

GREAT BOARDS

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Sarbanes-Oxley heads to not-for-profit sector

By Barry S. Bader

Speculation that provisions of the Sarbanes-Oxley Act—or SOX—apply to the not-for-profit sector has turned in recent months from a question of “if” to a matter of “when and how.”

A flurry of reports and initiatives has quickly come from influential public and private groups. They include:

- **Senate Finance Committee.**

The committee, chaired by Sen. Chuck Grassley, R-Iowa, is working on legislative reforms to curb abuses and improve charities’ accountability to taxpayers and potential donors. The committee held hearings in May, and afterward sent a letter posing 46 questions to 10 large health systems asking them to account for their charitable activities and defend their tax-exempt status.

- **Independent Sector.**

At the behest of the Senate Finance Committee, Independent Sector—a coalition of corporations, foundations and private volunteer groups that works to strengthen America’s nonprofit organizations—formed a prestigious panel of charitable sector leaders to come up with recommendations to strengthen accountability, transparency and governance. Their 80-page report recommends, among other things, that boards undertake a full review of their governing documents and policies at least every five years to stave

off a mandatory IRS review of charitable status. The report also recommended that the full board—not just a committee—approve executive compensation, and that at least a third of a board’s members be independent (i.e., no conflicts of interest). It called for boards to have separate audit committees and for IRS to require greater annual disclosure on its Form 990.

- **Moody’s and Fitch.**

Both rating agencies issued reports on not-for-profit governance. Fitch went further than Moody’s, saying not-for-profits should pursue not just the “easy-to-implement”

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provisions of SOX, but all the provisions, including controversial Section 404, which calls for costly audits of financial controls. When it assesses the creditworthiness of providers, Fitch plans to ask about the audit committee, its makeup and processes, and its policies regarding rotation of the audit firm or lead partner, which SOX requires every five years. It will ask if the organization plans to disclose quarterly and annual audited financial statements to bondholders, as private companies do,

and if it plans for the CEO and CFO to certify the statements, as SOX does. Fitch will inquire whether the provider plans to adopt Section 404, to what extent, and if not, how management and the board assess internal controls over financial reporting.

- **Tax authorities.**

IRS has initiatives underway to require greater disclosure on Form 990 and increase oversight of charitable organizations, particularly their executive compensation practices. Local governments are stepping up questioning of not-for-profit hospitals’ tax-exempt status.

While the outcome of all this activity is unpredictable, the shift toward greater accountability, transparency and governance effectiveness for the not-for-profit sector is unmistakable. The size and financial resources of hospitals and health systems, coupled with the tax breaks they receive, make them a prime target.

Some boards will wait to see final legislation before they act. Others already are proactive, publishing audited financials quarterly and initiating Section 404-style audits. Some are measuring the value of their community benefit services to ensure they exceed the value of their tax exemptions. In this case, being proactive is simply good governance. The time to act is now.

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