



# The Public Road

## WHAT DOES THE SARBANES-OXLEY ACT MEAN TO TODAY'S NONPROFITS?

By Kristine Blenkhorn Rodriguez

The Sarbanes-Oxley Act (SOX) may have been chiefly designed for public corporations, but its winds of change have blown over to the nonprofit sector as well.

"There has been a 'trickle down' impact on nonprofits," says Kirsten Lescher, a CPA with Plante & Moran in Elgin, Ill. "Because many nonprofits have board members that come from the for-profit arena, as well as large donors—both corporate and individuals with corporate backgrounds—these constituents have played a significant role in imposing some of the principles underlying SOX as 'best practices' on the nonprofit community, particularly in the areas of improving governance."

SOX directly impacts nonprofits in two ways: First, in requiring no retaliation against whistleblowers, and second, in prohibiting document destruction in certain circumstances. "As a result, many organizations consider it a best practice to have both a whistleblower policy and a document retention and destruction policy," says Janice Rodgers, partner and chair of tax exempt organizations in the Chicago office of law firm Quarles & Brady.

While other SOX requirements may not speak directly to nonprofits, this new era of stepped-up corporate governance has not failed to touch them. SOX calls for independent directors, an audit committee to oversee the auditors, the presence of a financial expert on audit committees, CEO and CFO sign off on financial statements, and increased focus on internal controls, etc.

What's more, some states have adopted legislation requiring nonprofits to comply with certain aspects of SOX. And, in order to maintain public trust and to satisfy and attract donors, says Lescher, many nonprofits have voluntarily chosen to adopt many SOX provisions, particularly those relating to corporate governance reform.

"In today's environment in which there is increased competition for limited donor resources, many organizations feel that improving governance and financial transparency and accountability will help them to ensure continued financial support," she explains.

Take the Alzheimer's Association. It has instituted a records-retention policy, a hotline for confidential reporting of unethical or inappropriate practices, an independent audit committee, and more. "We are committed to adopting best practices because of the value we believe it provides. It sends a message to staff and donors that we believe in transparency and are good stewards of their donated dollars by ensuring that we are doing all we can to provide solid leadership for the organization and the cause," says Richard Hovland, chief administrative and financial officer of the Chicago-based association.

The American Institute of Certified Public Accountants has been very busy over the last two years fine-tuning auditing standards that impact nonprofits, clearly in reaction to SOX, says James Hill, founder of the Institute of Compliance & Learning in Chicago. The demand for safety and soundness for nonprofits is growing. Proactive nonprofit organizations are realizing that management control environments and board governance models are under public scrutiny.

For example, "Much of the gray has been taken out of determining what an internal control finding is. Nonprofit management is pretty scared of this one, as they are more likely to be written up for poor controls in 'SOX-like' ways. In the past they have been able to sometimes squash being written up by relying on the strength of the relationship and maybe even bullying their auditors. Not so easy to do anymore!" says Hill.





"There is now a 'two-way' communication that audit firms and their nonprofit boards must follow. This will have a powerful effect, as nonprofit management can no longer 'filter the relationship' between auditors and the board of directors," he says.

### Small Nonprofits, Big Hit

"This past June was the end of the first fiscal year where these new standards will come into play," Hill explains. "If (nonprofits) lack documentation, if they are not prepared for audits, they will be written up. This is all trickling down from SOX. The smaller organizations don't have the staff to prepare the internal control documentation and some don't have detailed corporate policies and procedures. It's likely to be a tough auditing season for some organizations."

What's more, says Robert Cameron, a CPA with the firm of Cameron, Smith & Company in Springfield, Ill., "Some small organizations are unable to segregate duties and implement a sound internal control system in the manner that SOX envisioned."

"On a scale of 1 to 10, the overall impact of the indirect and direct changes is about seven, with large organizations suffering a much lower impact," Hill explains.

The nonprofit sector is extremely large and diverse, and for many governance matters and best practices there is no one-size-fits-all. "Often, those in government and sometimes even membership organizations lose sight of that fact," says Rodgers. "If organizations focus on what will help them accomplish their missions, that is generally time (and money) well spent. But if they focus on SOX itself or what may suit a much larger or very different organization, the time and money invested may be out of proportion to the benefit achieved, and the result could even be detrimental to the accomplishment of the organization's mission."

Although the fact that the IRS is now paying more attention to nonprofit governance isn't a direct result of SOX, it does flow out of the climate created by the legislation, says Rodgers. "The IRS position is that a well-governed organization is more likely to be a tax-compliant organization, and this is probably true," she says.

The IRS has gone further by including a host of questions relating to policies and other governance practices on its new 2008 Form 990, the annual tax return filed by most nonprofit organizations. "The IRS freely admits that most of the policies and practices it inquires about are not required by the tax laws, but nonprofits will naturally feel compelled to take steps to be able to answer the way the IRS would like, whether or not the specific policies and practices would otherwise make the most sense for them. As more and more nonprofits become aware of these questions, this will result in a tremendous expenditure of time and money, much of which may not be necessary for good governance of particular organizations," says Rodgers.

Irwin Lyons, principal for Miller Cooper & Co. in Northbrook, Ill., says some small organizations are setting up committees to address the pressure, essentially trying to play the game the way a big corporation would. "Yet they have eight people in the office. They are spending a lot of resources and not getting much return. Most of the smaller organizations are happy to have active board members, let alone trying to find board members with financial expertise," he says.

### Rise to Meet New Challenges

For the United Cerebral Palsy Land of Lincoln in Springfield, Ill., SOX hasn't proved to be an operational headache. "Our auditors changed the recognition of administrative costs in the audit report, including maybe \$10,000 additional costs, and also included our fundraising costs under administrative costs in the Statement of Functional Expenses. We disclosed funders who donated more than \$5,000 in the 990 report. We make certain that any conflict of interest on the board of directors is acknowledged, and that board members may not vote on related issues. We have policies and procedures to cover this issue," explains CFO Char Fanning, CPA.

What's Fanning's advice for nonprofits? "Accreditation, programs of excellence, transparency, excellent internal controls, strong leadership, an active and superb board of directors, and excellent auditors are the recipe for no SOX problems. Also, use a good accounting system, one that is the best for tracking costs and leaving audit trails."

Jean Houston Shore, CPA, director and audit committee member for the National Speakers Association, says the focus on SOX-like governance has helped her organization identify policies that need to be created or strengthened. "Not only did we set up a separate audit committee, we updated our conflicts of interest policy and implemented a whistleblower policy. Strengthening governance helps our members trust that their board members and staff are acting in reasoned ways with a strong understanding of our fiduciary responsibilities," she explains.

It's been a challenge. "In volunteer organizations, progress toward the mission comes from harnessing the spirit and energy of volunteers, but asking these volunteers to focus on controls, financial reports and audits dampens their enthusiasm. While they understand financial oversight is important, they'd rather be spending their time on programs that help us achieve our mission," says Shore.

She sees three important factors on the horizon: "First, well-run nonprofits will take SOX-like governance requirements in stride. However, the importance of employing financially savvy staff will drive costs up at a time when revenues are stagnating. This will necessitate stricter cost control, which may not please volunteer leaders. Second, smaller or more loosely controlled nonprofits will struggle to comply, unless they can find assistance in their communities. Third, with the increased scrutiny, some nonprofit misdeeds will come to light and this may hurt donations for all nonprofits."

Don't wait until you're forced to do something. "Organizations that take their time to address best practices and attempt to implement practices meant to satisfy the overall intent of SOX will find themselves ahead of the curve," says Lescher.

Get your arms around the changes, know what's coming down the pike, and make a conscious decision about what you will and won't do. Form a task force to address all the changes, since this is likely to be too much for one person to handle. And consult knowledgeable counsel and auditors to assist in the process.

Rodgers offers a final piece of advice: "Keep the focus on what's best for accomplishing the mission, rather than going through the motions because someone says it's a good idea." □