

## Are Gray Skies Clearing Up? Shedding Light on Nonprofit Governance in the Wake of Revamped IRS Form 990\*

### INTRODUCTION

A 1970s study<sup>1</sup> examined the crime rates of two virtually indistinguishable Texas neighborhoods.<sup>2</sup> The control neighborhood saw a five percent increase in crime, while the treatment neighborhood experienced a thirty-one percent decrease.<sup>3</sup> What was the independent variable? The treatment neighborhood experienced a threefold increase in street lighting.<sup>4</sup> Numerous subsequent studies have confirmed what common sense suggests: light tends to dissuade ill-intentioned people from committing delinquent acts.<sup>5</sup> A parallel principle—that transparency reduces bad corporate governance—is similarly recognized and accepted.<sup>6</sup> As Justice Louis Brandeis succinctly opined when criticizing opaque and monopolistic

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1. Edward B. Lewis & Tommy T. Sullivan, *Combating Crime and Citizen Attitudes: A Study of the Corresponding Reality*, 7 J. CRIM. JUST. 71, 71–72 (1979).

2. *Id.* at 73 (“To evaluate the impact of higher intensity illumination on crime, a statistical comparison of selected criminal activity was developed for the Impact South Area, an adjacent area with similar demographic characteristics, and the city as a whole.”).

3. *Id.*

4. *Id.* at 72.

5. BRANDON P. WELSH & DAVID C. FARRINGTON, EFFECTS OF IMPROVED STREET LIGHTING ON CRIME, CAMPBELL COLLABORATION 3, 17 (2008), [http://www.crim.cam.ac.uk/people/academic\\_research/david\\_farrington/light.pdf](http://www.crim.cam.ac.uk/people/academic_research/david_farrington/light.pdf) [<https://perma.cc/KU3R-6HWJ>] (reviewing thirteen studies of street lighting interventions in the United Kingdom and United States and finding that crime decreased by twenty-one percent in areas that experienced street lighting improvements compared to similar areas that did not). However, it should be noted that the exact effects of literal light on violent and property crimes are still being debated. Some argue that the effects are too spurious to make causal claims with any certainty. See Mike Riggs, *Street Lights and Crime: A Seemingly Endless Debate*, CITYLAB (Feb. 12, 2014), <http://www.citylab.com/housing/2014/02/street-lights-and-crime-seemingly-endless-debate/8359/> [<https://perma.cc/HR4Z-XWV4>].

6. See, e.g., Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1222 (1999) (“The Securities Act is strong insofar as publicity is potent; it is weak insofar as publicity is not enough . . . . The existence of bonuses, of excessive commissions and salaries, of preferential lists and the like, may be all open secrets among the knowing, but the knowing are few. There is a shrinking quality to such transactions; to force the knowledge of them into the open is largely to restrain their happening. Many practices safely pursued in private lose their justification in public. Thus social standards newly defined gradually establish themselves as new business habits.” (alteration in original) (quoting Felix Frankfurter, *The Federal Securities Act: II*, FORTUNE, Aug. 1933, at 53, 55)).

investment banking practices at the dawn of the twentieth century, “[s]unlight is . . . the best of disinfectants.”<sup>7</sup>

The public’s ability to access relevant information—sunlight—encourages best practices and transparency. Unfortunately, recent scandals suggest that—at least regarding nonprofit governance—it is cloudy far too often. For example, in April 2015, auditors discovered that Dana Cope, the former executive director of the State Employees Association of North Carolina (“SEANC”),<sup>8</sup> spent nearly \$500,000 of company money on private expenses between 2012 and 2015.<sup>9</sup> According to the audit, Cope—the only person to review annual financial and governance reports<sup>10</sup>—used SEANC funds to renovate his home, take a family trip to China, and purchase private flight lessons.<sup>11</sup> Mitch Leonard, the director who replaced Cope, lamented that the abuses “stem[med] from a culture of submissiveness, deliberately built over time by Mr. Cope, and maintained for his own financial benefit. As a result, established financial controls were compromised, transparency thwarted, and the truth denied.”<sup>12</sup>

Unfortunately, director abuse of nonprofit funds is not extraordinary.<sup>13</sup> In 2015, public scandals implicating nonprofit directors surfaced nationwide.<sup>14</sup> As executives<sup>15</sup> and commentators<sup>16</sup>

7. LOUIS D. BRANDEIS, *OTHER PEOPLE’S MONEY AND HOW THE BANKERS USE IT* 92 (1914). Justice Brandeis called for the public disclosure of commissions and profits made by bankers to be used as a remedy for unreasonable compensation and as an aid that investors could use to judge the safety of their investments. *Id.* at 92–108.

8. SEANC is a 501(c)(5) nonprofit whose stated mission is to protect and enhance “the rights and benefits of current, retired and future [North Carolina] state employees.” *Mission/Bylaws*, SEANC, <https://www.seanc.org/mission-bylaws> [<https://perma.cc/4UMY-MMQ8>].

9. Joseph Neff, *Ex-SEANC Leader Dana Cope Misspent \$500k, Audit Finds*, NEWS & OBSERVER (Raleigh) (Apr. 11, 2015, 4:34 PM), <http://www.newsobserver.com/news/politics-government/state-politics/article18281918.html> [<https://perma.cc/4BBU-XZ72>].

10. *See infra* notes 108–12 and accompanying text.

11. *See* Neff, *supra* note 9.

12. *Id.*

13. *See, e.g.*, Deborah A. DeMott, *Self-Dealing Transactions in Nonprofit Corporations*, 59 BROOK. L. REV. 131, 133–34 (1993) (describing self-dealing by directors of United Way, the San Diego National Sports Training Foundation, and Boston University); Melanie B. Leslie, *Helping Nonprofits Police Themselves: What Trust Law Can Teach Us About Conflicts of Interest*, 85 CHI.-KENT L. REV. 551, 551–52 (2010) (reviewing several prominent nonprofit scandals).

14. For example, in California, the CEO and other executives of the Chicana Service Action Center were charged with embezzlement of more than eight million dollars and conspiracy to commit fraud. David Zahniser & Abby Sewell, *Chicana Service Action Center Executives Charged in \$8.5-Million Fraud Case*, L.A. TIMES (July 8, 2015, 4:00 AM), <http://www.latimes.com/local/cityhall/la-me-chicana-services-charges-20150708-story.html> [<https://perma.cc/SD4Q-9BKM>] (“Prosecutors contend that [the CEO] improperly

have noted, the wrongdoing in these and myriad other cases is partially attributable to a lack of good governance procedures and a dearth of transparency.<sup>17</sup> While the current nonprofit governance reporting scheme deserves some blame for this lack of transparency, the Internal Revenue Service (“IRS”) has recently taken positive transparency-inducing steps. In 2008, recognizing the inability of existing deterrents to satisfactorily reduce bad governance<sup>18</sup> and in light of increasingly public nonprofit scandals,<sup>19</sup> the IRS addressed the nonprofit governance issue by enhancing reporting requirements<sup>20</sup> contained in IRS Form 990 (“Form 990” or “990”).<sup>21</sup> While some viewed the enhanced 990 as an unfortunate usurpation of directors’

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provided herself and her fellow executives salary and compensation packages by creating fraudulent Board of Directors’ meeting minutes. [The CEO], according to the criminal complaint, listed several people as being members or board members without the individuals’ knowledge or permission.”). Scandals also surfaced in Hawaii, *Former Executive Director of Non-Profit Organization Pleads Guilty to Federal Theft Charge*, U.S. DEP’T JUST. (June 12, 2015), <https://www.justice.gov/usao-hi/pr/former-executive-director-non-profit-organization-pleads-guilty-federal-theft-charge> [<https://perma.cc/VQ3J-256N>] (stating that a former executive director pled guilty to embezzling over \$150,000), and in Washington, D.C., Mike Fish, *FBI, IRS Investigating Patricia Driscoll*, ESPN (June 12, 2015), [http://espn.go.com/espn/otl/story/\\_id/13059226/fbi-irs-investigating-kurt-busch-ex-girlfriend-patricia-driscoll](http://espn.go.com/espn/otl/story/_id/13059226/fbi-irs-investigating-kurt-busch-ex-girlfriend-patricia-driscoll) [<https://perma.cc/BR4Y-BSEA>] (reporting that the executive director of the Armed Forces Foundation self-dealt and falsified/misreported information on Form 990).

15. See *supra* note 12 and accompanying text.

16. See, e.g., JAMES J. FISHMAN, STEPHEN SCHWARZ & LLOYD HITASHI MAYER, *NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 124 (Robert C. Clark et al. eds., 5th ed. 2015) (“Examples of poor judgment, ethical lapses and outright fraud course throughout these materials. Nothing so tarnishes the nonprofit sector’s halo than wrongdoing by charities. More often than not, these actions indicate inadequate corporate governance procedures and a lack of transparency of the organization’s activities. Good governance is the implementation of certain principles and policies that should protect the organization from misconduct.”).

17. Thomas Lee Hazen & Lisa Love Hazen, *Punctilios and Nonprofit Corporate Governance—A Comprehensive Look at Nonprofit Directors’ Fiduciary Duties*, 14 U. PA. J. BUS. L. 347, 362 (2012).

18. As commentators have noted, remedies for breaches of nonprofit directors’ duties are extremely limited. *Id.* at 405 (noting that the basic remedies for director misconduct are action by the state attorney general and the potential for a derivative suit for a membership nonprofit). While it is possible that potential liability from derivative suits has some deterrent effect on nonprofit governance, the effect of potential suits on director behavior is likely marginal. See *id.* at 411–12.

19. Scandals at United Way, the American Red Cross, and the Nature Conservancy focused public attention on nonprofit governance. John F. Coverdale, *Legislating in the Dark: How Congress Regulates Tax-Exempt Organizations in Ignorance*, 44 U. RICH. L. REV. 809, 821–22 (2010).

20. The enhanced reporting requirements are discussed in detail below. See *infra* Section I.B.

21. Grace Allison, *The New Form 990 for Tax-Exempt Organizations: Revolution in Progress*, 37 EST. PLAN. 14, 14 (2010).

business judgment,<sup>22</sup> most observers generally welcomed the changes as a signal that nonprofit boards were going to be more thoroughly scrutinized.<sup>23</sup> However, in the years following 990's enhancement, the heightened examination of nonprofit governance has produced mixed results.<sup>24</sup>

This Recent Development argues that while enhancing the reporting requirements in Form 990 was a step in the right direction, the IRS and state governments should do more to illuminate nonprofit governance practices. Analysis proceeds in four Parts. Part I outlines the impetus behind 990's 2008 enhancements and examines its current disclosure requirements. Part II shows that the current reporting requirements leave both practical and actual gaps in public knowledge regarding nonprofit governance. Part III analyzes solutions and argues that mandating IRS Form 990 e-filing, participating (on a state-by-state basis) in single portal consortium initiatives, and enhancing watchdog sites' reporting practices could ameliorate the effects of the practical information gap. Part III

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22. BONNIE S. BRIER ET AL., ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, INTERNAL REVENUE SERV., THE APPROPRIATE ROLE OF THE INTERNAL REVENUE SERVICE WITH RESPECT TO TAX-EXEMPT ORGANIZATION GOOD GOVERNANCE ISSUES 1 (2008) [hereinafter 2008 ACT REPORT], [https://www.irs.gov/pub/irs-tege/executive\\_summary\\_actgovernancerept.pdf](https://www.irs.gov/pub/irs-tege/executive_summary_actgovernancerept.pdf) [<https://perma.cc/K53T-2S29>] (“Charities can feel pressured to adopt the specified practices, even where it is inadvisable in their situation, because they believe the IRS or others will consider them poorly governed if they fail to do so. This then can effectively usurp the judgment of governing boards in determining what governance practices make sense in their specific context, place undue burdens on organizations, divert their attention to proxies for governance instead of actual governance, and adversely impact the unique, diverse, vibrant, and flexible charitable sector in this country. Accordingly, we believe the IRS should approach this area with caution.”). Furthermore,

[t]he inclusion of the questions [in Form 990] inherently (and intentionally) suggests that the IRS supports adoption of specific governance policies and practices. The danger then is that organizations will take the path of least resistance and adopt the policies and practices whether or not they are appropriate for them, or effective in their context.

*Id.* at 3; see also Karen Donnelly, Comment, *Good Governance: Has the IRS Usurped the Business Judgment of Tax-Exempt Organizations in the Name of Transparency and Accountability?*, 79 UMKC L. REV. 163, 181 (2010) (listing similar concerns to those in the 2008 ACT Report regarding IRS inquiries into specific good governance practices).

23. See, e.g., Melanie B. Leslie, *The Wisdom of Crowds? Groupthink and Nonprofit Governance*, 62 FLA. L. REV. 1179, 1205 n.113 (2010) (“[T]he IRS has strengthened the annual 990 Form to require corporations to report self-dealing transactions, which sends a clear message to those corporations that certain transactions are suspect.”).

24. *Id.* (noting that Form 990 “may have a desirable effect on boards and may assist prospective donors in identifying whether the charitable fiduciaries are abusing their positions[,]” but conceding that “it is unclear if this will increase legal pressure to conform to fiduciary standards”).

further argues that, to close the actual information gap, North Carolina should require certain kinds of nonprofits to annually file enhanced governance reports. Part IV evaluates counterarguments and offers recommendations.

## I. FORM 990'S INCEPTION AND EVOLUTION

### A. *Why Form 990 Needed Enhancement*

Two major factors behind 990's 2008 enhancement were (1) previous versions' lack of meaningful governance-related disclosure requirements and (2) contemporary, scandal-begotten public focus on nonprofit abuses. In 1942, congressional concerns regarding the lack of nonprofit accountability prompted the IRS to begin requiring some tax-exempt organizations<sup>25</sup> to file annual reports.<sup>26</sup> Unfortunately, many nonprofits were exempt from filing the 990<sup>27</sup> and very little, if any, governance-related information was discernible from these reports.<sup>28</sup> Though Form 990 periodically underwent minor changes, it remained mostly untouched until 2008.<sup>29</sup> Conversely, public awareness of nonprofit abuses grew drastically during the same period.<sup>30</sup> Scandals at highly regarded nonprofits including United Way, the American Red Cross, and the Nature Conservancy focused public (and congressional) attention on nonprofit governance in

25. Section 501 of the Internal Revenue Code grants tax-exempt status to qualifying nonprofits. I.R.C. § 501(c)(a) (2012). Most charitable nonprofits fall in the 501(c)(3) category. *Id.* § 501(c)(3). Nonprofits that qualify for tax-exempt status as 501(c)(3) entities must file form 990. INTERNAL REVENUE SERV., COMPLIANCE GUIDE FOR 501(C)(3) PUBLIC CHARITIES 8–9, <https://www.irs.gov/pub/irs-pdf/p4221pc.pdf> [<https://perma.cc/A2ZW-4GA4>].

26. James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545, 564–65 (2010). Importantly, the IRS reporting does not mandate that nonprofits *adopt* governance best practices; it simply requires them to answer *whether* they are occurring. *See infra* Section I.B.

27. Paul Arnsberger et al., *A History of the Tax-Exempt Sector: An SOI Perspective*, STAT. INCOME BULL., Winter 2008, at 105, app. B at 124 (noting that “religious organizations, most schools, and publicly supported charitable organizations, were exempt from [the Form 990] filing requirement”).

28. Fishman, *supra*, note 26, at 564–65 (noting that the bare-bones report consisted of “three questions, an income statement, and a balance sheet”).

29. *Id.* at 566 (“The redesigned Form 990, effective for the 2008 tax year, [was] the first revision since 1979 and a significant departure from past versions.”).

30. *See* Diana Aviv, *Earning the Public Trust*, NONPROFIT Q. (June 21, 2004), <https://nonprofitquarterly.org/2004/06/21/earning-the-public-trust/> [<https://perma.cc/HNT7-PZ58>] (“Negative media stories all over the country have detailed examples of alleged excessive compensation of executives, self-dealing, questionable fundraising practices, conflicts of interest and lavish expenditures. While these stories refer only to a very limited number of organizations, the public’s perception of the whole sector is colored by them.”).

uncomfortable but productive ways.<sup>31</sup> The combination of Form 990's increasingly apparent impotence and public pressure to effect change prompted Congress's eventual overhaul of Form 990 in 2008.<sup>32</sup>

*B. What Was Added to Form 990*

To characterize the IRS's 2008 changes<sup>33</sup> to Form 990 as "enhancements" probably understates the point.<sup>34</sup> Because previous iterations of Form 990 left governance-related questions largely unasked, Form 990 needed sweeping changes.<sup>35</sup> To this end, the IRS added a category of "key employees" whose identity and compensation must be reported.<sup>36</sup> Further, Part VI of Form 990 was amended to ask a series of questions meant to incentivize boards to adopt good governance best practices.<sup>37</sup> For example, the form now requires management to disclose the number of voting members on the governing body and how many are independent.<sup>38</sup> The form

31. Coverdale, *supra* note 19, at 821–22.

32. *See id.*; Fishman, *supra* note 26, at 566.

33. A comprehensive review of all of the changes made to Form 990 is beyond the scope of this Recent Development. For purposes of this Recent Development, the relevant changes were those aimed at influencing corporate governance contained in Section VI of the form. *See infra* notes 37–43 and accompanying text.

34. Allison, *supra* note 21, at 14 (stating that the revisions created a "dramatically new version" of the form).

35. *Id.* at 15–16 (discussing the new Form 990 requirements).

36. INTERNAL REVENUE SERV., INSTRUCTIONS FOR FORM 990 RETURN OF ORGANIZATION EXEMPT FROM INCOME TAX 24–25 (2015) [hereinafter FORM 990 INSTRUCTIONS], <https://www.irs.gov/pub/irs-pdf/i990.pdf> [<https://perma.cc/TEM3-PC97>]. "Key Employees" as defined on Form 990 are those, other than officers, directors, or trustees, who make over \$150,000 per year, have significant responsibility or control over the nonprofit, and are among the top twenty highest paid employees. *Id.* at 25.

37. Allison, *supra* note 21, at 16. Furthermore, "[a]t the heart of the new Form is the assumption that good governance at the board level—coupled with the adoption, implementation and disclosure of policies and procedures—fosters tax compliance and promotes public confidence." *See id.* at 14.

38. INTERNAL REVENUE SERV., FORM 990, at 6, nos. 1(a)–(b) (2015) [hereinafter FORM 990], <https://www.irs.gov/pub/irs-pdf/f990.pdf> [<https://perma.cc/3XRC-3KRW>]. A board member is deemed "independent" if (1) the board member was not compensated as an officer or other employee of the organization or of a related organization; (2) the board member did not receive total annual compensation or other payments in excess of \$10,000 as an independent contractor (other than reimbursement of expenses under an expense reimbursement procedure) or reasonable compensation for services provided as a member of the board; and (3) neither the board member nor any family member of the board member was involved in an "interested persons" transaction reportable on Schedule L. FORM 990 INSTRUCTIONS, *supra* note 36, at 64. Some examples of "Interested Persons" include current and former officers, directors/trustees, key employees, the creator or founder of the organization, and substantial contributors. INTERNAL REVENUE SERV., INSTRUCTIONS FOR SCHEDULE L (FORM 990 OR 990-EZ) 1 (2015), <https://www.irs.gov/pub/irs-pdf/i990sl.pdf> [<https://perma.cc/3Q56-UGQD>].

requires filers to state whether the nonprofit has a written conflict of interest policy.<sup>39</sup> The form also requires disclosure of whether the nonprofit's officers, directors and/or trustees, and key employees are required to annually disclose potential conflicts of interest.<sup>40</sup> Further, filers must indicate whether the nonprofit contemporaneously documents meetings of the board and its committees.<sup>41</sup> Additionally, management must disclose whether the process for determining the compensation for the CEO and other key officers included "review and approval by independent persons," consideration of compensation data for comparable positions at similar organizations, and "contemporaneous substantiation" of deliberations and decisions regarding compensation.<sup>42</sup> Finally, the form requires filers to disclose the process by which management reviewed the 990, who reviewed it, and the extent of the review.<sup>43</sup>

While the changes made to Form 990 were extensive, the extent to which those changes have actually impacted nonprofit governance by reducing self-dealing and other abuses is debated. On one hand, it seems clear that the additional disclosures the form requires probably incentivize better behavior.<sup>44</sup> For example, between 2005 and 2010, the percentage of public charities with audit committees increased by thirty percentage points.<sup>45</sup> Further, during the same period, the percentage of organizations with document retention and destruction policies also increased.<sup>46</sup> On the other hand, good governance practices have not been implemented as broadly among certain kinds of nonprofits, including smaller organizations,<sup>47</sup> which serves as evidence of 990's inability to effect widespread change. Critics further argue that requiring significant disclosures, rather than spurring

39. FORM 990, *supra* note 38, at 6, no. 12(a).

40. *Id.* at 6, no. 12(b).

41. *Id.* at 6, nos. 8(a)–(b).

42. *Id.* at 6, nos. 15(a)–(b). Affirmative responses will allow the nonprofit to qualify for the rebuttable presumption that the compensation is reasonable if certain conditions are met. FORM 990 INSTRUCTIONS, *supra* note 36, at 87.

43. FORM 990, *supra* note 38, at 6, nos. 11(a)–(b).

44. See generally AMY BLACKWOOD, NATHAN DIETZ & TOM POLLACK, URBAN INST., THE STATE OF NONPROFIT GOVERNANCE 14 (2014), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/413229-The-State-of-Nonprofit-Governance.PDF> [<https://perma.cc/27XF-YCPC>] (noting that "[t]he adoption of good governance practices is certainly on the rise").

45. *Id.* at 5.

46. *Id.* at 6. Also, while comparable 2005 data is not available, 2010 studies show that "more than 60 percent of organizations had a compensation review and approval process for chief executives and 46 percent of organizations had a similar process for other key employees." *Id.* at 14.

47. *Id.* at 9.

adoption of good governance practices, simply incentivizes organizations to bend the truth.<sup>48</sup>

## II. THE INFORMATION GAPS

### A. *Information Gaps: Where the Public Still Cannot See*

While recognizing Form 990's likely positive overall impact on nonprofit governance, this Recent Development asserts that greater transparency will continue to reduce financial mismanagement in the nonprofit sector. The current reporting requirements—embodied in the current Form 990—still leave the public “in the dark” in at least two ways. First, Form 990 leaves a *practical* gap in publicly accessible information because information discernible from 990s is not aggregated for comparative and other purposes.<sup>49</sup> Second, Form 990 leaves an *actual* gap in publicly accessible information because the form does not require disclosure of some relevant good governance practices.<sup>50</sup> The existence of these information gaps and their implications are addressed separately.

#### 1. Practical Gap<sup>51</sup>: How the Lack of Data Aggregation<sup>52</sup> Obscures Governance Practices

Data aggregation—the gathering and publishing of free, downloadable datasets<sup>53</sup>—benefits the public by improving comparability capabilities. Unfortunately, 990's current reporting requirements preclude feasible data aggregation, thereby limiting the public's ability to compare nonprofit governance data from one

48. *See id.* at 14. (“Does the required disclosure of certain governance practices lead to better nonprofit governance, though? Is it a pathway to reflective evaluation of governance practices for nonprofits or another way to gain legitimacy in the eyes of government and potential donors?”). Such arguments rest on the proposition that requiring the *reporting* of a practice does not necessarily ensure the practice's *implementation*.

49. *See infra* Section II.A.1.

50. *See infra* Section II.A.2.

51. For the purposes of this Recent Development, “practical gap” or “practical information gap” refers to information that is technically available but practically inaccessible due to systemic limitations.

52. Data aggregation is a concept similar to “open data.” Open data is defined as “data that are available to all, free of charge, in a standard format, published without proprietary conditions, and available online as a bulk download rather than only through single-entry lookup.” BETH SIMONE NOVECK & DANIEL L. GOROFF, ASPEN INST., INFORMATION FOR IMPACT: LIBERATING NONPROFIT SECTOR DATA 2 (2013), [http://www.thegovlab.org/static/files/publications/psi\\_Information-for-Impact.pdf](http://www.thegovlab.org/static/files/publications/psi_Information-for-Impact.pdf) [<https://perma.cc/E5W4-PPNX>].

53. *Id.*

organization against similarly situated nonprofits. The IRS makes “Forms 990 filed by exempt organizations available only as single, individual image files specific to each exempt organization.”<sup>54</sup> As the Advisory Committee on Tax Exempt and Government Entities (“ACT”) noted, “[t]he Form 990 data is not currently publicly available in a comprehensive, aggregated manner. It can be used and analyzed only on the basis of *one exempt organization at a time*.”<sup>55</sup> This means that, while much information is technically available, its utility is limited because observers cannot contextualize the data without significant time and energy expenditures. The data, though collected, is practically inaccessible.

The lack of data aggregation disadvantages would-be donors<sup>56</sup> (and favors corrupt nonprofit donees) as donors attempt to determine which organizations to philanthropically support. Imagine trying to buy a car without being able to quickly compare prices across years, models, and geography. While highly educated shoppers may notice red flags without utilizing comparative tools, regular laypersons would not be able to make fully informed decisions without first laboriously aggregating the data. Nonprofit donors currently face this dilemma.

The U.S. healthcare sector provides a recent example of the benefits data aggregation can provide to the public. When the U.S. Department of Health and Human Services published its database of hospital infection rates online in a searchable format, Microsoft and Google created an application showing infection rates for local hospitals across the country.<sup>57</sup> This gave the public—from an “investigative journalist to the parent of a sick child”—access to information on which hospitals were the safest regarding infections.<sup>58</sup>

The parallels between the healthcare and nonprofit sectors are easy to draw and hard to ignore. As open data allows concerned patients to compare relevant safety measures between hospitals, so too will data aggregation allow vigilant donors to compare similarly

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54. ADVISORY COMM. ON TAX EXEMPT & GOV'T ENTITIES, INTERNAL REVENUE SERV., 2015 REPORT OF RECOMMENDATIONS 104 (2015) [hereinafter 2015 ACT REPORT], [https://www.irs.gov/pub/irs-tege/tege\\_act\\_rpt\\_14.pdf](https://www.irs.gov/pub/irs-tege/tege_act_rpt_14.pdf) [<https://perma.cc/VT9D-UZZQ>].

55. *Id.* (emphasis added).

56. For the purposes of this Recent Development, “donors” refers to any member of the public who contributes money to a nonprofit. This includes those who donate money to charities as well as those who pay nonprofits like SEANC to provide services.

57. NOVECK & GOROFF, *supra* note 52, at 3–4.

58. *Id.* at 4.

situated nonprofits against each other.<sup>59</sup> Data aggregation allows third parties to turn discrete raw data into more useful, accessible knowledge.<sup>60</sup> By placing relevant, already-existing data into a central repository, thousands of individual Form 990s have the potential to become more than the sum of their parts.<sup>61</sup>

Specifically, data aggregation of information submitted on Form 990s would allow donors to quickly compare the corporate governance practices of myriad nonprofits devoted to advancing a particular cause.<sup>62</sup> For example, the only way for prospective donors to currently distinguish between the governance practices of organizations that serve refugees, like World Relief Durham,<sup>63</sup> Carolina Refugee Resettlement Agency,<sup>64</sup> Church World Service,<sup>65</sup> and many others, is to obtain each of their individual 990s, extrapolate relevant data, and perform comparative analyses. Unsurprisingly, many individual donors are unwilling to conduct such exacting due diligence.<sup>66</sup> Aggregating data should increase donor willingness to engage in comparative analyses by increasing the accessibility of relevant information.

In addition to greatly increasing prospective donors' willingness and ability to discern between nonprofits, data aggregation has the potential to crowdsource the task of fraud detection.<sup>67</sup> As some commentators have explained,

Without ready access to specific information about suspicious activity . . . there is a tendency [for the IRS] to regulate in broad

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59. *See id.* While individual donors do not always compare nonprofits when deciding where to donate, evidence suggests that it may not be for lack of trying. *See* BOB OTTENHOFF & GREG ULRICH, MORE MONEY FOR MORE GOOD 12 fig.1-1 (2012), <http://www.guidestar.org/ViewCmsFile.aspx?ContentID=4718> [<https://perma.cc/R9VH-2JBM>] (noting that each segment of donors—individuals, philanthropic advisors, and foundation officers—conducts general research on individual nonprofits at a greater rate than they conduct comparative research).

60. NOVECK & GOROFF, *supra* note 52, at 4.

61. *Id.*

62. A Google search of “donate to refugees in North Carolina” produces many nonprofits within the first pages of search results. There are only limited ways to meaningfully distinguish between the various organizations, especially for donors seeking confirmation of good corporate governance practices.

63. WORLD RELIEF DURHAM, <http://worldreliefdurham.org> [<https://perma.cc/72AF-C49Q>].

64. CAROLINA REFUGEE RESETTLEMENT AGENCY, <http://carolinarefugee.org> [<https://perma.cc/SJA3-8U8J>].

65. CWS DURHAM, <http://cwsrdu.org> [<https://perma.cc/3JW7-VXHU>].

66. *See* OTTENHOFF & ULRICH, *supra* note 59, at 12 fig.1-1 (noting that less than ten percent of individual donors perform comparative analysis).

67. NOVECK & GOROFF, *supra* note 52, at 21.

and heavy-handed strokes based mainly on anecdotes. With a Form 990 database, identifying potential fraud could be crowdsourced, giving the IRS and states' Attorneys General "more eyes and ears. *Making 990 forms public enlarges the volunteer staff of the IRS.*"<sup>68</sup>

Because data aggregation would allow the public to examine nonprofits (and their governance practices) within the context of the entire nonprofit sector, IRS creation of open data would likely increase the abilities of donors to detect and avoid potentially problematic organizations.<sup>69</sup>

One significant way that nonprofit fraud detection may be crowdsourced is through social media. Social media has already demonstrated crowdsourcing capabilities across a broad spectrum of areas, including disseminating developing news, launching marketing campaigns, and tracking contagious diseases.<sup>70</sup> Further, commentators have noted social media's ability to detect and warn about credit card and other financial fraud.<sup>71</sup> Essentially, by pulling real-time tweets containing fraud-related words (from a predetermined list of key "trigger" words) and correlating that data with information in financial transaction databases, analysts can identify anomalous financial transactions.<sup>72</sup> Aggregating data may allow fraud detection regarding nonprofit abnormalities to be similarly crowdsourced.

## 2. An Actual Information Gap: The Unasked Questions

While aggregating data will likely enhance public knowledge of nonprofit governance and improve fraud detection capabilities, data aggregation alone is insufficient to illuminate all problematic nonprofit governance practices. As previously discussed, Form 990's Part VI contains several governance-related "yes-or-no" questions.<sup>73</sup>

68. *Id.* (emphasis added).

69. For a discussion of whether data aggregation may have signaled poor governance practices in SEANC, see *infra* Section III.A.4.

70. Timothy Matti, Yuntao Zhu & Kuai Xu, *Financial Fraud Detection Using Social Media Crowdsourcing*, INT'L PERFORMANCE COMPUTING & COMM. CONF., 2014, at 1, 1.

71. *Id.*

72. *Id.*

73. See FORM 990, *supra* note 38, at 6, pt. VI. The questions in Part VI include, among others: whether any officer, director or key employee has a family or business relationship with any other officer, director, or employee; whether the organization has become aware of any significant changes to governing documents; whether the organization provided a copy of the 990 to all members before filing; whether there is a conflict of interest policy; whether there is a whistleblower policy; whether there is a document retention policy; and whether the process for determining executive compensation was subject to independent review. *Id.*

By indicating what the IRS perceives as the most desirable practices,<sup>74</sup> these questions send strong signals about the kinds of procedures the IRS—and the public—care about.<sup>75</sup> It follows that practices not asked about will likely be perceived as less important. Unfortunately, the form neglects to ask about some important practices.

For example, Form 990 fails to ask about the frequency of board meetings.<sup>76</sup> Further, Form 990 does not ask whether an organization participated in transactions with a related entity, whether an organization has an audit committee, or the percentage of independent directors.<sup>77</sup> As 990's 2008 enhancement and its aftermath illustrate, asking about these kinds of practices would likely further increase good governance adoption rates.<sup>78</sup>

In sum, the current 990 provides the public with helpful information.<sup>79</sup> Unfortunately, the lack of data aggregation limits the ultimate utility of this information.<sup>80</sup> Further, while 990's inquiries are helpful, some important questions remain unasked.<sup>81</sup> Until the IRS aggregates the data and asks further questions,<sup>82</sup> nonprofit governance practices will remain partially obscured.

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74. *Id.* It should be noted, however, that some might consider the “one size fits all” approach that Form 990 seems to take to be haphazard and inefficient. *See* 2015 ACT REPORT, *supra* note 54, at 91.

75. *See* Leslie, *supra* note 23, at 1205 n.113.

76. The frequency of board meetings is an important metric because it may indicate how closely nonprofit management follows corporate formalities. While Form 990 asks whether meetings or written actions were documented, FORM 990, *supra* note 38, at 6, no. 8, management is not required to report how often they deliberate. Information regarding meeting frequency may be located in other places, such as an organization's bylaws. However, it seems unlikely that an average layperson would have the expertise or desire to locate that information absent extenuating circumstances.

77. While the form asks about the number of independent directors, it does not ask about the percentage of independent directors, thereby missing an opportunity to communicate about board makeup expectations. FORM 990, *supra* note 38, at 6, nos. 1(a)–(b). Admittedly, because simple math allows one to ascertain the percentage of independent directors from a current 990, the primary benefit of inquiring about the percentage of independent directors would not derive from the creation of new information. Rather, asking about the percentage of independent directors would more clearly communicate to nonprofit leaders what the IRS perceives as a best practice and would likely result in an increased number of boards with optimal numbers of independent directors.

78. For an example of the effect official inquiry can have on governance adoption rates, see BLACKWOOD ET AL., *supra* note 44, at 6 (noting that between 2005 and 2010, the number of public charities with conflict of interest policies increased by twelve percentage points).

79. *See supra* Section I.B.

80. *See supra* Section II.A.1.

81. *See supra* Section II.A.2.

82. *See* discussion *infra* Sections III.A.1.

### III. SOLUTIONS

Solutions are aimed at closing two information gaps: practical and actual. After discussing the roles various actors may play in shrinking the practical information gap, this Recent Development examines what difference, if any, the proposed solutions would have made in the SEANC scandal. Similarly, after examining ways that relevant actors may close the actual information gap, this Recent Development applies those solutions to the unfortunate facts of the SEANC scandal.

#### A. *Filling the Practical Information Gap: How Data Aggregation Parts the Clouds*

Shrinking the practical information gap is a conundrum with multiple solutions. First, the practical gap could be closed by direct action from the IRS.<sup>83</sup> State attorneys general could also alleviate the data aggregation problem.<sup>84</sup> Private sector solutions are also briefly considered.<sup>85</sup>

##### 1. What the IRS Can Do to Aggregate Data

The most comprehensive solution to the data aggregation problem is likely attainable only through IRS action. As the ACT's 2015 Report on Recommendations<sup>86</sup> recognized, the highest-impact proposal involves (1) requiring all tax-exempt organizations to file all Form 990 series electronically,<sup>87</sup> and (2) mandating that the IRS make

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83. *See infra* Section III.A.1.

84. *See infra* Section III.A.2.

85. *See infra* Section III.A.3.

86. 2015 ACT REPORT, *supra* note 54.

87. *Id.* at 107. Organizations must file various versions of Form 990 depending on their size or purpose. The ACT Report explained by stating the following:

The forms that most tax-exempt organizations must use to comply with the annual information return requirement are the Form 990 (Return of Organization Exempt from Income Tax), Form 990-EZ (Short Form Return of Organization Exempt from Income Tax) or (more recently) Form 990-N (e-Postcard). Certain tax-exempt organizations are subject to special return filing requirements. Private foundations submit their information to the IRS on a Form 990-PF (Return of Private Foundation). Black lung benefit trusts described in Section 501(c)(21) use Form 990-BL (Information and Initial Excise Tax Return for Black Lung Trusts and Certain Related Persons), religious or apostolic organizations described in Section 501(d) use Form 1065 (U.S. Return of Partnership Income) and stock bonus, pension, or profit-sharing trusts qualifying under Section 401 use Form 5500 (Annual Return/Report of Employee Benefit Plan). Exempt organizations separately report their unrelated business income on a Form 990-T (Exempt Organization Business Income Tax Return).

the “electronically filed forms publicly available in a machine-readable format in a timely manner.”<sup>88</sup>

Because some nonprofits continue to manually file Form 990s<sup>89</sup> and the IRS lacks the resources to manually extract all reported data, the first step toward comprehensive data aggregation—and eventually open data—should be to require e-filing. As the ACT Report notes, requiring e-filing makes data mining a much simpler and less labor-intensive process.<sup>90</sup> Once the data has been aggregated in a central repository, the next step is to make the data publicly available in a machine-readable format.<sup>91</sup> Making existing nonprofit governance data publicly available in a readable, searchable format would make the data truly open and potentially transformative.<sup>92</sup>

While this Recent Development asserts that the above-mentioned proposal is the most comprehensive solution to filling the practical information gap, it recognizes that changes of such a sweeping nature are seldom quickly realized. In the meantime, other, more intermediate solutions can provide the public with greater access to information than they currently possess.

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*Id.* at 92. For the purposes of this Recent Development, the distinctions between the basic 990 and other forms are of little importance.

88. *Id.* at 111. The proposal further lists advantages to mandatory Form 990 e-filing, including:

use of the publicly available data by donors to make more informed contribution decisions, use by researchers, analysts and entrepreneurs to better understand the exempt organizations sector, and the creation of information tools and services to meet the needs of the sector, and also notes the usefulness of the data by state and local regulators, charity watch-dog groups, charitable beneficiaries and the press. According to the President’s proposal, requiring electronic filing is unlikely to impose a large burden on tax-exempt organizations, since they generally maintain financial records in electronic form and either hire a tax professional or self-prepare returns using tax preparation software that enables electronic filing. The proposal states that in many cases, electronic filing is more cost effective for taxpayers.

*Id.*

89. *Id.* at 97–98.

90. *Id.* at 107. The ACT Report states, “With all-electronic filing, the IRS could search and utilize all the information reported on the Form 990, not just what is manually entered from the paper forms.” *Id.* As of today, “the IRS Exempt Organizations division only utilizes from the electronically filed returns the same information that is manually transcribed from the paper returns for its data analytics functions, for parity reasons.” *Id.* Mandatory e-filing will allow the IRS to utilize more data.

91. *See supra* note 88 and accompanying text.

92. *See supra* notes 57–66 and accompanying text.

## 2. What North Carolina Can Do to Aggregate Data

North Carolina can take an incremental step toward open data by joining with states already engaged in the data aggregation process. To that end, North Carolina should join a consortium of states<sup>93</sup> currently supporting the Multistate Registration and Filing Portal (“MRFP”).<sup>94</sup> In addition to maximizing efficiency, data transparency, and information sharing, the MRFP aims to reduce duplication of efforts and increase publicly accessible information by “mak[ing] the collected data available to the public in a searchable and interactive format.”<sup>95</sup> Because some targeted information regards varying state registration requirements, participation in the MRFP requires state attorney general engagement and cooperation.<sup>96</sup> While MRFP necessarily lacks the *breadth* of a potential IRS database, its information would not lack in *depth*, as all data submitted on Form 990s within participating states would be available.<sup>97</sup> Further, as the ACT noted, the MRFP “may provide an opportunity to work more closely with the IRS on collection of basic data about nonprofit organizations.”<sup>98</sup> Clearly, any state participation in MRFP-like initiatives is a step toward greater transparency—a step into the light.

## 3. Help from the Private Sector: Watchdog Sites and Data Aggregation

Another solution—albeit an imperfect one—to the data aggregation problem is to reconsider watchdog sites’ reporting practices.<sup>99</sup> Charity Navigator, a widely used and respected site,<sup>100</sup> contains relevant information—including governance-related answers

93. The states belonging to the consortium are Alaska, California, Colorado, Connecticut, Georgia Hawaii, Illinois, Massachusetts, Michigan, Mississippi, Missouri, New Hampshire, and Tennessee. *About*, MULTISTATE REGISTRATION AND FILING PORTAL, <http://mrfpinc.org/about.html> [https://perma.cc/3ANC-QK65].

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. 2015 ACT REPORT, *supra* note 54, at 101.

99. Watchdog groups use different criteria to “grade” various nonprofits. For example, Charity Navigator uses tax returns to focus on financial health, accountability and transparency. *Overview*, CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=17#.VuCDrxi5BB8> [https://perma.cc/ULV3-BZ9E].

100. According to its own website, Charity Navigator is “America’s largest and most influential charity evaluator.” *Where We Are Headed: CN 3.0*, CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm?bay=content.view&cpid=1193#.Vs0j1Ri5BB8> [https://perma.cc/LL45-XNJG]. It had “over 9 million visits to [the] web site in 2015 alone and impact[s] at least \$10 billion of charitable donations each year.” *Id.*

from Part VI of Form 990—in relatively accessible pages.<sup>101</sup> Unfortunately, but understandably, the site does not aggregate the data.<sup>102</sup> More problematically, at least for the purposes of this Recent Development, Charity Navigator only reports on 501(c)(3)s.<sup>103</sup> This means that organizations like SEANC, a 501(c)(5), often escape meaningful third-party reporting of their governance practices.<sup>104</sup>

It is not entirely clear how watchdog sites should improve access to nonprofit governance information. Sites like Charity Navigator may consider aggregating the existing data in more comprehensive ways.<sup>105</sup> Such aggregation, however incomplete, would significantly improve public access to relevant governance-related information.<sup>106</sup> However, absent changing site missions<sup>107</sup> or improving incentives for watchdog sites to aggregate, they have little reason to change the status quo. Further, even if watchdog sites aggregate the data they already collect, it appears that leaving the task of data aggregation

101. See, e.g., *American Breast Cancer Foundation*, CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm?bay=search.summary&orgid=8004#.Vs0leRi5BB8> [<https://perma.cc/JR6C-HS57>] (denoting whether the American Breast Cancer Foundation complied with many of the inquiries listed in Part VI of Form 990).

102. It should be noted, however, that Charity Navigator allows site visitors, using a “compare” feature available for free, to select certain nonprofits for comparison against others. See *id.* However, because many organizations do not meet Charity Navigator’s requirements for rating eligibility, Charity Navigator’s comparability capabilities are significantly limited. *Id.*

103. See, e.g., *State Employees Association of North Carolina Inc.*, CHARITY NAVIGATOR, <http://www.charitynavigator.org/index.cfm?bay=search.profile&ein=200223349#.VsOnHhi5BB9> [<https://perma.cc/9KRZ-UDPC>] (denoting that data is unavailable for the State Employees Association of North Carolina because it is not a 501(c)(3) organization).

104. The Better Business Bureau (“BBB”), while reporting on all kinds of nonprofit (and for-profit) organizations, uses criteria for rating organizations that shed virtually no light on governance issues. *Overview of BBB Rating*, BETTER BUS. BUREAU, <http://www.bbb.org/council/overview-of-bbb-grade/> [<https://perma.cc/7V7X-HPB6>] (noting the only factors taken into consideration relating to transparency are whether the organization provides information about the products and services it offers, whether the organization provides ownership information, and whether the organization “uses a false address or an address cannot be determined”). Hence, BBB’s report on SEANC provides an “A+” based on, among other things, the lack of customer complaints and the overall customer experience. *State Employees Association of North Carolina, Inc.*, BETTER BUS. BUREAU, <http://www.bbb.org/raleigh-durham/business-reviews/professional-organizations/state-employees-association-of-north-carolina-in-raleigh-nc-90002621#reasonrating> [<https://perma.cc/JB28-YHKA>].

105. For example, watchdog sites could provide the data they collect in downloadable format.

106. If Charity Navigator aggregated the data it currently collects, the public would have the ability to compare corporate governance practices of many of the largest and most popular charities in the United States.

107. For example, Charity Navigator expanding its mission to include monitoring all types of 501(c) entities would be considered a changed site mission.

solely up to watchdog sites will prove to be an inefficient and relatively unsuccessful venture because no watchdog site comprehensively collects nonprofit data.

#### 4. The Potential Impact of Data Aggregation in the SEANC Scandal

Whether coming via the IRS, the MRFP, or watchdog sites, data aggregation could have made a meaningful difference in the SEANC scandal.<sup>108</sup> To analyze data aggregation's effect, this Recent Development examines Part VI of three recent SEANC 990s.<sup>109</sup> Interestingly, the form was never presented to all members of its governing body before submission.<sup>110</sup> Further, the only information about the "process" by which the form was reviewed consisted of the following: "A COPY OF THE FORM IS REVIEWED AND SIGNED BY THE EXECUTIVE DIRECTOR PRIOR TO

108. For data aggregation to meaningfully improve governance, the public needs to care about the data. SEANC's status as a 501(c)(5) (instead of a 501(c)(3)) precludes the possibility of tax-deductible donor contributions. Such non-501(c)(3) status, however, should not be seen as signaling either a lack of widespread interest in SEANC's governance structures or that the public is only interested in nonprofit governance practices of bona fide 501(c)(3) charities. Indeed, such an assertion begs the conclusion that those who *pay* nonprofits for services are somehow less invested with how their money is spent than are donors who *give* to charities. With both traditional charities and organizations like SEANC, those providing money to the organization have an interest in governance practices. For organizations like SEANC, with over 50,000 members, *Welcome, SEANC*, <http://www.seanc.org/about/welcome/> [<https://perma.cc/GX85-662M>], the interest in governance practices is likely quite robust. Hence, all kinds of nonprofits— not just charities—would benefit from data aggregation.

109. State Emp. Ass'n of N.C. Inc., IRS Form 990: Return of Organization Exempt from Income Tax, at 6, pt. VI (OMB No. 1545-0047) (2013) [hereinafter 2013 SEANC Form 990]; State Emp. Ass'n of N.C. Inc., IRS Form 990: Return of Organization Exempt from Income Tax, at 6, pt. VI (OMB No. 1545-0047) (2012) [hereinafter 2012 SEANC Form 990]; State Emp. Ass'n of N.C. Inc., IRS Form 990: Return of Organization Exempt from Income Tax, at 6, pt. VI (OMB No. 1545-0047) (2011) [hereinafter 2011 SEANC Form 990]. These forms are from the years when Cope allegedly self-dealt.

110. 2013 SEANC Form 990, *supra* note 109, at 6, no. 11(a); 2012 SEANC Form 990, *supra* note 109, at 6, no. 11(a); 2011 SEANC Form 990, *supra* note 109, at 6, no. 11(a). Interestingly, it appears SEANC filed two separate returns for each of the years referenced, an individual and a group return representing its subordinates. While SEANC's Form 990s state that the form was never presented to the members of its governing body, the group returns do. State Emp. Ass'n of N.C.—Group Return, IRS Form 990: Return of Organization Exempt from Income Tax at 6, no. 11(a) (OMB No. 1545-0047) (2013); State Emp. Ass'n of N.C.—Group Return, IRS Form 990: Return of Organization Exempt from Income Tax at 6, no. 11(a) (OMB No. 1545-0047) (2012); State Emp. Ass'n of N.C.—Group Return, IRS Form 990: Return of Organization Exempt from Income Tax at 6, no. 11(a) (OMB No. 1545-0047) (2011). At the very least, the discrepancies between these two sets of documents raise concerns regarding the level of oversight, or lack thereof, which went into preparing them.

FILING.”<sup>111</sup> Of course, when the executive director is also the one stealing from the company, the director’s unilateral review of Form 990 is an exercise in futility. If, however, the data had been aggregated, the problematic pattern (of no independent review of the form) may have been detected.<sup>112</sup>

To summarize, and as the SEANC anecdote suggests, providing open, aggregated nonprofit data will likely aid the public in detecting poor governance practices. The IRS is best suited for the important task of data aggregation. State charity officials also have significant power to help and may be able to aggregate data within a given state or series of states. However, leaving data aggregation entirely up to third parties will likely continue to prove ineffective.

*B. Filling the Actual Information Gap: How Additional Disclosures Part the Clouds*

While the SEANC scandal indicates that open data will aid in fraud detection, it also suggests that merely aggregating existing data may not be enough to detect poor nonprofit governance in some cases. Hence, in addition to data aggregation, which primarily has detection implications,<sup>113</sup> North Carolina should consider increasing the disclosures required by certain kinds of nonprofits.<sup>114</sup> As some states have already realized,<sup>115</sup> increasing disclosure requirements may improve both detection and deterrence.

1. Additional Disclosures Vigilant States Require

Florida, in addition to requiring nonprofits to file Form 990 and an annual report with its secretary of state,<sup>116</sup> requires organizations

111. 2013 SEANC Form 990, *supra* note 109, sched. O; 2012 SEANC Form 990, *supra* note 109, sched. O; 2011 SEANC Form 990, *supra* note 109, sched. O.

112. Of course, hindsight clarifies past mistakes in ways that are rarely obvious at the time they were committed. Much of the information contained in SEANC’s 990s is typical and may not have raised red flags.

113. The current required 990 disclosures have deterrent effects as well; it is just that much of the impact of those deterrent effects is already being realized. However, it is not unreasonable to suggest that data aggregation of current 990s may have some marginal deterrent effect as well. Because such an effect is tenuous and likely insignificant, this Recent Development focuses on data aggregation’s more concrete, predictable detection impact.

114. *See infra* Section III.B.2.

115. *See infra* Section III.B.1.

116. *Annual Report Overview (Part I) and Step-By-Step Filing Instructions (Part II)*, FLA. DEP’T STATE, [https://efile.sunbiz.org/sbs\\_ar\\_instr.html](https://efile.sunbiz.org/sbs_ar_instr.html) [<https://perma.cc/R9FV-TBH7>]. However, the report contains little more than basic organizational information, such as the organization’s principal place of business, mailing address, and basic contact information for its registered agents. *Id.*

soliciting funds within the state to file another annual report with the Florida Department of Agriculture and Human Services.<sup>117</sup> This more comprehensive report requires disclosure of persons authorized to write checks on behalf of the organization,<sup>118</sup> a certificate signed by all directors, officers, and trustees of the corporation evidencing their knowledge of and compliance with the organization's conflict of interest policy,<sup>119</sup> and independent CPA audits for organizations receiving over \$1,000,000 in annual contributions,<sup>120</sup> among other requirements. Similarly, New Hampshire, in addition to requiring Form 990 filings to the IRS, requires the 990 and an additional annual report to be filed with the state attorney general.<sup>121</sup> This additional report also requires an appendix containing information about "conflicts of interest and pecuniary benefit transactions."<sup>122</sup> Further, the report must be signed under oath *by someone other than the executive director*, preferably the treasurer or board chair.<sup>123</sup>

North Carolina's nonprofit reporting requirements are somewhat less exacting than Florida and New Hampshire's. While North Carolina law requires charities soliciting funds to annually file an

117. FLA. DEP'T OF AGRIC. & CONSUMER SERVS., SOLICITATION OF CONTRIBUTIONS REGISTRATION APPLICATION, at ii, <http://forms.freshfromflorida.com/10100.pdf> [<http://perma.cc/VK9U-3THX>].

118. *See id.* at 3, no. 10 ("List the name, address, and telephone number(s) of person(s) responsible for the custody and final distribution of contributions . . .").

119. *Id.* at 6, no. 25; *see also* FLA. STAT. § 496.4055(2) (West, Westlaw through 2016 2d Reg. Sess.) ("The board of directors, or an authorized committee thereof, of a charitable organization or sponsor required to register with the department under § 496.405 shall adopt a policy regarding conflict of interest transactions. The policy shall require annual certification of compliance with the policy by all directors, officers, and trustees of the charitable organization. A copy of the annual certification shall be submitted to the [Florida Department of Agriculture and Consumer Services].").

120. FLA. DEP'T OF AGRIC. & CONSUMER SERVS., *supra* note 117, at 6, no. 27. If a charitable organization receives at least \$500,000, but less than \$1,000,000, the organization must have a CPA review the financial statement, not necessarily audit it. *Id.*

121. N.H. ATT'Y GEN. CHARITABLE TR. UNIT, ANNUAL REPORT INSTRUCTIONS, <http://doj.nh.gov/charitable-trusts/documents/nhct-2a-report.pdf> [<http://perma.cc/S8NL-HP83>] ("Mail all materials to Charitable Trusts Unit, Department of Justice, 33 Capitol St., Concord, NH 03301.").

122. *Id.* This requirement is more exacting than the conflict of interest disclosure required by the current Form 990. While the current 990 requires disclosure of *whether* the organization has a conflict of interest policy, the New Hampshire form requires descriptive disclosures. N.H. ATT'Y GEN. CHARITABLE TR. UNIT, APPENDIX TO ANNUAL REPORT, <http://www.doj.nh.gov/charitable-trusts/documents/annual-report-appendix.pdf> [<https://perma.cc/RA7E-YT9G>].

123. N.H. ATT'Y GEN. CHARITABLE TR. UNIT, ANNUAL REPORT CERTIFICATE, <http://doj.nh.gov/charitable-trusts/documents/nhct-2a-report.pdf> [<http://perma.cc/S8NL-HP83>] (stating that "THE SIGNATURE OF THE EXECUTIVE DIRECTOR IS NOT ACCEPTABLE").

additional form,<sup>124</sup> the form focuses on solicitation practices without asking other governance-centric questions.<sup>125</sup> Further, non-501(c)(3) nonprofits are not statutorily required to file an annual state report at all.<sup>126</sup> These things ought not to be. Instead, as previously discussed, requiring certain kinds of nonprofits to file annual reports with a state entity increases the state's ability to detect fraud and sends strong signals about acceptable behavior.

## 2. How North Carolina Could Close the Actual Information Gap

By borrowing ideas from particularly vigilant states, North Carolina can increase public knowledge of nonprofit practices by requiring certain groups of nonprofits to file a simple but exacting annual report. While it is unclear exactly how such a report should be structured, it should inquire about a few basic practices, including the percentage of independent directors, the frequency of board meetings, and transactions with related entities.<sup>127</sup> Like Florida, North Carolina should require annual certification of conflict of interest policy compliance—not just a check mark indicating whether one

124. See N.C. DEP'T OF THE SEC'Y OF STATE, SOLICITATION LICENSE APPLICATION CHARITABLE OR SPONSOR ORGANIZATION INSTRUCTIONS, <https://www.sosnc.gov/CSL/pdf/CSLCharityLicenseInstructions.pdf> [<https://perma.cc/D98R-2L5T>].

125. See *id.*; see also N.C. GEN. STAT. § 55A-16-20(a) (2015) (“Except as provided in the articles of incorporation or bylaws of a charitable or religious corporation, a corporation upon written demand from a member shall furnish that member its latest annual financial statements . . .”). Nowhere does North Carolina require nonprofits to file an annual report detailing governance practices.

126. See § 55A-16-01(b) (stating that nonprofit organizations “shall *maintain* appropriate accounting records”) (emphasis added); *id.* § 55A-16-24(a) (2015) (stating that organizations, including non-501(c)(3)s, receiving more than \$5,000 from public funds each year, must disclose financial statements “upon written demand from any member of the public”). However, absent a request from a member of the public to an organization receiving more than \$5,000 annually from public funds, North Carolina does not as a matter of law require non-501(c) nonprofits to annually file a report with the state. Of course, such organizations are still responsible to the IRS and must file 990s. See N.C. DEP'T OF THE SEC'Y OF STATE, INCORPORATING YOUR NONPROFIT IN NORTH CAROLINA 11–12, <https://www.sosnc.gov/corporations/pdf/nonprofitcorporation.pdf> [<https://perma.cc/ZHM2-UC9K>] (“When a corporation is incorporated or domesticated in this state, the N.C. Department of the Secretary of State will automatically notify the North Carolina Department of Revenue. Then the Department of Revenue will send a letter of notification to the corporation. Along with the letter there will be a six-part questionnaire (Form CD-345) to be used for determination of tax status. The corporation should submit, along with the questionnaire, a copy of its Articles of Incorporation (including, if applicable, any tax exempt organization provisions) and bylaws. The Department of Revenue will then evaluate the documents and notify the corporation by mail as to whether it will be exempt from franchise and income taxes.”). In other words, after a non-501(c)(3) North Carolina organization obtains tax-exempt status, there is no automatic annual state reporting requirement. *Id.*

127. See *supra* notes 76–77 and accompanying text.

exists.<sup>128</sup> Following New Hampshire, North Carolina's annual report should disallow unilateral approval by the executive director as a matter of policy.<sup>129</sup> By combining the best ideas from proactive states into a single, governance-focused form, North Carolina will increase public fraud detection capabilities and further promulgate good governance practices.

### 3. The Effect of an Annual Report on the SEANC Scandal: Would It Have Made a Difference?

The requirement of an additional annual report similar to one discussed above would likely have made a positive difference in the SEANC scandal. First, an annual report requiring review by someone other than the executive director would have precluded Cope's impotent inspection.<sup>130</sup> Further, a report requiring a bona fide description of the organization's conflict of interest policy would have forced SEANC to be more explicit about its procedures and may have alerted other stakeholders that something was amiss.<sup>131</sup> While the exact disclosures required necessarily depend on the form and substance of the proposed report, it does not strain credulity to assert that nearly any additional governance-centric annual reporting requirement would have decreased the likelihood of Cope's abuses.

## IV. COUNTERARGUMENTS & RECOMMENDATIONS

### A. Counterarguments

While most agree that increased nonprofit governance transparency is a worthy aim, some remain skeptical about the feasibility of increasing public access to relevant information. These critics generally argue that enacting some of the changes this Recent Development espouses will be prohibitively costly, woefully ineffective, or both.<sup>132</sup> For example, some critics of data aggregation

128. See *supra* note 119 and accompanying text. While Form 990 certainly encourages conflict of interest policies, it does not require them.

129. See *supra* note 123 and accompanying text.

130. See *supra* notes 109–11 and accompanying text.

131. In the SEANC 990s, the only information about the conflict of interest policy is a disclosure that governing members are required to submit conflict disclosures and that the organization's contracts are reviewed by the organization's ethics officer. 2013 SEANC Form 990, *supra* note 109, sched. O; 2012 SEANC Form 990, *supra* note 109, sched. O; 2011 SEANC Form 990, *supra* note 109, sched. O.

132. While the most commonly referenced costs are the pecuniary costs of database implementation, some argue that usurpation of directors' business judgment may also be considered a "cost." See Donnelly, *supra* note 22, at 181; see also 2008 ACT REPORT,

assert that the IRS, and state governments, lacks the economic resources to create a central, searchable repository<sup>133</sup> and that relevant nonprofits lack the resources to adopt additional reporting reforms.<sup>134</sup> On the other hand, critics of enhanced reporting requirements urge that—in addition to being prohibitively expensive—enhancing reporting requirements further constrains nonprofit boards and ultimately diminishes their business judgment without actually changing director behavior.<sup>135</sup> These arguments are taken in turn.

### 1. The Costs of Data Aggregation: A Price Too High to Pay?

Two costs are relevant regarding data aggregation: the IRS's cost to create and maintain a searchable database and individual nonprofits' costs to prepare and electronically file Form 990 reports. First, data aggregation is likely not too costly for the IRS because, while creating an open database would incur one-time setup and perpetual maintenance costs, it would also reduce data conversion and quality assurance costs by an estimated combined \$600,000 annually.<sup>136</sup> However, as commentators have noted, the front-end costs associated with data aggregation have to this point been significant enough to deter congressional action, the long-term benefits of data aggregation notwithstanding.<sup>137</sup> Hence, the IRS's lack of immediate additional resources required to fund data aggregation

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*supra* note 22, at 4 (listing reasons why the IRS should proceed with caution when examining nonprofit governance).

133. NOVECK & GOROFF, *supra* note 52, at 27 (“In the current economic climate, spending any additional resources on digitizing or extracting data relating to nonprofit entities might be hard to justify without specific direction from Congress. Resources to digitize or extract data have not been appropriated. In fact, interviewees repeatedly stated that the IRS could not undertake such efforts under current circumstances because they would incur new costs.”).

134. 2008 ACT REPORT, *supra* note 22, at 2 (noting that because “smaller and more rural organizations have less governance resources available to them, there is a greater need to tread lightly because of the burdens flowing from encouraging unnecessarily extensive governance reforms”).

135. *See id.* at 1 (noting that “[c]harities can feel pressured to adopt the specified practices, even where it is inadvisable in their situation, because they believe the IRS or others will consider them poorly governed if they fail to do so. This then can effectively . . . divert their attention to *proxies for governance instead of actual governance*” (emphasis added)); Donnelly, *supra* note 22, at 181.

136. 2015 ACT REPORT, *supra* note 54, at 107 (citing NOVECK & GOROFF, *supra* note 52, at 18) (stating that “[t]he Aspen Institute reports that if the IRS makes e-filed data available in open form, it would save \$350,000 in the cost of data conversion and \$250,000 from a reduced need to conduct quality assurance checks”).

137. *See* NOVECK & GOROFF, *supra* note 52, at 27.

continue to prevent congressional action, even though data aggregation may actually pay for itself in the long run.

The second cost associated with data aggregation—nonprofits' costs in preparing and e-filing Form 990 reports—is also unlikely to create unbearable costs for nonprofits because “they generally maintain financial records in electronic form and either hire a tax professional or self-prepare returns using tax preparation software that enables electronic filing.”<sup>138</sup> The ACT Report further states “in many cases, electronic filing is more cost effective for taxpayers.”<sup>139</sup> For these reasons, data aggregation's price tag is well within IRS and nonprofit budgets.

## 2. The Costs of an Additional Annual Report

Even if some critics concede that requiring all nonprofits to e-file may not significantly increase costs, many of them note that mandating an additional annual report will inevitably do so.<sup>140</sup> This is at least a partially meritorious claim: requiring more information will require greater preparation costs. However, the increased cost may be justified by requiring additional reports only from nonprofits with revenues over a given figure.<sup>141</sup> A minimum revenue threshold requirement would ensure that only nonprofits with the resources to pay would be subject to additional scrutiny. Further, the increased costs of filing an additional annual report will likely be marginal because nonprofits already incur expenses related to their 990 information-gathering and reporting obligations.<sup>142</sup>

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138. 2015 ACT REPORT, *supra* note 54, at 111.

139. *Id.*

140. See 2008 ACT REPORT, *supra* note 22, at 2 (noting that the proposed changes in Form 990 would add annual costs to nonprofits).

141. The IRS already sorts nonprofits according to income. *Which Forms do Exempt Organizations File?*, INTERNAL REVENUE SERV., <https://www.irs.gov/charities-non-profits/form-990-series-which-forms-do-exempt-organizations-file-filing-phase-in> [<https://perma.cc/ZWL2-QPCX>]. While more research is required to determine the optimal minimal revenue threshold for requiring additional annual reports, this Recent Development suggests that the threshold be no less than \$1 million.

142. Because many nonprofits already hire professionals to aid in annual filing, it is not unreasonable to conclude that, for most affected nonprofits, the additional costs imposed by an additional annual governance report will be negligible. See *generally* 2015 ACT REPORT, *supra* note 54, at 125 (concluding that most nonprofits already hire professionals to prepare and file reports).

### 3. Do the Proposed Recommendations Usurp Directors' Business Judgment?

Another argument against increased reporting requirements is that such requirements, in effect, coerce directors into adopting practices that may or may not be best for their organizations.<sup>143</sup> As others have noted, enhancing reporting requirements simply “gives board members new incentives to adopt best practices.”<sup>144</sup> Such propositions highlight the difference between requiring the *reporting* of a practice and the *implementation* of a practice. Because most of the proposed changes<sup>145</sup> constitute the former proposition, adopting them will not usurp directors' business judgment. However, the same cannot be said regarding recommendations mandating the adoption of good governance practices.

Recommendations mandating director action (or inaction) necessarily implicate directors' business judgment. For example, the recommendations to disallow unilateral executive director approval of a Form 990 or similar report<sup>146</sup> and to require annual filing of a certificate signed by all directors evidencing compliance with a conflict of interest policy<sup>147</sup> technically usurp directors' business judgment to some degree because they force management to make certain business decisions. These and other similar proposed requirements remove director autonomy regarding a very narrow set of choices. Despite their restricting effect, this Recent Development posits that such recommendations are nevertheless appropriate in light of ongoing abuses and minimal actual judgment usurpation. In reality, how disruptive is the requirement to have at least two people review a 990? How much judgment is actually “usurped” by requiring large nonprofits to have and report on a conflict of interest policy? As Cope's crimes clarify, the benefits of implementing these kinds of requirements will likely far outweigh any judgment usurpation “costs.”

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143. 2008 ACT REPORT, *supra* note 22, at 1.

144. Thomas Lee Hazen & Lisa Love Hazen, *Duties of Nonprofit Corporate Directors—Emphasizing Oversight Responsibilities*, 90 N.C. L. REV. 1845, 1857 (2012).

145. Specifically, data aggregation and any inquiry that asks *whether* a practice occurs do not directly usurp directors' business judgment.

146. *See supra* Section III.B.2. The same can be said of the proposed North Carolina mandate to actually annually file a conflict of interest policy with the state Attorney General.

147. *See supra* text accompanying note 129.

## CONCLUSION

This Recent Development has argued that shrinking the public's practical and actual information gaps will reduce instances of poor nonprofit governance by "shedding light" on previously obscured or nonexistent data. The practical information gap is most effectively addressed via IRS creation of a searchable Form 990 database. To the extent possible, North Carolina legislators should support proposals mandating Form 990 e-filing.<sup>148</sup> The actual information gap is most properly addressed via state requirements of additional annual reports for relatively large nonprofits. North Carolina should follow the examples of watchful states that currently require annual governance-focused reports.

Sunlight is the best of disinfectants, and with the new Form 990, the clouds obscuring nonprofit governance practices continued to part. Adopting this Recent Development's recommendations will shed further light on nonprofit governance by increasing the public's access to aggregated information, which will in turn strengthen nonprofit decision-makers' incentives to adopt and adhere to appropriate governance practices. On nonprofit governance, the sun will shine all the brighter.

JORDAN C. HILTON\*\*

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148. A recent proposal from the IRS Advisory Committee is to

support a Congressional mandate to require electronic filing of the Form 990 series and . . . take interim steps to encourage and provide incentives for voluntary e-filing of the Form 990 series for exempt organizations that are not subject to the mandatory e-filing requirements. The IRS should recommend to the Department of Treasury the elimination of the \$10 million asset threshold for electronic filing of the Form 990 found in the Code Section 6011 regulations.

2015 ACT REPORT, *supra* note 54, at 141.

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