

# After SOX

## The implications of the Sarbanes-Oxley Act for institutions and affiliated foundations

By RITA FUERST ADAMS

**The whistle-blower protections and document-destruction policies outlined in SOX apply to all corporations—for profit and nonprofit.**

The recent downfall of seemingly successful companies like Enron, WorldCom, Global Crossing, and Tyco shook public confidence and eroded the trust these corporations long enjoyed. In the wake of these scandals, the U.S. government passed the American Competitiveness and Corporate Accountability Act (commonly referred to as the Sarbanes-Oxley Act or SOX) in July 2002 to restore confidence in public markets and independence and integrity to financial reporting of publicly traded companies.

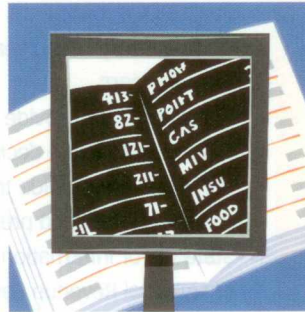
SOX significantly broadens the role board members of publicly traded companies play in overseeing companies' financial transactions and auditing procedures and seeks to strengthen the role of the board of directors in financial oversight, to create a firewall between the auditors and the management team they audit, and to provide opportunities for whistle-blowers to come forward.

Although most of SOX applies to publicly traded companies—not specifically to education institutions or their related foundations—many institution donors and trustees work for or sit on the boards of companies that must adhere to this new legislation. They might be aware that at least 14 states have introduced legislation modeled on SOX, some of which includes regulations for charitable and philanthropic organizations, and they are probably genuinely interested in how campus chief executive officers and chief financial officers are handling the issues SOX raises.

### ADAPTING SOX

Much of the Sarbanes-Oxley Act encourages the checks and balances that are already part of the laws and regulations governing education institutions.

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Various national organizations, however, are encouraging campuses and other nonprofits to adopt aspects of the act. The National Association of College and University Business Officers, Board Source, and Independent Sector are teaming up to suggest ways for institutions to comply with the spirit of the act. The suggestions they

offer address the composition and role of the audit committee, the role of the auditors hired, and the role of top administrators in financial management.

**Audit committees.** SOX mandates that public companies appoint an audit committee. Education institutions and their related foundations should consider complying with this mandate by appointing an audit committee composed of trustees, including at least one trustee who also is a financial expert.

Consider the audit committee the checks-and-balances system for financial management and operations: It receives the audit engagement letter, approves audit and nonaudit services before they are rendered, and is responsible for appointing, compensating, and overseeing the auditors.

Audit committees should operate independent of upper management, particularly CEOs and CFOs. Trustees should operate the committee according to a board-adopted charter specifying its tasks.

It is important for trustees to ensure the independence of the audit committee. Audit committee members should not be paid for their work in this role, even if they are compensated as board members, or they might lose their legal protection as volunteers.

**Auditors' role.** SOX addresses the independence of auditors and states that compliance is the auditing firm's responsibility. Setting and complying with their own standards, however, will best serve education institutions. To act in the spirit of SOX, the auditors institutions hire should

- report directly to the audit committee,
- disclose critical accounting policies and practices,



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- limit the services they provide other than the audit,
- rotate the lead partner off the account every five years, and
- prepare and present the audit engagement letter to the audit committee.

Many campuses have their auditors rotate the lead partner every 10 years; NACUBO recommends rotating the lead partner every seven years with a "time out" for two years.

Auditors can provide advice to institution managers to make decisions; answer technical questions; provide training, tools, and methodologies; and prepare federal and state tax or information return filings (including Internal Revenue Service form 990). Otherwise auditors should refrain from direct involvement in management issues or setting accounting or financial policies. Auditors are prohibited from performing management functions or making decisions, including developing or implementing accounting and information-technology systems, processing payroll, or posting transactions. Essentially, auditors cannot enact the recommendations they make in the management letter accompanying the audit and cannot audit their own work.

**Administrators' role.** NACUBO recommends that CEOs and CFOs adopt a code of ethics for themselves and for institution and foundation financial managers. It also recommends implementing policies and procedures to ensure compliance.

In the spirit of SOX, campus CEOs and CFOs should not only maintain accurate financial records and prepare accurate reports for all departments but document and demonstrate the accuracy of these records and reports. Senior managers should certify that internal controls are in place to cover the effectiveness and efficiency of financial operations, the reliability of financial reports, compliance with applicable laws and regulations, and policies and procedures to safeguard assets.

### UNCHARTED TERRITORY

Parts of SOX duplicate regulations education institutions are and have been complying

with for decades. The two areas SOX addresses that might be new to them are the whistle-blower protections and document-destruction policies, which apply to all corporations, for-profit and nonprofit. U.S. education institutions and foundations must comply with these parts of the act just like publicly traded companies do.

Institutions and foundations must provide confidential and anonymous opportunities for whistle-blowers to report concerns, such as hotlines, anonymous voice mail, anonymous e-mail, or secure suggestion boxes. There are penalties for retaliation against whistle-blowers. Campuses also must adopt formal policies to respond to employee concerns, which officials must investigate and, if they are justified, make corrections.

Institutions and foundations must have a written policy regarding document retention and periodic document destruction, including a stipulation that documents cannot be destroyed once an official investigation has begun. The policy must cover electronic documents and voice-mail messages, too, and it should address back-up procedures, archiving of documents, and regular check-ups of the reliability of the system.

It's important to remind donors and trustees that campuses already are under a great deal of scrutiny. Institutions that receive federal funding adhere to General Accounting Office standards related to auditor independence, which in many instances are more restrictive than the standards specified in Sarbanes-Oxley.

At the base of these rules, regulations, and laws is the fact that trustees have ethical and fiduciary duties to protect the best interests of the institutions and foundations they serve. Institutions' credibility depends upon the reliability of reported financial information and contributors' and the public's perception of that reliability. Trustees' and managers' understanding of the basic underlying accounting standards and rules is the first step toward credibility, accountability, and public acceptance. ■