PLDW
NONPROFIT
ORGANIZATIONS

CLIENT ADVISORY:

FINANCIAL ACCOUNTABILITY AND THE NONPROFIT ORGANIZATION

Congress has enacted very complex legislation to improve financial accountability of public companies in order to restore confidence, and demand a higher level of integrity from executives and board members in the business community. The enactment of Sarbanes-Oxley ("SOX") has also forced the nonprofit community to have a greater sense of urgency in adopting best practices with respect to financial accountability. Federal and state lawmakers have either passed or introduced legislation that will impact the operation of nonprofits now and in the future.

Although the Rhode Island General Assembly introduces different forms of legislation each year that begin to appear like "mini-Sarbanes" legislation, thus far, this type of legislation has not survived the committee debates. Notwithstanding, its introduction for passage should serve notice to the Rhode Island nonprofit community that executives and board members will be expected to improve their business practices and become more transparent to donors.

California and the Commonwealth of Massachusetts have enacted this type of "mini-Sarbanes" legislation which places accountability, transparency and ethical compliance at the forefront for nonprofit organizations. Dealing with this increased scrutiny will become a balancing act for boards as they struggle with the cost benefit analysis of compliance. Examples of governance changes that are in line with the SOX type requirements will include:

Audit Committee

Perhaps the most significant aspect of SOX requirements is the requirement that boards appoint audit committees to oversee the financial reporting of the 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 nonprofit'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.

Compensation Committee

Nonprofit 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 of 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.

Certification Requirements

Although most nonprofit 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 have become a requirement rather than a good practice. The executive is now required to certify the "accuracy of financial information" and not merely execute the Form 990. This requirement has caused changes in the method by which the organization assures accuracy of the financial statements and financial disclosures.

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 nonprofit 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.

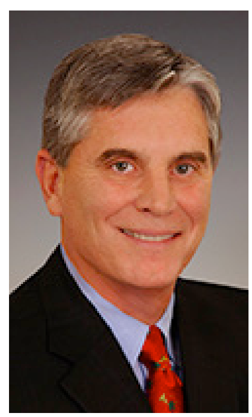
Reporting Mechanisms

Nonprofit 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.

Document Retention

The nonprofit 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 nonprofit.

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 nonprofit organizations. As of this writing at least almost forty percent of the states have either passed or introduced mini-Sarbanes legislation, with many more releasing best practice policies for nonprofits. The nonprofit 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.



GARY R. PANNONE
Managing Partner

Gary R. Pannone is the Managing Partner of Pannone Lopes Devereaux & West LLC and has been representing closely held business owners for thirty years. He is an experienced business lawyer specializing in the areas of business formations, corporate restructuring, mergers, acquisitions, corporate compliance and health care. His practice includes the representation of nonprofit organizations with respect to consolidations, mergers and acquisitions.