

soundwaves

NAVIGATING THE FUTURE
Information and Risk Management Ideas for Not-for-Profit Organizations

Keeping the Public Trust

Nonprofit Accountability Key in Post Sarbanes-Oxley World

When Congress enacted the Sarbanes-Oxley Act of 2002, lawmakers put publicly owned companies on notice that federal regulators would no longer tolerate shoddy accounting practices. Company officials and board of directors could be held personally liable for any financial misstatements. The act, which includes provisions dealing with accounting oversight, auditor independence, corporate responsibility, and enhanced financial disclosures, gave companies a new set of rules for the 21st century.

While the majority of Sarbanes-Oxley's provisions apply only to publicly owned companies, both private companies and nonprofit organizations have increasingly felt its impact. Because no matter what type of organization you're in, you are accountable to someone. For nonprofits, it includes donors, clients (those you serve), the government and the public at large.

The need to demonstrate accountability has been bolstered by efforts at the national level and in some state legislatures to expand Sarbanes-Oxley's reach to nonprofit organizations.

At the national level, the Senate Finance Committee has been looking into nonprofit oversight for the last couple of years. In response, the National Council of Nonprofit Associations (NCNA) developed a *Blueprint for Action*. The document calls on federal legislatures to support public policies that strengthen the nonprofit sector, including enacting accountability and oversight policies that increase the quality of information provided by nonprofits.

In a July 28, 2004 press release, NCNA Executive Director Audrey R. Alvarado said that Americans "rely on a well-functioning and accessible nonprofit service delivery network provided through thousands of community-based organizations. Policies and practices that support and nurture these valuable resources are essential to building and maintaining communities of hope and opportunity while eliminating the forces of hopelessness and despair."

While the U.S. Congress has not to date imposed any new oversight requirements on nonprofits, some state legislatures have moved ahead. In California, legislation that took effect January 1, 2005, requires all charities,

regardless of size, to make their audited financial statements available to the public and says every nonprofit "must establish and exercise control over its fundraising activities conducted for its benefit, including approval of all contracts and agreements." Massachusetts and several other states have also imposed new financial reporting requirements.

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The good news for nonprofits is you're starting off with more public trust than either the business sector or the government. According to the *2006 Edelman Trust Barometer*, 54 percent of those polled in the United States said they trust nongovernmental organizations "to do what's right." That compares to just 49 percent for business, 38 percent for government, and 30 percent for the media. More important, trust in nongovernmental organizations has risen over the last five years from a low of 41 percent in the aftermath of the 9/11 fundraising scandals.

So how do you keep the public trust? "Donors are going to contribute to an organization that's accountable and transparent and wants to do the right thing," says Susan Brinkeroff, an attorney with General Counsel, P.C., of McLean, Virginia, and former general counsel at the National Center for Missing and Exploited Children (NCMEC). "A nonprofit organization's obligation to its stakeholders is as robust as a publicly traded company's obligation to its shareholders."

Liz Marenakos agrees. The Enterprise Solutions Product Line Manager for Charleston-based Blackbaud, Marenakos says, "Sarbanes-Oxley has made nonprofits more conscious of how they need to control risk and govern their organizations." She cautions, however, "being more transparent imposes a new level of scrutiny that nonprofits have not been used to."

Marenakos highlights several steps nonprofits should take to bring their policies and procedures into line with the spirit of Sarbanes-Oxley:

- **Put an audit committee in place.** Marenakos notes that just having an audit committee isn't enough; members need to understand what automated systems and internal controls your nonprofit has in place and whether they are properly integrated. Equally important, she says, committee members should have appropriate expertise to understand both the internal controls and what the audit—and the auditor—are saying.

"The National Center for Missing and Exploited Children had a finance committee that worked with its auditors," says Brinkeroff. "After Sarbanes-Oxley, we revised the responsibilities of the committee to bring it into line with the oversight duties spelled out in the law."
- **Have a written code of business conduct and ethics.** Brinkeroff notes, for example, the NCMEC staff drafted a code of ethics shortly after Sarbanes-Oxley was enacted. And she stresses, "the board of directors was totally involved in reviewing and revising the code before approving it."
- **Understand whistleblower requirements.** Sarbanes-Oxley's ban on retaliation against an employee for certain whistleblower activities applies statutorily to nonprofits. NCMEC hired an external company to take anonymous whistleblower complaints in order to allay employees' fears of retaliation.
- **Report finances on a timely basis.** Avoid late reporting to validate results.
- **Assess internal controls on a regular basis.** "Assessing internal controls takes companies a lot of time and effort—and the same holds true for nonprofits," says Marenakos. She notes that technology companies are seeing an increasing demand from both the for-profit and nonprofit sectors for integrated software solutions to mitigate the risk of errors in the processing of financial transactions.

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"Sarbanes-Oxley has made nonprofits more conscious of how they need to control risk and govern their organizations."

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While the upfront effort to comply with the spirit of Sarbanes-Oxley may seem like a lot of work, it's worth it in the end, says Brinkerhoff. "We realized that aligning our policies with Sarbanes-Oxley and emerging state mandates would not be burdensome," she says. "Instead, it reinforced to our stakeholders that the National Center for Missing and Exploited Children wanted to do the right thing, and that we were exercising a good faith intent to comply with the spirit of the law."

Ethics and Compliance

While much of the accountability focus has been on Sarbanes-Oxley, for-profit organizations and nonprofits alike also need to take note of changes in the Federal Sentencing Guidelines. While you'll sometimes hear corporate officials refer to the guidelines, nonprofits have been slower to take note.

Changes implemented in 2004, which apply to nonprofits, provide guidance to organizations on how to mitigate the impact of criminal activity and how to put in place an effective ethics and compliance program. The changes, contained in Chapter 8, Part B¹, set standards for establishing "due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law."

Among its provisions, Chapter 8, Part B, requires organizations to make sure their ethics and compliance programs are followed, including monitoring and auditing to detect criminal conduct. An organization must also "take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program...by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities."

Organizations receiving federal grants should be particularly attentive to these requirements, as you could lose your funding and potentially be subject to fines if you don't have an effective ethics and compliance program in place. Implementing a program, on the other hand, not only puts your organization in compliance with the law but also signals to stakeholders that you have both good business practices and a written ethics policy.

Once the new guidelines went into force, the National Center for Missing and Exploited Children held a mandatory compliance training session for all employees—from CEO to entry-level secretary. As part of the training, staff reviewed all NCMEC's policies at some length, from lobbying rules to email and document retention guidelines.

Brinkerhoff stresses that nonprofits are "ahead of the curve if you can show the public you are taking steps to demonstrate ethics and accountability." Solid advice for the nonprofit sector—and your organization.

¹Chapter 8, Part B of the Federal Sentencing Guidelines is on the Web at http://www.ussc.gov/2004guid/8b2_1.htm.

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Correction:

The last edition of *Soundwaves*, *Navigating the Culture Wars*, incorrectly listed sources. Here is the correct information:

Mitchell Lee Marks, author of *Joining Forces: Making One Plus One Equal Three in Mergers and Acquisitions*, for his assistance: Department on Management, San Francisco State University, San Francisco, CA 94114; tel.: 415-436-9066; email: MitchLM@aol.com.

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