Nonprofit College Crash: Enforcing Board Fiduciaries Through Increased Accountability and Transparency in the IRS Form 990 Procedure

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NONPROFIT COLLEGE CRASH: ENFORCING BOARD FIDUCIARIES THROUGH INCREASED ACCOUNTABILITY AND TRANSPARENCY IN THE IRS FORM 990 PROCEDURE

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I. BACKGROUND OF NONPROFIT SCHOOL CLOSINGS AND INTRODUCTION

Since 1997, the United States has experienced a steady increase in college closings.[2] Private, nonprofit colleges are the most prevalent among these affected institutions. A 2017 study confirmed that 177 colleges failed a U.S. Education Department test for "financial responsibility."[3] Of these 177 colleges, well over half are private nonprofits. Further, several colleges have closed since the study was completed.[4] It is reasonable to conclude the financial irresponsibility of these schools contributes to their closures.

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2. Kate Smith, *Here's What Happens to Endowments When Colleges Close*, BLOOMBERG: BUSINESS, https://www.bloomberg.com/news/articles/2017-03-06/orphan-endowments-of-dead-schools-bedevil-states-across-america (last updated Mar. 8, 2017, 3:26 PM).

3. Chris Quintana & Joshua Hatch, *177 Private Colleges Fail Education Dept.'s Financial-Responsibility Test,* THE CHRONICLE OF HIGHER EDUC. (Mar. 8, 2017), https://www.chronicle.com/article/177-Private-Colleges-Fail/239436.

4. *Id*.

Moody's Investor Service Report predicts these closures will triple in the future.[5] Many factors lead to this predicted financial calamity. The inability to compete with larger state supported universities, geographical challenges for rural colleges, and lack of economies of scale contribute to these closings.[6] One particular challenge private colleges face is competing with lower tuition offered by public schools.[7] Private colleges must heavily discount tuition to compete with their public counterparts.[8] In addition to these geographical and economic factors, technological factors also apply financial pressure to private schools. The migration to online education decreases revenue for small, private colleges which cannot compete against online education providers.[9]

While each factor contributes to nonprofit college failures, one prevalent cause is simple: Mismanagement. It is possible this mismanagement may be exacerbated by poor resources, economic downturns, and competition; however, many of these closures are directly correlated with fiduciary duty violations by officers and directors.

Part I describes fiduciary duties of nonprofit board members and instances of their failure. Part II discusses inadequate nonprofit oversight and provides information regarding traditional denial of nonprofit stakeholder standing to sue. Part III provides additional examples of and a possible reason for

5. Kellie Woodhouse, *Closures to Triple*, INSIDE HIGHER ED (Sept. 28, 2015), https://www.insidehighered.com/news/2015/09/28/moodys-predicts-college-closures-triple-2017.

6. Caroline Simon, *For many small colleges, it's a challenge just to stay open*, USA TODAY C. (Feb. 24, 2017, 4:56 PM), http://college.usatoday.com/2017/02/24/for-many-small-colleges-its-a-challenge-just-to-stay-open/.

7. Rick Seltzer, *Days of Reckoning*, INSIDE HIGHER ED (Nov. 13, 2017), https://www.insidehighered.com/news/2017/11/13/spate-recent-college-closures-has-some-seeing-long-predicted-consolidation-taking.

8. Farran Powell, *Study: Private Colleges Up Tuition Discounts*, U.S. NEWS & WORLD REP. (July 18, 2016, 8:30 AM), https://www.usnews.com/education/best-colleges/paying-for-college/articles/2016-07-18/study-private-colleges-up-tuition-discounts.

9. Jeffrey J. Selingo, *Colleges Struggling to Stay Afloat*, N.Y. TIMES (Apr. 12, 2013), https://www.nytimes.com/2013/04/14/education/edlife/many-colleges-and-universities-face-financial-problems.html.

breaches of fiduciary duties. Part IV describes several required disclosures by colleges and other institutions. Part V describes IRS Form 990 and its Schedules. Finally, Part VI offers an analysis of a method to ensure stakeholder protection from malfeasant board members – strengthening IRS Form 990.

II. Board Member Fiduciary Duties and Failures

According to the Association of Governing Boards of Universities and Colleges, a board member must act with the duties of care, loyalty, and obedience to his institution and its beneficiaries. Specifically, for a college, these beneficiaries include students, faculty, alumni, and the college's community.[10] As will be discussed in Part II, these beneficiaries are unfortunately denied standing when attempting to impose liability for breaches of fiduciary duties.[11] These duties require a board member to use prudence and responsibility in dealings with his institution. A board member must make good-faith decisions in the best interest of his institution. A board member should ensure his decisions follow his organization's purpose and are not influenced by the board member's personal whims or interests.[12]

a. Duty of Care

The duty of care requires a board member to act in the best interest of his institution. He must use sensible judgment

10. AGB Statement on the Fiduciary Duties of Governing Board Members, Ass'n of Governing Boards of U. & C. 2 (2015), https://agb.org/wp-content/uploads/2019/01/statement_2015_fiduciary_duties.pdf.

11. *See, e.g.,* Steeneck v. Univ. of Bridgeport, 668 A.2d 688 (Conn. 1995) (holding that students, donors, alumni, and trustees of a university lacked standing to sue the university); O'Donnell v. Sardegna, 646 A.2d 398 (Ct. App. Md. 1994) (holding that subscribers to a non-profit health insurance company did not have standing to sue);
Tishok v. Dep't of Educ., 133 A.3d 118 (Pa. Commw. Ct. 2016) (holding that college alumnae did not have standing to sue the university); Carl J. Herzog Found., Inc. v. Univ. of Bridgeport, 699 A.2d 995 (Conn. 1997) (holding that a donor did not have standing to sue the university).

12. AGB Statement on the Fiduciary Duties of Governing Board Members, *supra* note 9, at 2–3.

when making decisions on behalf of the institution. These decisions must be made using Good Faith and Diligence which an ordinary prudent person would use.[13] Acting in Good Faith defined is, "Behaving honestly and frankly, without any intent to defraud or to seek an unconscionable advantage."[14] Diligence involves "Constant application to one's business or duty," and, "[Acting with] attention and care required from a person in a given situation."[15]

Lastly, a board member must base his decisions on evidence and resources in order to make the best decision possible. A board member is not expected to be an expert, but he should rely on expert opinions, data, and feasible studies when he makes decisions.[16] The duty of care necessitates a board member keep business information confidential, attend meetings, stay informed on his institution's dealings, and consider both short-term and long-term health of his institution.[17]

b. *Duty of Loyalty*

The duty of loyalty demands that a board member prioritize his institution's interests over his own. A board member may not benefit from financial opportunities which belong to the institution, and he must remain independent of his institution. Lastly, a board member must disclose and eliminate potential conflicts of interest.[18] For example, a manager influencing his company's board of directors regarding his salary may be a violation of the duty of loyalty.[19]

13. *Id.* at 4.
14. *Acting in Good Faith*, BLACK'S LAW DICTIONARY (10th ed. 2014).
15. *Diligence*, BLACK'S LAW DICTIONARY (10th ed. 2014).
16. AGB Statement on the Fiduciary Duties of Governing Board Members, *supra* note 9, at 5.
17. *Id.* at 4 (AGB's Statement on Fiduciary Duties).
18. *Id.* at 6–7.
19. *See, e.g.*, Levy v. Young Adult Inst., 103 F.Supp. 3d 426, 448–449 (D.N.Y. 2015). In *Levy v. Young Adult Institute*, Plaintiff was a CEO for Defendant and was responsible for some financial decisions. This position allowed Plaintiff to exert influence upon Defendant's board's compensation decisions. Defendant claimed this was a violation of Plaintiff's duty of loyalty. In

c. Duty of Obedience

The duty of obedience ensures a board member follows the purpose or mission of his institution as set by its by-laws. This duty requires a board member to oversee employees and ensure they are ethical and prudential; if employees are behaving improperly, the board should address such issues. Finally, this duty forces a board member to occasionally re-evaluate the institution's mission and to ensure it is closely followed.[20]

d. Failure of Fiduciary Duties

The duties of care, loyalty, and obedience exist to ensure board members act reasonably and for their institution; however, their existence does not guarantee board members always use their position appropriately. In some cases, the business judgement rule insulates board members from liability for breaches of fiduciary duties. A court will not question the judgement of a board member who it believes acted in good faith, with prudential care, and in the best interest of his institution.[21] The business judgement rule should not shield board members who fail to act or who act in bad faith.[22] As previously discussed, the duty of care requires a director to remain familiar with his organization so he can make optimal decisions.[23]

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dicta, the court explained that a manager who influences a board of directors with respect to his own salary may be a violation of the duty of loyalty.

20. AGB Statement on the Fiduciary Duties of Governing Board Members, *supra* note 9, at 8.

21. Lindsay C. Llewellyn, *Breaking Down the Business-Judgment Rule*, AM. BAR ASS'N (May 30, 2013), https://www.americanbar.org/groups/litigation/committees/commercial-business/articles/2013/breaking-down-business-judgment-rule.html.

22. Eileen L. Morrison, *Enforcing the Duties of Nonprofit Fiduciaries: Advocating for Expanded Standing for Beneficiaries*, 95 B.U. L. REV. Annex 19, 3 (2015).

23. AGB Statement on the Fiduciary Duties of Governing Board Members, *supra* note 9, at 4.

Brock Built, LLC. v. Blake illustrates how companies, profit and non-profit alike, are shielded by the business judgment rule. The Supreme Court of Georgia found that Defendant did not breach his fiduciary duties when he delayed payments to increase his incentive compensation.[24] Plaintiff, a construction company, hired Defendant as its president. Defendant received incentive compensation equal to a portion of Company's profit margin.[25] Company alleged that Defendant violated his fiduciary duties when he accelerated home buildings and delayed company payments to increase Company's annual profits and, thereby, increase his personal incentive compensation.[26] The court found Defendant negligently and carelessly performed his duties, but it stated this negligence did not qualify as a breach of his fiduciary duties due to the Business Judgment Rule.[27]

III. Inadequate Nonprofit Oversight

Very few individuals or organizations have authority to oversee nonprofit organizations. Lack of standing to sue nonprofits has permitted many nonprofit board members to elude oversight and liability. States generally defer the oversight and enforcement of nonprofit activities to the Attorney General (AG). It is not feasible for the AG's office in each state to oversee every nonprofit due to understaffing and lack of funding.[28] Furthermore, the AG may face a backlash in overseeing and policing nonprofits due to political interests. [29] Failure of the AG to regulate nonprofits is discussed further in Part VI.

24. Brock Built, LLC v. Blake, 686 S.E.2d 425, 431 (Ga. Ct. App. 2009).
25. *Id*. at 427.
26. *Id*. at 430.
27. *Id*. at 431.
28. Sarah R. Kusiak, Comment, *The Case for A.U. (Accountable Universities): Enforcing University Administrator Fiduciary Duties through Student Derivative Suits*, 56 AM. U.L. REV. 129, 141 (2006).
29. Morrison, *supra* note 21, at 5.

The Internal Revenue Service (IRS) also regulates certain nonprofits by requiring them to file Form 990.[30] Form 990 allows nonprofits to disclose information about their financial strength and mission.[31] Unfortunately, such disclosures are limited and insufficient as discussed in Part VI. Beyond government enforcement, donors of nonprofits may oversee nonprofits by ceasing donations, but unavailability of information as discussed in Part VI hinders donors' evaluation of nonprofits before they donate.[32]

IV. NONPROFIT BOARD MEMBER FAILURES

Without proper oversight, there are few mechanisms that ensure enforcement of fiduciary duties and thus, proper management. A recent example of a college's mismanagement is Sweet Briar Institute in Virginia. Sweet Briar is a private college that was established as a trust over 100 years ago.[33] In 2015, Sweet Briar's Board of Directors voted to close the school. The Board claimed closure was necessary because of financial issues and shrinking enrollment.[34] This decision sparked controversy which led to several lawsuits.[35] Experts reported that Sweet Briar actually had its best enrollment in history, and a forensic accountant stated no financial issues existed before the college's announcement to close.[36] The Board either chose not to obtain correct information or tried to close the school despite having correct information. Either decision is a breach of the Board members' fiduciary duties.

30. *Id.* at 6.

31. Form 990 from *Form 990 Series*, INTERNAL REVENUE SERV.: REQUIRED FILING, https://www.irs.gov/pub/irs-pdf/f990.pdf (last updated July 25, 2019).

32. Morrison, *supra* note 21, at 7.

33. William H. Hurd et al, *The Will to Prevail: Inside the Legal Battle to Save Sweet Briar*, 51 U. RICH. L. REV. 227, 229 (2016).

34. *Id.* at 228.

35. *Id.* at 234.

36. *Id.* at 237.

In another example in 2016, Burlington College closed primarily because of a poor investment; the school acquired property which resulted in it facing insurmountable debt.[37] In 2010, the Burlington College Board of Trustees purchased 32 acres of beachfront property for over $10 million.[38] The Board cited growth potential as the purpose for this transaction. The University of Vermont Provost made the following statements exhibiting her shock in Burlington's land acquisition, "Everyone was very interested to see who was going to buy this property."[39] She continued, "I think everyone was very surprised when it turned out to be Burlington College. It was like, 'Oh, wow. How are they doing that?'"[40]

Burlington financed this purchase with $6.5 million in tax-exempt bonds, $3.5 million in seller financing, and a $500,000 bridge loan.[41] Jane Sanders, Burlington's president at the time, informed the bank she secured $2.6 million in pledges to collateralize the purchase; however, Burlington reported less than $300,000 in gifts, grants, contributions, and pledges on its tax forms.[42] Clearly, Burlington lacked adequate income to warrant this purchase.[43]

Burlington made other poor decisions. In 2012, its officials recruited in China but only successfully enrolled one student.[44] In 2013, Burlington planned to sell some of its realty to pay overdue debt, but plans to sell were delayed until 2015 when it was too late.[45] In 2014, Burlington spent $2 million for building repairs despite Sanders's claim that Burlington's facil-

37. Rick Seltzer, *Trouble From the Grave*, INSIDE HIGHER ED (May 17, 2017), https://www.insidehighered.com/news/2017/05/17/burlington-college-campus-purchase-still-coming-back-haunt-jane-sanders.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. *Id.*

ities were in good condition.[46] In 2016, mismanagement failures accrued, and Burlington College announced plans to close.[47]

Nonprofit collapse is not solely confined to nonprofit colleges. In 2012, Hull House, a famed charity for European settlers in Illinois for over a century, closed due to financial uncertainty.[48] In January, Hull House alluded to potential closure late in 2012; they announced closure only one week later.[49] It is possible Hull House could have attempted to acquire funding from other sources before announcing to close.[50]

There were numerous warning signs for Hull House. When Hull House was founded in 1889, its staff consisted entirely of volunteers, and most of its funding came from one inheritance.[51] As this inheritance was exhausted, Hull House's business model needed to evolve for the charity to be able to continue financing itself.[52] Its endowment from 1889 would not exist forever.[53] Despite its long history of reliance on volunteer labor, Hull House began paying employees, a step in the wrong direction.[54] Further, Hull House expanded too quickly in the late 1900s, resulting in consecutive years of operating deficits.[55] Hull House's board members had a duty to act in the best interest of their organization, but they chose to ignore warning signs, refused change, and submitted to closure.[56]

As in Sweet Briar, several perverse incentives exist which encourage board members to violate their fiduciary du-

46. *Id.*
47. *Id.*
48. Rick Cohen, *Death of the Hull House: A Nonprofit Coroner's Inquest*, NONPROFIT Q. (August 2, 2012), https://nonprofitquarterly.org/2012/08/02/hull-house-death-nonprofit-coroners-inquest/.
49. *Id.*
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.*
54. *Id.*
55. *Id.*
56. *Id.*

ties. For example, an Illinois statute states the following regarding nonprofit board compensation, ". . .the board of directors, by the affirmative vote of a majority of the directors then in office, shall have authority to establish reasonable compensation of all directors for services to the corporation as directors, officers or otherwise."[57] This statute is specific to Illinois nonprofits, but similar laws exist in almost every state.[58] If board members can determine their own salaries, they have an incentive to violate their duty of loyalty by granting themselves a higher salary than warranted with the only limitation in the statute being the word "reasonable."

Board members also have incentives to misuse benefits. In 2005, Benjamin Ladner, former president of American University (AU) in Washington D.C. was ousted for misusing over $500,000 of university funds.[59] The president spent university funds on personal meals, entertainment, and an engagement party for his son.[60] Even more egregiously, after the president was dismissed, the board awarded him a $3.7 million severance package.[61] Consequently, not only did the president breach his fiduciary duties to the university, the board arguably breached their fiduciary duties by awarding a golden parachute.

V. REQUIRED FEDERAL DISCLOSURES

Colleges are required by the federal government to make several annual disclosures in order to qualify for federal student assistance programs.[62] For example, colleges are re-

57. 805 ILL. COMP. STAT. ANN. 105/108.05 (West 2010).

58. *See, e.g.*, ARIZ. REV. STAT. ANN. § 10-3812 (1991); IOWA CODE ANN. § 504.812 (West 2004); 15 PA. CONS. STAT. AND CONS. STAT. ANN. § 5730 (West 2013); W. VA. CODE ANN. § 31E-8-812 (West 2002).

59. Kusiak, *supra* note 27, at 132.

60. *Id.* at 131–132.

61. *Id.* at 132.

62. *Compliance Matrix*, HIGHER EDUC. COMPLIANCE ALLIANCE (2017), http://www.higheredcompliance.org/matrix/.

quired to report gender and race related information, graduation rates, and student aid information related to student-athletes.[63] Colleges are required to report this information annually by July 1.[64] This deadline allows colleges only six months to make the disclosure.[65]

College institutions must also conduct independent audits of their administrations.[66] This auditing requirement involves colleges reporting audited financial statements and the audits must be in accord with federal accounting standards.[67] Colleges are required by 34 CFR 668.23 to submit their audits no later than "six months after the end of the institution's fiscal year" again focusing on a quick release of information.[68]

The Jeanne Clery Disclosure of Campus Security Policy and Campus Crime Statistics Act and the Violence Against Women Act requires colleges to disclose a variety of data including their procedures related to reporting criminal activity on campus, security for and access to campus facilities, campus and local law enforcement agencies, and reporting registered sex offenders.[69] The report should also include local criminal statistics and information related to missing persons.[70] This report must be completed annually by October 1, allowing institutions only three quarters to compile data to make the disclosure.[71]

The Equity in Athletics Disclosure Act requires colleges to disclose its athletes' demographic information.[72] This Act also requires information to be reported. Specific information which must be reported includes the number of students re-

63. 34 C.F.R. § 668.48(a)(1)(i)-(ii) (2004).
64. *See id.* § 668.48(a)(1).
65. *Id.*
66. *See id.* § 668.23.
67. *See id.* § 668.23(d).
68. *See id.* § 668.23(a)(4).
69. *See id.* § 668.46(b).
70. *See id.* § 668.46(c)-(f).
71. *Compliance Matrix*, *supra* note 61.
72. *Id.* See a section called Institutional Reporting and Disclosure Requirements for Federal Student Assistance Programs.

ceiving aid by race and gender, recruiting expenses by gender, and operating expenses for each athletic team.[73] This disclosure is required by October 30.[74]

Colleges are not the only institutions required to make disclosures. Banks must disclose quarterly financial information pursuant to the Federal Deposit Insurance Act.[75] While required disclosure varies by institution size and type, generally, information disclosed includes consolidated reports and financial statements.[76] This disclosure is required within approximately 30 days of the end of each quarter.[77]

The Sarbanes-Oxley Act of 2002[78] tightened regulations on corporations. The Act set corporate standards for financial disclosures, independence of auditors, and corporate responsibility.[79] One important result of the act is that CEOs and CFOs are now personally responsible for ensuring information on the financial statement is correct and personally liable if the information is not correct.[80]

VI. IRS FORM 990

Except for religiously affiliated and small organizations, all tax exempt organizations must file "an annual return, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the internal revenue laws . . . ."[81] This statute re-

73. *See id.* § 668.47(c).

74. *Compliance Matrix*, *supra* note 61.

75. 12 U.S.C.A. § 1817 (West 2018).

76. *Bank Financial Reports*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/regulations/resources/call/index.html (last updated July 5, 2016).

77. *NCUA sets 2017 call report due dates*, NAT'L ASS'N OF FEDERALLY-INSURED CREDIT UNIONS (Nov. 22, 2016), https://www.nafcu.org/newsroom/ncua-sets-2017-call-report-due-dates.

78. Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 745 (2002).

79. Moat Associates, *Corporate Governance Under the Sarbanes-Oxley Act*, HG.ORG LEGAL RES., https://www.hg.org/legal-articles/corporate-governance-under-the-sarbanes-oxley-act-24966 (last visited July 26, 2018).

80. 15 U.S.C.A. § 7241(a) (West 2002).

81. I.R.C. § 6033(a)(1) (West 2018).

quires tax exempt nonprofits, including nonprofit colleges, to complete IRS Form 990. [82] In addition to cash flow information, a nonprofit is required to provide its purpose or mission, goals, donor information, and any outside interests.[83]

The information contained in this form is useful to donors and board members, but it is often unavailable for a long period of time. The form is typically publically available only after 12-18 months following the end of the nonprofit's fiscal year.[84] Thus, consumers, students, and employees are not permitted to see a complete financial picture as discussed in Part VI.

IRS Form 990 has several supplemental Schedules for disclosure information not directly reported on Form 990.[85] The table at the end of this Part lists each Schedule of Form 990 and its purpose.[86] Specific schedules of interest are Schedules E, G, and J.

Schedule E is required only by nonprofit schools.[87] It contains disclosures related to discrimination policies, recordkeeping, admissions, and scholarships.[88] Schedule G requires disclosures related to fundraising and gaming.[89] Specifically, nonprofits must disclose individual or business entities who held fundraisers for the nonprofits, the receipts and expenses generated by the fundraiser, and it contains detailed information about each fundraising event.[90] Schedule J requires nonprofits to disclose their key and highest paid employees'

82. *Id.*

83. Form 990 from *Form 990 Series*, *supra* note 30.

84. *How long does it take for Forms 990 to appear on Foundation Center's website?*, GRANTSPACE.ORG, https://grantspace.org/resources/knowledge-base/lag-time/ (last visited July 26, 2018).

85. Supplemental Schedules from *Form 990 Series*, INTERNAL REVENUE SERV.: REQUIRED FILING, https://www.irs.gov/pub/irs-pdf/f990.pdf (last updated July 25, 2019).

86. *Id.*

87. Schedule E from *Form 990 Series*, INTERNAL REVENUE SERV.: REQUIRED FILING, https://www.irs.gov/pub/irs-pdf/f990se.pdf (last updated July 25, 2019).

88. *Id.*

89. Schedule G from *Form 990 Series*, INTERNAL REVENUE SERV.: REQUIRED FILING, https://www.irs.gov/pub/irs-pdf/f990sg.pdf (last updated July 25, 2019).

90. *Id.*

compensation.[91] These disclosures include base compensation, bonus and incentive compensation, retirement compensation, and other nontaxable benefit.[92]

<u>Schedule</u>	**<u>Type of Information Disclosed on Schedule</u>**
A	Nonprofit's Support Provided to Public Charities
B	Gifts and other Contributions Received by the Nonprofit
C	Nonprofit's Campaign and Lobbying Expenses
D	Donations Received by the Nonprofit; Reconciliation of Revenue and Nonprofit's Expenses from Financial Statements and Tax Return
E	Discrimination, Admissions, Scholarship and Record-keeping Policies (Nonprofit Schools Only)
F	Nonprofit's Foreign Grants
G	Nonprofit's Fundraising and Gaming Activity
H	Financial Assistance, Management, and Facilities (Hospitals Only)
I	Nonprofit's Grants within the United States
J	Nonprofit's Key and Highest Paid Employee's Compensation Information
K	Nonprofit's Tax-exempt Bonds
L	Determines if Nonprofit's governing members are independent
M	Noncash Contributions Received by the Nonprofit
N	Nonprofit's Asset Disposal
O	Supplemental Information not Included on other Schedules
R	Nonprofit's Subsidiary Disclosures

Table 1.[93]

91. Schedule J from *Form 990 Series*, INTERNAL REVENUE SERV.: REQUIRED FILING, https://www.irs.gov/pub/irs-pdf/f990sj.pdf (last updated July 25, 2019).

92. *Id.*

93. *Form 990 Series*, INTERNAL REVENUE SERV.: REQUIRED FILING, https://www.irs.gov/charities-non-profits/required-filing-form-990-series (last updated July 25, 2019).

VII. ANALYSIS

Nonprofit boards are not often held liable for their absent or poor management. As established in Part II, lack of standing to sue nonprofits prevents those individuals adversely affected by nonprofits to hold nonprofits accountable.[94] As established in Part I, cases which are brought forth against nonprofits fail to hold nonprofits accountable due to protection under the Business Judgement Rule.[95] These protections prevent nonprofits from being held accountable after breaches occur, so safeguards must be set in place to prevent breaches before the fact.

Further, **s**takeholders of nonprofits continued to be denied standing to sue nonprofits for malfeasance of the board of directors. In *Lundberg ex rel. Orient Foundation v. Coleman*, the court held a nonprofit board member lacked standing to bring suit against other directors for breaches for fiduciary duties. [96] The court found this suit was the responsibility of the state's AG.[97] If even members of nonprofit boards of directors are not granted standing to oversee each other, it is reasonable to conclude other stakeholders will not be granted standing to sue them. After all, board members have access to organizational information unavailable to stakeholders, the public, and Attorney Generals.

In Sweet Briar, as discussed in Part III, the AG did not take action either. In fact, a county attorney rather than the AG led the case against Sweet Briar. Significant controversy was

94. *See, e.g.*, Steeneck v. Univ. of Bridgeport, 668 A.2d 688 (Conn. 1995) (holding that students, donors, alumni, and trustees of a university lacked standing to sue the university); O'Donnell v. Sardegna, 646 A.2d 398 (Ct. App. Md. 1994) (holding that subscribers to a nonprofit health insurance company did not have standing to sue);
Tishok v. Dep't of Educ., 133 A.3d 118 (Pa. Commw. Ct. 2016) (holding that college alumnae did not have standing to sue the university); Carl J. Herzog Found., Inc. v. Univ. of Bridgeport, 699 A.2d 995 (Conn. 1997) (holding that a donor did not have standing to sue the university).

95. Brock Built, LLC v. Blake, 686 S.E.2d 425, 431 (Ga. Ct. App. 2009).

96. Lundberg *ex rel.* Orient Found. v. Coleman, 60 P.3d 595, 598 (Wash. Ct. App. 2002).

97. *Id.* at 599.

associated with the county attorney leading this case, since this oversight is traditionally the responsibility of the AG.[98] Further, the AG did not file suit against American University president Benjamin Ladner for his malfeasant actions.[99] As stated previously, other stakeholders would also likely have failed to impose liability on Ladner and the American University board if they had tried, due to traditional lack of standing, to sue nonprofits.

As discussed in Part IV, nonprofit colleges are required to make several disclosures to qualify for federal funding. These disclosures are important, but they do not, alone, guarantee nonprofit consumer protection. One method of ensuring nonprofit stakeholder protection is for the IRS to strengthen Form 990 by requiring faster and more in depth disclosures.

a. Timeliness of Form 990

If colleges and other institutions are required and able to make disclosures available quickly as mentioned in Part IV, it should be possible for nonprofits also to make their Form 990 available in a timely fashion. Consumers examining the form are, in most cases, examining financial information that is two years old. In today's technologically advanced world, it is preposterous that an electronic process takes two years to shed light on nonprofits operating in the shadows. Consumers use 990 information to make investment and donation decisions, so it is imperative that correct and timely information on Form 990 is available.[100]

As discussed in Part IV, nonprofit colleges must provide numerous disclosures to the public.[101] Most of these disclo-

98. Hurd, *supra* note 32, at 236.
99. Kusiak, *supra* note 27, at 132–133.
100. Maureen Butler & Brian Butler, *Telling the not-for-profit story through Form 990*, J. OF ACCT. (Dec. 1, 2016), https://www.journalofaccountancy.com/issues/2016/dec/irs-form-990-for-not-for-profits.html.
101. *Compliance Matrix*, *supra* note 61.

sures are required to be completed six to ten months following the end of the college's fiscal year.[102] If nonprofit colleges can compile data and make computations for these numerous disclosures in a timely fashion, it follows they should also be able to make their financial data available quickly. The IRS oversees nonprofits through Form 990, and requiring faster reporting would allow stakeholders to complete due diligence sooner and make better donation decisions.

There are several reasons why Forms 990 are not filed in a timely way. For example, penalties for late filing are too lenient to be effective. According to the IRS, penalties for failure to file are as follows:

> A penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirements for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one return is $10,000. Any person, who willfully fails to comply with the public inspection requirements for annual returns, will be subject to an additional penalty of $5,000.[103]

While this late filing penalty may severely punish a medium-sized nonprofit organization, it is not severe enough to compel compliance for large nonprofits. Board members may derive more benefit from improper behavior than what it costs them through this penalty. For example, AU president improperly spent over $500,000, far greater than the penalty for noncompliance.[104] For board members, the gains they receive

102. *Id.*

103. *Political Organization Filing Requirements: Penalties for Failing to Make Forms 990 Publicly Available*, INTERNAL REVENUE SERV.: EXEMPT ORG. TYPES, https://www.irs.gov/charities-non-profits/political-organizations/political-organization-filing-requirements-penalties-for-failing-to-make-forms-990-publicly-available (last updated May 10, 2018).

104. Kusiak, *supra* note 27, at 132.

from mismanagement are far greater than this penalty which they would incur for their nonprofit failing to file or intentionally providing false information. Further, tax-exempt nonprofits with gross receipts below $50,000 may fill out Form 990-N instead of Form 990, but no penalty exists for late filing of Form 990-N.[105]

Another cause of late filing is the allowance for nonprofits to obtain an automatic extension.[106] Nonprofits may file Form 8868, which allows nonprofits to obtain automatically an extension to file.[107] Removing this option to defer would guarantee nonprofits file sooner.[108]

Coupled with the option to file electronically, there is no reason nonprofits should take 18 months to file form 990.[109] If colleges (including nonprofits) and banks can quickly make disclosures, such as those discussed in Part IV, available, nonprofit colleges should also be able quickly to disclose financial information.

In some cases, it may be possible for nonprofits to forego filing Form 990 altogether. Nonprofits which fail to file Form 990 for three consecutive years will lose their tax-exempt status.[110] Therefore, it follows that nonprofit institutions could elect to complete Form 990 only every third year and still retain tax exempt status.

105. *Annual Electronic Filing Requirement for Small Exempt Organizations – Form 990-N (e-Postcard)*, INTERNAL REVENUE SERV.: CHARITIES AND NONPROFITS, https://www.irs.gov/charities-non-profits/annual-electronic-filing-requirement-for-small-exempt-organizations-form-990-n-e-postcard (last updated June 29, 2018).

106. *About Form 8868, Application for Extension of Time to File an Exempt Organization Return*, INTERNAL REVENUE SERV.: FORMS AND INSTRUCTIONS, https://www.irs.gov/ forms-pubs/about-form-8868 (last updated July 25, 2019).

107. *Id.*

108. *Federal Filing Requirements for Nonprofits*, NAT'L COUNCIL OF NONPROFITS, https://www.councilofnonprofits.org/tools-resources/federal-filing-requirements-nonprofits (last visited July 26, 2018).

109. *e-File for Charities and Non-Profits*, INTERNAL REVENUE SERV.: MODERNIZED E-FILE, https://www.irs.gov/e-file-providers/e-file-for-charities-and-non-profits (last updated June 1, 2018).

110. *Revoked? Reinstated? Learn More*, INTERNAL REVENUE SERV.: LIFECYCLE OF AN EXEMPT ORG., https://www.irs.gov/charities-non-profits/automatic-revocation-of-exemption (last updated June 28, 2018).

b. Subject Matter Issues with Form 990

When Forms 990 are filed, they often contain errors.[111] According to a recent study published by the IRS, twenty percent of completed forms contained mathematical errors, thirty percent lacked the nonprofit's purpose, and others misreported income or compensation.[112] Further, it is common for nonprofits to fail to complete all "required" sections. [113] Simply implementing software which prohibits submittal of the form until all "required" sections are completing will resolve this issue. This malfeasant behavior of omitting necessary information from Form 990 by nonprofits hurts stakeholders. If a Form 990 incorrectly reports information about a nonprofit (or if it lacks information altogether), then the nonprofit stakeholders will not have credible information they need to make business related decisions or donations. Finally, board members of nonprofits should be personally liable for information provided on form 990 as are officers of corporations responsible for financial statements pursuant to Sarbanes-Oxley.[114]

Another problem with Form 990 is nonprofits have an incentive to report information incorrectly. The Form 990 is a primary resource stakeholders use when performing due diligence to decide if they want to contribute to a nonprofit, so it is important nonprofits ensure their 990 disclosures are accurate and correct.[115] Nonprofits will likely use written sections on their Forms 990 to obtain stakeholders' financial assistance.[116] It is possible nonprofits may exaggerate their financial stability to attract donors. There are numerous articles with infor-

111. Cheryl Chasin, Debra Kawecki, & David Jones, From *2002 Exempt Organizations Continuing Professional Education: G-Form 990,* INTERNAL REVENUE SERV., https://www.irs.gov/pub/irs-tege/eotopicg02.pdf.

112. *Id.* at 233.

113. *Id.*

114. 15 U.S.C. § 7241(a).

115. *See, e.g.*, Butler, *supra* note 99.

116. *Id.*

mation regarding how nonprofits can use their Forms 990 to attract donors.[117] This reinforces the idea that exaggerated reporting may be a problem.[118]

Furthermore, open-ended questions do not have easily analyzable answers, so this increases difficulty of the IRS to oversee nonprofits.[119] For example, Line 1 reads, "Briefly describe the organization's mission or most significant activities."[120] There is no clear definition of a "significant activity." A nonprofit may complete this line with rhetoric simply to influence donors.

Finally, Form 990 needs more disclosures with the purpose of preventing abuse of board power. Form 990 requires nonprofits to disclose the names and compensation of any key employee who receive excess of $100,000 per year.[121] It would also be beneficial for nonprofits to disclose excess business related expenses each key employee incurs; this disclosure would allow investors to be aware of any questionable spending by employees of the nonprofit such as in the case of American University.[122] This disclosure would ideally be included in Schedule J along with other information related to employee compensation.[123]

Sweet Briar Institute may not have closed if more detailed information was required for nonprofit colleges. For example, Schedule E could require disclosures pertaining to en-

117. *See, e.g.*, Butler, *supra* note 99 (encouraging that nonprofits carefully answer narrative section for the purpose of influencing shareholders); *Tell Your Not-for-Profit's Story with Form 990 Schedule O*, AM. INST. OF CPAS (Aug. 4, 2017), https://www.aicpa.org/interestareas/notforprofit/resources/taxcompliance/990-schedule-o.html (encouraging that nonprofits use Schedule O to highlight positive information of the nonprofit for the purpose of swaying donors); *IRS Form 990 is an Opportunity for Not-for-Profits to Shine*, AM. INST. OF CPAS (Apr. 13, 2016), http://blog.aicpa.org/2016/04/irs-form-990-is-opportunity-for-not-for-profits-to-shine.html#sthash.Gkt78F9r.dpbs. (encouraging that nonprofits consider their donors' opinions when completing Form 990).

118. *Id.*

119. Butler, *supra* note 99.

120. Form 990 from *Form 990 Series*, *supra* note 30.

121. *Id.*

122. Kusiak, *supra* note 27, at 131-132.

123. *See, e.g.*, Schedule J from *Form 990 Series*, *supra* note 90.

rollment trends. This information would have prevented Sweet Briar's board of directors from misleading stakeholders when they stated enrollment was low.[124]

In the case of Burlington College, perhaps greater disclosures about predicted cash inflows related to capital budgeting projects would have prevented it from closing. These types of disclosures on Form 990 will minimize board member abuse of power and allow potential stakeholders to make better decisions. There is currently no Schedule or requirement related to this type of disclosure; therefore, it follows creating a new schedule requiring acquisition information would be beneficial.

Burlington College's situation also would not have been as severe if disclosures related to recruitment expenditures were required. Significant funds were squandered during a recruitment trip in China. Recruitment disclosures could be required on Schedule E along with other nonprofit school information.[125] It would also follow for this information to be reported on Schedule G along with fundraising information. These suggestions represent only a few of many disclosures which would protect nonprofit stakeholders.

VIII. CONCLUSION

Private colleges are closing at an increasing rate due to mismanagement by their boards of directors. Because of inadequate standing to sue nonprofits and courts not questioning board decisions due to the business judgement rule, management of nonprofits is minimal after mishaps occur. Prevention measures must be established to ensure these breaches are prevented on the front-end. One solution is to strengthen IRS Form 990 by enforcing faster and more in-depth disclosures. This solution will allow stakeholders of nonprofits, such as

124. *See, e.g.*, Schedule E from *Form 990 Series*, *supra* note 86.
125. *Id.*

Burlington College and Sweet Briar, to complete their due diligence, make informed decisions faster and more efficiently, and increase the likelihood that such educational institutions will survive and thrive.