

## THE IMPACT OF THE SARBANES-OXLEY ACT ON NOT-FOR-PROFIT ORGANIZATIONS

NOVEMBER 12, 2004

The Sarbanes-Oxley Act of 2002 (the "Act") and its related regulations are intended to promote accountability and transparency among companies that are issuers of publicly-traded securities ("Issuers"). The Act was not intended to apply to private companies or to not-for-profit organizations. Nonetheless, the Act's criminal provisions on "whistleblowers" and "document retention" apply to "whoever" knowingly does certain acts. Thus, these provisions arguably apply to persons associated with not-for-profits. As a result, many not-for-profits have been considering whether to adopt protective whistleblower and document-retention policies. In addition, not-for-profits are increasingly considering adopting a code of ethics as a matter of good governance. This memorandum summarizes each of these provisions.

### **Whistleblower Protections**

The Act provides for fines and imprisonment for up to 10 years for any person who retaliates against a whistleblower who provides truthful information to a law enforcement officer regarding the commission of a federal offense.<sup>1</sup> This provision is motivating not-for-profits to consider and adopt broadly-drawn whistleblower protections and procedures. While organizations in the tax-exempt sector have previously focused on procedures for reporting personnel and program issues, whistleblower procedures aimed at encouraging reporting of accounting or financial wrongdoing are likely new to most in the sector.

### **Document Retention**

The Act also provides fines and imprisonment for up to 20 years for any person who knowingly alters, destroys, mutilates, conceals, covers up or falsifies any record, document or tangible object with the intent to impede, obstruct, or influence the investigation or administration of any matter within the jurisdiction of any federal department or agency or any bankruptcy proceeding.<sup>2</sup> This document-retention provision is very broadly drawn. As a result, this provision is motivating not-for-profits to consider and adopt detailed document retention and destruction policies.

---

<sup>1</sup> Act Section 1107.

<sup>2</sup> Act Section 802. Act Section 1102 provides parallel penalties to any person who corruptly alters, destroys or conceals documents needed in an official proceeding.

## Code of Ethics

SEC rules adopted under the Act require an Issuer to disclose in its public filings whether it has adopted a code of ethics for its senior officers.<sup>3</sup> These rules define a “code of ethics” to mean any standards that are reasonably necessary to promote:

- honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- full, fair, accurate, timely and understandable disclosure in the Issuer’s public filings and communications; and
- compliance with governmental laws, rules and regulations.

These codes are also popularly referred to as “codes of business conduct” and “business codes.” They are plain-English policy statements on such matters as handling conflicts of interest and following email and Internet policies. Many Issuers have posted their codes on the Issuers’ websites where they are readily available for public review.

Not-for-profit organizations exist to serve the public, whether through provision of services or of grants. Public trust is thus critical to the success of their missions. Therefore, we recommend that not-for-profits consider adopting a code of ethics for directors, officers, and employees.

\* \* \*

We are continuing to monitor the impact of the Act on not-for-profit organizations and evolving practices in the sector. If you have questions or would like further information, please contact Victoria B. Bjorklund ([vbjorklund@stblaw.com](mailto:vbjorklund@stblaw.com), 212-455-2875), David A. Shevlin ([dshevlin@stblaw.com](mailto:dshevlin@stblaw.com), 212-455-3682) or any other member of the Firm’s Exempt Organizations Group.

SIMPSON THACHER & BARTLETT LLP

---

<sup>3</sup> Act Section 406 and Item 406 under Regulation S-K.