

Sarbanes-Oxley & Nonprofits

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Why is it important?

The Sarbanes-Oxley Act of 2002 was a response to what was felt to be widespread corruption and fraud by publicly-traded US corporations at the time. It was enacted on the heels of significant accounting scandals involving Enron, Worldcom, and Global Crossing and the Anderson accounting firm. This bill was not intended to cover nonprofits but recent developments in individual states have raised the possibility of a national initiative to place similar controls on nonprofits.

Developments since 2002

In January 2003, New York Attorney General Eliot Spitzer proposed legislation that would require that New York nonprofits comply with Sarbanes-Oxley. New York nonprofits protested the additional expense and to date, these discussions continue. On September 29th, 2004 California adopted the Nonprofit Integrity Act of 2004 - the first state to specifically extend Sarbanes-Oxley-type reforms to nonprofits. This was in response to a number of fundraising scandals involving nonprofits and political campaign fundraising. Massachusetts is currently considering legislation in this area. A 2005 high profile case in Minnesota resulted in the spin off of an HMO by Allina and Medica after the Attorney General Mike Hatch's audit uncovered aggressive collections, excessive executive compensation, and hidden expenses. Finally, the Senate Finance Committee is considering federal legislation that would extend this type of reform to nonprofits, nationally.

Scope and purpose of the 2002 Act

Sarbanes-Oxley requirements impose a high standard of ethical and fiduciary responsibility for publicly-traded corporations - to improve public confidence in their integrity. The requirements include board integrity, auditor independence, retention of audit firm for other work, board audit committee, record retention, financial statement review, and insider transactions and disclosure. There are also several provisions relating to criminal penalties for misconduct. The essential point is that board members must provide real oversight of the company.

Their role is protecting shareholders and ensuring that their decisions benefit the ongoing success of the company and not their own financial gain. Of particular interest to board members should be the checks and balances among senior executives as well as monitoring their financial gain.

Steps for nonprofits to minimize risk

Considering the inevitability of some type of legislative nonprofit oversight, there are things nonprofits can afford to do to minimize the risk of questionable practice or public scrutiny. Most of these things would be a part of any sound, professionally run nonprofit. Reviewing the cases mentioned, I suggest the following:

1. Focus on accomplishing your social mission - measurable outcomes
2. Maintain and adhere to strict board and staff conflict of interest policy
3. Board members put mission ahead of personal gain
4. Board makes procedural inquiries about internal financial controls
5. Maintain reasonable solvency - financial health
6. Pay reasonable market-based exec. compensation
7. Maintain reasonable fundraising expenses and use funds for intended purposes
8. Prepare financial statements on time
9. Maintain fully independent Audit Committee separate from your Finance Committee, with at least one audit expert
10. Annual audit by reputable, experienced accounting firm and do not use this firm for management consulting - bid this contract out periodically
11. Meet all government and funder reporting obligations - in spirit, by the letter, and on time
12. Have sound/fair contract bidding processes
13. Don't punish whistleblowers or destroy documents when questions arise.

Sources:

Philanthropy News Digest, January 2003, by Whitman, Janet
Faegre & Benson, 2005, by Ann C. McCullough
Caplin & Drysdale, 2005, by Marcus S. Owens
Minnesota Public Radio, 2005 by Tom Scheck