



HANDOUT 1

Accountability for Nonprofit Organization

The Current Landscape

Sarbanes-Oxley Act

- July 30, 2002 President Bush signed the Sarbanes-Oxley Act of 2002 into law
- Introduced new requirements and responsibilities for public companies and their corporate officers, audit committee, board of directors and their accounting firm
- While not applicable to nonprofits, requirements have been forthcoming
 - State level proposals / cascade effect
 - Public perceptions

Key Provisions Relating to Nonprofit Organizations

Only two of the 60-plus sections of SOX apply to non-profits:

- Whistleblower provisions
- Record Retention

Both should be established by the Nonprofit

Key Provisions of SOX that Nonprofit Organizations Should Consider

- Increase the number of independent members on the board
- Minimize loans to executives and board members
- Implement code of ethics policy
- Rotate lead audit partners, ensure auditors follow other guidelines
- Adopt a conflict of interest policy
- Identify and review any business relationships with related parties

Key Provisions for NPO to Consider – Financial

- Evaluate financial capabilities of staff and board
- Assess and document internal control systems
- Perform more thorough reviews of annual audit and quarterly financial information
- Consider management's certification of financial statements
- Enhance financial statement disclosure
- Evaluate financial capabilities of staff and board
- Rotate lead audit partners, ensure auditors follow other guidelines

Key Provisions for NPO to Consider – Audit Committee

- Establish an Audit Committee and a charter
- Complete self-assessment of the committee
- Committee composition
 - Financial Expert
 - Adequate number of independent members
- Hold planning meetings and executive sessions with auditors
- Ensure all management letter comments are implemented



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Sarbanes-Oxley Act (Continued)

Key Provisions Relating to Public Accounting Profession

- Auditor independence
 - No provision for rotating firms
 - Partner rotation
 - Prohibited services
 - Conflict of interest
- Auditor reports to Audit Committee
- Auditor certification on internal controls
- Do not employ auditor in key positions within one year of performing the audit

Key Provisions Relating to Audit Committees

- Each member of audit committee must be independent
- At least one of the members must be a “financial expert”
- Directly responsible for appointment, compensation and oversight of public accounting firm
- All auditing and non-auditing services must be pre-approved by committee
- Establish procedures for handling complaints (whistle blower protection)
- Discuss with auditor prior to issuing audited financial statements:
 - Critical accounting policies and alternative treatments
 - Management letter, waived adjustments and material written communications
- Have authority to engage independent counsel and other advisors

Key Provisions Relating to Corporate Responsibility

- CEO/CFO certifications of financial results
 - No untrue statement or omission of a material fact
 - Presented fairly
- CEO/CFO certifications of internal controls
 - Designed to ensure material information is made known
 - Evaluated effectiveness of controls within 90 days of report
 - Present conclusions about effectiveness
 - Disclose to the auditors and audit committee all significant deficiencies
- Forfeiture of bonuses if restatement due to fraud
- Company loans to directors/officers prohibited
- Unlawful to fraudulently influence, coerce, manipulate or mislead auditors

Key Provisions Relating to Financial and Other Disclosures

- Disclosure of material correcting adjustments
- Off-balance sheet transactions and pro forma financial information
- Disclosure of transactions involving management and principal stockholders
- Management assessment of internal controls
- Disclosure of code of ethics
- Disclosure of Audit Committee “Financial Expert”



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Senate Finance Committee Work on Nonprofit Oversight and Accountability

The Senate Finance Committee is expected to draft legislation on nonprofit oversight and accountability in 2005. This is expected to be the most significant overhaul of nonprofit regulation since 1969. The following are some significant reforms discussed in preliminary hearings and discussions surrounding the potential legislation:

- Requiring the nonprofit organization to reapply for its tax-exempt status on every fifth anniversary of its initial tax exemption approval. Certain information may be required to be filed every five years including articles of incorporation, bylaws, conflicts of interest policies, evidence of accreditation (if applicable), management policies regarding best practices, a detailed narrative about the organization's practices and financial statements, with such information being made publicly available. The IRS would not be required to issue a new determination letter, but may be permitted to revoke the tax-exempt status. There has also been discussion of a potential sliding scale processing fee to cover the costs of these reviews.
- Limiting amounts paid for travel, meals and accommodations to the applicable U.S. government rate, or a potential alternative established/published nonprofit corporate rate.
- Requiring the signature of the Chief Executive Officer (or equivalent) to sign a declaration under penalties of perjury that the CEO (or equivalent) has put in place processes and procedures to ensure that the organization's Form 990 (and 990-T, if applicable) complies with the Internal Revenue Code and that the CEO was provided reasonable assurance of the accuracy and completeness of all material aspects of the return. This declaration would be part of the information or tax return.
- Increasing penalties for failure to file complete, timely and accurate Form 990s, as well as requiring electronic filing of the Form.
- Enhancing public availability of documents including disclosure of financial statements, posting the application for tax exemption, the IRS determination letter and five years' worth of financial statements on the organization's web site.
- Requiring public disclosure of the Form 990-T.
- Encouraging strong governance and best practices for exempt organizations including defining board duties, establishing board composition guidelines and potential IRS authority to remove board members who have violated self-dealing rules, conflicts of interest, excess benefit transaction rules, private inurement rules or charitable solicitation laws.

In addition, there has been discussion of an authorization of funding to the IRS to support a potential accreditation program for charities nationwide. Furthermore, during these discussions, the IRS Commissioner noted that the IRS has increased its budget for tax-exempt enforcement by 20%; stating that previously less than 0.5% of nonprofits currently get audited.



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State Legislation – California Nonprofit Integrity Act

The state of California passed a new law that will change the way nonprofit organizations who are registered with California's attorney general's Registry of Charitable Trusts manage their finances and seek contributions within the state. This law is effective January 1, 2005 and is targeted towards charities with gross annual revenues of \$2 million or more. The following are the significant provisions of Senate Bill 1262:

- An audit committee, separate from the finance committee, must be appointed by the board of directors. It can include people who are not board members, but it cannot include any staff members of the charity.
- The board of directors of all sizes are required to review and approve the compensation, including benefits, of each charity's president or chief executive officer and its treasurer or chief financial officer to assure that the compensation is "just and reasonable."
- Charities with gross annual revenue of \$2 million or more are required to prepare financial statements audited by independent certified public accountants annually. These audited statements must be made available for inspection by the state attorney general and the public no later than nine months after the end of the fiscal year to which the statements apply.

In addition, there are certain requirements and disclosures necessary for commercial fund raisers soliciting funds on behalf of the charity in California.