

# Examining The Impact Of Sarbanes-Oxley On Non-Profit Health Care Organizations

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## ABSTRACT

*This paper presented a proposal for research on how the Sarbanes-Oxley Act of 2002 impacts a non-profit health care organization. The research study follows a qualitative research method of the case study. In this study, the researcher presented a brief introduction of the SOX act and discussed the research data collected in the case study. Qualitative case study method was used for analysis.*

**Keywords:** Sarbanes-Oxley Act of 2002; Nonprofit; Health Care

## INTRODUCTION

The year 2002 was a big year in terms of high-profiled corporate accounting fraud. Financial reporting fraud cases at Enron, WorldCom, and Tyco dominated the headlines (Kulzick, 2004). A report issued by the General Accounting Office in 2002 stated that one out of every 10 public companies had restated their financial statements in the past five years (Kulzick, 2004), suggesting much of the present-day accounting turmoil. The list of U.S. companies that have engaged in accounting fraud is quite large. Enron, Tyco, and WorldCom are three of the better-known scandals that have been showcased in the media in the past few years.

The Sarbanes-Oxley Act of 2002 (known as the SOX Act) was passed in response to the numerous cases of publicly traded corporations issuing fraudulent financial statements, often with the help of senior management and outside auditors. In a sense, the SOX Act was designed to “force” publicly traded companies to take the necessary actions to strengthen and maintain effective corporate governance structures as well as to improve financial transparency, thus decreasing the likelihood of accounting fraud. When congress began the hearings on Enron Corporation in 2002, the vast number of financial reporting problems within U.S. corporations was quickly brought to the forefront. These financial problems caused massive stock market losses for individual investors, greatly hindering the public’s trust in U.S. corporations. The House Committee on Financial Services, chaired by Michael G. Oxley, held the majority of the congressional hearings. As a result, the bill, H.R. 3763, was born at that time. The bill went on to become S. 2673 when the Senate Committee on Banking, Housing, and Urban Affairs (chaired by Paul. S. Sarbanes) took up the bill. The final bill was signed on July 30, 2002, officially becoming Public Law 107-204, known as the Sarbanes-Oxley Act of 2002 (Kulzick, 2004). Two key sections of the SOX Act are Sections 201 and 404. Section 201 basically states that the same auditors that perform the financial statement audit cannot also perform any non-audit services for the same corporation. For example, the public accounting firm cannot issue an audit opinion if they are the same firm that performs bookkeeping services or financial system design and implementation (“Sarbanes-Oxley Act,” 2002). Section 404 is the section of the SOX Act that has been getting its fair share of attention. Section 404 details the criteria for internal control compliance (“Sarbanes-Oxley Act,” 2002). It stipulates that management has to have access to the company’s internal control structure and provide auditors with documented proof that an adequate internal control structure has been put in place as well as documented procedures for financial reporting. Management also has to assess the effectiveness of these documented procedures (Martin, 2005).

Currently, only publicly held corporations are required to comply with Sarbanes-Oxley. However, due to instances of fraud at well-known non-profit organizations, such as the United Way and the American Red Cross, non-profits are now being required to answer to the general public. This is especially due to the fact that a large amount of their funding comes from public donations. Regulators, legislators, and, of course, donors are calling for some type of oversight and regulation of non-profit organizations and, as a result, some non-profit organizations have already adopted some of the Sarbanes-Oxley (SOX) provisions, such as Section 404.

It is expected that in the near future, non-profits will be required to comply with Sarbanes-Oxley regulations in the same manner as their for-profit counterparts (Heffes, 2005). Currently, a large majority of hospitals are adhering to certain SOX regulations as a form of “best practice”, in particular those policies that are related to internal controls and conflicts of interest (Johnson, 2005). This research is seeking to gain greater insight on SOX regulations in relation to non-profit health care entities. In what ways, either negatively or positively, has the SOX Act impacted non-profit health care organizations?

Currently, two of the SOX provisions apply directly to non-profit organizations: the whistleblower provision and the record retention provision. The whistleblower provision protects employees from being fired when they report illegal activity within an organization. The record retention provision requires organizations to keep and maintain documents after they have been made aware of an investigation. Various organizations and government agencies, including the Department of Health and Human Services, the American Health Lawyers Association, and the Internal Revenue Service, are urging health care organizations to now go beyond the two SOX provisions mentioned above. The health care capital markets are also adding pressure on health care organizations as they ask, “What are you doing to insure internal controls?” (Bigalke & Burrill, 2007). Right now is a good time for non-profit health care organizations to take advantage of SOX provisions. This research may point out positive aspects of voluntarily adopting SOX and possibly encourage other entities to voluntarily adopt SOX policies as “best practices”.

Following are explanations of some terms and abbreviations used in the study:

Non-Profit organizations are those that are established to serve a purpose other than the accumulation of profits. Non-Profits usually provide some public benefit and are supported in part by society through charitable donations. Congress and the Internal Revenue Service determine which organizations can qualify to be non-profit organizations and receive tax exempt status. (“Not-For-Profit.org,” 2007) A non-profit hospital is a hospital that is organized as a non-profit corporation usually for a charitable purpose.

Non-Profit hospitals are often affiliated with a religious denomination such as the Baptist Memorial Health care system for example. For the purpose of this research the terms “Non-Profit” and “Not-For-Profit” are considered to be interchangeable and are used as such. SOX is the abbreviation used for the Sarbanes-Oxley Act of 2002 (“Investopedia.com,” 2006)

A company that has issued securities through an initial public offering and is traded on at least one stock exchange or over-the-counter market is considered to be a public company and is thus required to comply with SOX regulation (“Investopedia.com,” 2006).

## **RESEARCH QUESTIONS**

### **Central Research Question**

How has the Sarbanes-Oxley Act positively or negatively impacted non-profit health care organizations?

### *Sub-questions*

Below are the issue-oriented sub-questions that relate to the study:

- What are the benefits of implementing SOX policies?
- What are the drawbacks of implementing SOX policies?
- When was SOX implemented within your organization?
- What was the reason SOX implemented within your organization?
- Was the decision to implement SOX based on the experiences of similar organizations?
- What policies were more difficult or easy to implement?
- Has the workload for accounting/finance staff increased since the enactment of the SOX Act?
- What costs have been associated with implementing SOX policies?
- Has corporate governance (internal controls, standard policies and procedures, etc.) improved since the implementation of SOX? In what ways?

The procedural sub-questions are:

- What are the individual's thoughts about their experiences with implementing the SOX Act?
- What key words or statements describe the individual's experiences?
- What key elements are found within each individual's experiences?
- Are the experiences similar due to the individuals working within the same area within the organization?
- Do the individual's experiences differ due to the fact that they are on different levels within the same department?

The research focuses on a non-profit health care organization that has *voluntarily* chosen to adopt Sarbanes-Oxley practices since the Sarbanes-Oxley act was implemented in 2002. The research doesn't involve public and/or for-profit hospitals or health care systems as they are required by law to comply with SOX.

## **METHODOLOGY**

Qualitative research seeks to solve research problems through the analysis of information such as interviews, observations, videos, etc. Unlike quantitative research it does not rely on statistical data. Qualitative research emphasizes the use of five distinct approaches to inquiry: Narrative, Phenomenology Grounded Theory, Ethnography, and Case Study. Creswell states that there is a set of characteristics common to qualitative research (Creswell, 2007). It is a good method to use when one wants to gain insight into an individual or groups behaviors, values, motivations, and lifestyles. It is used when we want to understand the "why" and not so much as the "how" of a research problem. Qualitative research is conducted when there is a need for a complex understanding of the research problem.

This study plans to use the case study method of inquiry. The case study method is popular amongst fields such as medicine, psychology, and law (Creswell, 2007). This case study involves the study of the impact of SOX on non-profit health care organizations within a bounded system. The researchers interviewed the participants, observed their behavior, and analyzed the documentation and email observations.

### **Data Collection**

The researchers collected the data which consists of personal face to face interviews and email correspondence with accountants that worked for a nonprofit health care organization in Northeast Florida. The researchers also conducted an in-depth interview with the V.P. of Finance and Accounting Services as this individual was primarily responsible for managing the implementation process overall.

### **Interviews**

- The interviews were semi structured, with the face-to-face interviews conducted in the participants' workplace.
- The face-to-face interviews were recorded and the participant responses were summarized for the study.
- Participant responses from email interviews were summarized for the study.

### **Documents**

- The minutes from various meetings regarding SOX implementation were analyzed in addition to, internal control reports, flowcharts, and interdepartmental memos.
- Notes were taken throughout the implementation process.
- Emails including any attachments were archived.

### **Observations**

- Gathered field notes during in person meeting and web conferences as a participant. More time was spent gathering notes as a participant of various project teams created to facilitate timely and accurate implementation.
- Gathered field notes throughout the various implementation processes as an observer.

### **Resolving Field Issues**

- Keeping interviews within a reasonable time frame.
- Establishing set times to conduct interviews and/or observations to ensure that the participation in this study did not interfere with the participants other job duties.
- Making sure that the researchers made an effective use of time and ensuring that the data collected was pertinent to the study.
- Ensuring that notes were recorded accurately and that the researchers didn't miss recording any information that would be pertinent to the study.

### **Storing Data**

- A digital recorder was used for recording face-to-face interviews.
- Email correspondence was archived using Microsoft Outlook
- Any typed notes were recording in Microsoft Word and backup copies were saved on a flash drive.
- Anonymity of the participants was protecting by not including specific names in the data.

Recording Information-Interviews were recorded on an interview protocol form. The actual interview notes are documented in the results section.

### **Issues with Data Collection**

- Keeping the interviewee from going off topic.
- Keeping the interviewee focused on the specific question.
- Making sure the interview is recorded in its entirety. This includes making sure the batteries in the digital recording device are fresh, and making sure that the researchers are aware of all of the functions of the digital recording device.

## **RESULTS**

One of the main interviews that the researchers conducted consisted of an interview with the V.P. of Finance and Accounting Services. It is considered to be a key component of this case study because this individual is responsible for overseeing the entire accounting/finance component of the organization and thus overall responsible for the success of the SOX implementation. Below are the interview results:

### **Interview Protocol: Impact of Sarbanes-Oxley on Non-Profit Health Care Organizations**

The study is being conducted to examine the impact of the Sarbanes-Oxley Act of 2002 on Non-Profit Health Care Organizations, specifically to discuss the positive and negative aspects of voluntarily adopting SOX provisions.

*Q: Was the adoption of SOX a voluntary decision?*

A: Adopting the Sarbanes-Oxley Act was a voluntarily decision. The organization agreed to adopt specific aspects of the SOX provisions with the internal control provisions being the most important.

*Q: What internal control policies, if any, were in place prior to SOX implementation?*

A: The organization had some internal control policies in place, but some policies were practiced but not specifically documented. Specifically there were controls designed to prevent excessive supply and equipment costs, controls in place to ensure the proper allocation and management of donor gifts, and of course being a health care organization we had to adhere to HIPPA policies as well.

*Q: What policies were in place to ensure transparency of financial information?*

A: There are specific procedures that the accountants have to adhere to when recording financial transactions, particularly those involving research because a lot of our research projects are funded by federal dollars. Managers are required to sign off on journal entries and any entries designed to change current budgets. We also undergo internal audits, as well as having our financial statements audited annually.

*Q: What positive changes have you seen take place, in particular in the areas of corporate governance?*

A: We are even more confident that are internal controls are stronger. All of our procedures are documented. This was a goal that we were really working towards. We also have flow charts to accompany our written procedures. These flowcharts document all of our accounting transactions step by step. We've also begin performing internal controls testing to ensure that the controls we have put into place are working as they should. So we're confident that our procedures are being followed.

*Q: What challenges have you had to face regarding SOX?*

A: The costs involved in implementation is of course one of the biggest challenges. One of the requirements of SOX is that you have to have separate internal auditors and external auditors. So the costs involved in hiring an internal audit team as well as an external audit team can tremendously affect your bottom line. There are also costs involved in enhancing your IT systems to ensure they are in compliance and costs involved in hiring additional staff to work on specific aspects of implementation. Also implementing SOX is time consuming, it takes time to document controls and test controls.

*Q: What value do you see in non-profit health care organizations adopting SOX provisions, particularly provisions regarding record retention, whistleblower provisions, conflict of interest policies, and internal control processes regarding purchasing, and how donor funds are managed?*

A: We definitely see a benefit in increased internal controls, and the fact that part of the internal controls documentation process involves documented work instructions for all of our processes. This helps facilitate training when we bring in new staff members, and ensures that everyone is performing the same processes accurately and efficiently. We've also had issues in the past where we didn't have or couldn't easily locate documentation for specific accounting transactions. Having a sound record retention policy helps us in this regard. We know where records are located, and have this information documented for easy access. We are proud of how our internal control testing is going and the fact that we have policies in place to continue going in a positive direction as far as internal control policies are concerned. We previously had conflict of interest policies in place. Adopting SOX provisions would be extremely beneficial to all non-profit organizations, in particularly those that receive a large amount of public donations, or any federal or state funding. The key to maintaining a strong relationship with grantors is not only making good use of funds, but also the proper management of funds. Having internal controls and other policies in place ensure the proper management of these funds.

*Q: What SOX provisions does the organization currently have in place? Do you put more focus in certain areas, i.e. internal controls? What provisions do you feel are more affective in a health care environment?*

A: We currently have whistleblower provisions in place, as well as conflict of interest policies. We have policies in place in order to ensure that we have strong internal controls in place, including documenting all accounting procedures. The internal controls area is our biggest focus. We also have a solid record retention policy. Finally we are audited annually, performing both an internal audit and undergoing an external audit as well. In my opinion all of the above mentioned provisions are beneficial to a non-profit health care environment regardless of the size.

*Q: What future challenges do foresee in regards to SOX?*

A: Implementing SOX is a lot of work, as you have probably gathered via this interview. The biggest challenge with for-profit entities is getting companies to meet compliance deadlines, especially the small organizations. Because of the costs involved and the manpower that is required some smaller companies have struggled with compliance. Our next challenge is to encourage organizations that are private or non-profit to comply with SOX provisions. If companies such as ours can show other organizations not only that meeting SOX compliance can be accomplished, but also show how the benefits of having SOX provisions in place is worth the effort and costs involved, then I think we would be going in a positive direction for non-profit health care organizations. There has been some discussion that in the future non-profit organizations will be required to comply with Sarbanes-Oxley.

After organizing the interview data, the positive and negative effects of implementation are summarized in Table 1.

**Table 1: The Positive and Negative Effects of SOX Implementation**

<b>Positive</b>	<b>Negative</b>
Improved relationships with private donors and granting agencies	Time involved-documenting and testing, interviewing staff regarding processes and job duties
Increased confidence in processes	Costs involved-Technology Costs, Increased Staff
Documented procedures and policies	
Confidence in financial data	
Improved employee morale-whistleblower protection	

**CONCLUSION**

This paper presented a proposal for research on how the Sarbanes-Oxley Act of 2002 impacts a non-profit health care organization. The research study follows a qualitative research method of the case study. In this study, the researchers presented a brief introduction of the SOX act and discussed the research data collected in the case study. Qualitative case study method is used for analysis. A comparison of financial reporting between nonprofit health care entities that have voluntarily implemented SOX and those that don't adhere to SOX provisions would be an additional area for future research.

**AUTHOR INFORMATION**

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NOTES