

Brief Summary of Sarbanes-Oxley Act of 2002

Many cooperative board members have expressed concern over the implications of Sarbanes- Oxley act for cooperatives. To help clarify Sarbanes- Oxley and its implications we have summarized a basic outline of some of the most important provisions of the Act. This summary is simply informative and not intended to be used as legal advice. These provisions do not directly affect cooperative boards, but should be used as a guide for *“best practices.”*

Sarbanes- Oxley Act (SOX) was designed to restore investor confidence following the outbreak of corporate scandals and bankruptcies around 2000. Currently SOX is only applicable to publicly traded companies under jurisdiction of SEC, but some states are pushing for application to large non- profit organizations.

Main Provisions:

Sarbanes- Oxley Act called for the creation of the *Public Company Accounting Oversight Board*. This board will register and regulate all public accounting firms, including: inspections of accounting firms, investigations and disciplinary proceedings, and enforce compliance with professional standards.

SOX also outlines the responsibilities of the accounting firms:

- Section 204- Auditors must report all critical accounting policies and practices to the firm’s audit committee.
- Section 203- The lead audit and reviewing partner must rotate off the audit every 5 years.
- Section 201- Prohibits any public accounting firm from providing non- audit services while auditing firm. These services include bookkeeping, appraisal, and others (excludes tax preparation).

Section 301 calls for the formation of an independent and competent audit committee. The audit committee is responsible for hiring, setting compensation, and supervising the auditor’s activities. SOX requires that each member of a firm’s audit committee be a member of the board of directors and be “independent.” The term “independent” means the members are not part of the management team and do not perform any consulting or professional services for the firm. In addition, it is recommended that each audit committee have a “financial expert” as part of the committee. The board of directors currently has freedom to define “financial expert” based on the individual’s education and background.

Section 302 requires the CEO and chief financial officers to certify that the financial statements accurately and fairly represent the financial

condition and operations of the company. There are criminal sanctions for intentional false certification.

Section 402 prohibits loans to any of the firm's directors or executives.

Section 409 requires rapid disclosure of material changes in the financial conditions of the firm.

Section 404 requires that each annual report contain an internal control report. This report states the responsibility of management for establishing and implementing adequate procedures for financial reporting. This report must include: assessment of effectiveness of internal control structure and procedures, any code of ethics and contents of that code.

Whistle Blower Protection

SOX provides new protection for whistle blowers and mandates criminal penalties for actions taken against whistle-blowers. It is now illegal for any (includes private firms) firm to punish whistle-blowers in any way. This portion of the SOX is especially important for co-op boards to follow as a best practice. All organizations should implement procedures for handling employee complaints referring to accounting or financial management practices. It is recommended that organizations establish an anonymous complaint process to encourage employees to report any inappropriate financial management practices.

Section 1102 makes it a crime for any person to destroy, alter, or conceal any document to prevent its use in official legal proceedings.

References and helpful links used to compile this summary and commentaries concerning Sarbanes- Oxley and cooperatives can be found at:

Sarbanes- Oxley Act and Implications for Nonprofit Organizations:
<http://www.boardsource.org/clientfiles/Sarbanes- Oxley.pdf>

Summary of Sarbanes- Oxley Act of 2002:
http://www.aicpa.org/info/Sarbanes_oxley_summary.htm

Rural Cooperatives November/December 2002, Commentary by Randall Torgerson: Integrity essential in reporting financial results
<http://www.rurdev.usda.gov/rbs/pub/nov02/nov02.pdf>

Penn Lines Cooperative News Magazine June 2003, Commentary: "Good Governance"

<http://www.prea.com/Pennlines/June2003.pdf>

Dorsey & Whitney LLP Ag Coop Alert: Cooperatives Should Consider Implementing Whistleblower Policy

http://www.dorsey.com/publications/legal_detail.aspx?FlashNavID=pubs_legal&pubid=135873303