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The Sarbanes-Oxley Act: What Does It Mean for Not-for-Profits?

Since last summer's passage of the Sarbanes-Oxley Act, publicly traded companies have become subject to rigorous and far-reaching corporate governance regulations. Although the statute applies only to public companies, not-for-profits would be wise to comply with some of the regulations' requirements.

Earlier this year, New York State Attorney General Eliot Spitzer announced he would seek to impose requirements similar to those of Sarbanes-Oxley on not-for-profit organizations. Even if other states don't jump on Spitzer's bandwagon, not-for-profits could find themselves under pressure from funding sources, members and the media to comply with Sarbanes' standards for corporate responsibility.

Relevant Provisions

The most publicized provision of the legislation probably has been the requirement that a public company's chief executive officer (CEO) and chief financial officer (CFO) include a certification with the company's audit reports.

The executives must certify that the report "fairly presents, in all material respects, the financial condition and results of operations." Additionally, they must attest to the adequacy of the company's internal controls.

Companies also are required to establish audit committees, made up of board members. The audit committee is directly responsible for the independent auditors, including hiring, compensation and oversight. Auditors also report directly to the committee.

Audit committee members must be independent, and a company must disclose whether at least one member qualifies as a "financial expert" and, if not, why not.

What's a Not-for-Profit To Do?

Forward-thinking not-for-profit organizations are already reassessing some of their governance practices in light of Sarbanes-Oxley. They can put themselves ahead of the curve on compliance with potential future requirements by taking simple steps like having their CEOs and CFOs certify the accuracy, completeness and fairness of their financial statements and the adequacy of internal controls.

Not-for-profits also should establish audit committees; smaller organizations can have their finance committees serve as audit committees. The audit committee should be made up of board members.

To ensure independence, the committee can't include the CEO, CFO or other senior management nor any consultants or service providers. It should be determined whether any of the audit committee's members qualify as a financial expert — if not, such a member should be recruited.

Not-for-profit organizations should carefully consider so-called insider transactions, including executive compensation, fringe benefits and perks, cash advances, credit cards, loans and golden parachutes. Loans or credit arrangements with directors

and senior managers should be prohibited.

Conflict of interest policies should be formalized and extended beyond directors and officers. The policies should address the hiring of former consultants as staff members and vice versa, and provide for audit committee approval of non-audit services performed by auditors.

The conflicts policy ideally will evolve into an ethics code if one doesn't already exist, and should address the board and senior management's responsibility for oversight and accountability as well as outline their duties. Not-for-profits should then publicly disclose their adoption of ethics codes.