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Nonprofit Governance: The Basics

Lawrence J. Trautman

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NONPROFIT GOVERNANCE: THE BASICS

*Lawrence J. Trautman**

*Janet Ford***

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I. INTRODUCTION

Many nonprofit organizations are governed by boards of directors comprised of individuals who often have been invited to join the board based on their contributions of time and money. For many, this is either their first board membership or yet another conducted within an environment lacking the experience and structure of board governance typically found in a publicly-traded corporation. Accordingly, governance of many nonprofit enterprises presents both similarities to and differences from the governance of a for-profit entity.

How is nonprofit governance different from that conducted in for-profit organizations? How do you build the best board for your nonprofit? What attributes and skills are required by law and what mix of experiences and talents will give you the best result? What are the commonly required director attributes that are a must for each board, and how do you customize and fine-tune your efforts to achieve a high-performance board? Optimal board composition—achieving the best mix of director skills and experience—will depend on many enterprise-specific variables.¹ Some of the most important of these for nonprofits include, but are not limited to: (1) enterprise lifecycle stage, (2) extent to which certain experiences and skills are mission critical (detailed understanding of target culture, mission, stake-holder composition, and risk); (3) unique technology dependence (social media); and (4) the need for capacity expansion (fundraising).² Our goal in writing this paper is to provide the

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2. See e.g., Rajesh K. Aggarwal, Mark E. Evans & Dhananjay Nanda, *Nonprofit Boards: Size, Performance, and Managerial Incentives*, 53(1) J. ACCT. & ECON. 466 (2012); Ellen P. Aprill, *What Critiques of Sarbanes-Oxley Can Teach About Regulation of Nonprofit Governance*, 76(2) FORDHAM L. REV. 765 (2007); Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate*

following: answers to these basic questions; a roadmap for the nonprofit enterprise faced with recruiting a board; a matrix methodology that every nominating committee and board can employ to systematically inventory their people, assets, strengths and weaknesses, define their needs, and explore their options; and provoke radical thinking about how any

Governance Standards: A Fiduciary Duty of Care Without a Remedy, 57 CATH. U. L. REV. 701 (2008); Kathleen M. Boozang, *Does an Independent Board Improve Nonprofit Corporate Governance?* (Seton Hall Public Law Research Paper No. 1002421, 2007), <https://ssrn.com/abstract=1002421> [<https://perma.cc/WJ6Y-ERM6>]; L. David Brown, Sanjeev Khagram, Mark H. Moore & Peter Frumkin, *Globalization, Ngos and Multi-Sectoral Relations* (2000), <https://ssrn.com/abstract=253110> [<https://perma.cc/X9FY-8EXH>]; L. David Brown, Jane G. Covey & Mark Leach, *Organization Development for Social Change*, in HANDBOOK OF ORGANIZATION DEVELOPMENT (2004), <https://ssrn.com/abstract=622244> [<https://perma.cc/P45X-AEVC>]; Nicholas Donatiello, David F. Larcker & Brian Tayan, *What Can For-Profit and Nonprofit Boards Learn from Each Other About Improving Governance?* (Stanford University Graduate School of Business Research Paper No. 15-28, 2015), <https://www.gsb.stanford.edu/faculty-research/publications/what-can-profit-nonprofit-boards-learn-each-other-about-improving> [<https://perma.cc/6BZV-GVKJ>]; Brian D. Galle, *Social Enterprise: Who Needs it?*, 54 B.C. L. REV. (2013); Brian D. Galle, *Keep Charity Charitable*, 88 TEXAS L. REV. 1213 (2010); Erica Harris, Christine Petrovits & Michelle Yetman, *The Effect of Nonprofit Governance on Donations: Evidence from the Revised Form 990*, 90(2) ACCT. REV. 579 (2014); Henry Hansmann & Reinier H. Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000); Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors' Fiduciary Duties*, 14(2) U. PA. J. BUS. L. 347 (2012); Bernd Helmig, Marc Jegers & Irvine Lapsley, *Challenges in Managing Nonprofit Organizations: A Research Overview*, 15 INT'L J. VOL. & NONPROFIT ORGANS. 101 (2004); Klaus J. Hopt, *The Board of Nonprofit Organizations: Some Corporate Governance Thoughts from Europe* (Euro. Corp. Gov. Inst.—Law Working Paper No. 125/2009, 2009), <https://ssrn.com/abstract=1425670> [<https://perma.cc/Q5EC-5B69>]; Jill R. Horwitz, *Does Nonprofit Ownership Matter?*, 24 YALE J. REG. 140 (2007); Garry W. Jenkins, *Who's Afraid of Philanthrocapitalism?*, 61(3) CASE W. RES. L. REV. (2011); Robert A. Katz & Antony Page, *The Role of Social Enterprise*, 35 VT. L. REV. 59 (2010); Melanie B. Leslie, *The Wisdom of Crowds? Groupthink and Nonprofit Governance*, 62 FLA. L. REV. 1179 (2010); Christine W. Letts, *Effective Foundation Boards: The Importance of Roles* (KSG Working Paper No. RWP05-054, 2005), <https://ssrn.com/abstract=642562> [<https://perma.cc/UQ9Y-SUTX>]; Lloyd Hitoshi Mayer & Brendan M. Wilson, *Regulating Charities in the 21st Century: An Institutional Choice Analysis*, 85(2) CHI-KENT L. REV. 479 (2010); Ira M. Millstein, Katherine M. O'Regan & Sharon M. Oster, *Governance Practices Among Nonprofit Organizations Contracting with New York City* (Yale SOM Working Paper No. PM-02, 2000), <https://ssrn.com/abstract=244412> [<https://perma.cc/Q3K9-STTF>]; Lumen N. Mulligan, *What's Good for the Goose is Not Good for the Gander: Sarbanes-Oxley-Style Nonprofit Reforms*, 105 MICH. L. REV. 1981 (2007); J. Haskell Murray & Edward I. Hwang, *Purpose with Profit: Governance, Enforcement, Capital-Raising and Capital-Locking in Low-Profit Limited Liability Companies*, 66 U. MIAMI L. REV. (2011); Michael F. Murray, *Private Management of Public Spaces: Nonprofit Organizations and Urban Parks*, 34 HARV. ENVTL. L. REV. 179 (2010); Katherine M. O'Regan & Sharon M. Oster, *Does Government Funding Alter Nonprofit Governance? Evidence from New York City Nonprofit Contractors* (Yale SOM Working Paper No. PM-03, 2001), <https://ssrn.com/abstract=279310> [<https://perma.cc/HTE9-YVXN>]; Antony Page & Robert Katz, *Is Social Enterprise the New Corporate Social Responsibility?*, 34 SEATTLE U. L. REV. (2011); Dana Brakman Reiser, *Regulating Social Enterprise*, 14 U.C. DAVIS BUS. L.J. 231 (2014); Usha Rodrigues, *Entity and Identity*, 60 EMORY L.J. 1257 (2011).

enterprise-specific system of governance may be improved by questioning existing fundamental assumptions.

Our article proceeds in six parts. First, we offer a few thoughts about nonprofits, their various missions, and common challenges nonprofits face. Second, we discuss why good governance is important in a nonprofit setting and highlight examples of frauds that have been reported due to the absence of good governance. Third, we present a look at Internal Revenue Service (IRS) requirements imposed on nonprofits. Fourth, we explore the law of nonprofit corporate governance applicable to all directors serving on the board of a nonprofit. Fifth, we discuss board composition and committee structure. Sixth, we present a process that involves an inventory of current board strengths and weaknesses and then offer some thoughts about use of a matrix template to assist in discovering necessary board skills and experiences of board candidates.

The search for optimal board composition is not set out in a vacuum; rather, it is based on a clear prejudice by the authors that all current enterprise operations should be a part of and based upon articulated organizational strategy that is headed somewhere with purpose and clearly communicated to all involved. Hopefully, constructive thinking about board composition, succession planning, and a productive dialogue among all board members will result.

II. NONPROFITS ARE DIFFERENT

Many board members of nonprofit organizations serve because they believe in the mission of the enterprise, whether it is housing and feeding the homeless, finding a cure for cancer, or any of the numerous causes that seek to make our world a better place. Often nonprofit directors are recruited after they have shown financial support for the organization. Unlike in most for-profit settings, it is not unusual for board directors in a nonprofit environment to have little or no prior experience in corporate governance before joining the board. This creates a special need to onboard new nonprofit directors by providing basic or continuing education regarding legal responsibilities germane to the fiduciary duties of directorship.

According to *Forbes*, the 100 largest U.S. charities, “together received \$49 billion in gifts, a whopping 12% of the \$410 billion taken in by the country’s 1 million-plus nonprofits.”³ *The Washington Post* reports: “More than 1.6 million nonprofit groups are registered with the

3. William P. Barrett, ed., *America’s Top Charities 2018*, FORBES (Dec. 11, 2018), <https://www.forbes.com/top-charities/#42859eb676ab> [<https://perma.cc/3MYH-HHMF>].

federal government, and they control more than \$4.5 trillion in assets. An additional 700,000 organizations, such as churches and smaller groups, need not register.”⁴ Exhibit 1 provides a listing of the Top 10 U.S. charities ranked by private support.

Exhibit 1
Top Ten 2018 U.S. Charities Ranked by Private Support⁵

Rank	Name	Private Support	Donor Dependency
1	United Way Worldwide	\$3.471 B	100%
2	Feeding America	\$2.654 B	99%
3	Americares Foundation	\$2.379 B	81%
4	Task Force for Global Health	\$2.161 B	101%
5	Salvation Army	\$2.033B	69%
6	St. Jude Children’s Research Hospital	\$1.511 B	57%
7	Direct Relief	\$1.238 B	101%
8	Habitat for Humanity International	\$1.095 B	94%
9	Boys & Girls Clubs of America	\$989 M	80%
10	YMCA of the USA	\$974 M	55%

Source: Forbes

A. *The Business of Philanthropy*

Philanthropy is a business, and just like other businesses, it has finance, marketing, accounting, auditing, and operational challenges. However, unlike an electronic component manufacturer, many nonprofit and philanthropic enterprises have laser-like focus on raising and investing monies necessary to fund operations and making every dollar count. Yet, how is it in a world of unimaginable productivity and affluence

4. See Joe Stephens & Mary Pat Flaherty, *Inside the hidden world of thefts, scams and phantom purchases at the nation’s nonprofits*, WASH. POST (Oct. 26, 2013), https://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html?utm_term=.492b8c444037 [https://perma.cc/TE9C-9EK3].

5. *The 100 Largest U.S. Charities*, FORBES (2018), <https://www.forbes.com/top-charities/list/> [https://perma.cc/FVC3-SWDA].

that we still have “the persistence of poverty and need, of disease and suffering”?⁶ Dan Pallotta writes:

We give money to charities because we *do* want progress. We want things to change, not stay the same. Somewhere in the depths of our hearts we have a desire to make a difference. We all want our lives to matter. In an often dreary world, each dollar we give is a sign that we have not yet lost hope. In the midst of our busy lives, each contribution is a sign that we have not forgotten about all those who live in poverty, despair, and abandonment. Out of this basic charity *inside* of us has grown a charity *outside* of us—a multibillion-dollar industry employing millions of people who work to turn our contributions into positive change. We put our trust not just in individual charities, but in the *system* of charity itself to take our offerings and make of them a better world.⁷

B. *Common Challenges of NonProfit Governance*

Jack Lowe of Dallas, Texas was the recipient of the 2012 Lifetime Achievement Award from the National Association of Corporate Directors (NACD).⁸ His many contributions to his community exceed the space limitation of this article. However, in brief, Jack Lowe is a former Chairman of the Board of Directors of Zale Corporation; a former Chairman and Chief Executive Officer of TDIndustries (a national mechanical, electrical, and plumbing construction and facility service company); director of Drew Industries Incorporated; and former director of KDC Holdings, LLC (a private real estate development and investment firm).

In his career, Jack has been active in many civic and industry organizations, including serving on the boards of the Dallas Citizens Council, Salesmanship Club of Dallas, United Way of Metropolitan Dallas, Better Business Bureau of Metropolitan Dallas, Dallas Zoological Society, the advisory council of the Communities Foundation of Texas, Quality Texas Foundation, Texas Business and Education Coalition, and the Senior Citizens of Greater Dallas. His past community service includes serving on the boards of the Dallas Chapter of the American Red Cross, Center for Nonprofit Management, Cotton Bowl Athletic Association, Dallas County Community College District Foundation, Greater Dallas Chamber of Commerce, and Construction Education

6. See DAN PALLOTTA, UNCHARITABLE: HOW RESTRAINTS ON NONPROFITS UNDERMINE THEIR POTENTIAL xi (2008).

7. *Id.* at 4.

8. NACD DIRECTORSHIP 100, NACD B. Kenneth West Lifetime Achievement Award (2012), <https://www.nacdonline.org/directorship100/2012honorees.cfm> [<https://perma.cc/3HTQ-SLMU>].

Foundation. He is the past president of the Dallas Alliance, and the Community Council of Greater Dallas. He served for many years on the Board of Trustees of the Dallas Independent School District and as its president. He has been the Business Co-chair of the Texas Business and Education Coalition and on the board of the Center for the Reform of School Systems since 2000. He continues to chair the board of the Greenleaf Center for Servant Leadership. Jack Lowe believes that common challenges facing most nonprofit boards include that: “often non-profit board members have little or no preparation for board service and do not understand what they should and should not do as a board member.”⁹ Of particular importance, “Today’s fast changing world requires non-profit boards to assure the organization has an annually updated strategic plan and succession plan.”¹⁰

Dennis McCuiston is Clinical Professor of Corporate Governance at the University of Texas at Dallas where he also serves as Executive Director of the Institute for Excellence in Corporate Governance. He heads the Institute’s conferences, in-house programs, and events. He is a long-time member of the National Association of Corporate Directors (NACD). He holds NACD’s Governance Fellow designation and is a faculty member for the NACD’s Board Advisory Services. In addition to his own financial consulting firm, McCuiston & Associates, Inc., he is a former bank CEO, and has served on over a dozen private, public, and not-for-profit boards, including serving as Chairman of the Board and Lead Independent Director.

Professor McCuiston states that major challenges to nonprofits include “that there are too many of them and consolidation is needed. Additionally, boards are still uneducated as to what their real roles and duties are—so strategy is underdeveloped and succession of executive directors and boards is inadequate. Consistent revenue streams, not just annual ‘begs’ are also needed.”¹¹ When asked: what is different today from nonprofit governance five years ago, professor McCuiston says “the good news is that more director accountability is happening, more nonprofits are changing from founders to true leaders, and there are more

9. See e-mail from Jack Lowe, Corp. Dir., to Lawrence J. Trautman (Feb. 21, 2018, 13:59 EST) (on file with authors).

10. *Id.*

11. See e-mail from Dennis McCuiston, Clinical Professor of Corp. Governance, University of Texas at Dallas; Executive Dir., Institute for Excellence in Corporate Governance, to Lawrence J. Trautman (Jan. 21, 2018, 11:24 EST) (on file with authors).

metrics being used to truly measure results instead of just counting people served for example.”¹²

Deborah Cannon of Houston has served on at least sixteen nonprofit boards including: United Way of Texas Gulf Coast, YMCA of Greater Houston, Houston Technology Center, St. Luke’s Episcopal Health Charities, and Irving Healthcare System. Some boards she has chaired include: the Visiting Nurses Association, Greater Houston Partnership, Women’s Business Enterprise National Council and Memorial Hermann Health System. Ms. Cannon believes, “Major challenges include the need to build consensus among the staff, most of whom work for nonprofits because they believe in the mission. They are typically slower to realize the need for change and require a lot of time and effort to build consensus for actions needed.”¹³

C. *No Money – No Mission*

For-profit organizations exist to sell a product or service, and their revenue streams are often subject to a product life cycle. As demonstrated vividly in Exhibit 1, except for enterprises that are fully financially-endowed, nonprofit organizations differ in that their revenue stream is dependent almost entirely upon donations.¹⁴ Therefore, a major focus—if not the major focus of almost every nonprofit enterprise—is the raising and preservation of capital necessary to accomplish its stated mission.

12. *Id.*

13. See e-mail from Deborah Cannon, Corp. & Nonprofit Dir., to Lawrence J. Trautman (Jan. 26, 2018) (on file with authors).

14. See e.g., Peter Frumkin & Mark T. Kim, *Strategic Positioning and the Financing of Nonprofit Organizations: Is Efficiency Rewarded in the Contributions Marketplace?*, Hauser Center for Nonprofit Org. (Working Paper No. 2, 2000), <https://ssrn.com/abstract=253115> [<https://perma.cc/WF6D-PY52>]; Peter Dobkin Hall, *Philanthropy, the Welfare State, and the Transformation of American Public and Private Institutions, 1945–2000*, Hauser Center for Nonprofit Org. (Working Paper No. 5, 2000), <https://ssrn.com/abstract=262652> [<https://perma.cc/9TFV-XUN4>]; Russell N. James, *Cash Is Not King for Fundraising: Gifts of Noncash Assets Predict Contributions Growth*, 29(5-6) *NONPROFIT MGMT. & LEADERSHIP* (2018), <https://ssrn.com/abstract=3126983> [<https://perma.cc/47QZ-4YYB>]; Michele Margolis & Michael Sances, *Who Really Gives? Partisanship and Charitable Giving in the United States* (2013), <https://ssrn.com/abstract=2148033> [<https://perma.cc/LDH4-JS9X>]; David E. Pozen, *Remapping the Charitable Deduction*, 39 *CONN. L. REV.* 531 (2006); Norman I. Silber & Ely R. Levy, *Nonprofit Fundraising and Consumer Protection: A Donor’s Right to Privacy*, 15 *STAN. L. & POL’Y REV.* 519 (2004); Reid K. Weisbord & Peter DeScioli, *The Effects of Donor Standing on Philanthropy: Insights from the Psychology of Gift-Giving*, 45(2) *GONZ. L. REV.* 225 (2010); Xue Tan, Yingda Lu & Yong Tan, *Why Should I Donate? Examining the Effects of Reputation, Peer Influence, and Popularity on Charitable Giving Over Social Media Platforms* (2016), <https://ssrn.com/abstract=2820219> [<https://perma.cc/35KW-SLWG>].

Within the nonprofit universe, this revenue focus is often referred to as *capacity expansion*.¹⁵ After all, no money—no mission!

III. WHY GOOD GOVERNANCE IS IMPORTANT

A. *Fraud and Poor Governance at Nonprofits*

Fraud is defined as “1. A knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. . . . 2. A misrepresentation made recklessly without belief in its truth to induce another person to act. 3. A tort 4. Unconscionable dealing”¹⁶ A 2006 study reports that “many people have potential access to nonprofit revenues and assets since nine percent of all workers are employed within the sector . . . and an estimated 65 million adults provide volunteer services each year.”¹⁷ Furthermore, “media reports suggest the level of fraud might be extensive. For example, the FBI reported that more than two thousand of the internet sites soliciting relief for Hurricane Katrina victims were fraudulent.”¹⁸ Professors Greenlee, Fischer, Gordon and Keating offer the following examples of how fraud often presents in a nonprofit setting:

- *Occupational fraud*, e.g., a nonprofit employee overcharges his or her employer for travel expenses or steals cash from the bank account.

15. See e.g., Darrene Hackler & Gregory D. Saxton, *The Strategic Use of Information Technology by Nonprofit Organizations: Increasing Capacity and Untapped Potential*, 67(3) Pub. Admin. Rev. No. 3, 474-487 (2007), <https://ssrn.com/abstract=1742466> [<https://perma.cc/GN8Y-NJQW>]; Elizabeth K. Keating, Mary Fischer, Teresa P. Gordon & Janet S. Greenlee, *Assessing Financial Vulnerability in the Nonprofit Sector*, KSG Working Paper No. RWP05-002, Hauser Center for Nonprofit Organizations Paper No. 27 (2005), <https://ssrn.com/abstract=647662> [<https://perma.cc/JFS4-35BY>]; Claudio Travaglini, *Financial Statement Analysis in Nonprofit Organizations* (2005), <https://ssrn.com/abstract=1079380> [<https://perma.cc/4KPG-5YDU>]; Burton A. Weisbrod, *The Future of the Nonprofit Sector: Its Entwinning with Private Enterprise and Government*, 16(4) J. POL’Y ANAL. & MGMT. 541 (1997), <https://ssrn.com/abstract=1850797> [<https://perma.cc/S2YL-L4ZB>]; John Zietlow, *A Financial Health Index for Achieving Nonprofit Financial Sustainability* (2012), <https://ssrn.com/abstract=2049022> [<https://perma.cc/89HF-F2ET>].

16. *Fraud*, BLACK’S LAW DICTIONARY (3d Pocket ed., 2006).

17. Janet Greenlee, Mary Fischer, Teresa Gordon & Elizabeth Keating, *An Investigation of Fraud in Nonprofit Organizations: Occurrences and Deterrents*, Harv. U: Hauser Ctr. for Nonprofit Organizations, (Working Paper No. 35, 2006), https://webworks.typepad.com/lakecountyfiscalrangers/files/nonprofit_fraud_keating_35pgs.pdf [<https://perma.cc/A9BB-XCU8>].

18. *Id.* at 3.

- *Consumer fraud*, e.g., an attendee at a fund raising auction replaces the price tag on an item with the goal of purchasing it at a lower price.
- *Insurance fraud*, e.g., a nonprofit policy holder falsely claims its van or car has been stolen with the goal of collecting the value of the “stolen” vehicle in cash.
- *Medicare fraud*, e.g. a nonprofit healthcare worker “codes” services rendered with the goal of increasing Medicare reimbursement to the organization.¹⁹

Occupational fraud may be further dissected into “fraud *against the organization* (such as the misappropriation of cash or other assets, or the use of one’s position to benefit one’s self or others) and fraud *by the organization against its ‘owners’* or stakeholders (such as misstating financial statements).”²⁰ Instances of fraud and reputational crisis among nonprofits are legion.²¹ Greenlee, Fischer, Gordon and Keating report that a 2005 “survey conducted by the Association of Certified Fraud Examiners (ACFE) estimates that all organizations lose on average six percent of their revenue to fraud every year. Applying this percentage to the nonprofit sector would suggest that the fraud loss would be approximately \$40 billion each year.”²² Although nonprofits do not have the imposed discipline of stringent reporting requirements such as those imposed upon publicly held corporate securities issuers by the Securities and Exchange Commission (SEC), directors of nonprofit organizations still have the threat of individual, joint, and several legal liability for their actions or failure to act. During October 2013, *The Washington Post* reported their examination of nonprofit entity disclosures required on federal forms about “whether [the nonprofit entity] had experienced an embezzlement or other ‘diversion’ of its assets.”²³ This *Washington Post* analysis of these disclosures covering the period 2008 to 2012 indicated

19. *Id.* at 5–6.

20. *Id.* at 6.

21. See Ann E. Marimow, *Ex-chief of pathology nonprofit gets 4 years for stealing from organization*, WASH. POST (Jan. 29, 2016), https://www.washingtonpost.com/local/public-safety/ex-chief-of-pathology-nonprofit-gets-4-years-for-stealing-from-organization/2016/01/29/8888a530-c6c0-11e5-a4aa-f25866ba0dc6_story.html?utm_term=.c2175f1743b4 [https://perma.cc/Z9WF-WFER]; Valerie Strauss, *Report: Millions of dollars in fraud, waste found in charter school sector*, WASH. POST (Apr. 28, 2015), https://www.washingtonpost.com/news/answer-sheet/wp/2015/04/28/report-millions-of-dollars-in-fraud-waste-found-in-charter-school-sector/?utm_term=.31d41aec7647 [https://perma.cc/6BXX-62CQ].

22. Greenlee, *supra* note 17 at 5.

23. See Stephens & Flaherty, *supra* note 4.

“more than 1,000 nonprofit organizations . . . checked the box indicating that they had discovered a ‘significant diversion’ of assets, disclosing losses attributed to theft, investment fraud, embezzlement and other unauthorized uses of funds.”²⁴ *The Washington Post* further observes:

Just 10 of the largest disclosures identified by The Post cited combined losses to nonprofit groups and their affiliates that potentially totaled more than a half-billion dollars.

While some of the diversions have come to public attention, many others . . . have not been reported in the news media. And The Post found that nonprofits routinely omitted important details from their public filings, leaving the public to guess what had happened—even though federal disclosure instructions direct nonprofit groups to explain the circumstances. About half the organizations did not disclose the total amount lost.

The findings are striking because organizations are required to report only diversions of more than \$250,000 or those identified as having exceeded 5 percent of an organization’s annual gross receipts or total assets. Of those, filing instructions direct nonprofits to disclose “any unauthorized conversion or use of the organization’s assets other than for the organization’s authorized purposes, including but not limited to embezzlement or theft.”²⁵

The Washington Post provides the following list of nonprofit embezzlements or other reported diversions of assets:

- [The American Legacy Foundation] “became aware” of a diversion “in excess of \$250,000 committed by a former employee.” . . . Records and interviews reveal the full story: an estimated \$3.4 million loss, linked to purchases from a business described sometimes as a computer supply firm and at others as a barbershop, and to an assistant vice president who now runs a video game emporium in Nigeria.
- [T]he nonprofit Youth Service America reported two years ago that it discovered a diversion in 2009 of about \$2 million that had been “misappropriated” by a former employee. After The Post asked about the incident, he was charged in federal court and in June was sentenced to four years in prison for theft.

24. See Stephens & Flaherty, *supra* note 4.

25. See Stephens & Flaherty, *supra* note 4.

- AARP, the national charity that advocates for older Americans . . . [in 2011] disclosed two incidents with losses totaling more than \$230,000, attributed to embezzlement and billing irregularities.
- [T]he Maryland Legal Aid Bureau . . . disclosed two years ago that a former finance director and an accomplice had been convicted of making off with \$1.1 million; officials there said in interviews they now think the total loss was closer to \$2.5 million.
- The Global Fund to Fight AIDS, Tuberculosis and Malaria, based in Geneva but regulated and largely financed in the United States, reported in 2012 that it had found evidence of misuse or unsubstantiated spending of \$43 million in grant funds.
- The Conference on Jewish Material Claims Against Germany, a New York-based charity for Holocaust survivors, reported in 2010 that it had been bilked out of \$42 million in an elaborate, decade-long conspiracy by swindlers who created thousands of fake identities. A spokesman said the estimate has since been raised to \$60 million.²⁶

The following are just a few examples of sub-standard nonprofit governance to make our point.

B. *Toronto Salvation Army*

Professor Richard Leblanc reports that the executive director at the Toronto Salvation Army operation is alleged to have been involved in a “massive theft of \$2M in children’s toys . . . [which] likely involved inadequate internal controls over the segregation of duties, over the safeguarding of assets, and over restricted areas. Perhaps paper rather than IT controls were being used (still not uncommon), which is more capable of manual override.”²⁷ Professor Leblanc continues:

It is unclear, judging from the Salvation Army website, whether the Governing Council of the Salvation Army has adequate independence from management or financial expertise. . . . There is an advisory board,

26. See Stephens & Flaherty, *supra* note 4.

27. Richard Leblanc, *Governance at the Salvation Army*, DR. RICHARD LEBLANC GOVERNANCE BLOG: EMERGENT DEVELOPMENTS AND COMMENTARY ON GOVERNANCE AND ACCOUNTABILITY (Nov. 27, 2012), <http://rleblanc.apps01.yorku.ca/governance-at-the-salvation-army/> [<https://perma.cc/F95L-GBJB>].

but there is no indication that the Salvation Army has a proper, functioning board of directors, that oversees risk and controls. Advisory committees advise, but cannot direct.²⁸

C. *Penn State Sex Abuse Scandal*

Years after a scathing report was issued by Special Investigative Counsel Louis Freeh regarding “the culpability of Pennsylvania State University administrators in the Jerry Sandusky child-molestation scandal,” the issue is still in the news.²⁹ Following guilty pleas to child endangerment charges by Penn State’s former athletic director and a university senior vice president, and just hours after Graham B. Spanier, former Penn State president, was convicted of one count of misdemeanor endangering the welfare of children, Mr. Freeh observed:

For over 12 years, these men actively protected a notorious pedophile who inflicted irreparable harm on countless child victims on the campuses and locker rooms at PSU . . . Although these men had multiple opportunities to stop this vicious, serial predator from continuing to sexually assault children who trusted the PSU campuses and programs as safe havens, they decided together to protect this monster rather than report him to the police. . . .

Barron and a coterie of ‘Paterno denier’ board members, alumni, cultlike groups such as Penn Staters for Responsible Stewardship, a former professional football player, and certain elected state political hacks have been nothing but apologists for Paterno, Spanier, Schultz, and Curley, more concerned about bringing back a bronze statue than worrying about the multiple child victims who have forever been so grievously harmed on the PSU campus.³⁰

1. Background

The 267-page Report dated July 12, 2012 by the Investigative Counsel of law firm Freeh, Sporkin & Sullivan, LLP is a must read for all those considering nonprofit directorship.³¹ Because of the many important

28. *Id.*

29. Don Troop, *Louis Freeh Savages Penn State’s Leaders and Calls for Its President to Resign*, CHRON. HIGHER EDUC. (2017), <https://www.chronicle.com/blogs/ticker/louis-freeh-savages-penn-states-leaders-and-calls-for-its-president-to-resign/117422> [https://perma.cc/W9TF-FDD].

30. *Id.*

31. *See Report of the Special Investigative Counsel Regarding the Actions of The Pennsylvania State University Related to the Child Sexual Abuse Committed by Gerald A. Sandusky*, Freeh Sporkin

governance lessons this tragedy teaches, we offer the following excerpts from the Report's Executive Summary for serious thought and reflection:

On November 4, 2011 the Attorney General of the Commonwealth of Pennsylvania ("Attorney General") filed criminal charges against Gerald A. Sandusky ("Sandusky") that included multiple counts of involuntary deviate sexual intercourse, aggravated indecent assault, corruption of minors, unlawful contact with minors and endangering the welfare of minors. Several of the offenses occurred between 1998 and 2002, during which time Sandusky was either the Defensive Coordinator for The Pennsylvania State University . . . football team or a Penn State professor Emeritus with unrestricted access to the University's football facilities. On November 4, 2011, the Attorney General filed criminal charges against the University's Athletic Director ("AD") Timothy M. Curley ("Curley") and Senior Vice President Finance and Business ("SVP-FB"), Gary C. Schultz ("Schultz") for failing to report allegations of child abuse against Sandusky to law enforcement or child protection authorities in [2001] and for committing perjury during their testimony about the allegations to the Grand Jury in Dauphin County, Pennsylvania, in January 2011.

On June 22, 2012, a Centre County jury in Bellefonte, Pennsylvania found Sandusky guilty of 45 counts of the criminal charges against him. As of the date of this report, the charges against Curley and Schultz have not been heard by the court.

The criminal charges filed against these highly respected University and community leaders are unprecedented in the history of the University. Several senior University leaders who had knowledge of the allegations did not prepare for the possibility that these criminal charges would be filed. In the days and weeks surrounding the announcement of the charges, University leaders . . . and the University's Board of Trustees ("Board" or "Trustees"), struggled to decide what actions the University should take and how to be appropriately transparent about their actions. The high degree of interest exhibited by members of the University community, alumni, the public and the national media put additional pressure on these leaders to act quickly.³²

2. Findings

The findings from the Report of the Sandusky Special Investigative Counsel constitute an important case study in governance failure. While

& Sullivan, LLP (July 12, 2012), <https://assets.documentcloud.org/documents/396518/freeh-report-into-penn-state-university.pdf> [<https://perma.cc/EBP3-DZTD>].

32. *Id.*

reading and reflecting upon the entire document is highly recommended, space limitations confine us here to a brief synopsis:

The most saddening finding by the Special Investigative Counsel is the total and consistent disregard by the most senior leaders at Penn State for the safety and welfare of Sandusky's child victims. As the Grand Jury similarly noted in its presentment, there was no "attempt to investigate, to identify Victim 2, or to protect that child or any others from similar conduct except as related to preventing its re-occurrence on University property."

Four of the most powerful people at The Pennsylvania State University—President Graham B. Spanier, Senior Vice President-Finance and Business Gary C. Schultz, Athletic Director Timothy M. Curley and Head Football Coach Joseph V. Paterno—failed to protect against a child sexual predator harming children for over a decade. These men concealed Sandusky's activities from the Board of Trustees, the University community and authorities. They exhibited a striking lack of empathy for Sandusky's victims by failing to inquire as to their safety and well-being, especially by not attempting to determine the identity of the child who Sandusky assaulted in the Lasch building in 2001. Further, they exposed this child to additional harm by alerting Sandusky, who was the only one who knew the child's identity, of what McQueary saw in the shower on the night of February 9, 2001.

These individuals, unchecked by the Board of Trustees that did not perform its oversight duties, empowered Sandusky to attract potential victims to the campus and football events by allowing him to have continued, unrestricted and unsupervised access to the University's facilities and affiliation with the University's prominent football program. Indeed, that continued access provided Sandusky with the very currency that enabled him to attract his victims. Some coaches, administrators and football program staff members ignored the red flags of Sandusky's behaviors and no one warned the public about him.

By not promptly and fully advising the Board of Trustees about the 1998 and 2001 child sexual abuse allegations against Sandusky and the subsequent Grand Jury investigation of him, Spanier failed in his duties as President. The Board also failed in its duties to oversee the President and senior University officials in 1998 and 2001 by not inquiring about important University matters and by not creating an environment where senior University officials felt accountable.

Once the Board was made aware of the investigations of Sandusky and the fact that senior University officials had testified before the Grand Jury in the investigations, it should have recognized the potential risk to

the University community and to the University's reputation. Instead, the Board, as a governing body, failed to inquire reasonably and to demand detailed information from Spanier. The Board's overconfidence in Spanier's abilities to deal with the crisis, and its complacent attitude left them unprepared to respond to the November 2011 criminal charges filed against two senior Penn State leaders and a former prominent coach. Finally, the Board's subsequent removal of Paterno as head football coach was poorly handled, as were the Board's communications with the public. . . [T]he Special Investigative Counsel finds that it is more reasonable to conclude that, in order to avoid the consequences of bad publicity, the most powerful leaders at the University—Spanier, Schultz, Paterno and Curley—repeatedly concealed critical facts relating to Sandusky's child abuse from the authorities, the University's Board of Trustees, the Penn State community, and the public at large.

The avoidance of the consequences of bad publicity is the most significant, but not the only, cause for this failure to protect child victims and report to authorities. The investigation also revealed:

- A striking lack of empathy for child abuse victims by the most senior leaders of the University.
- A failure by the Board to exercise its oversight functions in 1998 and 2001 by not having regular reporting procedures or committee structures in place to ensure disclosure to the Board of major risks to the University.
- A failure by the Board to make reasonable inquiry in 2011 by not demanding details from Spanier and the General Counsel about the nature and direction of the grand jury investigation and the University's response to the investigation.
- *A President who discouraged discussion and dissent.*
- A lack of awareness of child abuse issues, the Clery Act, and whistleblower policies and protections.³³

3. Alarming Prevalence of Sexual Assault

Other examples of widespread sexual abuse, assault, and sexual harassment are reported seemingly daily.³⁴ For example, press reports

33. *Id.* (emphasis added).

34. See Melissa Korn, *Academia Faces a #MeToo Moment*, WALL ST. J., (Jan. 12, 2018), at A3 (college campuses); Ryan Dube & Francis X. Rocca, *Clerical Sex-Abuse Scandal Follows Pope*, WALL ST. J., (Jan. 16, 2018), at A16 (Catholic church); Blake Ellis & Melanie Hicken, *Sick, Dying and Raped in America's Nursing Homes*, CNN (2017), <http://www.cnn.com/interactive/2017/02/health/nursing-home-sex-abuse-investigation/> [<https://perma.cc/6Z4R-VJN6>]

abound describing the sentencing of Dr. Larry Nassar to up to 175 years in prison for the sexual abuse of hundreds of young girls engaged in the USA Gymnastics program.³⁵ Michigan State University president Lou Anna K. Simon states, “The survivor’s accounts are horrific. They are tragic, heartbreaking and personally gut-wrenching.”³⁶ She resigned amid criticism of the failure of the university over many years to follow-up reports of sexual assault.³⁷ Scandals such as these cause reputational damage with resulting economic consequences lasting many years.³⁸

D. *New York United Way*

In the nonprofit world, one of the most notorious examples of lack of effective governance is found in the example of the New York United Way, where William Aramony, president of United Way of America from 1970 to 1992, “spent six years in a federal prison after he was convicted in 1995 on 23 counts of felony charges, including conspiracy, fraud and filing false tax returns.”³⁹ *The Washington Post* reports:

(nursing homes); Lawrence J. Trautman, Kenneth J. Sanney, Eric D. Yordy, Tammy W. Cowart, and Destynie Sewell, *Beginning To Think About Ethics and Values in an Age of Rapid Technological Change*, <http://ssrn.com/abstract=3102552> [<https://perma.cc/GU9L-QL4C>]. (Stanford University rape case).

35. See Louise Radnofsky, *U.S. Gymnastics Star Says She Too Was Assaulted by Doctor*, WALL ST. J., (Jan. 16, 2018), at A3; Monica Davey & Mitch Smith, *Michigan State’s Defender Led Review of Abuse*, N.Y. TIMES, (Jan. 28, 2018), at A1; Rebecca Davis O’Brien, *USOC Failed to Act on Reports of Abuse*, WALL ST. J., (Feb. 2, 2018), at A3; Louise Radnofsky, *Senators Want Olympics Chief to Resign*, WALL ST. J., (Feb. 3–4, 2018), at A3; Rebecca Davis O’Brien, *Investigation Is Called for Training Site*, WALL ST. J., (Jan. 31, 2018), at A3.

36. See Lou Anna K. Simon, *President Simon Announces Resignation from MSU*, MICH. ST. U. (Jan. 24, 2018), <https://cabs.msu.edu/news/key-issues/issue-docs/simon-resigns.html> [<https://perma.cc/7TJJ-PHMY>].

37. See Dan Barry, Serge F. Kovaleski & Juliet Macur, *As F.B.I. Took a Year to Pursue the Nassar Case, Dozens Say They Were Molested*, N.Y. TIMES (Feb. 3, 2018), <https://www.nytimes.com/2018/02/03/sports/nassar-fbi.html> [<https://perma.cc/A5JJ-WTE3>]; Matthew Haag & Marc Tracy, *Michigan State President Lou Anna Simon Resigns Amid Nassar Fallout*, N.Y. TIMES (Jan. 24, 2018), <https://www.nytimes.com/2018/01/24/sports/olympics/michigan-state-president-resigns-lou-anna-simon.html> [<https://perma.cc/4Y3C-3JCX>]; Christine Hauser & Maggie Astor, *The Larry Nassar Case: What Happened and How the Fallout Is Spreading*, N.Y. TIMES (Jan. 25, 2018), <https://www.nytimes.com/2018/01/25/sports/larry-nassar-gymnastics-abuse.html> [<https://perma.cc/QA8B-BKDJ>].

38. See Michael Luca, Patrick Rooney & Jonathan Smith, *The Impact of Campus Scandals on College Applications*, HARV. BUS. SCH. (2016), <http://www.people.hbs.edu/mluca/CollegeScandals.pdf> [<https://perma.cc/73RS-Y849>].

39. See T. Rees Shapiro, *United Way leader’s fraud scandal marred charitable legacy*, WASH. POST, (Nov. 14, 2011), https://www.washingtonpost.com/local/obituaries/united-way-leaders-fraud-scandal-marred-charitable-legacy/2011/11/14/gIQUALnwbMN_story.html?utm_term=.7c63a5c0edfc [<https://perma.cc/35HH-K939>].

Revelations that he used United Way funds to pay for extramarital affairs—including a dalliance he began with a teenager soon after she graduated high school—embarrassed one of the nation’s most respected charities. His actions moved scores of charitable organizations to review their business practices.

...

- As president, Mr. Aramony helped United Way annual donations grow to more than \$3 billion in 1990 from \$787 million in 1970 . . .

...

- Mr. Aramony was one of the highest-paid executives in the charity field, earning an annual compensation package of more than \$460,000. Yet, as federal prosecutors charged, he used United Way money to support a luxurious lifestyle that included craps games in Las Vegas, frequenting velvet-rope dance clubs and eating lobster dinners in tony restaurants.

...

- He used United Way of America spinoff companies to buy and decorate a \$430,000 apartment in New York’s Upper East Side and purchase a \$125,000 condominium in Miami. . . .

...

- Mr. Aramony used United Way money to take vacations with [a 17 year old] and his other mistresses to Paris, London and Cairo. . . .
- Mr. Aramony resigned from United Way of America in February 1992, after *The Post* stories were published.
- During Mr. Aramony’s 1995 trial, four of his former lovers testified against him. In his defense, Mr. Aramony’s lawyers noted that a few weeks before he left United Way, board members gave him a unanimous vote of confidence. Ultimately, his lawyers called no witnesses. He was sentenced to seven years in a federal penitentiary.⁴⁰

E. Bernie Madoff Investment Scam

New Yorker Bernard Madoff is credited with one of the biggest ever investment frauds when he “[plead] guilty to eleven federal felony charges

40. *Id.*

and admitted that his wealth management business was nothing but a shell for running a Ponzi scheme.”⁴¹ For more than two decades “he ran a \$60 billion-dollar Ponzi scheme . . . causing thousands of investors to lose large sums, in many instances their life savings. Because thousands of victims lost money to Madoff’s fraud, the prosecutors developed a website to provide information about the case to the victims.”⁴² Professors Cassell and Erez observe, “More than one hundred wrote letters or emails to the presiding judge in the case, Judge Danny Chin. During Madoff’s sentencing hearing, ten victims spoke: eight of whom had also submitted written statements and two of whom had not.”⁴³

Among the victims, *The Washington Post* reports that “the Alliance for Excellent Education . . . disclosed . . . that investment manager Bernard L. Madoff’s Ponzi scheme had wiped nearly \$7 million from its balance sheets.”⁴⁴ Investigative efforts from *The Washington Post* discloses that among nonprofits, “Investment fraud was blamed for some of the largest losses identified. Funds linked to Madoff’s scheme, which bilked investors across the country for decades, reportedly drained \$106 million from Yeshiva University . . . \$38.8 million from the Upstate New York Engineers Health Fund and \$26 million from New York University.”⁴⁵

F. FIFA Fraud and Corruption

Internationally, the governing body of the most popular sport in the world has suffered embarrassment, humiliation, widespread bribery and corruption, convictions, and jail time.⁴⁶ The April 2016 release of *The*

41. *United States v. Madoff* (No. 1:09-cr-00213 (S.D.N.Y. 2009) (April 20, 2009)). See also Kaushik Basu, *Ponzis: The Science and Mystique of a Class of Financial Frauds*, World Bank Group, Off. Chief Econ., 3 Policy Research Working Paper No. 6967, <http://documents.worldbank.org/curated/en/660611468148791146/pdf/WPS6967.pdf> [<https://perma.cc/48GB-HCGT>]; Stephen G. Dimmock & William C. Gerken, *Finding Bernie Madoff: Detecting Fraud by Investment Managers*, <http://ssrn.com/abstract=1471631> [<https://perma.cc/VT3Q-2VNB>]; Miriam A. Cherry, *Review Essay: Learning Contracts Through Current Events: Lawrence Cunningham’s Contracts in the Real World, Stories of Popular Contracts and Why They Matter*, 35 U. HAW. L. REV. 129 (2013); Garima Rai, *The Vulnerability to fraud: Factors, Motivations, and fraud detection and Deterrence*, (April 19, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2962613 [<https://perma.cc/S6KY-EX7G>].

42. See Paul G. Cassell & Edna Erez, *Victim Impact Statements and Ancillary Harm: The American Perspective*, 15 CANADIAN CRIM. L. REV. 149 (2011).

43. *Id.*

44. See Stephens & Flaherty, *supra* note 4.

45. See Stephens & Flaherty, *supra* note 4.

46. See Lawrence J. Trautman, *Following the Money: Lessons from the “Panama Papers,” Part 1: Tip of the Iceberg*, 121 PENN ST. L. REV. 807, 807 (2017).

Panama Papers is the largest to date release of documents resulting from the year-long effort by over 400 journalists worldwide and “the International Consortium of Investigative Journalists [ICIJ] to expose a global pattern of crime and corruption.”⁴⁷ As Trautman describes elsewhere:

After release of the Panama papers, “Swiss authorities raided the headquarters of the European soccer association in Nyon, Switzerland . . . seizing information on television rights contracts with Argentine business executives implicated in the FIFA corruption scandal.” *The New York Times* article further reported that “FIFA’s independent ethics committee confirmed that one of its ethics lawyers was under internal investigation for a business relationship brought to light by the Panama Papers.”

On May 27, 2015, a 47-count indictment was unsealed by the United States Department of Justice in the U.S. District Court for the Eastern District of New York. Fourteen defendants were charged in this indictment with “racketeering, wire fraud and money laundering conspiracies, among other offenses, in connection with the defendants’ participation in a 24-year scheme to enrich themselves through the corruption of international soccer.” On the same day, coordinated raids were held by “United States and Swiss officials on FIFA facilities in Miami and at FIFA headquarters in Zurich. Swiss authorities also conducted an early morning raid on Zurich’s luxury Baur du Lac Hotel arresting seven FIFA officials.”

Known as soccer in the United States, “international football is the world’s most popular sport. It is played in every country, territory, and remote island on the planet . . . requiring no elaborate infrastructure, no expensive equipment, and no extraordinary physical characteristics for those who simply want to kick a ball toward a goal”

According to the DOJ, FIFA is composed of 209 member associations, each representing organized soccer in a particular nation or territory, including the United States and four of its overseas territories. FIFA also recognizes six continental confederations that assist it in governing soccer in different regions of the world. The U.S. Soccer Federation is one of 41 member associations of the confederation known as CONCACAF, which has been headquartered in the United States throughout the period charged in the indictment. The South American confederation, called CONMEBOL, is also a focus of the indictment.

47. *Id.*

As alleged in the indictment, FIFA and its six continental confederations, together with affiliated regional federations, national member associations and sports marketing companies, constitute an enterprise of legal entities associated in fact for purposes of the federal racketeering laws. The principal—and entirely legitimate—purpose of the enterprise is to regulate and promote the sport of soccer worldwide.

As alleged in the indictment, one key way the enterprise derives revenue is to commercialize the media and marketing rights associated with soccer events and tournaments. The organizing entity that owns those rights—as FIFA and CONCACAF do with respect to the World Cup and Gold Cup, their respective flagship tournaments—sells them to sports marketing companies, often through multi-year contracts covering multiple editions of the tournaments. The sports marketing companies, in turn, sell the rights downstream to TV and radio broadcast networks, major corporate sponsors and other sub-licensees who want to broadcast the matches or promote their brands. The revenue generated from these contracts is substantial: according to FIFA, 70% of its \$5.7 billion in total revenues between 2011 and 2014 was attributable to the sale of TV and marketing rights to the 2014 World Cup.⁴⁸

G. *Beware of Foreign Operations*

On August 29, 2017, the DOJ filed a criminal complaint against Joseph Baptiste, a founder of a nonprofit intended to assist the poor in Haiti, and also a retired U.S. Army colonel. He was charged in a criminal complaint, “stemming from his alleged role in a corruption scheme connected to a Haitian development project.”⁴⁹ According to Gibson Dunn:

Unbeknownst to Baptiste, the project’s investors who provided him the bribe money were undercover FBI agents. Unbeknownst to the undercover FBI agents, Baptiste used the \$50,000 down payment on a bribe for his own personal expenses. DOJ alleges that there was an FCPA violation because Baptiste allegedly intended to use additional payments for actual bribery of Haitian port officials. Baptiste reportedly entered into a signed plea agreement with DOJ after being approached by authorities and before the charges were made public, but then backed out of that deal, leading to his arrest.⁵⁰

48. *Id.* 823–25 (citations omitted).

49. *See* 2017 Year-End FCPA Update, GIBSON DUNN 12 (Jan. 2, 2018), <https://www.gibsondunn.com/2017-year-end-fcpa-update/> [<https://perma.cc/5KGG-5KAL>].

50. *Id.*

It appears that bribery and corruption minefields are everywhere, as demonstrated during 2017 by revelations “concern[ing] a new branch of corruption at the United Nations.”⁵¹ John Ashe, former President of the U.N. General Assembly, has been implicated in “a scheme to corruptly influence a plan to build a U.N.-sponsored conference center in Macau. . . . On November 20, 2017, DOJ unsealed a criminal complaint alleging a completely distinct bribery scheme involving Ashe’s successor to the U.N. General Assembly presidency.”⁵² Gibson Dunn reports:

Chi Ping Patrick Ho, the head of a non-governmental organization that holds “special consultative status” at the United Nations and is associated with the China Energy Fund, and *Cheikh Gadio*, the former Foreign Minister of Senegal and a business consultant, were each charged with substantive and conspiracy FCPA and money laundering violations associated with two separate bribery schemes. The first involved an alleged scheme to pay \$2 million to the President of Chad to secure valuable oil concessions and reduce a substantial fine for environmental violations by Ho’s Chinese employer. The second scheme, allegedly “hatched in the hallways of the United Nations,” involved a separate plan to bribe the current Foreign Minister of Uganda and then-President of the U.N. General Assembly with \$500,000 for various illicit benefits, including a share in profits from a Ugandan joint venture with Ho’s Chinese employer. . . . Neither individual has yet (publicly) entered a plea in connection with these charges.⁵³

IV. INTERNAL REVENUE SERVICE REQUIREMENTS

As we have seen in Exhibit 1, the largest U.S. charities are substantially donor dependent and therefore reliant upon the motivation of contributor tax deductions for the bulk of their revenues. Federal law, in what is commonly referred to by the shorthand expression *section 501*, provides for tax-exempt status for certain entities,⁵⁴ and also provides that contributions to tax-exempt entities are tax deductible for the donors.⁵⁵

51. *Id.* at 13.

52. *Id.*; see also Lawrence J. Trautman, *U.S. Entrepreneurial Risk in International Markets: Focus on Bribery and Corruption*, (Feb. 6, 2017) (unpublished manuscripts) (on file with authors), <https://ssrn.com/abstract=2912072> [<https://perma.cc/MSE4-HQMV>]; Lawrence J. Trautman & Kara Altenbaumer-Price, *Lawyers, Guns and Money – The Bribery Problem and U.K. Bribery Act*, 47 INT’L L. 481 (2013); Lawrence J. Trautman & Kara Altenbaumer-Price, *Foreign Corrupt Practices Act: An Update on Enforcement and SEC and DOJ Guidance*, 41 SEC. REG. L.J. 241 (2013); Joanna Kimbell & Lawrence J. Trautman, *Bribery and Corruption: The COSO Framework, FCPA, and U.K. Bribery Act*, 30(3) FLA. J. INT’L L. (2019).

53. See 2017 Year-End FCPA Update, *supra* note 50, at 13(emphasis in original).

54. I.R.C. §501(a) (West 2017).

55. I.R.C. §170 (West 2019).

Accordingly, nonprofit governance must be conducted with an understanding of and strict compliance with Internal Revenue Service (IRS) regulations that govern tax deductibility of donations. Such awareness and focus is paramount to the health, wellbeing, and survival of nonprofit organizations.

Nonprofit organizations, like their for-profit counterparts, are subject to a variety of state and federal laws and must comply with applicable laws at both levels in order to maintain their tax-exempt status and thus the tax deductibility of contributions by donors. As noted by the IRS, “[n]onprofit status is a state law concept. . . . [O]rganizing as a nonprofit organization at the state level does not automatically grant the organization exemption from federal income tax.”⁵⁶ A nonprofit organization begins its existence under state law by filing the necessary documents with and submitting the required fees to the appropriate state office, typically the Secretary of State. In order to obtain tax-exempt status from the IRS, the nonprofit entity must include in its charter a *purposes* provision and a *dissolution* provision. The purposes provision ensures that the organization will pursue activities and objectives that fall within the exemption requirements of section 501, and the dissolution provision ensures that, upon dissolution of the organization, its assets will be distributed either for another exempt purpose under section 501(c) or to the federal, state, or local government.⁵⁷

Once the nonprofit entity has been established under state law, it may then apply to the IRS for tax-exempt status. The organization must obtain a federal Employer Identification Number (EIN) regardless of whether it has employees. The EIN serves as an identifier for the organization in its interactions with the IRS in much the same way that a Social Security Number identifies individual taxpayers.⁵⁸ In addition to the application itself (Form 1023 or Form 1023 EZ), the IRS requires copies of the organization’s state charter and a filing fee. If the IRS reviewer finds that the organization’s application is complete and meets all requirements for tax-exempt status, the IRS will issue a determination letter or ruling granting tax-exempt status.⁵⁹

56. INTERNAL REVENUE SERVICE, *Frequently Asked Questions about Applying for Tax Exemption*, <https://www.irs.gov/charities-non-profits/frequently-asked-questions-about-applying-for-tax-exemption> [https://perma.cc/3424-HE9M].

57. 26 C.F.R. §1.501(c)(3)-1 (West 2017).

58. INTERNAL REVENUE SERVICE, *Employee Identification Number*, <https://www.irs.gov/charities-non-profits/employer-identification-number> [https://perma.cc/3BY3-ENU4].

59. INTERNAL REVENUE SERVICE, *Exempt Organizations – Rulings and Determinations Letters*, <https://www.irs.gov/charities-non-profits/charitable-organizations/exempt-organizations-rulings-and-determinations-letters> [https://perma.cc/DCM8-8J9S].

While the application process for tax-exempt status may seem straightforward, the interim period between the creation of the nonprofit entity under state law and the granting of tax-exempt status by the IRS poses some practical concerns that must be addressed by the governing board of the nonprofit. Perhaps the primary concern is whether or to what extent contributions made to the organization during this interim period are tax deductible. The answer is: It depends. If the organization files a timely application and the IRS grants tax-exempt status, then its tax-exempt status dates back to the date of its organization and contributions received during that interim period are tax deductible. However, if tax-exempt status is denied, then those contributions are not tax deductible.⁶⁰ This begs the question: what is a *timely* application? Under current IRS policy, a nonprofit entity's tax-exempt status will be retroactive to the date on which it was organized if its application was filed within 27 months from the end of the month in which it was organized. If the application is filed after that 27-month window, then tax-exempt status, and thus the tax-deductibility of contributions, will be retroactive only to the date of the application's receipt, defined as either the postmark date on the cover of the application or the date that is stamped on the application when it is actually received by the IRS.⁶¹

The interim period between a nonprofit's organization and its receipt of tax-exempt status from the IRS is also a period that requires careful recordkeeping and reporting, as well as oversight of the organization's activities to ensure that it does not jeopardize its pending tax-exempt status. Most nonprofit organizations, with some exceptions, are required to file annual exempt organization returns (Form 990 or one of its variants) with the IRS, even while their application for tax-exempt status is pending.⁶² Filing Form 990 late, filing an incomplete return, or failing to file at all will trigger penalties unless the organization can show *reasonable cause* for the failure to properly file. Importantly for all tax-exempt organizations, failure to file a Form 990 for three consecutive years will trigger an automatic revocation of tax-exempt status.⁶³

Once tax-exempt status has been granted by the IRS, a nonprofit organization must protect this status through required filings, such as the

60. INTERNAL REVENUE SERVICE, *Contributions to Organization with IRS Application Pending*, <https://www.irs.gov/charities-non-profits/charitable-organizations/contributions-to-organization-with-irs-application-pending> [<https://perma.cc/M3AL-GZ6S>].

61. Tax Exempt Status for Your Organization, I.R.S. Pub. No. 557, Cat. No. 46573C, at 22 (Jan. 30, 2017), <https://www.irs.gov/pub/irs-pdf/p557.pdf> [<https://perma.cc/W47R-RE65>].

62. I.R.C. §6033 (West Mar. 23, 2018).

63. I.R.C. §6033(j) (West Mar. 23, 2018).

Form 990 discussed above, along with any additional information required by the federal or state government. While Form 990 or one of its variants, Form 990-EZ or Form 990-N (the e-postcard), is used by most nonprofit tax-exempt organizations, there are special forms for certain categories of nonprofits, such as Form 1065 for religious organizations or Form 5500 for employee benefit trusts.⁶⁴ In addition to information concerning revenue and disbursements, Forms 990 and 990-EZ also require a brief summary of the organization's activities and accomplishments for the reporting period. Form 990 and Form 990-EZ also require disclosure of the organization's governance structure and practices. The three most recent annual exemption returns filed by tax-exempt organizations are required to be available for public inspection.⁶⁵

In addition to annual filings required under the Internal Revenue Code, many states also require annual financial statements to be filed or made available to the public as well.⁶⁶ As with for-profit entities, state laws typically require that a nonprofit's leadership meet regularly and maintain minutes of actions taken.⁶⁷ Many states require that a nonprofit

64. INTERNAL REVENUE SERVICE, *Exempt Organizations Annual Reporting Requirements – Overview – Annual Return Filing Exceptions*, <https://www.irs.gov/charities-non-profits/exempt-organizations-annual-reporting-requirements-overview-annual-return-filing-exceptions> [<https://perma.cc/A4K8-R4FP>].

65. I.R.C. §6104(d) (West Dec. 19, 2014).

66. See, e.g. ARK. CODE ANN. §4-28-403 (2018); MASS. GEN. LAWS CH. 12, §8F (2017); N.C. GEN. STAT. §55A-16-24 (2018); OR. REV. STAT. §128.670 (2017); TEX. BUS. ORG. CODE ANN. §22.353 (2017).

67. See, e.g. ALA. CODE §§10A-2.13, 2.32 (2018); ALASKA STAT. §§10.20.116, 131 (2018); ARIZ. REV. STAT. ANN. §§10.3820, 11601 (2018); ARK. CODE ANN. §4-28-218 (2018); CAL. CORP. CODE §6320 (WEST 2018); COLO. REV. STAT. §§7-128-201, 136-101 (2018); CONN. GEN. STAT. §§33-1095, 1235 (2018); DEL. CODE ANN. TIT. 8, §224 (2018); D.C. CODE §§29-406.20, 413.01 (2018); FLA. STAT. §§617.0820, 1601 (2018); GA. CODE ANN. §§14-3-820, 1601 (2018); HAW. REV. STAT. §§414D-143, 301 (2018); IDAHO CODE §§30-6-1101, 30-612 (2018); ILL. COMP. STAT. 805 ILCS 105/ §§107.75, 108.20 (2018); IND. CODE §§23-17-15-1, 27-1 (2018); IOWA CODE §§504.821, 1601 (2019); KY. REV. STAT. ANN. §§273.223, 233 (2018); KAN. STAT. ANN. §§17-6301, 6514 (2018); LA. STAT. ANN. §§12:223, 224 (2018); ME. REV. STAT. ANN. TIT. 13-B, §§705, 715 (2018); MD. CODE ANN., CORP. & ASS'N., §2-409 (LEXISNEXIS 2018); MASS. GEN. LAWS CH. 156B, §§32, 56 (2017); MICH. COMP. LAWS §§450.2485, 2521 (2017); MINN. STAT. §§317A.231, 461 (2018); MISS. CODE ANN. §§79-11-255, 283 (2018); MO. REV. STAT. §§355.376, 821 (2018); MONT. CODE ANN. §§35-2-427, 906 (2017); NEB. REV. STAT. §§21-1980, 19165 (2018); NEV. REV. STAT. §§82.181, 266 (2018); N.J. STAT. ANN. §§15A:5-24, 6-10 (2018); N.M. STAT. ANN. §§53-8-22, 27 (2018); N.Y. NOT-FOR-PROFIT CORP. LAW §§621, 710 (2018); N.C. GEN. STAT. §§55A-8-20, 16-01 (2018); N.D. CENT. CODE §§10-33-39, 80 (2018); OHIO REV. CODE ANN. §§1702.15, 31 (2018); OKLA. STAT. TIT. 18, §§1027, 1069 (2017); OR. REV. STAT. §§65.337, 771 (2017); 15 PA. CONS. STAT. §§1508, 1703 (2018); 7 R.I. GEN. LAWS §§7-6-27, 30 (2018); S.C. CODE ANN. §§33-31-820, 1601 (2018); S.D. CODIFIED LAWS §§47-23-21, 24-1 (2018); TENN. CODE ANN. §§48-58-201, 66-101 (2018); TEX. BUS. ORG. CODE ANN. §§22.220, 351 (2017); UTAH CODE ANN. §§16-6A-812, 1601 (2018); VT. STAT. ANN. TIT. 11B, §§8.20, 16.01 (2018); VA. CODE ANN. §§13.1-864, 932 (2018); WASH. REV. CODE §§24.03.120, 135

organization register with or obtain a license from the state prior to soliciting contributions from their citizens.⁶⁸ A nonprofit organization that fails to comply with state recordkeeping and reporting requirements may be administratively dissolved by the Secretary of State or other official⁶⁹ or judicially dissolved by a court of competent jurisdiction.⁷⁰

The governing body of a nonprofit organization may also jeopardize its tax-exempt status by allowing that organization to engage in forbidden activity or forbidden transactions. Section 501 of the Internal Revenue Code, through its many sub-sections, provides the opportunity for a wide variety of organizations to be granted tax-exempt status.⁷¹ The common

(2018); W. VA. CODE §§31E-8-820, 15-1501 (2018); WIS. STAT. §§181.0820, 1601 (2019); WYO. STAT. ANN. §§17-19-820, 1601 (2018).

68. *See, e.g.* ALA. CODE §13A-9-71 (2018); ALASKA STAT. §45.68.010 (2018); ARK. CODE ANN. §4-28-402 (2018); CAL. BUS. & PROF. CODE §17510.3 (WEST 2018); COLO. REV. STAT. §6-16-104 (2018); CONN. GEN. STAT. §21A-190B (2018); D.C. CODE §44-1703 (2018); FLA. STAT. §496.405 (2018); GA. CODE ANN. §43-17-3.1 (2018); HAW. REV. STAT. §467B-2.1 (2018); IDAHO CODE §48-1004 (2018); ILL. COMP. STAT. 225 ILCS 460/ §2 (2018); KAN. STAT. ANN. §17-1761 (2018); KY. REV. STAT. ANN. §367.657 (2018); LA. STAT. ANN. § 51:1901.1 (2018); ME. REV. STAT. ANN. TIT. 9, § 5004 (2018); MD. CODE ANN., BUS. REG. §6-401 (LEXISNEXIS 2018); MASS. GEN. LAWS CH. 12, §8E (2017); MICH. COMP. LAWS §400.273 (2017); MINN. STAT. §309.52 (2018); MISS. CODE ANN. §79-11-503 (2018); MO. REV. STAT. § 355.456 (2018); NEV. REV. STAT. §82A.100 (2018); N.H. REV. STAT. ANN. §7:28-B (2018); N.J. STAT. ANN. §45:17A-23 (2018); N.M. STAT. ANN. §57-22-6 (2018); N.Y. NOT-FOR-PROFIT CORP. LAW §115 (2018); N.C. GEN. STAT. §131F-5 (2018); N.D. CENT. CODE §50-22-02 (2018); OHIO REV. CODE ANN. §1716.02 (2018); OKLA. STAT. TIT. 18, §552.3 (2017); OR. REV. STAT. §65.337 (2017); 10 PA. CONS. STAT. §162.5 (2018); 5 R.I. GEN. LAWS §5-53.1-2 (2018); S.C. CODE ANN. §33-56-30 (2018); TENN. CODE ANN. §48-101-504 (2018); UTAH CODE ANN. §13-22-5 (2018); VT. STAT. ANN. TIT. 9, §2473 (2018); VA. CODE ANN. §57-49 (2018); WASH. REV. CODE §19.09.065 (2018); W. VA. CODE §29-19-5 (2018); WIS. STAT. §202.12 (2019).

69. *See, e.g.* ALASKA STAT. §10.20.325 (2018); ARIZ. REV. STAT. ANN. §§10-11420-11422; CONN. GEN. STAT. §33-1181 (2018); GA. CODE ANN. §14-3-1420 (2018); HAW. REV. STAT. §414D-249 (2018); ILL. COMP. STAT. 805 ILCS 105/ §112.35 (2018); IOWA CODE §504.1421 (2019); ME. REV. STAT. ANN. TIT. 13-B, §1112 (2018); MISS. CODE ANN. §79-11-347 (2018); MO. REV. STAT. § 355.706 (2018); NEB. REV. STAT. §21-19,137 (2018); N.M. STAT. ANN. §53-8-53 (2018); N.C. GEN. STAT. §55A-14-20 (2018); OR. REV. STAT. §65.647 (2017); S.C. CODE ANN. §33-31-1420 (2018); S.D. CODIFIED LAWS §47-24-13.1 (2018); TENN. CODE ANN. §48-64-201 (2018); TEX. BUS. ORG. CODE ANN. §22.360 (2017); UTAH CODE ANN. §16-6A-1410 (2018); VT. STAT. ANN. TIT. 11B, §14.20 (2018); VA. CODE ANN. §13.1-915 (2018); WASH. REV. CODE §23.95.605 (2018); W. VA. CODE §31E-13-1320 (2018); WIS. STAT. §181.1420 (2019); WYO. STAT. ANN. §17-19-1420 (2018).

70. *See, e.g.* ALASKA STAT. §10.20.325 (2018); ARIZ. REV. STAT. ANN. §§10-11420-11422; CONN. GEN. STAT. §33-1181 (2018); GA. CODE ANN. §14-3-1420 (2018); HAW. REV. STAT. §414D-249 (2018); ILL. COMP. STAT. 805 ILCS 105/ §112.35 (2018); IOWA CODE §504.1421 (2019); ME. REV. STAT. ANN. TIT. 13-B, §1112 (2018); MISS. CODE ANN. §79-11-347 (2018); MO. REV. STAT. § 355.706 (2018); NEB. REV. STAT. §21-19,137 (2018); N.M. STAT. ANN. §53-8-53 (2018); N.C. GEN. STAT. §55A-14-20 (2018); OR. REV. STAT. §65.647 (2017); S.C. CODE ANN. §33-31-1420 (2018); S.D. CODIFIED LAWS §47-24-13.1 (2018); TENN. CODE ANN. §48-64-201 (2018); TEX. BUS. ORG. CODE ANN. §22.360 (2017); UTAH CODE ANN. §16-6A-1410 (2018); VT. STAT. ANN. TIT. 11B, §14.20 (2018); VA. CODE ANN. §13.1-915 (2018); WASH. REV. CODE §23.95.605 (2018); W. VA. CODE §31E-13-1320 (2018); WIS. STAT. §181.1420 (2019); WYO. STAT. ANN. §17-19-1420 (2018).

71. I.R.C. §501 (West 2017).

thread that runs through the many categories of potentially tax-exempt organizations is that they must not serve as investment vehicles whose profits “inure[] to the benefit of any private shareholder or individual.”⁷² Additionally, a *substantial* portion of a tax-exempt organization’s activities and expenditures must be addressed to objectives *other than* influencing legislation.⁷³ The law allows for limited lobbying efforts but sets out a maximum amount, based on exempt purpose expenditures, that a section 501 entity may expend for such purposes.⁷⁴ Section 501(c)(3), under which many nonprofit organizations obtain tax exemption, includes a flat prohibition of political activity that supports or opposes a candidate for public office.⁷⁵ Nonprofit governance must ensure that the private benefit and political restrictions are carefully observed.

V. 2017 TAX CUTS: CRISIS FOR NONPROFITS?

Changes in the tax code during late 2017 have resulted in concern among some nonprofit executives as to whether donations may decline as a result. *The Wall Street Journal* reports that toward the end of 2017, “Americans . . . poured money into charitable-giving vehicles known as donor-advised funds, which allow immediate tax deductions but gradual distributions to nonprofits—a sign of ways the new tax law could reshape how Americans donate money for years to come.”⁷⁶

Not-for-profit colleges and hospitals, according to National Council of Nonprofit vice president David Thompson, “are probably going to be fine because they tend to have development offices and tend to have big donors. . . . It’s the front-line human services groups. They rely on donations in the community and those are the ones that are probably going to dry up.”⁷⁷ The Council on Foundations estimates that the Tax Cuts and Jobs Act “will drain \$16 billion to \$24 billion a year from the nonprofit

72. I.R.C. § 501(c)(3) (West 2017).

73. *Id.*

74. I.R.C. §501(h); 26 U.S.C. §4911 (West 2017).

75. I.R.C. §501(c)(3) (West 2017).

76. See Richard Rubin, *Charity Funds Take Off as Tax Law Reshapes Giving*, WALL ST. J. (Feb. 1, 2018) at A1, <https://www.wsj.com/articles/charity-funds-take-off-as-tax-law-reshapes-giving-1517502089> [<https://perma.cc/3544-352N>].

77. See J.B. Wogan, *Tax Law Could Deliver Billion-Dollar Blow to Social Services*, GOVERNING (Jan. 17, 2018), <http://www.governing.com/topics/health-human-services/gov-nonprofits-tax-law-charitable-giving-human-services.html> [<https://perma.cc/8JP7-4FR6>].

sector going forward.”⁷⁸ In a *Los Angeles Times* Op-Ed, Bryan McQueeney writes:

The problem is that while the Tax Cuts and Jobs Act preserves the deductibility of charitable contributions, it restructures the system so that millions will lose incentives to give. Most people donate from their hearts to causes they care about, regardless of taxes. It is undeniable, however, that the reward for giving will go down and the cost of giving will go up. . . . The Tax Cuts Act simultaneously raises the standard deduction to \$24,000 for a married couple. For millions it will no longer make sense to itemize, and that too means fewer charitable gifts: You can only deduct donations if you itemize.⁷⁹

Regarding the likely impact of recent tax code changes resulting in lower rates and therefore less value to the taxpayer for charitable donations, director Deborah Cannon states, “While the tax changes may create less benefit from a donation, those individuals who believe strongly in a nonprofit’s mission may have more disposable income to contribute and donors who gave only because of a tax benefit aren’t ones who are going to advance the mission of the organization.”⁸⁰ Director Jack Lowe states, “The changes in the tax code will require non-profit boards even more clearly demonstrate and communicate their organization’s value proposition.”⁸¹ University of Texas at Dallas professor Dennis McCuistion says:

While there is always angst among the nonprofit community when tax rates are lowered, I think that less taxes means more giving not less because there is more to give. Also, while taxes are A factor, they are seldom THE factor and small gifts that are so important are seldom even deductible anyway, so why worry?⁸²

78. See Bryan McQueeney, Op-Ed: *The GOP tax reform will devastate charitable giving*, L.A. TIMES (Dec. 27, 2017), <http://www.latimes.com/opinion/op-ed/la-oe-mcqueeney-charitable-giving-under-new-tax-law-20171227-story.html> [https://perma.cc/4FMM-T6V9].

79. *Id.*

80. See e-mail from Deborah Cannon, Corporate and nonprofit director, to Lawrence J. Trautman (Jan. 26, 2018) (on file with authors).

81. See e-mail from Jack Lowe, Corporate Director, to Lawrence J. Trautman (Feb. 21, 2018, 13:59 EST)(on file with authors).

82. See e-mail from Dennis McCuistion, Clinical Professor of Corporate Governance, University of Texas at Dallas; Executive Dir., Institute for Excellence in Corporate Governance, to Lawrence J. Trautman (Jan. 21, 2018, 11:24 EST) (on file with authors).

VI. GOVERNANCE: THE BASICS

A considerable amount of scholarship has been written about corporate governance and the duties owed by directors to shareholders in a for-profit, particularly publicly-traded situation.⁸³ While less has been written about governance in a nonprofit enterprise, many of the same fiduciary duties apply.⁸⁴

83. See John Armour, Henry Hansmann & Reinier Kraakman, *The Essential Elements of Corporate Law*, Oxford Legal Studies Research Paper No. 20/2009; Yale Law, Economics & Public Policy Research Paper No. 387; Harvard Law and Economics Research Paper No. 643; Harvard Public Law Working Paper No. 09-39; ECGI - Law Working Paper No. 134/2009, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1436551 [<https://perma.cc/PLX9-UC8B>]; Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006); William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002); John Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications* (Columbia Law School Center for Law and Economic Studies, Working Paper No. 144, 1999), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=142833 [<https://perma.cc/EBX8-ZWSY>]; David F. Larcker & Brian Tayan, *Seven Myths of Boards of Directors*, INSIGHTS BY STAN. BUS. (Oct. 12, 2015), <https://www.gsb.stanford.edu/insights/seven-myths-boards-directors> [<https://perma.cc/N7PA-YVXC>]; Robert A. Prentice & David B. Spence, *Sarbanes-Oxley as Quack Corporate Governance: How Wise is the Received Wisdom?*, 95 GEO. L.J. 1843 (2007); Brian Tayan, *The Wells Fargo Cross-Selling Scandal*, Rock Center for Corporate Governance at Stanford University Closer Look Series: Topics, Issues and Controversies in Corporate Governance No. CGRP-62; Stanford University Graduate School of Business Research Paper No. 17-1 (Dec. 2, 2016); Chris W. Waddell, Waddell, Kendrick Nguyen, Evan Epstein, Francis Daniel Siciliano & Joseph Grundfest, *Identifying the Legal Contours of the Separation of Economic Rights and Voting Rights in Publicly Held Corporations* (Rock Center for Corporate Governance at Stanford University Working Paper No. 90, 2010).

84. See Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, 37th Ann. Conf. on Sec. Reg. & Bus. L. 7, 178 (Feb. 13, 2015). See also Ellen P. Aprill, *What Critiques of Sarbanes-Oxley Can Teach About Regulation of Nonprofit Governance*, 76 FORDHAM L. REV. 765 (2007); Carter G. Bishop, *The Deontological Significance of Nonprofit Corporate Governance Standards: A Fiduciary Duty of Care Without a Remedy*, 57 CATH. U. L. REV. 701 (2008); Evelyn Brody, *Charity Governance: What's Trust Law Got to Do with it?*, 80 CHI.-KENT L. REV. 641 (2005); Sue Chen, *Art Deaccessions and the Limits of Fiduciary Duty*, 14 ART ANTIQUITY & L. 103 (2009); Brian D. Galle, *Why Do Foundations Follow the Law?: Evidence from Adoption of the Uniform Prudent Management of Institutional Funds Act*, 36 J. POL'Y ANALYSIS & MGMT. 532 (2017); Urs Gasser, Herbert Burkert, John G. Palfrey & Jonathan L. Zittrain, *Accountability and Transparency at ICANN*, Berkman Center Research Pub. No. 2010-13 (2010); 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 (2012); Klaus J. Hopt, *The Board of Nonprofit Organizations: Some Corporate Governance Thoughts from Europe* (European Corp. Govn. Institute - Law Working Paper No. 125 2009); Robert A. Katz, *Let Charitable Directors Direct: Why Trust Law Should Not Curb Board Discretion Over a Charitable Corporation's Mission and Unrestricted Assets*, 80 CHI.-KENT L. REV. 689 (2005); Elizabeth K. Keating, Mary Fischer, Teresa P. Gordon & Janet S. Greenlee, *Assessing Financial Vulnerability in the Nonprofit Sector* (KSG Working Paper No. RWP05-002; Hauser Center for Nonprofit Organizations Paper No. 27 2005); Benjamin M. Leff, *Federal Regulation of Nonprofit Board Independence: Focus on Independent Stakeholders as a 'Middle Way'*, 99 KY. L.J. 731 (2011); Roy Mersland & R. Øystein Strøm, *Performance and Corporate Governance in Microfinance Institutions*,

Governance law fundamentals for nonprofit organizations largely mirror those of for-profit organizations and are driven primarily by state laws. The IRS does not mandate any particular governance structure as a condition of tax-exempt status. However, the IRS strongly encourages nonprofit entities to adopt and maintain sound management practices.⁸⁵ Additionally, failure to remain in good standing under state law threatens the very existence of a nonprofit organization and will necessarily threaten its tax-exempt status. Accordingly, every member of an organization's governing body must have a basic understanding of that body's legal obligations and his or her role in meeting those obligations. The discussion below highlights some of the major state law requirements that must be satisfied in order for nonprofit organizations to remain in good standing with their state of incorporation. A number of states have adopted, with or without modifications, some version of either the Model Nonprofit Corporation Act⁸⁶ (MNCA) drafted by the American Bar Association or the Uniform Unincorporated Nonprofit Association Act⁸⁷ (UUNAA) drafted by the National Conference of Commissioners on Uniform State Laws, or a combination of both. Both acts, and those of most states, are organized roughly by the life cycle of a nonprofit organization. For illustration purposes, we will refer to the laws of the MNCA and UUNAA. However, every state is different, and the laws of the relevant state must be applied.

Once a nonprofit entity is formed, the MNCA requires that a board of directors, if not named in the articles of incorporation, be elected.⁸⁸ The

33 J. BANKING & FIN. 662 (2007); Curtis J. Milhaupt, *Nonprofit Organizations as Investor Protection: Economic Theory, and Evidence from East Asia*, 29 YALE J. INT'L L. 169 (2004); Alicia Plerhoples, *Representing Social Enterprise*, 20 CLINICAL L. REV. 215 (2013); Dana Brakman Reiser, *Charity Law's Essentials*, 86 NOTRE DAME L. REV. 1 (2011); Mark Sidel, *The Promise and Limits of Collective Action for Nonprofit Self-Regulation: Evidence from Asia*, 39 NONPROFIT & VOLUNTARY SECTOR Q. 1039 (2010); Robert J. Yetman & Michelle Yetman, *The Effects of Governance on the Accuracy of Charitable Expenses Reported by Nonprofit Organizations* (2011).

85. U.S. Department of The Treasury Internal Revenue Service, *Governance and Related Topics – 501(c)(3) Organizations*, IRS (2008), https://www.irs.gov/pub/irs-tege/governance_practices.pdf [<https://perma.cc/HBD7-QPW2>].

86. American Bar Association, *Model Nonprofit Corporation Act*, (Draft Revision), AMERICANBAR (2017), apps.americanbar.org/dch/thedl.cfm?filename=/CL580012/newsletterpubs/mnca.pdf [<https://perma.cc/C3RS-8H6M>]. The ABA subcommittee responsible for this model act is currently in the process of reviewing and revising it so that it will conform to the Model Business Corporations Act, last revised in 2016.

87. National Conference of Commissioners on Uniform State Laws, *Uniform Unincorporated Nonprofit Association Act*, UNIFORMLAWS (2015), [http://www.uniformlaws.org/Act.aspx?title=Unincorporated%20Nonprofit%20Association%20Act%20\(2008\)%20\(Last%20Amended%202011](http://www.uniformlaws.org/Act.aspx?title=Unincorporated%20Nonprofit%20Association%20Act%20(2008)%20(Last%20Amended%202011)) [<https://perma.cc/K8AJ-GGZ9>].

88. MNCA § 2.05 (2017).

UUNAA provides for governance of the organization through one or more *managers*, which may but need not be labeled as a board of directors.⁸⁹ The broad scope of the term *manager* under the UUNAA easily encompasses what are traditionally thought of as *officers* of an organization, such as president, secretary, or treasurer. The MNCA and UUNAA both provide that nonprofit organization may have members, and contain provisions outlining the rights and responsibilities of those members.⁹⁰ But whether there are members or not, both acts contemplate that there will be some kind of governing body.

The governing body of a nonprofit organization *may*, but under the MNCA is not required to, adopt bylaws.⁹¹ The UUNAA likewise does not require formal bylaws, but speaks in terms of *governing principles*. This term encompasses not only bylaws, to the extent they exist for a particular organization, but also “agreements, whether oral, in a record, or implied from its established practices, or in any combination thereof, which govern the purpose or operation of an unincorporated nonprofit association”⁹²

Both acts contain provisions that specifically outline the rights and responsibilities of directors. As noted above, the MNCA requires that a nonprofit organizations have a board of directors with fixed terms, with some exceptions. Under the MNCA, a nonprofit organization may establish a “designated body” to exercise the powers that would ordinarily be exercised by a board.⁹³ The UUNAA is somewhat more flexible in how a nonprofit organization’s governing body is denominated and structured, but it achieves essentially the same result. Both acts place responsibility for oversight of the organization’s activities upon its governing body.⁹⁴ Neither act specifies any particular qualifications that a director or manager must possess. Under both the MNCA and UUNAA, members of a nonprofit organization’s governing body owe a fiduciary duty to the organization, requiring them to act in good faith, with due care, and in what they “reasonably believe[]” to be in the best interest of their organization.⁹⁵

In discharging their duties to a nonprofit organization, members of its governing body may participate in regular or specially called

89. UUNAA § 2(3) (2015).

90. MNCA § 6.01 (2017) and UUNAA §2(4) (2015).

91. MNCA § 2.06 (2017).

92. UUNAA § 2(2) (2015).

93. MNCA § 8.12 (2017).

94. MNCA § 8.01 (2017) and UUNAA § 21 (2015).

95. MNCA § 8.30 (2017) and UUNAA § 22 (2015).

meetings.⁹⁶ To inform their decision making when acting in their governance role, directors or managers have a right to relevant information,⁹⁷ and are generally shielded from liability for their decisions and actions, provided they have been made in good faith and upon due diligence.⁹⁸ Both acts also provide for indemnification to directors or managers who incur expenses or are made a party to a proceeding as a result of their actions, provided that they have met their fiduciary obligations.⁹⁹

Because it places governance under the broad umbrella term of “manager(s),” the UUNAA does not have provisions addressed specifically to “officers” in the traditional sense of corporate governance. The MNCA, however, contains a separate subchapter addressed to officers. Under the MNCA, a nonprofit organization “has the officers described in its articles of incorporation or bylaws, or appointed or elected by the board of directors in accordance with the articles or bylaws.”¹⁰⁰

VII. FIDUCIARY DUTIES

Like directors, officers owe a fiduciary duty to the organization and must act in good faith, with due care, and in a manner they reasonably believe to be in the best interest of the organization.¹⁰¹ Like directors, officers who have complied with their fiduciary obligations are shielded from liability¹⁰² and may be entitled to indemnification for expenses or costs associated with their actions as officers.¹⁰³

The UUNAA does not contain a provision that specifically mandates records to be kept by the organization,¹⁰⁴ but the MNCA requires that certain records be generated and maintained by the organization for a specified period of time.¹⁰⁵ The MNCA grants members of the organization the right to inspect the records that must be maintained,¹⁰⁶ and, to the extent that an organization subject to the UUNAA generates

96. MNCA § 8.20 (2017) and UUNAA § 23 (2015).

97. MNCA § 8.30 (2017) and UUNAA § 24 (2015).

98. MNCA § 8.31 (2017) and UUNAA § 8 (2015).

99. MNCA § 8.51 *et seq.* (2017) and UUNAA § 26 (2015).

100. MNCA § 8.40 (2017).

101. MNCA § 8.42 (2017).

102. MNCA § 8.42(d) (2017).

103. MNCA § 8.50 *et seq.* (2017).

104. UUNAA § 24, comment (2015).

105. MNCA § 16.01 (2017).

106. MNCA § 16.02 (2017).

records, that act also grants a right of inspection to members and managers.¹⁰⁷

VIII. IMPORTANCE OF STATE LAW

Application of state law regarding fiduciary duties of directors may be observed in the fifth circuit's sharp criticism in *Gearhart Industries, Inc. v. Smith International* of the parties' failure to cite Texas cases in their briefs and reliance on Delaware case law:

We are both surprised and inconvenienced by the circumstances that, despite their multitudinous and voluminous briefs and exhibits, neither plaintiffs nor defendants seriously attempted to analyze officers' and directors' fiduciary duties or the business judgment rule under *Texas* law. This is particularly so in view of the authorities cited in their discussions of the business judgment rule: Smith and Gearhart argue back and forth over the applicability of the plethora of out-of-state cases they cite, yet they ignore the fact that we are obligated to decide these aspects of this case under Texas law. . . .¹⁰⁸

Byron Egan observes that:

The Fifth Circuit stated in *Gearhart* that under Texas law “[t]hree broad duties stem from the fiduciary status of corporate directors; namely the duties of obedience, loyalty, and due care,” and commented that (i) the duty of obedience requires a director to avoid committing ultra vires acts, i.e., acts beyond the scope of the authority of the corporation as defined by its articles of incorporation or the laws of the state of incorporation, (ii) the duty of loyalty dictates that a director must act in good faith and must not allow his personal interests to prevail over the interests of the corporation, and (iii) the duty of due care requires that a director must handle his corporate duties with such care as an ordinarily prudent man would use under similar circumstances. Good faith under *Gearhart* is an element of the duty of loyalty. *Gearhart* remains the seminal case for defining the fiduciary duties of directors in Texas¹⁰⁹

107. UUNAA § 24 (2015).

108. See Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, 37th Ann. Conf. on Sec. Reg. & Bus. L. 7 (Feb. 13, 2015) (citing *Gearhart Indus., Inc. v. Smith Int'l, Inc.*, 741 F.2d 707, 719 n.4 (5th Cir. 1984) (emphasis in original, internal citations omitted)).

109. *Id.* at 7.

IX. CORE PERSON ATTRIBUTES, QUALITIES, AND SKILLS REQUIRED OF EVERY DIRECTOR

A. *Every Nonprofit Board Has an Insatiable Need for Director Talent*

Every board is responsible for approving nominees for election as directors. To assist in this task, most boards will designate a standing committee, usually called the “nominating and governance committee,” which is responsible for reviewing and recommending nominees to the board. In a for-profit environment, the nominating and governance committee should be comprised solely of independent directors as defined by the rules of the New York Stock Exchange (NYSE)¹¹⁰ and the board’s corporate governance guidelines. A written charter for every standing committee should be adopted by the full board.¹¹¹ Although nonprofit organizations are not subject to the same requirements as publicly-traded enterprises, use of SEC-mandated reporting requirements, practices and standards may help ensure better nonprofit governance. Therefore, in evaluating the qualifications of candidates, the nominating and governance committee will be well advised to look for the following minimum desired personal attributes, qualifications, qualities, professional skills, and experience in all director candidates.

B. *Desired Personal Attributes*

What human qualities are desired for every board member? This seems an appropriate starting point for director recruitment and selection. Every nonprofit board should agree on a clear statement of desired personal attributes of all board members to provide guidance to the nominating and governance committee as they search for director candidates. As is the case in for-profit enterprises, each director candidate should possess the following necessary core personal attributes: high standards of ethical behavior; availability; outstanding achievement in the individual’s personal and professional life; possession of strong

110. See SEC, NASD & NYSE Rulemaking Rel. No. 34-48745, NASD and NYSE Rulemaking: Relating to Corporate Governance (2003).

111. See *NYSE Euronext Corporate Governance Guide*, NYSE (2014), https://www.nyse.com/publicdocs/nyse/listing/NYSE_Corporate_Governance_Guide.pdf [<https://perma.cc/Y92L-VAPA>]. See also Katherine M. O’Regan & Sharon M. Oster, *Does the Structure and Composition of the Board Matter? The Case of Nonprofit Organizations*, 21(1) J. L., ECON. & ORGAN. 205 (2005).

interpersonal and communication skills; independence; and soundness of judgment.¹¹²

C. *Personal Integrity*

Every board nominating committee should have a focus on personal integrity as a sought-after candidate characteristic. High standards of ethical behavior are an absolute must. The potential costs to the enterprise and other directors are just too high to assume likely risks. The risk of litigation for lapses of personal integrity is a major reason why for-profit boards tend to find directors who are already well-known to at least one sitting director when looking for replacements. This propensity appears motivated by the desire of sitting directors to mitigate perceived risks to themselves and the organization. The risk, to both reputation and personal net worth, is likely reduced by recruitment of a new *already-known* director. Far too many instances of fraud or substantial injury brought upon a nonprofit raise the question, “where were the directors?”¹¹³

D. *Adequate Time Availability and Schedule Flexibility*

As we ponder the impact of fraud on many of our most important nonprofit institutions, consider how much time a directorship should require. Certainly, serving on a for-profit board these days requires a significant time commitment, even under normal circumstances. The last two decades has brought significant increases to the time demands placed on directors. Sarbanes-Oxley legislation¹¹⁴ during 2002 and Dodd-Frank reforms¹¹⁵ have each added many hours to the amount of time directors must devote to board responsibilities. As a result, while each board is different, Kenneth P. Kopelman observes:

Trying to overlay upwards of 175 hours of annual board service—including review and preparation, travel, board and committee meetings, plus informal calls and emails on top of a full time staff or line job is surely a challenge both for the executive and his or her employer.

112. Lawrence J. Trautman, *The Matrix: The Board's Responsibility for Director Selection and Recruitment*, 11 FLA. ST. U. BUS. REV. 75, 82 (2012) [hereinafter “The Matrix”].

113. See discussion of United Way of New York, *supra* note 39; Penn State University and Jerry Sandusky, *supra* note 29; Michigan State University and Dr. Larry Nassar, *supra* note 35.

114. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. See also Lisa M. Fairfax, *Form Over Substance?: Officer Certification and the Promise of Enhanced Personal Accountability Under the Sarbanes-Oxley Act*, 55 RUTGERS L. REV. 1 (2002).

115. Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010); see also Andrew Verstein & Roberta Romano, *Assessing Dodd-Frank*, YALE LAW & ECON. RESEARCH PAPER NO. 434 (2011).

Recently retired, seasoned executives seem to be able to get up to speed quickly and devote the ongoing time.¹¹⁶

In the for-profit environment, because of increased time demands resulting from greater requirements falling on members of audit and compensation committees, every director will find it difficult, if not impossible, to have the schedule flexibility allowing for concurrent service on more than just a few boards. While nonprofit directors should not expect to deal with a crisis situation such as a hostile battle for corporate control or corporate disasters such as the BP Gulf oil spill,¹¹⁷ other crisis situations may arise from natural disasters such as hurricanes or tornadoes, pandemics, and fires, thus providing the unexpected crisis backdrop for a nonprofit board.¹¹⁸

E. A Passion for the Mission

In the for-profit world, broad business experience, including considerable prior high-level decision making and a demonstrated track record of problem solving is an obvious set of primary skills desired for every director. However, among nonprofit boards, often the most valuable assets are those individuals who have the passion and desire to devote their talents and substantial amounts of their time toward achieving the organization's mission.

F. Strong Interpersonal and Communication Skills

A major requirement of productive directors is the ability to work well with others; and the ability to ask the right penetrating questions at the right time, without being disagreeable. These skills can be developed, but are not amply present in all.

G. Importance of Independence

Actual independence is evidenced by an ability to represent the total enterprise interests of the company (as opposed to representing the interests of any particular group—for non-management directors, they must be independent in fact of management and the organization). In the

116. See Kramer Levin, *Kopelman Participates in NACD Directorship Roundtable*, KRAMERLEVIN (2010), <http://www.kramerlevin.com/Kopelman-Participates-in-NACD-Directorship-Roundtable-04-14-2010/> [https://perma.cc/R5DZ-L9GL].

117. Lawrence J. Trautman, *The Board's Responsibility for Crisis Governance*, 13 HASTINGS BUS. L.J. 275 (2017).

118. *Id.*

for-profit environment, corporate governance has progressively become federalized during the not too distant past as a result of requirements imposed by the Sarbanes-Oxley¹¹⁹ legislation (in response to fraud at Adelphia Communications, Enron, Worldcom, and others) and Dodd-Frank¹²⁰ (in response to the 2008–09 financial crisis). Independence is now required for members of for-profit audit, compensation, and nominating and governance committees.¹²¹

Each nonprofit board should adopt a clearly-written statement specifying what constitutes director independence. As an example, here is the statement adopted by profit-oriented Texas Instruments:

The board has adopted the following standards for determining independence.

A. In no event will a director be considered independent if:

1. He or she is a current partner of or is employed by the company's independent auditors; or
2. An immediate family member of the director is (a) a current partner of the company's independent auditors or (b) currently employed by the company's independent auditors and personally works on the company's audit.

B. In no event will a director be considered independent if, within the preceding three years:

1. He or she was employed by the company (except in the capacity of interim chairman of the board, chief executive officer or other executive officer) or any of its subsidiaries;
2. He or she received more than \$120,000 during any twelve-month period in direct compensation from TI (other than (a) director and committee fees and pension or other forms of deferred compensation and (b) compensation received for former service as an interim chairman of the board, chief executive officer or other executive officer);
3. An immediate family member of the director was employed as an executive officer by the company or any of its subsidiaries;
4. An immediate family member of the director received more than \$120,000 during any twelve-month period in direct compensation from

119. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

120. Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. (2010).

121. See *NYSE Euronext Corporate Governance Guidelines* (2011).

TI (excluding compensation as a non-executive officer employee of the company);

5. He or she was (but is no longer) a partner or employee of the company's independent auditors and personally worked on the company's audit within that time;
6. An immediate family member of the director was (but is no longer) a partner or employee of the company's independent auditors and personally worked on the company's audit within that time;
7. He or she was an executive officer of another company, at which any of TI's current executive officers at the same time served on that company's compensation committee;
8. An immediate family member of the director was an executive officer of another company at which any of TI's current executive officers at the same time served on that company's compensation committee;
9. He or she was, and remains at the time of the determination, an executive officer or employee of a company that made payments to, or received payments from, TI for property or services in an amount which, in any single fiscal year, exceeded the greater of \$1 million or 2 percent of the other company's consolidated gross revenues for its last completed fiscal year (for purposes of this standard, charitable contributions are not considered "payments"); or
10. An immediate family member of the director was, and remains at the time of the determination, an executive officer of a company that made payments to, or received payments from, TI for property or services in an amount which, in any single fiscal year, exceeded the greater of \$1 million or 2 percent of the other company's consolidated gross revenues for its last completed fiscal year (for purposes of this standard, charitable contributions are not considered "payments").

C. Audit Committee members may not accept any consulting, advisory or other compensatory fee from TI, other than in their capacity as members of the board or any board committee. Compensatory fees do not include the receipt of fixed amounts of compensation under a retirement plan (including deferred compensation) for prior service with TI (provided that such compensation is not contingent in any way on continued service).

D. The following relationships will not be considered material relationships with the company for the purpose of determining director independence:

1. A director is an employee, director or trustee of a charitable organization and TI or the TI Foundation makes discretionary contributions to that organization that are less than the greater of \$50,000 or 2 percent of the organization's latest publicly available consolidated gross revenue.

2. A director is an employee, director or trustee of another entity that is indebted to TI or to which TI is indebted, and the total amount of either company's indebtedness to the other is less than 2 percent of the total consolidated assets of the entity he or she serves as an executive officer, director or trustee.

For any other relationship, the determination of whether it is material, and consequently whether the director involved is independent, will be made by directors who satisfy the independence criteria set forth in this section. For purposes of these independence determinations, "immediate family member" will have the same meaning as under the NYSE rules.¹²²

H. Soundness of Judgment

A demonstrated soundness of judgment and effectiveness, as evidenced by a pro-active and results oriented approach to problem solving, and the ability to make independent, analytical inquiries of factual patterns is desired. Also helpful is an interest in and familiarity with management theory and best business practices.

I. Experience Attributes

Every board should also set forth a statement of desired experience attributes for each director candidate. In a typical for-profit setting, these might include such characteristics as:

- *General business experience* – Possess a general understanding of elements related to the success of a company like ours in the current business environment;
- *Specific industry knowledge* – Possess a reasonable knowledge about our businesses;

122. See Texas Instruments, Proxy Statement (Form DEF 14A) at 55 (Mar. 7, 2011), https://www.sec.gov/Archives/edgar/data/97476/000120677411000437/texasins_def14a.htm [<http://perma.cc/8CMK-WKPA>].

- *Financial acumen* – Should have a good understanding of business finance and financial statements;
- *Educational and professional background* – Should possess a complementary set of skills within a framework of total board knowledge base;
- *Diversity of background and viewpoint* – Bring to the board an appropriate level of diversity; and
- *Other attributes* – Provide those special attributes identified as needed.¹²³

X. BOARD COMPOSITION AND COMMITTEE STRUCTURE

The business of any corporation is conducted and overseen by its board of directors.¹²⁴

A. *Each Board is Different*

Board composition for nonprofit entities is vastly different from that of profit seeking organizations in some respects, and similar in others. The needs of a local or national U.S. nonprofit board will differ from multinational governance involving global production, marketing, or international financing relationships necessary in organizations such as Coca-Cola, General Electric, Microsoft, or Pfizer. However, the governance skills and lessons learned by corporate directors in such organizations may prove to be valuable assets in a nonprofit setting. The concerns and issues faced by an entity having international operations, such as Doctors Without Borders, are profoundly different from the mission of a local Humane Society dealing with the needs of abandoned animals. To a considerable extent, a board standing committee structure tailored to the specific needs of a nonprofit organization should result in best practice. In smaller nonprofits, business may be conducted as a committee of the whole, with efficiency increased by providing for particularly necessary committees such as audit and nominating and governance. Houston director Deborah Cannon advises, “Nonprofits need

123. See Trautman, *The Matrix*, *supra* note 113 at 87.

124. See Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, 37th Ann. Conf. on Sec. Reg. & Bus. L. 3 (Feb. 13, 2015), (citing TBOC § 21.401); TBCA art. 2.31; and DEL. CODE ANN. Tit. 8 § 141(a) (title 8 of the Delaware Code Annotated to be hereinafter referred to as the “DGCL”); *CA, Inc. v. AFSCME Employees Pension Plan*, 953 A.2d 227, 238 (Del. 2008) (Board authority to manage the corporation under DGCL § 141(a) may not be infringed by a bylaw adopted by the stockholders under DGCL § 109 in a manner that restricts the power of directors to exercise their fiduciary duties).

to ensure that they have strong boards with diverse backgrounds who mirror their organization's target audience."¹²⁵

B. Board Committee Structure

In a for-profit setting, many corporations have committees such as audit and compensation mandated by regulators and securities listing and trading organizations to be composed of independent directors (non-employees, employee-related, or otherwise compromised).¹²⁶ The standing committee schematic prevalent in most modern for-profit organizations consists of the following minimal structure: (1) audit, (2) compensation, (3) executive, and (4) nominating and governance.¹²⁷ This is not necessarily so for the nonprofit sector. However, a recent look at the organization structure of The United Way Worldwide Board of Trustees, having "fiduciary oversight of United Way Worldwide, and . . . responsib[ility] for overseeing the business affairs of the organization," discloses: a Board Chair; Secretary of the Board; Treasurer and Chair, Finance Committee; Chair, Audit Committee; Chair, Executive Compensation Committee; Chair, Membership Accountability Committee; Chair, Governance Committee; Chair, Resource Development; and Chair, Brand Stewardship.¹²⁸

The duties and responsibilities will be specified in charters drafted and adopted for each core standing committee. Examples of committee charters and experience from the for-profit world may serve as valuable templates for nonprofit organizations and are offered in the following pages for consideration and to provoke critical thinking. A discussion of the typical responsibilities for each of these core standing committees and other potentially valuable committees will now be presented along with thoughts about relevant nominee considerations.

125. See e-mail from Deborah Cannon, Corporate and nonprofit director, to Lawrence J. Trautman (Jan. 26, 2018) (on file with authors). See also Lawrence J. Trautman, *Corporate Boardroom Diversity: Why Are We Still Talking About This?*, 17 SCHOLAR 219 (2015), <http://www.ssm.com/abstract=2047750> [<https://perma.cc/KPC3-8HWG>].

126. See Trautman, *The Matrix*, *supra* note 113.

127. See Trautman, *The Matrix*, *supra* note 113.

128. *United Way 2016 Annual Report*, UNITED WAY, (2018), <https://www.unitedway.org/annual-report/2016> [<https://perma.cc/46VD-FNX2>].

C. *Audit (Risk) Committee*

Financial, tax, and accounting expertise is critical to the governance of any nonprofit organization.¹²⁹ As discussed above, meticulous compliance with federal and state laws is critical to maintain a nonprofit organization's tax-exempt status, and thus the tax-deductibility of contributions to that organization. Since nonprofit organizations are not investment vehicles and thus do not market ownership interests, they fall outside of the reporting and disclosure requirements imposed upon publicly-held organizations. However, they are still accountable for their financial activities, and much of their financial activity is subject to public disclosure. Moreover, to the extent that they solicit contributions, many nonprofits are subject to state laws requiring licensure prior to fundraising solicitations. Therefore, much can be learned about the function of an audit committee by looking at how they are structured and operate in SEC-regulated environments.

In a for-profit setting, "a board's audit committee will be a standing committee established to comply with the requirements of Section

129. See Christopher P. Agoglia, Timothy Doupnik & George T. Tsakumis, *Principles-Based Versus Rules-Based Accounting Standards: The Influence of Standard Precision and Audit Committee Strength on Financial Reporting Decisions*, 86 ACCT. REV. 747 (2011); Robert M. Bushman & Abbie J. Smith, *Financial Accounting Information and Corporate Governance*, JAE ROCHESTER CONFERENCE (2000), <https://ssrn.com/abstract=253302> [<https://perma.cc/R93T-FY79>]; Robert M. Bushman & Abbie J. Smith, *Transparency, Financial Accounting Information, and Corporate Governance*, 9 ECON. POL'Y REV. (2003); Joseph V. Carcello, Carl W. Hollingsworth, April Klein & Terry L. Neal, *Audit Committee Financial Expertise, Competing Corporate Governance Mechanisms, and Earnings Management* (2006), <https://ssrn.com/abstract=887512> [<https://perma.cc/W7GP-76FE>]; Gin Chong, *Detecting Fraud: What Are Auditor's Responsibilities?*, 24(2) J. CORP. ACCT. & FIN. 47 (2013); Jeffrey Cohen, Ganesh Krishnamoorthy & Arnold Wright, *The Corporate Governance Mosaic and Financial Reporting Quality*, J. ACCT. LIT. 87 (2004); Aswath Damodaran, *Risk Management: A Corporate Governance Manual* (2010), <https://ssrn.com/abstract=1681017> [<https://perma.cc/U3AN-RWU7>]; Gene Imhoff, *Accounting Quality, Auditing and Corporate Governance*, ACCT. HORIZONS SUPP. 117 (2003), <https://ssrn.com/abstract=374380> [<https://perma.cc/J27Y-65AM>]; April Klein, *Audit Committee, Board of Director Characteristics, and Earnings Management*, NYU, Law and Economics Research Paper No. 06-42 (2000), <https://ssrn.com/abstract=246674> [<https://perma.cc/T4SB-DWFS>]; Ranjani Krishnan, Michelle Yetman, Robert Yetman, *Financial Disclosure Management by Nonprofit Organizations* (2002), <https://ssrn.com/abstract=319581> [<https://perma.cc/G97T-8QDA>]; Lloyd Hitoshi Mayer, *The Promises and Perils of Using Big Data to Regulate Nonprofits*, 94 WASH. L. REV. (forthcoming), <https://ssrn.com/abstract=3350677> [<https://perma.cc/T46G-R663>]; Christine Petrovits, Catherine Shakespeare & Aimee Shih, *The Causes and Consequences of Internal Control Problems in Nonprofit Organizations* (2010), <https://ssrn.com/abstract=1582765> [<https://perma.cc/MQ6Y-MGLN>]; Douglas F. Prawitt, Jason L. Smith & David A. Wood, *Internal Audit Quality and Earnings Management*, 84 ACCT. REV. 1255 (2009); Robert Rosen, *Risk Management and Corporate Governance: The Case of Enron*, 35 CONN. L. REV. 1157 (2003); Robert Yetman & Michelle Yetman, *The Effects of Governance on the Accuracy of Charitable Expenses Reported by Nonprofit Organizations* (2011), <https://ssrn.com/abstract=590961> [<https://perma.cc/5Q7S-QKG4>].

3(a)(58)(A) of the Securities Exchange Act of 1934,¹³⁰ as amended. All members of the audit committee must be independent under the rules of the NYSE and the board's corporate governance guidelines."¹³¹ As demonstrated by the Audit Committee Charter for AT&T, the audit committee of any public corporation will generally be responsible to: "assist the Board in its oversight of: (1) the integrity of the financial statements of the Company, (2) the independent auditor's qualifications and independence, (3) the performance of the Company's internal audit function and independent auditors, and (4) the compliance by the Company with legal and regulatory requirements."¹³² In addition,

Committee Membership

At the first meeting of the Board of Directors following each Annual Meeting of Stockholders, the Board, after receiving the recommendations of the Corporate Governance and Nominating Committee, shall appoint the members of the Committee and shall determine the Chairperson of the Committee, each to serve at the pleasure of the Board. Committee members shall not have a fixed term. The Committee shall consist of no fewer than three members, including the Chairperson. Each member of the Committee shall meet the independence and experience requirements of the listing standards of the New York Stock Exchange and the independence requirements of Section 10A(m)(3) of the Securities Exchange Act of 1934 (the "Exchange Act") and the rules of the Commission thereunder. The Board shall periodically determine (i) whether each Committee member meets such independence and experience requirements and (ii) whether or not any member of the Committee is an 'audit committee financial expert' as that term is defined by the rules and regulations of the Commission. Committee members may not accept, directly or indirectly, any consulting, advisory, or other compensatory fee from the Company other than in their capacity as a Director.

Procedures

The Committee shall meet as often as it determines, but not less than six times a year. The Committee shall meet periodically with management, the senior internal auditing executive, and the independent auditor in separate executive sessions. The Committee may request any officer or employee of the Company or the Company's outside counsel or

130. See The Matrix, *supra* note 113 at 91 (citing 15 U.S.C. § 78a (2008)).

131. See The Matrix, *supra* note 113 at 91.

132. *Audit Committee of the Board of Directors of AT&T, Charter* (as amended June 26, 2015), INVESTORS.ATT (2015), <https://investors.att.com/~media/Files/A/ATT-IR/committees-and-charters/audit-committee-charter.pdf> [<https://perma.cc/529K-TN2H>].

independent auditor to attend a meeting of the Committee or to meet with any members of, or consultants to, the Committee. After the Committee meets or otherwise takes action, it shall, as soon as practicable, make a report of its activities at a meeting of the Board. The Committee may form and delegate authority to subcommittees when determined by the Committee to be necessary or appropriate.

Committee Authority and Responsibilities

The Committee shall have the authority, to the extent it deems necessary or appropriate, to conduct investigations and to retain independent legal, accounting or other advisors. The Committee may authorize and direct the payment of compensation by the Company to the independent auditor for the purpose of preparing or issuing an audit report or for other services and to any advisors employed by the Committee as well as the payment of ordinary administrative expenses of the Committee that are necessary or appropriate in carrying out its duties. The Committee shall review and reassess the adequacy of this Charter annually and recommend any proposed changes to the Corporate Governance and Nominating Committee. The Committee shall annually evaluate the Committee's own performance and share such evaluation with the Corporate Governance and Nominating Committee.

Oversight of the Company's Relationship with the Independent Auditor

1. The Committee shall be directly responsible for the appointment, compensation, retention and oversight of the work of the independent auditor employed by the Company for the purpose of preparing or issuing an audit report or performing other audit, review or attest services (including resolution of disagreements between management and the independent auditor regarding financial reporting). The independent auditor shall report directly to the Committee.
2. The independent auditor may be engaged by the Company to perform audit services and, to the extent permitted by applicable Federal securities laws and rules thereunder, non-audit services, in each case only where the Committee has pre-approved each such service, subject to the *de minimus* exception for non-audit services described in Section 10A(i)(1)(B) of the Exchange Act. The Committee may either approve such audit and non-audit services or adopt pre-approval policies and procedures provided that the policies and procedures are detailed as to the particular service provided and the Committee is informed of each such service. As a part of such policies and procedures, the Committee may delegate

authority to subcommittees consisting of one or more members to grant pre-approvals of audit and permitted non-audit services.

3. The Committee shall establish policies for the Company's hiring of employees or former employees of the independent auditor.
4. The Committee shall obtain and review a report from the independent auditor at least annually regarding: (a) the independent auditor's internal quality-control procedures, (b) any material issues raised by the most recent internal quality-control review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities within the preceding five years respecting one or more independent audits carried out by the firm, (c) any steps taken to deal with any such issues, and (d) all relationships between the independent auditor and the Company. After reviewing the foregoing report and the independent auditor's work during the year, the Committee shall evaluate the qualifications, performance and independence of the independent auditor, taking into account the opinions of management and the senior internal auditing executive. As a part of this evaluation, the Committee shall review and evaluate the performance and qualifications of the lead partner of the independent auditor.
5. The Committee shall, as appropriate, discuss with management the timing and process for the rotation of the lead audit partner, the concurring partner and any other active audit engagement team partner and consider whether, in order to assure continuing auditor independence, it is appropriate to rotate the independent auditing firm.
6. The Committee shall meet with the independent auditor prior to the audit to discuss the planning and staffing of the audit.

Financial Statement and Disclosure Matters

7. The Committee shall review and discuss with management and the independent auditor . . . the annual audited financial statements
8. The Committee shall review and discuss with management and the independent auditor . . . the quarterly financial statements . . . and the results of the independent auditor's review of the quarterly financial statements [not applicable if quarterly reports are not required].

9. The Committee shall periodically review and discuss with management and the independent auditor: (a) any major issues regarding accounting principles and financial statement presentations, including any significant changes in the Company's selection or application of accounting principles, and major issues as to the adequacy of the Company's internal controls and any special audit steps adopted in light of material control deficiencies; (b) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; and (c) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the Company.

10. The Committee shall review and discuss with management and the independent auditor reports from the independent auditor on:

- a. All critical accounting policies and practices to be used;
- b. All alternative treatments of financial information within generally accepted accounting principles that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred by the independent auditor; and
- c. Other material written communications between the independent auditor and management, such as any management letter or schedule of unadjusted differences.

11. The Committee shall review and discuss with management the Company's earnings press releases as well as financial information and earnings guidance provided to analysts and rating agencies. Such discussion may be done generally (i.e., discussion of the types of information to be disclosed and the type of presentation to be made). The Committee need not discuss in advance each earnings release or each instance in which the Company may provide earnings guidance.

12. The Committee shall review and discuss with management the Company's major financial risk exposures and the steps management has taken to monitor and control such exposures, including the Company's risk assessment and risk management policies. This would include, among other matters, evaluating risk in the context of financial policies, counterparty and credit

risk, and the appropriate mitigation of risk, including through the use of insurance where appropriate.

13. The Committee shall annually discuss with the independent auditor the matters required to be discussed by Auditing Standard No. 16, Communications with Audit Committees, including any difficulties encountered in the course of the audit work, any restrictions on the scope of activities or access to requested information, and any significant disagreements with management. The discussion shall address, to the extent applicable, any accounting adjustments that were noted or proposed by the independent auditor but were “passed” (as immaterial or otherwise), any communications between the audit team and the auditor’s national office with respect to auditing or accounting issues presented by the engagement and any “management” or “internal control” letter issued, or proposed to be issued, by the independent auditor.
14. The Committee shall review disclosures made to the Committee by the Company’s Chief Executive Officer and Chief Financial Officer . . . about significant deficiencies or material weaknesses in the design or operation of internal control over financial reporting and any fraud involving management or other employees who have a significant role in the Company’s internal control over financial reporting. The Committee shall review with management, the senior internal auditing executive, and the independent auditor, as appropriate, attestations and reports by the independent auditor on internal control over financial reporting.

Oversight of the Company’s Internal Audit Function

15. The Committee shall review with management the appointment and replacement of the senior internal auditing executive and shall annually evaluate his or her performance. The Committee shall provide the senior internal auditing executive with access to communicate personally and directly with the members of the Audit Committee at any time on any auditing or internal control matter.
16. The Committee shall review with the senior internal auditing executive the significant reports to management prepared by the internal auditing department and management’s responses.
17. The Committee shall review with the senior internal auditing executive, the independent auditor and management the

internal audit department responsibilities, budget and staffing and the internal audit plan for the coming year.

Compliance Oversight Responsibilities

18. The Committee shall obtain from the independent auditor assurance that Section 10A(b) of the Exchange Act (relating to reports by the independent auditor made to the Company of illegal acts discovered by the independent auditor) has not been implicated.
19. The Committee shall establish procedures for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters, and the confidential, anonymous submission by employees or other interested persons, of concerns regarding questionable accounting or auditing matters.
20. The Committee shall discuss with management and the independent auditor any correspondence with regulators or governmental agencies and any published reports made known to AT&T's executive officers that raise material issues regarding the Company's financial statements or accounting policies.
21. The Committee shall discuss with the Company's General Counsel any significant legal, compliance or regulatory matters that may have a material impact on the financial statements or the Company's compliance policies.
22. The Committee shall meet periodically, but no less than annually, with the Company's Chief Compliance Officer ("CCO") regarding the CCO's assessment of the Company's compliance and ethics risks, the effectiveness of the Company's Corporate Compliance Program, and any other compliance related matters that either the Committee or the CCO deems appropriate. The Committee shall provide the CCO with access to communicate personally and directly with the members of the Audit Committee at any time on any matter of compliance and ethics. The Committee shall oversee the administration and enforcement of the Company's Code of Business Conduct, Code of Ethics and Corporate Compliance Program.

Other

23. The Committee shall be responsible for any other matters expressly delegated to the Committee by the Board from time to time.

Limitation of Committee's Role

While the Committee has the responsibilities and powers set forth in this Charter, it is not the duty of the Committee to plan or conduct audits or to determine that the Company's financial statements and disclosures are complete and accurate and are in accordance with generally accepted accounting principles and applicable rules and regulations. These are the responsibilities of management and the independent auditor.¹³³

D. *The Financial Expert*

A nonprofit's audit committee will likely be best chaired by a director who brings many years of independent accounting, auditing, and tax experience. Lessons gained from actual audit experience such as statistical sampling and other audit methodologies and a familiarity with and understanding of highly technical emerging accounting issues is valuable in understanding the audit function.¹³⁴

E. *Compensation Committee*

Board compensation committees exist to ensure that executive compensation comports with performance and is aligned with marketplace requirements without being unduly excessive.¹³⁵ The efficient operation of a for-profit board compensation committee will serve to provide the enterprise with motivated executives whereby compensation is tied to performance, thus staving off reputation damage caused by reports in the press alleging excessive and improper levels of compensation. Examples of such legal actions include allegations of excessive compensation and perks received previously in the New York United Way case.¹³⁶ Under Texas law, officer and director compensation

133. *Id.*

134. *See* The Matrix, *supra* note 113 at 93.

135. *See* Stephen M. Bainbridge, *Executive Compensation: Who Decides?*, 83 TEX. L. REV. 1615 (2005); Lucian A. Bebchuk & Jesse M. Fried, *Pay Without Performance: Overview of the Issues*, 30 J. CORP. L. 647 (2005).

136. *See supra* note 39.

in nonprofit corporations may present issues of conflict of interest.¹³⁷ Regarding compensation issues, Byron Egan writes:

[S]ince non-profit corporations often seek to qualify for exemption from federal income taxation under § 501(c)(3) of the Internal Revenue Code of 1986, as amended (the 'IRC'), as organizations organized and operated exclusively for charitable, religious, literary or scientific purposes and whose earnings do not inure to the benefit of any private shareholders or individuals, the compensation of directors and officers of non-profit corporations can be subject to scrutiny by the Internal Revenue Service ('IRS'). Excessive compensation can be deemed the sort of private inurement that could cause the organization to lose its

137. See Byron F. Egan, *How Recent Fiduciary Duty Cases Affect Advice to Directors and Officers of Delaware and Texas Corporations*, 37th Ann. Conf. on Sec. Reg. & Bus. L. (Feb. 13, 2015) at 178, citing TBOC § 22.230 of the Texas Non-Profit Corporation Act and provides as follows: Section 22.230. Contracts or Transactions Involving Interested Directors, Officers, and Members.

- a) This section applies only to a contract or transaction between a corporation and:
 - 1) One or more of the corporation's directors, officers, or members; or
 - 2) An entity or other organization in which one or more of the corporation's directors, officers, or members:
 - (A) Is a managerial official or a member; or
 - (B) Has a financial interest.
- b) An otherwise valid contract or transaction is valid notwithstanding that a director, officer, or member of the corporation is present at or participates in the meeting of the board of directors, of a committee of the board, or of the members that authorizes the contract or transaction, or votes to authorize the contract or transaction, if:
 - 1) The material facts as to the relationship or interest and as to the contract or transaction are disclosed to or known by:
 - (A) The corporation's board of directors, a committee of the board of directors, or the members in good faith and with ordinary care authorize the contract or transaction by the affirmative vote of the majority of the disinterested directors, committee members or members, regardless of whether the disinterested directors, committee members or members constitute a quorum; or
 - (B) The members entitled to vote on the authorization of the contract or transaction, and the contract or transaction is specifically approved in good faith and with ordinary care by a vote of the members; or
 - 2) The contract or transaction is fair to the corporation when the contract or transaction is authorized, approved, or ratified by the board of directors, a committee of the board of directors, or the members.
- c) Common or interested directors or members of a corporation may be included in determining the presence of a quorum at a meeting of the board, a committee of the board, or members that authorizes the contract or transaction.

status as an exempt organization under the IRC and subject the recipient to penalties and other sanctions under the IRC.¹³⁸

F. Critical Domain Expertise

In a for-profit setting, if your product is semiconductor chips, you expect to have semiconductor engineering and manufacturing expertise and experience represented on your board. If your product is computer software, then software engineering expertise is a necessity. Accordingly, if the mission of your nonprofit organization is to eradicate a certain disease like ebola, the medical expertise germane to your stated mission is required in abundance on your board. If your mission is subject to cultural and political constraints imposed by the geographical and political environment existing in vast spaces of the African continent, then your board decision process should benefit from experience and expertise in the relevant regional dynamics. Assessing whether you have too much or not enough of this critical domain expertise represented on a nonprofit board of directors will likely be an organizational challenge. In many nonprofit organizations, laser focus on critical domain expertise at the expense of appropriate audit committee or compensation committee experience and background will introduce excessive risk to all involved.

G. Executive Committee

In order for the enterprise to exercise the powers of the Board to direct the business and affairs of the organization between meetings of the Board, an executive committee is typically empowered. For example, composition of this committee might consist of the Chairman of the board and Chairpersons of all standing committees. Important considerations for membership on this committee will be the ability of members to be available on short notice (physical proximity) and other measures of actual availability. AT&T's Executive Committee Charter, in relevant part, follows:

Committee Membership

Except as otherwise provided by the Board of Directors, the members of the Committee shall be the Chairman of the Board and the Chairpersons of each of the Audit, Corporate Development and Finance, Corporate Governance and Nominating, Public Policy and Corporate Reputation, and Human Resources Committees. The Chairman of the

138. See *id* at 179 (citing Rpt. on Exempt Organizations Executive Compensation Compliance Project – Parts I and II, March, 2007).

Board shall also act as the Chairman of the Committee. Upon election as the Chairman of the Board or the Chairperson of any of the foregoing Committees, a Director shall automatically become a member of this Committee (and Chairman of the Committee in the case of the Chairman of the Board) and shall serve until such person no longer holds a qualifying position or the person otherwise resigns or is removed by the Board from his or her position with this Committee. Committee members shall not have a fixed term.

Procedures

The Committee shall meet as often as it determines. The Committee may request any officer or employee of the Company to attend a meeting of the Committee or to meet with any consultant to the Committee. After the Committee meets or otherwise takes action, it shall, as soon as practicable, make a report of its activities at a meeting of the Board. The Committee may form and delegate authority to subcommittees when determined by the Committee to be necessary or appropriate.

Committee Responsibilities and Authority

The Committee shall have the authority to exercise all the power and authority of the Board of Directors, to the extent permitted by law, during the intervals between meetings of the Board . . . ¹³⁹

H. Nominating and Governance Committee

Although crafted for application in a for-profit setting, the Kimberly-Clark Corporation's Nominating and Corporate Governance Committee Charter has material application to a nonprofit organization as well. Accordingly, Kimberly-Clark's N&G committee is responsible to:

periodically review and reassess the adequacy of this charter and recommend any proposed changes of the charter to the Board for approval. The Nominating and Corporate Governance Committee, in consultation with the Chairman of the Board, shall recommend members for appointment to, and the Chairman of, the Nominating and Corporate Governance Committee to the Board for its approval. The Nominating and Corporate Governance Committee shall be comprised of at least three directors, each of whom is independent of management and the

139. Executive Committee of the Board of Directors of AT&T, Charter (as amended April 27, 2012), INVESTORS.ATT (2012) <https://investors.att.com/~media/Files/A/ATT-IR/committees-and-charters/executive-committee-charter.pdf> [<https://perma.cc/M5AY-FLKJ>].

Corporation. The Nominating and Corporate Governance Committee shall maintain minutes of its meetings and report to the Board.¹⁴⁰

In terms of policy, the Kimberly-Clark N&G committee is charged with the responsibility to:

- (1) oversee the process by which individuals are nominated to become board members;
- (2) oversee matters of corporate governance, including advising the Board on matters of:
 - (A) board organization, membership and function; and
 - (B) committee structure and membership; and
- (3) oversee matters relating to sustainability, corporate social responsibilities and corporate citizenship.

The Nominating and Corporate Governance Committee shall have the authority to retain special legal, accounting or other consultants to advise the Nominating and Corporate Governance Committee and to assist it identifying suitable potential board nominees. The Nominating and Corporate Governance Committee may request any officer or employee of the Corporation or the Corporation's outside counsel to attend a meeting of the Nominating and Corporate Governance Committee or to meet with any members of, or consultants to, the Nominating and Corporate Governance Committee.¹⁴¹

I. Succession Planning

Succession planning is a necessary governance task facing every enterprise. Nonprofits are no exception. Many smaller nonprofits may not have the benefit of a management team deep in redundant talent. This makes the death or disability of a chief executive officer particularly problematic. An annual discussion of what the organization might do in the event of the loss of key people or assets may prove exceedingly important as the board considers future governance and management needs.

140. Nominating and Corporate Governance Committee Charter, Kimberly-Clark Corporation (as amended through Feb. 8, 2018), <https://www.kimberly-clark.com/en/investors/corporate-governance> [<https://perma.cc/89GK-S9ZF>].

141. *Id.*

J. Marketing Expertise: Particularly Social Media

Social media marketing is of vital importance to any enterprise these days, and may be more than a mystery to nonprofit boards comprised mostly of those ages 40 or older. In terms of how today is different from just five years ago, Houston director Deborah Cannon states, “social media has made it far easier to get a nonprofit’s message out there. But that also means that there are far more people writing about their experiences. Thus, a less than perfect experience or false information gets wide exposure . . . organizations need to closely monitor what is out there.”¹⁴²

In the following example, the identity of the specific entity involved is disguised. Professor Trautman recalls the story told by a marketing friend of a nonprofit operating a major historical landmark [think Historic Williamsburg, the historic mansions of Newport, Rhode Island, or a famous botanical garden; none of these are the actual subject of this example]. Because admission is relatively pricey, as might be suspected, the primary demographic of those visiting this attraction for many years has been affluent tourists and those within commuting distance, either at or nearing retirement age. Accordingly, the primary traditional customer base is in the process of dying off and must somehow be replaced with much younger visitors (often much less affluent). How to solve this marketing dilemma?

As might be expected, how to reach millennial, gen x, gen y, or whatever the various components of the under-40 demographic may be described is a major topic of discussion among management and the board of this prominent nonprofit. Consider that Instagram provides its 800 million worldwide users with a fun and creative way to capture, edit and share photographs, messages, and videos, either publicly or privately, with pre-approved followers.¹⁴³ For the year 2017, Instagram discloses the following list of most-followed celebrities:

1. Selena Gomez (130+ million followers)
2. Cristiano Ronaldo (116+ million followers)
3. Ariana Grande (115+ million followers)

142. See e-mail from Deborah Cannon, Corporate and nonprofit director, to Lawrence J. Trautman (Jan. 26, 2018) (on file with authors). See also Lawrence J. Trautman & Oliver W. Aho, *Crowdfunding, Entrepreneurship, and Start-Up Finance*, Entrepreneur & Innovation Exchange (EiX) (2019), <http://ssrn.com/abstract=3251538> [<https://perma.cc/A2U8-KD9M>] (for a discussion of crowdfunding and use of social media).

143. See *Instagram*, INSTAGRAM, <https://www.instagram.com/?hl=en> [<https://perma.cc/A8C8-HU8L>].

4. Beyoncé (108+ million followers)
5. Kim Kardashian West (104+ million followers)
6. Taylor Swift (104+ million followers)
7. Kylie Jenner (99.5+ million followers)
8. Dwayne Johnson (96+ million followers)
9. Justin Bieber (93.9+ million followers)
10. Kendall Jenner (84.8+ million followers)¹⁴⁴

And now we describe the missed opportunity at this nonprofit because management didn't have a plan in place to understand and capture the wonder of social media. Unannounced, one of the above celebrities, along with this celebrity's entourage pays a visit to our example tourist attraction and immediately starts sharing their enjoyable visit with approximately 100 million followers. Someone on staff at the admissions gate recognizes their famous guest and immediately informs management. Because management presumably didn't recognize this great promotional opportunity, employees were instructed not to approach the celebrity until "marketing can figure out what to do." You guessed it, by the time marketing and management figured out what to do, the famous guest along with their 100 million followers had left the property. Contrast this result with the celebrity's next stop down the road where they were embraced with refreshments, free products, open arms, and proceeded to spend the afternoon showing the 100 million followers what a wonderful time he/she was having with the new host's product. The dollar value of this endorsement, broadcast with big smiles from the celebrity, is beyond estimation. Understanding internet marketing, social media, mobile platforms, and the culture of sub-40 year olds is not a skill or deep experience held by many above the age of 40.¹⁴⁵ For most nonprofit organizations, these skills critically need to be represented in governance discussions.¹⁴⁶

144. See *Instagram's 2017 Year in Review*, INSTAGRAM-PRESS (2017), <https://instagram-press.com/blog/2017/11/29/instagrams-2017-year-in-review/> [<https://perma.cc/8VZK-XE3P>].

145. See Trautman, et al., *supra* note 34; See also David Adam Friedman, *Bringing Candor to Charitable Solicitations*, MD. L. REV. (forthcoming); Chao Guo & Gregory D. Saxton, *Tweeting Social Change: How Social Media are Changing Nonprofit Advocacy*, 43(1) NONPROFIT & VOLUN. SECTOR Q. 57 (2014); Kristen Lovejoy & Gregory D. Saxton, *Information, Community, and Action: How Nonprofit Organizations Use Social Media*, 17(3) J. Computer-Mediated Comm. 337 (2012); Gregory D. Saxton & Lili Wang, *The Social Network Effect: The Determinants of Giving through Social Media*, 43 NONPROFIT & VOLUN. SECTOR Q. 850 (2014); Weiai Wayne Xu & Gregory D. Saxton, *Does Stakeholder Engagement Pay Off on Social Media? A Social Capital Perspective*, NONPROFIT & VOLUN. SECTOR Q. (forthcoming).

146. See Ahmed Abdel Moamen, *An Actor-Based Middleware for Crowd-Sourced Services*, 3(8) EAI Endorsed Transactions on Mobile Communications and Applications (2017).

XI. ENGINEERING NONPROFIT GOVERNANCE SUCCESS

During the next few pages we present a methodology to assist a self-assessment of organizational leadership strengths and weaknesses. An exhaustive treatment of this topic is not possible in the space allowed for this article. However, we hope that our brief discussion and analysis template will prove useful to nonprofit boards as they seek to structure a more rewarding future for themselves.

A. *Talent Inventory and Search Matrix*

What then are the most important attributes needed in director candidates for a nonprofit's particular situation? Assuming that all director candidates meet the common criteria of required personal attributes (high standards of ethical behavior; time availability; outstanding achievement in the individual's personal and professional life; possession of strong interpersonal and communication skills; independence; and soundness of judgment), we can then proceed to use a blank matrix as a framework for analyzing specific needs. Our talent inventory and search matrix presented as Exhibit 7, represents a two-step process. The first stage involves a comprehensive discussion among the board as to which talents and experiences are mission critical to achieve top enterprise governance. This exercise is conducted within the context of prioritizing the perceived importance of these various talents. As needed skills are identified, they can be added to the matrix and moved up and down the vertical axis as a result of debating and determining relative importance. Second, an inventory of the skills and experiences of existing board members is undertaken. Thus, after defining existing and desired people strengths, Exhibit 7 will hopefully assist with board discussions aimed at identifying needed skills and in candidate selection.

The matrix methodology facilitates discussion as you seek to define the experience and skills wish list that is important to the organization's future success. It may be as simple as moving yellow Post-it notes on a wall to enable moving and repositioning of each skill-set to determine an agreement of relative importance. The discussion of must-have skills may also help determine board size. Presented below is a logic road-map that might be utilized to assess needs and recruit directors having the skills and experience that will help to optimize composition of the new board.

B. *The Chair and CEO Roles Are Separate*

A threshold issue is separation of the board chair role from that of CEO—they are two demanding jobs. In recognition of the importance of this issue in a for-profit, reporting company setting, Section 972 of Dodd-Frank legislation signed into law on July 21, 2010, requires disclosure as to whether the same individual serves as both CEO and Chairman of the board and why or why not.¹⁴⁷ For most high-performance enterprises there are two full-time jobs represented by the CEO position and the distinct function of *running the board*, which falls to a Lead Director or non-executive chair.¹⁴⁸

C. *The Audit (Risk) Committee Challenge*

From our prior discussion of *must have* skills and experience, we know that at least one, maybe two, and preferably three audit committee candidates who qualify as financial experts are optimal. In a for-profit, publicly-traded company, one director *must* qualify as a financial expert. This also seems like an important attribute for a nonprofit as well. If two directors qualify as financial experts, then an audit committee vice chair position may be filled for succession purposes, and three qualified individuals will bring even more strength to the board's audit committee. Trautman and Altenbaumer-Price have also suggested that the Audit Committee (in the absence of a *risk* committee) may be the appropriate place to exercise corporate governance of Information Technology (IT), with appropriate IT skills and experience needing to be considered.¹⁴⁹ Such an approach to filling these audit committee needs will allow for directors to amass years in service (particularly helpful in building an understanding of the most important audit issues facing an enterprise). In addition, having directors in various age categories will help to provide for orderly education as to company board mechanics and succession. The

147. See Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 972 (2010).

148. See David F. Larcker & Brian Tayan, *Chairman and CEO: The Controversy Over Board Leadership Structure* ROCK CTR. FOR CORP. GOV., Stanford University Closer Look Series, Corporate Governance Research Initiative (2016), <https://www.gsb.stanford.edu/faculty-research/publications/chairman-ceo-controversy-over-board-leadership-structure> [<https://perma.cc/25PR-D5MM>].

149. See Lawrence J. Trautman & Kara Altenbaumer-Price, *The Board's Responsibility for Information Technology Governance*, 28 JOHN MARSHALL J. OF COMP. & INFOR. LAW, 313 (2011). See also Andrea H. Tapia, Louis-Marie Ngamassi Tchouakeu, Edgar Maldonado & Carleen F. Maitland, *Crossing Borders, Organizations, Levels, and Technologies: IS Collaboration in Humanitarian Action*, 9(1) INFO. TECH. & INT'L DEV. 1 (Spring 2013).

advent of new technologies such as blockchain¹⁵⁰ and quantum computing¹⁵¹ also require additional board governance skills and experience.

D. *The Cyber Threat*

Only within the past few decades have cyber threats grown to become a major problem for every enterprise.¹⁵² The governance of enterprise data and cyber vulnerabilities is perhaps the most difficult challenge facing boards everywhere.¹⁵³ At the same time, the acute shortage of computer engineers who have prior governance experience combine to make these talents exceedingly difficult to identify and recruit.

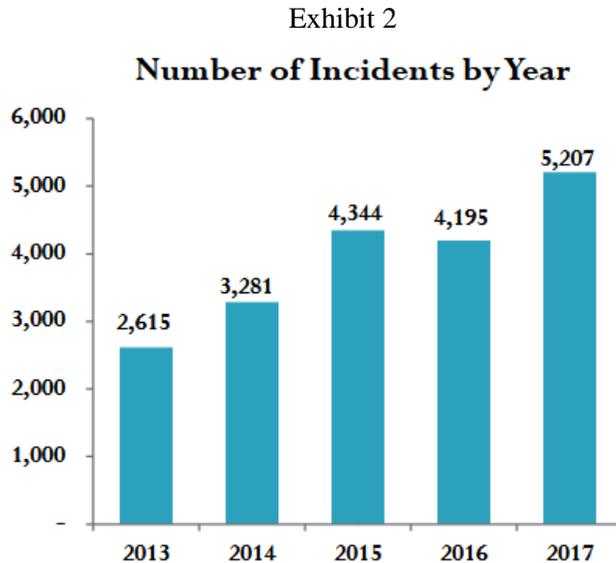
150. See Lawrence J. Trautman & Mason J. Molesky, *A Primer for Blockchain*, 88 UMKC L. Rev. (2019), <https://ssrn.com/abstract=3324660> [<https://perma.cc/G9AU-UCXW>]; Walter G. Johnson, *Blockchain Meets Genomics: Governance Considerations for Promoting Food Safety and Public Health*, J. FOOD L. & POL'Y (Forthcoming). SSRN: <https://ssrn.com/abstract=3344839> [<https://perma.cc/9RVR-7P2F>].

151. See Walter G. Johnson, *Governance Tools for the Second Quantum Revolution*, 59 JURIMETRICS (2019). <https://ssrn.com/abstract=3350830> [<https://perma.cc/E5MB-77AE>].

152. See David F. Larcker, Peter C. Reiss & Brian Tayan, *Critical Update Needed: Cybersecurity Expertise in the Boardroom* ROCK CTR. FOR CORP. GOV., Stanford University Closer Look Series, Corporate Governance Research Initiative (2016), <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-69-cybersecurity-expertise-boardroom.pdf> [<https://perma.cc/CHR7-ABFU>]; David D. Schein & Lawrence J. Trautman, *The Dark Web and Employer Liability*, 18(1) Colo. Tech. L.J. (2019), <http://ssrn.com/abstract=3251479> [<https://perma.cc/N95N-AYRP>]; Lawrence J. Trautman, Jason Triche & James C. Wetherbe, *Corporate Information Technology Governance Under Fire*, 8 J. STRATEGIC & INT'L STUD. 105 (2013); Lawrence J. Trautman, *Cybersecurity: What About U.S. Policy?*, 2015 U. ILL. J.L. TECH. & POL'Y 341 (2015); Lawrence J. Trautman, *Congressional Cybersecurity Oversight: Who's Who & How It Works*, 5 J. L. & CYBER WARFARE 147 (2016); Lawrence J. Trautman, *Is Cyberattack The Next Pearl Harbor?*, 18 N.C. J.L. & TECH. 232 (2016).

153. See Lawrence J. Trautman, *Managing Cyberthreat*, 33 SANTA CLARA HIGH TECH. L.J. 230 (2016); Lawrence J. Trautman, *How Google Perceives Customer Privacy, Cyber, E-commerce, Political and Regulatory Compliance Risks* (2013), <https://ssrn.com/abstract=3067298> [<https://perma.cc/3LYG-LUVC>]; Lawrence J. Trautman & Peter C. Ormerod, *Industrial Cyber Vulnerabilities: Lessons from Stuxnet and the Internet of Things*, 72 U. MIAMI L. REV. 761 (2018); Lawrence J. Trautman & George P. Michaely, *The SEC & The Internet: Regulating the Web of Deceit*, 68 CONSUMER FIN. L. Q. RPT. 262 (2014); Lawrence J. Trautman, *E-Commerce and Electronic Payment System Risks: Lessons from PayPal*, 17 U.C. DAVIS BUS. L.J. 261 (2016); Lawrence J. Trautman, *Is Disruptive Blockchain Technology the Future of Financial Services?*, 69 CONSUMER FIN. L.Q. RPT. 232 (2016).

Examples of major cyber breaches abound.¹⁵⁴ Exhibit 2 illustrates the growing number of cyber breach incidents per year.¹⁵⁵



Source: Risk Based Security, Inc. (2018)

Just as the raw number of cyber breach incidents grows every year, so too does the corresponding cost to consumers and all within society. As a proxy for the continued growth in injury to consumers due to cyber breach, Exhibit 3 shows the Number of Records Exposed by Year (in millions).¹⁵⁶

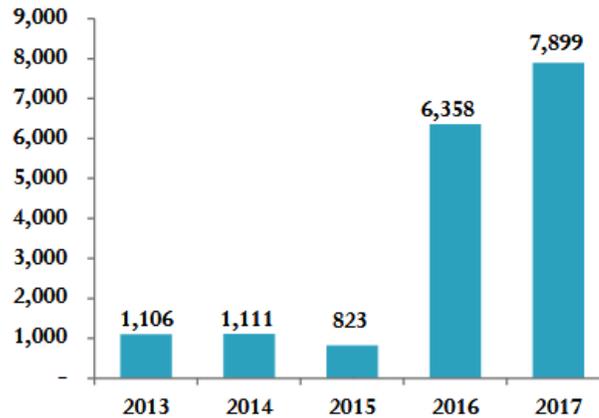
154. See Lawrence J. Trautman & Peter C. Ormerod, *Corporate Directors' and Officers' Cybersecurity Standard of Care: The Yahoo Data Breach*, 66 AM. U. L. REV. 1231, 1290 (2017) (examples of major cyber breaches).

155. See Risk Based Security, *Data Breach QuickView Report, Year End 2017*, 5, (2018) https://www.rpsins.com/media/2884/mc_0000634a-yearendreport.pdf [https://perma.cc/A67N-2B7G].

156. *Id.*

Exhibit 3

**Number of Records Exposed by
Year (in millions)**



Source: Risk Based security, Inc. (2018)

Although often not large enough to reach the headlines of most newspapers, a brief sample of reported nonprofit organization breaches are depicted in Exhibit 4.¹⁵⁷

157. See *Data Breaches*, PRIVACY RIGHTS CLEARINGHOUSE, https://www.privacyrights.org/data-breaches?title=&org_type%5B%5D=263&taxonomy_vocabulary_11_tid%5B%5D=2436&taxonomy_vocabulary_11_tid%5B%5D=2434 [https://perma.cc/2ATR-Q24N].

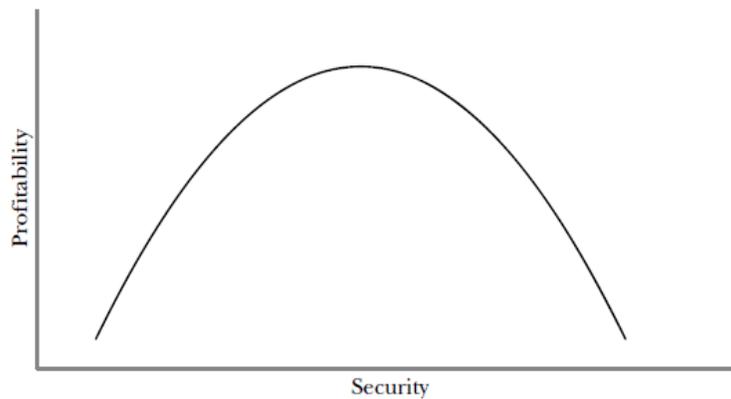
Exhibit 4
Data Breach Examples Among Nonprofits

Organization	Date Made Public	Location	What Happened (Records Breached)
Pension Fund of The Christian Church	01/16/2018	Indianapolis, Indiana	Names, SSN, financial account or credit or debit card numbers . . .breached
SAY San Diego	12/28/2017	San Diego, California	A citizen returned some paper files to their office that were found in a filing cabinet purchased from a salvage store
Walk in the World Ministries	07/13/2017	Elgin, Illinois	Nonprofit notified by third party e-commerce provider of potential breach of credit card, debit card, or checking account information used to receive and process donations
YMCA of San Diego	07/12/2017	San Diego, California	Excel spreadsheet containing personal information of certain YMCA employees was inadvertently sent over email to certain YMCA employees
Veterans of Foreign Wars of the United States	04/11/2014	Kansas City, Missouri	Hacker, thought to be in China, was able to download tables containing names, addresses, SSNs, of approximately 55,000 VFW members

Source: Privacy Rights Clearing House (2018)

While a detailed discussion of cyber enterprise risk management far exceeds the scope of this article, some useful resources are listed below.¹⁵⁸ A helpful explanation of a way to think about the management of cybersecurity, *The Profit-Maximizing Model of Security*,¹⁵⁹ is presented by professors Ormerod and Trautman in Exhibit 5.

Exhibit 5
The Ormerod-Trautman Profit-Maximizing Model of Security¹⁶⁰



Here, at the leftmost point on the curve, enterprise data security is so abysmal that few, if any, users trust the enterprise with their Personally Identifiable Information (PII), therefore rendering the profitability or efficiency of the enterprise's data security function a nullity. To paraphrase, zero security measures as shown at the bottom left-hand side of the graph result in zero users and, therefore zero profitability (efficiency). But, as the enterprise security improves, an increasing number of users trust the enterprise with their PII and the risk of data breach and loss of users' PII decreases, both of which contribute to increased profitability (efficiency). At a point where the number of users is maximized, increased security measures (spending on cybersecurity) result in limiting the usability of the data/website and thus decrease profitability (efficiency). Thus, taken to an extreme, excessive security measures may, theoretically, drive usability to the point of futility,

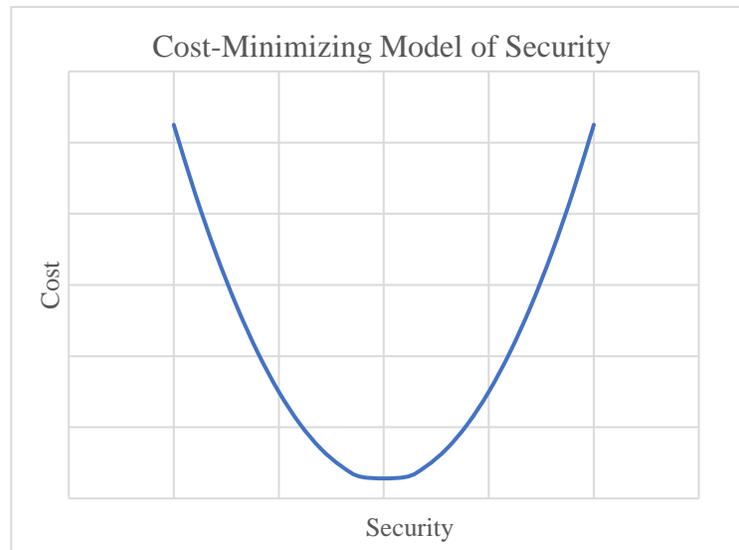
158. See Lawrence J. Trautman & Peter C. Ormerod, *WannaCry, Ransomware, and the Emerging Threat to Corporations*, 86 TENN. L. REV. (2019). Lawrence J. Trautman & Kara Altenbaumer-Price, *D&O Insurance: A Primer*, 1 AM. U. BUS. L. REV. 337 (2012).

159. See Trautman & Ormerod, *supra* note 155 at 1290. See also Peter C. Ormerod, Ormerod, Peter, *A Private Enforcement Remedy for Information Misuse*, 60 B.C. L. REV. (forthcoming).

160. *Id.*

achieving no additional benefit from the next dollar spent on cybersecurity and decreasing utility of additional spending. For nonprofits, the Ormerod-Trautman Model can be rephrased to illustrate the *cost-minimizing* level of security, as shown in Exhibit 6.¹⁶¹

Exhibit 6
Ormerod-Trautman Nonprofit Cost-Minimizing Model of Security



As professor Ormerod explains:

Here, on the left, cyber services are costly due to the threat of litigation and penalties; on the right, cyber services are costly because they are prohibitively difficult to use and cost money to generate / host. This re-conception allows nonprofits and governments to express security within the confines of a dollar amount.¹⁶²

The critical takeaway is that little or no digital security may be just as damaging to an enterprise's financial health as implementing overly excessive security. Professors Trautman and Ormerod further observe:

As this area of the law develops and matures in the coming years, courts, regulators, shareholders, and commentators will increasingly view the relationship between data security and [enterprise efficiency] as described in [Exhibits 5 and 6 herein]. Perhaps the most important

161. See Trautman & Ormerod, *supra* note 155.

162. See Notes from discussion between professor Peter C. Ormerod & Lawrence J. Trautman (Feb. 12, 2018) (on file with authors).

implication of embracing the relationship depicted in the [Ormerod-Trautman model] is that there is a profit-maximization [or cost effective] amount of security. And, as this view of the relationship between security and profitability is embraced, there can be little doubt that the various constituencies of stakeholders will increasingly expect corporate officers and directors to actively seek their company's profit-maximizing level of data security.¹⁶³

E. Capacity Expansion

In a philanthropic organization, lessons learned from prior successful fundraising experience are often considered a premium skill desired for board members. Raising money and cultivating mission support from like-minded community members is a difficult task, particularly in a difficult economy. Board of directors candidates who have been down this road before may prove particularly useful additions to any organization. Within recent years, knowledge and experience with social media marketing is also highly valuable as discussed above.

F. The Mission Critical Challenge

Populating a board with directors having the skills and experience unique to the primary mission of the nonprofit is essential. Here, we will logically seek to draw upon those candidates who have successfully guided other enterprises from our board's stage of development to leadership in the organization's desired future setting. We want to ensure that represented on our board is ample understanding of those factors which will determine success in the organization's mission and allow the board to play a supportive and visionary role in monitoring operations, management, and assisting in crafting strategy for success. If our stated mission is to provide healthcare clinics to underserved inner city communities, our board will probably be well served with several physician directors having actual experience serving this type of community need. If we determine that drug abuse is a major problem, then a social worker with on-point experience may prove optimal.

G. The Governance Challenge

Serving competently on a board requires understanding of a considerable body of enterprise (corporate) governance knowledge. Novel and disruptive technological innovations create a constant challenge to

163. See Trautman & Ormerod, *supra* note 155.

those seeking to govern any enterprise.¹⁶⁴ Corporate governance is a legally-intensive endeavor. An understanding of the legal foundation of corporate governance is a requisite for the knowledgeable discharge of fiduciary duties and responsibilities owed by each director. Therefore, each director must understand the duties of care and loyalty as refined over the years by developments in relevant case law and the regulatory impact brought about by relevant regulation. While non-attorneys may grow to understand the ramifications of these laws through years of board service with the education and guidance provided by proximity to skilled legal counsel, people are not born understanding the role and constraints surrounding the discharge of these duties and responsibilities. Accordingly, years of progressively responsible enterprise governance experience will be a valuable attribute of attractive candidates. It is no wonder that approximately 27 percent of all directors serving on Texas for-profit corporate boards have a legal background.¹⁶⁵ More about corporate governance may be learned from the National Association of Corporate Directors (NACD).¹⁶⁶

H. Matrix Analysis

The matrix template included as Exhibit 7 is a first step toward a *needs analysis* for any nonprofit board. For this example, involving a hypothetical non-profit board for an inner-city healthcare clinic, we start with an inventory of current board members. Use of this assessment tool will hopefully result in productive discussions about needed skills and experience, producing the start of a plan for optimal candidate recruitment. In our example, it may be reasonable to seek three audit committee members who will each qualify as a financial expert. As a starting search criterion, director candidates having drug addiction treatment, social media marketing, and legal experience is desired. With

164. See Lawrence J. Trautman & Mason J. Molesky, *A Primer for Blockchain*, 88(1) UMKC L. REV. (2019); Lawrence J. Trautman, *Bitcoin, Virtual Currencies and the Struggle of Law and Regulation to Keep Pace*, 102 MARQ. L. REV. 447 (2018); Lawrence J. Trautman & Alvin C. Harrell, *Bitcoin Versus Regulated Payment Systems: What Gives?*, 38 CARDOZO L. REV. 1041 (2017); Lawrence J. Trautman, *Virtual Currencies: Bitcoin & What Now After Liberty Reserve, Silk Road, and Mt. Gox?*, 20 RICH. J.L. & TECH. 13 (2014).

165. See Lawrence J. Trautman, *Who Sits on Texas Corporate Boards?, Texas Corporate Directors: Who They Are and What They Do*, 16 HOUS. BUS. & TAX L.J. 44 (2016); Lawrence J. Trautman, Anthony “Tony” Luppino & Malika S. Simmons, *Some Key Things U.S. Entrepreneurs Need to Know About The Law and Lawyers*, 46 TEX. J. BUS. L. 155 (2016) (many entrepreneurial considerations are desirable and transferable to a nonprofit enterprise).

166. Lawrence J. Trautman, *Present at the Creation: Reflections on the Early Years of the National Association of Corporate Directors*, 17 DUQ. BUS. L.J. 1 (2015).

several members of the board of directors no longer available to serve, a significant opportunity exists to recruit needed talent and experience and to expand the size and scope of the new board.

1. Continuing CEO and Director #1

Our first continuing director is also one of our founding board members. She is a medical doctor and business school graduate. She enjoys the challenge of day-to-day operations, welcomes the ability to grow the enterprise & seems up to the task.

2. Continuing Director #2: Medical Doctor

Our next continuing director is a highly-regarded medical doctor who has been responsible for launching a number of inner-city community projects, including a food bank. He is an internal medicine doctor by training and his network of relationships in this space should remain a major enterprise asset.

3. Non-Continuing Director #3: Lawyer (Departing Board)

This lawyer has served on our board and audit committee for many years, will retire in a few months, and plans to move to Florida. Because these talents and experience will no longer be available to our board, all experience and talent attributes for this director will be removed from our talent inventory appearing at Exhibit 7.

4. Non-Continuing Director #4: Community Leader

This former college president has served on our board, compensation, and nominating and governance committees for many years. All stakeholders of this nonprofit seem to agree that this individual makes significant contributions of time and talent to our mission.

5. Continuing Director #5: Religious Leader

This civic and religious leader has served on our board and audit committee for many years, is retiring and plans to move away from our geographic area to be in close proximity to children and grandchildren. Because these talents and experience will no longer be available to our board, all experience and talent attributes for this director will be removed from our talent inventory appearing at Exhibit 7.

6. Continuing Director #6: Accountant

This director has many years of accounting and auditing experience, has served on our board and audit committee for many years, and will be

our single director having audit committee skills and experience. Accordingly, identifying and recruiting members for our audit committee will be a primary focus.

7. Continuing Director #7: High School Counselor

This director continues to be a major contributor to the mission of this enterprise. She has served for many years on the compensation and nominating and governance committees.

I. The Talent and Experience Inventory

The narrative information for continuing directors presented above is depicted in the first few columns of Exhibit 7. As the nominating and governance committee and full board review and discuss the skills and experience needed for future board composition, the following thoughts and criteria emerge. First, this board will benefit from additional medical doctor and, in particular, drug treatment experience in our particular community. A consensus is reached that one or more candidates having social work experience in our community is a good idea. Audit committee experience, expertise, and cyber risk awareness is also needed. Continued discussion points to an awareness of a lack of social media sensitivity and marketing prowess within our nonprofit. A board member having these skills is desired. Our inner-city healthcare clinic seems to be living a very risky existence due to its present limited funding and sources of revenue. Accordingly, there is general agreement that director candidates having philanthropic experience, and personal contacts with likely donors are desired.

Exhibit 7
Example of Inner-City Healthcare Clinic
Board Talent Matrix Analysis

			Director									Candidate			
Experience / Skills	# 1	# 2	#3	# 4	#5	# 6	# 7	A	B	C	D	E	F		
	CEO	MD													
Independent (Yes or No)	N	Y	N/A	Y	N/A	Y	Y	Y	Y	Y	Y	Y	Y		
Medical Doctor	X	X										Y			
Drug Treatment Experience															
Our Community Social Work Exp.									Y						
Philanthropy Experience															
Accounting / Financial Expert						X		Y		Y			Y		
Social Media Marketing Skills															
Legal Skills & Experience											Y				
Prior Audit Committee Experience						X		Y		Y					
Prior Compensation Comm Exp.				X			X	Y		Y					
Prior Governance/Nom Comm Exp.				X			X	Y							
Other:															

1. Candidate A: Retired Audit Partner

Candidate A is an experienced audit partner at one of the world’s largest auditing service firms with considerable nonprofit audit experience. A financial expert, she also brings directorship experience; having served as audit chair on an industry board and as a member of compensation and governance and nominating committees.

2. Candidate B: Retired Social Worker

This retired, former inner-city social worker brings considerable experience in our local community. Her vast experience with our neighborhoods, understanding of needed health-related services available

elsewhere throughout the community and existing relationships with providers—all appears very attractive. In addition, she has prior organizational governance experience.

3. Candidate C: Financial Expert

She is a veteran audit partner at a major accounting firm and qualifies as a financial expert, as defined.¹⁶⁷ She also brings prior audit and compensation experience gained while on the board of a major hospital management company.

4. Candidate D: Attorney

She is an experienced attorney with many year's experience representing corporate board clients in the discharge of their fiduciary duties. Our nonprofit views this expertise to be an absolute mission-critical component to success, and these skills have been defined as particularly essential.

5. Candidate E: Former Hospital CEO

This former hospital CEO had medical administrative experience about fifteen years ago and presided over a medical clinic outreach program affiliated with his hospital in another large city at that time. His hospital, medical and hospital liability, strategic planning, and prior executive committee experience is attractive. Also trained as a medical doctor, if nominated, this will be his first nonprofit board.

6. Candidate F: Former CFO

She is a former CFO of a successful high-growth cardio-device manufacturer. She joined while the company was at venture-stage and served as CFO during the high growth phase. She qualifies as a financial expert, and has corporate governance experience gained by virtue of serving on two different company audit, compensation, and governance and nominating committees. She is now looking to give back by contributing her time and energies where most needed to her community.

7. Candidate G: Attorney Wants to Make Pro Bono Contribution

This lawyer is an attractive candidate by virtue of his serving previously as general counsel to a regional hospital system. Among his

167. See Lawrence J. Trautman, *Who Qualifies As An Audit Committee Financial Expert Under SEC Regulations and NYSE Rules?*, 11 DEPAUL BUS. & COMM. L.J. 205 (2013).

peers, he appears highly regarded and knows the health delivery business, legal issues involved, and has executive and audit committee experience.

8. Candidate H: Financial/Wealth Management Advisor

This individual has an MBA degree with a concentration in finance and investments and has worked for many years providing wealth management services. Having several members on a nonprofit's board with this type of background is probably a good idea and may decrease the likelihood of experiencing a Bernie Madoff type of investment outcome. However, it is also a good idea to have an understanding up front that no funds of the nonprofit will be held at this director's corporation or affiliated entity and that no commissions will accrue to any party in any way affiliated with any director.

9. Candidates: Director of Numerous Nonprofits

Several board candidates bring prior philanthropic board service. Several are considered pillars of the community and highly active among many important community organizations. Their previous fundraising experience and knowledge of what works and who tends to have the capacity and desire to give financial support is clearly mission critical to our nonprofit's future.

J. The Analysis Process

A director search will involve many considerations tailored to the unique requirements of the organization involved. The Nomination and Governance committee will likely have many director candidates with diverse talents to consider. Among nonprofit boards, it is often helpful to bring a discussion to the full board explaining the matrix analytical process employed and identifying those talents particularly being sought. This step may produce suggestions about individuals who might fill these vacancies in talent and experience. Hopefully, considerations presented here will provoke thoughtful discussions and better decisions.

XII. CONCLUSION

It is every director's legal duty of care that requires a careful, diligent approach to the effective recruitment and selection of new directors. Optimal board composition, that is, the best mix of director skills and experience will depend on many enterprise-specific variables. Some of the most important of these variables include: (1) enterprise lifecycle stage; (2) extent to which certain experiences and skills are mission

critical (detailed understanding of target culture, mission, stakeholder composition, and operational risk); (3) unique technology dependence (social media); and (4) need for capacity expansion (fundraising). A fundamental starting point for director recruitment and selection will ask, “What human qualities are desired for every board member?” Every board should agree on a clear statement of desired personal attributes of all board members to provide guidance to the nominating and governance committee as they search for director candidates.

High standards of ethical behavior are an absolute must. The last decade has brought significant increases to the time demands placed on each director. Independence is now required for members of the audit, compensation, and nominating and governance committees in a for-profit setting where shareholders are protected by SEC regulations. Adoption of this reasoning by nonprofits seems prudent, and each board should adopt a clearly-written statement specifying what constitutes director independence. Ideal director candidates will possess a demonstrated soundness of judgment and effectiveness, as evidenced by a pro-active and results-oriented approach to problem solving. They will also have the ability to make independent, analytical inquiries about challenging organizational issues. Whatever the board has determined to be its major weakness or biggest challenge should probably be the area of focus for new board talent. At the fifty-thousand-foot level, the question that must be asked and answered by every board nominating committee is “What Is It That the Organization Does to Create Value? Do members of the board understand this value creation process – so they might govern it effectively?”

After exploring current board membership strengths and weaknesses, various desirable skills and experience of director candidates are explored with a matrix methodology utilized to assist with analysis. Finally, the benefit of highly diverse approaches to problem solving and broadly different talents and experiences seems desirable when seeking to engineer the optimal people mix for productive small group decision making. The difficult monitoring of enterprise systems and a likely constant flow of future problems will require skillful navigation. It doesn't seem healthy to want our decisions to be made by nine directors having the same narrow prisms in which they view the world. It is our hope that analysis considerations presented here will evoke thoughtful discussions and better decisions by nonprofit organizations.