Sox research paper

Running head: Nonprofits and SOX Heather Tanenbaum Student ID: 3750548620 Accounting Capstone: Senior Seminar in Accounting ACC499 004016 Summer 2009 Nonprofits and the Sarbanes Oxley Act Submitted: Submitted to: Tee M. Thein Table of Contents Abstract Introduction SOX regulations for nonprofits Reasons for nonprofits to adopt SOX Conclusion Research file memorandumCommunicationmemorandum References Abstract Introduction The Sarbanes-Oxley Act (SOX) of 2002 (U.

S. House of Representatives 2002) was passed by congress as a result of a wave of accounting scandals and related financial irregularities in corporations such as Enron, WorldCom and Tyco. SOX is called the most significant securities legislation since 1933 and 1934 securities ACT. The Act attempted to make ethics more black and white rather than a gray area. The increased guidelines have changed businesses and business relationships.

These new requirements have placed greater demands on directors, audit committees, auditors and management. Most, of these provisions where only made towards publicly held companies, similar regulations targeted nonprofit organizations (Panel on the Nonprofit Sector 2005). Two hundred and fifteen nonprofit organizations have voluntarily adopted provisions of the Sarbanes-Oxley Act of 2002 (SOX). Many, nonprofits are currently in the process of adopting SOX.

The Panel on the Nonprofit Sector (2005), in its final report to Congress in June 2005, recommends more than 120 actions to be taken by charitable organizations, Congress and the IRS (Internal Revenue Service) to strength nonprofits against, transparency, governance andaccountability. The most significant provision of the Act is the requirements in Section 404 the reporting on the effectiveness of internal controls over the financial reporting. PCAOB auditing standard 2 requires that the audit of internal control be integrated with the audit of the financial statements.

The PCAOB requirements also only apply to public and private for profit companies, these would be new requirements for nonprofits wishing to adopt to SOX. The requirements of SOX section 404 requirements on internal controls have proven to be quite expensive for public companies (D'Aquila 2004; Pomeroy 2006), further research in to the current state of governance in the nonprofit sector would be beneficial before similar measures are mandated. Nonprofits have several reasons they might be compelled to adopt SOX provisions. First, several states are likely to emulate provisions similar to those of SOX.

Some of these new laws incorporate elements of SOX including: expanding whistleblower protection, requiring officers of the organization to sign the corporation's annual report, appointing an audit committee and increasing penalties against those who commit fraud or impede an investigation of fraud. California passed the Nonprofit Integrity Act in 2004. This Act addresses financial reporting, corporate governance, compensation, independence and fund raising (Silk and Fei 2005). New Hampshire requires audited financial statements for nonprofits with revenues greater than one million.

Massachusetts, Connecticut and Kansas have similar requirements (Anderson and Kelley 2006). Second, unethical behavior seems as common in the nonprofit organizations as it does in the private sector. Recent scandals in nonprofit organizations such as: The NYSE, Upsala College, United Way andEducation& Research Foundation, have had a negative effect on the public trust in their charitable organizations (Gibelman 1997). For nonprofits trust from the public is vital because the majority of their funds come from donors.

SOX could result in more positive responses from donors, investors and future board members (Orlikoff and Totten 2004). Finally, some provisions of SOX already apply to nonprofits. Nonprofits must establish whistleblower protection and document destruction policies. Other provisions are inevitable, because of the large amount of grants nonprofits receive which come with the own regulations and restrictions (BoardSource 2003). The purpose of this paper is to provide a reasonable understanding of how nonprofits have been affected by SOX. SOX regulations for nonprofits

SOX requires that companies have an audit committee that includes independent members and members of the board. SOX also requires the company to disclosure whether one of the internal auditor is a financial expert and whether they are directly responsible for overseeing the external auditors. This is to ensure that the financial statements are understand, that there is proper communication with the external auditors and that there is an understanding of internal controls. In order to enhance standards for nonprofit accountability and financial reporting all nonprofits should have an independent audit committee (BoardSource 2003).

Sox requires that nonprofits disclose whether a code of ethics has been adopted for senior financial officers. If they do not have a code of ethics reasons for not having one have to be disclosed. This is to encourage the development of a code of ethics in order to enhance trustworthiness to contributors and other constituents. The whistleblower protection policy applies to nonprofits as well as for profit organizations. This regulation protects whistleblowers from special damages and attorney’s fees. It also, prohibits the employer from punishing the whistleblower in any manner.

SOX provides additional protection for whistleblowers by, instating criminal penalties for actions taken against whistleblowers. Nonprofits should develop confidential and anonymous procedures for handling employee complaints. Although the CEO and CFO do not need to sign financial statements they do need to understand them and ensure that they are fairly presented in all materially respects. Theresponsibilityfor approving the financial statements ultimately belongs to the board of directors. Section 404 of SOX requires companies to include an internal controls report along with their annual report.

Their internal control report should state the responsibility of management to establish and maintain an internal control structure and procedures for financial reporting. It should also contain, an assessment at the end of the most recent fiscal year as to the effectiveness of internal controls and the procedures for financial reporting (O’Hare 2002; BoardSource 2003; Walters 2003; Tran 2005). SOX requires auditors of public companies to prepare and maintain audit workpapers and other information related to any report in sufficient detail to support the auditors conclusions, for a period not less than seven years.

Failing to do so is a criminal offence subject to fines and up to ten years in prison. Existing standards for audits of nonprofits do not include a mandated audit documentation retention period. Instead, those standards require nonprofits and auditors to retain records long enough to sastify any pertinent legal requirements of record retention. Reasons for nonprofits to adopt SOX Larger organizations with more resources will be more likely to adopt SOX. The public and media are more likely to be harsher on larger nonprofits, which makes them more likely to have stronger governance mechanisms.

The board of directors have the ultimate responsibility of overseeing properfinancial statementpresentation (BoardSource 2003; Walters 2003). Research on the relationship between board size and firm value has had mixed results. Yermack (1996) provides evidence that smaller boards are associated with a higher firm value. In 2008, Coles find that are diversified among industries or have high leverage, are more likely to benefit from a larger board of directors. Corporate governance characteristics, have been shown to be related to the size of the board.

Bradbury (1990) finds board size and intercompany ownership to be determinants of voluntary audit committees in public companies. In another study shows that larger boards are more likely to create audit committee boards (Beasley, Salterio, 2001). In a NASDAQ over the counter study done by Pincus (1989), he found that managerial ownership, leverage, size of the company, proportion of outside directors to total directors, use of Big 8 auditors and participation in the National Market System are related to voluntary formation of audit committees.

As a result as the size of the board of directors of a nonprofit increases, so does the likely hood that they will voluntarily adopt SOX. Nonprofits with independent boards of directors are also more likely to adopt SOX. The main reasons nonprofits would voluntarily adopt SOX would be to increase the trust in the public in order to receive more funds. However some nonprofits, feel that the provisions in SOX burden the nonprofits so much that it is beneficial not to adopt SOX.

These nonprofits strongly believe that SOX should not be required for nonprofits for the following reasons: • One, nonprofits are grassroots organizations with small staffs and have boards filled with community-minded people with little or no business and management background. If SOX was required out of these nonprofits, the staff would be overwhelmed, along with the board and it would take away from the nonprofits primary mission. • Two, nonprofits are already held to higher standards by the public then private or government agencies because, if the public doesn’t trust the organization they won’t donate theirmoney.

Also, nonprofits receive a large portion of their funds from government grants which are held to strict oversight and laws and regulations. • Three, certain regulations of SOX will increase overhead costs and make the nonprofits look less efficient to contributors. On the other hand, by voluntarily adopting SOX, nonprofits are showing to the public that they are concerned about protecting funds, increasing operating efficiency and effectiveness, also enhancing accountability. Conclusion Research file memorandum Communication memorandum References Anderson, S. , and C. L. Kelley. 2006.

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