

Sarbanes-Oxley Act and Not-For-Profit Organizations.

Where are we today?

By Jim Welch



Sarbanes-Oxley Act of 2002 (the Act) was enacted by Congress in response to several high profile corporate accounting scandals in publicly traded companies. While the Act does not apply to Not-for-Profit Organizations (NFP), except for certain "whistleblower" and document destruction provisions, it has raised a variety of issues for NFP boards and management.

The provisions of the Act are generally aimed at corporate governance, management accountability for financial reporting, related party transactions and auditor oversight. Some of the requirements of the Act which have particular relevance to an NFP are:

Governance:

- ◆ The organization must have a code of ethics.
- ◆ There must be a policy providing protection to "whistleblowers" from retaliation.

Related Party Transactions:

- ◆ Loans to executives and board members are prohibited (an NFP is already constrained by the no private inurement provisions of the Internal Revenue Code).

Financial Reporting:

- ◆ The CEO and CFO must publicly attest to the fairness of the organization's financial statements and to the adequacy of its internal controls.
- ◆ Management must report annually on the quality of the organization's internal controls and the outside auditor must attest to the fairness of that report.

Auditor Oversight:

- ◆ The organization must have an audit committee.
- ◆ Members of the audit committee must be financially independent of the organization (management can't serve).
- ◆ All work performed by the outside auditor must be approved by the audit committee.
- ◆ There are restrictions on the type of nonaudit services that may be performed by the audit firm.
- ◆ There are various provisions regarding the auditors relating to retention of workpapers, independence, review of reports, rotation of partners and peer reviews.

This is a very comprehensive "to do" list for any NFP. The question for boards and management is do we have to do anything? If so, what should be done?

Before attempting to answer, some background is appropriate. The NFP sector provides invaluable services and constitutes a significant component of our economy. According to the panel on the NFP sector, NFP's provide almost 12 million jobs, which is 9% of the workforce. In my experience, volunteer activity at NFP's is indispensable to their mission and financial success. Charitable giving is vital to their well being and carries with it a responsibility to their constituencies, as well as reporting requirements to state oversight agencies.

The Act came along at a time when Congress and many states were expressing concern about governance and financial oversight in the NFP sector. In recent years NFP's have had their share of high profile abuse cases (many related to "excessive" executive compensation and benefits), which has resulted in Congressional hearings. Most likely legislation will result to expand reporting on the federal Form 990 and adopt some Sarbanes-Oxley like provisions. Massachusetts is also considering legislation proposed by the Attorney General to require governance and financial oversight similar to some of the provisions the Act.

So, where are we today? Without question, the increased public scrutiny has caught the attention of NFP boards and management. Many organizations had governance and financial oversight practices in place. Boards recognize that the Act raised the bar and that improvements are needed, but that full compliance with the Act, in most cases is not necessary to fulfill their fiduciary responsibilities. They are reviewing both governance and financial practices in light of the Act and trying to determine what fits given their size and complexity. Since Massachusetts has an audit requirement for public charities with revenue over \$500,000, many NFP's already have audits.

continued on back



Our experience over the past several years has been that NFP boards and management are responding to the changed climate and have:

1. Established an audit committee (or designated the finance committee to oversee the audit relationship).
2. Authorized the audit committee to engage the auditors, review and approve nonaudit services and develop committee charters. Audit committees are grappling with the best way to assess the adequacy of the organization's internal control without undertaking the costly process required by the Act.
3. Revisited governance practices (many have established governance review committees) and where needed adopted code of ethics and conflict of interest policies for the board and key management and "whistleblower" policies.
4. Adopted policies for identifying all compensation and benefits (including determining if they are reasonable) for key employees and approving their compensation at the board level.

The Act, combined with anticipated new federal and state reporting requirements has had a significant impact on the NFP sector. Boards are more attuned to their fiduciary responsibilities and interested in the best practices appropriate for the organization. They want to keep faith with their constituencies and fulfill the mission with good governance and cost effective oversight. Most organizations have good management and practices in place. Therefore, responding to new requirements and best practices has not been and should not be unduly burdensome. ♦

If you have any questions, please feel free to contact me at (781) 982-1001 or jwelch@nwscpas.com.