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## FOR YOUR INFORMATION

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November 2006

News for School and Municipal Clients

### **Sarbanes-Oxley Applies to School Districts and Other Municipalities**

On July 30, 2002, President George W. Bush signed into law the American Competitiveness and Corporate Accountability Act of 2002, more commonly known as the Sarbanes-Oxley Act. The Sarbanes-Oxley Act was passed in response to the financial scandals involving companies such as Enron, Arthur Anderson, and others. The main purposes of the Act are three-fold: (1) to improve the accuracy and reliability of corporate disclosures; (2) to promote corporate compliance with federal, state, and local laws; and (3) to prevent similar scandals from occurring in the future. Most of the provisions of the Sarbanes-Oxley Act apply only to publicly traded companies regulated by federal securities laws. However, two provisions of the Sarbanes-Oxley Act are applicable to local municipalities, including school districts, and the officers, agents and employees of those municipalities. The first relevant provision governs document destruction, and the second provision provides whistleblower protections.

With regard to the provisions governing document destruction, the Sarbanes-Oxley Act makes it a crime for any person or organization to knowingly destroy an internal financial or legal document with the intent to obstruct or influence "the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United

States . . . or in relation to or contemplation of any such matter or case." In order to comply with the document destruction section of the Sarbanes-Oxley Act, municipalities and school districts must implement records retention schedules and strictly adhere to them. At a minimum, it is recommended that the records retention schedules meet the Sarbanes-Oxley Act's audit standards, such that documents sent and/or received as part of an audit are retained for seven years. Wisconsin statutes require that school districts and other municipalities, as a general rule, retain records for a period of seven years, unless a shorter period has been requested and approved by the public records board. Accordingly, most school districts and municipalities already meet the minimum document retention standards set forth in the Sarbanes-Oxley Act.

With regard to the provisions providing whistleblower protections, the Sarbanes-Oxley Act makes it a crime for any person or organization to intentionally retaliate against anyone for providing to a law enforcement officer any truthful information relating to the commission of any federal offense. There are two key elements to this provision. First, the report must be made to a law enforcement officer. A whistleblower will not be protected under the Sarbanes-Oxley Act if he or she makes a report to a Human Resources Director, District Administrator or Board Member. Second, the report must refer to the commission of a federal offense. The federal

offense about which the whistleblower is reporting must be a violation of any of the specific criminal statutes identified in the Sarbanes-Oxley Act, a violation of any Securities and Exchange Commission rule or regulation, or a violation of any provision of federal law relating to fraud against shareholders. The criminal statutes identified in the Sarbanes-Oxley Act are mail fraud (18 U.S.C. § 1341), wire fraud (18 U.S.C. § 1343), bank fraud (18 U.S.C. § 1344), and securities fraud (18 U.S.C. § 1348). It is important to understand that a whistleblower will not be protected under the Sarbanes-Oxley Act if he or she reports conduct that does not rise to the level of these enumerated federal offenses.

Whistleblower cases are likely to focus on three crucial issues: (1) whether the employee engaged in protected activity under the statutes; (2) whether the employee had a “reasonable belief” that the employer was committing fraud; and (3) whether the retaliation or adverse employment action took place shortly after the employee’s complaint or investigation. The employee must hold the “reasonable belief” at the time he or she makes the complaint or investigates the fraud, and the belief must be objectively and subjectively reasonable. That said, the employee does not have to be correct that fraud was occurring. It is necessary only that the employee have a good faith, reasonable belief that fraud occurred.

As a means of avoiding unnecessary litigation, it is advisable for municipalities

and school districts to offer employees an opportunity to bring concerns about the financial practices of the municipality to the municipality’s attention before reporting the concerns regarding questionable accounting or auditing matters to law enforcement. To encourage such early reporting, municipalities may establish an entity or identify a position to receive such reports.

Finally, in addition to the actual provisions of the Sarbanes-Oxley Act that can be applied to municipalities, their officers, agents and employees, the Sarbanes-Oxley Act has also increased the public’s expectations regarding the financial practices of municipalities, including school districts. As a result, much of the scrutiny of the financial practices of municipalities may be assuaged by the audits conducted by independent financial experts each year. Municipalities should also consider adopting and publicizing a Code of Ethics for board members and other public officers, consistent with state law. Ultimately, responsibility for the municipality’s financial accountability rests with the governing body and having established guidelines in place will serve to protect the municipality and the public.

The Sarbanes-Oxley Act has simultaneously put both the benefit and burden of more accountability on school districts and other municipalities in terms of their audits and financial activity. The enactment of this Act has resulted in more scrutiny of a school district’s and municipality’s financial activity; scrutiny that is both a symptom and a cause that led to the creation of the Act.

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