

BusinessGazette

WWW.GAZETTE.NET • FRIDAY, NOVEMBER 11, 2005

PRACTICAL MATTERS

Sarbanes-Oxley's impact on nonprofits

The Sarbanes-Oxley Act was enacted in 2002 in response to the accounting scandals of Enron and others. It is well known that it has resulted in dramatic changes in governance and accounting practices for public companies.

Far less publicized, but in many ways just as significant, is the impact Sarbanes-Oxley is having on nonprofits, many of which are headquartered in the Washington metropolitan area.

While the Act was written essentially to police publicly traded companies, many nonprofits are nevertheless looking at it as a catalyst to implement governance reforms. Sarbanes-Oxley provisions regarding retaliation against whistleblowers and its document-destruction prohibitions apply to everyone, so at a minimum, all nonprofits should have appropriate policies to ensure compliance with the law.

It is a crime for an employer to punish an employee who reports suspected illegal activity, so policies should be adopted that provide a process by which organizations can deal with complaints or allegations on a confidential basis, while making it clear that the employee is protected from retaliation. It is also a crime for anyone to knowingly alter, destroy or falsify any record with the intent to impede or influence any federal investigation or proceeding.

There is no one retention policy that fits all organizations. However, all such policies should include a clear mandate that once litigation, an investigation or a proceeding is under way or anticipated, the destruction of documents relating to the matter must immediately cease.

Many nonprofits are voluntarily instituting governance reforms growing out of Sarbanes-Oxley, even though most of the provisions are legally required only of public companies. It makes good business sense—and reflects any group's commitment to conduct itself responsibly—to implement such action items as



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establishing audit committees with detailed responsibilities, adopting a code of ethics and increasing the directors' focus on conflict-of-interest issues.

The audit committee should consist solely of "independent" directors—those who are not part of management and do not receive compensation other than reasonable director fees that may be paid to all directors. The committee's responsibilities include hiring the auditor, approving the auditor's compensation, ensuring the auditor's independence and reviewing the adequacy of the organization's internal controls and accounting policies. The responsibilities of the audit committee may be substantially more expansive depending on the organization.

Nonprofits should also have compensation committees comprised of independent directors that decide on the compensation of the CEO and determine or review the compensation of other key executive officers to ensure that it is fair and reflects the actual value to the organization.

CEOs and CFOs should be required to certify to their knowledge that the financial reports and other disclosures are accurate.

Nonprofits should also consider adopting and implementing a code of ethics that sets forth the values of the organization. While no two codes of ethics are the same, they often include a commitment to honest and ethical business conduct, and compliance with both the letter and spirit of the law. In addition, nonprofits should re-examine their conflict-of-interest policies to make sure they include proper disclosure and safeguards against self-dealing.

There is any number of excellent reasons why nonprofits should voluntarily adopt Sarbanes-Oxley-type reforms. It is probably only a matter of time before the federal and state governments begin to pass legislation applying similar reforms specifically to nonprofits. California, for example, has taken the lead and adopted the California Nonprofit Integrity Act with many similar provisions.

However, even in the absence of specific legislation, nonprofits should strongly consider governance reforms. It is well accepted that Sarbanes-Oxley-type controls and accountability are considered "best practices" of responsible organizations. Controls and accountability will be expected by contributors, organization members, and current and future directors.

As Sarbanes-Oxley-type requirements become more standard in the nonprofit world, failure to implement such requirements may be an indication of malfeasance, if and when financial problems arise. Most importantly, nonprofits serve the public sector, and in providing that service, they should highly value any steps that promote financial accountability, integrity and transparency.