



**TOPIC:** **SARBANES-OXLEY, CORPORATE RESPONSIBILITY and COLLEGES AND UNIVERSITIES**

**DISCUSSION:** The [Sarbanes-Oxley](#) Act is a federal law enacted in response to the corporate accounting scandals of 2002. Among other things, it establishes a new oversight mechanism for the public accounting profession, creates new rules for the auditor/client relationship, and institutes new criminal penalties for corporate finance-related crimes. Most importantly for purposes of this note, the law establishes new "corporate responsibility"-related rules and procedures for executive, board and legal counsel conduct.

*Sarbanes-Oxley* itself, with limited exceptions noted below, applies only to publicly traded companies, their executives, and to public accounting firms. However, the public policy principles supporting *Sarbanes-Oxley* apply regardless of organizational status. Colleges and universities can expect to feel the impact of *Sarbanes-Oxley* in several ways:

- Closer scrutiny and questioning of institutional transactions and relationships by board members sensitized to a new environment of corporate responsibility in general and the obligations of trustees in particular;
- More vigilant enforcement and oversight by state agencies (e.g., attorneys general), the IRS and other regulatory entities with jurisdiction over the financial integrity and other aspects of non-profit, tax exempt organizations;
- The use of *Sarbanes-Oxley* provisions as models for future non-profit legislation and for standards of fiduciary conduct; and
- More rigorous review of transactions and financial statements by institutional auditors, and heightened oversight of and restrictions on auditors themselves.

In response to the new environment of corporate responsibility, college administrators may wish to consider (or may find that Board members, legislators or other state government officials insist upon), new policies or

practices that mirror many provisions of *Sarbanes-Oxley*. These might include:

- establishing a dedicated audit committee of the Board for the purpose of overseeing the accounting and financial reporting processes of the institution and audits of its financial statements, with specific duties and obligations of committee members and qualifications for members and direct reporting on key matters from the external auditor ([Secs. 204, 301](#));
- prohibiting the purchase of consulting services from the institution's external auditor; requiring periodic rotation of the audit firm and/or the lead audit partner; barring the engagement of audit firms that employ key institutional personnel within a year of the initiation of an audit and confirming that the audit firm will comply with rules for auditor professional conduct to be established by the new Public Company Accounting Oversight Board ([Secs. 201, 203, 206](#)).
- prohibiting officers and trustees from applying improper influence on the audit firm or employees engaged in the audit process ([Sec. 303](#)); and
- revising institutional policies to comply with new rules and prohibitions governing the destruction, alteration or falsification of records. [Sec. 802](#) of *Sarbanes-Oxley* creates a new federal criminal obstruction of justice offense that applies to all individuals, not just employees of publicly traded companies. It states:

**Sec. 1519. Destruction, alteration, or falsification of records in**

**Federal investigations and bankruptcy.** 'Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence *the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case*, shall be fined under this title, imprisoned not more than 20 years, or both (emphasis supplied).

The section provides for a broader criminal liability than existing federal obstruction of justice statutes, and other criminal statutes specifically applicable to higher education, e.g. see [§490 of the Higher Education Act](#). The scope of this new offense is very broad, and counsel will want to take steps to ensure that employees with custody or access to the records described are well informed of this provision.

In addition, *Sarbanes-Oxley* creates new rules of professional responsibility for

attorneys practicing before the SEC. Specifically, it obligates an attorney to report "evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the company or any agent thereof" to the chief legal counsel of the company ("CLO") or the CLO and the chief executive officer of the company (or the equivalent); and, if they do not respond appropriately to the evidence, the attorney is required to report the evidence to the audit committee, another committee of independent directors or the full board of directors.

A preliminary report by an ABA Task Force has already indicated that it may recommend similar revisions to the ABA Model Rules of Professional Conduct governing representation of organizations. If such recommendations are adopted, it is likely that there will be a significant impact on the ethical obligations of all corporate counsel, regardless of industry practices, as the separate states update their individual rules of attorney conduct.

## **SUMMARY:**

The *Sarbanes-Oxley* Act generally applies only to publicly traded companies. Regulatory agencies with jurisdiction over colleges and universities (e.g., state attorneys general and the IRS), however, are recognizing that the constituents of such nonprofit organizations have a very real stake in the financial integrity of these organizations and a deep interest in the types of problems and abuses *Sarbanes-Oxley* addresses. Accordingly, it may be a prudent course of action for colleges and universities to consider the prophylactic benefit of compliance with the most relevant provisions of *Sarbanes-Oxley*.

Key steps include understanding the applicable law, adopting a general philosophy of compliance, preserving the independence of the institutional audit, and reviewing and refining governance policies and procedures (including review of policies on conflicts of interest, confidentiality, executive compensation, investment management, and institutional audit). In addition, institutions may also wish to apply specific review procedures to major transactions to ensure compliance with applicable law governing non-profit organizations, and strengthen procedures for monitoring the application of restricted gifts and endowments.

## **RESOURCES for COUNSEL:**

**Statutory:** [\*Sarbanes-Oxley\* Act of 2002](#)

[SEC Final Rule on Certification of Financial Reports](#)

[SEC Proposed Rule on Auditor Independence](#)

[SEC Proposed Rule on Retention of Records Relevant to Audits](#)

[SEC Proposed Rule on Attorney Professional Conduct Standards](#)

[SEC Proposed Rule on Improper Influence on Audit](#)

[IRS Announcement 2002-87: Corporate Responsibility-Form 990](#)

**Non-Profit  
Corporate  
Responsibility  
Checklists:**

[Checklist for Review of Institutional Governance Policies and Procedures](#)

[Checklist for Board Decision-Making Processes](#)

[Non-Profit Law Checklist for Review of Major Transactions](#)

[Checklist for Monitoring Application of Restricted Gifts and Endowments](#)

[Checklist for Preserving Independence of Institutional Audit](#)

[Checklist for Auditing Executive Compensation](#)

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