

Legislation, regulation, and the role of the AMC: as illustrated with the Sarbanes-Oxley Act, AMCs play a key role in informing and protecting their association clients

By Sammi Soutar
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The latest wave of legislative and regulatory initiatives--witness the historic and far-reaching American Competitiveness and Corporate Accountability Act of 2002 passed last summer--provide apt illustration of the key role association management companies have to play in disseminating information and guidance to their association clients. With their business acumen, resources at hand, and independent contractor status, AMCs are well-positioned as fiduciary partners to their clients in the common effort to meet the challenges of an evolving association community. The Sarbanes-Oxley Act, as the corporate accountability law is known, is an excellent case in point.

Sarbanes-Oxley in brief

First some background on the Sarbanes-Oxley Act: Effective July 30, 2002, Sabanes-Oxley introduces sweeping new criminal provisions including those for obstruction of justice by document destruction and retaliation against informants that apply to both corporations and nonprofits. The Act also requires changes in corporate governance including involvement of independent directors, committee protections, adoption of a code of ethics, and additional financial disclosures. While targeted at corporate governance, the law may in effect force association boards and staff to formulate appropriate adjustments to their internal operations. (For additional information regarding the Sarbanes-Oxley Act, read "What Corporate Governance Legislation Means to You," by W. Warren Hamel, in the March 2003 issue of *Association Management*.)

To some degree, the new corporate governance legislation has caught some associations off guard. During recent interviews, roundtable discussions, and conferences, association executives admitted having little knowledge of the new legislation. In other associations, boards and staff already are feeling pressured to adapt as reaction at the state level to sweeping federal legislation starts to have an impact on the way nonprofits do business.

Minimal understanding of the possible implications of Sarbanes-Oxley within the association community comes as no surprise. A common misperception is that the law affects only publicly traded, for profit entities. But nonprofit association boards and staff that persist in this thinking do so at their peril, warn association advisers. The Sarbanes-Oxley Act contains provisions that affect everyone, including nonprofit organizations.

Among those provisions are two in particular that association leaders should heed. One, retaliation against informants, grants greater protections to whistleblowers. Another builds upon established legislation pertaining to obstruction of justice by document destruction by tightening

loopholes and making it a crime to knowingly destroy documents that might become of interest during a federal investigation. Association boards and staff would be prudent to review their records management policies to ensure that they comply with this new provision.

Trends in state legislation

More significantly, some industry watchdogs believe legislation and regulation now being considered at the state level could well affect nonprofits in ways that could prove cost-prohibitive. The state attorney general in New York, for example, has proposed Sarbanes-Oxley-like requirements on nonprofits with annual revenues of \$250,000 or more, including certified financial statements by independent auditing committees not in contractual relationships with the nonprofit. His reasoning: to ensure financial accountability by boards of charitable groups.

Other states, propelled by the Sarbanes-Oxley paradigm shift, also are considering legislation aimed at imposing further restrictions and requirements on nonprofit entities. At this writing, corporate accountability legislation was moving through the Ohio General Assembly. In short, while the Sarbanes-Oxley Act applies to nonprofits only through a limited set of provisions, it promises to have far-reaching, if indirect, influence through standard setting at the state level. The bar on corporate accountability has been raised, and nonprofits are not immune.

To predict the extent of Sarbanes-Oxley's impact on the nonprofit community, we must first revisit trends of the past few decades, says Hugh Webster, a partner with Webster, Chamberlain & Bean, a law firm based in Washington, D.C., specializing in association law. Webster, who serves as legal counsel for the International Association of Association Management Companies, Westmont, Illinois, says that treatment of associations has eroded during the past 30 years.

"We've seen how an isolated incident, usually a scandal involving a charitable foundation, as in the case of the United Way, can have a cumulative impact on all nonprofits," Webster says. "Over the years, the courts, for instance, have slowly shown a greater willingness to hold nonprofit boards accountable, while 15 or even 10 years ago they might have been willing to apply a lesser standard to nonprofit boards."

Regulators and politicians tend to view the nonprofit world through a lens clouded by scandals that crop up from time to time. "They develop a skewed perception of the nonprofit community, including associations, even though 99 percent are run appropriately," Webster explains. "It's that small one percent that generates legislation the rest have to live with."

Boards and staffs of associations should take notice. "The trend of increased aggressiveness by state attorneys general suggests where the effects of the Sarbanes-Oxley Act could be headed," Webster says. "They have become the primary enforcers against nonprofits- some with enthusiasm. And they don't hesitate to investigate. They aren't reluctant to sue an association or a board."

Association compliance challenges

Michael Deese, a managing partner with Charapp, Deese and Weiss, a law firm based in Washington, D.C., says distinctions must be made between nonprofit trade and professional associations and charitable entities, which typically operate with public contributions and, frequently, with government funding as well. Deese serves on ASAE's AMC Section Council and is chairman of ASAE's AMC Accreditation Appeals Committee.

“Over the last decade, legislators and regulators have taken a harder look at a number of issues, such as what types of revenue should be taxable,” Deese says. “With respect to Sarbanes-Oxley, although much of the new law doesn't pertain to nonprofits, we ought to learn from it. On the other hand, the real issue is how the states will respond. Will attorneys general focus on nonprofits in the broadest sense or exclusively on charities?”

Deese anticipates smaller associations in particular could experience problems in complying with certain standards that incur great expense, and he foresees a need to distinguish between charities and other tax-exempt entities, such as trade associations, professional societies, user groups, and non-industry-wide trade groups.

“Budget size is but one threshold,” Deese says. “Different tax exemption categories should require different levels of scrutiny. Somebody needs to be out there representing the noncharitable nonprofits,” he adds. “Otherwise, the language and scope of higher standard-setting legislation could become greater than what was intended by lawmakers.”

The AMC industry responds

These are among the issues that those who serve the nonprofit community have been tracking since Congress passed the Act last summer.

Chief among priorities are helping boards of client associations prepare for the repercussions of the Sarbanes-Oxley Act, providing updates and educational materials that address the rationale that's being used to apply Sarbanes-Oxley requirements to nonprofits, and leveraging the considerable resources within the AMC environment to protect clients and ensure compliance in the wake of emerging legislative and regulatory trends.

“This is precisely where an AMC can help in its role as partner to an association and its board,” says Bill MacMillan, CAE, 2002--2003 chair of ASAE's AMC Section Council, and CEO of Association Headquarters, an association management company based in Mount Laurel, New Jersey.

“I can understand the necessity for imposing rigorous standards and security controls on public organizations,” he adds. “But it would be extremely difficult for an association, especially for a small nonprofit corporation. Such an organization will be hard-pressed to make ends meet in

terms of professional staff and resources. On the other hand, we as AMCs can help by playing a significant role as partner, since we're much more likely to have the appropriate systems in place, as well as the resources, human and otherwise, to ensure compliance than those associations not being managed by an AMC.”

In fact, AMCs are duty bound in their roles as association stewards to ensure clients’ compliance with all applicable laws and regulations. They must stay abreast of legislative developments so that their policies and practices remain current.

“It is the AMC’s responsibility as the association client’s management company to ensure compliance,” Deese asserts. “Suppose an organization under AMC management is found to have violated some legal provision that applies to nonprofits, or discovers that it has violated new state legislation that applies to nonprofits. In my view, the client would be entitled to hold the AMC accountable.”

Not all associations may be so fortunate as to have staff with the know-how, expertise, and initiative to keep the leadership apprised of trends and developments such as Sarbanes-Oxley, continues MacMillan. “As professional service providers, we absolutely must remain on top of issues. It’s the cost of doing business. At our firm, for instance, we are following this legislation, as well as other trends as they emerge, very closely. Our policy is to pay attention, educate, and forecast. Planning in any business, especially a nonprofit business, is essential. Clients count on their AMC to keep them apprised of trends and developments that could adversely affect them. It's part of earning our keep.”

Webster says that when it comes to protecting the organization and ensuring that it is properly managed, the selection process is a board's first line of defense. “The most important function of a board is to ensure the association is properly managed,” he says. “Hiring a quality association management company is one of the best ways a board can demonstrate its good faith and responsibility.”

Another advantage of hiring an AMC, Webster adds, is the indemnification clause included in most service agreements.

Webster also asserts that the AMC option offers some distinct advantages to boards concerned about liability issues because the element of competition exists.

“AMCs present several important advantages,” Webster says. “First, there’s the issue of employee liability. As many as 70-80 percent of legal actions taken against associations are employment-related. As a result, an association can avoid most claims by contracting with an AMC, which is an independent contractor,” he explains. “In addition, AMCs are compelled to offer the best professional options that their investment in staff, education, and other resources can afford in an effort to distinguish themselves from competitors who, in turn, are also offering

a high level of service, standards, and professional expertise. Competition boosts performance standards.”

Collaborations build cohesion and compliance

Competition notwithstanding, some see opportunities for collaboration within the AMC industry on behalf of association clients.

David Baumann, IAAMC president, anticipates the industry working collaboratively through his association to ensure client boards are aware of and in compliance with regulatory requirements associated with legislative mandates, such as Sarbanes-Oxley.

“There is also an opportunity for ASAE, particularly the AMC Section, and IAAMC to jointly formulate white papers and other educational tools focused on interested third parties, such as federal and state legislators and regulators,” Baumann explains. “This will help ensure laws and regulators are appropriately targeted and are reasonable with respect to compliance.”

Baumann believes this kind of educational outreach will be critical to clients. “Few legislators and regulators differentiate between [501] C6s and C3s, much less between charitable foundations and membership organizations. This fundamental ignorance of associations causes all nonprofits to be burdened with regulatory responsibilities intended to address concerns within a narrow spectrum of the association community,” he says.

“The reality is there were serious if isolated problems that caused the SarbanesOxley legislation,” he continues. “It was a response to unacceptable behavior. We can acknowledge the challenges of compliance, but we also need to be part of the solution.”

Baumann, chief operating officer of Executive Director, Inc., an AMC located in Milwaukee, believes legislative trends and developments provide AMCs with opportunities to shine as service providers, as well as to work together as an industry on behalf of the association community at large.

“The depth and breadth of our experience as managers of multiple associations in many geographic locations puts us in a unique position to develop workable processes for associations in general,” Baumann says.

Baumann points out that an AMC-managed association is structured with several layers of internal and external controls. “Within the typical AMC environment, you have three levels of accountability—you have a board watching over the association, you have staff, and you have a third layer of accountability: the AMC owners,” he explains. “The AMC owners have a vested interest in making sure the client is well served and that staff are operating at the highest ethical and legal level possible.” Within an AMC structured to provide that third layer of accountability, questionable expenditures, for example, are likely to be challenged.

“This is a tremendous boost to the individual organization, whether it is large or small in membership and budget size,” Baumann says. “In our firm, for instance, although every client has an executive that is interacting with the board, there is a consulting partner who provides that extra level of oversight to provide guidance and to ensure proper, ethical, and legal functioning at all times.”

Perhaps the most significant benefit of aligning with an AMC, MacMillan notes, is its stability and economic leverage, especially considering the impact of political and technological changes.

Because of our considerable resources, AMCs are an intelligent choice for boards concerned about the impact of legislation such as the Sarbanes-Oxley law, MacMillan says. “We’re equipped to monitor trends, provide competent staff, implement systems within a changing environment, and respond with great maneuverability as political winds shift. Clients, we’ve discovered, find a great deal of security and peace of mind in that kind of leverage.”

With that leverage, boards will be better equipped to serve their associations’ members and mission by overseeing highly accountable, responsible, and transparent operations. The payoff will be greater trust and strengthened relationships with both their constituents and the public at large.

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