



**THE IMPACT OF SARBANES-OXLEY  
ON PRIVATE & NONPROFIT COMPANIES**

**2006 NATIONAL DIRECTORS INSTITUTE  
Presented by:**

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## **Executive Summary**

- The Sarbanes-Oxley Act continues to have a significant impact on private organizations, as 86% of survey respondents felt that SOX and other corporate governance reform requirements have impacted their organizations.
- A majority (70%) of the private organizations surveyed have self-imposed corporate governance reforms.
- There is relative consistency in year-over-year results from 2004 to 2006 which we attribute to the realization of a “steady state.” In comparing the data, there are three groups consistently influencing the decision to adopt corporate governance standards: the organizations themselves, their board members and their auditors. We believe that the influence of these three groups fuels the continued adoption of these standards by private companies as perceived “best practices.”
- When the Sarbanes-Oxley Act was adopted, the Congressional record indicated that it was not intended to apply to any organization other than public companies. At that time, many commentators opined that regardless of the intent of Congress, these guidelines would eventually permeate all businesses under the guise of “best practices.” Although an unintended consequence, the verbatim responses we received over the past three years indicate this is in fact happening.
- The most common aspects of corporate governance reform that responding private organizations have implemented or plan to implement in response to the regulations on public companies have remained consistent year over year and include:
  - Audited financial statements
  - Establishing independent directors
  - Audit committee oversight of auditors
  - Establishment of a corporate ethical code
- We believe this trend has remained consistent because the above areas of governance reform are among the least expensive to adopt.
- More nonprofit survey participants cited implementation or planned implementation of more aspects of corporate governance reforms than for-profit organizations. This result is consistent with the results of our 2005 survey.
  - We believe this trend is logical because nonprofit organizations have a greater number of stakeholders to whom they are accountable as compared to for-profit organizations which are typically more closely held.
- When asked why these companies are adopting Sarbanes-Oxley Act standards, smaller organizations responding to the survey were more likely to self-impose (73%) when compared to large organizations (63%). In addition, large organizations were more likely to adopt these standards in response to auditors (56%) than smaller organizations (28%). We believe auditors generally perceive they have more risk on audits they perform for large organizations and therefore exert more pressure on these organizations to adopt these standards.

*The Impact of Sarbanes-Oxley on Private & Nonprofit Companies*

- A large percentage (84%) of private organizations responding to the survey felt that corporate governance reform is “about right,” which represented an increase in comparison to 2005 when 78% responded in this manner.
- In addition, it is interesting to note that 82% of the public companies responding to our 2005 study, *The Cost of Being Public in the Era of Sarbanes-Oxley*, felt that the reforms are “too strict.” We attribute this disparity between public and private company responses to the fact that the vast majority of private organizations participating in our study have self-imposed corporate governance requirements and therefore were able to pick and choose the reforms that made sense for their organization, while the responding public companies had more extensive corporate governance reforms imposed on them.
- The voluntary corporate governance measures private organizations have implemented continue to come at a cost to those organizations. Private organizations responding to our survey estimated an average annual price tag of \$105,000 for corporate governance procedures, representing an estimated increase of approximately 26% over their estimated costs prior to the enactment of the Sarbanes-Oxley Act.

## VERBATIMS

### **On why corporate governance rules and standards are being implemented by their organizations...**

- *We are implementing some of the above because of best practices and sound business processes.*
- *Generally, [we] have implemented SOX provisions as best practices with [the] exception of Sections 302 and 404.*
- *As a private, closely held company, we wanted to be sure the firm would survive multiple generations of ownership.*
- *We believe these represent best practices.*
- *Items that are not required of us are still viewed by the board and executive management as [a] best practice and in keeping with our nonprofit mission.*
- *We wish to be essentially 'SOX ready' in case we wish to attract outside investors or consider going public.*
- *We believe that SOX is the new standard of best management practices that private companies will be held to. Further, in today's world it is not possible to avoid interaction with any public companies who are covered by SOX.*
- *The company is structured for an acquisition exit strategy within three years.*
- *In anticipation of SEC and market requirements if the company goes public and to satisfy investors who desire that we be prepared in advance in case of a merger or acquisition involving a public company.*
- *These are mostly areas in which our largest customers and prospects require some sort of positive response when we respond to RFPs. While they're ridiculous requirements for a closely held corporation, compliance helps us be competitive.*
- *It's the right thing to do.*

**PRIVATE ORGANIZATION SURVEY**

In January of 2006, Foley & Lardner LLP distributed a survey to approximately 9,000 CEOs, CFOs, General Counsel, Chief Compliance Officers, Board Members, Directors and other corporate executives of public companies and private organizations. A total of 56 surveys were returned from private organizations. The results below reflect the input of 20 nonprofit organizations and 36 for-profit private companies (Please note: due to rounding, not all percentages will add up to 100%).

**Has the Sarbanes-Oxley Act or other corporate governance reform requirements impacted your company?**

	2004	2005	2006
Yes	77%	87%	86%
No	23%	13%	14%
Don't know/No Answer	-	-	-

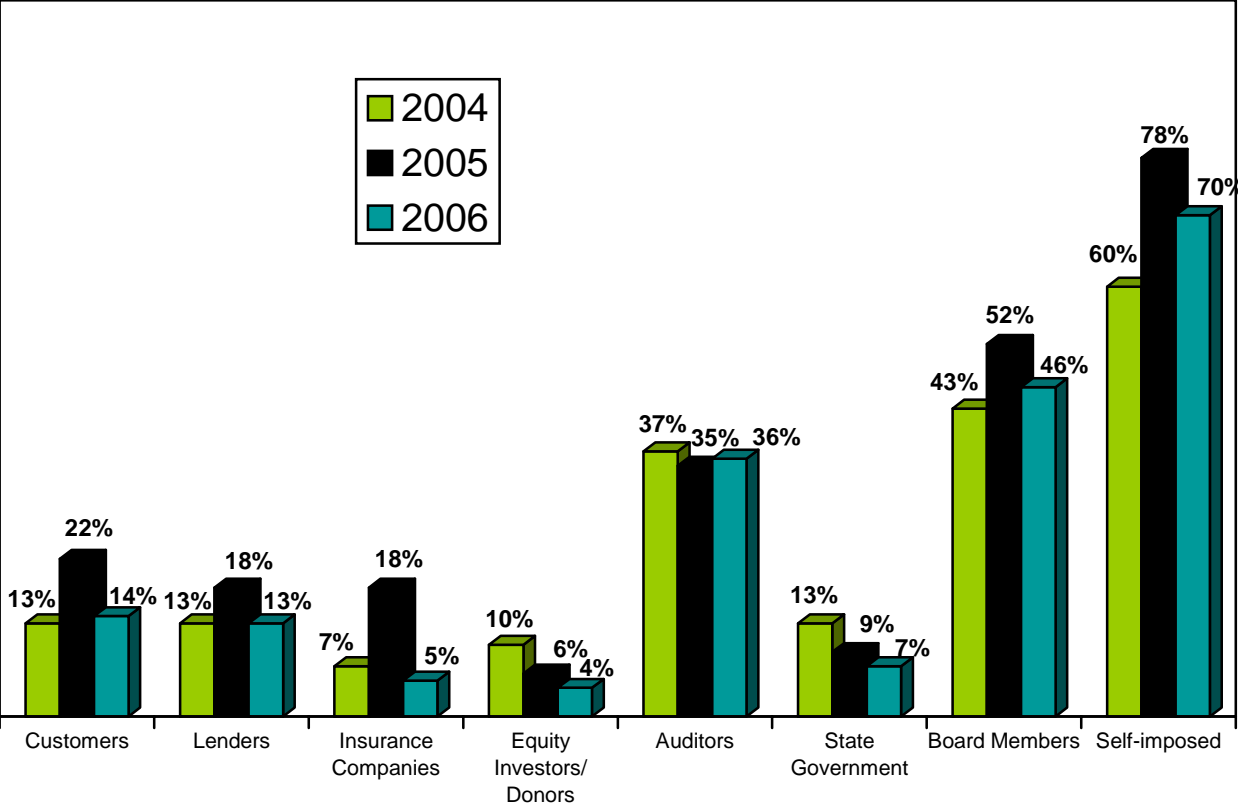
- The Sarbanes-Oxley Act continues to have a significant impact on private organizations, as 86% of survey respondents felt that SOX and other corporate governance reform requirements have impacted their organizations.
- After analyzing three years of data, we are beginning to witness a “steady state” in which most private organizations have realized the full impact of their decision to adopt aspects of the Sarbanes-Oxley Act.
- The impact of corporate governance reform on nonprofit organizations was even more apparent, as 100% of nonprofits responding to the survey felt that corporate governance reform had impacted their organizations compared to 78% of for-profit organizations.

**What groups have caused your company to adopt new corporate governance requirements? (Check all applicable boxes.)**

	2004	2005	2006
Self-imposed	60%	78%	70%
Board members	43%	52%	46%
Auditors	37%	35%	36%
Customers	13%	22%	14%
Lenders	13%	18%	13%
Federal government*	N/A	9%	11%
State government	13%	9%	7%
Don't know/No Answer	17%	3%	7%
Insurance companies	7%	18%	5%
Other	7%	4%	5%
Equity investors/donors	10%	6%	4%

\* Note: “Federal government” was not offered as an option on the 2004 survey.

**What groups have caused your company to adopt new corporate governance requirements?**



- A majority (70%) of the private organizations surveyed have self-imposed corporate governance reforms.
- Consistent with results from every year in which the study was conducted, this year more than a third of respondents (36%) also indicated that outside auditors have caused them to adopt new corporate governance requirements.
- There is relative consistency in year-over-year results from 2004 to 2006, which we again attribute to the realization of a “steady state.” In comparing the data, there are three groups consistently influencing the decision to adopt these standards: the organizations themselves, their board members and their auditors. We believe that the influence of these three groups fuels the continued adoption of these standards by private companies as perceived “best practices.”
- When the Sarbanes-Oxley Act was adopted, the Congressional record indicated that it was not intended to apply to any organization other than public companies. At that time, many commentators opined that regardless of the intent of Congress, these guidelines would eventually permeate all businesses under the guise of “best practices.” Although an unintended consequence, the verbatim responses we received over the past three years indicate this is in fact happening.

- Nonprofit organizations responding to the survey appear more likely to self-impose (80%) these standards than for-profit companies (64%).
- Additionally, a larger percentage of nonprofit organizations responding to the survey cited auditors (45%) and board members (55%) as influencing their decision to adopt these standards as compared to for-profit companies (31% and 42% respectively). Our experience is that nonprofit boards have a higher percentage of directors who also serve as directors of public companies than the boards of private, for-profit companies. We believe this accounts for the difference.

**For each of the following corporate governance practices listed below, please indicate whether your company has implemented that practice prior to SOX, implemented in response to SOX, plans to implement in response to SOX, or does not plan to implement that practice. (Check all applicable boxes.)**

	Implemented or plans to implement			Does not plan to implement			Don't know/ No Answer		
	04	05	06	04	05	06	04	05	06
Audited financial statements	87%	97%	93%	10%	3%	7%	3%	-	-
Establishing independent directors	73%	79%	82%	20%	21%	14%	7%	-	4%
CEO/CFO financial statement attestation	57%	68%	59%	40%	31%	32%	3%	2%	9%
Audit committee oversight of auditors	77%	78%	84%	20%	22%	14%	3%	-	2%
Establishment of an audit committee separate from the finance committee*	N/A	62%	66%	N/A	38%	29%	N/A	-	5%
Establishment of corporate ethical code	77%	94%	88%	17%	6%	11%	7%	-	2%
Establishment of whistle-blower procedures	57%	72%	70%	40%	28%	25%	3%	-	5%
Increasing internal audit function	67%	74%	68%	30%	27%	30%	3%	-	2%
Outside audit of internal financial controls	61%	57%	61%	33%	41%	36%	7%	2%	4%
Board approval of non-audit services by auditors	63%	75%	71%	33%	24%	25%	3%	2%	4%
Restricting executive compensation	40%	47%	38%	53%	52%	48%	7%	2%	14%
Independent director approval of related party transactions	60%	58%	59%	33%	41%	27%	7%	2%	14%
Adoption of corporate governance policy guidelines	77%	76%	70%	20%	24%	20%	3%	-	11%
Disclosure of critical accounting policies and estimates	77%	88%	73%	20%	10%	13%	3%	2%	14%
Disclosure of off-balance sheet and contingent liabilities	83%	81%	70%	13%	16%	13%	3%	3%	18%
Addition of a financial expert on audit committee*	N/A	68%	68%	N/A	32%	21%	N/A	-	11%

\* Note: These areas were not included on the 2004 survey

- The most common aspects of corporate governance reform that responding private organizations have implemented or plan to implement in response to the regulations on public companies have remained consistent year over year and include:
  - Audited financial statements
  - Establishing independent directors
  - Audit committee oversight of auditors
  - Establishment of a corporate ethical code
  
- We believe this trend has remained consistent because, with the exception of “audited financial statements,” the above areas of governance reform are among the least expensive to adopt. Our 2004 survey results indicated that audited financial statements were already in place for more than 87% of respondents.

- “Restricting executive compensation” and “outside audit of internal controls” continue to be areas of governance reform to which private organizations give less attention, with 48% and 36% of respondents claiming they do not plan to implement these measures, respectively.
- In reviewing only those areas of the Sarbanes-Oxley Act private organizations said they planned to implement, a number of trends emerge:

Area	Planning to implement in 2004	Planning to implement in 2005	Planning to implement in 2006
CEO/CFO financial statement attestation	17%	22%	9%
Establishment of an audit committee separate from the finance committee*	N/A	7%	5%
Establishment of a corporate ethical code	17%	7%	13%
Establishment of whistle-blower procedures	23%	10%	9%
Increasing internal audit functions	27%	21%	5%
Outside audit of internal financial controls	27%	10%	5%
Board approval of non-audit services by auditors	20%	4%	9%
Adoption of corporate governance policy guidelines	20%	12%	11%
Addition of financial expert on audit committee*	N/A	10%	9%

\* Note: These areas were not included on the 2004 survey

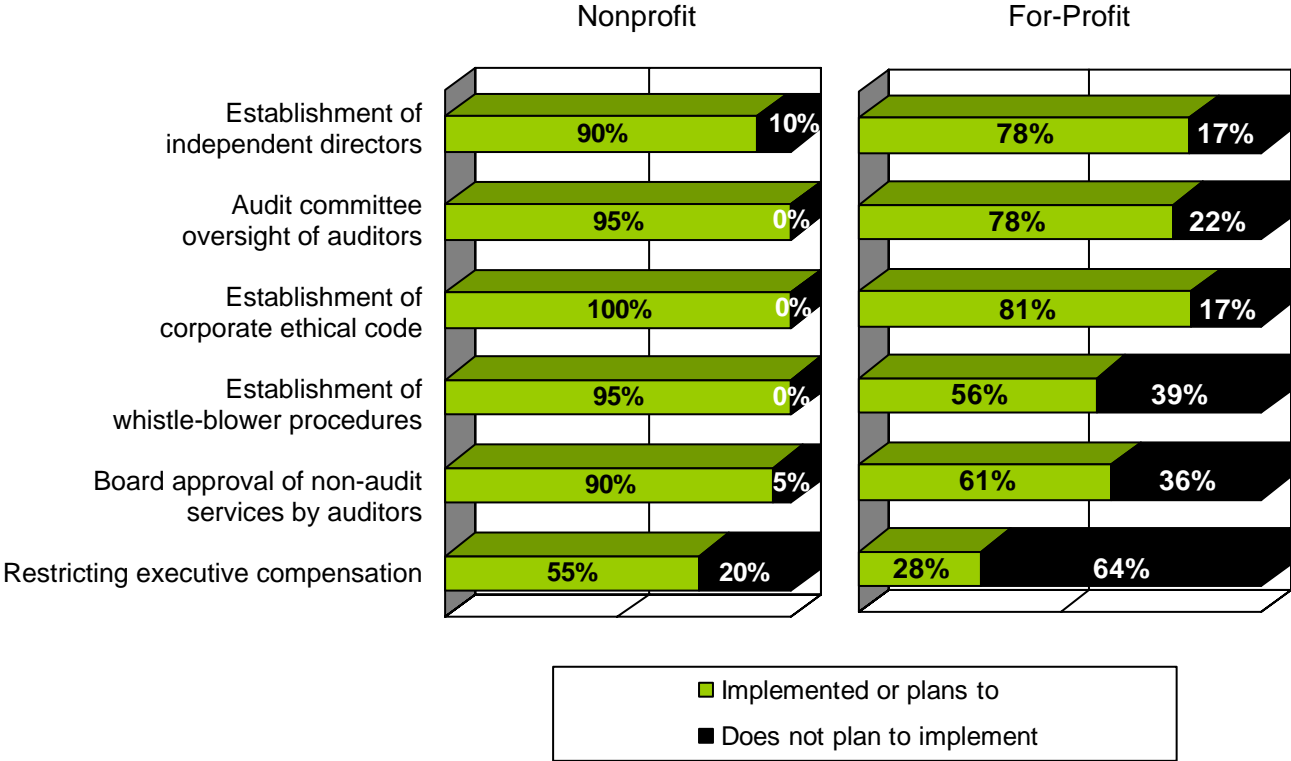
- The year-over-year data from our surveys supports those organizations that said they have been “planning to implement” the areas outlined above. In 2005, for example, all of the above categories reflected double-digit percentages of respondents who had implemented these measures “in response” to the Sarbanes-Oxley Act, consistent with the 2004 respondents who had planned to implement these measures. Areas that organizations have implemented in response to the Act have gradually declined year over year, supporting the conclusion that we have reached a “steady state.”

### **Analysis of the Implementation of Governance Reform by Nonprofit Organizations**

- More nonprofit survey participants cited implementation or planned implementation of more aspects of corporate governance reforms than for-profit organizations. This result is consistent with the results of our 2005 survey.
  - We believe that this trend is logical because nonprofit organizations have a greater number of stakeholders to whom they are accountable as compared to for-profit organizations which are typically more closely held.

Area	Nonprofit	For-Profit
Establishment of independent directors	Implemented or plans to: 90% Does not plan to implement: 10%	Implemented or plans to: 78% Does not plan to implement: 17%
Audit committee oversight of auditors	Implemented or plans to: 95% Does not plan to implement: 0%	Implemented or plans to: 78% Does not plan to implement: 22%
Establishment of a corporate ethical code	Implemented or plans to: 100% Does not plan to implement: 0%	Implemented or plans to: 81% Does not plan to implement: 17%
Establishment of whistle-blower procedures	Implemented or plans to: 95% Does not plan to implement: 0%	Implemented or plans to: 56% Does not plan to implement: 39%
Board approval of non-audit services by auditors	Implemented or plans to: 90% Does not plan to implement: 5%	Implemented or plans to: 61% Does not plan to implement: 36%
Restricting executive compensation	Implemented or plans to: 55% Does not plan to implement: 20%	Implemented or plans to: 28% Does not plan to implement: 64%

**Implementation of Governance Reform:  
Nonprofit Versus For-Profit Organizations**



### **Analysis of the Implementation of Governance Reform by Revenue/Annual Budget**

We also analyzed the responses of organizations with annual revenue or budgets in excess of \$300M (deemed “large organizations”) compared to those with less than \$300M (deemed “small organizations”):

Area	Small Organization (<\$300M)	Large Organization (>\$300M)
Establishment of independent directors	18% do not plan to implement	6% do not plan to implement
CEO/CFO financial statement attestation	38% do not plan to implement	19% do not plan to implement
Audit committee oversight of auditors	20% do not plan to implement	0% do not plan to implement
Establishment of an audit committee separate from the finance committee	35% do not plan to implement	13% do not plan to implement
Establishment of whistle-blower procedures	28% do not plan to implement	19% do not plan to implement
Increasing the internal audit function	40% do not plan to implement	6% do not plan to implement
Outside audit of internal financial controls	40% do not plan to implement	25% do not plan to implement
Board approval of non-audit services by auditors	35% do not plan to implement	0% do not plan to implement
Restricting executive compensation	53% do not plan to implement	38% do not plan to implement
Addition of a financial expert on audit committee	28% do not plan to implement	6% do not plan to implement

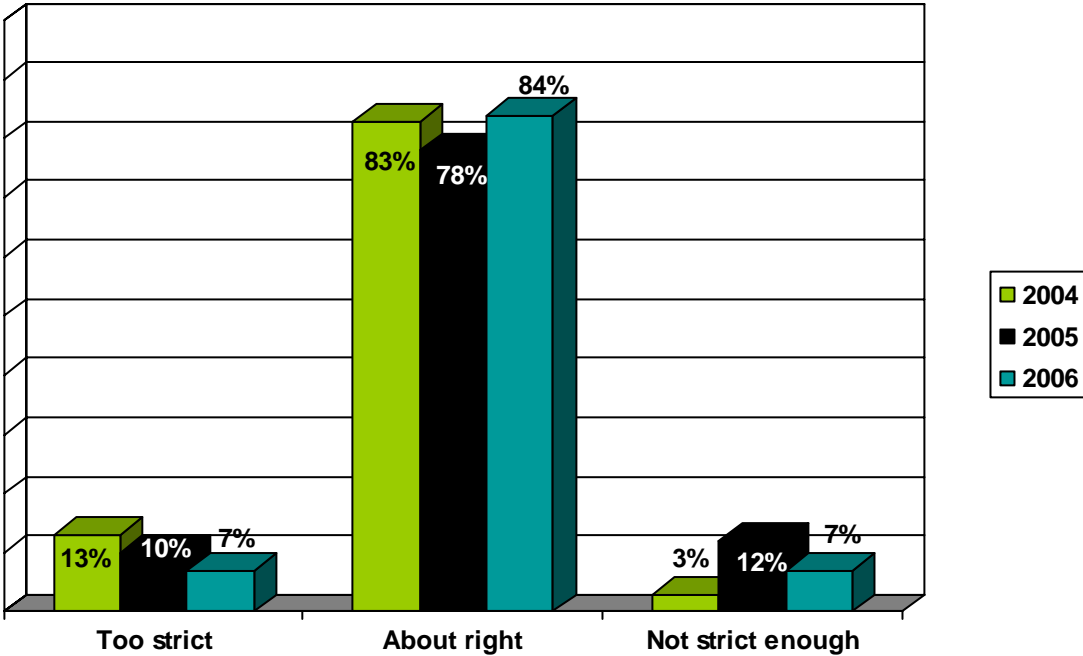
- More large organizations participating in the study have implemented or plan to implement more aspects of governance reform when compared to smaller organizations.
- We also note that smaller organizations typically answer to a smaller number of constituencies that may be less concerned about corporate governance reform.
- We believe this trend is logical because large organizations are more able to easily absorb the costs associated with adopting aspects of governance reform.

- In addition, we believe many of the more costly aspects of corporate governance reform do not pass a cost-benefit analysis when taking into account the limited administrative budgets of small organizations.
- When asked why these companies are adopting Sarbanes-Oxley Act standards, smaller organizations responding to the survey were more likely to self-impose (73%) when compared to large organizations (63%). In addition, large organizations were more likely to adopt these standards in response to auditors (56%) than smaller organizations (28%). We believe auditors generally perceive they have more risk on audits they perform for large organizations and therefore exert more pressure on these organizations to adopt these standards.

**Taking into account any corporate governance reforms you have recently adopted or plan to adopt, do you feel your corporate government procedures are too strict, about right or not strict enough?**

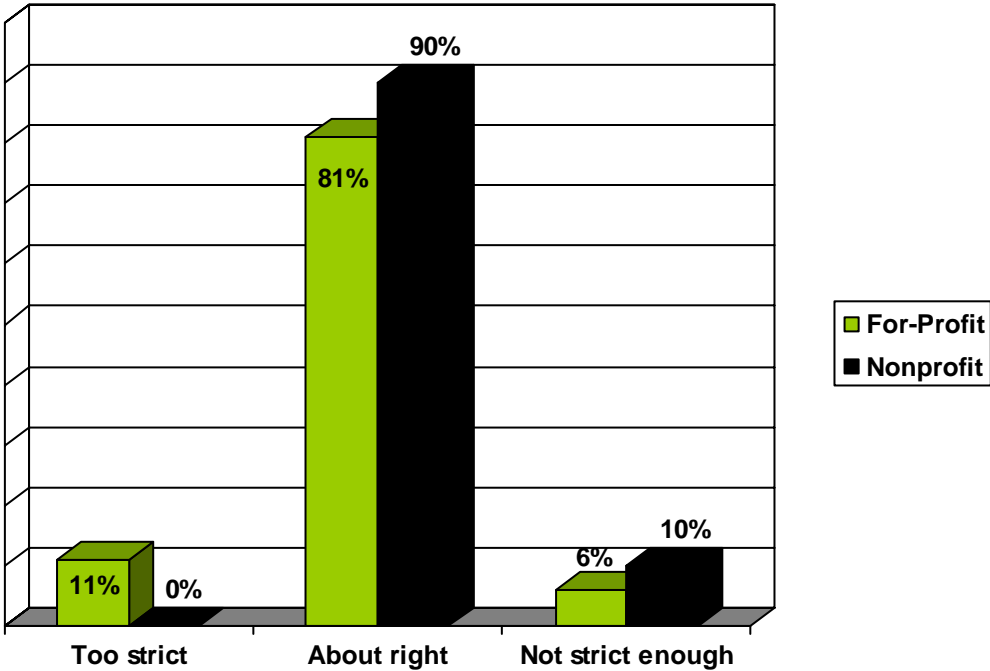
- A large percentage (84%) of private organizations responding to the survey felt that corporate governance reform is “about right,” which represented an increase in comparison to 2005 when 78% responded in this manner.

	2004	2005	2006
Too strict	13%	10%	7%
About right	83%	78%	84%
Not strict enough	3%	12%	7%
Don't know/No Answer	-	-	2%



- In addition, it is interesting to note that 82% of the public companies responding to our 2005 study, *The Cost of Being Public in the Era of Sarbanes-Oxley*, felt that the reforms are “too strict.” We attribute this disparity between public and private company responses to the fact that the vast majority of private organizations participating in our study have self-imposed corporate governance requirements and therefore were able to pick and choose the reforms that made sense for their organization, while the responding public companies had more extensive corporate governance reforms imposed on them.
- In analyzing the nonprofit organizations participating in this year’s study, 90% of nonprofits surveyed felt that reform procedures are “about right” compared to 81% of for-profit organizations. Further, not a single nonprofit respondent felt the rules are “too strict” compared to 11% of for-profit organizations responding to the survey.

**Attitudes Toward Corporate Governance Procedures: For-Profit Versus Nonprofit**



**Please estimate the increased annual cost to your organization as a result of additional corporate governance practices adopted since the Sarbanes-Oxley Act was enacted in July 2002, both in approximate dollar amount and as a percentage increase to the cost of your corporate governance practices prior to July 2002.**

- The voluntary corporate governance measures private organizations have implemented continue to come at a cost to those organizations. Private organizations responding to our survey estimated an average annual price tag of \$105,000 for corporate governance procedures, representing an estimated increase of approximately 26% over their estimated costs prior to the enactment of Sarbanes-Oxley.

	2004	2005	2006
Mean approximate dollar amount	\$50,000	\$138,000	\$105,000
Mean percentage increase	13%	34%	26%

- We attribute the decrease in perceived costs in 2006 versus 2005 to the fact that a number of the corporate governance reforms that these organizations have been adopting (establishing independent directors, audit committee formation, establishing ethical codes and whistleblower procedures, etc.) involve considerably more start-up costs (one-time consulting, legal and accounting fees) than ongoing maintenance costs.

**Do the benefits of additional corporate governance initiatives outweigh the costs for your organization?**

- Private organizations remained split as to whether the benefits of additional corporate governance initiatives outweigh the costs for their organizations. The number of respondents who believe the benefits outweigh the costs has increased steadily year over year.

	2004	2005	2006
Benefits outweigh costs	23%	29%	32%
Benefits = costs	40%	38%	38%
Costs outweigh benefits	27%	28%	29%
Don't know/No Answer	10%	4%	2%

- Looking at only those respondents who believe the costs of corporate governance requirements outweigh the benefits, more than half (63%) are self-imposing these requirements.

## **METHODOLOGY**

Working with a third-party research organization, KRC Research, in January of 2006, Foley & Lardner distributed a survey to approximately 9,000 CEOs, CFOs, General Counsel, Chief Compliance Officers, Board Members, Directors and other executives of both public companies and private and nonprofit organizations. Recipients were asked to complete the survey that applied to their organization, based on their standing as either a public company or private organization. The survey was distributed to and completed by private organizations via an interactive Web site.

A total of 56 surveys were returned from private organizations. The results reflect the input of 20 nonprofit organizations and 36 for-profit private companies.

Due to rounding, not all percentages contained in the study results will add up to 100%.