

Influence Of The Sarbanes-Oxley Act On Governance Of Nonprofit Organizations

The Editor interviews **Stephen A. Timoni**, Partner and Chair of the Pro Bono Practice in Kirkpatrick & Lockhart LLP's Newark, New Jersey office.

Editor: What is the nature of your practice?

Timoni: I began my career as a certified public accountant in Price Waterhouse's New York office, where I continued to work after I completed my J.D. degree at Seton Hall University School of Law. I then went into private law practice and am now a partner with Kirkpatrick & Lockhart. Concentrating in the area of corporate law, I find that about 70 percent of my practice is in the life sciences field that includes the representation of pharmaceutical companies, and for profit and nonprofit health care organizations. I also serve as outside legal counsel to hotels, financial institutions, chemical manufacturers and food service companies. My health care clients include physicians, group medical practices, ambulatory care and surgical centers, hospitals, pharmacy benefit management companies, home health care agencies and long-term care facilities. I provide advice and counsel to these clients on entity formation and restructuring, mergers, licensing acquisitions, dissolutions, financings, taxes, asset valuation, fraud, regulatory matters, corporate governance and ethical issues.

I provide regular advice and counsel on a pro bono basis to nonprofit organizations such as a group home for the developmentally disabled and other community service organizations. I am a member of the board of trustees of the group home organization as well as a community non-profit hospital. Also in the nonprofit arena, K&L represents medical clinics, daycare centers and other nonprofit organizations on pro bono matters assigned through the ProBono Partnership, a very fine organization that coordinates pro bono counsel with local nonprofit organizations needing legal services in the New York, New Jersey, Connecticut metropolitan area.

Editor: How does the governance and ethical climate for nonprofit organizations differ from the for-profit arena?

Timoni: Historically nonprofit organizations, particularly in the health care industry, have been very focused on governance and ethical issues because of the numerous laws and regulations governing their operations. For example, the Stark Act prohibits a physician from referring patients for designated health services to hospitals or other health care entities with which the physician has a financial relationship. The various exceptions to this prohibition set forth in the Act, as well as its implementing regulations and the periodic amendments to the legislation, illustrate the complexity of the laws and regulations that contribute to a challenging governance and ethical climate for nonprofit organizations.

The Office of the Inspector General of the U.S. Department of Health and Human Services (OIG) over the years has developed compliance plan guidance to assist various healthcare entities' ethics officers and governing boards in their compliance efforts. In contrast with the Sarbanes-Oxley Act, the OIG's guidelines are industry specific and, unlike the dictates of the Sarbanes-Oxley Act that are mandatory, the OIG's guidelines are just that – they offer guidance. While they do not have the full force and effect of law, it behooves a



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nonprofit organization to follow them inasmuch as the OIG uses its guidelines in its investigation and enforcement actions.

First published in 1998, the OIG guidelines deal with corporate ethics, anti-kick back laws and various other obligations of a healthcare organization's officers and directors. The guidelines give examples of transactions and relationships that healthcare organizations need to avoid. In June, the OIG issued a supplemental compliance program guidance for hospitals in response to the increasing complexities of the health care industry.

Editor: How has the Sarbanes-Oxley Act impacted nonprofit organizations?

Timoni: Some of the directives of the Sarbanes-Oxley Act apply directly to nonprofit organizations. For example, nonprofit organizations, like for-profit companies, are subject to the Act's criminal provisions for destroying documents in the midst of a government investigation. The Act's whistleblowers retaliation protections also apply.

Editor: Why does it make a lot of sense for nonprofit organizations to become familiar with the Sarbanes-Oxley Act?

Timoni: A variety of government agencies and professional associations have undertaken initiatives to expand the Sarbanes-Oxley Act to nonprofit organizations. Similar initiatives are underway before the New York, Massachusetts and California legislatures, and state attorneys general are looking to apply the requirements of the Sarbanes-Oxley Act to nonprofit organizations. For example, State Attorney General Eliot Spitzer has introduced legislation to strengthen New York's corporate accountability laws. Pieces of such legislation would apply Sarbanes-Oxley standards to nonprofit organizations.

Editor: Please give an example of the federal government's initiatives to tighten regulation of nonprofit organizations.

Timoni: On June 22, the Senate Finance Committee under the leadership of Senator Charles Grassley (R-IA) held hearings to discuss proposals for tightening regulation of nonprofit organizations. Topics included setting caps on compensation for executives serving nonprofit organizations and investigating loans made by nonprofit organizations to their officers or trustees, particularly where the lender is a charity created by the borrower.

Editor: Like Congress, are federal agencies tightening regulation of nonprofit organizations?

Timoni: Yes. In September 2002, the IRS announced its proposed changes to the reporting requirements for many types of nonprofit organizations on Form 990. The form requires detailed disclosure of such information as income, expenses, assets and liabilities. The goal is to help a potential contributor to find out how much a charity spent on its programs, fundraising and administrative expenses in the then most recent fiscal year. The proposed changes cover the way fundraising expenses and transfers with other 501(c) organizations are reported.

In explaining its proposed changes, the IRS noted that recent events have raised concerns about the integrity of financial disclosures by publicly traded companies. Reflecting on the similarities between the need for veracity in the public information used by shareholders making investment decisions and the need for veracity in the public information used by contributors in making decisions regarding nonprofit organizations, the proposed changes tighten Form 990 disclosure requirements. Among the modifications, the nonprofit organizations are required to disclose on Form 990 whether they have adopted conflicts of interest policies or have an independent audit committee. These requirements are quite similar to the requirements for publicly traded companies under the Sarbanes-Oxley Act.

Editor: How are the federal sentencing guidelines tightening regulation of nonprofit organizations?

Timoni: Proposed revisions to the federal sentencing guidelines would be applicable to nonprofit, as well for-profit, organizations. They would tighten standards for effective compliance and ethics programs, including rigorous compliance oversight for senior management and board members.

Editor: What activity in the insurance industry is influencing the governance and ethics environment for nonprofit healthcare organizations?

Timoni: Certain state insurance departments that oversee the financial stability of managed healthcare organizations – many of which are nonprofit organizations – have taken an active role in the arena of corporate governance and ethics. More disclosure, ethics, corporate governance and oversight requirements, like those under the Sarbanes-Oxley Act, can be anticipated.

Editor: Where can general counsel for a nonprofit healthcare organization find guidance for navigating today's governance and ethics environment?

Timoni: One excellent place to begin is the collaborative resource developed by the OIG and the American Health Lawyers Association called *An Integrated Approach to Corporate Compliance: A Resource for Health Care Boards of Directors*. Published July 1, it supplements the April 2003 publication *Corporate Responsibility and Corporate Compliance: A Resource for Health Care Boards of Directors*.

Focused on the unique context of healthcare compliance and healthcare law, this helpful guidebook addresses the roles

of the in-house general counsel and chief compliance officer in supporting the compliance oversight function of the healthcare organization's governing board. The topics it covers include recent legal developments related to corporate responsibility and lawyers' professional ethical obligations. It also discusses the recent modifications of the Federal Sentencing Guidelines for Organizations, as well as the recommendations of the American Bar Association (ABA) Task Force on Corporate Responsibility. The guidebook reflects the OIG's expressed view regarding the risk of subordinating an organization's compliance function to its general counsel function.

Editor: Do you have any practical tips for an in-house counsel who is invited to serve on the board of a nonprofit organization?

Timoni: At the threshold, questions about conflicts of interest should be addressed when a lawyer is invited to serve on the board of a company. Does the in-house counsel or his/her company have any financial relationships with the nonprofit organization? The role of the in-house counsel board member should be clearly defined. Will the in-house counsel be asked to give legal advice to the organization? While a dual role has many benefits because the lawyer knows a great deal about the organization and would likely develop effective working relationships with other board members, potential conflicts in the relationship should be disclosed, discussed and resolved openly before the lawyer accepts a board position.

The ABA has some very good guidelines for lawyers invited to serve on a nonprofit organization's board. Entitled a "Guidebook for Directors of Nonprofit Organizations," it addresses such questions as how does a nonprofit board work? What do nonprofit directors do, how do they do it and for whom? What are the legal risks and implications for volunteers and board members of nonprofit organizations? What are the functions of a nonprofit organization's committees and advisory bodies? What are some examples of board orientation best practices?

First published in 1993, the most recent edition of the ABA's guidebook addresses today's changed political and legal environment for nonprofits; tax ramifications of for-profit ventures; employee relationships, laws and policies; and duties of directors in special circumstances, such as change-of-control events and bankruptcy.

Editor: What do you see on the horizon in the future governance and ethical landscape for nonprofit organizations?

Timoni: I see more regulation and more scrutiny as the government expands the regulatory landscape for nonprofit organizations. Corporate counsel must not stop learning. It is very important for them to be educated about their industry, their company and how their company fits within the industry. They should continually educate the company's board members, as well as its top management, about the legal and regulatory trends impacting corporate responsibility and corporate compliance. This educational process includes identification of potential problem areas with practical examples of how emerging laws and regulations would be applied. Corporate compliance and ethics should be a higher priority agenda item for every board meeting.