

Financial Accountability in the Non-Profit Sector
The applicability of Sarbanes Oxley Principles to Non Profit Corporations

Gary Pannone, Esq.

Matthew Jill

The goal of Sarbanes-Oxley Act of 2002 ("SOX") was to restore public confidence and demand a higher level of accountability from executives and board members. Since the enactment of this legislation, the non-profit world has gained a heightened awareness of financial accountability. Federal and state lawmakers have either passed or introduced legislation that will impact the operation of non-profits now and in the future. During the 2006 session, the Rhode Island General Assembly introduced a form of what has been termed "mini-Sarbanes" legislation. Although the legislation was not passed, it should serve notice to the Rhode Island corporate community that executives and board members of private and non-profit organizations will be expected to improve financial disclosures and corporate governance policies in this state.

The so-called "mini-Sarbanes" legislation has been passed in several jurisdictions, including the state of California and Commonwealth of Massachusetts. Accountability, transparency and ethical compliance are the cornerstone of this legislation. Dealing with this increased scrutiny will become a balancing act for non-profits with costs and results being the primary issues. Examples of governance changes that are in line with the SOX type requirements are as follows:

1. Audit Committee

Perhaps the most significant aspect of SOX requirements is the

implementation of an audit committee by the governing board of directors of a non-profit organization. The audit committee is responsible for financial accountability and its implementation is considered a form of "best practices." The members of a properly constituted audit committee should include independent directors with at least one member possessing financial expertise. This committee is responsible for the selection of outside auditors who will review all aspects of the non-profit's financial accounting system. The audit committee interacts with the auditor in reviewing performance, accounting policies and procedures, financial decisions and internal controls of the organization.

2. Compensation Committee

Non-profit organizations will eventually be required to establish a separate committee comprised of independent directors charged with the responsibility of determining appropriate levels of compensation for the CEO and other officers. This committee will establish criteria for the review and scheduling of executive compensation based upon actual performance and the accomplishment specified goals and objectives. The compensation committee is responsible for making ongoing determinations regarding the effectiveness of executives by measuring performance against stated goals of the organization.

3. Certification Requirements

Although most non-profit executives are required to certify the financial statements of the organization through the form 990 filing, the internal controls and policies applicable to the executive director or chief executive officer will become a necessity rather than a luxury. It is expected that the executives will be required to certify the "accuracy of financial information" and not merely execute the 990. This requirement will necessarily cause changes in the method by which the organization assures accuracy of the financial statements and financial disclosures.

4. Business Code of Conduct

Adoption of a business code of conduct is an essential mitigating factor in adopting an effective corporate governance program. Codes of conduct should be applicable to directors, senior management, agents and employees of the non-profit and reflect a commitment to operating in the best interest of the nonprofit. The goal of the code of conduct should be to establish a minimum standard of accountability for all employees as to compliance with applicable law, accountability of financial information, and ethical business standards.

5. Reporting Mechanisms

Non-profit organizations must establish procedures for receiving, investigating and taking appropriate action regarding fraud or other compliance issues.

"Whistleblowers" must be protected from retaliation, thus a common and effective measure of monitoring compliance is an anonymous hotline. Designating an officer of the organization to receive information delivered through hotlines is a requirement of SOX.

6. Document Retention

The non-profit must develop and implement effective document retention policies regarding the storage and

destruction of documentation that is in compliance with applicable law. Policies should provide for the retention of documents that may be relevant to possible legal proceedings or government investigations. The internal controls regarding an effective document retention and destruction policy is an essential SOX requirement for the non-profit.

Oversight by the federal and state government is on the rise and will likely result in additional legislation requiring increased transparency with respect to the operation of non-profit organizations. As of this writing at least 17 states have either passed or introduced mini-Sarbanes legislation with many more releasing best practice policies for non-profits. In 2006, Rhode Island has also become more active in this area and legislation will likely be passed in the near future which will increase the level of scrutiny by agencies as well as require improved internal policies. The non-profit organization is best served to remain in the lead with respect to reform and the undertaking of an informal audit of policies and procedures is a prudent step in this process.

This outline is not a complete analysis and may not be relied upon as legal advice. Please contact Gary R. Pannone, Esquire for further consultation at 401-824-5115 or send an email to him at gpannone@pldw.com.