

# ARTS Law Memo

## Sarbanes-Oxley Explained

In the wake of the Enron scandal and the subsequent revelations of numerous cases of corporate misconduct, sweeping legislation was enacted to reform the system of corporate financial oversight and to ensure better protection for employees and investors.

The Sarbanes-Oxley Act of 2002, nicknamed SOX, covers several broad areas, including enhanced financial disclosure, the role of accountants and auditors and procedures to stifle fraud. Two specific areas apply to all corporations — yes, that means nonprofit organizations: whistleblower protection and record retention/destruction.

Other SOX reforms, such as conflict of interest policies, independent audit committees and procedures governing and limiting executive compensation, are rapidly becoming best practices, so your organization should take steps to discuss how they may apply to your nonprofit.

This issue of *Arts Law Memo* explains the mandatory policies and outlines the overall policy making process.

Sample policies are available on VLAA's Web site, [www.vlaa.org](http://www.vlaa.org).

### WHISTLEBLOWER PROTECTION

The whistleblower provision requires nonprofit organizations to provide a safe and confidential method for employees to express concerns about questionable processes or to report criminal, fraudulent or unethical acts without fear of retaliation.

According to longtime whistleblowing researcher Roberta Ann Johnson, the first whistleblower law dates back to the Civil War. It addressed wartime profiteering. Ordinary citizens who exposed fraud were rewarded with a percentage of the money they saved the federal government. More recently, the term whistleblower evolved to

distinguish “ethical dissenters” like Ralph Nader from informants, stool pigeons and “friendly” witnesses.

Technically, whistleblower is defined as an employee who reveals wrongdoing within an organization to the public. Of course, it is better to learn about a problem internally than on the evening news or a letter from the state’s attorney general.

Adopting a whistleblower policy should not be viewed as regulatory burden. Instead, a user-friendly policy that is disseminated to your organization’s staff, board members and key volunteers will send a clear message that your organization promotes ethical behavior and does not tolerate misconduct. It also should be seen as part of the nonprofit sector’s larger effort to promote transparency and accountability.

The whistleblower policy should encourage staff, board members and volunteers to report suspected fraud or dishonest conduct in accordance with the procedures outlined in the policy.

Those procedures should provide multiple avenues for reporting concerns, including the option of raising a matter anonymously. The third-party hotline reporting systems used by major corporations would be overkill for all but the very largest cultural institutions.

The policy should make clear that all relevant matters, included suspected but unproven matters, will be thoroughly investigated and that appropriate corrective action will be taken. It should unambiguously state that whistleblowers have the right to raise concerns without being subject to reprisal and that those who engage in retaliation will face disciplinary action. At the same time, the whistleblowers should be cautioned to avoid baseless allegations.

Of course, merely adopting the policy is not enough to empower and protect those who step forward to report unethical or unlawful practices. The policy must be understood and vigorously enforced.

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VLAA helps artists and arts organizations solve and avoid legal and accounting problems by:

- Making referrals to lawyers and accountants;
- Mediating arts-related disputes;
- Publishing *Arts Law Memo* and concise how-to guides;
- Sponsoring seminars and public forums;
- Arranging for guest speakers;
- Maintaining a reference library;
- Operating an arts space clearinghouse;
- Supplying model contracts and other arts law and business materials;
- Facilitating meetings;
- Conducting and disseminating research;
- Contributing articles to publications;
- Collaborating on arts advocacy initiatives; and
- Providing access to the national volunteer lawyers for the arts network.

This issue was written by VLAA Executive Director Sue Greenberg. Special thanks to Fred Rusche, Susan Hagen, Dan Tierney, Jill Nowak, Christi Schultenijens and Shellie Hexter.

*This publication is distributed with the understanding that VLAA is not engaged in rendering legal or accounting counsel. We urge you to seek professional services to address your specific needs.*

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## RECORDS RETENTION

The SOX records retention provision makes it a crime to alter, conceal, falsify or destroy any document to prevent its use in an official proceeding. Failure to comply can result in criminal penalties including imprisonment and substantial fines.

While it is unlikely that a nonprofit arts organization will be involved in a fraud investigation or that your chief executive will join Ken Lay and Dennis Kozlowski in the rogue's gallery, the SOX policy record retention/destruction policy requirement should be seen as an opportunity to examine your organization's procedures — to consider what kinds of documents are critical to your work and to keep them as long as necessary, but no longer.

Have you ever wondered how long you should keep a contract, bank statements or employee records? Or are you keeping every single invoice? Is your arts organization tight on storage space? Are you tempted to pitch those moldy boxes that have not been opened since the first President Bush administration? Or would a trip to the dumpster conjure up images of Arthur Andersen employees in handcuffs?

Many nonprofits are unsure as to how long they should retain business documents and records. If you adopt and follow a well-crafted document retention policy, you will promote efficiency, saving your company valuable computer and physical storage space, ensuring compliance with applicable laws and protecting your organization in the remote chance of litigation.

A document retention policy provides for the systematic review, retention and destruction of documents received or created in the course of conducting business. The policy will identify documents that need to be maintained and contain guidelines for how long certain documents should be kept and how they should be destroyed.

What sort of records should a document retention policy cover? Categories include organization documents, such as your by-laws and tax-exempt letter from the IRS;

accounting and corporate tax records; employment documents; legal records, such as contracts, safety records and insurance policies; and fund-raising records, such as gift acknowledgement letters, which also can be important to your donors if they are audited.

Maintenance and destruction of electronic records, such as computer disks, emails, hard drives and Web pages, may be the most challenging part of the document retention policy.

When you develop your document retention policy be sure to consult with employees or technical consultants who maintain your data so they follow procedures that ensure your electronic

data is maintained as consistently as your hard data. Essential procedures include making paper copies of crucial documents, creating archive files, backing up computers, testing the backup procedures on a regular basis and storing back-up disks or tapes off premises.

While emergency planning may be addressed elsewhere in your organization's policies and procedures it is important to ensure that documents will be stored in a safe, secure and accessible manner. Please take appropriate measures to protect any materials that are vital to the continuation of your organization.

### **Whistleblower Policies: Questions for Discussion**

- In a general sense, does our organization value and encourage open communication?
- Does the proposed policy send a clear message that our organization promotes ethical behavior and does not tolerate misconduct?
- What procedures should we put into place for receiving complaints?
- What additional procedures are needed for handling confidential and anonymous complaints?
- How will we ensure that there are several avenues for reporting suspected fraud or waste? How will we ensure that complaints are taken seriously and thoroughly investigated? How will the results of the investigation be disseminated?
- What measures do we need to take to prevent retaliation, even if the claim is found to be without merit?
- How will the policy protect our volunteers, who do not have the same underlying job protection as employees?
- Has our attorney reviewed the proposed policy?
- After we adopt the policy, what steps will we need to take to ensure that the policy is disseminated, understood and enforced? Do our managers and supervisors need training so they are equipped to address employee concerns?

### **Records Retention Policies: Questions for Discussion**

- Are we safeguarding our organizations essential documents, including databases and other materials housed in our computers?
- Are records that are no longer needed being retained?
- As a practical matter, are there some documents that should be retained longer than required by law?
- Has our draft policy be reviewed by an accountant or an attorney to ensure that it complies with applicable federal and state laws and regulations?

# Guide to Policy Making

Although setting policy is a primary board responsibility, in all but a few situations, staff in put into board decision-making is essential because successful implementation depends on involving the organization's key employees in the entire process.

Policies reflect an organization's values, ensure continuity of management and delineate parameters that serve as guidelines for action or decisions. They help build and sustain public trust and the reputation of the organization.

Policy making is a multi-step process:

## Step 1: Define the Issue or Problem

The process of policy development begins with recognizing the need for written policy. Remember, the board is not alone in identifying policy needs. Staff, volunteers, donors, grantmakers, service organizations and government agencies are all sources of policy-related priorities.

## Step 2: Research

Gather the necessary information on the issue. Helpful resources include the experience of other organizations, articles and books and state or federal laws and regulations. It may also be appropriate to involve a lawyer throughout the development and adoption process.

**Sample policy language can streamline the process and is a good starting point. But it is never a good idea to simply insert your organization's name and present the document to the board for approval. The policy MUST be discussed and tailored to reflect your organization's culture, to conform to your other policies and to ensure that it is embraced by everyone involved in its implementation.**

## Step 3: Discuss and Debate at the Board Level

To set the stage for informed dialogue, consider assigning one board member to educate the board on the key issues to be addressed in the policy. A first step could be to examine your current practices in light of the contents of a model policy. Ask, "What changes should be made due to our special circumstances?" Encourage lively debate.

## Step 4: Draft the Policy

After the board has reached consensus on policy content, the board's policy writer goes to work. This person must be able to write clearly, directly and succinctly. Pomposity, verbosity, jargon and "legalese" should be avoided.

## Step 5: Read and Revise

Once in writing, the draft policy should be placed on the board's agenda. Be sure to distribute the draft in advance of the meeting. Again, begin with a presentation that summarizes the content. Then ask:

- Is the policy limited to one topic?
- Does it adequately cover the subject?
- Is it written in plain English? Is it brief and unambiguous?
- Does it support the organization's mission and goals?
- What editing is required so that anyone who must comply will easily understand the policy?
- Is it practical?
- Is it consistent with local, state and federal law?
- Is it sound business practice?
- Is it consistent with existing policies?
- Does it have the full support of the CEO and/or those who will be responsible for carrying out the policy?

Revise the policy based on the information gained from the questions, comments and suggestions obtained after the first reading.

## Step 6: Adopt the Policy

Before the policy is adopted, be sure the board understands what has been revised. Discuss what steps need to be taken to ensure that the policy accomplishes its goal.

## Step 7: Implementation

Policies should be centrally available. They should not be scattered about, discoverable only by scouring years of board meeting minutes. They should be disseminated to the staff and made available, on request, to the public and media. Above all, the policy — and the spirit of the policy — must be embraced and lived by everyone involved with its implementation or the policy will be meaningless.

## Step 8: Policy Evaluation and Revision

Up-to-date policies are the only ones that work. They can become out of date, unclear or even contrary to the way in which the organization is operating. Policies should be reviewed on a regular basis to ensure that they comply with applicable laws and the ethical guidelines established by professional and service organizations. The policy modification process is the same as the policy adoption process.

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## RESOURCES

*The Sarbanes-Oxley Act and Implications for Nonprofit Organizations* published by BoardSource and Independent Sector (available [www.independentsector.org/PDFs/sarbanesoxley.pdf](http://www.independentsector.org/PDFs/sarbanesoxley.pdf)) provides a thorough discussion of SOX that compares how the standards are being applied in the corporate and nonprofit arenas. Independent Sectors' *Checklist for Accountability* ([www.independentsector.org/issues/accountability/Checklist/index.html](http://www.independentsector.org/issues/accountability/Checklist/index.html)) is one a growing number of guides outlining best practices.

*Sarbanes-Oxley for Nonprofits* (2005) by Peggy M. Jackson and Toni Fogarty, the first book on the topic, does a good but repetitive job covering the standards covered in the legislation including audits, financial statements, teaching board members how to read and interpret financial statements, conflict of interest, whistleblower protection, records retention. Less useful are the sample policies included in the book.

*This book, and many others on arts law and business practices, are available at the St. Louis Volunteer Lawyers and Accountants for the Arts library, located within the Regional Arts Commission office, 6128 Delmar. The collection's catalogue is searchable on the Web, [www.vlaa.org](http://www.vlaa.org).*

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