to Table 7, there is a difference in management perceptions of prioritizing giving on the ability to attract versus the ability to retain board members. A larger proportion of those organizations who *do not* prioritize giving disagree that

executive officers who report their organizations prioritize giving somewhat or a lot “agree” or “strongly agree” that the board selection criteria negatively affects the organization’s ability to attract and retain board members with diverse skillsets.

We then asked whether the executive officers believe that their organizations’ boards would be more effective if they adopted some of the procedures followed by for-profit boards. We asked them “[h]ow effective do you believe the following practices would be to create effective boards?”⁷¹

Table 9. Percent of Executive Officers who Believe that the Following Practices would Help Create Effective Boards

In general, how effective do you believe the following practices would be to creating effective boards?	percent Very Valuable	percent Valuable	percent Somewhat Valuable	percent Limited Value	percent Not Valuable	percent Total
Performing an annual self-evaluation of board performance	32.8	44.5	14.1	7.1	0.2	100
In general, how effective do you believe the following practices would be to creating effective boards?	percent Very Valuable	percent Valuable	percent Somewhat Valuable	percent Limited Value	percent Not Valuable	percent Total

prioritizing giving affects their ability to retain (not attract) board members who have extensive experience relative to the organization (Chi-Sq =25.7, d.f.=4, p=.00) and retain board members who have the energy necessary to satisfy their duties (Chi-Sq=83.6, d.f.=3, p=.00). This is likely because they report that they do not prioritize giving.

71. See Table 9.

Performing an annual self-evaluation of the performance of the nominating committee	26.5	30.9	25.8	14.4	1.7	100
Adopting a written charter for the nominating committee	20.4	32.1	35.5	10.2	1.2	100
Drafting a list of qualifications that must be met by the nominee	29.2	36.3	24.1	7.5	2.4	100
Maintain a standing nominating committee	24.1	33.1	30.7	9.5	2.4	100
Paying a third party to assist in identifying nominees	21.4	33.3	30.2	9	5.4	100
Paying a third party to assist in evaluating nominees	20.7	35	28.7	9.2	5.1	100
Maintain records of gender identity of nominees	20	33.8	29.8	10.2	6.8	100
Maintain records of racial identity of nominees	22.6	31.9	27.5	12.2	5.1	100

Table 9 reflects that most non-profit executive officers would find many of the practices used by for-profit boards to be “valuable” or “very valuable.”

III. DISCUSSION

This Study shows that senior management at non-profit organizations believe that their organizations prioritize the ability to give financially in their board selection and retention decisions and that they do so across all organizational sizes.⁷² They also report that this practice comes at a cost to the organization in terms of finding and retaining the needed organizational skillsets and its effects on organizational performance.⁷³ Senior management believes that the continued practice of prioritizing the potential for donations in board selection and retention decisions distracts from recruiting candidates who have passion for the mission, extensive experience relevant to the organization, and sufficient time to be fully engaged and attentive in their responsibilities as board members.⁷⁴ These findings are a warning sign that board selection and retention criteria may not provide sufficient protection to the organizations that the boards serve.

We further maintain that prioritization based on the ability to give money has a tenuous relationship to board members' ability to fulfill mission-related and fiduciary duties. As such, board selection and retention criteria that are focused on giving over other criteria—such as being social-mission focused and fully engaged and attentive in their responsibilities—could contribute to poor governance. Good governance requires a board with diverse and deep expertise that will more competently provide useful strategic oversight to management. As other researchers have pointed out, it is important that boards reflect the constituencies that they serve.⁷⁵ We argue that failing to have a board with the right profile is bad governance or, at the very least, mediocre governance. Further, the continued give-or-get ethos is perpetuating the challenges of constituting broadly diverse boards. For example, a board composed entirely of wealthy individuals may foster great financial support for the non-profit's mission, but can suffer from poor attendance and poor program participation, resulting in weak governance. Weak governance comes at a cost to non-profit stakeholders, and this Study's practical consequences warn there is a managerial belief that current

72. *See supra* Table 3, Table 4.

73. *See supra* Table 7, Table 8.

74. *Id.*

75. *See generally* HANNA FENICHEL PITKIN, *THE CONCEPT OF REPRESENTATION* (1967).

selection procedures interfere with the choosing of the very people one would expect to be fully engaged and attentive in their responsibilities as board members.

A. RISKS OF LOSS AT NON-PROFITS DUE TO MALFEASANCE

When non-profits lack good governance, they can fall prey to otherwise avoidable problems and risk damaging their missions. Recent scandals highlight all too common instances when failures of external and internal oversight caused public harm and tarnished the collective reputations of non-profit organizations. In 2015, the Third Circuit Court of Appeals affirmed a decision finding that the directors of a non-profit nursing home breached their duty of care when they failed to remove a CFO who did not keep financial records and an unqualified CEO.⁷⁶ The directors (along with the officers) were found to be liable for \$2,250,000 in damages.⁷⁷ The directors were not sufficiently focused on governance to recognize what would have otherwise been an obvious problem for them to address.⁷⁸

Other problems at non-profit organizations highlight the need for better internal controls at the board level.⁷⁹ For instance, *In the Matter of the Investigation by Eric T. Schneiderman* involved an investigation of and settlement by the Disabled Veterans National Foundation (DVNF) and the direct marketing companies it retained, Quadriga Art and Convergence Direct Marketing.⁸⁰ In that matter, the Office of the New York State Attorney General found that, in connection with fundraising, the DVNF engaged in “misleading statements regarding the nature [of its] programs and [the] effectiveness” of the organization.⁸¹ The findings revealed an organization in which “[n]one of the founding directors had any [prior] experience dealing with direct mail campaigns or large-scale

76. *In re* Lemington Home for the Aged, 777 F.3d 620, 626 (3d Cir. 2015).

77. *Id.*

78. *Id.*

79. Barbara E. Taylor et al., *The New Work of the Nonprofit Board*, HARV. BUS. REV. (1996), <https://hbr.org/1996/09/the-new-work-of-the-nonprofit-board> [<https://perma.cc/AN94-5RMY>].

80. Assurance of Discontinuance at 2, *In re* the Investigation by Eric T. Schneiderman (2014) (No. 14-145), https://ag.ny.gov/pdfs/DVNF-Quadriga-Convergence-AOD_14-145.PDF [<https://perma.cc/TW4T-6JH4>].

81. *Id.*

fundraising.”⁸² More significant focus on governance in board selection decisions would have prevented this problem. Instead, the unqualified board relied on Quadriga Art and Convergence Direct Marketing to conduct direct marketing for it.⁸³ The Attorney General concluded that those arrangements netted \$115,000,000, and 90 percent of that sum was used to pay its “direct mail expenses.”⁸⁴ Additionally, “despite having already paid over \$104 million to its direct mail vendors, [the DVNF was] still in debt to [its marketing partners] in the amount of \$14 million.”⁸⁵ The resulting settlement reportedly required the DVNF to “discontinue misleading fundraising appeals” and led to its retention of an “experienced fundraiser for a new position of development director.”⁸⁶

Similarly, the Attorney General of New York sued the National Rifle Association of America, Inc. (the NRA), seeking an order dissolving the non-profit organization.⁸⁷ The Attorney General asked the court to withdraw the NRA’s charter alleging, among other things, that the directors and members wasted corporate assets, and that its audit committee was a rubber stamp for fraudulent and self-interested dealings by its officers, costing the organization millions of dollars.⁸⁸ Proper attention to governance by the boards of these organizations would likely have protected the stakeholders of the organizations from the alleged abuse of its officers and directors.

In another case, the governance failings of the Florida Coalition Against Domestic Violence (the “FCADV”) contributed to a scandal in which the state of Florida sued the anti-domestic violence organization.⁸⁹ The FCADV’s purpose was to allocate funds to domestic violence centers.⁹⁰ However, as a result of its board’s lax governance standards, it

82. *Id.* at 3.

83. *Id.* at 8-9.

84. *Id.* at 2.

85. *Id.*

86. Suzanne Perry, *N.Y. Wins \$25-Million in Fundraising Abuse Case* (June 30, 2014), <https://www.philanthropy.com/article/n-y-wins-25-million-in-fundraising-abuse-case/> [https://perma.cc/Z9K2-6PJC].

87. Verified Complaint at 5, *New York v. Nat’l Rifle Assoc. of Am., Inc.* (2020) (No. 451625/2020).

88. *Id.* at 11-12.

89. Mary Ellen Klas & Samantha J. Gross, *Florida Sues Nonprofit and its Former CEO Who Was Paid \$7.5M*, TAMPA BAY TIMES (Mar. 4, 2020), <https://www.tampabay.com/florida-politics/buzz/2020/03/04/state-sues-nonprofit-and-its-former-ceo-who-was-paid-75m/> [https://perma.cc/3ZKD-Y773].

90. *Id.*

approved the CEO's request for \$4 million in paid time off without asking sufficient questions.⁹¹ Eventually, and after the damage had been done, the board voted to place the FCADV in receivership, which likely would not have been necessary if it were properly governed in the first place.⁹²

Other cases reflect a lack of public oversight of non-profit organizations, compounding the argument for the necessity of good governance. In a 2019 case, the Key WorldWide Foundation reported in its tax filings that it paid nearly \$2 million to tutor children in Oakland, California and fund dental work for needy Cambodians.⁹³ However, those funds were not used for those purposes and WorldWide's IRS filings did not contain, and were not required to contain, documentation for the payments.⁹⁴ That money did not go to the needy. Instead, the non-profit funneled money to colleges and universities in order to help wealthy people get their children into elite schools.⁹⁵ Further abusing the tax laws, the parents freely deducted their "donations," relying on the non-profit status of Key WorldWide.⁹⁶ In early March 2019, the foundation's president pled guilty to federal crimes including racketeering and money laundering.⁹⁷

In a separate incident reflecting the serious lack of public oversight over non-profit organizations, the Federal Trade Commission (the FTC) and official representatives of every state and the District of Columbia sued the Cancer Fund of American and affiliated entities for violating federal and state statutes and common law, alleging it fraudulently induced and absconded with \$187 million in donations.⁹⁸

91. *Id.*

92. Dara Kam, *Moody Fires Back Over Domestic Violence Coalition*, WLRN (Mar. 30, 2020, 4:35 PM), <https://www.wlrn.org/post/moody-fires-back-over-domestic-violence-coalition#stream/0> [<https://perma.cc/BV5U-Z3YN>].

93. Vicky Nguyen & Kevin Nious, *Key WorldWide Foundation's Dubious Donations to Charities Linked to Bay Area*, NBC BAY AREA (Mar. 14, 2019, 11:45 AM), <https://www.nbcbayarea.com/news/local/key-worldwide-foundations-dubious-donations-charities-linked-to-bay-area/194707/> [<https://perma.cc/UWQ9-8LKZ>].

94. Martin Levine, *Hiding in Plain Sight: A Nonprofit Fraud Story*, NONPROFIT Q. (Mar. 19, 2019), <https://nonprofitquarterly.org/hiding-in-plain-sight-a-nonprofit-fraud-story/> [<https://perma.cc/3GJV-GBFT>].

95. *Id.*

96. *Id.*

97. *Id.*

98. Complaint at 15-16, *FTC v. Cancer Fund of Am., Inc.* (2015) (No. 2:15-cv-00884-NVW). *See also* Suzanne Perry, *\$187-Million Fraud Case Puts Charities on the*

The purpose of outlining these scandals is to demonstrate that, despite their philanthropic missions, non-profits without strong corporate governance are at high risk of abuse. Such organizations need to be protected by board members with necessary abilities and specific disclosure requirements to reduce the all too present risks to their missions. This is particularly essential because non-profits serve our most needy populations, exist at public expense, and are not monitored to the extent that for-profit organizations are.⁹⁹ Organizations should find alternative ways to honor grantors, such as through a gala, naming rights, or the creation of an honorary boards that do not have governance roles. Jay Leno, for example, donated to United Hatzalah, a non-profit mobile medical services organization.¹⁰⁰ He serves on the “honorary board” of the organization, but is not on the audit committee.¹⁰¹ That honorary board appears to be an “advisory board” that does not have governance obligations.¹⁰² As one leading commentator explained:

Non-profit organizations can be established with either an advisory board or with a governing board. Unlike formal governing boards, advisory boards do not have either statutory authority or statutory obligations. In contrast, when a board is established as a formal governing board, board members have fiduciary obligations.¹⁰³

There is a benefit to honoring those who donate to worthy cases, and this is not to say that there are no good reasons to place wealthy donors

Defensive, CHRON. PHILANTHROPY (June 1, 2015), <https://www.philanthropy.com/article/187-Million-Fraud-Case-Puts/230567/> [<https://perma.cc/E5N2-HU6R>].

99. Heaslip, *supra* note 19. *See generally* *Hearing*, *supra* note 6 (statement of Ira M. Millstein of Weil, Gotshal & Manges LLP); Erica Harris et al., *The Effect of Nonprofit Governance on Donations: Evidence from the Revised Form 990*, 90 ACCT. REV. 579 (2015).

100. *Friends of United Hatzalah of Israel to Honor Jay Leno with Humanitarian Award at its 1st Annual Los Angeles Gala*, PR NEWswire (Feb. 25, 2019, 5:00 PM), <https://www.prnewswire.com/il/news-releases/friends-of-united-hatzalah-of-israel-to-honor-jay-leno-with-humanitarian-award-at-its-1st-annual-los-angeles-gala-300800862.html> [<https://perma.cc/X2B7-2SWS>]. *See also* *Jay Leno Helps Raise \$5 Million for United Hatzalah at Gala*, JERUSALEM POST (Mar. 6, 2019), <https://www.jpost.com/diaspora/jay-leno-helps-raise-5-for-united-hatzalah-at-gala-582581> [<https://perma.cc/WKB4-5KXM>].

101. *International Committee*, UNITED HATZALAH, <https://israelrescue.org/blog/international-committee/> [<https://perma.cc/DNC3-EC9>] (last visited Apr. 10, 2022).

102. *See* Hazen & Hazen, *supra* note 17, at 355.

103. *Id.*

on a non-profit board. They may have expertise or the ability to attract attention that will help the organization fulfill its mission. However, it does more harm than good to prioritize giving ability over operational effectiveness in non-profit board selection; such a decision has the potential to undermine the capacity of the governing board to protect the integrity of the organization. This prioritization is especially concerning because current IRS rules do not require disclosure of board member contributions, making it difficult to accurately measure its impact.

B. UNDISCLOSED CONTRIBUTIONS OF DIRECTORS

In order to evaluate whether an organization has good governance, people frequently turn to Charity Navigator, an organization that rates the accountability and transparency of charities with a focus on good governance practices.¹⁰⁴ To do so, it collects data from non-profits' IRS Form 990s and reviews charities' the websites.¹⁰⁵ As to governance, Charity Navigator considers whether organizations have:

- Independent boards of at least five members and whether the independent members have a voting majority;
- Absence of diversion of assets;
- Audited financials prepared by an independent accountant with oversight from a dedicated board committee;
- Absence of loans to or from related parties;
- Board meeting minutes;
- Provided the organization's IRS Form 990 to the board before it is filed;

104. *See About Us*, CHARITY NAVIGATOR, <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=8658> [<https://perma.cc/ET5G-QUH5>] (last visited Apr. 10, 2022). *See also How Do We Rate Charities' Accountability and Transparency?*, CHARITY NAVIGATOR, <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=1093/> [<https://perma.cc/3N7R-WE4U>] (last visited Apr. 10, 2022).

105. *Accountability and Transparency Ratings Tables*, CHARITY NAVIGATOR, <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=1283> [<https://perma.cc/7A93-6AQX>] (last visited Apr. 10, 2022).

- Conflict of interest and whistleblower policies;
- Document retention and destruction policies;
- Disclosed the CEO's salary;
- Documented criteria for calculation of the CEO's salary; and
- Confirmed that board members are not compensated.¹⁰⁶

In assessing organization accountability and transparency, Charity Navigator also confirms that the organization provides the following information on its website:

- Identities of board members;
- Listing of key staff;
- Published audited financial statements;
- Published its IRS Form 990; and
- Assurance of privacy of donor lists.¹⁰⁷

Charity Navigator then calculates a score by adding measures of financial health to the organization's accountability and transparency scores by allotting them an original score of 100 on each and making deductions for relative failures to comply with the required criteria.¹⁰⁸ It also publishes lists of the top charities overall and in various sectors.¹⁰⁹ Although its governance and transparency criteria are a reasonable manner to evaluate non-profit overall governance and performance, Charity Navigator does not directly evaluate the ability of each board member to contribute to good governance, and it does not consider the

106. *Id.*

107. *Id.*

108. *How Do We Calculate the Overall Score and Star Rating?*, CHARITY NAVIGATOR, <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=1287/> [https://perma.cc/2ZZD-AFLL] (last visited Jan. 29, 2022).

109. *Top Ten Lists*, CHARITY NAVIGATOR, <https://www.charitynavigator.org/index.cfm?bay=topten> [https://perma.cc/TH4V-7XY8] (last visited Apr. 10, 2022).

role of selection procedures that prioritize ability to contribute money.¹¹⁰ It cannot do so, because the rankings are based on what the IRS requires non-profits to disclose, which does not include a certification that good governance is a high priority in the selection of board members.

C. POTENTIAL SOLUTIONS

One way to partially remedy this information gap would be to add questions to IRS Form 990¹¹¹ that would confirm the importance of governance in board selection. For example, non-profit organizations would be well served if the IRS were to add questions akin to the following:

- Is quality governance the first priority of the organization in selecting persons to serve on its governing body?; or
- Does the governing board have a policy prioritizing the quality of governance in its selection of its members?

These types of certifications would make it more difficult for boards to be taken over by wealthy donors who may be more interested in demonstrating or exercising power than those with the skills necessary to help the organization fulfill its mission. Additionally, federal law should be expanded to require that non-profit organizations disclose the names and contribution amounts of all their board members.

Moreover, the absence of donor information means that stakeholders do not know whether people are buying their way onto boards. This also precludes them from assessing the benefits or costs of organization's prioritization of giving ability as a criterion to select board members. That is, one could conceive of situations in which it would be an advantage to allow a particular person who does not have the ability to contribute to good governance onto a non-profit board. Perhaps admitting a celebrity whose prominence would further the mission of the organization could benefit the mission more than the loss of a board member who could contribute to better governance would hurt it. Similarly, allowing

110. *Accountability and Transparency Ratings Tables*, CHARITY NAVIGATOR, <https://www.charitynavigator.org/index.cfm?bay=content.view&cpid=1283> [<https://perma.cc/VK4X-2SL4>] (last visited Apr. 10, 2022).

111. See Hazen & Hazen, *supra* note 17, at 367-68 (providing a clear summary of IRS requirements).

someone who gave such a significant amount of money that it would further the mission of the organization more than the organization would lose in good governance might be a reasonable choice. But because information on how much board members give is publicly unavailable, the burden should be on the organization to show that selection procedures that prioritize picking board members based on their ability to give is a good thing.

Additionally, taxpayers have a right to know how boards make their decisions. Because the public allows them to have tax exempt status, these organizations should be obligated to show that their activities further their missions. IRS Form 1023 sets forth the mission of non-profit organizations, and non-profits owe their existence to its protections.¹¹² Yet, direct stakeholders and taxpayers have no realistic way of assessing the ability of and extent to which organizations are meeting their missions if they will not disclose how they select their board members. In the absence of disclosure of director donations, boards cannot show that the loss to governance led to a net gain in the furtherance of the organization's missions.

A board that knowingly trades money for governance may not be acting in good faith, in the interests of its organization, or in furtherance of the mission. Trading governance for money breaches organizations' duties to their stakeholders because, as discussed, doing so affects their ability to attract people who will be engaged and effective board members and have the time to dedicate to that cause. If the selection of board members relies on the ability to contribute undermines those basic abilities, selection practices may be interfering with obtaining effective board members and should be changed or, at minimum, receive closer scrutiny than they currently receive. One may maintain that an organization can have it both ways, that someone may be qualified and make contributions. That may be true; however, not only must the qualification piece come first, but there also must be a way for stakeholders to make that assessment for themselves.

112. INTERNAL REVENUE SERV., FORM 1023 (2017), <https://www.irs.gov/pub/irs-pdf/f1023.pdf> [<https://perma.cc/9P7J-NWXF>]. See also *Instructions for Form 1023 (01/2020)*, IRS, <https://www.irs.gov/instructions/i1023> [<https://perma.cc/BE3K-SLJW>] (last visited Apr. 10, 2022).

CONCLUSION

Non-profit organizations should select board members based on the likelihood that the board members will support the success of the organization's mission. Boards should not hide secret director contributions behind feckless I.R.C. provisions that allow them to withhold the identities of contributors. Instead, based on the findings of this Study, the federal government should force organizations to disclose the names of directors making contributions to organizations that exist for public purposes and at public expense, and require them to certify that quality governance is the first priority of the organization in selecting persons to serve on their governing bodies.¹¹³ To do otherwise improperly validates the decisions of organizations to accept money in exchange for influence at the expense of their duties to stakeholders.

113. The IRS requires disclosure of governance related items (but does not yet require the ones we suggest). *See* INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 19-25 (2021), <https://www.irs.gov/pub/irs-pdf/i990.pdf> [<https://perma.cc/PAL5-37PF>].