

Should the Requirements of the Sarbanes-Oxley Act of 2002 (SOX) be Applicable for Universities and Colleges?

Dr. Gene Smith, Eastern New Mexico University, U.S.A.

ABSTRACT

SOX's primary intent was to increase corporate responsibility and accountability. Responsibility and accountability are key concerns also for universities' and colleges' internal and external customers. Should SOX requirements be applicable to universities and colleges given annually the significant revenue dollars and expenditures received and disbursed by these organizations? A ten question survey was developed to determine the current observations of universities and colleges senior officers concerning SOX. The differences of opinion among university and college business officers for nine of the ten questions were statistically significant. Question 5 concerning audit partner rotation was the only question where there was not statistically significant differences of opinion. The percentage of respondents that strongly or moderately disagreed with implementing SOX at colleges and universities was 51.5%. The percentage of respondents that agreed or strongly agreed with implementing selected sections of SOX at colleges and universities was 52.5%. If certain sections of SOX are mandated, 54.6% of the respondents agreed or strongly agreed that Section 103 should be mandated, 51.6% of the respondents agreed or strongly agreed that Section 404 should be mandated, and 40.4% of the respondents agreed or strongly agreed that Section 203 should be mandated.

INTRODUCTION

The Sarbanes-Oxley Act of 2002 (SOX) requirements currently only apply to publicly-traded corporations. SOX requirements represented the most significant changes to federal securities laws since 1934. SOX, signed by the President of the United States, George W. Bush, on July 30, 2002, resulted from poor corporate governance by publicly-held corporations and accounting scandals occurring during the 1990s. SOX contains reforms designed to change corporate governance within publicly-held corporations. SOX addressed numerous items including management responsibilities, punishment for fraud, financial reporting, disclosures, and recordkeeping concerning publicly-held companies.

The SOX provisions were implemented to provide investors, potential investors and regulators confidence that publicly-held companies were undertaking the necessary steps to increase corporate governance and prevent accounting frauds. SOX increased significantly the standards for publicly-traded corporations' directors and officers, external auditors, securities analysts and legal counsels. SOX requirements not only monitored the accounting industry as a whole, but also increased penalties for directors, officers and employees (Summary of Sarbanes-Oxley Act of 2002).

Currently, publicly-held companies' executives, investment analysts, investors and potential investors are debating Sox's ongoing merits. SOX's advantages and disadvantages to date are as follows:

Advantages of SOX

- Publicly-held companies are required to present accurate financial statements to external users
- Publicly-held companies officers and employees are required to maintain an effective internal control system over financial reporting

- Internal control over the financial reporting process is an effective deterrent to fraud and a key factor in preventing financial misstatements
- Company personnel know what accounting controls are being performed and by whom
- Management obtains a better understanding of their business work processes and methods to improve their effectiveness
- Management can more effectively consider and manage risk (McGladrey.com/Resource_Center)

Disadvantages of SOX

- High implementation costs
- Implementation issues concerning specific SOX provisions are currently being developed by the regulators

Research Question

Should SOX requirements be applicable to universities and colleges given annually the significant revenue dollars and expenditures received and disbursed by these organizations?

Background for the Question

SOX's primary intent was to increase corporate responsibility and accountability. Responsibility and accountability are key concerns also for universities' and colleges' internal and external customers.

Some SOX implementation advantages and disadvantages for universities and colleges are as follows:

Implementation Advantages – Universities and Colleges

- Increased accountability over expenditures
- Universities' and colleges' officials can be held more responsible for errors, fraud, or other acts of malfeasance
- Strengthen penalties and accountability for individuals found to have committed fraud violations. (Securities & Exchange Commission)
- Reduced potential for conflicts of interest by universities' and colleges' employees and officials
- Increased financial disclosures
- Formalized ethics policy required
- External auditors conflict of interest risk reduced
- All universities' and colleges' personnel held accountable to a consistent uniform financial and internal control regulations

Implementation Disadvantages – Universities and Colleges

- Inconsistency in accounting and reporting requirements among Financial Accounting Standards Board (FASB), Public Company Accounting Oversight Board (PCAOB), Governmental Accounting Standards Board (GASB) and Federal Accounting Standards Advisory Board (FASAB)
- High implementation costs
- Reforms for publicly-traded corporations are being modified and adjusted as necessary by the PCAOB
- Minimal manpower in small universities and colleges insuring compliance with additional regulatory requirements
- The most relevant sections for universities and colleges are Sections 303 and 404 which are also the most complicated sections
- Enforcement difficulties
- Difficulty in assessing criminal penalty liability are preserved.

The Corporate and Criminal Fraud Act of 2002 and White-Collar Crime Penalty Enhancement

Act of 2002, which are included in SOX, strengthen penalties and accountability for individuals committing fraud violations (Summary of Sarbanes-Oxley Act of 2002). The same penalties should apply to individuals committing such acts while employed by universities and colleges. Sox's Title IV "Enhanced Financial Disclosures" contains disclosure standards providing increased safety measures to universities' and colleges' constituents.

The term, code of ethics, is mentioned throughout SOX. Code of ethics is defined in Sec. 406 (3) as: honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships.

Code of ethics requirements should be applied to all entities regardless whether their status is profit or not-for-profit, private or public, or governmental. SOX addresses conflicts of interest by external auditors in Section 206 and sets forth rules for auditing, quality control, and independence standards in Section 103. Sections 206 and 103 provide guidelines preventing professional affiliations between external auditors performing audits and the organization itself or any affiliate or subsidiary of the organization, either currently or within the last year (Summary of Sarbanes-Oxley Act of 2002). Assurances that external auditors are objective and honest are equally as important for universities and colleges as for publicly-traded corporations.

Arguments for applying SOX requirements to colleges and universities are significant. There are disadvantages, however, which could arise if SOX requirements are required for colleges and universities. If universities and colleges are required to adhere to SOX requirements, GASB and FASB accounting guidelines would need adjustment to compensate for inconsistencies between SOX, GASB and FASB. These potential circumstances could be very time consuming and expensive for impacted colleges and universities.

Universities and colleges, with ongoing budget and personnel constraints, could experience significant implementation costs. Funding is often limited, especially for small universities and colleges. Additional appropriations and funding to assist in implementing accounting reforms seldom occur. GASB 34, Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments, implementation costs were significant which therefore took dollars away from the universities and colleges ongoing program needs. The General Accounting Office (GAO) points out "that reforms are still being implemented and the GASB 34 full impact is still uncertain" (North Carolina Office of the State Auditor, 2006).

Additional SOX compliance costs would reduce funds available for universities and colleges to utilize in accomplishing their primary mission. Many small universities and colleges have few employees and the individuals managing the operations are not financially literate. The officials may not be aware of significant occurrences from a financial and internal control perspective.

Small universities and colleges have budgets and committees watching over the activities and the funding of those activities. Many small universities and colleges do not have personnel needed to implement checks and balances to detect fraud or funds misappropriation. Adopting SOX would assist their constituents' understanding and confidence in the universities' and colleges' internal controls and financial information. Budgets are another difference between universities and colleges and corporations. Budgets are not the controlling daily document for corporations. Budgets however are the controlling document for universities and colleges.

RESEARCH DESIGN

A ten question survey was developed to determine the current observations of universities and colleges senior officers concerning SOX. The following ten questions/statements represented the content of the survey:

1. The requirements of the Sarbanes-Oxley Act of 2002 (SOX) should be applicable to colleges and universities?
2. Selected sections of SOX should be applicable to colleges and universities?
3. Has your university or college voluntarily adopted portions of SOX?

4. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 103 – Auditing, Quality Control, and Independence Standards and Rules.
5. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 203 – Audit Partner Rotation.
6. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 204 – Audit Reports to Audit Committees.
7. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 301 – Public Company Audit Committees.
8. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 302 – Corporate Responsibility for Financial Reports.
9. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 402 (a) – Prohibition on Personal Loans to Executives.
10. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 404 – Prohibition on Personal Loans to Executives.

For all ten questions with the exception of question three, a Likert scale of 1 to 5 was utilized where 1 = strongly disagree, 2 = moderately disagree, 3 = moderately agree, 4 = agree and 5 = strongly agree. Question three requested the participants to answer either yes or no to the question. The yes/no responses for question three were converted to a quantitative response based on a 2-point scale where a “no” response = 1 and a “yes” response = 2.

Emails were sent to 978 senior business officers from 896 universities or colleges requesting the completion of the SOX questionnaire. The selected senior business officers were from all the two year and four year educational institutions that are members of National Association of College and Universities Business Officers (NACUBO), Western Association of College and Universities Business Officers (WACUBO), Southern Association of College and Universities Business Officers (SACUBO) or Central Association of College and Universities Business Officers (CACUBO). The selected universities and colleges were located in the western half of the United States. For the purposes of the study, the senior business officer positions of Chief Financial Officer, VP for Finance and Controller were selected for each university or college. If none of the specific positions existed for the university/college, the highest ranked employee holding an equivalent position was selected.

The selected senior business officers that are members of NACUBO and WACUBO were retrieved from the NACUBO Members Directory 2005 and from the NACUBO website directory (www.nacubo.org). For the members of CACUBO and SACUBO, the data were retrieved from the organizations’ websites. (www.cacubo.org and www.sacubo.org). Both sites had downloadable files, PDF for CACUBO and Excel for SACUBO, that contained the name and state of the institution, and the name, position and email of one senior business officer.

RESEARCH RESULTS

A *t* test, utilizing SPSS and an alpha rate of 0.05, was performed on the responses for each question. The mean, standard deviation, standard error mean, *t*, *p* and significant statistical difference were calculated for each question.

1. The requirements of the Sarbanes-Oxley Act of 2002 (SOX) should be applicable to colleges and universities?

	Response Percent
Strongly disagree	29.3%
Moderately disagree	22.2%
Moderately agree	35.4%
Agree	9.1%
Strongly Agree	4.0%

Mean	2.36
Standard deviation	.12
Standard error mean	.11
<i>t</i>	-5.65
<i>p</i>	.000
Statistical difference	Yes

There were significant statistical differences of opinion as to whether SOX should be applicable to colleges and universities. Only 13.1% of the respondents agreed or strongly agreed that SOX should be applicable to colleges and universities. The percentage of respondents that strongly or moderately disagreed with implementing SOX at colleges and universities was 51.5%.

2. Selected sections of SOX should be applicable to colleges and universities?

	Response Percent
Strongly disagree	8.1%
Moderately disagree	10.1%
Moderately agree	29.3%
Agree	40.4%
Strongly Agree	12.1%
Mean	3.38
Standard deviation	1.09
Standard error mean	.04
<i>t</i>	3.52
<i>p</i>	.001
Statistical difference	Yes

There were significant statistical differences of opinion as to whether selected sections of SOX should be applicable to colleges and universities. The percentage of respondents that agreed or strongly agreed with implementing selected sections of SOX at colleges and universities was 52.5%. Only 19.2% of the respondents strongly or moderately disagreed that selected sections of SOX should not be applicable to colleges and universities.

3. Has your university or college voluntarily adopted portions of SOX?

	Response Percent
Yes	73.2%
No	26.8%
Mean	1.27
Standard deviation	.44
Standard error mean	.04
<i>t</i>	-16.39
<i>p</i>	.000
Statistical difference	Yes

There were significant statistical differences of opinion as to whether colleges and universities had voluntarily adopted portions of SOX. The percentage of respondent universities and colleges voluntarily adopting SOX was 73.2% whereas 26.8% of the responding universities had not voluntarily adopted SOX.

4. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 103 – Auditing, Quality Control, and Independence Standards and Rules.

	Response Percent
Strongly disagree	8.1%
Moderately disagree	12.1%
Moderately agree	25.3%
Agree	44.4%
Strongly Agree	10.2%
Mean	3.36
Standard deviation	1.08
Standard error mean	.11
<i>t</i>	3.34
<i>p</i>	.001
Statistical difference	Yes

There were significant statistical differences of opinion as to whether SOX Section 103 should be mandated, if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that agreed or strongly agreed that Section 103 should be mandated if selected portions of SOX were applicable to colleges and universities was 54.6%. Only 20.2% of the respondents strongly or moderately disagreed that SOX Section 103 should be mandated if selected portions of SOX were applicable to colleges and universities.

5. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 203 – Audit Partner Rotation.

	Response Percent
Strongly disagree	13.1%
Moderately disagree	22.2%
Moderately agree	24.2%
Agree	32.3%
Strongly Agree	8.1%
Mean	3.00
Standard deviation	1.19
Standard error mean	.12
<i>t</i>	.000
<i>p</i>	1.00
Statistical difference	No

There were no significant statistical differences of opinion as to whether SOX Section 203 should be mandated, if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that agreed or strongly agreed that Section 203 should be mandated if selected portions of SOX were applicable to colleges and universities was 40.4%. The percentage of respondents that strongly or moderately disagreed that SOX Section 203 should be mandated if selected portions of SOX were applicable to colleges and universities was 35.3%.

6. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 204 – Audit Reports to Audit Committees.

	Response Percent
Strongly disagree	5.1%
Moderately disagree	16.3%
Moderately agree	19.4%
Agree	40.8%
Strongly Agree	18.4%

Mean	3.51
Standard deviation	1.12
Standard error mean	.11
<i>t</i>	4.50
<i>p</i>	.000
Statistical difference	Yes

There were significant statistical difference of opinion as to whether SOX Section 204 should be mandated if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that agreed or strongly agreed that Section 204 should be mandated if selected portions of SOX were applicable to colleges and universities was 59.2%. Only 21.4% of the respondents strongly or moderately disagreed that SOX Section 204 should be mandated, if selected portions of SOX were applicable to colleges and universities.

7. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 301 – Public Company Audit Committees.

	Response Percent
Strongly disagree	18.4%
Moderately disagree	38.8%
Moderately agree	17.3%
Agree	17.3%
Strongly Agree	8.2%
Mean	2.58
Standard deviation	1.21
Standard error mean	.12
<i>t</i>	-3.43
<i>p</i>	.001
Statistical difference	Yes

There were significant statistical differences of opinion as to whether Section 301 should be mandated if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that strongly or moderately disagreed with mandating Section 301 was 57.2%. Only 25.5% of the respondents agreed or strongly agreed that SOX should be mandated if selected portions of SOX were applicable to colleges and universities.

8. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 302 – Corporate Responsibility for Financial Reports.

	Response Percent
Strongly disagree	7.1%
Moderately disagree	17.3%
Moderately agree	29.6%
Agree	35.7%
Strongly Agree	10.2%
Mean	3.24
Standard deviation	1.08
Standard error mean	.11
<i>t</i>	2.24
<i>p</i>	.028
Statistical difference	Yes

There were significant statistical differences of opinion as to whether SOX Section 302 should be mandated if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that agreed

or strongly agreed that Section 302 should be mandated if selected portions of SOX were applicable to colleges and universities was 45.9%. Only 24.4% of the respondents strongly or moderately disagreed that SOX Section 302 should be mandated if selected portions of SOX were applicable to colleges and universities.

9. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 402 (a) – Prohibition on Personal Loans to Executives.

	Response Percent
Strongly disagree	3.0%
Moderately disagree	11.1%
Moderately agree	10.1%
Agree	35.4%
Strongly Agree	40.4%
Mean	3.99
Standard deviation	1.11
Standard error mean	.11
<i>t</i>	8.86
<i>p</i>	.000
Statistical difference	Yes

There were significant statistical differences of opinion as to whether SOX Section 402 (a) should be mandated, if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that agreed or strongly agreed that Section 402 (a) should be mandated if selected portions of SOX were applicable to colleges and universities was 75.8%. Only 14.1% of the respondents strongly or moderately disagreed that SOX Section 402 (a) should be mandated if selected portions of SOX were applicable to colleges and universities.

10. If selected portions of SOX were applicable to colleges and universities, you would support mandating the requirements of Section 404 – Prohibition on Personal Loans to Executives.

	Response Percent
Strongly disagree	13.1%
Moderately disagree	13.1%
Moderately agree	22.2%
Agree	35.4%
Strongly Agree	16.2%
Mean	3.28
Standard deviation	1.26
Standard error mean	.13
<i>t</i>	2.23
<i>p</i>	.028
Statistical difference	Yes

There were significant statistical differences of opinion as to whether SOX Section 404 should be mandated, if selected portions of SOX were applicable to colleges and universities. The percentage of respondents that agreed or strongly agreed that Section 404 should be mandated if selected portions of SOX were applicable to colleges and universities was 51.6%. The percentage of respondents that strongly or moderately disagreed that SOX Section 404 should be mandated if selected portions of SOX were applicable to colleges and universities was 26.2%. The percentage of respondent universities and colleges that have not voluntarily adopted portions of SOX was 73.2%. The percentage of respondents that agreed or strongly agreed that Section 204 should be mandated if selected portions of SOX were applicable to colleges and universities was 59.2%. The percentage of respondents that strongly or moderately disagreed with mandating Section 301 was 57.2%. The percentage of respondents that

agreed or strongly agreed that Section 302 should be mandated if selected portions of SOX were applicable to colleges and universities was 45.9%. The percentage of respondents that agreed or strongly agreed that Section 402 (a) should be mandated if selected portions of SOX were applicable to colleges and universities was 75.8%.

RESEARCH CONCLUSIONS

The differences of opinion among university and college business officers for nine of the ten questions were statistically significant. Question 5 concerning audit partner rotation was the only question where there was not statistically significant differences of opinion. The percentage of respondents that strongly or moderately disagreed with implementing SOX at colleges and universities was 51.5%. The percentage of respondents that agreed or strongly agreed with implementing selected sections of SOX at colleges and universities was 52.5%. If certain sections of SOX are mandated, 54.6% of the respondents agreed or strongly agreed that Section 103 should be mandated, 51.6% of the respondents agreed or strongly agreed that Section 404 should be mandated, and 40.4% of the respondents agreed or strongly agreed that Section 203 should be mandated.

Conclusions

The issues publicly-held corporations encountered with SOX are miniscule when compared to problems universities and colleges would have in implementing SOX requirements. At the same time, the concept of holding universities' and colleges' leaders personally responsible for inaccurate accounting is very appealing. Universities and colleges are not free from corruption, fraud, or misuse of funds. Universities and colleges are entities American citizens should be able to trust. These organizations are responsible for managing receipts and disbursements. Universities and colleges must manage their affairs in the constituents' best interests. If accounting applications are being misused, procedures should be implemented to assist the public in detecting irregularities and holding appropriate individuals accountable for their actions. The biggest question is whether universities and colleges can afford to completely comply with the SOX requirements. Several universities and colleges are voluntarily complying with some SOX requirements simply because it is prudent business. For universities and colleges to completely comply, funds normally designated for other purposes would be expended for SOX compliance.

Implementing all the SOX requirements would be costly and time consuming, considering the various sizes of universities and colleges, straining existing cash-strapped budgets and further aggravating existing budget deficits. As publicly-held companies have already concluded, SOX is costly and time consuming. Temptation to shortcut SOX implementation procedures would be great especially for smaller universities and colleges. Finally, assessing responsibility and/or possible criminal liability, for universities and colleges personnel would be extremely problematic.

Recommendations – Limited Implementation of SOX

Congress and the President of the United States should not require all the current SOX requirements for universities and colleges. SOX, in the present form, would be detrimental to smaller universities and colleges. However, a modified version should be passed by Congress pertaining to large universities and colleges. Smaller universities and colleges should be exempted from any proposed legislation. Larger universities and colleges have significant dollars going through their budgets. Requiring parts of SOX for universities and colleges could raise their constituents' confidence.

Although SOX could not be used entirely in current legislative format for universities and colleges, the current legislation was a good starting point. Both larger universities and colleges would benefit from a) additional measures designed to maintain reasonable financial records, b) more involvement from upper level management in the financial reporting process and 3) universities' and colleges' chief operating and financial officers having direct responsibility for financial information accuracy provided to the public.

Four topics addressed by SOX should be considered by Congress including audit committees' independence, external auditors' independence, management's and external auditor's responsibilities regarding internal control and fraud. The fraud subject is closely related to financial reports and disclosures accuracy. McGladrey & Pullen, CPAs (McGladrey.com/Resource_Center) make the point "faith and trust placed in government units is gone. Many believe they can no longer rely on a community-service ethic driving the actions of public employees, management, committee members, and/or their governing boards."

Another SOX provision prohibits publicly-held companies extending personal loans to officers or directors. This prohibition is a very sound policy. Eliminating this potential area for abuse makes good common sense and large universities and colleges would benefit from this same prohibition. SOX prohibits publicly-traded companies' external auditors from also providing additional specific services, such as the companies' bookkeeping or legal services, as well as financial system design and implementation. Again, this provision would be advantageous for large universities and colleges.

Large universities and colleges should have audit committees. Even though large universities and colleges may have difficulty in forming audit committees possessing the necessary financial literacy to understand financial statements, evaluate external auditing firms' proposals and make sound financial decisions as part of their fiduciary responsibilities, an effective audit committee's advantages exceed the difficulties of creating a qualified audit committee.

SOX limits lead audit partners involvement for publicly-traded companies to five years. To insure ongoing objectivity, independence and service quality from external auditors, this provision should be applicable for large universities and colleges. Impacted universities and colleges may incur increased costs to comply with requirements for preparing accurate financial reports and insuring an adequate internal financial reporting control system. However, benefits from compliance should exceed incremental implementation costs.

Specific requirements of Title III - Corporate Responsibility should be applicable to larger universities and colleges. Section 302, Corporate Responsibility for Financial Reports, would require an organizations' chief executive and financial officer to certify the accuracy of financial statements and internal controls over financial reporting. Requiring certification from an organizations chief executive and financial officers should improve the accuracy of the financial reporting process. Section 305, Officer and Director Bars and Penalties: Equitable Relief, establishes the possibility senior executives and board of directors could be removed from their position and never permitted to serve on other boards. These provisions should be applicable for universities and colleges.

SOX's purposes were not just to regulate public companies and their external auditors but also to boost confidence by the public in these companies and the external auditing profession. This is the primary reason a modified SOX version should occur for large colleges and universities. The public is served when losses from fraud, abuse, and neglect are prevented, detected and corrected on a timely basis. Theft, misuse, waste and deception can be more easily accomplished in universities and colleges because there are no stockholders with a financial stake to put pressure on management to do what corporations are supposed to do, which is to increase shareholders wealth. SOX sections mentioned above certainly can provide guidelines for increasing accountability of larger colleges and universities

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