

# PKF PERSPECTIVES

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## BEST PRACTICES AND GOOD GOVERNANCE

### Sarbanes-Oxley and the Privately-Held Company

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It has been almost three years since the passage of the Sarbanes-Oxley Act (SOX) and, although most of its provisions apply by law only to publicly-traded companies, state accounting regulatory agencies and professional associations are considering adopting certain provisions and making them applicable to privately-held companies as well. In the interim, many privately-owned companies, including not-for-profit organizations, are voluntarily adopting and adapting some SOX corporate governance stipulations.

Why? Simply because they make good business sense. This is especially true in the case where a private company has outside partners or investors, or an organization receives contributions for charitable work. Lending institutions, as well as insurance providers, may also look to an organization's corporate governance when evaluating them for loans and setting premiums. Being a "good corporate citizen" may reap benefits for the company.

Listed below are a few "best practices" and some "good governance" ideas that your privately-held company or not-for-profit organization may wish to put into place if it has not already done so.

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#### Audit Committee

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- Establish an Audit Committee from members of your Board and formulate a charter.
- Consider requiring that all or a majority of the members of the Committee be independent, i.e., not recipients of any compensation from the company other than for service as a member of your Board.
- At least one member of the Audit Committee should have a financial background.
- The Audit Committee should be responsible for, among other things, the appointment and oversight of your outside auditors, and overseeing the integrity of your financial accounting process and systems of internal control with respect to finance, accounting and the use of assets.

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#### Management

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- If the CEO, CFO, Controller, Chief Accounting Officer or any person in an equivalent position was employed by your company's audit firm during the one-year period preceding the audit, that person should not be placed in a situation where he/she could exert undue influence on the outside auditors servicing your account.
- Your CEO and CFO should certify to the Board that the financial statements and disclosures contained in the financial statements fairly present, in all material respects, the operations and financial condition of your organization.
- Management should be responsible for establishing and maintaining an adequate internal control structure, including procedures for financial reporting.
- Your CEO and CFO should review the company's tax returns before filing.
- The company should not extend credit to any director or executive officer.

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#### Records Retention

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- Establish guidelines for the retention of appropriate records and routinely monitor compliance.
- These guidelines should take into consideration Federal, state and industry requirements and should be consistently applied within your organization.
- Regardless of whether your company is public or private, it is a crime to intentionally alter, falsify or destroy any documents to prevent their use in an official proceeding, e.g. a bankruptcy, a federal investigation, etc.

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### Code of Conduct

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- Draft and distribute firmwide a comprehensive Code of Conduct on corporate behavior to ensure:
  - honest and ethical conduct, including the handling of actual or apparent conflicts of interest between personal and professional relationships
  - full, accurate and timely financial reports
  - compliance with governmental laws, rules and regulations.
- Develop formal procedures for handling and investigating employee complaints and communicate throughout the entire organization that misconduct at any level will not be tolerated.
- Demonstrate through your actions your commitment to the Code.

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### Your Outside Audit Firm

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- Your outside audit firm should not also contemporaneously provide non-audit services to your company, such as bookkeeping, financial information systems design and implementation, actuarial services, etc. (Generally, tax compliance services are permitted under SOX.)
- Your audit firm should remain independent in both appearance and fact.
- If your audit firm is registered by the Public Company Accounting Oversight Board (PCAOB), it will be inspected annually if it audits 100 or more issuers or triennially if it audits fewer than 100 issuers. The PCAOB will inspect the firm's SEC practice only.
- As members of the American Institute of Certified Public Accountants (AICPA), your audit firm will also continue to participate in the AICPA triennial peer review program with respect to their non-SEC clients.

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### In the Words of ...

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In March 2002, the Federal Reserve Chairman, Alan Greenspan, gave a noteworthy speech on corporate governance at New York University. The speech was rich in business historical perspective and economic observation. Two memorable lines stand out:

***Capital employed on the basis of misinformation is likely to be capital misused.***

and

***... rules cannot substitute for character. In virtually all transactions, whether with customers or colleagues, we rely on the word of those with whom we do business.***



THE "BEST PRACTICES" OUTLINED ABOVE ARE INTENDED FOR THE CONSIDERATION OF THE OWNERS AND MANAGERS OF PRIVATELY-HELD COMPANIES AND NOT-FOR PROFIT ORGANIZATIONS. PUBLIC COMPANIES, AS DEFINED BY SOX, ARE REQUIRED TO FOLLOW THE RULES AND REGULATIONS OF THE PCAOB AND THE SECURITIES AND EXCHANGE COMMISSION (SEC).

Items in this publication should not be considered official statements of position, nor advice for individuals or organizations without consulting financial and legal professionals. For more information, please contact John Haslbauer, Henry Freire or Tom Sorrentino.

The logo for PKF, consisting of the letters 'PKF' in a bold, stylized, sans-serif font.

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