THE SARBANES-OXLEY ACT AND THE NONPROFIT SECTOR: A STUDY OF UNINTENDED IMPACTS

by

TAMARA G. NEZHINA

Under the direction of Jerome S. Legge, Jr.

ABSTRACT

The Sarbanes-Oxley Act was passed by the U.S. Congress in 2002 in the aftermath of well-publicized scandals in the for-profit world. The Act was intended to improve accountability and transparency in for-profit corporations and deter future abuses. Although SOX was not binding on nonprofit organizations, anecdotal evidence suggests widespread consideration and adoption of SOX by these organizations. However, to understand SOX adoption by the nonprofit sector, more systematic studies are needed.

The goal of the study is threefold: (1) to understand the depth of penetration of SOX rules into nonprofit management and governance practices, (2) to explain the voluntary compliance of nonprofits with SOX, and, (3) to determine positive and negative effects of SOX in nonprofit organizations. This study investigates the impact of SOX on nonprofit organizations through the quantitative analysis of the original data collected by surveying the representative sample of public charity organizations. The data analysis employs Poisson and negative binomial regressions to explain SOX adoption and effects in nonprofit organizations.
The study was informed by the following organizational behavior theories: (1) resource dependence theory, (2) internal determinants theory; (3) diffusion of innovation theory, and, (4) the anticipatory accountability model. These theories were chosen because they best explain the voluntary adoption of SOX by nonprofit organizations. These theories define external and internal factors that were expected to influence nonprofit leaders’ adoption decisions.

This dissertation examines the unintended SOX spillover effects to the nonprofit sector, and reveals that nonprofit organizations adopt SOX differently. Although the extent of SOX adoption is not great, it is large enough to warrant scholarly attention. The results of the quantitative and qualitative analyses demonstrate that nonprofit organizations adopt SOX voluntarily and experience both positive and negative effects. The voluntary SOX adoption by nonprofits provides the evidence that the unintended SOX spillover is happening in the nonprofit sector. The theoretical and practical implications of the public policy spillover on the untargeted subjects – the universe of nonprofit organizations are discussed, and new directions for the future public policy spillover research are suggested.

INDEX WORDS: accountability, governance, nonprofit organizations, voluntary SOX adoption, public policy spillover, SOX impact on the nonprofit sector, nonprofit management, SOX positive and negative effects
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UNINTENDED IMPACTS

by

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DEDICATION

To my parents Lira and Genrich Nezhin
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CHAPTER 1

THE SARBANES-OXLEY ACT AND THE NONPROFIT SECTOR

Introduction

The Sarbanes-Oxley Act, Public Law 107-204 (SOX, the Act), officially titled the Public Company Accounting Reform and Investor Protection Act of 2002 and commonly called SOX or SarbOx, was signed into law on July 30, 2002 by President George W. Bush. SOX was designed to deal with accountability issues in publicly traded corporations after Enron, WorldCom, Xerox, and many other companies were found to be involved in financial mismanagement and accounting fraud, divesting thousands of investors in the United States and abroad in 2001-2002. The purpose of SOX is to improve transparency and accountability in publicly-held corporations and to reinforce control, thus rehabilitating public confidence in the securities market. Yet, many foreign publicly traded corporations listed with the U.S. Securities Exchange Commission (SEC), domestic private business companies, and nonprofit corporations which were not bound by SOX reacted to SOX enactment by adopting some or all of its provisions. Although not required to implement them, these organizations discovered that the ideas embedded in SOX resonated with their own organizational and practical needs.

The subject of this inquiry is the behavior of nonprofit organizations in response to SOX enactment. The study undertakes to reveal the reasons and patterns of diffusion and adoption of SOX requirements by nonprofit organizations, to understand the extent of change in management practices, and to determine the effects of SOX on the operations of nonprofit organizations.
Although there is no obvious reason for nonprofit organizations to comply with legislation intended for other economic actors, anecdotal evidence suggests that a process of adoption of SOX by nonprofits is underway because SOX provisions are viewed as a “best business practice.” However, compliance with SOX entails significant change in standard operating procedures, establishment and formalization of new policies, as well as reevaluation of the roles and responsibilities of board members and top management. These changes are not easy, and for some organizations are quite costly.

Why would some nonprofit organizations undertake this significant and costly change of internal controls, oversight procedures, board operations, and management standard operating procedures in response to a law that was not legally binding for them? What motivated them to follow the requirements of SOX? Which types of nonprofit organizations were more likely to adopt SOX? What is the extent of adoption of SOX provisions? What did they do to practically comply? What were the effects of SOX-related changes on operations of nonprofit organizations and their stakeholders? This dissertation seeks to answer these questions and to understand why the nonprofit world paid attention to the “alien” legislation, why some nonprofit organizations decided to comply, how different types of organizations chose to act, and what benefits and costs arose from compliance.

This study is motivated by the desire to learn about the consequences of the public policy triggered by the enactment of the Sarbanes-Oxley Act of 2002 to nonprofit organizations in the U.S.A. SOX is found to have unanticipated effects on US publicly-held corporations — institutions that SOX is designed to regulate. Moreover, the policy has spilled over to unintended subjects—private business companies, foreign publicly-held corporations listed with SEC, and nonprofit organizations in the USA. I intend to uncover the reasons, the extent, and the effects of
SOX spillover to the nonprofit sector organizations four years after it was enacted. The spillover effects may be found beneficial or costly to nonprofit organizations and their clients. Results will inform policy makers of the consequences of public policy’s unintended effects on untargeted subjects, and point out the necessity to distinguish among various economic actors with regard to regulation.

Chapter I presents the dissertation research topic and briefly discusses the unintended effects of the Sarbanes-Oxley Act on nonprofit organizations. The background section goes back to the events that triggered enactment of a new policy, which has had unintended consequences on the publicly-traded corporations and unanticipated effects on the nonprofit sector organizations. The next sections describe the research questions and the framework for analysis. Chapter II describes the context for SOX adoption by the nonprofit sector organizations and covers the implementation actions of nonprofit organizations. Chapter III discusses expected positive and negative effects of SOX on nonprofit organizations, using for-profit implementation effects as a benchmark. Chapter IV describes the research design and the methods followed by a discussion of the dependent and independent variables. Chapter V reports the results of the face-to-face interviews with the executives of nonprofit organizations in Georgia. The analysis of SOX adoption by nonprofit organizations and findings are presented in Chapter VI. The analysis of benefits and costs from SOX adoption is discussed in Chapter VII. Finally, Chapter VIII summarizes the findings of the study, discusses theoretical and practical implications, and suggests questions for the future research.
Implications for Theory and Practice

This study seeks to understand the intersectoral spillover effects of a public policy. Public policy spillover describes an unanticipated impact of a public policy or a law on untargeted legal subjects. This happens when a public program or a law spills over its economic and jurisdictional boarders to indirectly affect legal entities in other sectors of the economy functioning outside the jurisdiction of the law. By contrast, direct effects are observed on the legal subjects within the jurisdiction of the law.

An example of policy spillover could be a regulation establishing fiscal controls for government organizations that gradually spreads further to get a legal footing in private for-profit and nonprofit organizations (Keating and Frumkin, 2000). Sometimes legally established practices for organizations in one sector of the economy are viewed as “best practices” that may be recommended or mandated to organizations in other sectors. For example, a nongovernmental entity, the Financial Accounting Standards Board (FASB) initially developed accounting standards for business organizations, which later became required from nonprofit organizations (Fremont-Smith, 2004). Likewise, Wilson (1995) maintains that a financial reporting system for nonprofit organizations was adopted from a similar model developed for the business sector.

A body of scholarship on public policy spillover effects was developed by scholars from a variety of disciplines. Economists have studied negative and positive public policy externalities (Weimer & Vining, 1999; Mehay, 1977; Block and Feinstein, 1986), cross-border spillovers of knowledge and technologies (Eaton & Kortum, 1996; Breschi & Lissoni, 2001), budget spillovers and fiscal interdependence (Case, 1993), and environmental spillovers and degradation (Tisdell, 1993).
Business scholars have considered patterns of diffusion of technological or administrative innovations from one company (industry) to another. They have often studied innovations in terms of rational (quasi-economic) analysis of costs and benefits accruing to firms initiating change (Jensen, 2001; Eyestone, 1977; Lecvall & Wahlbin, 1973), diffusion of patents and innovations (Hall, 2003), or spillover problems and prospects for international business (Caves, 1998). Legal scholars have described effects of planned and ad hoc regulations (Pildes, 1991; Schwert, 1981).

Political scientists and public administration scholars have studied diffusion and adoption of public policy among the states, at various levels of governments, and among institutions (Walker, 1971; Gray, 1973; Rogers, 2003; Dunet, 2005). Rogers (2003) described innovation studies in the fields of sociology, anthropology, mass communication, rural sociology, and technical assistance. One can see that the diffusion of innovations and policy spillover are popular topics among researchers in different fields of knowledge.

Several researchers have investigated the spillover effect of the presence of nonprofit organizations on local communities, and, conversely, the spillover effect of public policy on nonprofit organizations. Wolpert et al. (2001) studied positive effects of nonprofit activities on neighborhoods in New York. Grobowski & Hirth (2003) discussed positive competitive spillovers among nonprofit and for-profit health care industries. Although the phenomenon of regulatory spillovers from the business and government sectors to the nonprofit sector is not totally new and has been briefly mentioned by policy scholars in articles devoted to various topics (Keating and Frumkin, 2000; Wilson, 1995; Fremont-Smith, 2004), few nonprofit scholars have studied the unintended effects of public policy on nonprofit organizations empirically with regard to effects on management practices. An interesting example of spillover effect is the
social policy known under the name of the Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA), which truncated and devoluted some government social services (Weaver, 2002) thus creating a surge of demand for assistance provided by nonprofit social service organizations (Abramovitz, 2002; Cnaan et al, 1999; Burt et al., 2000; Magnum and Salevurakis, 2000; Withorn, 1999). Several studies have examined the role of nonprofit organizations in implementing welfare reforms or the effects of policy change on nonprofits’ capacity to continue providing social services (Briggs, 1999; Johnson, 1008, Riccio and Orenstein, 1996). However, only one study (Sommerfeld and Reisch, 2003) investigated the unforeseen effects of the PRWORA on management in nonprofit social service organizations. The study focused on the effects produced by the PRWORA on managerial practices, mostly on the structure and functions of social service nonprofit organizations. Sommerfeld and Reisch (2003) found that those organizations that worked with low-income clients experienced the greatest surge of service demand and carried the heaviest burden of the policy change. They found that organizations that experienced serious difficulties in meeting an increasing demand for their services had to adapt by changing their structure and functions. In response to new challenges, nonprofits created new services and started to engage their clients in program development and service delivery (Sommerfeld & Reisch, 2003).

Public policy spillover effects on nonprofit organizations have received little attention compared to other policy studies. My study intends to explore the unexpected effects of a new regulatory policy, the Sarbanes-Oxley Act, on nonprofit organizations’ management functions including the role of the board and top management, financial controls and oversight, and disclosure mechanisms. The study seeks to explore the extent of SOX spillover to the nonprofit sector; understand how nonprofit leaders coped with new requirements for more accountability.
and higher transparency; discover the kinds of challenges the Sarbanes-Oxley Act created for the board of directors and top executives of nonprofit organizations; and unearth the benefits and costs that policy compliance generated for the adopting organizations. Briefly, this study seeks to uncover whether the Sarbanes-Oxley Act spillovers took place between the sectors, and how these spillovers might have affected management in nonprofit organizations under the circumstance of wide managerial discretion about adoption of SOX policies.

**Background of the Sarbanes-Oxley Act**

Congress enacted the Sarbanes-Oxley Act (SOX) in 2002 to improve standards of corporate accountability following several highly publicized corporate scandals. The Sarbanes-Oxley Act was the reaction of Congress to the occurrence of frauds by the management of publicly traded companies and auditing firms. “The Act represented the most sweeping overhaul of the securities law since the Great Depression and brought significant changes to corporate governance and boards of directors” (Linck, Netter & Yang, 2005).

In 2003, Jorge Guerra, a consultant from the Institute of Management Accountants (IMA), conducted a study of 116 of the most notorious cases of corporate governance accounting frauds by corporations, public audit firms, investment banks, and other financial institutions. Guerra revealed that the most common transgressions were related to net profit overstatements using a creative variety of fraudulent accounting records affecting revenues, costs and expenses, or special reserves accounts. “The number of executives who openly tapped company funds for their personal benefit or who profited from insider trading or misleading public disclosures was not insignificant” (Guerra, 2003).
Rightfully, Congress felt its duty was to protect investors and the public from such fraudulent occurrences in the future. The Sarbanes-Oxley Act 2002, sponsored by and named after Senator Paul Sarbanes of Maryland and Representative Michael Oxley of Ohio, was designed to reinforce the standards of corporate transparency and accountability by mandating more accurate preparation and presentation of financial records, independence standards in corporate governance and oversight, safeguards against conflicts of interest, and protection of whistle-blowers. It was designed, ultimately, to prevent future crises of confidence in the American capital markets (The CPA Journal, 2004).

SOX was intended to address directly accountability issues in publicly traded companies. However, American private companies, foreign publicly traded companies and foreign private companies, as well as American nonprofit organizations, found themselves affected by the new regulations because “the concerns that the Act raised for corporate governance were universal for many government board members” (NACUBO, 2003). As a result, the unintended consequences of SOX on corporations that were not subject to its regulations are becoming a matter of discussion within the United States and abroad (Vagts, 2003; Engelen, 2004; Bisoux, 2005). The unanticipated effects of SOX on nonprofit organizations are the subject of this study. The following sections discuss the effects of SOX on for-profit and nonprofit corporations that were described in academic studies or found by surveys conducted by business consulting companies (Linck et al. 2005; Zhang, 2005; Gifford and Howe, 2004; Grant Thornton LLP, 2003, 2004, 2005; Foley and Lardner LLP, 2004, 2005).

**Intended and Unintended Consequences of SOX for For-Profit Corporations**

The Sarbanes-Oxley Act strengthened regulations in several areas of corporate governance to improve oversight of financial management and accounting in publicly traded
companies. SOX also required certain disclosure procedures to make corporations more transparent. The Table 1.1 below briefly presents a summary of SOX requirements and their relevance to nonprofit organizations. Although most of the SOX provisions are explicitly addressed to for-profit publicly traded corporations, the private business and nonprofit sectors found some of these provisions relevant and useful for strengthening accountability in nonprofit organizations.

**Table 1.1 The Sarbanes-Oxley Act Requirements**

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<th>Requirements of SOX addressed to publicly traded organizations</th>
<th>Relevance to Nonprofit Organizations</th>
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<tr>
<td>Title I: Public Company Accounting Oversight Board (PCAOB) created to</td>
<td>N/R</td>
</tr>
<tr>
<td>• Register accounting firms to perform audit services</td>
<td>N/R</td>
</tr>
<tr>
<td>• Regulate accounting firms’ audit activities</td>
<td>N/R</td>
</tr>
<tr>
<td>• Establish accounting standards</td>
<td>N/R</td>
</tr>
<tr>
<td>Title II: Auditor Independence provision</td>
<td>R</td>
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<tr>
<td>• Prohibits the auditor from performing specified non-audit services</td>
<td>R</td>
</tr>
<tr>
<td>• Requires rotation of audit partners every five years</td>
<td>R</td>
</tr>
<tr>
<td>• Bars an audit firm from serving a company whose executive was employed by the audit firm less than one year before the audit</td>
<td>R</td>
</tr>
<tr>
<td>Title III: Corporate Responsibility provision requires to</td>
<td>R</td>
</tr>
<tr>
<td>• Establish an audit committee by the board of directors</td>
<td>R</td>
</tr>
<tr>
<td>• Ensure an audit committee independence</td>
<td>R</td>
</tr>
<tr>
<td>• Institute an audit committee responsibility to select, compensate, oversee, and discharge the auditor</td>
<td>R</td>
</tr>
<tr>
<td>• Certify financial reports for accuracy by CEO and CFO</td>
<td>R</td>
</tr>
<tr>
<td>• Establish CEO responsibility for internal controls evaluation</td>
<td>R</td>
</tr>
<tr>
<td>• Prohibit personnel from exerting improper influence on the auditor</td>
<td>R</td>
</tr>
<tr>
<td>• Forfeit certain bonuses and compensations to CEO and CFO if the company is found materially noncompliant</td>
<td>R</td>
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<tr>
<td>• Prohibit directors and officers trading public company stock during pension blackout period</td>
<td>N/R</td>
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<tr>
<td>• Obligate attorneys to report violations of securities laws and fiduciary duties</td>
<td>N/R</td>
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</table>

1 To define the relevance of the Sarbanes-Oxley Act requirements to nonprofit financial management and accountability practices it was assumed that all requirements were relevant besides those that explicitly imposed control over activities related to securities because nonprofit organizations typically do not issue securities and are not registered by the SEC.
**Title IV: Enhanced Financial Disclosure provision requires to**
(Specific requirements of the SEC concerning financial reporting)

- Disclose all off-balance sheet transactions  
- Prohibit personal loans to executives and directors  
- Disclose changes in securities ownership or swap arrangements within two business days  
- Institute electronic filing of all disclosures  
- Incorporate internal control reports in annual reports  
- Disclose whether a code of ethics is adopted for senior financial executives  
- Disclose whether at least one member of the audit committee is financially qualified  
- Establish an annual review of corporate disclosures by SEC

| Title V: Securities Analysts Conflict of Interests | N/R |
| Requires independence of securities analysts from undue influence | N/R |
| Title VI: Commission Resources and Authority | N/R |
| Establishes the size of SEC appropriations and powers | N/R |

| Title VII: Studies and Reports | N/R |
| Requires studies of securities market conditions and impact of some of SOX provisions | N/R |

| Title VIII: Corporate and Criminal Fraud Accountability provision requires to | R |
| Amend the U.S. Code by establishing criminal penalties for knowingly destroying, altering, concealing or falsifying records to obstruct federal investigation | R |
| Preserve financial and other relevant documents for five years | R |
| Institutionalize whistle-blower protection, and prohibit retaliation against informants who assist investigation by federal regulators by making amendments to the U.S. Code | M^1 |
| Establish fines or imprisonment (up to 25 years) to any person who knowingly defrauds shareholders of publicly traded companies | N/R |
| Declare debts resulting from fraudulent activities non-dischargeable in bankruptcy | N/R |

| Title IX: White Collar Crime Penalty Enhancement | N/R |
| Title X: Corporate Tax Returns | R |
| Federal income tax returns should be signed by the CEO | R |

| Title XI: Corporate Fraud Accountability | N/R |
| Increases penalties for fraudulent activities in publicly traded corporations | N/R |
| Limits future employment of SOX violators as publicly traded company CEOs | N/R |

^2 Ensures independence of security analysts in order to improve objectivity of securities market research and to provide investors with more reliable information.

^3 Defined as mandatory for all types of organizations by the U.S. Code. Two SOX provisions are viewed by experts as mandatory for all types of private organizations because they are incorporated in the text of the U.S. Code. SOX refers to the amendment to the Section 42121 (b) of the Title 49 of the U.S. Code, which requires protection for informants who assist federal investigations in fraud cases. SOX also stipulates that similar amendment to the U.S. Code Chapter 3 Title 18 prohibit destruction, alteration or falsification of records, including corporate audit records (Sarbanes-Oxley, 2002; see Appendix I).
All of the measures summarized in Table 1.1 are designed to enhance the transparency of publicly traded companies and the accountability of their leadership and to ensure that investors receive adequate information about company performance. However, accountability reinforcement is not without cost. Preliminary analysis of the plausible consequences of SOX for the companies listed under the Securities and Exchange Commission (SEC) revealed the expectation that the legal responsibilities of Chief Executive Officers (CEO) and Chief Financial Officers (CFO) would increase; competition among the audit firms would decrease; the quality of audit might decrease, while audit fees might increase; corporate managers would become more risk-averse; boards would become less effective; board composition and function would change; public companies may decide to go private (Gifford and Howe, 2004).

To address the above concerns a PricewaterhouseCoopers’ analytical group surveyed corporate board members in 2004 to learn about the early consequences of SOX. The survey found that in publicly owned companies the working-time on the boards increased; the composition of boards changed, with the board membership becoming more independent; compensation for board directors increased; board evaluations became commonplace; and managers of companies spent more time on SOX compliance issues to the detriment of company performance (PricewaterhouseCoopers, 2004.)

Linch et al. (2005) discovered significant changes in the operation of governing boards in publicly traded corporations in a study of 7,000 SEC listed companies. Their study found several important impacts of SOX on boards: board independence increased; average board size increased; a dual leadership structure became more common; director turnover and replacement

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2 Board independence is defined as a proportion of outside directors—those not employed by the organization.  
3 Dual leadership is defined as separation of the board of directors and the corporate management leadership.
increased significantly; board tasks became more demanding and complex; board directors’ cash compensation increased substantially (Linck, Netter and Yang, 2005.)

Perhaps because SOX was targeted to publicly-held corporations, the effects of SOX were formally studied by business administration scholars and business analysts, and informally surveyed by the mass media. While studying the effects of SOX mostly on for-profit corporations, mass media journalists, business consultants and analysts discovered that SOX indirectly impacted the nonprofit sector organizations as well (Grant Thornton LLP, 2003, 2004, 2005; Foley and Lardner LLP, 2005).

**Expected SOX Effects on Nonprofit Sector Organizations**

Although nonprofit sector entities are not directly subject to SOX regulations, many provisions of the Act, which are expected to lead to better business practices, are likely to be adopted by nonprofit organizations voluntarily to enhance public trust (BoardSource and Independent Sector, 2003; Tate, 2003). Therefore, the unintended consequences of the Act may be found in nonprofit organizations as well. By 2005 the Attorneys General in 13 states had proposed regulations similar to SOX to reinforce the transparency and accountability practices in nonprofit organizations (Hempel and Borrus, 2004; Gordon, Hughs and Banks LLP, 2003; National Council of Nonprofit Associations (NCNA), 2005). Among the requirements of SOX that may be relevant to the accountability practices of nonprofit organizations (see Table 1.1) and that may affect boards of directors and top management, the following can be highlighted:

- Boards should be independent[^4] (board independence is characterized as the percentage of non-employee directors [outsiders] on the board, the percentage of firms with a

[^4]: Here it is appropriate to mention the important distinction between the for-profit and the nonprofit boards. Nonprofit boards are typically independent in the sense that all board members are outsiders; while the for-profit boards may have more than 50% of the board directors as insiders -- the executive directors of the company.
majority of outsiders on the board, and the percentage of firms with a separate CEO and Chairman [Linck et al. 2005]).

- Boards should have an audit committee or subcommittee;
- Audit committees should have at least one person qualified as a financial specialist;
- Audit committees should select the auditing firm and oversee its performance;
- Boards should approve all services provided by the auditing firm;
- Boards and the audit committees should review and approve the IRS Form 990 or 990-PF, and revise the internal control policies (Independent Sector, 2003);
- The CEO and CFO must certify the accuracy of financial reports and evaluate and report the effectiveness of internal controls;
- Organizations should adopt conflict of interest and whistle-blower protection policies;
- Organizations should have a policy for document preservation for a period of five years.

Business consultants, nonprofit consulting groups—but rarely academic researchers—discussed the requirements of SOX in the popular press and on the Internet, and the ways it might affect nonprofit boards and executives. The Independent Sector (IS) forum suggested in 2003 that nonprofit organizations should prepare for higher standards of accountability and work to improve organizations’ governance. The National Association of College and University Business Officers (NACUBO, 2003) anticipated increased demand for accountability from higher education institutions following implementation of SOX, and provided recommendations concerning SOX adoption (Basinger, 2004; Linck et al., 2005; Vermeer, 2005). John Carver (2004) discussed the requirements of SOX and compared them to the requirements of his Policy
Governance model. He found that the Policy Governance model predated SOX regulations in terms of establishing open and transparent board-management relations. Dana Reiser (2004) discussed the ongoing debates in the state offices of Attorneys General concerning regulations for nonprofits modeled after SOX. Many other publications in popular newspapers and magazines have discussed the implications of SOX for nonprofit organizations (Wiehl, 2004; Williams, 2004; Basinger, 2004). An article in the *Chronicles of Philanthropy* predicted increased costs for nonprofits that chose to comply with SOX (Anft and Williams, 2004.)

Amid many anecdotal reviews of SOX effects, only two studies—by the business consulting firm Grant Thornton LLP and consulting firm Foley and Lardner LLP—attempted to analyze the nonprofit leadership awareness of SOX, and to measure the changes in the nonprofit boards and executives operations within the nonprofit sector in a systematic way. Analysts from Grant Thornton conducted four surveys among executives and boards of large nonprofit organizations in 2003, 2004, 2005, and 2006. Their reports are available on the Grant Thornton web site (http://www.grantthornton.com/portal/site/gtcom/), and some articles in popular magazines refer to the results of their study (Green, 2004; Williams, 2004). However, it may be assumed that the results of these surveys are indicative rather than conclusive because of the low response rate (3 percent). The details of these surveys are discussed below.

Table 1.2 summarizes the results of the surveys conducted by the Grant Thornton consulting company in 2003, 2004, 2005, and 2006 among CEOs, CFOs, and board members of large nonprofit organizations. Grant Thornton was contacted to learn details about their study methods. The information they provided is shown in the Table 1.2 to give a comparative view of the sample, the response rate, and the major findings. Comparative analysis of the surveys’ results reveals that the attitude of nonprofit organization leadership to SOX requirements
changed from one year to another. In 2003 nonprofits were in no hurry to change their accountability practices following the enactment of SOX. In 2004, there was a considerable increase in their level of awareness and in their implementation rate of SOX requirements. The 2005 and 2006 survey results indicated an incremental increase in the already high level of SOX awareness, and a more prominent increase in the implementation rate.

Table 1.2 Summary of the Grant Thornton Nonprofit Leadership Survey Results

<table>
<thead>
<tr>
<th>Year of the survey</th>
<th>Organization revenues</th>
<th>Sample size</th>
<th>Number of respondents</th>
<th>Level of SOX awareness (% of those who claimed to be “very” or “somewhat” aware of SOX)</th>
<th>Percentage of respondents saying that they have introduced change in response to SOX</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>10 million - 20 million</td>
<td>21,000</td>
<td>&gt;300</td>
<td>56%</td>
<td>20%</td>
</tr>
<tr>
<td>2004</td>
<td>10 million - 20 million</td>
<td>21,000</td>
<td>&gt;700</td>
<td>83%</td>
<td>48%</td>
</tr>
<tr>
<td>2005</td>
<td>10 million - 20 million</td>
<td>21,000</td>
<td>&gt;800</td>
<td>88%</td>
<td>67%</td>
</tr>
<tr>
<td>2006</td>
<td>10 million - 20 million</td>
<td>21,000</td>
<td>&gt;900</td>
<td>N/A</td>
<td>52-78%</td>
</tr>
</tbody>
</table>

Source: Interview with Grant Thornton experts, November 15, 2005

Although the results of these surveys are limited because of the low response rates and the possibility of a response bias, they indicate that the process of SOX adoption may be underway among larger nonprofit organizations. The study results showed that the number of nonprofit organizations that have been informed about SOX requirements and have changed their board responsibilities and oversight procedures increased considerably in the period from 2003 to 2005. The survey of 2006 was focused on governance issues. It did not ask about the awareness level, but confirmed the earlier trend for more implementation of SOX requirements.

results, they found that SOX exerted an even larger impact on nonprofit organizations in 2005 as indicated by 97 percent of respondents compared to 2004 when 80 percent of respondents reported SOX impacts (Broude & Prebil, 2005). These dynamics implied that SOX impacts on nonprofit organizations were becoming more pronounced.

The studies conducted by the for-profit consulting firms in 2003 through 2006 suggest that an increasing interest in SOX exists among nonprofit organizations. The number of nonprofit organizations that adopted SOX requirements increased from 20 percent in 2003, to 67 percent in 2005, and to 78 percent in 2006 (Grant Thornton LLP, 2003-2006). However, the low response rate in the previous studies suggests a possibility of response bias, and prompts a study of the dynamics of SOX adoption by applying more rigorous methods. My study undertakes to investigate the adoption of SOX more thoroughly by employing the rigorous standards of academic research.
CHAPTER 2
RESEARCH QUESTIONS AND FRAMEWORK FOR ANALYSIS

Research Findings about SOX Effects in the Nonprofit Sector

This study seeks to explain why and how nonprofit organizations adopted the Sarbanes-Oxley Act 2002, which was intended for for-profit corporations, and what effects adoption has had on nonprofit organizations and some of their stakeholders such as clients and donors.

Although the possible spillover effect of SOX to the nonprofit sector has received a considerable amount of attention in the popular press, there is little academic research on adoption of SOX by nonprofit organizations. I found only three academic studies by Heinz (2003), Vermeer et al. (2005), and Ostrower and Bobowick (2006) that tried to assess the impact of SOX on nonprofit organizations, and one study by Behn et al. (2005) that indirectly linked SOX to nonprofit organization behavior.

Heinz (2003) conducted an early study of SOX effects among affiliates of a parent nonprofit organization “Alliance for Children.” The CEOs and the board directors were surveyed to find whether SOX caused any change in nonprofit organizations’ control practices, and what the expectations of nonprofit leaders were concerning the adoption of SOX-related rules. The author found that in 2003 from 104 executives who responded to the survey (33 percent response rate), more than half (55 percent) indicated that they were somewhat familiar with SOX, 7 percent were very familiar, and 39 percent were not at all familiar with the law. In answering the question about any changes made or intended in response to SOX, a quarter (24 percent) of respondents said “Yes,” and three quarters (76 percent) said “No” (Heinz, 2003).
These findings indicated that nonprofit leaders were somewhat informed about SOX although in no apparent hurry to comply. The CEOs participating in a focus group were asked to express their opinion about the accountability situation in nonprofit organizations before SOX. They contended that accountability standards in the nonprofit sector were more demanding than in many for-profit organizations, and that their auditors were doing an excellent job. Consequently, most believed that no additional regulations were necessary for the nonprofit sector (Heinz, 2003). Although this study had limitations because it was conducted among members of one organization, and it was a single snapshot made soon after enactment of SOX, it was informative and indicative of the nonprofit leadership’s attitude to SOX. This study provided information about the early reaction to SOX by affiliated organizations of the “Alliance for Children,” offered a glimpse into the assessment of financial reporting and auditing practices by the CEOs of these organizations, and documented their lack of intention to change these practices in response to SOX.

Vermeer et al. (2005) explored the availability of audit committees and their activities in nonprofit organizations after SOX enactment. They sought to explain variations in nonprofit audit committee practices through the lens of the resource dependency framework. The authors hypothesized that sources of funding would drive differences in the demand for audit committee practices at nonprofit organizations. This study found that (1) larger organizations with government grants were more likely to have independent audit committees (defined as having members who are neither employed nor do business with the nonprofit organization); (2) the composition of the fund balance and the size of the nonprofit organization were positively related to more frequent meetings between the audit committee and the external auditor; (3) the composition of the fund balance and the presence of tax-exempt bond liabilities correlated with
the responsibility of the audit committee to hire and oversee the external auditor. The researchers concluded that nonprofit organizations responded to resource dependency and demands for monitoring mechanisms by adopting suitable audit committee related measures (Vermeer et al. 2005). This group of researchers also found that differences existed in the functioning of audit committees for hospitals and universities when compared to other nonprofits. The study surveyed CEOs of 128 of the largest U.S. nonprofit organizations. The acknowledged limitations of this study were the possible self-selection bias and the small response rate (13 percent) (Vermeer et al. 2005).

A study by Behn et al. (2005) addressed the transparency issue of nonprofit organizations without explicitly connecting it to SOX. But because the study was conducted in 2004 after SOX was passed in 2002, its findings can be indirectly attributed to the influence of SOX since SOX explicitly required improving transparency and outlined disclosure mechanisms. The authors of the study maintained that SOX might have been one of the factors that affected the disclosure procedures in nonprofit organizations. The study contemplated why some nonprofits voluntarily provided their audited financial statements when asked, and others did not. The researchers focused on large nonprofit organizations with revenues larger than $10,000,000. The study related more transparent behavior to (1) the larger size of an organization, (2) higher debt ratio, (3) larger contribution ratio, (4) the policy area of participating organizations. Behn et al.’s (2005) findings suggested that higher education institutions and those organizations that had higher compensation expense ratio were characterized by more transparent behavior.

The latest study by Ostrower and Bobowick (2006) examined the current state of nonprofit adherence to some major SOX provisions and the perceptions of nonprofit leaders about the difficulty of compliance. They found that nonprofit organizations established various
SOX provisions to different extents, and that the size of organizations was one of the major factors that determined compliance. In their study Ostrower and Bobowick (2006) included organizations of all sizes and policy areas. Their findings suggest that from all SOX provisions the practices most often adopted by nonprofits were regular external audits, certification by the CEOs of the financial and tax documents, public disclosure of audit reports and the IRS Form 990, and whistleblower protection policy. Other SOX provisions, such as establishment of separate audit committees and a written document destruction and retention policy were not widely adopted by nonprofits. Ostrower and Bobowick (2006) contended that some SOX policies do not require serious change in nonprofit organizations because similar policies were required by existing nonprofit regulations (Fremont-Smith, 2004). Most leaders of nonprofit organizations perceived that adherence to SOX provisions that did not exist in their organizations would be difficult (Ostrower and Bobowick, 2006).

These four systematic empirical studies contributed important ideas to my research. Heinz (2003) described the attitude of top managers to SOX, the current level of awareness about SOX, and the initial adoption of SOX practices. Vermeer et al. (2005) demonstrated that certain changes were undertaken by nonprofit organizations in their auditing practices in response to SOX, and identified the types of organizations most likely to make those changes. Behn et al. (2005) found association among the size, the funding patterns, and the policy area of nonprofit organizations and the level of transparency. Ostrower and Bobowick (2006) found that organizations were selective in adopting SOX provisions: some SOX practices were adopted to a higher extent than others. Another finding of this study suggests that SOX affected nonprofit organizations of different sizes differently (Ostrower and Bobowick, 2006).
The above findings provided useful information about SOX adoption by the nonprofit sector organizations by shedding light upon the processes of SOX adoption. However, only few rigorous studies, which examine adoption by nonprofits of only some parts of SOX, do not produce sufficient knowledge to understand SOX spillover to the nonprofit sector. To better understand the reaction of the nonprofit sector to SOX more studies are necessary.

**Dissertation Research Questions**

My purpose is to investigate thoroughly the scope and level of SOX adoption by nonprofit organizations. The goal of the study is to understand the motivation of nonprofit organizations to comply with any part of SOX, the adoption decisions made by different types of organizations, the actual compliance actions undertaken by organizations, and the effect of these actions. This research investigates a broad range of possible changes induced by SOX in nonprofit organizations’ governance structure, board functions and responsibilities, financial control mechanisms, and policies related to disclosure and transparency of an organization’s activities. Finally, this study intends to establish whether organizations that adopted SOX-related changes experienced any ensuing positive or negative effects on financial controls, board operations, and fundraising capabilities.

This research intends to answer the following questions:

1. How can we explain the adoption of any part of SOX by nonprofit organizations that are outside of SOX jurisdiction?
2. To what extent have nonprofits adopted SOX?
3. How can we explain differences in adoption behavior among nonprofit organizations?
4. What are the effects of SOX adoption on organizational management, clients, services, costs, fundraising and board effectiveness?

To understand what induced some nonprofit organizations to implement SOX-related changes I turn to the resource dependence and stakeholder theory (Pfeffer and Salancik, 1978; Freeman, 1984), diffusion of innovation theory (Rogers, 2003), anticipatory accountability theory (Kearns, 1994), and the internal determinants model (Mohr, 1969; Damanpour, 2000). The following section describes the contextual framework for explaining the SOX spillover to the nonprofit sector, as well as its expected effects.

**Framework for Analysis of SOX Adoption by Nonprofit Organizations**

Literature on resource dependence theory, stakeholder theory, diffusion of innovation theory, the policy spillover proposition, and the anticipatory accountability theory help to develop a theoretical framework for analysis of the adoption of any parts of SOX by nonprofit organizations. Table 2.1 below describes the heuristic model of SOX adoption by nonprofit organizations. It briefly presents the units of analysis, the guiding questions for the study, and the theoretical and practical frameworks for analysis of SOX adoption by nonprofit organizations.
Table 2.1  Heuristic Model of SOX Adoption and Effects

<table>
<thead>
<tr>
<th>Units of analysis</th>
<th>I. The nonprofit leaders and organizations</th>
<th>II. Org. adopters (subsample)</th>
<th>III. Org. adopters (subsample)</th>
<th>IV. Org. adopters (subsample)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Study guides</td>
<td>Research question</td>
<td>Explanation</td>
<td>Explanation</td>
<td>Explanation</td>
</tr>
<tr>
<td></td>
<td>What external and internal factors may induce nonprofit leaders to adopt any parts of SOX?</td>
<td>Explanatory framework</td>
<td>Explanatory framework</td>
<td>Benchmark for comparison</td>
</tr>
<tr>
<td></td>
<td>To what extent are SOX requirements adopted by different types of nonprofit organizations? What explains different level of SOX adoption by nonprofit organizations?</td>
<td>Text of SOX. Literature describing for-profits’ and nonprofits’ compliance actions.</td>
<td>Text of SOX. Literature describing for-profits’ and nonprofits’ compliance actions.</td>
<td>Literature describing benefits and costs incurred as a result of compliance to SOX by for-profit publicly traded organizations.</td>
</tr>
</tbody>
</table>

The first part of the model focuses on the external conditions that make nonprofit leaders decide to adopt SOX requirements (see Figure 3.2, Chapter III). Several studies considered the role of the context in policy adoption. Elkin (1983) suggested applying a contextual approach to learning about innovations. He maintained that propensity to innovate was closely connected to a changing context. The following theories may be useful to explain the attention of nonprofit leaders to SOX: resource dependence and stakeholder theory (Pfeffer and Salancik, 1978; Freeman, 1984), diffusion of innovations theory (Rogers, 2003), and the anticipatory accountability model (Kearns, 1994). These theories provide insights that help hypothesize why nonprofit sector leaders would perceive SOX requirements as relevant to the nonprofit sector, and decide to establish them in their respective organizations.
Further in the model the focus shifts to practical issues, the nonprofit individual organizations’ actions, and effects of these actions. Three consequent parts of the heuristic model presented in Table 1.3 intend to explore the extent of SOX adoption by nonprofit organizations, determine the external and internal factors that influence adoption of SOX requirements by nonprofit organizations, describe the actions that may be undertaken by nonprofit organizations in response to SOX, and explain the benefits and costs of SOX experienced by organizations that adopted SOX. Graphical presentation of the full heuristic model can be found in Figure 3.2 in Chapter III. The model explores the role of external and internal conditions for conceiving the adoption of SOX by nonprofit organizations, particular compliance actions of nonprofit organizations, and the effects of the implementation actions. The sections that follow will describe the model in more detail. The next section discusses the context for SOX adoption by the nonprofit sector, as well as the internal organizational conditions conducive to SOX adoption.
CHAPTER 3
HEURISTIC MODEL: THEORETICAL FRAMEWORK FOR ADOPTION OF SOX BY THE NONPROFIT SECTOR

To understand why nonprofit organizations adopt SOX requirements I employ a theoretical framework that explains the voluntary decisions to adopt SOX by nonprofit leaders. SOX adoption by nonprofits is induced by external and internal factors. I assume that nonprofit leaders would adopt SOX to achieve two goals: (1) to meet demands from external stakeholders, (2) and to gain benefits for their organizations. The stakeholder, resource dependence, and the anticipatory accountability theories can explain decisions to adopt SOX. Likewise, the diffusion of innovation theory and the internal determinants theory help to understand SOX adoption. Diffusion of innovation theory describes how innovations travel from state to state or from industry to industry through various communication channels. I employ the communication channels proposition to explain how SOX requirements become known to the nonprofit leaders. The internal determinants theory, which is often paired with diffusion of innovation theory, is used to explain the adoption of innovations by a state or organization. It emphasizes the internal characteristics of adopters as factors that affect the innovativeness.

Together, the four theories contribute to a more comprehensive explanation of voluntary adoption of SOX by nonprofit organizations. In the section that follows I discuss how the theories mentioned above help understanding SOX adoption by nonprofit organizations.
**Diffusion of Innovation Theory**

The diffusion of innovation theory (Rogers, 2003) may be useful as a framework to understand how new for-profit accountability standards find their way to the nonprofit industry. Newly established accountability and disclosure standards entail changes in internal policies, organizational procedures, and management and board responsibilities. These changes are triggered by a new regulation and are considered an innovation. As such they can be explained within the framework of diffusion of innovation theory.

Rogers (2003) defines diffusion as the process in which an innovation is communicated through certain channels over time among the members of a social system. Diffusion is defined as a special type of communication in which messages are sent about new ideas. Adoption refers to the decision of any individual or organization to make use of an innovation, whereas diffusion refers to the accumulated level of users of an innovation in a market (Rogers 1995).

Diffusion theory is used to explain the spread of SOX rules from for-profit to nonprofit corporations. Following Rogers (2003) and Lasswell’s (1953) discussion of the diffusion of innovation, it is suggested that information about innovation was transferred from the business sector to the nonprofit sector through various channels: individual networking, professional interactions, the popular press, industry publications, board members, audit partners, staff accountants, and efforts of change agents (Lasswell, 1953, Rogers, 2003).

Abrahamson (1997) advances the theory of social networks as an explanatory framework for understanding diffusion of innovation. He suggests that potential adopters learn about innovations through social networks. He proposes that the number of network links can have
very large effects on the extent of an innovation’s diffusion among members of a social network (Abrahamson, 1997).

Rogers (2003) discusses four critical elements in the analysis of the diffusion of innovations: (1) the innovation, (2) its communication from one individual to another (3) and that it takes place in a social system (4) over time. The process of diffusion is described as the dissemination of a new idea from its source of invention or creation to its adopters. The new idea is spread through communication channels. Diffusion of an innovation involves both interpersonal channels and mass communication channels, through which decision-makers get information about the innovation and its characteristics (Lasswell, 1953). A social system is defined by Rogers (2003) as a population of individuals who are engaged in collective problem-solving behavior. And, finally, the time factor describes the period that passes from the awareness of a new idea to the final adoption (Rogers, 2003).

Following Rogers’ classification of the critical elements for the diffusion of a new idea, this study includes the following elements in the analysis: the innovation – SOX; multiple channels of diffusion; and a social system, defined as a nonprofit organization and its stakeholders. The time factor is not included in the analysis because this study of SOX adoption was designed as a snap-shot observation of adoption and its effects over the comparatively short period of time that has passed since the Act was passed in 2002. A longitudinal study would be appropriate after a longer period of time, which Rogers defines as nine years on the average after an idea starts spreading within a social system. In the early stage of adoption, it seems more appropriate to establish empirically the extent of adoption of SOX provisions by nonprofit organizations and the impacts of adoption. This early examination may help to further predict the spread of innovation in the system.
Many studies of adoption of legislative policy or bureaucratic guidelines at the state level were made within the framework of diffusion of innovation theory by examining the national and regional models of policy adoption (Walker, 1969; Grey 1973; Dunet, 2005). This study of SOX adoption by nonprofit organizations briefly considers the pattern of adoption among the states. However, because SOX is not mandatory for nonprofits, only one characteristic attributable to all states will be considered – the intent, or the lack of intent, of the state legislature to adopt a new regulation for the nonprofit sector following SOX philosophy. Discussions in the state legislative bodies may influence the adoption behavior of nonprofit organizations in these states. This study examines the behavior of nonprofit organizations in states whose state legislatures considered the enactment of a new law for nonprofit organizations modeled after SOX, such as a new law passed in California in 2005 under the title of Nonprofit Integrity Act.

**Hypothesis # 3-1:** Nonprofit organizations in the states whose legislature considered the enactment of a new law for nonprofit organizations following the SOX model are likely to adopt SOX more comprehensively than organizations in other states.

Many policy adoption studies focus on a state, an organization, or an individual as units of analysis (Walker, 1969; Grey, 1973; Carter & Williams 1959; Rogers, 2003; Dunet, 2005). Rogers (2003) states that “the individual is usually the unit of analysis, although in recent years a number of studies have been conducted in which an individual organization is the unit of
analysis (Wildemuth, 1992; Zaltman, Duncan, & Holbek, 1973).” The present study will focus on nonprofit organizations as units of analysis.

**Hypothesis # 3-2:** Leaders of nonprofit organizations are more likely to adopt SOX provisions if they received information about SOX through formal and informal professional networks.

**Hypothesis # 3-3:** Leaders of nonprofit organizations are more likely to adopt SOX provisions if they received information about SOX from the nonprofit industry publications.

Innovations in organizations have also been studied by organizational scholars. Their studies extensively used the internal determinants model to explain the diffusion of innovations within the population of organizations. Discussion of the internal determinants model follows the description of external factors that may influence adoption of SOX by nonprofit organizations.

**Rate and Extent of Adoption in Nonprofit Organizations**

Rate or level of adoption was defined by Rogers and Shoemaker (1971) as “the relative speed with which an innovation is adopted by members of a social system. This rate of adoption is usually measured by the length of time required for a certain percentage of the members of a system to adopt an innovation.” (p. 28). The innovation literature distinguishes between two types of innovation with regard of the adoption rate. Researchers state that organizations behave differently while adopting technological and administrative innovations (Damanpour & Evans, 1984; Teece, 1980). The introduction of administrative innovations requires serious reassignment
of administrative functions and responsibilities, unlike technological innovations. The reassignment presents internal challenges and “set up” costs, which may lead to organizational disruption (Teece, 1980). Teece (1980) demonstrates that administrative innovations develop more slowly than technological ones.

Organizations in the nonprofit sector are expected to adopt SOX-related accountability requirements at a different pace. Some organizations may have already adopted new standards, while others have postponed the adoption. I believe that three factors are especially important for understanding SOX adoptions by nonprofit organizations: voluntariness (Moore and Benbasat, 1991), political pressure (Burns and Wholey, 1993), and the possible threat to the organization’s reputation (Hoffman & Ocasio, 2001; Deephouse, 1996). Two of these factors describe the external circumstances: the willingness of the stakeholders to exercise political or professional pressure to persuade nonprofit leaders to adopt an “alien” legislation. The second factor describes the perceived legitimacy needs of an organization to enhance its reputation by adopting widely recognized “best practices.” The third factor is the non-binding status of SOX for the nonprofit sector, which implies that nonprofit leaders adopt SOX voluntarily. I will discuss these conditions in the following section.

**Pressure to Innovate: Resource Dependence and Stakeholder Theories**

Characteristics of the environment are important for organizational readiness to introduce change (Mohr, 1969; Elkin, 1983; Hoffman and Ocasio, 2001; King and Lenox, 2001). Stakeholder demands to adopt new accountability standards specified in SOX may start the process of adoption. Donor organizations may exert formal or informal pressure on fund recipients by making a donation conditional upon change, or by setting an example (Ocasio,
Audit firms regulated by SOX may bring to a nonprofit organization new accountability standards and expectations for more rigorous internal controls and financial reporting (Heinz, 2003).

To explain why nonprofits adopt SOX, I apply resource dependency theory, which holds that organizations depend on providers of resources for their activities and heed their demands (Pfeffer and Salancik, 1978). As open systems, most nonprofit organizations depend on the external environment for resources and support (Young et al., 1981; Heimovics, Herman, and Jurkievicz, 1993).

Resource dependence theory draws attention to the sources of nonprofit organizations’ revenues. Applied to nonprofit organizations, resource dependency theory helps to explain nonprofit organization behavior in response to conditions of charitable giving, private grants and government funds (Middleton, 1987; Heimovics et al., 1993, Vermeer et al., 2005). Private contributions of individuals, foundations, corporations, and government grants and contracts provide nonprofit organizations with necessary resources to perform their mission (Heimovics et al. second, 1993). By applying resource dependency theory Vermeer et al. (2005) hypothesized that differences in the types and composition of resources provided by government, donors and creditors would be associated with differences in monitoring demands from the nonprofit organizations’ donors. Their research found positive relationships between the composition of resources, organization size, and demand for increased financial control by donors (Vermeer et al., 2005). Because nonprofit organizations depend on resources from external actors, responsiveness and accountability are emphasized in the nonprofit sector organizations.

Another explanation of SOX adoption behavior is offered by stakeholder theory, which is closely related to resource dependence theory for nonprofit organizations. Stakeholder theory
maintains that an organization and its leaders owe legitimate stakeholders an obligation to manage given resources effectively and efficiently (Freeman, 1984; Phillips, 2004). Nonprofit organizations have multiple stakeholders. Thus, they owe responsibility to policymakers and political decision makers, program sponsors, target participants, program managers, program staff, and contextual stakeholders (Rossi et al. 1999). Stakeholders often consist of two major groups – donors and recipients. Nonprofits receive funds from government, public direct and indirect contributions, and donations from corporations and foundations (Salamon, 1999). Donated funds are used to provide services to target populations. By transforming funds into services for recipients, nonprofit organizations establish credibility among donors and the client community. However, donors are in a position of power, and for this reason they feel entitled to receive detailed reports on spending. By combining dependence and stakeholder theory we may conclude that donors are important stakeholders for nonprofit organizations, and organizations depend on donors for their decisions to contribute or withdraw resources. Thus, I expect to find that nonprofit organizations heed the demands of their donors to adopt best business practices entailed in SOX.

**Hypothesis # 3-4**: Nonprofit organizations will be more likely to adopt SOX provisions if donors demand or recommend adoption.

Board members are another group of stakeholders, who control an organization’s adherence to its mission, its financial and its operational performance. Often, board members are donors to the organization to which they provide leadership. In practice, the fiduciary role of board members makes them especially keen on the issues of accountability and transparency
(Carver, 2004; Holland & Jackson, 2003). Based on this proposition, we can expect that board members will exercise their authority to pressure organizations’ management into compliance with SOX-related best practices.

**Hypothesis # 3-5**: Nonprofit organizations will be more likely to adopt SOX provisions if board members demand or recommend adoption.

Another important group of stakeholders are auditors. On the one hand, auditors’ interest in organizational performance is mediated by the contract, which requires them to provide quality services to their client nonprofit organizations (Fremont-Smith, 2004). On the other hand auditors’ obligations to PAOCB—the institution created by SOX, which is responsible for controlling auditing companies and establish auditing standards—ensures that auditors follow the rules and procedures established by SOX.

**Hypothesis # 3-6**: Nonprofit organizations will be more likely to adopt SOX if external auditors advise them to comply.

Given the perceived political and social pressure to follow the best business practices entailed in SOX, leaders of nonprofit organizations may feel an obligation to change their practices to comply with SOX. They may expect that procedures labeled as best practices will improve their reputation as transparent and trustworthy organizations and enhance their credibility and legitimacy (Deephouse, 1996).
**Hypothesis # 3-7:** Those nonprofit organizations that experienced political and social pressure to adopt SOX are more likely to adopt any provisions of SOX.

**Hypothesis # 3-8:** Those nonprofit leaders who perceive adoption of SOX as a potential enhancer of organization credibility will adopt SOX to a more complete extent.

**Internal Factors: Theory of Anticipatory Accountability**

The concept of anticipatory accountability for nonprofit organizations suggested by Kearns (1994) is helpful in understanding decisions of top management to introduce innovations. The anticipatory accountability concept holds that nonprofit managers may improve accountability practices in anticipation of growing pressure to innovate from organizational stakeholders. In nonprofit organizations, managers are likely to understand threats posed by SOX to their organizational accountability standards and take action to meet the challenge. This proactive management strategy describes the discretionary decision of nonprofit managers to adhere to new accountability standards imported from the external environment (Kearns, 1994).

The conventional concept of accountability is based on the idea of hierarchical or bureaucratic responsibility to a higher authority. This concept is hardly applicable to nonprofit organizations for one simple reason: there is no hierarchy and no formal higher authority in the bureaucratic sense of the word (Kearns, 1994, p.186). Nonprofit accountability is more realistically described by the broader concept of accountability proposed by Shafritz (1992, p.10), which holds that officials are to be held answerable for general notions of democracy and morality as well as for specific legal mandates. This broad definition better describes the
relationships of nonprofits with their stakeholders by connecting accountability to the practices
of open and transparent governance.

Kearns (1994) suggested some new dimensions to the nonprofit accountability framework, which focuses on tactical and strategic implications of accountability in nonprofits. This framework emphasizes the behavior of managers within nonprofit organizations, and proposes four types of nonprofit management approaches to accountability: (1) compliance accountability, a reactive management tactic that describes adherence to explicit procedures and standards; (2) negotiated accountability, a reactive management tactic that adheres to ad hoc reconciliation of responsibilities between the nonprofit organization and the indirect outside authority; (3) professional accountability, a proactive management strategy that has as its core discretionary compliance with internal professional standards of performance; (4) and anticipatory accountability, a proactive management strategy that uses discretionary adherence to explicit performance standards imported from the external environment (Kearns, 1994, p.187).

Anticipatory accountability best describes why nonprofit managers may decide to comply with SOX. Managers in nonprofit organizations may take a proactive stance by scanning the environment to identify existing threats such as new accountability and transparency standards. In order to eliminate the potential threat, they act proactively by establishing new accountability and transparency standards in anticipation of nonprofit regulation similar to SOX in the future. This type of behavior is characterized as anticipatory proactive management. Additionally, nonprofit leaders understand that improved accountability standards may enhance donors’ trust in an organization. Strategic proactive management may be one of the explanations why SOX is adopted by nonprofit organizations. Nonprofit managers may think that it is a good strategy to be prepared to meet future accountability demands from their immediate external environments.
Hypothesis # 3-9: Nonprofit managers with a proactive attitude toward SOX are more likely to adopt SOX rules.

Figure 3.1 summarizes the theories described above. The explanatory model for SOX adoption in Figure 3.1 provides the context for understanding why nonprofit leaders adopt SOX although it is not mandatory for their organizations. While no single theory can provide a full understanding of active SOX adoption, the combined explanation given by several theories presents a more complete and comprehensive picture.

Why would the nonprofit leaders adopt SOX - a policy that is not binding on the nonprofit sector?

- Innovation diffusion theories (Walker, 1969; Rogers, 2003)
- Internal determinants theory (Mohr, 1969; Walker, 1969; Downs, 1976; Regents, 1980)
- Resource dependence theory (Pfeffer and Salancik, 1978) and stakeholder theory (Freeman, 1984)
- Anticipatory accountability theory (Kearns, 1994)

Figure 3.1 Contextual Explanation of Nonprofit Sector Attention to SOX

The model combines the theoretical frameworks that were discussed above, and are expected to explain partially the decisions of nonprofit leaders to adopt SOX provisions. The next section discusses the internal factors that may explain the adoption of SOX by various types of nonprofit organizations.
Internal Organizational Factors

Another model often used to explain the organizational predisposition to innovate is the internal determinants model, which many researchers have applied to understand organizational change determined by such internal characteristics of a state or an organization as innovativeness or openness to innovations, size, wealth, internal structure, and culture (Mohr, 1969; Berry & Berry, 1992; Mooney & Lee, 1995; Smith et al., 2001; Dunet, 2005).

The studies of policy adoption by the states were informed by the internal determinants model, which assumes that some specific state characteristics are responsible for adoption behavior (Walker, 1969). The multiplicity of state internal characteristics used by researchers is impressive. The effects of the following dimensions were explored by various studies: perception of innovation (Moore and Benbasat, 1991, Kearns 1992), openness to innovation (Roessner, 1979), culture (Bemelmans-Videc, 1998), political orientation or ideology (Berry & Berry, 1992; Mintrom, 1997), size and wealth (Downs & Mohr, 1976; Mooney & Lee, 1995; Smith et al. 2001), and availability of change agents (Mintrom, 1997; McKinney et al. 1992; Skocpol et al. 1993).

Various factors are expected to influence the decisions of nonprofit leaders to comply with SOX. Besides the external factors discussed earlier, the internal determinants model predicts that organizational internal characteristics influence SOX adoption by individual nonprofit organizations. The internal organizational factors are also expected to explain variations in SOX adoption by nonprofit organizations. The internal determinants model maintains that the probability and extent of policy adoption depends on the characteristics of an adopting unit such as an organization (Mohr, 1969; Walker, 1969; Downs, 1976; Dunet, 2004).
The internal characteristics of a nonprofit organization can be subdivided into three groups: structural-organizational, management-procedural, and leadership and board characteristics. Considering all three groups of characteristics, the pertinent literature suggests that the size, wealth, age, sources of funding, legitimacy needs, policy area, personal characteristics of individual leaders, and the effective management practices will play important roles in a decision of nonprofit leaders to adopt SOX recommended changes (Berry et al. 1992; Downs, 1967; Mooney and Lee, 1995; Mohr, 1969; Dewar & Dutton, 1986; Damanpour, 1991; King & Lenox, 2001; Rogers, 2003). Building upon earlier research findings, I explore the effects of the internal explanatory variables on adoption of SOX by nonprofit organizations.

**Organizational characteristics**

The literature suggests that larger and wealthier organizations are better prepared structurally and materially to undertake change (Mohr, 1969; Damanpour, 1991; Deephouse, 1996; King and Lenox, 2001). The age of a nonprofit organization is a factor that may also influence adoption of new rules. Old, well-established nonprofits may have sufficiently rigorous accountability procedures in place, and may be unwilling to change. Younger organizations may be more open to change their accountability procedures, may have less rigid operating procedures, and may be able to change their internal practices more easily (Blau, 1973; Downs, 1967; Baker & Cullen, 1993; Deephouse, 1996). Younger organizations may also have higher legitimacy needs than older well-established organizations. The policy area is expected to be another factor of change (Damanpour, 1991; Vermeer et al., 2005; Behn et al., 2005). For example, several studies suggest that universities and hospitals are among the most active nonprofit organizations in adopting SOX requirements (Vermeer et al. 2005; Behn et al., 2005).
I expect that nonprofit organizations receiving funds from the federal government, or those channeled through the state governments, are less likely to introduce extensive change to follow SOX because they are guided by the GAAP standards, the Single Audit Act (1984)\(^5\), and the OMB Circular A-133 (1990)\(^6\), which carry many provisions similar to SOX and in several instances have even more stringent financial control requirements than SOX (Keating et al., 2005). Moreover, federal government contractor nonprofit organizations are expected to already have an audit committee on the board, and to have arranged for external audit procedures (Vermeer et al., 2005; Ruppel, 2006). Vermeer et al. (2005), tested the resource dependence theory in relation to the SOX requirements and auditing practices of nonprofit organizations, and found that the composition of fund balance was a factor in nonprofit management decisions about adoption of SOX. Considering the internal determinants theory, the above findings, and the opinions of nonprofit experts concerning SOX adoption by nonprofit organizations, I propose the following hypotheses:

**Hypothesis # 3-10:** Large organizations are more likely to adopt SOX practices.

**Hypothesis # 3-11:** Wealthy organizations are more likely to adopt SOX practices.

**Hypothesis # 3-12:** Younger organizations are more likely to adopt SOX practices.

**Hypothesis # 3-13:** Universities are more likely to adopt SOX practices.

**Hypothesis # 3-14:** Hospitals are more likely to adopt SOX practices.

\(^5\) The Single Audit Act of 1984 established uniform entity-wide audit requirements for state and local governments receiving Federal financial assistance. Audits performed under the Single Audit Act are intended to satisfy all Federal agencies providing assistance to the entity. (http://www.ignet.gov/pande/audit/mains.html)

\(^6\) Office of Management and Budget (OMB) Circular No. A-133, re-titled "Audits of States, Local Governments, and Non-Profit Organizations," establishes uniform audit requirements for non-Federal entities that administer Federal awards. One of the more significant revisions is that the threshold for when an entity is required to have an audit is raised from $25,000 to $100,000. The circular took effect in March 1990. http://www.whitehouse.gov/omb/circulars/a133/a133-lead.html

OMB Circular A-133 provides for audit consistency and uniformity of nonprofit organizations as well as defining Federal responsibilities for implementing and monitoring these audit requirements (Staples, 1993).
**Hypothesis # 3-15: Nonprofit organizations that receive federal government funds directly or through the state governments are less likely to adopt the SOX requirements.**

**CEO characteristics**

The characteristics of chief executive officers (CEOs) are expected to influence decisions to adopt SOX. Individuals in nonprofit organizations are important decision-making actors who can speed or slow the adoption of SOX rules (Heinz, 2003). Having a higher educational level may influence executive directors’ decision to adopt SOX requirements (Mohr, 1969; Damanpour, 1991). Knowledge and understanding of SOX requirements may foster or impede adoption of the new policy (Blau, 1963; Kearns, 1992; Damanpour, 1991, Rogers 2003). The direction of the relationship between knowledge and the decision to adopt is not clear because SOX is not designed for nonprofit organizations. Those top executives who know SOX well and understand its for-profit orientation, as well as those who are well informed about SOX-related costs incurred by for-profit corporations, may be reluctant to undertake SOX-related change. Yet, some well informed executives may adopt SOX provisions creatively by adjusting its provisions to the specific conditions of nonprofit organizations, thereby avoiding the costly change. In other words, knowledge of SOX may enhance or impede its adoption.

Diffusion of innovations theory and structural equivalency theory maintain that members of professional groups receive information about innovation through networking with other members (Rogers, 2003; Galaskiewicz and Burt, 1991). Consequently, we may expect that those executive directors of nonprofit organizations who are members of professional associations may receive information about SOX from these groups or associations, may know more about SOX requirements, and may initiate more change. Some directors come to the nonprofit world from
business companies and often maintain connections with their colleagues in the for-profit world (Vermeer, 2005). We can expect that such CEOs will be better informed about SOX and more likely to implement its provisions.

Rogers (2003) maintains that managers’ positive attitudes toward SOX may increase their rate of adoption. In other words, if managers perceive SOX as beneficial to their organizations they are more likely to adopt SOX provisions. As Kearns (1994) predicts, proactive nonprofit managers will be predisposed to adopt SOX if new procedures will eliminate or lessen external pressure for more accountability and will help them to improve organizations’ reputation and legitimacy. Conversely, they will be less likely to adopt SOX if they do not perceive non-compliance with new requirements as a threat. Based on the theories of diffusion of innovations, internal determinants, and anticipatory accountability applied to chief executive officers of nonprofit organizations, I hypothesize the following relationships between the managers’ characteristics and the level of SOX adoption:

**Hypothesis # 3-16:** Nonprofit executives with higher education level are more likely to adopt SOX practices.

**Hypothesis # 3-17:** Nonprofit executives who are members of professional associations are more likely to adopt SOX practices.

**Hypothesis # 3-18:** Nonprofit executives who are more familiar with SOX are more likely to adopt SOX practices.

**Hypothesis # 3-19:** Nonprofit executives with for-profit sector backgrounds are more likely to adopt SOX practices.
By combining the external contextual factors that lead to SOX adoption with the internal organizational characteristics and personal characteristics of nonprofit executives, I have built a model to explain SOX adoption by nonprofit organizations. A graphical presentation of the model is seen in the Figure 3.2 below.

![Figure 3.2 Framework for Understanding Adoption of SOX Requirements by Nonprofit Organizations](image-url)

**External factors**
- Political pressure
- Donors’ pressure
- Board members pressure
- Auditor pressure
- Channels of information

**Internal determinants**

a) Organizational characteristics:
- Size
- Wealth
- Age
- Government support
- Existing accountability structure
- External audit
- Increased audit fee
- Universities
- Hospitals

b) CEO characteristics:
- Attitude to SOX
- Education level
- Membership in associations
- Familiarity with SOX

**SOX adoption level by nonprofit organizations**
Implementation Actions by Nonprofit Organizations

The previous sections discussed the external and internal determinants of nonprofit organizations’ compliance with SOX. To continue analyzing the behavior of nonprofit organizations in response to SOX, the emphasis in this section shifts to the specific actions that nonprofit organizations are expected to undertake in order to comply with SOX.

Innovation as a process consists of two stages: conditions and activities that lead to decisions about adoption of innovation, and activities that lead to implementation of the decision (Damanpour, 1991; Rogers, 2003). The model for SOX implementation in Figure 3.3 describes the activities required to comply with SOX. This model is based on the text of the Sarbanes-Oxley Act and on opinions of the nonprofit experts who write about the relevance of SOX provisions to the nonprofit sector (Sarbanes-Oxley Act, 2002; BoardSource and Independent Sector, 2003; Heinz, 2003; NACUBO, 2003; Tate, 2003; Gordon, Hughes and Banks LLP., 2003; Green, 2003; Hamel, 2003; Broude & Prebil, 2005; Weihl; 2004; Foley and Lardner LLP, 2005; Silber, 2005; Vermeer, 2005; Ruppel, 2006). Figure 3.3 contains a brief presentation of SOX requirements that nonprofit organizations are expected to adopt because of their relevance to the nonprofit sector. As Figure 3.3 presents below, I expect that nonprofit organizations that decide to comply with SOX governance, disclosure, and accountability rules will make changes to the board structure, composition and functions; the roles and responsibilities of the CEO and the board; external audits procedures; document preservation, code of ethics, conflict of interest, whistle blower protection, and public disclosure policies.
II
What actions do nonprofit organizations undertake most often to comply with SOX??

Audit committee and external audit
- establish audit committee
- allocate to an audit committee a responsibility to select an auditor and oversee the audit results
- require five year rotation of an audit partner
- separate audit from non-audit services

Boards
- size reduction
- ensure independence
- ensure dual leadership
- provide financial training
- hold executive sessions

CEO
- require to certify financial statements accuracy
- provide financial training
- require internal controls evaluation and attestation

Policy
- retain financial documentation
- adopt whistle-blower protection
- adopt conflict of interest policy
- grant public access to audit reports and financial statements

Figure 3.3 Framework for Compliance Actions with SOX

Outline of SOX Requirements

SOX emphasizes the importance of external audits and internal controls, governance, accountability, and improved disclosure procedures (Adelson, 2003; Clark, 2005; Bisoux, 2005). The external audit provision of SOX requires public corporations to contract a registered accounting firm to review their financial documents and reporting procedures, and to issue an audit statement as a result of their activities. The internal controls provisions in Section 404 of
SOX require management to revise and evaluate the existing internal controls with regard to material weakness (a condition of internal controls that does not allow timely detections and the reduction of risk of mismanagement or fraud that would be material to a financial statement (Ruppel, 2006)), and the audit firm is required to attest the statement of internal controls certified by the CEO. SOX requires establishing the responsibility of board members for the company financial reporting process. The board should establish an audit committee with broad financial oversight functions. The audit committee is required to have at least one financially literate member, be independent, select and oversee the external audit firm, and receive the final report from the auditor. Enhanced governance entails top management responsibility for accurate financial reporting and adequate internal controls, board responsibility for establishing the code of ethics for senior financial officers, a financial documents retention policy, a whistle-blower protection policy, and various disclosure policies. New disclosure standards include full disclosure of the financial situation to shareholders, and real time reporting about important financial transactions (The Sarbanes-Oxley Act of 2002; Adelson, 2003; Gifford and Howe, 2004; Clark, 2005; Bisoux, 2005).

In response to SOX, nonprofit organizations are expected to undertake changes to meet most but not all of the SOX requirements because (1) SOX is not mandatory for nonprofit organizations, (2) some of the SOX requirements are already satisfied by the existing procedures, and (3) some of the SOX requirements may be prohibitively costly to nonprofit organizations (Tate, 2003, Ruppel, 2006). The next section presents a detailed discussion of expected compliance actions. Although not all of these actions will be undertaken by nonprofit organizations, I will describe the full spectrum of required change.
Audit related change

The likely changes in nonprofit organizations are the institutionalization of external audits by those organizations that did not have them before SOX and the establishment of independent audit committees with a qualified financial expert (AICPA, 2005; Vermeer, 2005; Clark 2005). Although the external audit requirement is not new, SOX requirements add to it by establishing barriers to building close relationships between the audit firm and the audited organization. For example, audit firms are prohibited from performing non-audit services, audit partners must be rotated, and auditors must be independent. Although larger nonprofit organizations (with annual revenues more than $500,000 (Ruppel, 2006)) are likely to have already had external audit practices in place before SOX, they are expected to change their external audit arrangements by separating audit activities from non-audit activities by allocating them to different accounting firms. Alternatively, they may seek preliminary board approval to allocate non-audit functions to an audit performing firm, and to initiate rotation of an auditing partner every five years (Clark, 2005, Foley and Lardner LLP, 2005; BoardSource and Independent Sector, 2003; Tate, 2003). SOX requires that the external auditor must verify and attest the adequacy of organizational internal controls and report it to the audit committee.

SOX strongly emphasizes an increasing role of audit committees of the board; these committees are required to select auditors, oversee the audit process, and review audit results. Establishment of audit committees and detailing their functions may become a priority change for nonprofit organizations (Tate, 2003; Foley and Lardner LLP). SOX requires that audit committees should consist of only independent board members, which means that they cannot be managers of the organization, nor can they do any business with the organization they serve.
I rely on the text of SOX and the opinions of nonprofit experts to develop expectations about the establishment of audit committees by nonprofit organizations to comply with SOX. Against this background I build scale items of the main variable of interest – adoption of SOX – that consist of expected specific actions by nonprofit organizations in compliance with SOX. Below I describe the compliance actions of nonprofits to establish audit committees and define their responsibilities following SOX provisions.

SOX requires several compliance actions regarding audit committees:

1. *Nonprofit organizations are expected to institutionalize regular external financial audits to comply with SOX.*

2. *Nonprofit organizations are expected to separate the external audit functions from non-audit functions by allocating them to a different accounting firm.*

3. *Nonprofit organizations are expected to establish a requirement for rotation of audit firms or partners within an audit firm every 5 – 7 years.*

4. *Nonprofit organizations are expected to initiate the assessment of internal controls by top management, and to hire an external auditor to attest the internal controls statement.*

5. *Nonprofit boards are expected to establish an audit committee to comply with SOX.*

**Board-related change**

SOX requires that the board of directors of publicly traded corporations be independent, which means that directors cannot be employed by or do business with the public company where they serve as board directors. Another requirement of SOX mandates dual leadership, which means that the CEO of a publicly traded corporation is prohibited from serving as chair of the board of directors. Compliance with independent board standards and the dual leadership
requirement will not pose a problem to most nonprofit corporations because most nonprofit boards are independent, and leadership of the organization and the board of directors is typically separated in nonprofit organizations.

The board members of nonprofit organizations are expected to take more responsibility for financial control in the post-SOX period. To boost the capacity of board members to undertake financial control, the board members of nonprofit organizations are expected to take financial literacy training (BoardSource and Independent Sector, 2003).

In line with regulations written by the New York Stock Exchange (NYSE)\(^7\) to detail SOX requirements, boards are expected to initiate executive sessions, which exclude members of the management team. The purpose of these sessions is to discuss organizational management openly and critically.

In sum, nonprofit organizations may change their boards to comply with SOX requirements. Boards are likely to become more independent, with separated leadership; to establish independent audit committees; to organize financial training to all board members; and to start holding executive sessions.

Although SOX does not require reduction of board size, the post-SOX regulations written by the NYSE\(^8\) recommend publicly traded corporations to have smaller boards. In the post-SOX period the U.S. Senate proposed new legislation for nonprofit organizations, which also contains a provision for smaller boards. The draft white paper of the Senate calls for a no less than five and no more than fifteen members on the board of a nonprofit organization (U.S. Senate Finance Committee, 2004; Grant Thornton LLP, 2004; Maehara, 2004). Although this proposal is not yet enacted as a law, we may find that nonprofit organizations that are aware of this proposal start

\(^7\) NYSE CG rules §330A.03.
\(^8\) Ibid.
reducing or intending to reduce the size of their boards, which in many nonprofit organizations are larger than 15 members (McKinsey & Company, 2004; Andringa and Engstrom 2001).

From the above discussion of board changes in for-profit corporations following SOX requirements I expect that nonprofit organizations might take similar actions to comply with SOX.

SOX compliance actions regarding board change:

1. **Boards in nonprofit organizations are expected to become independent.**

2. **Nonprofit organizations are expected to separate the organizational leadership by having different people serving as a CEO and a Chair of the board.**

3. **Nonprofit organizations are expected to reduce the size of their boards in response to the Senate 2004 proposal.**

4. **In nonprofit organizations board members are expected to take financial literacy training to perform SOX related responsibilities.**

5. **Boards of directors are expected to establish regular executive sessions.**

**CEO-related change**

To comply with SOX requirements a CEO and a CFO in a nonprofit organization are expected to start certifying the accuracy of financial reports and the IRS Form-990 (BoardSource and Independent Sector, 2003; Tate, 2005). This requirement is intended to increase the responsibility of the top executives for sound financial management. In order to facilitate implementation of the certification requirement, the CEO of the organization is expected to take financial literacy training.
SOX makes internal controls the responsibility of the CEO, the board of directors, and the audit firm. It is expected that the CEO will review and evaluate the existing internal control procedures, and include the internal controls report into the consolidated annual financial report.

With regard to the above description of SOX requirements, the chief executives of nonprofit organizations will take the following actions:

1. The CEOs of nonprofit organizations are expected to start certifying accuracy of financial reports and the Form-990 to comply with SOX.
2. The CEOs of nonprofit organizations are expected to undertake financial literacy training to fulfill the requirements of SOX.
3. The CEOs of nonprofit organizations are expected to review, evaluate, and report existing internal control practices to comply with SOX.

Policy-related change

Two requirements of SOX are viewed by experts as directly applicable to nonprofit organizations as well as other types of organizations: a whistle-blower protection policy and a document retention policy (Independent Sector, 2003; Heinz, 2003; Vermeer et al., 2005, Tate, 2003; Foley and Lardner, 2005). These two requirements are viewed as universal for all corporations, which is clear from the SOX provision informing that the amendment has been made to the Section 42 121 (b) of the Title 49 of the U.S. Code, requiring that informants who assist federal investigations be protected against retaliation in fraud cases. Further, SOX stipulates that similar amendment has been made to the U.S. Code Chapter 3 Title 18 to prohibit destruction, alteration or falsification of records, including corporate audit records (Sarbanes-
Oxley, 2002; see Appendix I). It is expected that these two policies will be instituted by nonprofit corporations in the first place to follow requirements of the U.S. Code, supported by SOX, which is equally applicable to all types of organizations in the US.

Among other policies required by SOX are the establishment of a conflict of interest policy and disclosure policies. A conflict of interest policy is expected to reduce situations where board members or the CEOs’ self-interest may induce them to act against the interests of their shareholders. A disclosure policy requires corporations to provide full financial disclosure to shareholders and other public investors. Disclosure of financial reports is expected to reduce frauds and scandals. Besides, law drafters believe that better information would enable investors to judge corporation performance and make fewer bad investment decisions (Clark, 2005). To comply with best practices embedded in SOX, it is likely that nonprofit organizations will adopt a conflict of interest policy and a disclosure policy (Heinz, 2003; Grant Thornton, 2004, 2005; Foley and Lardner, 2005).

Nonprofits are expected to adjust disclosure procedures to their existing reporting means -- the IRS Form-990 (Keating and Frumkin, 2005). To meet new disclosure standards, more nonprofit organizations can be expected to allow access to their financial statements and the IRS Form-990 for their primary stakeholders and the general public (Independent Sector, 2003).

Because SOX explicitly mandates all types of organizations to comply with two practices – the whistle-blower protection against retaliation, and the document retention practice – nonprofits are expected to adopt these practices to a greater extent. To comply with SOX requirements, nonprofit organizations are expected to take the following steps:
1. Nonprofit organizations are expected to adopt a whistle-blower protection policy to comply with SOX requirements.

2. Nonprofit organizations are expected to establish a financial documentation preservation policy for five years to comply with SOX.

3. Nonprofit boards are expected to adopt a conflict of interest policy to comply with SOX.

4. Nonprofit organizations are expected to adopt a public access to audit reports policy to comply with SOX.

5. Nonprofit organizations are expected to provide public access to their financial statements to comply with SOX.

Figure 3.3 (p. 45) contains brief presentation of SOX requirements that nonprofit organizations are expected to adopt because of their relevance to the nonprofit sector. Individual practices in the Figure 3.3 were used to construct a SOX adoption scale, which was later included in the survey to gather information about SOX adoption in general, and for the purpose of understanding adoption of each individual practice.

Impacts of SOX-Related Changes on Nonprofit Organizations

*Anticipated Effects*

The implementation of SOX-related change proved to be very costly for publicly traded corporations (Clark, 2005, Zhang, 2005; Linck et al., 2005). The effects of SOX compliance in nonprofit organizations have, as yet, not been studied systematically. However, it is important
for nonprofit sector leaders, as well as for policy makers, to understand the impact of a new policy on unintended subjects – nonprofit organizations. This study determines the nonprofit executives’ perception of benefits and costs that their respective organizations have experienced since implementing SOX requirements. The study of such effects has certain limitations. Because financial data that may explain SOX effects, such as the audit fee increase, or reallocation of funds from the program to administrative expenses are not typically included in the NCCS datasets, it is impossible to know about direct financial costs of SOX compliance (NCCS, 2005 (nccs.urban.org/)). For this reason the required data on SOX effects is collected directly from the chief executive officers through a survey.

Several studies of SOX effects on for-profit corporations show that SOX implementation brings certain benefits and imposes direct and indirect monetary costs that are high even for large publicly traded corporations (Zhang, 2005; Clark, 2005; Bisoux, 2005; Linck et al., 2005). With regard to nonprofit organizations, I expect that their compliance decisions are commensurate with the accountability and disclosure challenge and with the available resources as Mohr (1969) and Hoffman and Ocasio (2001) theorize. Figure 3.4 below presents a framework for understanding SOX effects on nonprofit organizations that implement SOX requirements.
IV
What are the benefits and costs associated with adoption of SOX by nonprofit organizations?

**Benefits:**
- better financial controls
- reduced risk of accounting fraud
- enhanced effectiveness of the board
- enhanced reputation
- more government contracts
- more private donations
- better fundraising
- more resources to meet clients’ needs

**Costs**
- less resources to meet clients’ needs
- difficulties to achieve board independence
- reduced fundraising capacity
- CEO and board training expenses
- longer audit committee working meetings
- longer board working meetings
- fees for external audit of internal controls
- less funds for mission-related activities
- reallocation of resources from program to administrative expenses

Figure 3.4 Framework for Understanding SOX Effects
One of my goals in this study is to discover positive and negative effects of SOX related changes in nonprofit organizations. SOX related change may turn out to be costly to nonprofit organizations, although these costs are expected to be lower than in for-profit corporations because certain features such as compensation to the board directors simply do not exist in most nonprofit organizations. Yet, the increased working time on the board and audit committees may impose indirect costs to nonprofit organizations by complicating the retention and recruitment of board members.

Business analysts, scholars, and the popular press have discussed positive and negative effects of SOX on publicly traded corporations (Bumgarder, 2003; CFO Research Services, 2005; Clark, 2005; Zhang, 2005; Linck et al., 2005, Bisoux, 2005). Literature on the benefits and costs of SOX compliance incurred by publicly traded corporations’ provides a clue to anticipate certain effects in nonprofit organizations if they decide to introduce SOX-related change.

**Benefits from adoption of SOX-related change**

The experience of for-profit executives helps to understand the positive and negative effects of SOX. On the positive side, some business executives state that SOX requirements make them reexamine the system of internal controls to find weaknesses and eliminate them. Results of a survey conducted by a group of business consultants including CFO Research Services together with Virsa Systems and PricewaterhouseCoopers LLP (2005) indicate that many responding executives of business corporations found the following benefits of compliance with SOX: (1) increased understanding, effectiveness, and communication of business processes (65 percent); (2) discovered internal control weaknesses that were potentially damaging (65 percent); (3) more effective risk management (45 percent); (4) reduced fraud (20 percent); and
increased effectiveness of the board (8 percent) (CFO Research Services, 2005). One respondent remarked that “the immediate reward is greater assurance that the information the company provides to its external auditors is accurate and fully attested, for investors as well as management.” Executives from some companies believed that investors acted on their perception of SOX compliance, and that market penalized loose governance and poor controls with lower share prices (CFO Research Services, 2005).

The nonprofit sector specifics may produce similar but not identical benefits accruing to nonprofit organizations that comply with SOX. Nonprofit organizations do not have investors but donors. This particular difference suggests that donors do not aspire to receive monetary returns from their donations, unlike business investors. However, while this fact can make donors’ expectations less intense, it may not eliminate their demands for improved accountability in nonprofit organizations. Second, a review of financial reporting and internal controls leads to a better understanding of the risks and control weaknesses, which is beneficial for nonprofit organizations as well as for for-profits. Third, the increased effectiveness of the board is a primary benefit for both types of organizations.

It is reasonable to expect that nonprofit organizations may benefit from adopting the SOX requirements of rigorous financial control and higher involvement of boards in control of organizational finances (Greene 2003). Management in nonprofit organizations can be improved by establishing better financial control procedures and reducing the risk of fraud. However, the most beneficial effect of compliance with SOX for nonprofit organizations is an improved reputation as a “transparent and trustworthy organization,” which may enable the organization to attract more individual and corporate donations, and to receive more funding from government. Enhanced reputation may also help to facilitate government contracts and to develop community
support. Thus, organizations that improve their transparency and accountability procedures may have better chances to enlarge their programs and serve more clients. However, the effect of improved reputation might lag behind the time when the change was implemented. Only four years after SOX enactment, it may be too early to observe the improved organization-donor relationships.

The only way to establish whether organizations have experienced specific benefits from SOX adoption is by surveying the top executives about what happened to their respective organizations as a result of SOX adoption. Specific questions about the benefits and costs of SOX adoption should be included in the survey.

Knowledge about benefits gained by for-profit organizations from SOX adoption and revision of their financial procedures and internal controls helps to formulate the following hypotheses:

**Hypothesis # 3-20:** Compliance with SOX will result in better financial controls in nonprofit organizations.

**Hypothesis # 3-21:** Compliance with SOX will reduce risk of fraud in nonprofit organizations.

**Hypothesis # 3-22:** Compliance with SOX will enhance effectiveness of the boards of directors in nonprofit organizations.

**Hypothesis # 3-23:** Compliance with SOX will improve the reputations of nonprofit organizations.

**Hypothesis # 3-24:** Compliance with SOX will facilitate government contracts to nonprofit organizations.

**Hypothesis # 3-25:** Compliance with SOX will facilitate more private donations to
nonprofit organizations.

**Hypothesis # 3-26:** Compliance with SOX will improve fundraising in nonprofit organizations.

**Hypothesis # 3-27:** Compliance with SOX will help them to obtain more resources to meet clients’ needs.

**Cost of compliance**

Several studies have discussed the effects of SOX on the cost of running a for-profit organization, and on the functions of the CEOs and boards of directors in for-profit organizations (Gifford and Howe, 2004; Linck et al. 2005, Clark, 2005; Zhang, 2005; Bisoux, 2005). They found that SOX requirements for board independence increased the percentage of independent directors (outsiders) on the board, increased the percentage of firms with majority outsiders on the board, and increased the percentage of firms with dual leadership or separate CEOs and board chairmen (Linck et al. 2005). Linck et al. (2005) showed that firms improved board independence by adding new independent outside directors instead of replacing old insider directors who often were the executive managers of corporations, which increased the board size. For for-profit corporations, this move was costly because directors receive compensation for their work on the board. The bigger the board, the higher the total compensation cost. Furthermore, the increased responsibilities and legal liabilities of board members dictated by SOX raised the risk of working on the board, which led corporate leadership to increase compensation to attract new board members, and led insurance companies to increase insurance costs for the corporation (Linck et al. 2005; Clark, 2005). Some companies changed their board composition by removing executive managers of the company from the board and hiring non-
executive board members who are not employed by the company (Linck, 2005). However, some studies showed that high director turnover was negatively related to firm performance (Hermalin & Weisbach, 1988; Yermack 2004). These studies found that board independence increased costs to for-profit organizations.

Nonprofit boards of directors are different from the for-profit boards in that board members typically do not receive compensation for their work (O’Neil, 2001; Colombo and Hall, 1995). This nonprofit board characteristic may eliminate material costs for most nonprofit organizations that comply with the SOX requirement to achieve board independence.

Other SOX related actions originate from post-SOX regulations issued or proposed by legislators. In June 2004 the U.S. Senate Finance Committee proposed a new law modeled after SOX aimed to improve financial control practices for nonprofit organizations. Senator Charles Grassley (R-Iowa) initiated a press release and a White paper that called for major reforms and new SOX-like regulations for the nonprofit sector (United States Senate Finance Committee, 2004). The white paper contained a provision for a limited board size of “no less than five, and no more than fifteen members on the board of a nonprofit organization” (United States Senate Finance Committee, 2004; Grant Thornton LLP, 2004; Maehara, 2004). Although this proposal has not yet been enacted as a law, it is plausible that nonprofit leaders may be proactive and decide to reduce the size of their boards, which in many nonprofit organizations are larger than 15 members (McKinsey & Company, 2004; Andringa and Engstrom 2001). This effect, although not required by SOX, is triggered by the intention of SOX to improve board accountability in for-profit organizations. However, board size reduction might be undesirable for nonprofits because, as studies suggest, fundraising capabilities of nonprofit organizations are positively related to their board size (Dalton et al., 1999; Brown, 2005).
After SOX the NYSE\(^9\) issued rules requiring publicly traded corporate boards to hold regular executive sessions, at which management of the firm and other insiders are not present (Clark, 2005). Although these sessions, if implemented, will not incur direct monetary costs for nonprofit organizations, they will be costly in terms of time commitment for many board members. The same rules require boards to engage in formal periodic self-assessment and evaluation (Clark, 2005). Such evaluations entail reassessment of boards’ roles and functions, and formalization of boards’ responsibilities. This development in nonprofit organizations may deter some board members from participating on the boards because of increasing time commitment, and may create a challenge of increased responsibility and legal liability. The effect of this new policy would be an extended time working on the board.

SOX shifts the power to hire, fire, and compensate the external auditor from the management to the board’s audit committee. Working as an audit committee member is likely to entail more time and higher responsibility for financial reporting and internal financial controls. If nonprofits choose to establish audit committees with required responsibilities, the indirect cost of working on the audit committee will increase. Vermeer et al. (2005) suggest that it would be more difficult for nonprofits to attract new board members and qualified persons to work on audit committee because of increased demands for working time, and increased liabilities for financial performance of the organization.

To comply with SOX requirements to increase the board’s and personal CEO’s responsibility for financial oversight and financial reporting, nonprofit organizations will need to train CEOs and board members to understand details of financial reporting (Independent Sector, 2003). Financial training costs will affect the organizations’ administrative costs.

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\(^9\) NYSE CG rules §330A.03.
Clark (2005) and Zhang (2005) suggest that the largest monetary cost in for-profit corporations will be caused by Section 404 of SOX, which mandates a review of the internal controls and further attestation by external auditors. Clark (2005) also maintains that many publicly traded companies, in order to comply with SOX requirements to revise their internal controls procedures, will have to build up their internal auditing staff. Besides, corporations must devote resources to document processes more completely and to improve security of their financial information systems. Additionally, they may have to pay from 50 to 100 percent higher fees to external auditors for auditing their internal controls (Clark, 2005, Zhang, 2005). Zhang (2005) maintains that the average first-year cost estimate for public firms that complied with Section 404 auditing requirements was about $4.36 million for roughly 27,000 hours of internal work and 8,000 hours of external work, including increases of 57 percent in audit fees.

Accordingly, we may expect that those nonprofit organizations that decide to invite audit firms to review their internal controls will incur considerably higher costs because of increased audit fees (Anft & Williams, 2004). Moreover, organizations that undertake revision and improvement of their internal controls may need to hire additional staff to deal with internal controls procedures (Vermeer, 2005).

Compliance with SOX requirements may lead to increased operational costs for nonprofit organizations. Moreover, the overall rise of operating costs to run nonprofit organizations may limit their ability to expand services to clients. This means that the cost of SOX compliance may undermine the ability of a nonprofit organization to deliver on its mission. The benefits and costs of SOX implementation will depend on the extent of SOX adoption by nonprofit organizations. I do not expect that all nonprofits will adopt SOX to the same extent as for-profit
corporations do. Because SOX is not binding on nonprofit organizations, the extent to which they adopt it will vary. Accordingly, the costs incurred by different organizations will vary.

Based on for-profit corporations’ experience with SOX, nonprofits may be expected to accrue certain costs if they adopt SOX practices. The following hypotheses describe the costs that nonprofits may incur by complying with SOX:

*Hypothesis # 3-28:* Nonprofit organizations will not incur costs if they comply with SOX requirements to improve board independence.

*Hypothesis # 3-29:* Nonprofit organizations will experience reduced fundraising capability if they comply with post-SOX regulation requiring reduction of their boards.

*Hypothesis # 3-30:* SOX related financial oversight responsibilities will increase indirect costs in nonprofit boards by increasing the frequency and duration of board meetings.

*Hypothesis # 3-31:* SOX related financial literacy training for the board members and the CEO will lead nonprofit organizations to additional administrative costs.

*Hypothesis # 3-32:* The SOX requirement to reallocate responsibility to hire and fire audit firms from executives to audit committees will increase the audit committee working time.

*Hypothesis # 3-33:* Nonprofit organizations that decide to do external audit of internal controls to comply with Section 404 of SOX will increase their audit costs.

*Hypothesis # 3-34:* SOX related increase of administrative costs will limit the ability of nonprofit organizations to expand services to clients.

*Hypothesis # 3-35:* Adoption of SOX practices will lead to reallocation of resources from program to administrative expenses.
Hypothesis # 3-36: Adoption of SOX will make it difficult for nonprofit leaders to recruit new board members.

Hypothesis # 3-37: Adoption of SOX will make it difficult for nonprofit leaders to recruit new audit committee members.

Effects of SOX adoption explained

Conventional wisdom suggests that only those organizations that adopt SOX practices will experience the effects of adoption. Initially I planned to explain effects by the level of SOX adoption. However, after interviewing nonprofit executives face-to-face I discovered that some respondents who reported no SOX adoption claimed that their organizations still benefited from SOX because their existing financial control practices were reviewed and improved. Respondent executives explained that improvements did not follow SOX requirements, but were inspired by SOX enactment. To account for possible effects of SOX to those organizations that did not purposely adopt any SOX provisions, I include two more explanatory variables in the analytical model that explains effects of SOX adoption – prior to SOX adoption of SOX-like practices, and intention to adopt SOX. Figure 4.5 below graphically presents the expected relationships among the various forms of adoption and the effects – benefits and costs.
Taking into consideration the different modes of SOX influence on nonprofit practices I hypothesize that these forms will explain SOX effects differently. Although, apparently, relationships exist beyond SOX adoption and effects, I expect to find a stronger association between SOX adoption and effects than between no SOX adoption and effects.

*Hypothesis # 3-38: The organizations that report SOX adoption are more likely to experience benefits and costs than the organizations that experience indirect influence of SOX and report no adoption.*
CHAPTER 4

METHODS AND DATA

Introduction

The review of the recent research literature reveals that a very limited number of systematic studies address the effects of the Sarbanes-Oxley Act 2002 on the operation and performance of nonprofit boards and on top executives and staff in nonprofit organizations. An extensive search of academic databases such as GALILEO, Jstor, Ingenta, Factiva, Google scholar, and EBSCOhost produced few academic articles exploring the effects of SOX for nonprofit institutions, the most notable exceptions were the studies by Heinz (2003), Vermeer et al. (2005), Behn et al. (2005), and Ostrower and Bobowick (2006). However, based on several academic studies and anecdotal evidence in the popular press and Internet I assume that the effects of SOX are already palpable, and can be systematically observed in the nonprofit sector. During the five years since SOX was enacted in 2002, nonprofit organizations might have changed their financial oversight and governance procedures. These changes could have brought benefits as well as constraints to nonprofit organizations such as improved organizational accountability and financial control procedures; enhanced trust of donors and improved fundraising capability, and, possibly, increased overhead spending.

To understand SOX induced change in nonprofit organizations I utilize the for-profit corporations’ compliance actions as a benchmark for comparison. In for-profit corporations SOX changed the role of the board of directors and the responsibilities of top managers; it was also instrumental in the adoption of new internal policies. Researchers have tested these effects
empirically and discovered that the board structure, functions and responsibilities changed; the CEO’s responsibilities for financial and internal control also changed; new policies dealing with document preservation, codes of ethics, conflicts of interest, and whistle-blower protection were instituted. An enormous and costly change to for-profit operations is brought on by the institutionalization of Section 404 requirements for assessment and attestation of internal controls with regard to any material weaknesses (Linck, et al.; Clark 2005; Zhang 2005).

This study attempts to determine whether similar changes were initiated in nonprofit organizations. The nonprofit sector reaction to a new law helps to understand the benefits and constraints that SOX imposed on them. My purpose is to explain how policy decisions impact operations of nonprofit organizations. Results of this research will be useful to the leaders of nonprofit organizations who need to understand SOX spillover effects, to make important strategic decisions, and to rebuild operating and management procedures if necessary. Policy makers will gain an insight into the effects of the new policy, and enhance or eliminate such effects depending on the consequences. Additionally, this study will expand the body of academic research on unintended public policy effects.

The Sample

In order to study adoption and impacts of SOX on nonprofit organizations, a survey was chosen as the primary data collection device. The survey is instrumental in gathering the necessary information for analyzing the adoption of the Sarbanes-Oxley Act by nonprofit organizations nationwide. Because a comparatively short period has passed since SOX was adopted in June of 2002, only top executive officers have sufficient knowledge about the SOX-
related changes to assess the early effects. As yet, none of the available datasets contain any SOX-related data.

To conduct the survey nationwide, a representative random sample of 2,000 public charities was selected from the NCCS Core Files 2004, which was obtained from the National Center for Charitable Statistics (NCCS). The NCCS Core Files 2004 (hereafter referred to as Core Files 2004) have been compiled annually since 1989. Core Files combine descriptive registration information from the Business Master Files (BMF) and financial variables from the Return Transaction Files (RTF). Only organizations required to file the IRS Form 990 are included in the Core Files 2004. Examples of public charities that are not required to obtain official recognition of their 501(c)(3) status are those public charities or other exempt organizations that have less than $25,000 in gross receipts, and churches, conventions or associations of churches. The IRS does not keypunch financial data for approximately 80,000 organizations that filed Form 990 but that were not required to do so because they had less than $25,000 in gross receipts or were religious congregations. Separate files are compiled for private foundations (called NCCS Core PF) and organizations under subsections other than 501(c)(3) (called NCCS Core 501(c) others). NCCS typically excludes from the Core Files 2004 a small number of other organizations, such as foreign organizations or those that are generally considered part of government (NCCS, 2006).

Financial variables such as total revenues, receipts, assets, expenditures, and net income were obtained from the Core Files 2004 dataset. The majority of data files that NCCS compiles are based on data that the Internal Revenue Service (IRS) collects from nonprofit organizations. The obtained Core Files 2004 include data on all 501(c)(3) organizations that were required to file Form 990 or Form 990-EZ and complied, except for public foundations. U.S. Tax Code
501(c)(3) public serving charities include most nonprofit organizations involved in the arts, education, health care, human services, and community service, as well as many other areas. The distinctive feature of the Core Files 2004 organizations is their income tax exempt status (Salamon, 1999). Public charities are 501(c)(3) organizations that receive significant public support. Public charities are the main focus of NCCS databases and account for nearly 90 percent of all 501(c)(3) organizations (NCCS, 2006). This is the largest group of nonprofit organizations among other groups of nonprofits registered under different codes, such as 501(c)(4) – social welfare organizations, 501(c)(5) – mutual benefit organizations, or 501(c)(6) – business leagues. Because 501(c)(3) coded organizations present the largest and most inclusive group of public charities, it was selected for the study.

Although the IRS databases compile the most comprehensive standardized data on tax-exempt organizations, they have certain limitations. The IRS Form 990 has been notoriously criticized for inaccuracy by many scholars who have researched the databases, (Froelich & Knoepfle, 1996; Froelich et al., 2000; Keating and Frumkin, 2001, Hager et al., 2003; Gronbjerg & Paalberg, 2002; Behn et al., 2005). While NCCS employs a range of data checking procedures, its limited resources do not permit systematic in-depth verification of every record. For example, in 1994, the IRS examined errors in a sample of 501 (c)(3) organizations in the BMF and found that twenty-one percent of the organizations had either ceased operations or could not be found (Internal Revenue Service, 1994). According to NCCS, 27 percent of the records for organizations actually located listed an incorrect address (NCCS, 2006). Inaccurate addresses presented an additional challenge in obtaining a decent response rate for this study. To verify the NCCS findings concerning incorrect addresses I randomly selected 200 organizations from the stratified random sample of 2000 organizations and checked their addresses via the
Internet. I found that approximately 21 percent of the addresses listed for the survey population were inaccurate.

The Core File 2004 for public charities contains 303,077 organizations. To select a sample of 2000 organizations I used a stratified sampling technique. The sampling frame of 303,077 organizations was stratified into three groups based upon the size of the organization’s expenditure (Hager & Pollack, 2002; Ostrower & Bobowick, 2006). Table 4.1 presents the stratification principle. The three size strata included smaller organizations and larger organizations as follows:

Table 4.1 Nonprofit Organizations Size Categories

<table>
<thead>
<tr>
<th>Size of expenditure</th>
<th>Small</th>
<th>Mid-Size</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100,000 to $1,999,999</td>
<td>600 org-s</td>
<td>700 org-s</td>
<td>700 org-s</td>
</tr>
<tr>
<td>$2,000,000 to $9,999,999</td>
<td>700 org-s</td>
<td></td>
<td></td>
</tr>
<tr>
<td>$10,000,000 to the maximum</td>
<td>700 org-s</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The dataset was stratified into three sub-datasets, which were used to randomly select 2000 organizations – 600 from the stratum of smaller organizations, and 700 from each of the two strata of mid-size and large organizations. This stratification was necessary in order to test the extent of SOX adoption by size. The literature on adoption suggests that SOX might be expected to have its greatest effects on larger organizations (Grant Thornton, 2003, 2004, 2005, 2006; Vermeer et al., 2005; Behn et al., 2005; Ostorwer & Bobowick, 2006). To illustrate, after receiving expert opinions, California Attorney General Lockyer proposed a threshold for imposing SOX-like rules on nonprofit organizations with a minimum of $2,000,000 annual revenues, government grants excluded. Nevertheless, SOX effects remain very much an empirical question in nonprofit organizations of various sizes. I want to evaluate SOX impacts on different nonprofit organizations. Some research suggests that SOX effects might be greater
in hospitals (Wiehl, 2004; Vermeer, 2005; Linck et al., 2005; Behn, 2005) or higher educational institutions (Basinger, 2004; NACUBO, 2003; Vermeer, 2005; Behn, 2005). I believe that a sample providing broad coverage of distinct sizes and types of nonprofit organizations is essential for the purpose of generalization.

Several earlier surveys about adoption of SOX provisions were conducted in nonprofit sector organizations in 2003, 2004, 2005, and 2006 (Grant and Thornton, 2003, 2004, 2005; Foley and Lardner, 2005; Heinz, 2003; Ostrower & Bobowick, 2006). I used the survey instruments from previous research to develop a questionnaire for nonprofit organizations by adapting questions from these studies and adding my own questions as necessary. Appendix II presents the questionnaire.

Survey Administration

Prior to survey administration, a pretest of the survey instrument was arranged with local and national nonprofit organizations of various sizes. I conducted a pretest among eight executive directors of nonprofit organizations in Georgia and Washington D.C. to check and refine the instrument. Eight participants of the pretest provided comments on the survey instrument, and relevant changes were introduced in the survey.

The Survey of Adoption of the Sarbanes-Oxley Act by Public Charitable Organizations was administered between April and October 2006. The survey was a six-page questionnaire (See Appendix II), which addressed six categories of interest for this particular research: (1) awareness of SOX among top executives; (2) the pattern of government funding to those organizations; (3) external pressure to adopt SOX; (4) adoption patterns and extent of SOX
adoption; (5) effects of adoption including benefits and costs; and (6) relevant characteristics of nonprofits and their chief executive officers.

The questionnaires together with the postage-paid return envelopes were enclosed in an outer envelope with a University of Georgia logo, with a line in the left bottom corner explaining the purpose of the survey which read “Nonprofits and Sarbanes-Oxley Project.” The explanation line was printed to attract the attention of the potential respondents.

I mailed a total of three survey packages (including a cover letter, questionnaire, and postage-paid return envelope), and two reminder cards to 2000 sample organizations. For the first attempt, I did not personalize the letters, which were addressed to Executive directors/CEOs of the listed organizations. To increase the response rate, for the second mailing of the surveys, I addressed the letters to specific individuals. To find out the names of the executive directors or Presidents/CEOs I obtained another dataset from the NCCS, the Key Employee file 2003, which was the latest file of this type available. The file contained the names that were derived from the IRS Form-990, section B, which required nonprofit organizations to list their key employees’ names. The limitation of this dataset is that it has not been updated since 2003.

All return envelopes had an identification number, which was needed to match the responding organizations to the NCCS Core 2004 dataset, which contained the financial data used for explanatory analysis. The identification number was also needed to follow up with the nonrespondents. Prior to mailing the surveys, approval was obtained for the mail protocol, the content of the cover letter, and survey composition from the University of Georgia Institutional Review Board.

The survey was administered by mail. In order to achieve a high response rate, the recommended procedures were used (Dillman, 2000; Edwards et al, 2002). The survey was
reiterated three times, with reminder postcards between the surveys, and reminder follow up telephone calls after the second survey. The telephone calls were deemed necessary to determine whether organizations received the surveys because of the concern for incorrect addresses.

**Survey Response Rate**

Survey response rate was calculated approximately at 20 percent (19.6 percent). Mailing of 2000 surveys generated a crude response rate of 15.5 percent. To make the estimation of the response rate more accurate I excluded from the calculation 21 percent of the organizations that were not reached by surveys at given addressees because the original dataset from the NCCS Core files contained erroneous addresses. However, the response rate of near 20 percent was still lower than expected.

The survey to study SOX adoption by nonprofit organizations applied the recommended techniques to enhance the response rate (Babbie, 2002, Dillman 2000). Among those techniques the following were used: an explanation of the purpose of the study printed on the envelopes, a cover letter explaining the purpose of the research, an endorsement letter from a national nonprofit association, a promise to share the research findings, a postage-paid return envelope, personalization, and three follow-ups. Notwithstanding this effort, the rate of response remained low.

Given the paucity of information about the appropriate response rate from the executive directors of nonprofit organizations, it seems relevant here to cite several studies that explained

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10 The NCCS Core files are based on the Internal Revenue Service’s annual Return Transaction Files (RTF). They contain data on all 501(c)(3) organizations that were required to file a Form 990 or Form 990-EZ and complied. Researchers at Urban Institute found that twenty-seven percent of the records for organizations actually located listed an incorrect address (NCCS data description). I randomly checked 200 addresses in the whole sample of 2000 organizations and discovered that 21% of addresses were different from those provided by the dataset.
the response rates in organizational surveys. Hager et al. (2003) maintained that some researchers insisted that acceptable response rate from nonprofit organizations in general should not be under 50-60 percent (Babbie, 2002; Schutt, 1999), while others argue that surveys of organizations typically receive substantially lower return rates, with 15 percent return rate sometimes reaching a level of acceptability for organizational surveys (Hager et al, 2003).

In order to understand the reason for the low response rate, I turned to the literature that describes surveying top level executives in organizations. I discovered that earlier research had found that top executives invited to participate in surveys behaved differently from other groups of organizational respondents. Cycyota and Harrison (2002) studied response enhancement techniques for executive directors of 1000 private businesses, and found that none of the conventional response-rate enhancement techniques, such as incentives (gifts), advance notice, follow-up, and personalization were effective. They also assumed that the response rate of 18 percent was quite common for top executive officers in private businesses (Cycyota & Harrison, 2002). In conducting the experimental study with manipulation of response enhancing techniques, Cycyota and Harrison received completed surveys for a total response rate of 18 percent. This rate was comparable to those obtained by other researchers (Huselid, 1995; Kumar, Subramanian & Yauger, 1998; Milliken, Martin & Morgan, 1998; Simonin, 1997). Cycyota and Harrison (2002) rigorously controlled their analysis of response rates by including all possible bias factors, and found no conceivable bias among respondents.

In a second study for the top executives’ response rate enhancement, the same authors using meta-analytic procedures, analyzed the response rate data from 231 studies that surveyed executives that appeared in top management journals from 1992 to 2003. This study confirmed that conventional methods of enhancing response rates from top executives were not effective for
three reasons: (1) executives under the current pressures of running an organization simply had less time and energy to spend on pro bono, low-priority behaviors such as survey completion; (2) executives are receiving increasing numbers of questionnaires from academic scholars, students, vendors, internal surveys, and market researchers, which might have exhausted their patience; (3) the first two reasons have prompted formal company policies to reject survey requests, limiting the demands on executives and employees (buffer systems to control requests).

However, the authors found that topic salience and sponsorship by an organization or person in the executive's social networks did result in response rate increase (Cycyota & Harrison, 2006).

These findings help to explain the response rate obtained by this study. First of all, the expectation that SOX rules constituted a salient issue for most nonprofit executives was not supported by the opinions of nonprofit executives and financial comptrollers who were interviewed face-to-face during the period when the survey was administered (see description below). Secondly, the endorsement letter from the National Council of Nonprofit Associations was not effective, probably because of low membership in this organization (the national association includes state-based nonprofit associations from 22 states). Moreover, one example suggests that even the comparatively well-known nonprofit resource organization, the BoardSource, was not able to obtain a high response rate in its nationwide survey on nonprofit executives. The BoardSource organization achieved a nine percent response rate from the survey it administered in 2004 to chief executives of nonprofit organizations with the purpose of collecting information about nonprofits’ board composition, policies, and practices (BoardSource, 2004).

Although which response rate enhancement techniques are the most effective for nonprofit executive directors is an empirical question, it seems that sponsorship by an
organization that was assumed to be within the executive’s social network might not have worked in this particular study.

Having discussed the problems with the response rate in surveying nonprofit organizations’ top level executives, I attempt to eliminate the possibility of nonresponse bias in the next section of this chapter, which presents statistical assessment of the possibility of nonresponse bias.

**Sampling Bias Considerations**

The research design employs a stratified probability sample, which is aimed at achieving greater statistical precision. Based on the size of organization budget I divided the population of public charitable organizations into three strata by the budget size. I chose three unequal strata intentionally to have larger samples of bigger organizations, and a smaller sample of small organizations, because empirical and anecdotal evidence suggests that larger organizations adopted SOX more aggressively and my purpose is to find information about adoption (Grant Thornton LLP, 2003, 2004, 2005, 2006; Ostrower & Bobowick, 2006). From each stratum I selected a random computer generated sample for the three size categories.

I employed a standard error of proportions to test the probability that the estimates based on the sample can represent the population\(^{11}\) of public charity organizations. By using a central variable of interest—the number of organizations that reported SOX adoption—the standard error was calculated based on the following formula proposed by O’Sullivan and Rassell (1999):

\[
SE_p = \sqrt{p(1-p)/n*(N - n)/(N - 1)},
\]

where

\(SE_p = \text{standard error for proportions (percentage of positive responses)}\)

---

\(^{11}\) By population I mean the 2000 organizations that were selected by a disproportional stratified random sampling technique.
\( p \) = the proportion of the sample in one category of the variable of interest (positive response to the question about SOX adoption)

\( \sqrt{p(p-1)} \) – variability of population (standard deviation)

\( N \) – the population size

\( n \) – the sample size

\( \frac{(N-n)}{(N-1)} \) – a finite population correction factor used for calculating sampling errors in small populations

By substituting the sample statistics we receive the following results:

\[
SE_p = \sqrt{0.497(1- 0.497)/304} \times \frac{(1580 - 304)}{(1580 - 1)} = 0.0230
\]

The calculated standard error is verified by applying the probability test (t-test), which suggests that at a 95 percent confidence level the sample falls within the margin of error of +/- 4.5 percent (0.0230* 1.96 standard errors) of the population parameters of public charity organizations filing the IRS Form-990\(^\text{12}\).

**Nonresponse Bias Considerations**

Because my response rate is lower than expected (19.6%), I considered the possibility of response bias. It might be the case that only executive directors of non-profit organizations that have initiated SOX related change have responded. It is probable that larger and wealthier organizations are better networked and have more information channels to learn about SOX and more human resources to participate in the survey. To eliminate the possibility of nonresponse bias I conducted several tests. Fortunately, the Core File 2004 dataset contained indicators that allowed comparing the characteristics of respondents and nonrespondents to determine the

\(^{12}\) The population size was calculated as 2000 - 420 = 1580, where 420 (21 percent) was the number of organizations with erroneous addresses that did not receive the survey.
nonresponse bias. I compared respondents to nonrespondents on a number of statistics available for both groups: the size of organizations, slack resources, age, and policy area.\textsuperscript{13} A one-way ANOVA difference of means test compared respondent and nonrespondent organizations by size, slack resources, age, and policy area. The means of the 1690 nonresponding organizations and the 310 responding organizations were used to test the nonresponse bias. Test results showed no difference of means between respondents and nonrespondents on the following indicators: size, slack resources, and policy area. However, a significant difference was found between respondents and nonrespondents regarding age, with responding organizations being approximately four years older than nonresponding ones on average. Few surveys found that response rate was related to the age of organizations (Gupta et al., 2000). Gupta et al. found a weak negative relationship between the age of organization and the response rate. They maintained that their findings were consistent with organizational nonresponse theory (Tomaskovic-Devey et al., 1994), which determined that informants in older, larger, and unionized organizations took longer to return completed questionnaires. The results of my analysis contradict Gupta’s findings, and suggest that older organizations respond better than the newer ones. ANOVA shows that the difference in age between respondents and nonrespondents is statistically significant.

**Secondary Data**

The research model described in Chapter III includes variables representing specific internal and external characteristics of the organizations under study. The NCCS Core 2004

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\textsuperscript{13} As was mentioned earlier, the size of organization was measured by the yearly expenditure amount, the slack resources were calculated as a difference between annual revenues and expenditures, the age was calculated from the year when the tax-exempt status was granted to an organization, and policy area was defined based on the NTEECC classification provided by the Urban Institute.
dataset provides data on the size of organizations (measured as annual budget size), the age of an organization (calculated from the date of income tax exempt status acquisition), their geographical location (the state), and the policy area (NTEE-CC classification codes), all of which are needed to understand the predisposition of organizations to adopt any provisions of SOX, or to innovate. These variables are included in the analytical model following the internal determinants theory proposition that internal characteristics of organizations influence the rate of innovation. Additionally, the NCCS dataset on Key Employees was obtained from the Urban Institute in order to personalize the surveys. The Key Employees data was matched to the sampled organizations by the Employer Identification Number (EIN). Secondary data are used to obtain information that describes the participant organizations in order to supplement the information received from the survey.

**Qualitative Data**

Concurrently with the survey administration I conducted an in-depth study of the attitude of nonprofit practitioners in decision-making positions toward SOX. I arranged interviews with the executive directors and chief financial officers/comptrollers in nonprofit organizations of different sizes in Athens, Georgia. Six organizations were selected with regard to their size—two small, two middle-size, and two large organizations—to be consistent with the survey sampling strategy. This purposive sample helped to gather additional qualitative information from organizations of different sizes and policy areas. Interviews were conducted in the period from August 28 to September 12, 2006. A new semi-structured questionnaire was developed for these interviews with several open-ended questions. The interviews sought to find information that could explain the attitude of nonprofit leaders to SOX in general, and adoption or non-
adoption behavior of participants, which could give a clue for understanding the adoption trends in the surveyed organizations. Discussion of interview results and findings will follow below in Chapter V.

Model 1a. SOX Adoption: Dependent and Independent Variables

*Contextual external explanatory variables*

The heuristic model that guides this study is presented in Chapter II (p.19). The full all-inclusive Figure 4.1 below combines two explanatory models that answer the two major research questions, explaining SOX adoption and SOX effects. Figure 4.1 describes Model 1a (see also page 19) with the names of the contextual external variables and specific internal organizational variables that influence adoption of SOX requirements by nonprofit organizations. Choice of external factors was guided by the diffusion of innovation, resource dependence, and stakeholder theories; choice of internal factors was guided by internal determinants and diffusion of innovation theories. Model 1b focuses on the consequences of SOX adoption. It reflects the expectation that those organizations achieving certain levels of SOX adoption would experience consequences of their action, positive and negative alike. The SOX adoption level is presented in Model 1b as an explanatory variable that hypothetically influences the level of benefits and costs accruing to organizations that adopt SOX. Figure 4.1 below depicts a path model, which was explained in detail in Chapter II.
Figure 4.1. Framework for Understanding Adoption and Effects of SOX

Model 1a

Explanatory contextual factors – (IV)
- donors’ request to adopt SOX
- board members’ advice to adopt SOX
- auditor’s information about SOX
- dependence on government funds (government contracts and grants)
- sources of information about SOX
- political pressure to adopt SOX
- audit fee increase

Explanatory internal factors - (IV)
- organizational size
- organizational wealth
- organizational age
- CEO familiarity with SOX
- CEO attitude to SOX
- CEO members of professional association
- CEO years of formal education, experience
- adoption of policies required by SOX prior to SOX enactment in 2002
- regular audit

Adoption behavior – IV
Index of SOX adoption, constructed as a summated scale from 1 to 15

Effects of SOX - DV
Costs – index
Benefits – index
Net benefits – index
Model 1a above details the list or external and internal variables that are expected to influence adoption of SOX, and Model 1b identifies the link between the adoption and the consequences. In the next section I will explain how I operationalize and measure the variables from Model 1a and Model 1b in Figure 4.1.

Operationalization of Dependent and Independent Variables

Table 4.2 below describes the contextual and organizational variables that are hypothesized to influence SOX adoption by nonprofit organizations. These variables are conceptualized and operationalized by applying theories of diffusion of innovation, resource dependence, internal determinants, and anticipatory accountability. The measurement of the variables was conceived when that questionnaire was constructed, and actualized when the survey responses were received.
Table 4.2 Model 1a. Dependent and Independent Variables and Measurement

<table>
<thead>
<tr>
<th>#</th>
<th>Type</th>
<th>Variable name</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DV</td>
<td>Adoption level</td>
<td>Summated scale measure from 1 through 15 practices required by SOX. Count variable.</td>
</tr>
<tr>
<td>2</td>
<td>IV</td>
<td>Familiarity with SOX</td>
<td>CEOs’ familiarity with SOX was measured as an ordered scale from not familiar-1, somewhat familiar-2, and very familiar -3;</td>
</tr>
<tr>
<td>3</td>
<td>IV</td>
<td>Federal Knowledge about pending federal and state legislations similar to SOX to regulate nonprofit organizations - dichotomous variables: No - 1, Yes - 2</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>IV</td>
<td>State</td>
<td>Knowledge about pending federal and state legislations similar to SOX to regulate nonprofit organizations - dichotomous variables: No - 1, Yes - 2</td>
</tr>
<tr>
<td>5</td>
<td>IV</td>
<td>Networks Five variables: sources of information about SOX –</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>IV</td>
<td>Publications dichotomous variables: – No -1, Yes - 2</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>IV</td>
<td>Board members</td>
<td>Five variables: sources of information about SOX –</td>
</tr>
<tr>
<td>8</td>
<td>IV</td>
<td>Staff or bookkeeper</td>
<td>Five variables: sources of information about SOX –</td>
</tr>
<tr>
<td>9</td>
<td>IV</td>
<td>Auditors</td>
<td>Five variables: sources of information about SOX –</td>
</tr>
<tr>
<td>10</td>
<td>IV</td>
<td>Donor</td>
<td>Donors’ demand to adopt SOX - a dichotomous variable: No – 1, Yes – 2</td>
</tr>
<tr>
<td>11</td>
<td>IV</td>
<td>External audit</td>
<td>Availability of regular external audit - a dichotomous variable: No - 1, Yes – 2</td>
</tr>
<tr>
<td>12</td>
<td>IV</td>
<td>Credibility</td>
<td>Four variables: attitudes of managers to SOX measured as ordered scale variables on the scale from 1- strongly disagree, to 5 - strongly agree</td>
</tr>
<tr>
<td>13</td>
<td>IV</td>
<td>Existing accountability</td>
<td>Four variables: attitudes of managers to SOX measured as ordered scale variables on the scale from 1- strongly disagree, to 5 - strongly agree</td>
</tr>
<tr>
<td>14</td>
<td>IV</td>
<td>Proactive</td>
<td>Four variables: attitudes of managers to SOX measured as ordered scale variables on the scale from 1- strongly disagree, to 5 - strongly agree</td>
</tr>
<tr>
<td>15</td>
<td>IV</td>
<td>Political pressure</td>
<td>Four variables: attitudes of managers to SOX measured as ordered scale variables on the scale from 1- strongly disagree, to 5 - strongly agree</td>
</tr>
<tr>
<td>16</td>
<td>IV</td>
<td>Experience</td>
<td>Number of years the CEO works in current position, interval variable</td>
</tr>
<tr>
<td>17</td>
<td>IV</td>
<td>Government</td>
<td>Three variables: occupational background, measured by the number of years, interval variable</td>
</tr>
<tr>
<td>18</td>
<td>IV</td>
<td>Business</td>
<td>Three variables: occupational background, measured by the number of years, interval variable</td>
</tr>
<tr>
<td>19</td>
<td>IV</td>
<td>Nonprofit</td>
<td>Three variables: occupational background, measured by the number of years, interval variable</td>
</tr>
<tr>
<td>20</td>
<td>IV</td>
<td>Association</td>
<td>Membership in association - a dichotomous variable: No - 1, Yes – 2</td>
</tr>
<tr>
<td>21</td>
<td>IV</td>
<td>Education</td>
<td>Years of formal education, interval variable</td>
</tr>
<tr>
<td>22</td>
<td>IV</td>
<td>Expenditure Measure of organization size – categorical variables – (1) - small - $100,000-1,999,999; (2)‐ mid-size - $2,000,000 – 9,999,999; (3) - large - $10,000,000 - ∞</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>IV</td>
<td>Had before SOX</td>
<td>Summated scale measure from 1 through 15 SOX-like practices adopted prior to SOX, count variable.</td>
</tr>
<tr>
<td>24</td>
<td>IV</td>
<td>Government revenues</td>
<td>Revenues from government contracts and grants, interval variable</td>
</tr>
<tr>
<td>25</td>
<td>IV</td>
<td>Audit fee</td>
<td>Audit fee increase- a dichotomous variable: No – 1, Yes - 2</td>
</tr>
</tbody>
</table>
Dependent variable – The level of SOX adoption by nonprofit organizations

The main variable of interest in this study—the level of SOX adoption by nonprofit organizations—is a count variable constructed as a summated scale index. Count outcomes take on three or more values that represent the number of occurrences of certain events during a given period of time. Count variables often demonstrate a Poisson distribution with most responses being at zero level. First, most cases have a score of zero; second, the count variables are not continuous, they are finite; and third, the proportion of cases with a higher positive value decreases at the value of count increases. By using a Poisson regression we achieve the data log transformation, which eliminates the skewness problem and prevents the model from producing negative predicted values. I will discuss in depth the model choice for the data analysis in Chapter VI, where I present my data characteristics and distribution.

Adoption is conceptualized as a process of institutionalization by nonprofit organizations of individual practices entailed in the Sarbanes-Oxley Act. As discussed earlier, adoption of SOX is mandatory only for publicly traded for-profit corporations, and is not binding on private businesses or nonprofit corporations. Thus, the adoption of the Act is discretionary for nonprofit organizations. Table 1.1 in Chapter I briefly presents all the SOX practices and policies. This table highlights certain policies that are relevant to the nonprofit sector (See Table 1.1, Chapter 1, p. 16). I use the literature that describes opinions of nonprofit experts concerning the relevance of SOX practices for the nonprofit sector to design the questionnaire for the survey participants. Responses of nonprofit executives to this questionnaire serve to determine the actual level of SOX adoption. The questions concerning adoption or non-adoption of SOX practices and policies are organized in a table with several choice options: (1) the policy was adopted before SOX, (2) the policy was considered after SOX, (3) the policy was adopted after
SOX, and (4) the policy was neither considered nor adopted after SOX. The participants were requested to check one of the options. The option “had before SOX 2002” is included to distinguish the prior to SOX adoption level from the post SOX adoption level. This is a purposeful separation between practices existing before and adopted after SOX of 2002. Appendix II (question 11) lists SOX adoption questions that are used to assign values to the SOX adoption count variable.

**Operationalization of dependent variable**

**SOX Adoption level.** As mentioned earlier, the SOX adoption count variable is constructed as a summated scale. Table 11 from the survey (see Appendix II) contains fifteen SOX practices and policies relevant for nonprofit organizations. All fifteen are derived from the literature that describes the expert opinion about the relevance of SOX practices to the nonprofit sector. The expert opinion and the pretest define the content validity of the construct. Adoption of each individual policy is regarded as an independent event that followed SOX enactment. The level of SOX adoption is a summated scale constructed by adding the number of practices from zero to fifteen for the practices actually adopted by nonprofit organizations after SOX was enacted in 2002. The value and importance of each individual practice is assumed to be comparable to the value of other practices, so no weighting technique is applied to the scale. The scale of adoption practices is tested with the Cronbach’s alpha test with resulting $\alpha = 0.704$, which shows a high level of scale internal reliability. A dimensionality test is performed with factor analysis, which determined that the construct is unidimesional. Unidimensionality is indicated by factor loadings that demonstrate that the constructed summated scale loads highly on one factor, which accounts for 65 percent of the underlying construct.
Independent variables – contextual and internal

To measure the independent variables I use various approaches. As can be seen from the Table 4.2, some independent variables are continuous such as the amount of government revenues, organizational slack resources, and years of CEOs’ experience and formal education. I reconstruct the budget size variable from the interval to categorical by dividing expenditure amounts into three size categories in order to analyze and compare size groups. Other variables are categorical or ordered scale variables such as the level of familiarity with SOX and the CEOs’ attitudes toward SOX. The rest of the variables are constructed as dummy variables such as the sources of information, stakeholders’ indirect pressure, occupational background, membership in associations, availability of regular external audit, and increase in audit fees.

Independent variables - description

Familiarity with SOX. In order to implement SOX, the leaders in nonprofit organizations are expected to have knowledge about SOX requirements. Familiarity with SOX is conceptualized as an explanatory variable, and is measured on an ordinal scale. Respondents were prompted to mark their level of familiarity with the Act by choosing either “not familiar”- 1, “somewhat familiar”- 2, or “very familiar - 3.” Other measures of familiarity included in the survey are the knowledge about proposals made by federal and state legislatures to institute laws similar to SOX to regulate nonprofit organizations, which are constructed as dichotomous variables.

Sources of information about SOX. Several questions in the survey explore the propositions from the diffusion of innovation theory, which states that innovation decisions are
influenced by sources of information (Rogers, 2003). Sources of information include mass media, individual formal and informal networks, nonprofit publications, board members, and auditors. Responses to the questions concerning the sources of information are coded 1 for the “NO” answer and 2 for the “YES” answer. Two questions in the survey determine the expected influence of mass media on executives’ perception of SOX relevance to nonprofit organizations. One question asks whether nonprofit leaders learn about SOX from the nonprofit publications, and the second question prompts respondents to agree or disagree with the statement that mass media compared scandals in public for-profit corporations to incidences of mismanagement in nonprofit corporations. Answers to the second question are coded as a scale from 1 to 5 ranging from strong disagreement to strong agreement.

**Stakeholder pressure.** To test the propositions from the resource dependence and stakeholder theory, three questions in the survey are used to define whether the organizations experienced any pressure from their donors or other stakeholders to adopt SOX. Questions concerning the influence of important stakeholders—board members, donors, and auditors—help to determine whether the stakeholders’ pressure prompted adoption of SOX. “NO/YES” answers to these questions are used to create dichotomous variables.

**Political and social pressure.** Another question asks whether the organization experienced strong political or social pressure to adopt SOX. The scale from one (strongly disagree) to five (strongly agree) is used to measure the extent of political pressure to adopt SOX.

**Auditors’ indirect pressure.** Availability of an external audit is conceptualized as an environmental condition that may have impeded SOX adoption. The external audit availability is assumed to influence adoption of SOX negatively because of accompanying regulations. The
availability of regular external audit is measured as dichotomous variable following “NO/YES” answers.

Audit fee change. An audit fee increase is assumed to signal nonprofit leaders that a certain change is underway in the audit procedure. It is expected that the audit fee may increase by 10 to 100 percent as a result of SOX (Clark, 2005; Linck et al. 2005; Zhang, 2005; Bisoux, 2005). Three questions measure the change in audit fees. One question asks whether there is any change in audit fee, and two follow-up contingency questions ask whether there has been an increase or a decrease in audit fees after 2002. The audit fee variable is constructed as a dichotomy based on the answers that indicate an increase or no change in the audit fee. A decrease in the audit fee is excluded from the analysis because only 4.3 percent of respondents marked this option.

Attitude toward SOX. The attitude toward SOX-induced change, and the proactive stance of executives is measured by two statements, which ask participants to express their opinion by using the “strongly agree- strongly disagree” ordinal scale from 1 to 5. One statement maintains that nonprofit managers should follow their existing accountability standards and procedures regardless of SOX until change is required by a specific nonprofit law. Another statement prompts respondents to agree or disagree that at times of uncertainty about nonprofit regulations in the future, the best choice would be to establish the procedures required by SOX-2002 early. The third statement maintains that by adopting SOX, organizations might gain credibility. The answers to these questions from “strongly disagree” to “strongly agree” are used to measure executives’ predisposition to change internal procedures to comply with SOX on a scale from 1 to 5.
Characteristics of CEOs and organizations. Other explanatory variables, such as the CEO’s and organizational characteristics, are constructed as dichotomous variables, which include the CEO’s occupational background, and membership in professional associations, or as continuous variables, which include formal education of the CEO, revenues, net income, and other financial information about organizations.

Size and slack resources. The organizational size is measured by the level of annual expenditure which is believed to be a more reliable measure than the annual revenue for nonprofit organizations (Foster & Meinhard, 2000). Three categories of expenditure are constructed to create three size categories as defined in Table 4.2, which identify three size groups in the sample—an ordinal scale variable. The slack resources of organizations are measured as a difference between the annual revenues and expenditures.

Government funding. The budget revenue structure is expected to influence decisions to adopt SOX procedures. To know the amount of federal funds received by organizations, the survey asks about the percentage of the total budget received directly from the federal government or indirectly from the state governments. Further, the amount of revenues received from federal or state governments is calculated from the total revenues of organizations and the percentage of government funding provided by the respondents.¹⁴

Prior to SOX adoption. Certain requirements of SOX were satisfied by the long-standing practices of nonprofit organizations even before SOX was enacted in 2002. An example of such practice would be having an independent board of directors; such boards involve only outsiders to the organization, people who are not the organization’s employees. To distinguish between the practices established as a result of SOX adoption and practices that existed in organizations before SOX was enacted in 2002, respondents are asked to mark those practices and policies in

¹⁴ Amount of total revenue * percent of government funds = amount of government funding
the table that were established before SOX 2002. Table 11 from the survey (see Appendix II) contains 15 practices and policies relevant to nonprofit organizations that define the SOX adoption concept. Similar to the SOX adoption summated scale, the concept of prior to SOX adoption is constructed as a summated scale by adding the number of policies from zero to fifteen marked as existing prior to SOX enactment in 2002.

**Model 1b. SOX Effects: Dependent and Independent Variables**

Model 1b in Figure 4.1 (p.78) explains how SOX related costs and benefits are associated with the extent of SOX adoption by nonprofit organizations. Benefits are conceptualized as positive developments resulting from SOX adoption that bring advantages to the nonprofit organizations in terms of improved management, resource acquisition, and improved credibility. Costs are conceptualized as negative developments resulting from SOX adoption that disadvantage the organizations in terms of additional spending and working time, and hiring difficulties.

Table 4.3 below shows three dependent variables, which are operationalized as costs, benefits, and net benefits indices; in statistical terms they are count variables constructed as summated scales, which present the incidences of benefits and costs accruing to nonprofit organizations from SOX adoption. The level of SOX adoption becomes an independent variable that explains costs, benefits, and net benefits accruing to those organizations that adopted SOX. A description of dependent and independent variables with explanation of measurement is presented in Table 4.3.
To discover SOX effects, the table of positive and negative effects is presented to the survey participants with two answer options (NO/YES) for each item of costs and benefits. Respondents were requested to mark any number of effects that their respective organizations experienced as a result of SOX adoption (see Appendix II, question 21). Responses to this table are used to create summated scales for costs and benefits.

**Dependent variables – SOX effects**

The table of costs and benefits accumulates information from research literature on SOX effects in publicly traded for-profit corporations that describes specific costs and benefits of SOX adoption. The information about effects in for-profits is used as a benchmark because no research has been done, as yet, to learn about SOX effects in nonprofit organizations. The table contains 18 individual items that describe the benefits and costs of SOX adoption. The dependent variables that measure the effects of SOX adoption are constructed as three summated

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**Table 4.3. Model 1b. Dependent and Independent Variables**

<table>
<thead>
<tr>
<th>#</th>
<th>Type</th>
<th>Variable</th>
<th>Measurement</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>DV</td>
<td>Benefits from SOX adoption</td>
<td>A summated scale index is built as the number of benefits items from 1 to 8 reported by respondents</td>
</tr>
<tr>
<td>2</td>
<td>DV</td>
<td>Costs from SOX adoption</td>
<td>A summated scale index is built as the number of costs items from 1 to 10 reported by respondents</td>
</tr>
<tr>
<td>3</td>
<td>DV</td>
<td>Index of net benefits</td>
<td>An index is built by subtracting costs from weighted benefits</td>
</tr>
<tr>
<td>4</td>
<td>IV</td>
<td>SOX adoption level</td>
<td>A summated scale index is built by adding reported adoption from 1 to 15 practices, count variable</td>
</tr>
<tr>
<td>5</td>
<td>IV</td>
<td>Considered for adoption after SOX</td>
<td>A summated scale index is built by adding reported practices considered for adoption from 1 to 15 practices, count variable</td>
</tr>
<tr>
<td>6</td>
<td>IV</td>
<td>Prior to SOX adoption level</td>
<td>A summated scale index is built by adding reported practices existing prior to SOX from 1 to 15 practices, count variable</td>
</tr>
</tbody>
</table>
scale indices for the purpose of separate analysis of the cost effects, benefit effects, and net benefits. Below I provide a description of the variables.

**Benefits index.** The effects table contains eight questions that describe benefits that for-profit organizations experienced from adopting SOX. The index is constructed as a summated scale of a number of items from one to eight in the benefits table\(^\text{15}\) marked by respondents as experienced (see Appendix II, question 21).

**Costs Index.** The effects table\(^\text{16}\) contains ten questions describing costs accruing to organizations from SOX adoption. The index is constructed as a summated scale of the number of items from one to ten marked by a respondent as experienced (see Appendix II, question 21).

**Net benefits Index.** Benefits and costs are different substantively, but statistically no difference exists between the costs and benefits the organizations experienced from SOX adoption. I cannot conclude, following the literature describing SOX effects in publicly traded organizations, that any costs outweighed benefits or vice versa with one exception. Business experts maintain that compliance with SOX Section 404, which required streamlining internal controls, imposed significant costs on for-profit corporations. On average, for-profit corporations spent about $4.36 million dollars to comply with Section 404 (Zhang, 2005). Because of such a dramatic effect of the Section 404 on for-profit corporations, I excluded the effects of Section 404 from the table of effects presented to survey respondents. I decided to analyze Section 404 effects independently from other SOX effects (see Appendix II, Q. 20).

Net benefits from SOX are calculated by subtracting costs from benefits. In order to assign equal weight to benefits (8 items) and costs (10 items), I weight the benefits by

\(^{15}\) Internal reliability of the benefits summated scale is high as the Cronbach’s alpha test indicate (\(\alpha = 0.733\))
\(^{16}\) Internal reliability of the costs summated scale is high as the Cronbach’s alpha test indicate (\(\alpha = 0.737\))
multiplying each item by 1.25 (10/8). Further, I subtract the cost index from the benefit index to receive a net benefits index.

**Analytical Models**

I will briefly describe the analytical model choice for the Model 1a and the Model 1b. In Model 1a the first dependent variable $Y_1$—“adoption of SOX” is constructed as a count variable, which is measured by the number of individual SOX practices adopted by organizations. The univariate distribution of $Y_1$- shows a Poisson distribution, where the mean $\mu > 0$ defines the variance and the distribution. The univariate distribution of $Y_1$—number of practices adopted—has a mean of 1.72 with a long tail to the left showing the decreasing incidences of increasing values of SOX adoption (Graph 6.1, Chapter VI). The dependent variable distribution and structure suggest the model choice. The Poisson regression model and its inverse the negative binomial regression model are standard models for a count dependent variable. When the dependent variable is a count variable its particular characteristics make the use of the OLS problematic. The count variable does not meet the assumptions for OLS. The count variable distribution is usually skewed, while it should be symmetric in OLS; the distribution of errors is heteroscedastic, while the OLS requires errors to be homoscedastic; the variance changes with the mean, while the OLS assumes constant variance; a count variable cannot take a negative value, which may happen with the dependent variable in OLS (Berry, 1993). When OLS is still used with count variables the following problems emerge: predicted values may fall outside the possible range of the count outcome, regression coefficients are biased, error terms are not normally distributed. These problems may lead to wrong direction and size of estimators, and to a biased standard error, which can invalidate the statistical significance test (Garner et al., 1995).
Alternatively, count outcomes can be analyzed with the use of Poisson regression or the negative binomial regression models. To analyze the relationships between the SOX adoption level and the explanatory independent variables I use the Poisson regression model (PRM). The choice and application of the Poisson regression model is explained in detail in Chapter VI.

In Model 1b the dependent variables “benefits” and “costs” graphically demonstrate the Poisson distributions as well (see Graph 6.3, Chapter VI). For analyzing relationships between the effects of SOX adoption and the level of SOX adoption, I apply the negative binomial regression model (NBR), an alternative to the Poisson regression model for the count variables in the presence of data overdispersion (see the detailed description in Chapter VI). The alpha test for the PRM and the NBR suggested a preference for the negative binomial instead of the Poisson regression model.

To understand how the individual items of benefits and costs indices contributed to building the underlying constructs—the positive and the negative effects of SOX adoption—I ran the multiple correspondence analysis for all of the effects items. The multiple correspondence analysis exhibits a unidimensional loading for all items. The Cronbach’s alpha test shows high level of coefficient reliability in the summated scales of benefits and costs (see the detailed description in Chapter VI).

Summary

To analyze the early adoption of SOX by nonprofit organizations I chose the cross-sectional study design. The unit of analysis is the nonprofit organization. To collect the data about SOX adoption, a questionnaire is sent to the executive directors of randomly selected nonprofit organizations of various sizes. The purpose of the study is to determine which contextual and internal variables explain SOX adoption in nonprofit organizations. The second
purpose is to find out how SOX adoption influences SOX related benefits and costs in participating organizations. The choice of analytical models is driven by data characteristics. Poisson regression model is used to explain SOX adoption. The effects of SOX adoption are explained with the negative binomial regression model.
CHAPTER 5

QUALITATIVE STUDY

The Nonprofit Leaders’ Attitudes toward the Sarbanes-Oxley Act and Its Relevance to the Nonprofit Sector

Before initiating a survey, I collected a considerable body of anecdotal evidence and expert opinion about the impact of SOX on the nonprofit sector, which suggested that SOX was being actively adopted by large nonprofit organizations. To have a better sense of what nonprofit leaders think and do about SOX, I conducted local interviews with top managers of nonprofit organizations registered under the tax code 501(c)(3). I selected two small organizations that provide educational services and humanitarian assistance, with budgets less than $2,000,000; two mid-size organizations that serve youth, with budgets under $5,000,000; and two large organizations—a healthcare institution and a university—with budgets considerably bigger than $5,000,000. On purpose, I selected a convenience sample for face-to-face interviews following the strategy for sample stratification. My purpose was to understand better how SOX was adopted in organizations of various sizes.

Besides specific questions about adoption of SOX practices, several questions that specifically interested me concerned the sources of information about SOX, existing accountability and transparency policies within organizations, the sense of urgency in relation to SOX adoption, the attitudes of managers’ towards SOX, relationships with an auditor, and the effects of SOX.
**Level of familiarity with SOX.** I discovered during my preliminary talks over the telephone that all interviewees were familiar with SOX. However, the level of familiarity varied. In the largest organizations where I interviewed chief financial officers, level of SOX awareness was high. A leader of one small organization was also well informed about SOX and its requirements. The top leaders in mid-size organizations and in the other small organization were somewhat informed about SOX requirements. Two interviewed CEOs were from organizations affiliated with the larger nationwide organizations. Both organizations received information about SOX from their national headquarters. In one case it was a detailed description of SOX with recommendations to adopt four specific rules. In another case, headquarters provided a general financial advisory and comments about SOX and other new laws without recommending adoption of any specific provisions.

**Sources of information about SOX.** All participants encountered information about SOX for the first time in newspapers, nonprofit publications, and discussions with colleagues from other organizations. These discussions were informal and hardly informative. Only one interview participant from the large organization reported having a formal discussion of SOX at the meeting of the professional association of accounting professionals. She also reported that Representative Oxley was present at this meeting, and that he disclaimed any intention of using SOX to regulate the nonprofit sector. Some respondents learned about SOX from their business counterparts, office accountants, and auditors. Two respondents participated at the United Way training sessions, where SOX was mentioned several times but no in-depth discussion followed.

In most cases the nonprofit leaders were informed about SOX because it was an important political topic, which was discussed widely in newspapers and nonprofit publications. Apparently, there was no concerted effort to educate nonprofit organizations about requirements
of the law at national or state levels. National headquarters provided information about SOX to their branches through their internal network channels. Some organizations have heard about SOX from the auditors and through informal networks.

Existing accountability and transparency policies. On acquainting myself with the text of SOX I realized that some provisions had already been established by nonprofit organizations as long-standing practices. For example, the independent boards and separation of leadership between the Chair of the board and the CEO were typical arrangements in organizations of the nonprofit sector. I also knew that nonprofit organizations of a certain size and organizations with federal grants larger than $500,000 were required to have external annual audits (Ruppel, 2006; Fremont-Smith, 2004). However, during the interviews I discovered that most of the participant organizations had already established many SOX-like practices in their organizations some time before SOX was adopted.

An interview participant from a small organization stated that many SOX-like practices already existed in her organization: “Most policies embedded in SOX had been long-standing practices in our organization a long time before the Sarbanes-Oxley Act was passed in 2002. We’ve always had an annual external audit, dual leadership, independent board of directors, executive sessions of the board, and public access to financial documents.” She added that SOX, nevertheless, had an indirect effect on her organization. Because of the emphasis that SOX placed on financial management, her organization improved financial management, revised and formalized internal controls by printing control rules and distributing them to personnel. Certain policies, such as the whistle-blower protection policy and the requirement to provide financial training to the executive director and the board members, were considered after SOX enactment
but were not yet adopted. However, two policies were adopted because of SOX: rotation of the
audit partner, and reassessment of internal controls.

The executive director of this small organization is quite satisfied with the existing
financial oversight procedures in her organization. For example, she reports that the Board
Executive Committee holds budget oversight meetings monthly, and that the full Board of
Directors discusses the organization’s budget bimonthly. These two financial oversight
measures are the regular practices in all the organizations interviewed. Further, the Chairman of
the Board is responsible for receiving and hearing the auditor’s reports annually. The Investment
Committee oversees the investment activities of the restricted funds. The IRS form 990 is posted
on the organization’s web site, and can also be found at the GuideStar web site. I concluded that
the financial oversight in the small organization with the budget of less than $1,000,000 is
impressive. I observed that the accountability and transparency practices in this organization are
in line with many of the SOX requirements.

The other small organization is an affiliate of a large national organization. In this
organization, financial internal controls include the rule of double signature for any routine
payment document, and the approval of the board of directors for a large money transfer. During
its monthly meeting, the Finance Committee considers all important financial documents such as
the balance sheet, consolidated accounts, and year-to-year budget comparisons. It may be that
this organization’s accountability and transparency procedures are explained by its affiliate
status, and by a long-standing practice of close involvement of the board.

A manager of a mid-size organization, with a budget of about $3,000,000, argued that
“accountability and oversight requirements in nonprofit organizations are more demanding than
in for-profit organizations.” She speaks from her ten years of work experience in the business
sector and 12 years in the nonprofit sector. In her organization, the Board of Directors actively conducts oversight of the organization’s financial activities, evaluates the organizational performance bimonthly, and receives reports from the executive director monthly. Annual reports and IRS Form 990 are posted on the organization’s web site.

The chief financial officer of the largest organizations, the hospital, talked about existing standard accountability and oversight procedures in the hospital that includes 11 out of the 15 practices recommended to nonprofit organizations based on the text of SOX. He reported that only one new policy was adopted as a result of SOX: the policy requiring rotation of an audit partner. The chief financial officer explained the existing robust transparency and accountability arrangements in hospitals by the fact that they are already heavily regulated because of government grants and other reporting requirements of large donors.

While confident about accountability and transparency in his own organization, the hospital chief financial officer expressed doubts about the state of accountability and transparency in smaller nonprofit organizations. He contended that “saying that all nonprofit organizations have good accountability and disclosure mechanisms is too global of a statement.” He believes that accountability and transparency arrangements in most nonprofit organizations would be significantly improved if organizations chose to comply with SOX.

The financial comptroller of the large university also reported that most of the policies required by SOX were already in place at the university before SOX was passed in 2002, including the conflict of interest policy, financial document retention policy, annual external audits (separate for each of 13 funds), provision for separation of audit and non-audit services, independent Audit Committee of the board, dual leadership structure, executive sessions of the board, independent Board of Regents, financial statement certified by the chief executive officer.
and the chief financial officer, and public access to the financial statements and audit reports. She presented multiple volumes of government regulations for financial management and controls, and regulations for conducting internal and external audits.

To summarize, the interviewed leaders of nonprofit organizations, small and large, feel that their accountability and transparency procedures are adequate and that they precede many SOX requirements. In fact, all the six organizations that I interviewed had well designed accountability procedures in place before SOX was enacted in 2002. Of course, this finding warrants more general empirical testing. For this reason I include in the survey a question about the prior to SOX accountability and oversight practices in nonprofit organizations.

*Sense of urgency in relation to SOX adoption.* From my conversations with nonprofit leaders, I learned that they have very little sense of urgency to adopt SOX. None of the participants experienced any pressure to adopt SOX from the organizations’ donors or members of the boards. Moreover, the interview participants did not hear much about SOX at the meetings and training sessions with other nonprofit organizations. One of my interviewees expressed her view of SOX by the phrase “SOX for us is more of a nuisance than real concern.” Two interviewees do not think SOX is very useful for their organizations because most of its practices were instituted earlier. One leader expressed her opinion that most leaders of small nonprofit organizations are not concerned about possible SOX implications because they do not expect that their organizations will be required to comply with SOX in the future.

In contrast, the leader of the small affiliate organization maintains that there is a certain pressure from the headquarters to adopt specific SOX requirements. People in her organization do feel some urgency to adopt SOX, although they are well informed that SOX is not mandatory for nonprofit organizations. However, at the local level, this organization has experienced no
political pressure to adopt SOX. This leader opined that the reason for the national parent organization to establish SOX rules and pressure its affiliates to adopt specific SOX practices is to revitalize its accountability and transparency practices and gain higher credibility. She thinks that SOX standards are beneficial for her organization because it helps to reinforce financial control and oversight. Another affiliate organization, by contrast, does not experience any pressure from headquarters to adopt SOX. The executive director only received one paragraph of information about the new law with no recommendations to comply with SOX.

I found mixed evidence about how nonprofit organizations feel about SOX. Some believe that the law is not going to affect the nonprofit sector, and others believe that SOX may serve to improve nonprofits’ legitimacy. Half of the participants view SOX as potentially beneficial, while others are aware that SOX is not binding for nonprofits, and they do not plan to adopt it voluntarily.

*Attitudes of managers towards SOX.* Opinions about the utility of SOX are divided. Some interviewees consider SOX beneficial for organizations, and others consider SOX to be very costly and potentially resource draining. Leaders from the large organizations think that SOX practices are worth considering for adoption, while leaders of small organizations are concerned with the cost of adoption.

Both large and small organizations’ leaders agree that SOX adoption may improve the credibility of nonprofit organizations. Some believe that since the Enron scandal the general public has become sensitized to the issues of proper governance and oversight over financial management in for-profit and nonprofit organizations alike. One participant maintained that “there is always a room for improvement of financial control and oversight procedures that SOX may help with;” she also believes that SOX provides an opportunity to reassess and improve the
audit process, the internal controls, and the responsibility of nonprofit organizations leaders. The leader of the large youth organization argues that the importance of SOX is not well understood by smaller nonprofit organizations. He suggested that many organizations would be interested in complying with SOX if they understood the meaning of SOX. Most participants disagreed with the statement that the best strategy for nonprofits would be to maintain existing accountability arrangements until a specific nonprofit law is enacted. They maintained that SOX is a useful regulation for nonprofit organizations to consider for voluntary adoption. Most leaders stressed that SOX provisions ought to be adopted creatively to meet every organization’s individual need for transparency and accountability.

After interviewing leaders of nonprofit organizations, I received the impression that, in general, their attitudes toward SOX are positive, although some concerns exist about the cost of adoption. Many participants believe that SOX may bring more good than bad to nonprofit organizations.

*Relationships with auditors.* Large organizations receive information about SOX from their auditors. Auditors do not insist on compliance, but highlight some requirements that could be relevant to nonprofit organizations. Large organizations report well established relationships with their auditors, and are not willing to rotate the audit firms. Nonetheless, the hospital did make the decision to rotate the partners within the auditing company, but the hospital CFO does not attribute this decision to the direct influence of SOX. He also observed recent changes in auditors’ behavior. According to the CFO, the auditor performs more tasks now, is risk-averse, and attends to concerns more readily. He attributes the auditor’s increased vigilance to the influence of SOX requirements.
The leader of another large organization reports that an auditor advised her to comply with those requirements of SOX that are binding to all types of organizations—the whistle blower protection and retention of financial documents. This auditor also recommended formalizing the whistle-blower protection policy, educating employees about it, and then asking them to sign the awareness statement. Consequently, the organization’s board of directors is preparing to institute the whistle-blower protection policy. Another recommendation the auditor made is to include the endowment fund report in the general audit report. This procedure changed the audit practice to some extent. Another small organization changed its audit firm recently to meet requirements of SOX, but did not see any change in the content or scope of the audit. The audit fee did not change at all.

The most visible effect of SOX on relationships of nonprofit organizations with their auditors is the increase in audit fees and the difficulty in hiring a new audit firm. All interview participants stressed that they now receive fewer responses to tender advertisements for audit services. The university comptroller argues that SOX created a market for audit services. As a result, higher demand for audit services has led to an increase in audit fees and a decrease in supply. For example, the university did not receive any bids from audit companies after advertising a tender for a special fund auditing. The human service organization also experienced difficulty in hiring auditors as accounting firms were not readily available. The youth organization leader maintained that finding a competent auditor is becoming a problem for nonprofit organizations. The board of directors in this organization turned down three bids because of low quality, and had to look for two months before they found a new auditor.

Leaders of large organizations maintained that their organizations experienced a 20 to 30 percent increase in audit fees. The hospital, however, did not experience a large fee increase.
The chief financial officer says that the fee increase was insignificant and was not related to SOX. The small, youth-serving organization experienced only a five percent increase in audit fees, which its leaders attribute to inflation rather than to SOX influence.

The most noticeable change in relations with auditors for most organizations under study was the growing shortage of audit services in the market and the higher audit fees. Auditors do not pressure their nonprofit clients to comply with SOX, although they inform them about certain SOX requirements and provide valuable advice about which provisions could be beneficial should organizations decide to adopt.

Effects of SOX. Half of the participants attribute change in their organizations to the influence of SOX. The other half does not see the direct effects of SOX in their organizations, but admits that some effects could be indirect.

Those who admitted the influence of SOX introduced change knowing that it is a requirement of SOX. Others learned about SOX requirements shortly after they established new procedures. They maintained that probably some indirect influence of SOX was present. For example, the hospital CFO reviewed internal controls with the purpose of finding any material weaknesses on the advice of his auditor. An internal control review led to improvements and reduced the possibility of fraud. But he also maintains that the review of internal controls is a regular practice in the hospital not directly related to SOX enactment. The leader of the small youth organization revised financial reporting and control policy when she heard discussions about SOX, but with no direct reference to the contents of SOX provisions. She says that SOX sensitized her to financial management and control issues. Revising internal controls helped to minimize the possibility of mismanagement. She considers this an indirect influence of SOX.
The university leaders are aware that SOX is not binding for nonprofit organizations. Although they have no intention or plan to comply with SOX, they did revise the regulations that govern their financial reporting and the oversight procedures, which helped to improve them. They are considering adoption of a whistle-blower protection policy, and establishment of an internal audit committee separate from the Board of Regents audit committee. These decisions are pending. The university comptroller does not see a direct influence of SOX on her organization but agrees that there is an indirect effect.

Two organizations, however, did make conscientious efforts to comply with SOX. The small human service organization, a branch of a national organization, took the following actions to comply with SOX: establishment of an independent audit committee, rotation of audit partners, approval of audit and non-audit services provided by different accounting firms, implementing the whistle-blower protection policy, and introducing a Code of Ethics for senior financial officers. The other small organization experienced both direct and indirect effects of SOX. Following SOX, the leaders established a five year rotation requirement for audit partners. The executive director attributed the difficulties in hiring auditors and recruiting new board directors to the indirect influence of SOX.

Summary

The interview findings are very important for analyzing the survey data. I received useful information concerning the state of accountability and disclosure in nonprofit organizations, the attitudes of top managers to SOX, the feeling of urgency with regard to SOX adoption, relationships with auditors, and the effects of SOX.

Through the interviews I found that the nonprofit leaders are informed about SOX and its requirements. The information channels are mass media and informal networks. Some learned
about SOX from their auditors. The level of awareness is high enough to expect some kind of proactive or reactive behavior with respect to SOX requirements on the part of nonprofit leaders.

The interviews provided considerable information about the existing accountability and transparency structures in nonprofit organizations. The fact that most organizations already had well designed existing accountability and transparency structures may have created a weaker sense of urgency with regard to SOX adoption. Regardless of the positive attitudes of managers to SOX, I do not expect a very high level of SOX adoption simply because there is no feeling of urgency or obligation to adopt SOX.

Nonprofit leaders cite increased audit fees as the material impact of SOX. Another important negative effect is a deficit of audit services. All interviewed organizations experience certain direct or indirect effects of SOX apart from changed relations with auditors. Some organizations conscientiously complied with certain provisions of SOX such as the establishment of a whistle-blower protection policy, auditor rotation, and creation of audit committees. Others were affected indirectly. Although the participants did not report that they adopted any SOX provisions purposefully, they agree that because of SOX they revisited and reviewed their financial management and oversight procedures, which benefited their organizations by reducing the possibility of fraud and financial mismanagement.
CHAPTER 6
QUANTITATIVE STUDY

The Level of Adoption of the Sarbanes-Oxley Act by Nonprofit Organizations

Introduction

In this chapter I report the results of the descriptive statistics and the analytical model findings concerning the level of adoption of the Sarbanes-Oxley Act (SOX) by nonprofit organizations. As described in Chapter III, the SOX adoption analysis is framed by the diffusion of innovation theory (Rogers, 2003), the resource dependence theory (Pfeffer and Salancik, 1989), the anticipatory accountability theory (Kearns, 1994), and the internal determinants theory (Mohr, 1969; Damanpour, 2001).

I start the survey data analysis by presenting and explaining descriptive statistics that profile survey respondents and organizations, and illustrate differences between two groups of respondents within the sample defined by the main variable of interest—adoption of SOX practices in the post-SOX period. I use the Poisson regression models to understand the association between the independent variables and the dependent variable—the extent of SOX adoption by nonprofit organizations. This stage of analysis answers two research questions: To what extent have nonprofits adopted SOX? How can we explain differences in SOX adoption by nonprofit organizations? Additionally, I analyze and explain any differences in adoption behavior by state and policy area of nonprofit organizations.
Finding 1. Characteristics of Respondents and Organizations

In Tables 6.1 and 6.2, I present the characteristics of the respondents and the organizations they represent. The total number of responses is 315, but five of them either had too many missing answers or refused to participate because they believed that SOX was inapplicable to them. Six organizations were not identifiable by the number on the response envelopes, which impeded finding their descriptive information from the secondary data set, such as the organizational policy area, state, size, age and income. However, they responded to the survey fully and are included in the analysis where the information about their size, age, state, policy area or income is not required. Four cases are excluded because the respondents did not answer the questions concerning the main variable of interest—SOX adoption. Finally, two extreme outliers are excluded for the purpose of more accurate statistical analysis. The remaining 304 responding organizations are identified and described in Table 6.1 below. Several respondents chose not to report some personal information. As a result several observations are missing – one respondent did not indicate years in current position, and six did not report their level of formal education.

Table 6.1. Characteristics of Respondents

<table>
<thead>
<tr>
<th>Respondent characteristics</th>
<th>N of resp.</th>
<th>% of resp.</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief executive officers</td>
<td>216</td>
<td>71.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Chief financial officers</td>
<td>54</td>
<td>18.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Managers</td>
<td>34</td>
<td>11.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Years in current position</td>
<td>303</td>
<td>99.7</td>
<td>9.1</td>
<td>7.3</td>
</tr>
<tr>
<td>Membership in associations</td>
<td>302</td>
<td>99.3</td>
<td>1.7</td>
<td>0.5</td>
</tr>
<tr>
<td>Level of formal education</td>
<td>298</td>
<td>98.0</td>
<td>17.8</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Among respondents who completed the survey, 89 percent are chief executive and financial officers, who are expected to know the most about the SOX related change in
organizations. On average, the leaders of nonprofit organizations have held their current leadership positions for about nine years, obtained around 18 years of formal education, and are members of professional associations (99 percent).

Table 6.2 below presents major characteristics of surveyed organizations by the number of paid staff, government funding through federal or state contracts and grants, the size and the policy area of organizations.

Table 6.2. Characteristics of Organizations

<table>
<thead>
<tr>
<th>Organizational characteristics</th>
<th>N of resp.</th>
<th>% of resp.</th>
<th>Mean</th>
<th>Std. Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of paid staff</td>
<td>298</td>
<td>98.0</td>
<td>367</td>
<td>2160</td>
</tr>
<tr>
<td>Government funds recipients</td>
<td>297</td>
<td>98.0</td>
<td>0.89</td>
<td>1.15</td>
</tr>
<tr>
<td>(4 categories)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0% - no government funds</td>
<td>159</td>
<td>53.6</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>1-30% - of the budget</td>
<td>67</td>
<td>22.6</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>31-50% - of the budget</td>
<td>17</td>
<td>5.7</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>51-100% - of the budget</td>
<td>54</td>
<td>18.2</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Age of organizations</td>
<td>296</td>
<td>97.0</td>
<td>29.8</td>
<td>17.7</td>
</tr>
<tr>
<td>Budget size of organizations</td>
<td>297</td>
<td>98.0</td>
<td>2.2</td>
<td>0.8</td>
</tr>
<tr>
<td>(three categories)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 – $100,000-1,999,999</td>
<td>111</td>
<td>37.4</td>
<td>$888,893</td>
<td>$495,573</td>
</tr>
<tr>
<td>2 - $2,000,000 – 9,999,999</td>
<td>107</td>
<td>36.0</td>
<td>$4,723,240</td>
<td>$2,336,662</td>
</tr>
<tr>
<td>3 - $10,000,000 – maximum</td>
<td>79</td>
<td>26.6</td>
<td>$41,129,012</td>
<td>$67,398,823</td>
</tr>
<tr>
<td>Policy area:</td>
<td>304</td>
<td>100</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Hospitals</td>
<td>15</td>
<td>4.9</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Environmental</td>
<td>9</td>
<td>3.0</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Public and Societal Benefits</td>
<td>31</td>
<td>10.2</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Religious</td>
<td>8</td>
<td>2.6</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Human services</td>
<td>108</td>
<td>35.5</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Health organizations</td>
<td>52</td>
<td>17.1</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Education</td>
<td>30</td>
<td>9.9</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Higher Education institutions</td>
<td>13</td>
<td>4.3</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Arts, culture, and humanities</td>
<td>26</td>
<td>8.6</td>
<td>n/a</td>
<td>n/a</td>
</tr>
<tr>
<td>Other</td>
<td>12</td>
<td>3.9</td>
<td>n/a</td>
<td>n/a</td>
</tr>
</tbody>
</table>

The average organization in the sample has 367 paid employees. However, the standard deviation of 2160 employees indicates that a great difference exists among organizations in the
sample by their paid staff size. The size of paid stuff varies from 0 to 33,000 from the smallest to the largest organization.

More than half of all organizations (53.6 percent) do not receive any funding from federal or state governments, while the rest of the organizations receive funds from governments. Among the government beneficiaries, 22.6 percent of organizations have a low level of dependence on government funds (1-30 percent of the budget), and 18.2 percent heavily depend on government for funding (51-100 percent of the budget).

The average age of organizations is approximately 30 years (29.8 years), with a high level of difference among them. All sample organizations are stratified into three size categories by the annual budget size. From the responding organizations 37.4 percent are in the group of small organizations with an average budget size of $888,893; the second group consists of 36.0 percent of mid-size organizations with an average budget size of $4,723,240; and the third group consists of 26.6 percent of large organizations with an average budget size of $41,129,012 and a standard deviation of $67,398,823, indicating a huge size variation among organizations in this group. The annual budget size varies from $108,823 in the smallest organization to $439,483,714 in the largest organization.

Although most organizations in the sample are registered as 501(c)(3) for tax purposes, they have different missions and areas of activities. Table 6.2 shows that the most numerous group among the organizations in the sample is the human service organizations (35.5 percent); the second largest group is the health organizations (17.1 percent); the third group is the public and social benefits organizations (10.2 percent), and the fourth group is the arts, culture and humanities organizations (8.6 percent); two groups of organizations that are of special interest for the purpose of this research—hospitals and higher education institutions—were represented
by groups of 15 and 13 organizations (4.3 percent, and 4.9 percent accordingly). Religious organizations are routinely included in the group of 501(c)(3), but are not required to file an IRS 990 tax form. For this reason they were represented by only eight organizations (2.6 percent) out of 304. Environmental organizations constitute only nine out of 304 or three percent of the total sample. Groups of organizations defined as “other” are in policy areas such as international or government organizations.

**Finding 2. SOX Adoption by Nonprofits from Different Policy Areas**

The analysis of adoption of SOX practices by organizations in different policy areas showed very little difference in adoption levels among them. Yet, as Table 6.3 demonstrates, some differences were found among hospitals, health organizations, public and societal benefits and environmental and arts organizations in their levels of SOX adoption.

Table 6.3. Independent Sample T-test Results for Difference of Means in SOX Adoption among Organizations in Different Policy Areas

<table>
<thead>
<tr>
<th>Variables</th>
<th>Means</th>
<th>Variables</th>
<th>Means</th>
<th>T-statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hospitals</td>
<td>1.93</td>
<td>Environmental</td>
<td>0.56</td>
<td>1.757*</td>
</tr>
<tr>
<td>Health</td>
<td>1.37</td>
<td>Environmental</td>
<td>0.56</td>
<td>2.136**</td>
</tr>
<tr>
<td>Health</td>
<td>1.37</td>
<td>Education</td>
<td>0.87</td>
<td>1.653*</td>
</tr>
<tr>
<td>Health</td>
<td>1.37</td>
<td>Arts</td>
<td>0.76</td>
<td>1.840*</td>
</tr>
<tr>
<td>Public benefits</td>
<td>1.32</td>
<td>Environmental</td>
<td>0.56</td>
<td>1.674*</td>
</tr>
<tr>
<td>All types org-s</td>
<td>1.14</td>
<td>Environmental</td>
<td>0.56</td>
<td>1.876*</td>
</tr>
</tbody>
</table>

** significant at p = 0.05  
*   significant at p = 0.10

Judging from the means of adoption, the hospitals adopted SOX practices to the highest extent (mean=1.93), and environmental organizations adopted SOX to the lowest extent (mean=0.56). To check the visual impression of the differences, I ran individual sample t-test for the difference of means. The difference of means between the hospitals and the environmental organizations is
statistically significant \((p=0.10)\). I estimated difference of means t-test for all types of organizations in the sample. The statistically significant results of the test are in Table 6.3. Table 6.3 shows that health organizations adopted SOX practices to a higher extent than environmental \((p=0.05)\), education \((p=0.10)\), and arts organizations \((p=0.10)\). The test also shows that public and societal benefits organizations have adopted more SOX practices than environmental groups. I tested environmental groups’ means against the means of SOX adoption of all other organizations in the sample, and found that SOX adoption level in environmentalist groups was lower than in the whole sample \((p=0.10)\).

This analysis provides weak evidence that hospitals adopted more SOX practices than organizations in the environmental protection policy area. This finding provides support for hypothesis 3-14 (Chapter III, page 40), which states that hospitals adopt SOX to a higher extent than other nonprofit organizations. Another finding suggests that public benefits and health organizations adopted SOX to a higher extent than a number of other groups. However, the small size of the subsample of hospital organizations and the weak t-test results preclude generalization of this finding to the whole population of hospitals in the population. Finally, with regard to higher education institutions, the difference of means test did not support the similar hypothesis, which states that higher education institutions would adopt SOX practices to a greater extent than organizations in other policy areas.

In sum, I find no strong support for the hypotheses that hospitals and institutions of higher education adopt SOX rules to a greater extent than other groups of 501(c)(1) organizations. The slightly significant difference of means test suggests that hypothesized relationships may exist in the real world, but a larger sample size and more data are needed to confirm it conclusively.
Finding 3. SOX Adoption by Nonprofits in 46 States

The Attorneys General in 50 States reacted differently to SOX enactment with regard to the nonprofit sector. In some states like California, New York, Massachusetts, Michigan and others, the Attorneys General decided that SOX regulations can be beneficial for the nonprofit sector by streamlining their accountability and transparency practices. This discussion had practical effects in California, where a new law, the Nonprofit Integrity Act, which was modeled after SOX, became effective on January 1, 2005. Table 6.4 below presents the whole sample of respondent organizations by the state of their origin. States with the highest response rate are highlighted.
Table 6.4. Frequency of SOX Adoption by State

<table>
<thead>
<tr>
<th>State</th>
<th>Number of respondents (adopters)</th>
<th>Percent of state adoption from the total adoption</th>
<th>AGs initiatives to regulate nonprofits</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Alaska</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Arizona</td>
<td>6</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Arkansas</td>
<td>5</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>California**</td>
<td>21</td>
<td>6.9</td>
<td>+</td>
</tr>
<tr>
<td>Colorado</td>
<td>5</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>Connecticut</td>
<td>4</td>
<td>1.3</td>
<td>+</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>3</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Florida</td>
<td>13</td>
<td>4.3</td>
<td></td>
</tr>
<tr>
<td>Georgia*</td>
<td>10</td>
<td>3.3</td>
<td></td>
</tr>
<tr>
<td>Hawaii</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Idaho</td>
<td>1</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Illinois</td>
<td>15</td>
<td>4.9</td>
<td></td>
</tr>
<tr>
<td>Indiana</td>
<td>7</td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td>Iowa</td>
<td>4</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>Kansas</td>
<td>5</td>
<td>1.6</td>
<td>+</td>
</tr>
<tr>
<td>Kentucky</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Louisiana</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Maine</td>
<td>4</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>Maryland</td>
<td>5</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>Massachusetts</td>
<td>9</td>
<td>3</td>
<td>+</td>
</tr>
<tr>
<td>Michigan</td>
<td>8</td>
<td>2.6</td>
<td>+</td>
</tr>
<tr>
<td>Minnesota</td>
<td>8</td>
<td>2.6</td>
<td></td>
</tr>
<tr>
<td>Mississippi</td>
<td>3</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Missouri</td>
<td>5</td>
<td>1.6</td>
<td></td>
</tr>
<tr>
<td>Montana</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Nebraska</td>
<td>1</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Nevada</td>
<td>1</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>New Jersey</td>
<td>8</td>
<td>2.6</td>
<td>+</td>
</tr>
<tr>
<td>New Mexico</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>New York</td>
<td>26</td>
<td>8.6</td>
<td>+</td>
</tr>
<tr>
<td>North Carolina</td>
<td>8</td>
<td>2.6</td>
<td></td>
</tr>
<tr>
<td>North Dakota</td>
<td>3</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Ohio</td>
<td>10</td>
<td>3.3</td>
<td>+</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>4</td>
<td>1.3</td>
<td></td>
</tr>
<tr>
<td>Oregon</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>22</td>
<td>7.2</td>
<td>+</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>2</td>
<td>0.7</td>
<td></td>
</tr>
<tr>
<td>South Carolina</td>
<td>1</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Tennessee</td>
<td>7</td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td>Texas</td>
<td>18</td>
<td>5.9</td>
<td>+</td>
</tr>
<tr>
<td>Utah</td>
<td>3</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Virginia</td>
<td>13</td>
<td>4.3</td>
<td></td>
</tr>
<tr>
<td>Washington</td>
<td>7</td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td>Wisconsin</td>
<td>6</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>1</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>US Total</td>
<td>304</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

WY, WV, VT, SD, NH, DE are excluded for no responses
** - above four up to nine per cent of adopting organizations
* - above two up to four percent of adopting organizations
Hypothesis 3-1 (Chapter III, p.29) states that nonprofit organizations in the states in which the Attorneys General initiated discussions aimed at new nonprofit regulations similar to SOX would adopt SOX to a higher extent than nonprofit organizations in other states. Table 6.5 below presents the information concerning proposals and decisions of state legislatures to regulate the nonprofit sector in their relative states, similar to how SOX regulates for-profit public organizations.

Table 6.5. Nonprofit Oversight and Accountability Proposals and Bills at the State Level, 2005

<table>
<thead>
<tr>
<th>State</th>
<th>Bill number</th>
<th>Proposed regulations containing similar to SOX rules</th>
<th>Last day of legislative session</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>SB 946, HB 6515</td>
<td>Audited financial statement. Conflict of interest policy.</td>
<td>June 8, 2005</td>
</tr>
<tr>
<td>Kansas</td>
<td>SB 121</td>
<td>Audited financial statement. Verification of the charity audit.</td>
<td>May 28, 2005</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>HB 21</td>
<td>Verification of the charity audit. Control over financial reporting. Whistle-blower protection.</td>
<td>November 15, 2005</td>
</tr>
<tr>
<td>Michigan</td>
<td>SB 454</td>
<td>Legal penalties for financial embezzlement.</td>
<td>December 31, 2005</td>
</tr>
<tr>
<td>Ohio</td>
<td>SB 143</td>
<td>Document preservation policy. Audited financial statement.</td>
<td>December 31, 2005</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>HB 632, SB 210</td>
<td>Audited financial statement for organizations with higher than $300,000 in annual contributions.</td>
<td>November 30, 2005</td>
</tr>
<tr>
<td>Texas</td>
<td>SB 1215, HB 3417</td>
<td>Audited financial statement for organizations with gross revenue of $250,000 and higher. Audit committee of the board. Public access to an audit report.</td>
<td>May 30, 2005</td>
</tr>
</tbody>
</table>

Source: National Council of Nonprofit Associations (www.ncna.org)

To check the relationships between SOX-like legislation proposals and the actual adoption of SOX practices in nonprofit organizations, I constructed a variable where nonprofit organizations from the states with SOX-like initiatives are coded differently from nonprofit
organizations from other states. In total, there are 131 (43 percent) nonprofit organizations from SOX initiation states and 173 (57 percent) nonprofit organizations from other states. I applied an independent sample t-test for the difference of means to determine whether a difference exists in SOX adoption levels between these two groups. The test showed no difference of means in the level of SOX adoption between the group of nonprofits from SOX initiation states and the group from other states. Thus, I conclude that the hypothesis that the difference in the level of SOX adoption exists between the nonprofit organizations in states which initiated SOX-like legislation and nonprofit organizations in other states is not supported by the empirical evidence.

In sum, two hypotheses concerning the differences in adoption behavior among nonprofit organizations from different policy areas and the differences in adoption behavior among nonprofit organizations from SOX initiation states and other states are not supported by the results of statistical analysis. Thus, I conclude that no such differences exist between the above groups of nonprofit organizations.

**Finding 4. SOX Adoption by Nonprofit Organizations**

After SOX was enacted in 2002 many nonprofit experts and business consultants expressed their belief that SOX would be voluntarily adopted by organizations of the nonprofit sector (BoardSource and Independent Sector, 2003; Tate, 2003; Hempel and Borrus, 2004; Gordon, Hughes and Banks LLP, 2003; Wiehl, 2004; Williams, 2004; Basinger, 2004; Anft & Williams, 2004). Some consultants to nonprofit organizations instructed their analytical centers to survey nonprofits for the purpose of learning how SOX adoption was evolving. The results of these surveys demonstrated steadily increasing levels of SOX adoption by nonprofit organizations (Grant Thornton LLP, 2003, 2004, 2005, 2006; Broude & Prebil, 2005). Several
academic studies also provided evidence that SOX practices were spreading to the nonprofit world (Heinz, 2003; Vermeer et al., 2005; Behn et al., 2005; Ostrower & Bobowick, 2006).

This research is motivated by the desire to establish the facts of practical SOX adoption as well as the effects of SOX on management in nonprofit organizations. Following the findings of the business consultants and academic researchers, I expected to find a comparatively high level of SOX adoption by nonprofit organizations.

Yet, the results of my survey data descriptive analysis moderate my expectations to the lower side of the continuum “very high – high – middle of the road – low – very low.” Table 6.6 below exhibits the adoption level of SOX-like practices by nonprofits prior to SOX enactment in 2002, the intention to adopt SOX, practical SOX adoption level after SOX enactment in 2002, and no action with respect to SOX adoption. The timeframe is important because SOX enactment established a very specific date, which divided organizational activities before and after SOX. To ensure that certain practices were adopted because of SOX and not for other reasons I included the question about the prior to SOX state of governance, accountability and disclosure practices in nonprofit organizations into the adoption table in the survey (see Appendix II, q. 11).
Table 6.6 lists 15 practices entailed in SOX. These are not all the practices mandated by SOX, but only those that are considered relevant to nonprofit activities. The scale of 15 adoption practices is tested with the Cronbach’s alpha test ($\alpha = 0.704$), which shows a high level of the scale internal reliability. A dimensionality test is performed with the factor analysis, which determines that the construct is unidimensional. Unidimensionality is confirmed by the factor loadings that demonstrate that the constructed summated scale loads highly on one factor, which accounts for 65 percent of the underlying construct.

The first response column in Table 6.6 presents SOX-like practices that existed in respondent organizations prior to SOX enactment. The second column presents SOX practices which are considered but not yet adopted by nonprofits after SOX. The third column presents information on the actual adoption of SOX practices after SOX enactment in 2002—the main Table 6.6.

<table>
<thead>
<tr>
<th>SOX-related Policy or Procedure</th>
<th>Had before SOX-2002</th>
<th>Considered after SOX-2002</th>
<th>Adopted after SOX - 2002</th>
<th>Did not adopt after SOX-2002</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
<td>%</td>
<td>N</td>
<td>%</td>
</tr>
<tr>
<td>Conflict of Interest policy</td>
<td>217</td>
<td>71.4</td>
<td>16</td>
<td>5.3</td>
</tr>
<tr>
<td>Whistle-blower Protection policy</td>
<td>83</td>
<td>27.3</td>
<td>27</td>
<td>8.9</td>
</tr>
<tr>
<td>Document Preservation policy</td>
<td>192</td>
<td>63.2</td>
<td>21</td>
<td>6.9</td>
</tr>
<tr>
<td>Annual (or biannual) external audit</td>
<td>279</td>
<td>91.8</td>
<td>7</td>
<td>2.3</td>
</tr>
<tr>
<td>Audit partner rotation after 5-7 years</td>
<td>105</td>
<td>34.5</td>
<td>37</td>
<td>12.2</td>
</tr>
<tr>
<td>Separation of audit and non-audit services</td>
<td>120</td>
<td>39.5</td>
<td>27</td>
<td>8.9</td>
</tr>
<tr>
<td>Audit committee of board</td>
<td>122</td>
<td>40.1</td>
<td>25</td>
<td>8.2</td>
</tr>
<tr>
<td>Dual leadership</td>
<td>286</td>
<td>94.1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Board holds executive sessions</td>
<td>260</td>
<td>85.5</td>
<td>2</td>
<td>0.7</td>
</tr>
<tr>
<td>Independent board members</td>
<td>287</td>
<td>94.4</td>
<td>3</td>
<td>1.0</td>
</tr>
<tr>
<td>Basic financial training was provided for board members</td>
<td>150</td>
<td>49.3</td>
<td>20</td>
<td>6.6</td>
</tr>
<tr>
<td>Basic financial training for executive director</td>
<td>188</td>
<td>61.8</td>
<td>6</td>
<td>2.0</td>
</tr>
<tr>
<td>Financial documents accuracy is certified by executive director</td>
<td>197</td>
<td>64.8</td>
<td>15</td>
<td>4.9</td>
</tr>
<tr>
<td>Allows public access to financial statements</td>
<td>237</td>
<td>78.0</td>
<td>10</td>
<td>3.3</td>
</tr>
<tr>
<td>Allow public access to audit reports</td>
<td>233</td>
<td>76.6</td>
<td>6</td>
<td>2.0</td>
</tr>
</tbody>
</table>

*Percentage of organizations by row does not always adds up to 100 percent because of the omitted number of missing organizations
variable of interest in this study. The fourth column presents those SOX practices that were neither considered for adoption nor adopted by organizations after SOX. The first column numbers present the number of organizations responding to a particular question and the adjacent column numbers describe the percentage of responses.

Table 6.6 demonstrates that the majority of SOX-like practices existed in nonprofit organizations sometime prior to SOX enactment in 2002. The practices that were the most common in nonprofit organizations before SOX are the regular external audit (91.8 percent), dual leadership or separation of leadership roles between the CEO and the Board Chair (94.1 percent), and independence of board directors (94.4 percent). The second large group of preexisting practices includes the conflict of interest policy (71.4 percent), executive sessions of the board (85.5 percent), public access to financial statements (78.0 percent) and to audit reports (76.6 percent). The high level of preexisting SOX-like practices in nonprofits raises an expectation that post SOX adoption of these practices will be low. The frequency Table 6.6 provides support for this expectation by illustrating that these practices are adopted at a very low level in the after SOX period, by no more than 2 percent of organizations.

Among the practices actually adopted in the post-SOX period, two practices stand out. Organizations most often adopted the whistle-blower protection policy (20.1 percent) and the institutionalization of the audit committees (20.4 percent). The second largest group of the practices adopted after SOX includes the conflict of interest policy (14.5 percent), document preservation policy (12.5 percent), audit partner rotation, separation of audit from non-audit services (12.8 and 10.5 percent accordingly), and certification of financial documents by the CEOs (10.2 percent).
One of the SOX mandated practices for for-profit corporations is in the Section 404 of the Act. This section requires chief executive officers to reassess internal controls, attest the absence of material weakness, and invite an audit firm to check internal controls for material weakness. Section 404’s requirements have proven to be the most costly for for-profit corporations. This SOX requirement was not included in the table of SOX practices relevant to the nonprofit sector because of the concern that it could have biased the responses of the participants. Its outstanding impact on for-profit public corporations suggested such a possibility. In order to understand the Section 404 impact on nonprofit organizations, several contingent questions were asked about the attestation and the audit of the internal controls (see Appendix II, Q. 20). The results of frequency analysis demonstrated that only 4.1 percent of all organizations have attested their internal controls, and only 1 percent of nonprofits have audited their internal controls. Because the proportion of organizations that assessed, attested, and audited their internal controls was so low, it was not included in the analysis of adoption of individual SOX practices. The lack of action on the part of nonprofit organizations to revamp their internal controls may be explained by the dissemination of information about the very high costs incurred by for-profit corporations with respect to Section 404.

In sum, the major finding of a descriptive analysis is that pre-SOX adoption of SOX-like practices was considerable. The descriptive analysis also indicates that post-SOX adoption is considerably lower than pre-SOX adoption of SOX-like practices. After SOX was enacted in 2002, some organizations adopted SOX practices more actively than others. Apparently, pre-SOX adoption influences the post-SOX adoption of SOX practices. For the sake of complete analysis I define the pre-SOX adoption level as a “pre-existing condition” and include it in the
explanatory analysis of post-SOX adoption by nonprofit organizations. A detailed explanation of SOX adoption by nonprofit organizations is presented in the section below.

**Finding 5. Post SOX Adoption of SOX Practices**

The data collected from the survey present a challenge for analysis because the frequency analysis demonstrates that the sample is divided into two almost equal groups with regard to the main variable of interest—the level of SOX adoption. SOX adoption is measured as the number of SOX policies and practices from one to fifteen that were adopted by nonprofit organizations after enactment of SOX in 2002. The descriptive statistics in Table 6.7 show that 50.3 percent of respondents did not adopt any SOX related policies or procedures after SOX was enacted in 2002, while 49.7 percent of respondents have adopted at least one SOX policy. The distinct feature of this almost equal breakdown is a large number of zero SOX adoptions.

<table>
<thead>
<tr>
<th>Adopted policies</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>153</td>
<td>50.3</td>
<td>50.3</td>
</tr>
<tr>
<td>1</td>
<td>58</td>
<td>19.1</td>
<td>69.4</td>
</tr>
<tr>
<td>2</td>
<td>48</td>
<td>15.8</td>
<td>85.2</td>
</tr>
<tr>
<td>3</td>
<td>18</td>
<td>5.9</td>
<td>91.1</td>
</tr>
<tr>
<td>4</td>
<td>13</td>
<td>4.3</td>
<td>95.4</td>
</tr>
<tr>
<td>5</td>
<td>9</td>
<td>3.0</td>
<td>98.4</td>
</tr>
<tr>
<td>6</td>
<td>1</td>
<td>.3</td>
<td>98.7</td>
</tr>
<tr>
<td>7</td>
<td>1</td>
<td>.3</td>
<td>99.0</td>
</tr>
<tr>
<td>8</td>
<td>1</td>
<td>.3</td>
<td>99.3</td>
</tr>
<tr>
<td>9</td>
<td>1</td>
<td>.3</td>
<td>99.7</td>
</tr>
<tr>
<td>11</td>
<td>1</td>
<td>.3</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>304</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Although the overall SOX adoption is not very high, the statistics in Table 6.7 show that SOX adoption happens among nonprofit organizations. However, the level of SOX adoption seems
low in comparison with the findings of other researchers from the business research centers as exhibited in Table 1.2, page 17 (Grant Thornton LLP, 2003, 2004, 2005, 2006). My research finds that more than 50 percent of all respondents did not adopt any SOX policies after SOX was enacted in 2002, and about 45 percent of adopter organizations only adopted from one to four policies out of fifteen. The distribution of responses is nonlinear, with a large number of responses at the lower level of adoption from one to two policies (34.9 percent). Graph 6.1 below graphically presents the distribution of responses with regard to post-SOX adoption.

Graph 6.1. Distribution of Post SOX Adoption Responses

As described in Chapter IV, the post-SOX adoption level is the dependent variable, which I seek to explain by various external and internal factors. This dependent variable is constructed as a count variable, which exhibits characteristics of the Poisson distribution. The Poisson distribution has the following characteristics: most cases have a score of zero, the distribution is skewed, it is nonnegative, and the variance increases as the mean increases. The
univariate distribution of the dependent variable suggests a possibility of overdispersion, which may lead to the use of alternative negative binomial model if overdispersion is not mitigated by the regressors. The choice of the model for SOX adoption analysis is discussed further in the next section.

**Prior to SOX Adoption of SOX-like Practices**

As stated earlier, I expected that nonprofit organizations would have established certain SOX-like practices before SOX was enacted in 2002, such as the independent boards, dual leadership, and regular external audits. However, this expectation needed empirical testing. Because of the concerns for the plausible confounding “pre-existing condition” effects in the study of post-SOX adoption I decided to learn about the pre-SOX existing accountability practices in nonprofit organizations and contrast them with the practices adopted following SOX requirements. To ensure that no confusion exists among the respondents concerning pre-SOX adoption and post SOX adoption of SOX mandated practices, I incorporated in the survey the question about the existing practices. The survey respondents were asked to mark SOX practices as “had before SOX” if these practices existed in their respective organizations before SOX was enacted in 2002 (see Appendix II, q. 11). The information about prior to SOX adoption plays an important role in this study.

Other researchers who explored SOX adoption by nonprofit organizations, did not purposefully examine the “preexisting condition” of accountability practices in nonprofit organizations or its effect on SOX adoption decisions by nonprofit leaders (Heinz, 2003; Vermeer et al., 2005; Behn et al., 2005; Ostrower & Bobowick, 2006; Grant Thornton LLP, 2003, 2004, 2005, 2006; Broude & Prebil, 2005). The nonprofit and business experts anticipated
that nonprofit organizations would adopt SOX rules as “best business practices,” which would enable them to improve accountability standards and leaders’ responsibilities for organizations’ financial performance. Although the cost of SOX adoption was discussed as the only possible impeding factor, none of academic or practitioner writers considered the possibility that existing accountability and governance policies preceded SOX, and that this might deter adopting SOX standards on a large scale.

The frequency analysis of pre-SOX adoption of SOX related practices produced an unexpected result: a large number of organizations (302 out of 304, or 99 percent) had already established from one to fifteen SOX-like policies and procedures within their organizations prior to SOX enactment in 2002. This finding suggests that the prior to SOX accountability structure in many nonprofit organizations preceded most of SOX requirements and could only marginally be improved by adoption of SOX rules. Developing this line of thought further, it seems logical to assume that the large number of zero post-SOX adoptions is explained by the high level of adoption of SOX-like practices prior to the enactment of SOX in 2002. At the beginning of the study, I expected to find some level of “preexisting condition”; however, the survey results were surprising because of the very high level of “preexisting condition” in nonprofit organizations. In Table 6.8, frequency statistics show that only two organizations from the whole sample did not adopt any of the SOX-like requirements before the Act became effective in 2002. This finding questions the widely expressed opinions that nonprofit organizations would be seriously affected by SOX ((BoardSource and Independent Sector, 2003; Tate, 2003; Hempel and Borrus, 2004; Gordon, Hughs and Banks LLP, 2003; Wiehl, 2004; Williams, 2004; Basinger, 2004; Anft & Williams, 2004).
Table 6.8. Frequency of Prior to SOX Adoption

<table>
<thead>
<tr>
<th>Adopted policies</th>
<th>Frequency</th>
<th>Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>2</td>
<td>.7</td>
<td>.7</td>
</tr>
<tr>
<td>2</td>
<td>3</td>
<td>1.0</td>
<td>1.6</td>
</tr>
<tr>
<td>4</td>
<td>6</td>
<td>2.0</td>
<td>3.6</td>
</tr>
<tr>
<td>5</td>
<td>7</td>
<td>2.3</td>
<td>5.9</td>
</tr>
<tr>
<td>6</td>
<td>18</td>
<td>5.9</td>
<td>11.8</td>
</tr>
<tr>
<td>7</td>
<td>25</td>
<td>8.2</td>
<td>20.1</td>
</tr>
<tr>
<td>8</td>
<td>31</td>
<td>10.2</td>
<td>30.3</td>
</tr>
<tr>
<td>9</td>
<td>42</td>
<td>13.8</td>
<td>44.1</td>
</tr>
<tr>
<td>10</td>
<td>41</td>
<td>13.5</td>
<td>57.6</td>
</tr>
<tr>
<td>11</td>
<td>42</td>
<td>13.8</td>
<td>71.4</td>
</tr>
<tr>
<td>12</td>
<td>45</td>
<td>14.8</td>
<td>86.2</td>
</tr>
<tr>
<td>13</td>
<td>22</td>
<td>7.2</td>
<td>93.4</td>
</tr>
<tr>
<td>14</td>
<td>16</td>
<td>5.3</td>
<td>98.7</td>
</tr>
<tr>
<td>15</td>
<td>4</td>
<td>1.3</td>
<td>100.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>304</strong></td>
<td><strong>100.0</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: The Sarbanes-Oxley Act and Nonprofit Organizations survey, 2006

Table 6.8 demonstrates a bell-shaped distribution of responses that describe pre-SOX adoption of SOX practices, which is slightly negatively skewed. This distribution can also be observed in Graph 6.2 below.
The histogram in Graph 6.2 illustrates the bell-shaped distribution of responses. The average respondent had adopted 9.72 of SOX-like practices prior to SOX enactment in 2002. Moreover, the majority of respondents (67%) adopted a high level of SOX-like policies, from nine to fifteen, prior to SOX.

This unusually high level of “preexisting conditions” leads to the expectation that the level of adoption of SOX-like procedures before SOX was enacted in 2002 influences downward the adoption of SOX practices after SOX enactment. Further analysis of SOX adoption by nonprofit organizations is modeled to account for the confounding effect of the adoption level existing prior to SOX.
Analysis of Bivariate Correlations

I estimated bivariate correlations for exploratory purposes. The bivariate correlations focus attention on those explanatory variables that have significant associations with the dependent variable of interest—the after-SOX adoption (further on referred to as SOX adoption or post-SOX adoption). As the frequency analysis in the previous section suggests, the post-SOX adoption level might depend on the pre-SOX adoption level. The level of pre-SOX adoption likely confounds the post-SOX adoption by decreasing it. To verify how the pre-SOX adoption affects the post-SOX adoption behavior, I split the whole sample into two groups—a Low Prior Adoption group and a High Prior Adoption Group. The Low Prior Adoption group consists of those respondents who report adopting from zero to eight SOX-like policies prior to SOX (under the mean = 9.7), and the High Prior Adoption group consists of those who report adopting from nine to fifteen SOX-like policies prior to SOX.

Because of the “pre-existing condition,” I hypothesize that the High Prior Adoption group adopted fewer SOX-like policies after SOX was enacted in 2002 than the Low Prior Adoption group. The reasoning is straightforward: the organizations that had already established policies and procedures similar to SOX before SOX would have less urgency and opportunity to adopt such practices after SOX was passed in 2002. I ran simple bivariate correlations within the split sample to assess the post SOX level of adoption controlling for the prior to SOX level of adoption in two groups.
Two adoption variables describing organizations’ behavior in the pre-SOX and post-SOX periods “SOX adoption” and “had before SOX”\textsuperscript{17} are tested for correlation too. In the Low Prior Adoption group the correlation between these two variables is not statistically significant, while in the High Prior Adoption group the correlation between the post-SOX and the pre-SOX adoption levels is -0.306***. It is negative, as expected, and significant at a 0.001 level. This bivariate correlation is exploratory. It indicates that in the High Prior Adoption group the pre-existing accountability practices decreased the post-SOX adoption level.

Moreover, frequency statistics for the split sample in Table 6.9 below show that 50 percent of organizations in the Low Prior Adoption group adopt from one to five SOX policies after SOX, while only 43 percent of organizations in the High Prior Adoption group adopt as few as one to three SOX policies after SOX.

Table 6.9. Post-SOX Adoption for Two Prior Adoption Groups

<table>
<thead>
<tr>
<th>Low Prior Adoption group</th>
<th>High Prior Adoption group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>Frequency</td>
</tr>
<tr>
<td>----------</td>
<td>-----------</td>
</tr>
<tr>
<td>0</td>
<td>41</td>
</tr>
<tr>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>8</td>
<td>1</td>
</tr>
<tr>
<td>9</td>
<td>1</td>
</tr>
</tbody>
</table>

| Total   | 90        | 100.0   | Total | 212       | 100.0   |

\textsuperscript{17} An explanation of differences between two pre-SOX adoption measures employed in the analysis is helpful here: The explanatory variable “had before SOX” was constructed as a count variable, which counted the number of SOX-like policies from 1 to 15 adopted prior to SOX enactment. Another measure of prior to SOX adoption was constructed completely differently: the whole sample was split into Low Prior Adoption and High Prior Adoption groups based on responses to the “had before SOX” question. Those respondents with eight and lower pre-existing SOX-like practices were grouped into a Low Prior Adoption group (90 organizations), and those organizations with higher than nine pre-existing SOX-like practices were grouped into a High Prior Adoption group (212 organizations). Two organizations did not adopt any SOX-like policies prior to SOX.
I estimated a one-way ANOVA difference of means test between the two groups with post-SOX adoption as the dependent variable. The means between the groups are significantly different at the level of $p = 0.0001$.

The difference in the level of post-SOX adoption in the two groups led me to hypothesize that the explanatory variables may associate differently with the post SOX adoption level in the two groups. In Chapter III, I discussed 38 hypotheses (see Chapter III, p. 29 - 42) which maintain that the contextual variables together with internal determinants variables influence SOX adoption level. The independent variables were conceptualized based on theory and were statistically tested for significance through application of analytical models. The whole list of independent variables is presented in Table 4.2 (Chapter IV, p. 82).

Table 6.10 below presents all the independent variables and exhibits the correlations with the dependent variable—SOX adoption level—separately for two prior adoption groups. To explore relationships among the dependent variable “after SOX adoption” and all explanatory variables I used bivariate correlations for a split sample. The sample was split into the Low Prior Adoption and the High Prior Adoption groups as defined earlier. As expected, some explanatory variables are significantly associated with post-SOX adoption in both groups, while other explanatory variables are associated with the post SOX adoption behavior only in the Low Prior Adoption group, and not in the High Prior Adoption group, and vice versa, which suggests different explanations for the post-SOX adoption behavior in the two groups.
Table 6.10. Bivariate Correlations in Two Prior to SOX Adoption Groups

<table>
<thead>
<tr>
<th>After SOX Adoption</th>
<th>Low Prior Adoption gr. N</th>
<th>High Prior Adoption gr. N</th>
</tr>
</thead>
<tbody>
<tr>
<td>Familiarity</td>
<td>.420(**) 90</td>
<td>.257(**) 212</td>
</tr>
<tr>
<td>Networks</td>
<td>.376(**) 83</td>
<td>.175(*) 204</td>
</tr>
<tr>
<td>Publications</td>
<td>.410(**) 83</td>
<td>.129 203</td>
</tr>
<tr>
<td>Board member</td>
<td>.431(**) 83</td>
<td>.094 204</td>
</tr>
<tr>
<td>Auditor</td>
<td>.274(*) 83</td>
<td>-.037 204</td>
</tr>
<tr>
<td>Donor</td>
<td>.187 83</td>
<td>.027 200</td>
</tr>
<tr>
<td>State</td>
<td>.513 90</td>
<td>.449 212</td>
</tr>
<tr>
<td>Federal</td>
<td>.379(**) 89</td>
<td>.153(*) 211</td>
</tr>
<tr>
<td>External audit</td>
<td>.190 87</td>
<td>.118 212</td>
</tr>
<tr>
<td>Credibility</td>
<td>.151 87</td>
<td>.207(**) 210</td>
</tr>
<tr>
<td>Accountability</td>
<td>-.386(**) 88</td>
<td>-.319(**) 212</td>
</tr>
<tr>
<td>Proactive</td>
<td>.264(*) 88</td>
<td>.086 212</td>
</tr>
<tr>
<td>Pressure</td>
<td>.249(*) 87</td>
<td>.068 211</td>
</tr>
<tr>
<td>Experience</td>
<td>-.259(*) 90</td>
<td>-.054 211</td>
</tr>
<tr>
<td>Government</td>
<td>-.221(*) 81</td>
<td>-.034 194</td>
</tr>
<tr>
<td>Business</td>
<td>.054 86</td>
<td>-.028 198</td>
</tr>
<tr>
<td>Nonprofit</td>
<td>-.157 86</td>
<td>.057 209</td>
</tr>
<tr>
<td>Association</td>
<td>.230(*) 89</td>
<td>.029 211</td>
</tr>
<tr>
<td>Education</td>
<td>.147 88</td>
<td>.093 208</td>
</tr>
<tr>
<td>Size</td>
<td>.275(*) 86</td>
<td>.285(**) 210</td>
</tr>
<tr>
<td>Income</td>
<td>-.006 86</td>
<td>.166(*) 210</td>
</tr>
<tr>
<td>Government revenue</td>
<td>.138 88</td>
<td>-.030 206</td>
</tr>
<tr>
<td>Audit fee</td>
<td>.492(**) 89</td>
<td>.153(*) 208</td>
</tr>
<tr>
<td>Had before SOX</td>
<td>.021 90</td>
<td>-.306(**) 212</td>
</tr>
</tbody>
</table>

Bivariate correlations in Table 6.10 illustrate that post SOX adoption behavior in the two groups is explained by different variables. Some variables are associated with the SOX adoption level in one group but are not associated with the SOX adoption level in another group. Other variables influence adoption behavior in both groups, but the magnitudes of the effect vary. For example, we can observe that the “familiarity with SOX” variable explains adoption in both groups, but the magnitude of the effect is larger in the Low Prior Adoption group (0.420 in Low Prior Adoption group > 0.275 in the High Prior Adoption group). The sources of information such as the networks, publications, board member, and auditor variables better explain adoption.
behavior in the Low Prior Adoption group than in the High Prior Adoption group. In the High Prior Adoption group, only the “networks” variable is associated with post-SOX adoption behavior, which means that information received from the network members influenced decisions to adopt SOX in this group unlike information from other sources. The donors’ recommendation to adopt SOX is not statistically significant in either group, which suggests that donors rarely request that SOX policies be established by organizations in any group. Simple frequency analysis confirms this finding by demonstrating that only five percent of all respondents report that donors recommended them to comply with SOX. Thus the Hypothesis #3-4 (page 33) is not supported by empirical evidence. The lack of pressure from donors explains the overall low level of post-SOX adoption in both groups. This finding is consistent with the proposition of the resource dependency theory, which holds that organizations satisfy demands from the external actors on whose resources they depend. I conclude that because nonprofit organizations did not experience pressure from their donors to comply with SOX they did not hurry to adopt SOX requirements.

Those nonprofit leaders with knowledge about the Senate Finance Committee white paper draft aimed at reforming and establishing “best business practices” in nonprofit organizations18 adopted more. In contrast, decisions of top leaders in nonprofit organizations to adhere to existing accountability standards regardless of SOX are negatively and significantly related to post-SOX adoption level in both groups. This means that those leaders who choose to

18 In the wake of a number of negative news stories about activities at some charities and foundations, the Senate Finance Committee released a staff discussion draft with reform proposals for the charitable sector modeled after the Sarbanes-Oxley Act. On June 22, 2004, Senate Finance Committee held hearing on charity oversight and reform. (http://www.cof.org/Action/content.cfm?ItemNumber=1703&navItemNumber=2467)
adhere to existing accountability procedures in their respective organizations do not extensively adopt SOX practices.

Variables that describe top managers’ attitude toward SOX, such as “credibility” (response to the statement - Nonprofit organizations may gain credibility among the donors and the public by following “best business practices” introduced by SOX-2002), “proactive” (response to the statement - At times of uncertainty about the nonprofit regulations in the future, the best choice is to establish the procedures required by SOX-2002 early), and “pressure” (response to the statement - My organization experienced strong political and social pressure to adopt the provisions of SOX-2002), help to understand the different attitudes toward SOX in the two groups. In the High Prior Adoption group, the consideration of improved credibility affects post-SOX adoption, while preference to adhere to existing accountability standards reduces post-SOX adoption. By contrast, in the Low Prior Adoption groups, improved credibility is not associated with post SOX adoption level, while proactive behavior of managers and political/social pressure are associated with higher levels of post SOX adoption. The size of the organization (measured by the budget size) and the audit fee increases are positively associated with the adoption behavior in both groups, while slack resources (measured as the difference between the revenues and expenditures) is related to post SOX adoption only in the High Prior Adoption group.

To summarize, through application of frequency and correlation analyses I found that the post-SOX adoption level is related to the pre-SOX behavior of nonprofit organizations. Those organizations that extensively adopted SOX-like policies some time before SOX was enacted in 2002, do not adopt many SOX policies afterwards. This is a new and unexpected finding. Many researchers and practitioners who study SOX and nonprofits only ask questions about the intent
to adopt, and about the actual SOX adoption; and in many cases they do not consider the pre-
SOX accountability framework in nonprofit organizations as determining the post-SOX adoption
Ostrower and Bobowick, 2006).

Bivariate correlations between the dependent variable “SOX adoption” and each of the
explanatory variables, which were run in the two pre-SOX adoption groups separately, provide
evidence of both differences in adoption behavior between the two groups and differences in the
explanatory power of the independent variables. In the Low Prior Adoption group the sources of
information and individual characteristics of managers are associated with adoption behavior,
while this is not the case in the High Prior Adoption group. Size and wealth are associated with
post-SOX adoption in the High Prior Adoption groups, while no such association is found in the
Low Prior Adoption group. Familiarity with SOX increases SOX adoption in both groups, and
preferences of managers to adhere to existing accountability practices decreases SOX adoption in
both groups. The level of pre-SOX adoption, as expected, is negatively and significantly
associated with the post-SOX adoption level in the High Prior Adoption group, but has no
relationship to the post-SOX adoption behavior in the Low Prior Adoption group. The bivariate
correlation analysis suggests that some variables explain post-SOX adoption behavior in both
groups, while other variables are associated with the post-SOX adoption behavior only in one of
the groups. The exploratory correlation analysis helps to identify those independent variables
that are associated with the change in the dependent variable, but calls for verification of these
observations with the models specifically designed to deal with nonlinear relationships, which
are suggested by the Poisson distribution of the dependent variable. The choice of model is
discussed in the section below.
Poisson Regression Vs. Negative Binomial Regression Models

The main variable of interest—adoption of SOX practices—is constructed as a count variable. The count-type variables indicate how many times a certain event has happened throughout a given period of time. The number of SOX practices adopted by respondent organizations is counted from one to fifteen, which is the number of counts of adoption actions occurring from a direct point observation. In this study the time is limited from the SOX adoption in 2002 till the time of the survey in summer 2006. To explain the SOX adoption level in nonprofit organizations I used the recommended standard model for the count data, which is the Poisson regression model (PRM) – a nonlinear regression model appropriate for cross-sectional studies (Cameron & Trivedi, 1998). Although the ordinary least squares regression model is often used to analyze the association of count variables with explanatory variables, it is not the best model to apply for this type of dependent variable or for nonlinear relationships because of the possibility of biased and inconsistent estimates (Long & Freese, 2006).

Several approaches are specifically designed to deal with count variables; among them are Poisson (PRM) and negative binomial regressions (NBR). The Poisson model is essentially a log-linear model. One of the assumptions of the Poisson distribution holds that the error variance is equal to the error mean, which implies equidispersion. Graph 6.1 in the above section illustrates that the dependent variable the “adoption of SOX” has the characteristics of the Poisson distribution—skewed to the right with a low mean of 1.14. However, Graph 6.1 also shows that zero SOX adoption counts are significant, which may be the reason for overdispersion, a condition where the variance is larger than the mean. If overdispersion is perceived as a potential problem, the statistics literature recommends using the negative binomial
regression model, which accounts for overdispersion (Long & Freese, 2006; Huet et al, 2004; Cameron & Trivedi, 1998). Below I will discuss the statistical test for preference of the NBR over the PRM or vice versa. Graph 6.1 illustrates the univariate distribution of the dependent variable. Although the raw data show overdispersion, inclusion of regressors may decrease or eliminate the overdispersion (Cameron & Trivedi, 1998). The overdispersion suggests the presence of an unobserved heterogeneity in the sample of the post SOX adopters. I expect that post SOX adopters are different from non-adopters (zero-adopters). Luckily, the reason for heterogeneity within the whole sample is well understood because of the results of frequency and correlation analysis: the level of pre-SOX adoption divides the sample into two different groups—the Low Prior Adoption (1-8 adopted practices) and the High Prior Adoption group (9-15 adopted practices)—and influences the post-SOX adoption behavior. Knowledge about the reason for heterogeneity within the sample helps to model the data.

NBR runs a simple alpha test automatically. The alpha test determines the overdispersion and helps to choose between the PRM and the NBR models. Firstly, I estimate the NBR with the dependent and all independent explanatory variables, which includes the likelihood ratio test for overdispersion. The test results show that chi-square is equal to 0.05 (p = 0.412), which does not allow rejection of the null hypothesis of alpha = 0. When alpha equals zero, it indicates that a Poisson regression is appropriate. Thus, I decided to use Poisson regression for my analysis to evaluate the impact of independent variables on the level of SOX adoption. However, two heterogenic groups combined in one sample affect the calculation of the predicted value of SOX adoption. For this reason, I considered estimating the Poisson regression models separately for the Low Prior Adoption and the High Prior Adoption groups by splitting the sample. To make sure that the overdispersion problem does not arise in the split samples I estimated the NBR for
each of the pre-SOX adoption groups. The alpha test confirms that the PRM is a preferred model for both groups. The Poisson regressions in two models also permit direct comparison of predicted values of post-SOX adoption in two pre-SOX adoption groups, and allow for straightforward interpretation of a marginal effect of each of the independent variables on the predicted value of the dependent variable “adoption of SOX”.

Results of the Poisson regression analysis

The analysis of SOX adoption level involves five PRM models: two split sample models are estimated for all explanatory variables including external contextual variables and internal characteristic variables. The three PRM models explain adoption of SOX in organizations of different sizes.

Marginal effects of independent variables on SOX adoption

The theories of stakeholder and resource dependence (Freeman, 1984; Pfeffer and Salancik, 1978), diffusion of innovations (Rogers, 2003), internal determinants (Mohr, 1969; Damanpour, 2001), and anticipatory accountability (Kearns, 1994) frame the analysis of SOX adoption by nonprofit organizations. The hypotheses derived from these theories (3-3 through 3-38) maintain that contextual and internal variables influence SOX adoption among nonprofit organizations. Initially, I included in the model all independent variables that were explored for relationship with the dependent variable by the bivariate correlations (see Table 6.9, p. 131). Then I estimated separate Poisson regressions for two pre-SOX adoption groups to examine the association between the dependent variable “adoption of SOX” and a group of contextual independent variables: sources of information about SOX—network, nonprofit publications,
board of directors, auditors, donors, and federal legislation draft; political and social pressure; availability of external audit and increase of audit fees; and a group of internal explanatory variables that described characteristics of CEOs, size and resources of organizations, and prior to SOX adoption behavior.

With regard to contextual variables I hypothesized that managers of nonprofit organizations who receive information through professional networks, nonprofit publications, from board members, auditors and donors are more likely to adopt SOX rules; managers who perceive external political or social pressure to adopt SOX are more likely to adopt; organizations with existing regular external audits are less likely to adopt SOX; organizations experiencing increases of audit fees are more likely to adopt SOX rules; and organizations with higher support from government are more likely to adopt SOX. Another expectation is that in the two groups—High Prior Adoption and Low Prior Adoption groups—the level of post-SOX adoption varies, and different variables are associated with post-SOX adoption. Therefore, I expect that the parameters and z-values for the same variables will vary across the two models. I anticipate that the predicted post-SOX adoption will be higher in the Low Prior Adoption group that in the High Prior Adoption group.

The internal explanatory variables describe characteristics of CEOs, size and resources of organizations, and the prior to SOX adoption behavior. However, such internal characteristics as slack resources and government revenues are excluded from further analysis because they lack statistical significance. I hypothesized positive relationships among the post-SOX adoption

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19 Wealth of organizations was defined as slack resources, which were measured as a difference between the revenues and expenditures (net income) in organizations. Government revenues were defined as funds received from federal or state governments. It was measured in several ways – by a percentage of total revenues, by a category of government dependence (with 0-10% defined as independent, 11-29 as low dependent, 30-49% - as moderately dependent, and 50-100% defined as highly dependent on the scale from 0 to 3), and by the amount of funds received from government. None of these measures produced a significant effect on SOX adoption.
levels and managers’ familiarity with SOX, managers’ belief that adoption of SOX may improve credibility of their organizations, membership of CEOs in professional associations, the CEOs level of education, business background of managers, proactive stance of managers, and the size of organization (measured by the budget size). I hypothesized negative relationships between the SOX adoption and the belief of managers that they should adhere to the existing accountability standards until a nonprofit specific law is passed. The post SOX adoption level is hypothesized to relate negatively to the prior to SOX level of adoption of SOX-like practices by nonprofit organizations. Considering the evidence of differences in pre-SOX adoption behaviors in the Low Prior Adoption and High Prior Adoption groups, I hypothesize that differences exist in the level of post SOX adoption and the explanatory power of contextual and internal characteristics variables.

Table 6.11 below presents marginal effects of individual contextual variables and internal variables, which were estimated by the Poisson regressions and the marginal effects function on post SOX adoption (1) in the Low Prior Adoption group, and (2) in the High Prior Adoption group. The table presents only those independent variables that are found significantly related to the post-SOX adoption in any of the two pre-SOX adoption groups. Many variables are excluded from the models because of insignificant relationships with the dependent variable. Certain hypotheses are not sustained by statistical analysis. No statistically significant relationships are found between most sources of information except for nonprofit publications and board members and the level of post-SOX adoption. Likewise, no relationships exist between the belief that SOX may improve credibility of nonprofits, proactive stance of managers, occupational background of managers, level of education, membership in professional associations and the dependent variable.
As expected, a difference is observed among the two pre-SOX adoption groups in the predicted level of post-SOX adoption and the explanatory power of regressors. This difference is the supporting evidence of heterogeneity, which is accounted for by estimating Poisson regressions independently for the two groups. Table 6.11 below illustrates the differences between the groups in post-SOX adoption and an explanation of adoption behavior.

Table 6.11. Predicted Means of Post SOX Adoption Practices In Two Groups

<table>
<thead>
<tr>
<th>Estimated Effects</th>
<th>Yhat = 1.059</th>
<th>Yhat = 0.713</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Low Prior Adoption</strong></td>
<td><strong>High Prior Adoption</strong></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>Marginal SE</td>
<td>Variable</td>
</tr>
<tr>
<td>Familiarity</td>
<td>1.619**** 0.484</td>
<td>Familiarity</td>
</tr>
<tr>
<td>Publications</td>
<td>0.479** 0.236</td>
<td>Publications</td>
</tr>
<tr>
<td>Board</td>
<td>0.529*** 0.213</td>
<td>Board</td>
</tr>
<tr>
<td>Accountability</td>
<td>-0.236** 0.115</td>
<td>Accountability</td>
</tr>
<tr>
<td>Size</td>
<td>0.178 0.121</td>
<td>Size</td>
</tr>
<tr>
<td>Prior to SOX</td>
<td>-0.185*** 0.075</td>
<td>Prior to SOX</td>
</tr>
<tr>
<td>Audit fee</td>
<td>0.830**** 0.279</td>
<td>Audit fee</td>
</tr>
</tbody>
</table>

* Significant at the 0.10 level  
** Significant at the 0.05 level  
*** Significant at the 0.01 level  
**** Significant at the 0.001 level  
***** Significant at the 0.0001 level

Yhat = Ybar

An important feature of the Poisson regression model is that the predicted independent variable is simultaneously the mean of prediction with all independent variables held at their means. The results of two PRMs and follow up marginal effect functions show that the predicted mean post-SOX adoption level is higher in the Low Prior Adoption group (1.059) and lower in the High Prior Adoption group (0.713). This finding confirms the later hypothesis 3-33 (p. 63), which states that the organizations that adopted SOX-like practices before SOX was enacted—the High Prior Adoption group—would be less prone to adopt SOX after 2002.
As discussed earlier, the pre-SOX adoption level is negatively and significantly associated with the post-SOX adoption level in both groups, the High Prior Adoption group and the Low Prior Adoption group. Those associations suggest the causal effect of the pre-SOX adoption level on the post-SOX adoption level. Following conventional logic and the time sequence of events, I conclude that nonprofit organizations in the High Prior Adoption group and the Low Prior Adoption group did not extend much effort to adopt SOX after it was enacted in 2002 because they had already established most of its requirements prior to this event. Further support comes from the fact that the predicted SOX adoption level in the Low Prior Adoption group is higher than in the High Prior Adoption group.

The marginal effects of independent variables are interpreted as follows: the unit change in one independent variable produces marginal change in the mean predicted SOX adoption level equal to the magnitude of the coefficient, while other independent variables are held at their means. Coefficients in Table 6.11 demonstrate marginal changes in the predicted Y are explained by change in each independent variable. In Poisson regressions the effects of independent variables are not cumulative. When independent variables are qualitative, the effect of a binary variable $X_k$ is computed by letting $X_k$ change from 0 to 1, with the marginal effect observed in the expected value of the dependent variable. For example, the effect of a binary variable “board member,” which determines how the information originating from the board member influences SOX adoption, is interpreted as follows: in the Low Prior Adoption group when organizations receive information about SOX from their board members, the predicted value of SOX adoption at 1.059 increases by 0.529 ($p = 0.01$) holding other independent variables at their means.
By contrast, I interpreted the negative marginal effect of the categorical variable “existing accountability” as follows: when a respondent reports a one unit increase in his or her preference to adhere to “existing accountability” standards (1 – strongly disagree, 2 – disagree, 3 – neither, 4 – agree, 5 – strongly agree), the expected SOX adoption level at 1.059 in the Low Prior Adoption group decreases by 0.236 holding other independent variables at their means, and the expected SOX adoption level at 0.713 in the High Prior Adoption group decreases by 0.225 holding other independent variables at their means. The marginal effects of “existing accountability” standards in both groups are negative and significant at 0.05 and 0.001 levels accordingly. I interpreted marginal effects of other independent variables similarly.

Analysis of different explanatory power of independent variables

The results of the Poisson regression show that the Low Prior Adoption group and the High Prior Adoption group have adopted SOX practices to a different extent: the former having on average 1.059 adoptions, and the latter having 0.713 adoptions. Analysis of the Poisson regression model and the marginal effects function reveals that three explanatory variables provide strong explanation for SOX adoption; all three are almost equally important for influencing SOX adoption behaviors in both the Low Prior Adoption and the High Prior Adoption groups. These three explanatory factors are “familiarity with SOX,” preference of leaders to adhere to “existing accountability practices,” and pre-SOX adoption of SOX-like practices described as “had before SOX.” In the Low Prior Adoption group, a one unit change in “familiarity with SOX” produces a 1.619 marginal increase in post SOX adoption, leading to a 2.678 level of SOX adoption. In the High Prior Adoption group, a one unit change in “familiarity with SOX” produces a 1.220 marginal increase over the mean SOX adoption level.
(.713) and leading to a 1.933 post-SOX adoption level. In both groups, coefficients are significant at 0.001 level for the “familiarity with SOX” variable. The explanatory power of the “existing accountability practices” is comparable in both groups, but it is more significant in the High Prior Adoption group at the level of 0.0001 as compared to 0.05 in the Low Prior Adoption group. As expected, “existing accountability practices” is negatively associated with adoption behavior in both groups leading to decrease in SOX adoption level. As hypothesized earlier, the “prior to SOX adoption” variable negatively relates to the post SOX adoption level in the High Prior Adoption group, has larger magnitude and higher statistical significance at the level of 0.0001 than in the Low Prior Adoption group. In the Low Prior Adoption group the “prior to SOX adoption” variable negatively relates to the post-SOX adoption level, and is statistically significant at 0.01 level.

Other variables offer differing explanations of the post-SOX adoption behavior in two groups. Sources of information such as “nonprofit publications” and “board members” are significant positive explanatory variables in the Low Prior Adoption group (0.479 and 0.529, at p = 0.05 and p = 0.01 accordingly), but do not explain the post-SOX adoption behavior in the High Prior Adoption group.

Interestingly, the organizational size does not explain SOX adoption behavior in the Low Prior Adoption group, but leads to an increase in predicted SOX adoption in the High Prior Adoption group. This finding suggests that in the former group a one unit increase in the size category does not change SOX adoption behavior, while in the latter group a one unit increase in size category leads to a 0.154 (p = 0.05) increase in SOX adoption level.

Finally, the variable “audit fee increase” explains adoption behavior in the Low Prior Adoption group, but not in the High Prior Adoption group. The audit fee increase is a
dichotomous variable, which can be interpreted as follows: change from a zero unit audit fee raise to a one unit audit fee raise leads to a 0.893 (p = 0.001) increase in the level of post-SOX adoption in the Low Prior Adoption group leading to a predicted adoption value of 1.952.

Other independent variables such as information from formal and informal networks, availability of external audits, credibility, political pressure, number of years in current position, years of education, membership in associations, government funding, and wealth did not offer statistically significant explanations of SOX adoption behavior in either group.

Discussion of results

Both contextual variables and internal characteristics explain post SOX adoption in nonprofit organizations. Familiarity with SOX is an important prerequisite for making a decision to adopt SOX rules. It is logical that the level of familiarity with the Act positively influences post-SOX adoption in both the Low Prior Adoption and the High Prior Adoption group. According to the diffusion of innovation theory, channels of communication about the innovation influence adoption decisions (Rogers, 2003). This analysis illustrates the importance of industry publications for spreading information about new SOX requirements concerning accountability and transparency standards. This research finds that when information about new requirements originates from board members and nonprofit publications, it is more likely to be heard and considered for implementation. Two variables account for decreases in the level of SOX adoption in both groups. The “existing accountability practices” variable describes the attitudes of the CEOs toward SOX. By answering the questions of whether nonprofit managers should adhere to existing accountability standards regardless of SOX until a specific nonprofit regulation requires change, managers reveal their preferences to follow established practices.
Another variable, “had prior to SOX,” describes the pre-SOX established accountability structure in nonprofit organizations measured by the number of SOX-like practices instituted prior to SOX enactment in 2002. As discussed earlier, established practices, as soon as they are perceived as satisfactory by organizations and their direct constituencies, provide a sense of security and prompt less urgency for nonprofit leaders to adopt SOX practices.

The “audit fees increase” stimulates nonprofit organizations with low pre-SOX adoption levels to adopt more SOX practices after SOX enactment. Although, no significant relationship was found between the auditor as a source of information about SOX and the level of post-SOX adoption in either group, apparently, an indirect mechanism for transferring information about SOX through increased audit fees does affect the SOX adoption levels among organizations in the Low Prior Adoption group. Changed audit standards that could have influenced the increase in audit fees may be an explanation for this effect.

Availability of an external audit is a widely established procedure in nonprofit organizations (91.8 percent of organizations reported having a regular external audit, see Table 6.6, p. 117). For this reason it could not discriminate between the two pre-SOX adoption groups of organizations or explain their behavior. Nor does networking and membership in professional associations offer an explanation for SOX adoption because, as participants in the face-to-face interviews indicated, SOX is not perceived as an external threat or as a binding law and, for this reason, it has not been discussed at professional meetings.

Average education level among nonprofit executives was 17 years with a standard deviation of 2 years, indicating that most of them had a college education. Such educational homogeneity did not provide sufficient discrimination among the leaders of nonprofit
organizations by education. Nor did the number of years in a leadership position influence SOX adoption behavior in responding organizations.

Contrary to expectations, organizational slack resources, and government funding\textsuperscript{20} through grants and contracts did not explain SOX adoption in participating organizations. One explanation for the lack of explanatory power of government funding could be the considerable number of missing responses to this question.

With regard to size effects, many researchers indicated that the influence of the size of organizations on SOX adoption level was so pronounced that it required individual analysis of each size group (Ostrower & Bobowick, 2006). I felt that previous analysis did not sufficiently differentiate SOX adoption by the size of organizations, so I decided to do a new analysis to better understand the effects of size on post-SOX adoption.

\textbf{Size Effect}

The frequency analysis of post-SOX adoption by size groups demonstrates that the highest percent of zero-adopters was in the group of small organizations (about 65 percent) as compared to mid-size (about 47 percent) and large organizations (about 37 percent). Table 6.12 below describes SOX adoption by three size groups of respondent organizations at the zero level, at the basic level, and at above the basic level.

\textsuperscript{20} Organizational slack resources are measured as a difference between annual revenues and expenditures. Government resources are calculated differently. The first measure of government resources is the percentage of organizational revenues from government sources as reported by respondents; then, the categories of government dependence variable were constructed by dividing organizations into four dependence categories; finally, government funding was estimated from the total revenue and the reported percentage of government funds. None of these variables was significant.
Table 6.12 illustrates SOX adoption by size categories. The basic SOX adoption level is defined as having one to two SOX practices. Above the basic level of SOX adoption goes from 3 to 11 practices. Among small organizations, only 28 percent have the basic level of SOX adoption, among large organizations the proportion is 37 percent of organizations, while in mid-size organizations the proportion is 41 percent, the highest level. Table 6.12 shows that the highest percentage for the above the basic level of SOX adoption is in large organizations (26.6 percent); the second is in mid-size organizations (11.1 percent), and the lowest is in small organizations (7.2 percent).

To understand which specific independent variables offer explanations for SOX adoption by size, I estimated Poisson regression for the three size categories of organizations with the same explanatory variables I used for predicting SOX adoption in Low Prior Adoption and High Prior Adoption groups of organizations.

### Table 6.12. Frequency of SOX Adoption by Size

<table>
<thead>
<tr>
<th>No. of adopted SOX items</th>
<th>Small (111)</th>
<th>Mid-size (114)</th>
<th>Large (79)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>N</td>
<td>%</td>
<td>N</td>
</tr>
<tr>
<td>0</td>
<td>72</td>
<td>64.9</td>
<td>50</td>
</tr>
<tr>
<td>1</td>
<td>20</td>
<td>18.0</td>
<td>22</td>
</tr>
<tr>
<td>2</td>
<td>11</td>
<td>9.9</td>
<td>22</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
<td>2.7</td>
<td>6</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
<td>1.8</td>
<td>2</td>
</tr>
<tr>
<td>5</td>
<td>2</td>
<td>1.8</td>
<td>4</td>
</tr>
<tr>
<td>6</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>7</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>8</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>9</td>
<td>1</td>
<td>0.9</td>
<td>-</td>
</tr>
<tr>
<td>11</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>111</td>
<td>100.0</td>
<td>107</td>
</tr>
</tbody>
</table>
Explaining SOX adoption by size

Size is emphasized as a major distinguishing variable among SOX adopters and non-adopters in recent empirical studies (Ostrower and Bobowick, 2006; Vermeer et al., 2005; Behn et al., 2005). Yet, the evidence of size effects in my earlier research analyses of SOX adoption is not conclusive. For this reason I decided to estimate Poisson regressions for SOX adoption controlled for organizational size. I hypothesized that if I found differences in SOX adoption levels in the three size groups, it would indicate that size is an important discriminatory variable for the level of SOX adoption.

The size variable is constructed as a categorical variable, with three size categories measured by the size of the organizational budget as follows: (1) small, $100,000-1,999,999; (2) mid-size, 2,000,000 – 9,999,999; and (3) large, 10,000,000- maximum. I combined influential contextual external and internal variables and estimated Poisson regression models separately for the three size categories. SOX adoption in each size model was separately regressed on the following explanatory variables: (1) familiarity (familiarity of CEOs with SOX), (2) nonprofit publications, (3) members of the board, (4) existing accountability practices, (5) had before SOX, and (6) audit fee (increased audit fees). Table 6.13 below presents the results of three size models. The small organizations category has 111 organizations, the mid-size category has 107 organizations, and the large category has 79 organizations. Because of missing observations in some of the independent variables seven cases are dropped.
As seen in Table 6.13, the levels of SOX adoption vary in all three size models. The predicted mean of SOX adoption level in the group of large organizations (1.219) is approximately three times as large as the mean adoption in the group of small organizations (.484). The predicted mean of SOX adoption in the group of mid-size organizations (0.926) is approximately twice as large as in the group of small organizations. The difference in the levels of post-SOX adoption among three size categories proves that size explains SOX adoption well. The larger the nonprofit organizations are, the more SOX practices they adopt.

Marginal effects vary among independent variables. Some explanatory variables explain adoption effects in all three size models, and others provide different explanations among the models. “Familiarity with SOX” is a significant explanatory variable in all three size groups. It marginally increases SOX adoption by 0.903 in large organizations (p=0.001), by 0.750 (p = 0.0001) in mid-size organizations, and by 0.339 (p = 0.01) in small organizations.

The “sources of information about SOX” variable, such as nonprofit publications and board members, does not produce any explanatory effects in any of the three size groups.
Interestingly, the internal characteristics variable “existing accountability practices,” which describes the preference of managers to adhere to existing accountability practices, was found to be a strong explanatory variable in the Low Prior Adoption group and High Prior Adoption groups by the preceding analysis, yet it failed to produce a statistically significant effect on post-SOX adoption level in the mid-size group of organizations. In small and large organizations, however, the effects of “existing accountability” variable are negative, as expected, and are statistically significant at the 0.01 level.

The “prior to SOX adoption” variable decreases the post-SOX adoption level in all three size groups. The “prior to SOX adoption” variable magnitudes are moderate in all three size groups, which suggests that this variable has a moderate influence on the post-SOX adoption level in the size models. In the group of small organizations the “prior to SOX adoption” variable marginally decreases the predicted SOX adoption by -0.078 (p = 0.0001); in the mid-size organizations, by -0.160 (p = 0.0001); and in the large organizations, by -0.252 (p = 0.0001). The increasing magnitude of the “prior to SOX adoption” effects suggests that larger organizations experience a larger marginal decrease of the post SOX adoption level.

The “increase of audit fees” variable influences SOX adoption in groups of small and mid-size organizations. In large organizations the “audit fee” variable does not produce any significant effect. The explanation may be that in organizations with large budgets, the audit fee increase is only marginally important, and fails to alarm the leaders.

To conclude, the results of Poisson regressions controlled by the size of nonprofit organizations provide evidence that size is an important factor that influences SOX adoption behavior by nonprofit organizations. The predicted SOX adoption level increases as the size category changes from small to large. Similar to the results of Poisson regressions controlled by
the prior to SOX adoption level in two groups, “familiarity with SOX”, managers’ preference to adhere to “existing accountability practices,” and “prior to SOX adoption” level best explain the adoption behavior of organizations in all three size categories.
CHAPTER 7
EFFECTS OF ADOPTION OF THE SARBANES-OXLEY ACT BY NONPROFIT ORGANIZATIONS

Introduction

Research of business administration scholars and studies of business experts have determined that the implementation of SOX practices produces benefits as well as costs for publicly traded for-profit corporations (Bumgarder, 2003; CFO Research Services, 2005; Clark, 2005; Zhang, 2005; Linck et al., 2005, Bisoux, 2005). The effects of SOX compliance in nonprofit organizations have not yet been studied systematically. This study attempted to fill the gap and to find any specific effects that are positive or/and negative by examining the nonprofit managers’ perception of what kind of benefits and costs their respective organizations experience after implementing SOX requirements. A study of perceptions has limitations because it is considered to be subjective, but factual data that might be analyzed to understand the monetary costs or benefits in nonprofit organizations are not available at this early stage of SOX adoption. The literature about benefits and costs of compliance with SOX provisions in for-profit corporations provides a benchmark for anticipation of certain effects in nonprofit organizations.

Figure 3.4 on page 55 explains the benefits and costs that nonprofit corporations may experience following SOX adoption. The specific benefit and cost items are derived from the business experts’ opinions and from empirical studies of business scholars. To collect the data about benefits and costs the leaders of nonprofit organizations were offered a table listing benefits and costs (see Appendix II, q. 21), and asked to mark NO if their respective
organizations did not experience a specific positive or negative effect, or YES if the effect was present. Table 7.1 below shows the survey table with effects options (see also Appendix II, q. 21), and the distribution of positive and negative responses.

Table 7.1 contains eight positive effects and ten negative effects. Both types of effects were presented to respondents in one table to avoid possible selection bias by respondents, who may choose positive or negative more often depending on their attitudes to SOX.

Table 7.1. Frequencies of Benefits and Costs after SOX Adoption*

<table>
<thead>
<tr>
<th>Benefits and costs from SOX adoption</th>
<th>NO</th>
<th>YES</th>
<th>NO</th>
<th>YES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Better financial controls</td>
<td>194</td>
<td>63.8</td>
<td>83</td>
<td>27.3</td>
</tr>
<tr>
<td>Reduced risk of accounting fraud</td>
<td>200</td>
<td>65.8</td>
<td>74</td>
<td>24.3</td>
</tr>
<tr>
<td>Enhanced effectiveness of the board</td>
<td>209</td>
<td>68.8</td>
<td>64</td>
<td>21.1</td>
</tr>
<tr>
<td>Enhanced reputation of the organization</td>
<td>244</td>
<td>80.3</td>
<td>30</td>
<td>9.9</td>
</tr>
<tr>
<td>More government contracts</td>
<td>271</td>
<td>89.1</td>
<td>2</td>
<td>0.7</td>
</tr>
<tr>
<td>More private donations</td>
<td>265</td>
<td>87.2</td>
<td>8</td>
<td>2.6</td>
</tr>
<tr>
<td>Better fundraising capabilities</td>
<td>258</td>
<td>84.9</td>
<td>13</td>
<td>4.3</td>
</tr>
<tr>
<td>More resources to meet clients’ needs</td>
<td>268</td>
<td>88.2</td>
<td>8</td>
<td>2.6</td>
</tr>
<tr>
<td>Less resources to meet clients’ needs</td>
<td>246</td>
<td>80.9</td>
<td>29</td>
<td>9.5</td>
</tr>
<tr>
<td>Difficulties in achieving board independence</td>
<td>270</td>
<td>88.8</td>
<td>6</td>
<td>2.0</td>
</tr>
<tr>
<td>Decreased fundraising capabilities</td>
<td>264</td>
<td>86.8</td>
<td>9</td>
<td>3.0</td>
</tr>
<tr>
<td>Increased financial training costs</td>
<td>233</td>
<td>76.6</td>
<td>42</td>
<td>13.8</td>
</tr>
<tr>
<td>Increased fees for external audit</td>
<td>193</td>
<td>63.5</td>
<td>111</td>
<td>36.5</td>
</tr>
<tr>
<td>Longer and more frequent audit committee meetings</td>
<td>211</td>
<td>69.4</td>
<td>59</td>
<td>19.4</td>
</tr>
<tr>
<td>Longer and more frequent board meetings</td>
<td>255</td>
<td>83.9</td>
<td>21</td>
<td>6.9</td>
</tr>
<tr>
<td>Reallocations of resources from program to administrative expenses</td>
<td>231</td>
<td>76.0</td>
<td>45</td>
<td>14.8</td>
</tr>
<tr>
<td>Difficulties in recruiting board members</td>
<td>257</td>
<td>84.5</td>
<td>19</td>
<td>6.3</td>
</tr>
<tr>
<td>Difficulties in recruiting audit committee members</td>
<td>250</td>
<td>82.2</td>
<td>18</td>
<td>5.9</td>
</tr>
</tbody>
</table>

*Percentage of organizations by row does not always add up to 100 percent because of the omitted number of missing organizations

The first column of numbers shows that the great majority of responding nonprofits did not experience any effects of SOX adoption, either positive or negative. This is very obvious in the percentage column. However, from the earlier analysis of the levels of SOX adoption by nonprofit organizations it is clear that the half of nonprofits do not adopt SOX (50.3 percent), and that most of those who do adopt any SOX practices do it at the basic level of adoption,
which means that they adopt one or two practices (35 percent). Thus, it is no surprise that one observes no effects in most cases. But the more telling statistics, for the purpose of this research, are in the YES column. It provides information about the types of benefits and costs that adopting organizations experience. Later in this chapter I will analyze the association between the adoption and the effects.

Table 7.1 exhibits the descriptive statistics of the effects. As is suggested in Chapter III (p. 57), the costs of SOX adoption seem to materialize faster than the benefits. Actions required by SOX are aimed at building public confidence in organizations. However, public confidence cannot be built overnight. When required actions are implemented by management, certain costs are inevitable, whether these are material or immaterial costs. Yet, the benefits do not accrue until the news is spread about the improvements. For this reason I assume that although costs would be immediate, some of the benefits might be delayed for the time necessary to spread the information about change among the stakeholders. Responses of participants in Table 7.1 suggest that such material benefits of SOX adoption as “more private donations”, “more government contracts”, “better fundraising capabilities”, and “more resources to satisfy clients’ needs” are not experienced by the prevailing majority of respondents. But the good news is that some negative effects such as “decreased fundraising capabilities” and “difficulties in recruiting board members and members of audit committees” did not widely materialize either.

The benefits that accrue to nonprofit organizations as a result of SOX adoption are mostly the improvements of financial management and governance in organizations. From Table 7.1 one can see that 27, 24 and 21 percent of respondents mark “better financial controls,” “reduced risk of accounting fraud” and “enhanced effectiveness of the board” as positive effects experienced by nonprofit organizations after compliance with SOX. Among the negative effects
experienced by organizations as a result of SOX, those most often checked are the “increased external audit fees,” “longer audit committee meetings,” and “reallocation of resources from program to administrative expenses.” These findings support the expectation that the material costs of SOX adoption, such as higher audit fees and reallocation of resources, are immediate, while benefits, such as enhanced reputation and consecutive material gains like more private donations and government contracts, are not. The negative effect that stands out as the most frequently marked by respondents is the audit fee increase, which is reported by 36.5 percent of respondents. Other negative effects such as increased financial training costs, longer audit committee meetings and reallocation of resources to administrative expenses are experienced by fewer organizations (14, 19 and 15 percent respectively).

The question of whether organizations receive more net benefits or costs can be answered with the help of simple arithmetic by subtracting costs from benefits. To do this subtraction I needed to make benefits commensurate with costs. To achieve this goal I weighted the benefits to make them equal to costs, as Table 7.1 contains more cost items than benefit items (ten to eight). Giving more weight to benefit items brings benefits up to equal total costs items, and makes both indices comparable in their magnitude. To define the weighting amount I calculated the ratio of total costs to total benefits and used the ratio to weight the benefits—10/8 = 1.25. By multiplying the benefit responses for all observations by 1.25, adding them up and dividing by the number of responses I obtained a weighted total benefits index. I calculated the total costs index by adding positive responses in each observation and dividing them by the number of observations. The net benefits equal the difference between the total benefits index and the total costs index. The result of subtraction is -0.0084. The negative sign and the amount indicate that the net benefits are negative, but that the magnitude of the difference is minimal. Thus the
results show that the average costs of SOX adoption in all organizations are higher than the benefits by a trivial amount of 0.0084. However, because the difference is so minimal, one can say that on average the benefits and costs are almost balanced.

The results of frequency analysis support the hypothesis that material costs materialize faster than material gains. Yet, financial management improvements follow SOX adoption faster than other benefits. Direct material costs that adopting organizations experience are the increased audit fees, higher financial training costs for board members and the CEOs, and reallocation of resources from program to administrative expenses. The indirect cost experienced by organizations is longer and more frequent meetings of audit committees of the board.

The relationship between SOX adoption and the effects of adoption is established by analyzing whether benefits and costs accrue to those organizations that adopt SOX. In the following section, I explore the association between SOX adoption and the positive and negative effects experienced by responding organizations.

**Explanation of Positive and Negative Effects**

The same respondents reported both positive and negative effects. I start from a brief frequency analysis of total effects, including both benefits and costs. From 18 items on the scale of effects, respondents reported experiencing from 1 to 13 effects. Table 7.2 shows the frequency of adoption of combined benefits and costs.
As seen in Table 7.2, 132 respondents reported no effects of SOX. Because I hypothesized that relationships exist between SOX adoption and SOX effects, I went back to observe statistics of SOX adoption. Table 6.7 (Chapter VI, p. 122) shows that 153 organizations reported no SOX adoption. The difference between adopters and those who experienced effects of SOX is intriguing. There are 21 respondents who did not adopt any parts of SOX, but experienced SOX effects. The explanation for this inconsistency is provided by the participants of the face-to-face interviews. Some of the interviewed executive directors of nonprofit organizations in Georgia claim that their organizations experience costs from increased audit fees and benefits from the revisions of existing financial management and accountability procedures following SOX enactment, but at the same time they maintain that their respective organizations adopted no SOX practices. Apparently, after SOX was passed, the leaders of some nonprofit organizations revised and improved financial controls in their respective organizations, but did not literally
follow SOX requirements. Likewise, the increase of audit fees caused material costs to many organizations, but some directors did not attribute it to the influence of the new SOX related audit standards.

To explain SOX effects I estimated two models: one model explains benefits and the other model explains costs by the same independent variables. Before explaining the relationships among the benefits/costs (dependent variables) and the SOX adoption modes (independent variables), I discuss the univariate distribution of responses about the effects of SOX. This short analysis is necessary to understand the data, and the choice of the models.

The dependent variables representing effects of SOX adoption are constructed as count variables. Benefits and costs indices are dependent variables that are built using summated scales. The summated scale indices are considered the most appropriate for this type of data, where all items in the scale are equally important and equally distanced from each other. To assess the reliability of the scale I used the Cronbach’s alpha test, which produced a coefficient of reliability $\alpha = 0.737$ for the benefits scale and of $\alpha = 0.733$ for the costs scale. The alpha test confirms that the underlying constructs “benefits” and “costs” are well represented by the items in the scales. I also explored items in the benefits and costs tables for dimensionality by using the multiple correspondence analysis (MCA). The MCA is used instead of a factor analysis to define the number of dimensions among the binary variables. Results of the MCA exhibit only one dimension among all benefit variables, and one dimension among the cost variables. Considering the internal reliability and unidimensionality of both scales I built summated scale indices for benefit and cost variables.

The distributions of responses about benefits and costs of SOX adoption are nonlinear, with most responses at zero or at the low end of the adoption spectrum. Graph 7.1 and 7.2 below
present the distribution of responses about the benefits and costs of SOX adoption. To build the histogram in Graph 7.1 I used the weighted benefits index.

Graph 7.1. Distribution of Responses about Benefits of SOX Adoption

![Graph 7.1](image)

Graph 7.2. Distribution of Responses about Costs of SOX Adoption

![Graph 7.2](image)
Graphs 7.1 and 7.2 demonstrate nonlinear skewed univariate distributions of responses about SOX benefits and costs. The distributions in the graphs above have characteristics of Poisson distributions. However, the high level of zero responses leads to overdispersion, which suggests that the variance exceeds the mean—an indication of the hidden heterogeneity of observations.

To eliminate the complications caused by overdispersion, I estimated the negative binomial regression (NBR), which includes the alpha parameter that reflects the unobserved heterogeneity among the observations. Negative binomial regression automatically makes a test for the PRM and compares it to the NBR. The likelihood-ratio alpha test allows one to choose between the models on the basis of the Chi-square test for alpha = 0. If alpha is close to zero, the PRM model is preferred. The NBR with the benefits index as the dependent variable and the modes of SOX adoption as independent variables produces the likelihood-ratio alpha test Chi-square = 118.67 (p = 0.0001). Likewise, the likelihood-ratio alpha test for the costs index as dependent variable and modes of SOX adoption as independent variables, estimated as a regular procedure by the NBR, produces the Chi-square = 82.44 (p = 0.0001). Thus, both regressions produce alpha tests that strongly indicate that the NBR model is preferred to the PRM model.

Table 7.3 below exhibits the results of the negative binomial regression models and the marginal effects function. To explain SOX benefits I included in the model three adoption variables: “had before SOX,” “considered but not adopted after SOX,” and “adopted after SOX.” I used the “had before SOX” and “considered after SOX” variables in the regression to account for effects experienced by a certain number of organizations that reported no SOX adoption. All three variables are constructed as summated scale indices.

21 Cronbach’s alpha test of reliability for the SOX practice scale produced the coefficient of the scale $\alpha = 0.704$ (see Chapter IV, p. 84).
Table 7.3. SOX Effects Explained

<table>
<thead>
<tr>
<th>Estimated benefits</th>
<th>Estimated costs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yhat = 0.855</td>
<td>Yhat = 0.873</td>
</tr>
<tr>
<td><strong>Variable</strong></td>
<td><strong>Marginal</strong></td>
</tr>
<tr>
<td>Had before SOX</td>
<td>0.173*****</td>
</tr>
<tr>
<td>Considered after SOX</td>
<td>0.253*****</td>
</tr>
<tr>
<td>Adopted after SOX</td>
<td>0.346*****</td>
</tr>
</tbody>
</table>

| Yhat = Ybar |

Table 7.3 presents marginal effects of SOX adoption and SOX-induced revisions on the predicted levels of benefits and costs. Each of the three explanatory variables is positive and statistically significant, and produces its separate marginal effect on the predicted level of benefits and costs. It is obvious that the predicted levels of benefits and costs do not differ much, with costs exceeding benefits by only 0.018.22 The statistical significance of three explanatory variables is similar at the level of 0.0001. In both models, for benefits and costs alike, the largest explanatory power is exhibited by the post SOX adoption, as the magnitude of the coefficients suggest. In the benefits model, one additional adopted practice (measured on the scale of 1-15) increases predicted benefits by 0.346; and in the costs model one additional adopted practice increases predicted costs by 0.354. The marginal effects of the two variables “had before SOX” and “considered after SOX” also increase predicted benefits and costs. The explanation for these associations might be the assertion of nonprofit executives that the revision of existing financial control practices and accountability procedures benefited their organizations regardless of SOX adoption. Apparently, some organizations that do not report SOX adoption, experience certain SOX costs as well, such as the increased audit fees. The audit fees increase is one of the SOX consequences that are not directly related to adoption of SOX practices.

22 This result confirms the finding of the net benefit analysis, which also produced a trivial negative net benefit difference of 0.008.
Summary

This study analyzed positive and negative effects accruing to nonprofit organizations after the adoption of SOX practices for the first time since nonprofits started to adopt SOX. More than the half of all organizations in the sample reported experiencing some kind of effect from SOX since it was enacted in 2002. However, some respondents report having experienced SOX effects without admitting adoption of any parts of SOX. The explanation for such effects are provided by the nonprofit executive directors interviewed face-to-face, who claim experiencing benefits of SOX after revising existing financial controls and procedures.

The benefits most often experienced by nonprofits are improved financial management, reduced risk of fraud, and improved effectiveness of the boards. All these benefits characterize improved management in organizations. A very small number of respondents report any material benefits accruing to organizations because of SOX (below 5 percent), such as more government contracts, more private donations, or better fundraising capabilities. At the same time a number of organizations report considerable material costs from SOX adoption, such as increased audit fees, reallocation of resources from program to administrative expenses, and increased spending for financial training (37, 20, and 15 percent of organizations). These findings suggest that, as expected, materials costs accrue faster than material benefits to policy adopters. However, immaterial benefits such as improved financial management follow SOX adoption immediately.

Most organizations report both benefits and costs of SOX adoption. On average the organizations experience slightly higher costs than benefits. Yet the difference is so insignificant, with net benefits equaling -0.008, that one can say that the benefits and costs experienced by SOX adopters are balanced.
The explanation of SOX effects is provided by the modes of SOX adoption. To distinguish between the experience of SOX adopters and the experience of non-adopters, I included in the model two other variables: “prior to SOX adoption” and “considered but not adopted after SOX” additionally to independent variable “SOX adoption.” The NBR was estimated with three independent variables indicating different modes of SOX adoption. The results of the NBR show that SOX adoption produces larger marginal effects on predicted level of effects than prior to SOX adoption or revision of existing practices after SOX. The effects of all three independent variables describing different modes of SOX adoption are statistically significant. The explanatory power of “had before SOX” and “considered but not adopted after SOX” is explained by the information received from nonprofit executive directors, who report having SOX effects without adopting any parts of SOX.

In sum, the important conclusion is that currently nonprofit organizations experience benefits and costs of SOX adoption. Most organizations have benefits and costs accruing to them as a result of SOX adoption. But few organizations experience SOX effects without adopting any parts of SOX. Benefits and costs from SOX adoption are balanced. One item is responsible for most costs reported by nonprofits: the audit fee increase, reported by almost 37 (36.5) percent of organizations. Adoption of SOX explains effects better than revision of existing practices following SOX enactment. One important finding from the analysis of SOX effects is that improvement of management and governance in organizations follows SOX adoption very quickly, unlike other material benefits.
CHAPTER 8
SUMMARY OF FINDINGS, DISCUSSION, CONCLUSION

Research Goals and Design

The goal of this research is to study adoption of the Sarbanes-Oxley Act (SOX) by nonprofit organizations. The purpose of the study is to answer the following questions: (1) How can we explain the adoption of SOX practices by nonprofit organizations that are outside of SOX jurisdiction? (2) To what extent do nonprofits adopt SOX? (3) Do SOX adopters experience any effects from SOX adoption? SOX enactment was urged for political and practical reasons. The American Congress designed new regulations to calm down the public outrage caused by financial scams in large for-profit corporations and to restore the public trust in stock exchange participants. Common knowledge holds that SOX is specifically designed to streamline financial control, accountability and transparency procedures in for-profit publicly traded corporations. The requirements of SOX were recognized by business and Stock Exchange Commission experts as “best business practices.” As such, SOX requirements started spreading to other sectors of economy.

In order to learn about SOX adoption by nonprofit organizations, I surveyed a nationwide random sample of such organizations. To explain the SOX adoption patterns by nonprofit organizations this study used several theories, which helped to determine the explanatory factors for SOX adoption. Following the stakeholder and resource dependence theory I hypothesized that nonprofit organizations adopt SOX practices more actively if major stakeholders and
organizational donors recommend it. Another theory that helps explain SOX adoption is the diffusion of innovation theory, which states that the channels of communication influence decisions to adopt innovations. This theory induced me to pay attention to the sources of information about SOX to nonprofits. The diffusion of innovation theory also contends that the attitudes of managers are important for promoting innovation. To test this proposition, I collected information about the attitudes of nonprofit leaders toward SOX. Nonprofit leaders were asked whether they viewed the Act as beneficial for their organizations, or whether they preferred to adhere to existing accountability practices. The third theory that helps explain SOX adoption by nonprofits is the anticipatory accountability theory. According to this theoretical proposition, proactive managers will adopt new ideas to enhance their respective organizations’ legal and practical standing. Hence, I hypothesized that those nonprofit managers who consider SOX to be the “best business practice” are more likely to adopt its provisions and, vise versa, conservative managers would adhere to the existing practices. Finally, based on the internal determinants theory, I expected that certain organizational and individual leaders’ characteristics would facilitate SOX adoption by nonprofit organizations.

The second stage of the study inquired about SOX effects. Organizations that adopt SOX and organizations that revise their practices after SOX experience positive and negative consequences. The study described which specific effects organizations experience more often than others. Thus, after SOX adoption and revision nonprofit organizations reported improved financial control and management and more effective board of directors. In terms of costs, the most prominent SOX negative effects are material: increased audit fees and reallocation of resources from program to administrative expenses.
Summary of Findings

The data were collected by surveying nonprofit executives and from secondary sources. The survey questions prompted nonprofit leaders to provide information about requests of donors, board members and auditors concerning SOX adoption, about leaders’ attitudes to SOX, and about the top managers’ personal and organizational features that may influence SOX adoption. Two big questions in the survey asked participants about the practical adoption of individual SOX practices and about the effects of the adoption.

Adoption of SOX takes place in the nonprofit sector

Research determines that SOX adoption does take place in organizations of the nonprofit sector. However, the level of SOX adoption is modest. Half of the respondents reported adopting few SOX practices, while the other half reported adopting no SOX practices. This finding diverges from the expectations of most business and nonprofit experts expressed in the popular press and research articles that demonstrate considerable SOX adoption and predict ever-increasing SOX adoption levels. The survey results showed that the sample was divided into two groups with respect to SOX adoption. This division raises a question: Why do some nonprofit organizations adopt SOX while others do not? Preliminary independent sample t-test analysis indicated that differences exist between adopters and non-adopters with respect to organizational size and wealth. Other characteristics such as age, revenue, and policy area did not distinguish adopters from non-adopters. Yet, the most striking finding concerns the level of pre-SOX existing accountability, governance, and transparency condition in nonprofit organizations, which precedes most of SOX recommended practices. Although the “had before SOX” question was included in the survey to separate pre-SOX and post-SOX adoption of certain practices, the
discovered high level of “pre-existing condition” was surprising. In the light of this finding, I assume that existing SOX-like practices in most nonprofit organizations could be a factor that deters adoption of SOX practices. Furthermore, from the semi-structured interviews with nonprofit executives in Georgia, I learned that the nonprofit leaders did not perceive the Sarbanes-Oxley Act as a challenge to their accountability practices, did not feel urgency to adopt its provisions, and did not feel any pressure from their stakeholder to adopt SOX. Yet, most of them argued that, potentially, SOX may improve financial management and control as well as the effectiveness of the boards of directors.

All these findings led to the hypothesis that those nonprofit organizations that established SOX-like practices before SOX enactment were not likely to extensively adopt SOX provisions. For the purpose of further analysis I divided the whole sample into two groups that were defined by high or low prior to SOX adoption levels of SOX-like practices. I expected that the group with low prior to SOX adoption would adopt more SOX practices after SOX was enacted; and, by contrast, the group with high prior to SOX adoption of SOX-like practices would adopt fewer practices after SOX was enacted. To test this hypothesis and to explain SOX adoption in both pre-SOX adoption groups, I estimated the Poisson regression model for the level of SOX adoption as dependent variable, and sources of information about SOX, donors and auditors pressure to adopt SOX, CEOs characteristics (familiarity with SOX, education level, occupational background, membership in professional associations, and attitudes to SOX), and organizational characteristics (size, wealth, age, and external audit availability) as independent explanatory variables. Results of the ANOVA test and Poisson regression supported the hypothesis that the two groups, defined by their pre-SOX existing accountability structure, behave differently with respect to SOX. Those organizations that adopted many SOX-like
provisions before SOX was adopted in 2002, do not adopt as extensively as organizations with fewer pre-SOX adoption levels of SOX-like practices. The Poisson regression identified independent variables that explain adoption of SOX by nonprofit organizations.

The “preexisting condition” and conservatism of managers explain SOX adoption

Results of two Poisson regression models support several hypotheses that explain SOX adoption in the two groups of organizations defined by their pre-SOX adoption levels. In the first place, the models confirm that post-SOX adoption level is higher in the Low Prior Adoption group that in the High Prior Adoption group. Three independent variables explain the level of adoption in both groups. The “familiarity with SOX” variable produces the strongest marginal effect in both groups. The “accountability” variable, which describes the attitudes of managers who believe that it is better to adhere to existing accountability practices regardless of SOX, decreases SOX adoption in two groups, but is statistically more significant in the High Prior Adoption group. Finally, the “had before SOX” variable, which counts the number of SOX-like policies established by organizations before SOX enactment, is another strong negative predictor of post-SOX adoption in the High Prior Adoption group, and is slightly weaker but significant in the Low Prior Adoption group. These findings confirm certain propositions of the diffusion of innovation theory that maintain that characteristics and attitudes of managers toward innovation do matter. Lack of proactive behavior on the part of nonprofit executives leads to lower post-SOX adoption levels by nonprofit organizations. The explanation for that lies in the fact that most leaders do not perceive SOX as an external threat that warrants immediate action. The higher statistical significance of the “had before SOX” variable in the High Prior Adoption group indicates that more nonprofit organizations in this group had a “pre-existing condition” in terms
of established SOX-like practices, which explains lower post-SOX adoption. Interesting findings describe relationships among the post-SOX adoption level and other explanatory variables in both groups.

_Sources of information explain SOX adoption in one group_

The Low Prior Adoption group’s SOX adoption level is influenced by nonprofit publications and board members who provide information about SOX. These relationships indicate that sources of information and important stakeholders influence innovations in organizations, in accordance with the theory of diffusion of innovations and the stakeholder theory.

Several variables were excluded from the Poisson regression as lacking statistical significance. However, the theory of resource dependence was also confirmed by the statistically insignificant relationship between the donors’ recommendations to adopt, and the practical adoption of SOX. Frequency statistics work together with regression results to explain this relationship. From the whole sample, only 4.3 percent of organizations reported that donors advised them to adopt SOX. The proportion of donors who recommended SOX adoption is too small to establish a statistically significant relationship. The absence of the pressure to adopt SOX from the important resource suppliers explains why SOX adoption is modest in nonprofit organizations.

_Unintended material effect of SOX in the Low Prior Adoption group_

The variable “increase of audit fees” is an important explanatory factor of SOX adoption in the Low Prior Adoption group, though it does not influence SOX adoption in the High Prior
Adoption group. Raise of audit fees is the contextual variable, which explains how change in the environment impacts nonprofit organizations. Because there is a larger proportion of small organizations in the Low Prior Adoption group (about 30 percent), as compared to the High Prior Adoption group (about 15 percent), it is safe to assume that smaller organizations took the audit fee increase more seriously than the larger organizations. I propose the explanation that audit fee increase is an indirect information channel that influences SOX adoption in small organizations, unlike in large organizations, which are proportionally less affected by audit fee increase because of larger resources.

The size of the organization is a solid explanatory factor in the High Prior Adoption group, but does not provide a statistically significant explanation of SOX adoption in the Low Prior Adoption group. Frequency statistics demonstrate that in the Low Prior Adoption group the three size categories are represented evenly, while in the High Prior Adoption group larger organizations prevail. To explore how the size categories explain SOX adoption, I estimated Poisson regression models separately for the three size categories of nonprofit organizations.

*Size explains SOX adoption in nonprofit organizations*

The Poisson regressions of SOX adoption controlled by categories of size demonstrated that the size is an important factor that determines post-SOX adoption. On average, large organizations adopt SOX at a higher level than mid-size organizations, and mid-size organizations, in turn, adopt more SOX practices than small organizations. The strongest explanations of SOX adoption in all three size categories are the CEOs’ familiarity with SOX, and pre-SOX adoption of SOX-like practices.
SOX adoption brings benefits and costs to nonprofit organizations

One of the larger research and practical questions is about any benefits and costs that SOX adoption brings to nonprofit organizations post-SOX adopters. The negative binomial regression (NBR) results confirm that statistically a significant relationship exists between SOX adoption and the effects of adoption. However, because some nonprofit executives reported experiencing SOX effects without adoption of any SOX practices, I include two other variables in the model to explain SOX effects “had before SOX” and “considered but not adopted after SOX”, which describe the “pre-existing condition” and the intention to adopt SOX.

The results of NBR confirm that SOX adoption best predicts the effects—benefits and costs alike. However, the portion of effects is also explained by the “pre-existing condition” and “considered after SOX” variables. Although this finding seems to go beyond conventional wisdom, the explanation is in the hands of the practitioner nonprofit executives, who explained that because they were sensitized by SOX to the issues of financial mismanagement and fraud, they reviewed their existing procedures, which benefited their organizations.

Management improvements follow SOX adoption immediately

Interesting results were produced by the frequency analysis of benefits and costs. The effects table contains eight benefits and ten costs items. For the purpose of analysis I weighted the benefits to make them commensurate with costs. Net benefit analysis showed that benefits and costs are almost equally balanced. Yet, costs are monetary, while benefits are non-monetary. Most organizations reported improved financial management and governance as their primary benefits. This finding deserves attention. Even with minimal adoption of SOX practices and revision of existing financial control procedures, nonprofit leaders perceive improvement in
management of their respective organizations, particularly, improved financial management, reduced risk of fraud, and higher board effectiveness. However, statistics indicate that material benefits are not realized at the time of the survey. As expected, material benefits might be delayed for the time needed to disseminate the information about the improvements to the donors and stakeholders.

SOX adoption brings material costs to nonprofit organizations

The following direct costs are experienced because of SOX: higher financial training costs, increased audit fees, and reallocation of resources from program to administrative expenses. The indirect cost is longer and more frequent audit committee meetings. The proportion of organizations that had no SOX effects is large (41 per cent). These are both SOX adopters and non-adopters. These findings confirm the hypotheses that SOX adopters experience both positive and negative effects, as well as the expectation that material costs follow SOX adoption immediately, while the tangible benefits are delayed. One particular finding is of great importance to nonprofit organizations: the immediate benefit from SOX adoption is the improvement of financial management and governance. I can conclude that while material gains are delayed, improvements in management happen immediately following SOX adoption.

Advantages and Limitations of the Study

Advantages

This study of SOX adoption by nonprofit organizations was conducted in 2006. Considering the fact that only a few SOX provisions became effective immediately in June 30,
2002, and the largest part of SOX became effective only after the newly mandated Public Company Accounting Oversight Board was in operation and detailed SOX rules, one can say that the SOX adoption study by nonprofit organizations was conducted early, three years after SOX came into the full force.

This study was designed to capture the early reaction of the nonprofit sector to SOX. For this purpose, a cross-sectional research design is appropriate. SOX is a new law; it is politically popular and requires quick action. Although it is directed at a different group of economic actors than nonprofit organizations, some nonprofits climbed on the bandwagon for SOX adoption very early, the year after its enactment. The short analytic time-frame is appropriate for a newly established policy and captures the notion of early adoption by nonprofit organizations. This research does not consider the speed or the rate of SOX adoption by the nonprofit sector. It explicitly defines the main variable of interest as the level of SOX adoption, measured as the number of SOX practices adopted by nonprofit organizations after SOX enactment. At the same time, cross-sectional studies have certain limitations: time is not employed as a variable, and the study focuses on results of innovation rather than the process. Nonetheless, when determination of results and effects of SOX adoption is posited as the goal of the study, cross-sectional design is justified.

The data for this survey were collected by surveying the top executives of nonprofit organizations. This data collection technique is advantageous under the circumstances because it allows us to learn about the early changes in nonprofit organizations following SOX enactment, as well as the early effects of compliance with SOX in nonprofit organizations. The survey was addressed to the chief executives of nonprofit organizations because the top executives were in a position to know about the SOX induced change and to assess the early effects of adoption.
However, surveying top executives is sometimes viewed as a limitation because gathering data from only a few top-level individuals in sampled organizations precludes understanding the viewpoints of other organizational members regarding actual implementation (Rogers, 1995). However, it was important for this study to understand the bigger picture of SOX induced changes in nonprofit organizations and in boards of directors. It was assumed that top executives were the only persons in organizations sufficiently informed about activities of the organizations and their boards.

The scale of SOX adoption consists of 15 items that define the individual practices entailed in SOX (see Appendix II, q. 11). The scale is built based on the SOX text and on the opinions of nonprofit experts concerning the relevance of SOX provisions to the nonprofit sector. A table with practice items was sent ahead of the survey to eight nonprofit executives for pretest, and was approved by them for further use in the questionnaire. The scale is internally reliable (Cronbach’s alpha – 0.704) and unidimensional, which indicates that the scale represents well the underlying concept of “SOX related governance and accountability practices.”

The effects are also represented by the summated scales for benefits and costs. Internal reliability of the benefits and costs scales is high (Cronbach’s alpha tests = 0.737 and 0.733 respectively), and both concepts are unidimensional. External validity is supported by the findings of other researchers and by the opinions of practitioner executives and business experts. These conditions justify the utilization of the summated scales, which are recommended as best measures if generalizability or transferability is desired (Hair et al., 2003).

Another advantage of the study is its innovativeness. The unintended impacts of public policies on nonprofit organizations are seriously understudied. I found only one study that
explicitly and directly addressed the unanticipated effects of a public policy on management, functions and the consequences to nonprofit organizations (Sommerfeld and Reisch, 2003).

**Limitations**

This study has several limitations. The data that I used as a sampling frame contains some inaccurate information. The Core Files 2004 of the National Center for Charitable Statistics is notorious for its high percentage of errors (Froelich & Knoepfle, 1996; Froelich et al., 2000; Keating and Frumkin, 2001, Hager et al., 2003; Gronbjerg & Paalberg, 2002; Behn et al., 2005). My research confirmed the level of inaccuracy: after randomly checking 200 addresses from the sample of 2000 organizations, I found that 21 percent of addresses were inaccurate. Other researchers also found mistakes in the Form-990 financial data (Hager et al., 2003; Keating and Frumkin, 2001), which is used for building the Core Files 2004. The Key Employees file, which was used to identify the names of chief executives for the survey personalization, was from 2003, the latest available date. The old names and incorrect addresses may have decreased the survey response rate from the selected sample of organizations. Although the survey response rate was lower than expected (about 20%), it does not present a nonresponse or a sampling bias problem. The one-way ANOVA test and the standard error of proportions test suggest no evidence of such biases.

As was mentioned above, the sample of respondents is representative of the population of 2000 randomly selected organizations. However, the results of analysis of SOX adoption by the state and the policy area are inconclusive, and cannot be generalized because of the low number of respondent organizations from each state, and from the policy areas. Quite disappointing is the number of responses from the higher education institutions and hospitals (13 and 15
organizations respectively). These organizations are of a special interest to me because I expected that they would adopt SOX to a higher extent. Analysis of SOX adoption in these types of organizations does not provide sufficient evidence of higher or lower SOX adoption levels because of the small number of these organizations in the sample.

Another limitation arises from the selection of organizations for this research. The study of SOX adoption by nonprofit organizations includes certain types of nonprofit organizations registered under the tax code 501(c)(3), public serving charities of various types that are involved in the arts, education, health care, human services, and community service, and other activity areas. This group of organizations is selected because it is the most numerous and diverse. Yet, other types of organizations under different codes are excluded from the study. Among them are public foundations and other groups of organizations under the codes 501(c)(4)—social welfare organizations, 501(c)(5)—mutual benefit organizations, and 501(c)(6)—business leagues. Because of the selection decision and research design, the results of this study are limited only to the organizations coded 501(c)(3)—public charity organizations.

Theoretical Implications

The study of adoption of the Sarbanes-Oxley Act by nonprofit organizations expands the field of policy studies that inquire into the inter-jurisdictional and intersectoral policy spillovers. Policy spillover describes an unintended policy impact on an untargeted subject. It is not a rare occasion that happens when a public policy or a law designed for one industry or an economic sector is adopted by organizations in other sectors of economy. Studies about policy spillovers or externalities are conducted by researchers in many fields of knowledge. However, studies of regulatory spillovers from the business or government sectors to the nonprofit sector are of
particular interest because so little research exists. As mentioned in the introductory part of this dissertation, only one study was found that explicitly and directly addressed the impacts of the public policy under the title Personal Responsibility and Work Opportunity Reconciliation Act (PRWORA) on the activities and functions of social service nonprofit organizations (Sommerfeld & Reisch, 2003). Because PRWORA truncated some government social services (Weaver, 2002), needy members of the society turned to nonprofit organizations for help. It created a high demand for services among the social service nonprofits and induced them to change their structure, management and service delivery procedures (Sommerfeld & Reisch, 2003).

The impact of the Sarbanes-Oxley Act on nonprofit organizations is unique. The PRWORA had direct effects on social service nonprofits. The Sarbanes-Oxley Act, however, has had very different effects. Enactment of SOX did not establish an obligation on the part of nonprofits to comply with its requirements, nor did it create a new group of clients for nonprofit organizations that they would have to deal with. It was indirect rather than direct; ideological rather than practical. Because of its non-binding status for nonprofit organizations, SOX left considerable discretion to nonprofit leaders in terms of their decision to comply. The lack of legal pressure on the one hand and the political importance of the law on the other hand created a dilemma for nonprofit leaders with respect to SOX adoption. Had the federal government simply mandated SOX or a similar law for nonprofit organizations, this study would have been framed differently, and the focus would have been on implementation rather than on the decision to adopt or not to adopt SOX.

Because of the high level of uncertainty, the heavy political context, and voluntary adoption of SOX by nonprofits, this study applied the frameworks of resource dependency and
stakeholder theory, diffusion of innovations theory, and proactive accountability theory. The internal determinants theory was also used as it is often coupled with the diffusion of innovations theory as an explanatory framework (Berry & Berry, 1999). All four theories proved useful for explaining SOX adoption or lack of adoption.

The stakeholder theory holds that nonprofit organizations are responsive to the requests of important stakeholders (Freeman, 1978). The findings of this study demonstrate that the organizations in the Low Prior Adoption group adopt more SOX practices when they receive information about SOX from their board members. At the same time, the lack of demand to adopt SOX from the major resource providers to nonprofits—the donors—explains the low adoption level in all responding organizations. Additionally, most nonprofit leaders responded negatively to the question about any political and social pressure that their respective organizations experienced with regard to SOX adoption. These findings support the main proposition of the resource dependence theory (Pfeffer & Salancik, 1989) by demonstrating low compliance with SOX in the absence of pressure from the resource holders and important constituencies.

The diffusion of innovation theory is very broad and covers many aspects of diffusion—the diffusion process, the decision-making, and the results. For the purpose of this study, the propositions about the influence of the sources of information about the innovation (channels of communication) and participation of the top executives in individual networks were tested. The findings suggest that information about SOX received from the nonprofit publications and the board members is conducive to SOX adoption. Given the non-binding status of SOX for the nonprofit sector and the infrequent discussions about SOX at professional meetings, individual
networking and participation in professional associations was not found to be influential in promoting SOX adoption by nonprofit organizations.

The theory of anticipatory accountability emphasizes proactive managers’ behavior. Proactive managers scan the environment for new threats, and if they perceive new ideas (laws) as a threat to their organizations, they take actions to eliminate this threat. This study explores the attitudes of nonprofit leaders to SOX by asking them questions about whether they consider SOX beneficial for their organizations or a nuisance. Three questions explored the proactive attitude to SOX and asked nonprofit leaders to agree or disagree with the following statements:

- Nonprofit organizations may gain credibility among the donors and the public by following “best business practices” introduced by SOX-2002.
- Nonprofit managers should follow their existing accountability standards and procedures regardless of SOX-2002 until change is required by a specific nonprofit law.
- At times of uncertainty about the nonprofit regulations in the future, the best choice is to establish the procedures required by SOX-2002 early.

Results of the analysis show that with respect to SOX the average nonprofit leader behaves conservatively. He or she expresses a preference to follow the existing accountability standards regardless of SOX. This preference is significantly related to the decrease in SOX adoption level in all groups, defined by pre-SOX adoption level, and by size of organizations. Credibility considerations and the decision to establish SOX requirements early are not related to the SOX adoption level. This finding confirms the anticipatory accountability theory by reversing it: when managers do not demonstrate a proactive attitude to SOX, they are not likely to adopt SOX actively.

The internal determinants theory was applied to establish how organizational and individual characteristics of managers influence SOX adoption (Mohr, 1969; Rogers, 1995;
Surprisingly, many organizational characteristics, such as wealth, age, policy area, and location, failed to explain SOX adoption. The only organizational variable that was found influential in SOX adoption is the size of organization. Rogers (1995) maintained that size often serves as a surrogate measure for many other organizational characteristics, including the number of paid staff, slack resources, and administrative resources. By following this proposition, one can conclude that size is a reliable factor indicating propensity to innovate. Another important variable according to Mohr (1969) is the motivation of leaders to innovate. The previous discussion of nonprofit leaders’ attitudes to SOX suggests that the motivation to adopt SOX is quite low among them, which explains low innovativeness with regard to SOX. The fact that many organizations already had SOX-like practices in place prior to the enactment of SOX is an important finding that explains low post-SOX adoption by nonprofit organizations. Berry and Berry (1999) suggested including a set of separate dummy variables that indicate the presence or absence of other policies that have implications for the adoption of a new policy. In its analytical model, this study implicitly incorporates information about previous policies that impact adoption of SOX by including a variable that describes the “preexisting condition” in nonprofit organizations in terms of accountability and transparency structure. Accountability and transparency in nonprofit organizations are typically regulated through various mechanisms such as federal and state laws, requirements of donors, and government contracts and regulations for grants control (Ruppel, 2006; Fremont-Smith, 2004).

Individual characteristics of managers such as attitudes toward SOX and familiarity with SOX explain SOX adoption well, while other characteristics such as education level, number of years in a leadership position, and occupational background are not significantly related to SOX.
adoption. The homogeneity among managers with respect to educational level may explain the lack of discriminatory power of formal education with respect to SOX adoption or non-adoption.

In sum, four theoretical frameworks proved to be useful to explain the voluntarily adoption of SOX by nonprofit organizations. Certain theoretical propositions also served to frame the explanation for the lack of SOX adoption such as the anticipatory accountability and the resource dependence model. The study of SOX adoption by nonprofit organizations raised several questions that warrant further research. Accordingly, the next section briefly discusses the implications of this research, and the last section suggests a research agenda for the future.

Practical Implications

Research on Sarbanes-Oxley adoption by nonprofit organizations is of practical interest for various groups of professionals who work in nonprofit organizations, regulate the nonprofit sector, execute control functions, and work as partners with nonprofit organizations. For nonprofit staff and leaders the results of this research are of educational and practical value. Board members and executives in nonprofit organizations will find answers to questions about the relationships between the nonprofit sector and SOX – the new policy, which is not binding for the third sector. They will learn about the early level of SOX adoption by nonprofit organizations, the factors that influence adoption, and the early effects of SOX. This information will help in their decision-making about further SOX adoption. They will be able to assess the benefits and costs that adoption of SOX requirements will bring to their organizations.

For policy makers this research sends a message about the unintended impacts of SOX on the nonprofit sector. It also emphasizes that SOX creates environmental conditions that may affect the third sector inadvertently. Even those nonprofit organizations that did not adopt SOX
practices may experience difficulties and costs that emanate from SOX enactment. For example, the enactment of SOX created a market for accounting professionals by increasing demand for their services. This unforeseen effect of SOX impacted nonprofit organizations by decreasing the availability of audit services and increasing their costs. Because of the competitive environment in the market of audit services, some smaller and less affluent nonprofits may be unable to purchase audit services. Another SOX effect is the increased time commitment, responsibility, and legal liability of board directors, which may deter some people from serving as board members on nonprofit boards. Changes in the audit committee’s functions following SOX adoption may overburden the audit committee members by demanding extra service. The result may be the natural “mortality” of the audit committee members.

Auditors of nonprofit organizations are directly affected by SOX requirements. The Public Company Accounting and Oversight Board (PCAOB) establishes new standards for audit services that are mandatory for all accounting firms that provide audit services to all kinds of organizations. Some audit companies sell audit services to for-profit and nonprofit corporations alike. Because the audit scope has increased, the time commitment and the sophistication of audits have also risen. These developments lead to the rise of audit fees. As a result, audit firms face a dilemma: compromise the quality of audit service in order to keep their nonprofit clients or insist on performing a full audit with regard to the PCAOB requirements for a higher fee and probably to loose their nonprofit clients.

With regard to SOX requirements, nonprofit partners such as local governments, businesses, and other nonprofit organizations, will need to reconcile their reporting requirements with their partner nonprofit organizations with regard to new audit rules. The partners may need
to review their contracts and to revise their financial transfer practices to make them more transparent and to reconsider the level of mutual responsibility and liability.

Many business experts call SOX a landmark legislation that can be compared only to the Securities Act of 1933 and the Securities Exchange Act of 1934, when the securities market experienced considerable change through new rules and regulations. The continuing impact of SOX on nonprofit organizations is hard to predict today. Future research is needed to determine this impact and to provide further advice to policy makers concerning regulation of the nonprofit sector.

**Conclusion: Future Research Agenda**

The main research questions of this study deal with adoption of SOX by nonprofit organizations. These questions would not have risen had nonprofit organizations completely ignored SOX. The discovered fact of voluntary adoption of SOX provisions by nonprofit organizations raises further questions concerning the types of public policies that are more likely to spillover to the nonprofit sector. Apart from the present study and the study of the PRWORA policy spillover and unanticipated effects (Sommerfeld & Reisch, 2003), no other studies were found that addressed the unintended effects of public policies on nonprofit organizations. Public policy spillover effects on nonprofit organizations have received little attention compared to other policy areas. However, it would be useful for nonprofit practitioners to know which kinds of legislation and other political developments may impact the nonprofit sector. The purpose of such policy spillover studies is to make the nonprofit political and social environment more predictable.
Another interesting question grows from this study. How do nonprofits differ from business and government organizations with regard to the state of governance, accountability, and transparency? A comparative study of the accountability structures and disclosure mechanisms in nonprofit and business organizations, in nonprofit and government organizations, and finally in all three sectors, would be interesting and informative. Such a study might be beneficial to the reputation of the nonprofit sector in general because the present research reveals that before SOX was enacted in 2002 nonprofits already had robust governance, accountability and disclosure procedures in place.

A question that is related to the previous one emanates from the main research questions of this study: how did the present accountability system develop in the nonprofit sector, and which nonprofit-specific and “alien” laws and regulations exerted major influences on this system? Although the state of accountability in the nonprofit sector organizations has always inspired studies by public administration and nonprofit researchers, the current research shows that even better understanding could be achieved of the state of practice in nonprofit governance, accountability, and disclosure mechanisms if the investigations are informed by comparative studies.

The data collected and the analysis of that data demonstrate that the Sarbanes-Oxley Act spilled over its jurisdictional borders and produced unintended effects on nonprofit management, governance, and relations with the external environment. My focus has been mostly managerial. However, the theoretical lenses of political science might be useful to understand the political aspects of the spillover. Social studies may offer a better understanding of the interactions among the actors from different sectors that influenced SOX adoption or rejection by nonprofit
actors. In general, studies of public policy spillover to nonprofit organizations can be beneficial for predicting change and adjustments in the nonprofit sector.
REFERENCES


APPENDIX I

Summary of the Provisions of the Sarbanes-Oxley Act of 2002

Source: The American Institute of Certified Public Accountants, Center for Audit Quality

- Section 3: Commission Rules and Enforcement
- Section 101: Establishment; Administrative Provisions
- Section 102: Registration with the Board
- Section 103: Auditing, Quality Control, And Independence Standards And Rules
- Section 104: Inspections of Registered Public Accounting Firms
- Section 105: Investigations And Disciplinary Proceedings
- Section 106: Foreign Public Accounting Firms
- Section 107: Commission Oversight Of The Board
- Section 108: Accounting Standards
- Section 109: Funding
- Section 201: Services Outside The Scope Of Practice Of Auditors
- Section 202: Preapproval Requirements
- Section 203: Audit Partner Rotation
- Section 204: Auditor Reports to Audit Committees
- Section 205: Conforming Amendments
- Section 206: Conflicts of Interest
- Section 207: Study of Mandatory Rotation of Registered Public Accountants
- Section 208: Commission Authority
- Section 209: Consideration by Appropriate State Regulatory Authorities
- Section 301: Public Company Audit Committees
- Section 302: Corporate Responsibility For Financial Reports
- Section 303: Improper Influence on Conduct of Audits
- Section 304: Forfeiture of Certain Bonuses and Profits
- Section 305: Officer And Director Bars And Penalties
- Section 306: Insider Trades During Pension Fund Black-Out Periods
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- Section 401: Disclosures In Periodic Reports
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- Section 404: Management Assessment Of Internal Controls
- Section 405: Exemption
- Section 406: Code of Ethics for Senior Financial Officers
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- Section 408: Enhanced Review of Periodic Disclosures by Issuers
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- Section 501: Treatment of Securities Analysts by Registered Securities Associations and National
Securities Exchanges

- Section 601: Authorization of Appropriations
- Section 602: Appearance and Practice Before the Commission
- Section 603: Federal Court Authority to Impose Penny Stock Bars
- Section 604: Qualifications of Associated Persons of Brokers and Dealers
- Section 701: GAO Study and Report Regarding Consolidation of Public Accounting Firms
- Section 702: Commission study and report regarding credit rating agencies
- Section 703: Study and report on violators and violations
- Section 704: Study of Enforcement Actions
- Section 705: Study of Investment Banks
- Title VIII: Corporate and Criminal Fraud Accountability
- Title IX: White Collar Crime Penalty Enhancements
- Title X: Corporate Tax Returns
  - Section 1001: Sense of the Senate Regarding the Signing of Corporate Tax Returns by Chief Executive Officers
- Title XI: Corporate Fraud and Accountability
  - Section 1102: Tampering With a Record or Otherwise Impeding an Official Proceeding
  - Section 1103: Temporary Freeze Authority for the Securities and Exchange Commission
  - Section 1105: Authority of the Commission to Prohibit Persons from Serving as Officers or Directors

Section 3: Commission Rules and Enforcement.

A violation by any person of the Sarbanes-Oxley Act, any rule or regulation of the Securities and Exchange Commission (SEC or the Commission) or any rule of the Public Company Accounting Oversight Board (PCAOB or the Board) is treated as a violation of the Securities and Exchange Act of 1934, giving rise to the same penalties that may be imposed for violations of that Act.

Section 101: Establishment; Administrative Provisions.

The PCAOB was established to oversee the audits of public companies. The Board will have five financially-literate members, appointed for five-year terms. Two of the members must be or have been certified public accountants, and the remaining three must not be and cannot have been CPAs. The Chair may be held by one of the CPA members, provided that he or she has not been engaged as a practicing CPA for five years.

The Board's members will serve on a full-time basis.

No member may, concurrent with service on the Board, "share in any of the profits of, or receive payments from, a public accounting firm," other than "fixed continuing payments," such as retirement payments.

Members of the Board are appointed by the Commission, "after consultation with" the Chairman of the Federal Reserve Board and the Secretary of the Treasury.

Members may be removed by the Commission "for good cause."
Section 102: Registration with the Board. 
All public accounting firms that prepare or issue, or who participate in the preparation or issuance of, any audit report with respect to an issuer, must register with the Board.

Section 103: Auditing, Quality Control, And Independence Standards And Rules.

The Board shall:

1. register public accounting firms;
2. establish, or adopt, by rule, "auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for issuers;"
3. conduct inspections of accounting firms;
4. conduct investigations and disciplinary proceedings, and impose appropriate sanctions;
5. perform such other duties or functions as necessary or appropriate;
6. enforce compliance with the Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto; and
7. set the budget and manage the operations of the Board and the staff of the Board.

Auditing standards. The Board would be required to "cooperate on an on-going basis" with designated professional groups of accountants and any advisory groups convened in connection with standard-setting, and although the Board can "to the extent that it determines appropriate" adopt standards proposed by those groups, the Board will have authority to amend, modify, repeal, and reject any standards suggested by the groups. The Board must report on its standard-setting activity to the Commission on an annual basis.

The Board must require registered public accounting firms to "prepare, and maintain for a period of not less than 7 years, audit work papers, and other information related to any audit report, in sufficient detail to support the conclusions reached in such report."

The Board must require a 2nd partner review (concurring review) and approval of audit reports registered accounting firms must adopt quality control standards.

The Board must adopt an audit standard to implement the internal control review required by section 404(b). This standard must require the auditor to evaluate whether the internal control structure and procedures include records that accurately and fairly reflect the transactions of the issuer, provide reasonable assurance that the transactions are recorded in a manner that will permit the preparation of financial statements in accordance with GAAP, and a description of any material weaknesses in the internal controls.
Section 104: Inspections of Registered Public Accounting Firms.

Annual quality reviews (inspections) must be conducted for firms that audit more than 100 issues, all others must be conducted every 3 years. The SEC and/or the Board may order a special inspection of any firm at any time.

Section 105: Investigations And Disciplinary Proceedings.

All documents and information prepared or received by the Board shall be "confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, . . . unless and until presented in connection with a public proceeding or [otherwise] released" in connection with a disciplinary action. However, all such documents and information can be made available to the SEC, the U.S. Attorney General, and other federal and appropriate state agencies.

Disciplinary hearings will be closed unless the Board orders that they be public, for good cause, and with the consent of the parties.

Sanctions can be imposed by the Board to a firm if it fails to reasonably supervise any associated person with regard to auditing or quality control standards, or otherwise.

No sanctions report will be made available to the public unless and until stays pending appeal have been lifted.

Section 106: Foreign Public Accounting Firms.

The bill would subject foreign accounting firms who audit a U.S. company to registrations with the Board. This would include foreign firms that perform some audit work, such as in a foreign subsidiary of a U.S. company that is relied on by the primary auditor.

Section 107: Commission Oversight Of The Board.

The SEC shall have "oversight and enforcement authority over the Board." The SEC can, by rule or order, give the Board additional responsibilities. The SEC may require the Board to keep certain records, and it has the power to inspect the Board itself, in the same manner as it can with regard to SROs such as the NASD.

The Board, in its rulemaking process, is to be treated "as if the Board were a 'registered securities association'"-that is, a self-regulatory organization. The Board is required to file proposed rules
and proposed rule changes with the SEC. The SEC may approve, reject, or amend such rules.

The Board must notify the SEC of pending investigations involving potential violations of the securities laws, and coordinate its investigation with the SEC Division of Enforcement as necessary to protect an ongoing SEC investigation.

The SEC may, by order, "censure or impose limitations upon the activities, functions, and operations of the Board" if it finds that the Board has violated the Act or the securities laws, or if the Board has failed to ensure the compliance of accounting firms with applicable rules without reasonable justification.

The Board must notify the SEC when it imposes "any final sanction" on any accounting firm or associated person. The Board's findings and sanctions are subject to review by the SEC.

The SEC may enhance, modify, cancel, reduce, or require remission of such sanction.

Section 108: Accounting Standards.

The SEC is authorized to "recognize, as 'generally accepted'... any accounting principles" that are established by a standard-setting body that meets the bill's criteria, which include requirements that the body:

1. be a private entity;
2. be governed by a board of trustees (or equivalent body), the majority of whom are not or have not been associated persons with a public accounting firm for the past 2 years;
3. be funded in a manner similar to the Board;
4. have adopted procedures to ensure prompt consideration of changes to accounting principles by a majority vote; and
5. consider, when adopting standards, the need to keep them current and the extent to which international convergence of standards is necessary or appropriate

Section 109: Funding.

In order to audit a public company, a public accounting firm must register with the Board. The Board shall collect "a registration fee" and "an annual fee" from each registered public accounting firm, in amounts that are "sufficient" to recover the costs of processing and reviewing applications and annual reports.

The Board shall also establish by rule a reasonable "annual accounting support fee" as may be necessary or appropriate to maintain the Board. This fee will be assessed on issuers only.
Section 201: Services Outside The Scope Of Practice Of Auditors.

It shall be "unlawful" for a registered public accounting firm to provide any non-audit service to an issuer contemporaneously with the audit, including: (1) bookkeeping or other services related to the accounting records or financial statements of the audit client; (2) financial information systems design and implementation; (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports; (4) actuarial services; (5) internal audit outsourcing services; (6) management functions or human resources; (7) broker or dealer, investment adviser, or investment banking services; (8) legal services and expert services unrelated to the audit; (9) any other service that the Board determines, by regulation, is impermissible. The Board may, on a case-by-case basis, exempt from these prohibitions any person, issuer, public accounting firm, or transaction, subject to review by the Commission.

Section 202: Preapproval Requirements.

It will not be unlawful to provide other non-audit services if they are pre-approved by the audit committee in the following manner. The bill allows an accounting firm to "engage in any non-audit service, including tax services," that is not listed above, only if the activity is pre-approved by the audit committee of the issuer. The audit committee will disclose to investors in periodic reports its decision to pre-approve non-audit services. Statutory insurance company regulatory audits are treated as an audit service, and thus do not require pre-approval.

The pre-approval requirement is waived with respect to the provision of non-audit services for an issuer if the aggregate amount of all such non-audit services provided to the issuer constitutes less than 5% of the total amount of revenues paid by the issuer to its auditor (calculated on the basis of revenues paid by the issuer during the fiscal year when the non-audit services are performed), such services were not recognized by the issuer at the time of the engagement to be non-audit services; and such services are promptly brought to the attention of the audit committee and approved prior to completion of the audit.

The authority to pre-approve services can be delegated to 1 or more members of the audit committee, but any decision by the delegate must be presented to the full audit committee.

Section 203: Audit Partner Rotation.

The lead audit or coordinating partner and the reviewing partner must rotate off of the audit every 5 years.
Section 204: Auditor Reports to Audit Committees.

The accounting firm must report to the audit committee all "critical accounting policies and practices to be used; all alternative treatments of financial information within [GAAP] that have been discussed with management, ramifications of the use of such alternative disclosures and treatments, and the treatment preferred" by the firm.

Section 205: Conforming Amendments.

Conforming amendments are made to various Exchange Act definitions related to audit committees; registered public accounting firms; auditor requirements; and other conforming amendments.

Section 206: Conflicts of Interest.

The CEO, Controller, CFO, Chief Accounting Officer or person in an equivalent position cannot have been employed by the company's audit firm during the 1-year period preceding the audit.

Section 207: Study of Mandatory Rotation of Registered Public Accountants.

The GAO will do a study on the potential effects of requiring the mandatory rotation of audit firms.

Section 208: Commission Authority.

Not later than 180 days after the date of enactment of the Act, the Commission is to issue final regulations to carry out various subsections of the Act.

Section 209: Consideration by Appropriate State Regulatory Authorities.

State regulators are directed to make an independent determination as to whether the Boards standards shall be applied to small and mid-size non-registered accounting firms.
**Section 301: Public Company Audit Committees.**

Each member of the audit committee shall be a member of the board of directors of the issuer, and shall otherwise be independent.

"Independent" is defined as not receiving, other than for service on the board, any consulting, advisory, or other compensatory fee from the issuer, and as not being an affiliated person of the issuer, or any subsidiary thereof.

The SEC may make exemptions for certain individuals on a case-by-case basis.

The audit committee of an issuer shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer.

The audit committee shall establish procedures for the "receipt, retention, and treatment of complaints" received by the issuer regarding accounting, internal controls, and auditing.

Each audit committee shall have the authority to engage independent counsel or other advisors, as it determines necessary to carry out its duties.

Each issuer shall provide appropriate funding to the audit committee.

**Section 302: Corporate Responsibility For Financial Reports.**

The CEO and CFO of each issuer shall prepare a statement to accompany the audit report to certify the "appropriateness of the financial statements and disclosures contained in the periodic report, and that those financial statements and disclosures fairly present, in all material respects, the operations and financial condition of the issuer." A violation of this section must be knowing and intentional to give rise to liability.

**Section 303: Improper Influence on Conduct of Audits.**

It shall be unlawful for any officer or director of an issuer to take any action to fraudulently influence, coerce, manipulate, or mislead any auditor engaged in the performance of an audit for the purpose of rendering the financial statements materially misleading.

**Section 304: Forfeiture of Certain Bonuses and Profits**
If an issuer is required to prepare a restatement due to "material noncompliance" with financial reporting requirements, the chief executive officer and the chief financial officer shall "reimburse the issuer for any bonus or other incentive-based or equity-based compensation received" during the twelve months following the issuance or filing of the non-compliant document and "any profits realized from the sale of securities of the issuer" during that period.

Section 305: Officer And Director Bars And Penalties

In any action brought by the SEC for violation of the securities laws, federal courts are authorized to "grant any equitable relief that may be appropriate or necessary for the benefit of investors."

The SEC may issue an order to prohibit, conditionally or unconditionally, permanently or temporarily, any person who has violated section 10(b) of the 1934 Act from acting as an officer or director of an issuer if the SEC has found that such person's conduct "demonstrates unfitness" to serve as an officer or director of any such issuer.

Section 306: Insider Trades During Pension Fund Black-Out Periods.

Prohibits the purchase or sale of stock by officers and directors and other insiders during blackout periods. Any profits resulting from sales in violation of this section "shall inure to and be recoverable by the issuer." If the issuer fails to bring suit or prosecute diligently, a suit to recover such profit may be instituted by "the owner of any security of the issuer."


Attorneys appearing and practicing before the Commission in any way in the representation of issuers are required to report evidence of a material violation of securities laws to the chief legal counsel or the CEO of the company and if they do not appropriately respond to the evidence, attorney’s are required to report the evidence to the audit committee of the board of directors.

Section 308: Fair Funds for Investors.

Civil penalties added to the disgorgement funds for the relief of victims of such violation.
**Section 401: Disclosures In Periodic Reports.**

Each financial report that is required to be prepared in accordance with GAAP shall "reflect all material correcting adjustments . . . that have been identified by a registered accounting firm . . . ."

"Each annual and quarterly financial report . . . shall disclose all material off-balance sheet transactions" and "other relationships" with "unconsolidated entities" that may have a material current or future effect on the financial condition of the issuer.

The SEC shall issue rules providing that pro forma financial information must be presented so as not to "contain an untrue statement" or omit to state a material fact necessary in order to make the pro forma financial information not misleading.

SEC shall study off-balance sheet disclosures to determine a) extent of off-balance sheet transactions (including assets, liabilities, leases, losses and the use of special purpose entities); and b) whether generally accepted accounting rules result in financial statements of issuers reflecting the economics of such off-balance sheet transactions to investors in a transparent fashion and make a report containing recommendations to the Congress.

**Section 402: Enhanced Conflict of Interest Provisions.**

Generally, it will be unlawful for an issuer to extend credit to any director or executive officer. Consumer credit companies may make home improvement and consumer credit loans and issue credit cards to its directors and executive officers if it is done in the ordinary course of business on the same terms and conditions made to the general public.

**Section 403: Disclosures Of Transactions Involving Management And Principal Stockholders.**

Directors, officers, and 10% owners must report designated transactions by the end of the second business day following the day on which the transaction was executed.

**Section 404: Management Assessment Of Internal Controls.**

Requires each annual report of an issuer to contain an "internal control report", which shall:

1. state the responsibility of management for establishing and maintaining an adequate internal control structure and procedures for financial reporting; and
2. contain an assessment, as of the end of the issuer's fiscal year, of the effectiveness of the internal control structure and procedures of the issuer for financial reporting.

Each issuer's auditor shall attest to, and report on, the assessment made by the management of the issuer. An attestation made under this section shall be in accordance with standards for attestation engagements issued or adopted by the Board. An attestation engagement shall not be the subject of a separate engagement.

The language in the report of the Committee which accompanies the bill to explain the legislative intent states, "--- the Committee does not intend that the auditor's evaluation be the subject of a separate engagement or the basis for increased charges or fees."

Directs the SEC to require each issuer to disclose whether it has adopted a code of ethics for its senior financial officers and the contents of that code.

Directs the SEC to revise its regulations concerning prompt disclosure on Form 8-K to require immediate disclosure "of any change in, or waiver of," an issuer's code of ethics.

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Section 405: Exemption.

Nothing in Section 401, 402 or 404, the amendments made by those sections, or the rules of the Commission under those sections apply to any registered investment company.

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Section 406: Code of Ethics for Senior Financial Officers.

The SEC shall issue rules that require each issuer to disclose whether or not, and if not, the reasons therefore, such issuer has adopted a code of ethics for senior financial officers.

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Section 407: Disclosure of Audit Committee Financial Expert.

The SEC shall issue rules to require issuers to disclose whether at least 1 member of its audit committee is a "financial expert."

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Section 408: Enhanced Review of Periodic Disclosures by Issuers.

The SEC shall review disclosures made by issuers (including reports filed on Form 10-K) on a regular and systematic basis for the protection of investors. Issuers will not be reviewed less
frequently than once every three years.

Section 409: Real Time Issuer Disclosures.

Issuers must disclose information on material changes in the financial condition or operations of the issuer on a rapid and current basis.

Section 501: Treatment of Securities Analysts by Registered Securities Associations and National Securities Exchanges.

National Securities Exchanges and registered securities associations must adopt conflict of interest rules for research analysts who recommend equities in research reports.

Section 601: Authorization of Appropriations.

SEC appropriations for 2003 are increased to $776,000,000. $98 million of the funds shall be used to hire an additional 200 employees to provide enhanced oversight of auditors and audit services required by the Federal securities laws.

Section 602: Appearance and Practice Before the Commission.

The SEC may censure any person, or temporarily bar or deny any person the right to appear or practice before the SEC if the person does not possess the requisite qualifications to represent others, lacks character or integrity, or has willfully violated Federal securities laws.

Section 603: Federal Court Authority to Impose Penny Stock Bars.

Authority of the courts to prohibit persons from participating in an offering of penny stock.

Section 604: Qualifications of Associated Persons of Brokers and Dealers.

Amendments to the Exchange Act and Investment Advisors Act regarding brokers and dealers.
Section 701: GAO Study and Report Regarding Consolidation of Public Accounting Firms.

Section 702: Commission study and report regarding credit rating agencies.

Section 703: Study and report on violators and violations.

Section 704: Study of Enforcement Actions.

Section 705: Study of Investment Banks.

Various studies to be conducted as described in the Act.

Title VIII: Corporate and Criminal Fraud Accountability.

It is a felony to "knowingly" destroy or create documents to "impede, obstruct or influence" any existing or contemplated federal investigation.

Auditors are required to maintain "all audit or review work papers" for five years.

The statute of limitations on securities fraud claims is extended to the earlier of five years from the fraud, or two years after the fraud was discovered, from three years and one year, respectively.

Employees of issuers and accounting firms are extended "whistleblower protection" that would prohibit the employer from taking certain actions against employees who lawfully disclose private employer information to, among others, parties in a judicial proceeding involving a fraud claim. Whistle blowers are also granted a remedy of special damages and attorney's fees.

A new crime for securities fraud that has penalties of fines and up to 10 years imprisonment.

Title IX: White Collar Crime Penalty Enhancements.

Maximum penalty for mail and wire fraud increased from 5 to 10 years.

Creates a crime for tampering with a record or otherwise impeding any official proceeding.

SEC given authority to seek court freeze of extraordinary payments to directors, offices, partners, controlling persons, agents of employees.

U.S. Sentencing Commission to review sentencing guidelines for securities and accounting
SEC may prohibit anyone convicted of securities fraud from being an officer or director of any publicly traded company.

Financial statements filed with the SEC must be certified by the CEO and CFO. The certification must state that the financial statements and disclosures fully comply with provisions of the Securities Exchange Act and that they fairly present, in all material respects, the operations and financial condition of the issuer. Maximum penalties for willful and knowing violations of this section are a fine of not more than $500,000 and/or imprisonment of up to 5 years.

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**Title X - Corporate Tax Returns.**

**Section 1001: Sense of the Senate Regarding the Signing of Corporate Tax Returns by Chief Executive Officers.**

It is the sense of Congress that the Federal income tax return of a corporation should be signed by the chief executive officer of such corporation.

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**Title XI - Corporate Fraud and Accountability.**

**Section 1102: Tampering With a Record or Otherwise Impeding an Official Proceeding.**

Makes it a crime for any person to corruptly alter, destroy, mutilate, or conceal any document with the intent to impair the object's integrity or availability for use in an official proceeding or to otherwise obstruct, influence or impede any official proceeding is liable for up to 20 years in prison and a fine.

**Section 1103: Temporary Freeze Authority for the Securities and Exchange Commission.**

The SEC is authorized to freeze the payment of an extraordinary payment to any director, officer, partner, controlling person, agent, or employee of a company during an investigation of possible violations of securities laws.

**Section 1105: Authority of the Commission to Prohibit Persons from Serving as Officers or Directors.**

The SEC may prohibit a person from serving as an officer or director of a public company if the person has committed securities fraud.
Dear colleague;

Earlier in May 2006 I sent you a questionnaire asking about the adoption and effects of the Sarbanes-Oxley Act of 2002 in your organization. Because no one is sure about the adoption and effects of SOX 2002 on nonprofit organizations, I have made it the topic of my dissertation.

Several respondents to the earlier questionnaire said that the survey was too long and complicated. I listened to you!! I changed the questionnaire. This version of the survey is much shorter --I cut the number of questions by one-third -- and I made the survey less complicated.

Please help me by completing the questionnaire and returning it to me in the enclosed stamped, self-addressed envelope. I ask for your help: without your response, I cannot complete my dissertation – and the field will lack answers to my dissertation questions of the extent of adoption and effects of the Sarbanes Oxley Act on nonprofit organizations.

Please respond even if your organization did not make changes to comply with SOX-2002. Your response will support my doctoral research by providing valuable information and increasing response. If you kindly provide your e-mail address with your response, I will be pleased to send you a summary of my dissertation findings. I enormously appreciate your kind assistance. I welcome your response as soon as possible, but would be pleased to accept it at any time.

The survey takes about 10-15 minutes to complete. All responses are confidential and results will be published in aggregate or group form only. Individuals will not be identified, and organizational identifiers will be deleted at the close of the study, on October 30, 2006.

Participation is voluntary, and you may choose not to respond. You may discontinue participation at any time; refusal to participate will involve no penalty or loss of benefits to which you or your colleagues are entitled. This study will not involve any risk or discomfort to you. I ask only that you complete and return the survey in the stamped, self-addressed envelope enclosed.

Thank you for giving us the benefit of your knowledge and experience. If you have questions or further comments, please don’t hesitate to contact us at the following address or by telephone: Tamara Nezhina, MPA [(706) 254-7285] or Jeffrey Brudney, Ph.D. [(706)-542-2977] at the University of Georgia, 104 Baldwin Hall, Athens, GA 30602-1615; e-mail: tnezhina@uga.edu.
Additional questions or problems regarding your rights as a research participant should be addressed to the Chairperson, Institutional Review Board, University of Georgia, 612 Boyd Graduate Studies Research Center, Athens, Georgia 30602-7411. Tel: (706) 542-3199; email: IRB@uga.edu

With many thanks and best wishes,

Tamara Nezhina, Doctoral candidate
Jeffrey L. Brudney, Ph.D. (Major Professor)

Please start the survey here.

I. INFORMATION ABOUT YOUR ORGANIZATION

1. How many full-time paid staff does your organization employ?___________

2. How many volunteers work for your organization?_____________________

3. Does your organization have contracts with the federal government or federal contracts channeled through State government?
   - ☐ No ➔ please continue to q. # 5
   - ☐ Yes

4. If yes, what percentage of the overall 2005 budget for your organization came from the federal government or federal contracts channeled through State government? __________% of budget

5. Does your organization have a website?
   - ☐ No
   - ☐ Yes

II. THE SARBANES-OXLEY ACT OF 2002

The Sarbanes-Oxley Act of 2002 (referred to as SOX-2002) is legislation enacted in response to the Enron and WorldCom financial scandals to protect shareholders and the general public from accounting errors and fraudulent practices in businesses. SOX requires corporations to improve governance by allocating oversight responsibilities to the board, and to streamline disclosure procedures to make corporations transparent. The Sarbanes-Oxley Act was enacted on July 30, 2002.

6. How familiar are you with the Sarbanes-Oxley Act of 2002 (SOX-2002) relating to corporate governance reform?
   - ☐ Not familiar
   - ☐ Somewhat familiar
   - ☐ Very familiar

7. How did you learn about SOX-2002 requirements? Please check all that apply
   - ☐ Through formal or informal professional networks
   - ☐ From nonprofit publications
   - ☐ From your organization book-keeper or other staff
   - ☐ From a board member
   - ☐ From an auditor
   - ☐ Other________________

8. Did any of your board directors ask that your organization implement SOX-related policies and procedures after Congress passed SOX in 2002?
   - ☐ No
9. Did any of your donors ask that your organization implement SOX-related policies and procedures after Congress passed SOX in 2002?

☐ No
☐ Yes

10. In general, has SOX-2002 affected your organization either directly or indirectly to date?

☐ No
☐ Yes

11. Please answer the following questions in the table below:

   a. Did your organization have any of the following procedures or policies prior to SOX-2002? Please check in the table below (first column).

   b. Please indicate if your organization has considered, adopted, or not yet considered or adopted any of the following changes to comply with SOX-2002 requirements? Please check in the table below:

<table>
<thead>
<tr>
<th>Policy or Procedure</th>
<th>Check here if org. had before SOX-2002</th>
<th>Considered after SOX-2002 (no other action taken)</th>
<th>Adopted after SOX-2002</th>
<th>Not yet considered or adopted</th>
</tr>
</thead>
<tbody>
<tr>
<td>Conflict of Interest policy</td>
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<tr>
<td>Whistle-blower Protection policy</td>
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<tr>
<td>Document Preservation policy</td>
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<tr>
<td>Annual (or biannual) external audit</td>
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<tr>
<td>Audit partner rotation after 5-7 years</td>
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<tr>
<td>Non-audit services and audit services provided by separate firms</td>
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<tr>
<td>Audit committee of board</td>
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<tr>
<td>Audit committee members are not employed by your organization</td>
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<tr>
<td>Board size of your org. got reduced</td>
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<tr>
<td>Executive director and board chair are two different people</td>
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<tr>
<td>Board holds executive sessions</td>
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<tr>
<td>Board members are not employed by your organization</td>
<td></td>
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<tr>
<td>Basic financial training was provided for board members</td>
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<tr>
<td>Basic financial training was provided for executive director</td>
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<tr>
<td>Accuracy of all financial documents is certified by both the executive director and chief financial officer</td>
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<tr>
<td>Organization allows public access to financial statements</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Allow public access to audit reports</td>
<td></td>
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</tr>
</tbody>
</table>

12. Are you aware of any pending SOX-like legislative proposals in your State aimed at regulating nonprofit organizations?

☐ No
☐ Yes

13. Are you aware of any pending SOX-like federal legislative proposals aimed at regulating nonprofit organizations?

☐ No
III. AUDIT COSTS AND PROCEDURES

14. Does your organization have regular external financial audits?
   □ No  ➔ please continue to question # 18
   □ Yes

For audited organizations:

15. Did the external auditor advise your organization to implement SOX-2002 requirements?
   □ No
   □ Yes

16. Has the cost of external audit for your organization changed since SOX was enacted in 2002?
   □ No
   □ Yes ➔ If yes, did it…
   Decrease by __________ %
   or
   Increase by __________ %

17. Who in your organization has been responsible for engaging the audit firm and determining the scope
    of its work since SOX-2002?
   □ Executive director (president/chief executive officer)
   □ Chief financial officer
   □ Board of directors
   □ Audit committee of board
   □ Finance committee of board
   □ Board Chairperson
   □ Other __________________________

IV. BOARDS AND EXECUTIVE DIRECTOR

18. Did the size of the board of directors of your organization change as a result of SOX-2002?
   □ No
   □ Yes ➔ If changed, the board size changed from
   __________ members in 2002 to __________ members in 2006

19. If the board size changed, did the change in the board size increase your organization’s fundraising
    capabilities, decrease it, or have no effect on fundraising capability?
   □ No effect
   □ Decreased
   □ Increased

V. ORGANIZATION’S INTERNAL CONTROLS

20. To comply with Section 404 of SOX-2002, has the executive director revised any of the
    organization’s internal financial controls, such as access to payment, monitoring of inventory, control
    over the proper use of restricted funds, etc. since SOX was enacted in 2002?
   □ No
   □ Yes ➔ If yes, did the executive director prepare a statement of internal controls for the board?
□ No  
□ Yes → If yes, did your organization request an external auditor to attest the executive director’s statement of internal controls after SOX-2002?  
□ No  
□ Yes → If yes, did you have to pay an additional audit fee for this service?  
□ No  
□ Yes

VI. EFFECTS OF SOX-2002
21. Did your organization experience any of the following as a result of implementing provisions of SOX-2002? Please check Yes or No in the table below:

<table>
<thead>
<tr>
<th>Did your organization experience any of the following due to SOX-2002?</th>
<th>No</th>
<th>Yes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Better financial controls</td>
<td></td>
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<tr>
<td>Reduced risk of accounting fraud</td>
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<td>Enhanced effectiveness of the board</td>
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<td>Enhanced reputation of the organization</td>
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<td>More government contracts</td>
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<td>More private donations</td>
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<tr>
<td>Better fundraising capabilities</td>
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<td></td>
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<tr>
<td>More resources to meet clients’ needs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less resources to meet clients’ needs</td>
<td></td>
<td></td>
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<tr>
<td>Difficulties in achieving board independence</td>
<td></td>
<td></td>
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<tr>
<td>Decreased fundraising capabilities of your organization</td>
<td></td>
<td></td>
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<tr>
<td>Increased financial training costs</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increased fees for external audit</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Longer and more frequent audit committee meetings</td>
<td></td>
<td></td>
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<tr>
<td>Longer and more frequent board meetings</td>
<td></td>
<td></td>
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<tr>
<td>Reallocation of resources from program to administrative expenses</td>
<td></td>
<td></td>
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<tr>
<td>Difficulties in recruiting board members</td>
<td></td>
<td></td>
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<tr>
<td>Difficulties in recruiting audit committee members</td>
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<td></td>
</tr>
</tbody>
</table>

VII. ATTITUDE TOWARD SOX-2002
22. Nonprofit publications directly linked for-profit fraud problems to nonprofit financial management.
□ Strongly disagree  
□ Disagree  
□ Neither disagree nor agree  
□ Agree  
□ Strongly agree

23. Nonprofit organizations may gain credibility among the donors and the public by following “best business practices” introduced by SOX-2002.
□ Strongly disagree  
□ Disagree  
□ Neither disagree nor agree  
□ Agree  
□ Strongly agree

24. Nonprofit managers should follow their existing accountability standards and procedures regardless of SOX-2002 until change is required by a specific nonprofit law.
25. At times of uncertainty about the nonprofit regulations in the future, the best choice is to establish the procedures required by SOX-2002 early.

- Strongly disagree
- Disagree
- Neither disagree nor agree
- Agree
- Strongly agree

26. My organization experienced strong political and social pressure to adopt the provisions of SOX-2002.

- Strongly disagree
- Disagree
- Neither disagree nor agree
- Agree
- Strongly agree

VIII. BACKGROUND INFORMATION

27. What is your job title? Please specify ____________________

28. How long have you held this position? ________years

29. How long have you been in this organization? ______________years

30. What is your occupational background? Please check all that apply. Please indicate how long you have held positions in each of the sectors. I have held positions in:
   - Government, for__________ years
   - Business, for __________ years
   - Nonprofit, for __________ years

31. Do you belong to any nonprofit professional associations?
   - No
   - Yes

32. Please indicate how many years of formal education you have completed? (Please note: high school education =12 years, college B.A. =16 years, etc.)
   ____________years

THANK YOU VERY MUCH FOR SHARING YOUR KNOWLEDGE AND EXPERIENCE!

Please mail back to Tamara Nezhina in enclosed envelopes soonest. Thank you!