

Why All the Fuss About the Sarbanes-Oxley Act?

By Susan Budak

Only two of the 60+ sections of the Sarbanes-Oxley Act of 2002 apply to nonprofit organizations, yet recent surveys found that most financial executives of nonprofit organizations are familiar with the Act. Why is this Act, whose passage was fueled by public outrage at the corporate frauds committed by Enron, Worldcom, and others, being read and discussed by the management and governing boards of nonprofit organizations?

It could be that the nonprofit sector also experienced scandals during this same period, and several states' attorneys general have pushed to subject nonprofit organizations to rules similar to those that must be followed by publicly-traded companies as a result of the Act. (For a chart describing pending bills and proposals, see www.ncna.org.) However, the attention to the Sarbanes-Oxley Act is greater than those proposals warrant.

Instead, it is more likely that nonprofit management and governing boards expect that regulatory, investor, and donor communities may demand more transparent financial reporting and accountability from their organizations once they become accustomed to receiving the information demanded by the Act of publicly traded corporations. In other words, nonprofit management and governing boards are determining how they should respond when asked, "Why should nonprofit organizations be held to lesser standards of transparency and accountability?"

Perhaps more importantly, the Sarbanes-Oxley Act contains many requirements that could become best practices for governance of nonprofit organizations. Governing board members, especially ones who work for publicly traded companies that must comply, may want to ensure that their organization adopts certain provisions of the Act to improve internal control and minimize the risk of scandal. A nonprofit organization should consider implementing the following practices, most of which were established by the Sarbanes-Oxley Act and other regulations that resulted from the recent scandals among publicly traded corporations:

- ❖ A nonprofit organization should consider increasing the number of independent members of its governing board.
- ❖ A nonprofit organization that does not have an audit committee should establish one, and an organization that has an audit committee should review it to see if it operates within the guidelines in the Sarbanes-Oxley Act.
- ❖ A nonprofit organization should minimize loans to executives and board members, particularly loans with provisions that forgive all or a portion of the loan principal.
- ❖ A nonprofit organization that does not have a code of ethics policy should implement one, and an organization that has a policy should review it to see whether it needs to be updated or expanded.
- ❖ A nonprofit organization should assess whether its internal-control systems are operating at a level that will deter and detect fraud and whether the organizational culture promotes honesty and ethical behavior.
- ❖ A nonprofit organization should evaluate the financial savvy of its program directors and staff and, if necessary, conduct training on using financial statements and on being accountable during the budgeting and financial management processes.

- ❖ The lead audit partner and the reviewing partner should rotate off of the audit every five years.
- ❖ The CEO, Controller, CFO, Chief Accounting Officer, or any person in an equivalent position should not have been employed by the organization's audit firm during the one-year period preceding the audit unless the audit committee is directly involved in the audit.
- ❖ The audit committee should establish procedures for the receipt, documentation, and resolution of complaints regarding accounting, internal controls, and auditing, and ensure that employees are granted "whistleblower protection," which would prohibit the organization from taking certain punitive actions against employees who disclose information to the audit committee.
- ❖ A nonprofit organization should develop a written policy for records retention.

The two provisions of the Sarbanes-Oxley Act that directly affect nonprofit organizations are:

- ❖ It is a federal crime for anyone to "knowingly, with the intent to retaliate, take any action harmful to any person . . . for providing to a law enforcement officer any truthful information relating to the commission of a federal offense."
- ❖ It is a federal crime to alter, cover up, falsify, or destroy any document or make a false entry in accounting records with the intent of obstructing a federal investigation.

It is likely that the Act's other provisions will indirectly affect nonprofit organizations. Therefore, management of nonprofit organizations should start thinking about the Act's effects on the expectations of the board members, regulators, and donors who will be evaluating their organizations.

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