

Felonious Philanthropists

By John Barkhamer, Jeff Krehely, and Rick Cohen

In the wake of June's Senate Finance Committee hearings on corruption and malfeasance among some of the nation's private foundations, one might think that foundations do not want to be associated with corporate leaders whose questionable behaviors gave rise to the Sarbanes-Oxley corporate accountability legislation and now serve as grist for weekly jury deliberations.

NCRP recently released "Serving Time ... on Foundation Boards," a report that provides a list of individuals who have been accused or convicted of committing some type of corporate fraud, yet who are still serving on foundation boards of directors. It also discusses recent federal legislation designed to clean up the scandals plaguing the nation's for-profit organizations, as well as New York state's proposed efforts to better regulate its foundation and nonprofit sectors.

Actions by the Ford Foundation during the summer of 2003 prompted this research. The New York Times reported last year that Ford decided to retain Paul Allaire on its board of directors, even after the Securities and Exchange Commission (SEC) had fined him for questionable financial reporting and accounting practices as the chief executive officer of the Xerox Corporation and barred him from serving on the board of any publicly traded company (Allaire finally resigned from Ford's board in May 2004). This story raised the question of how many other individuals involved with the torrent of recent corporate scandals were still serving on foundation boards of directors.

To answer this question, a list of 80 recently alleged, confessed, or convicted corporate criminals was compiled from a range of sources, including SEC press releases from 2002 to the present. Each name was then searched for in the Foundation Center's Foundation Directory Online.¹ This search found the following, based on the Foundation Center's data:

- Nine corporate reprobates serving on boards of personal/family foundations;

- Two corporate malefactors serving on boards of both personal/family and independent foundations; and
- Two corporate rogues serving on boards of independent foundations.

Some of the individuals found serving on foundation boards have become household names, such as Enron's Kenneth Lay and Jeffrey Skilling, and Tyco's Dennis Kozlowski, while others are less familiar. Not including Ford, the foundations involved have assets that range from a relatively paltry \$200,000 up to nearly \$500 million, and total about \$1 billion.

The report acknowledges that this handful of individuals does not constitute the entirety of corporate scofflaws engaged in private philanthropy, either their own or as a member of a governing board of an independent foundation. Indeed, they represent the continuation of a dynamic of some of the less admirable players in the U.S. private market system—building or bolstering their good name and image through philanthropy—with nary a raised eyebrow from the philanthropic sector.

Unfortunately, current laws and regulations do not require those who commit corporate fraud to be removed from private corporations, such as foundations. They generally only bar people from serving with publicly traded companies. When the potential for corporate fraud exists, the SEC investigates the matter and, if necessary, seeks (from a federal judge or SEC administrative law judge) an officer-and-director (O&D) bar for the person in question. Bars are also agreed to as parts of settlements, in which an individual may agree to a settlement with no admission of guilt or the formal finding of facts related to a case.

Recent corporate scandals and their impact on the nation's economy and workforce have motivated the SEC to remove more corporate criminals from leadership positions at the nation's publicly traded companies. The recent increase in the number of O&D bars reflects

this interest, as well as the impact of relatively new regulations that make O&D bar rulings easier to obtain. In particular, under Sections 305 and 1105 of the Sarbanes-Oxley Act, passed in the wake of the Enron scandal, the SEC can seek an O&D bar in administrative proceedings before the SEC's own administrative law judges. Previously, the SEC could seek a bar only in federal court, a process that requires full-fledged discovery, as opposed to an administrative proceeding, which is expedited and has very limited discovery. The act also lowers the standard the SEC must meet for obtaining the bar from "substantially unfit" to "unfit." In 2000, there were 38 O&D bars; in 2001, 51; and in 2002 (the last year for which data are available), 126.²

SEC records indicate that the following individuals are either temporarily or permanently barred or sought to be barred from serving as board members or officers of publicly traded companies. Except for Allaire, all of the people listed appear to be still serving on foundation boards.

- Paul A. Allaire (5-year bar).
- Dean L. Buntrock
(term undisclosed/sought to be barred).
- Andrew S. Fastow (permanent bar).
- L. Dennis Kozlowski (permanent/sought).
- Phillip B. Rooney (term unknown/sought).
- Richard Scrushy (permanent/sought).
- Jeffrey K. Skilling (permanent/sought).
- Mark H. Swartz (permanent/sought).
- Frank E. Walsh (permanent).

By virtue of the comparative SEC actions, Allaire is hardly the worst of corporate leaders parading in front of the commission, much less those whose fates are being decided by judges and juries.

Currently, only the SEC possesses the power to seek O&D bars, and—once again—only has authority to bar people from serving as leaders of publicly traded companies. Considering that

foundations have no shareholders who can exert pressure on executive and board leadership to behave legally and ethically, and that experts estimate 45 percent of foundation assets (including family foundations) can be considered public dollars—thanks to tax breaks related to establishing and operating a foundation—the government needs to have authority to protect and defend the public's interest.

Quite simply, coverage of O&D bars needs to be expanded to include the nonprofit and foundation sectors. It is logical to believe that if individuals are barred from serving as an officer or director of a publicly traded corporation, then they should also be barred from serving as an officer or director of a private foundation or other nonprofit organization.

Options for expanding O&D bars to include foundations and nonprofit organizations include the following:

- Expand SEC O&D rulings to foundations and nonprofit organizations, effectively expanding the mandate of the SEC outside of publicly traded companies;
- Empower a current agency (aside from the SEC) to seek and issue O&D bars in the foundation and nonprofit sectors; or
- Create a standard that strongly encourages and recommends—but does not require—foundations and nonprofit organizations to bar individuals who have received an SEC O&D bar from serving as officers, directors, or trustees.

The SEC currently has no jurisdiction over private foundations and nonprofit organizations, which would make the first option difficult to implement. And based on the tendency of foundation leaders to defend and protect their colleagues when they face public scrutiny, as well as the failure of the foundation sector to police itself in recent years, the third option is not feasible.

Considering that the Internal Revenue Service is currently charged with regulating foundations and nonprofit organizations, the second option appears to be the most logical to legislate and implement. Legislation could be proposed that simply mandates that whenever individuals receive an O&D bar from the SEC, then they are also barred from serving as an officer, director or trustee of a foundation or nonprofit organization. The SEC would be required to notify the IRS when individuals have received an O&D bar, and the IRS would then conduct a search to see if those individuals are on the board of a registered foundation or nonprofit organization. If they are, then the IRS notifies the individuals (and other executives, directors and trustees of the foundation or nonprofit organization) that they must cease involvement with the foundation or organization within a predetermined period of time. A follow-up audit would check to ensure that the individuals have in fact ceased involvement with the foundation or nonprofit organization.

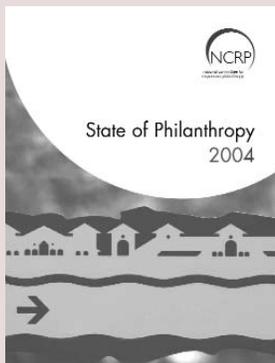
Unlike for-profit companies, there is no body of shareholders to provide oversight of a foundation. Similarly, the public does not get a

chance to vote foundation leaders out of office. Consequently, the government has an obligation to make sure that foundations are using and managing their resources effectively and legally. Expanding O&D bars to the foundation and nonprofit sectors is one way for the government to do just that. But the major responsibility lies with the foundation sector itself to steer clear of felonious philanthropists and to boot them out of the philanthropic communities whenever they sneak through the door.

Foundations often tap individuals from the for-profit sector for board service because of their specialized skills and abilities. Since an individual's skills and abilities can be so easily transferred from a for-profit corporation to a private foundation, it is easy to assume—and fear—that their illegal and unethical behavior can be transferred as well.

Notes

1. These searches took place during January 2004.
2. Based on fiscal years that begin on October 1 and end on September 30.



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