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Sarbanes-Oxley: SEC Materials

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DOCUMENT NO.	FORM	SUBJECT/TITLE	PAGES	DATE	RESTRICTION(S)
001	Press Release	SEC Roundtables on International Impact of Proposed...	2	12/05/2002	P5;

COLLECTION TITLE:
Counsel's Office, White House

SERIES:
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Sarbanes-Oxley: SEC Materials

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RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

P1 National Security Classified Information [(a)(1) of the PRA]
P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
P3 Release would violate a Federal statute [(a)(3) of the PRA]
P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
P5 Release would disclose confidential advise between the President and his advisors, or between such advisors [a)(5) of the PRA]
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Brief Summaries of SEC Actions Taken and Rules Proposed and/or Adopted Pursuant to the Sarbanes-Oxley Act of 2002

For informal, informational purposes only.
Prepared by the SEC's Office of Legislative Affairs.
Consists primarily of information found in SEC press releases.
For complete information, please refer to SEC official postings on ***www.sec.gov***

Section 101(e)(4)(A) – Appointment of PCAOB Members

On October 25, 2002, the Commission selected the initial members of the new Public Company Accounting Oversight Board (PCAOB) to oversee the accounting profession: Judge William H. Webster to be chairman, and Kayla J. Gillan, Daniel L. Goelzer, Willis D. Gradison Jr., and Charles D. Niemeier. (*Webster subsequently resigned on November 12, 2002. His replacement has not been named as of 12-4-02.)*

The Board was established by the Sarbanes-Oxley Act of 2002 to oversee the audits of the financial statements of public companies through rigorous registration, standard setting, inspection and disciplinary programs. The Act requires the Commission, in consultation with the Secretary of Treasury and the Chairman of the Federal Reserve Board, to select the members of the Board.

Section 208 - Auditor Independence

On Nov. 19, 2002, the Commission proposed rules that would make amendments to its existing requirements regarding auditor independence to enhance the independence of accountants that audit and review financial statements and prepare attestation reports filed with the Commission. As directed by Section 208(a) of the Sarbanes-Oxley Act of 2002, the Commission is proposing rules to:

- revise its regulations related to the non-audit services that, if provided to an audit client, would impair an accounting firm's independence (based on the nine prohibited services listed in Sarbanes-Oxley);

- require that an issuer's audit committee pre-approve all audit and non-audit services provided to the issuer by the auditor of an issuer's financial statements;

- prohibit partners on the audit engagement team from providing audit services to the issuer for more than five consecutive years and from returning to audit services with the same issuer within five years;

- prohibit an accounting firm from auditing an audit client's financial statements if certain members of management of that client had been members of the accounting firm's audit engagement team within the one-year period preceding the commencement of audit procedures;

- o require that the auditor of an issuer's financial statements report certain matters to the issuer's audit committee, including "critical" accounting policies used by the issuer; and

- o require disclosures to investors of information related to the audit and non-audit services provided by, and fees paid by the issuer to, the auditor of the issuer's financial statements. The disclosures, to be made in issuers' annual reports, would include fees paid by issuers for audits, tax preparation and all other fees. The proposal would require disclosure of fees for the year covered by the filing and for the previous year.

In addition, under the proposed rules, an accountant would not be independent from an audit client if any partner, principal or shareholder of the accounting firm who is a member of the engagement team received compensation based directly on any service provided or sold to that client other than audit, review and attest services.

Final rules are due to be issued within 180 days of enactment (Jan. 26).

Section 302 – CEO & CFO Certification

On August 27, 2002, the Commission adopted rules to require CEOs and CFOs to certify the financial and other information in issuers' quarterly and annual reports. The rules became effective on August 29, 2002.

The rules require an issuer's principal executive and financial officers each to certify, with respect to the issuer's quarterly and annual reports, that:

- the report does not contain any untrue statement of a material fact or omit to state a material fact;
- the financial statements fairly present in all material respects the financial condition and results of operations of the issuer;
- they are responsible for establishing and maintaining "disclosure controls and procedures" to ensure that material information is made known to them;
- they have disclosed to the issuer's auditors and to the audit committee of the board of directors any material weaknesses in internal controls and any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls;
- they have indicated in the report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of their evaluation.

The new rules will apply to the principal executive and financial officers of any issuer that files quarterly and annual reports with the Commission, including foreign private issuers and small business issuers.

Section 303 – Improper Influence on Audits

On October 16, 2002, the Commission voted to propose rule amendments to implement Section 303 of the Sarbanes-Oxley Act of 2002. Section 303 prohibits an issuer's officers, directors, and persons acting under the direction of an officer or director, from taking any action to fraudulently influence, coerce, manipulate or mislead the auditor of the issuer's financial statements for the purpose of rendering those financial statements materially misleading. Final rules are to be issued no later than 270 days after enactment (Apr. 25).

Section 306(a)(3) – Prohibition on Insider Trades During Blackout Periods

On October 30, 2002, the Commission proposed rules, developed in conjunction with the Department of Labor, to prohibit directors and executive officers of an issuer from selling an equity security of the issuer during a pension fund blackout period if the security was acquired as compensation. The proposed rules would apply to the directors and executive officers of all reporting companies, including foreign private issuers, banks and savings associations and small business issuers.

The statutory trading prohibition of Section 306(a) is limited to equity securities that a director or executive officer acquired in connection with his or her service or employment as a director or executive officer. The proposed rules would specify the instances where an acquisition of equity securities by a director or executive officer was "in connection" with his or her service to or employment with an issuer.

To prevent evasion of the statutory trading prohibition, the proposed rules would apply to indirect, as well as direct, acquisitions and dispositions of equity securities where a director or executive officer had a "pecuniary interest" in the transaction. Accordingly, acquisitions or dispositions of equity securities by family members, partnerships, corporations, limited liability companies and trusts would be deemed acquisitions or dispositions by a director or executive officer if he or she had a pecuniary interest in the equity securities.

Section 306(a) permits the Commission to exempt appropriate transactions from the statutory trading prohibition, including purchases pursuant to an automatic dividend reinvestment program or purchases or sales made pursuant to an advance election.

The statutory trading prohibition of Section 306(a) is triggered only if a blackout period lasts more than three consecutive business days and temporarily suspends the ability of at least 50% of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell or otherwise acquire or transfer an interest in issuer equity securities held in an account plan. The proposed rules would clarify application of the 50% test and describe how the two statutorily mandated exceptions to a blackout period would operate.

Statutory provision is effective 180 days after enactment and final rules are expected before then (Jan. 26).

Section 307 – Standards of Professional Conduct for Attorneys

On November 21, 2002, the Securities and Exchange Commission published proposed rules that prescribe "minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." Consistent with Section 307 of the Sarbanes-Oxley Act, the standards include a rule requiring an attorney to report evidence of a material violation of securities laws or material breach of fiduciary duty or similar material violation by the company or any agent thereof to the chief legal counsel (CLO) or the chief executive officer of the company (or the equivalent); and, if they do not respond appropriately to the evidence, requiring the attorney to report the evidence to the audit committee, another committee of independent directors, or the full board of directors.

The core of the proposed rule would affirmatively state that an attorney representing an issuer represents the issuer as an entity rather than the officers or others with whom the attorney interacts in the course of that representation, and that the attorney is obligated to act in the best interests of the issuer and its shareholders.

'Up-the-Ladder' Reporting. The proposed rule would prescribe the duty of an attorney who appears or practices before the Commission in the representation of an issuer to report evidence of a "material violation." It would not require an attorney to "know" that a violation has been committed. The rule's "up the ladder" reporting obligation would be triggered when an attorney becomes aware of information that would lead an attorney, acting reasonably, to believe that a material violation has occurred, is occurring or is about to occur, limiting the instances in which the reporting duty prescribed by the rule will arise to those where it is appropriate to protect investors. The attorney would be initially directed to make this report to the issuer's CLO (or to the CLO and the chief executive officer). The attorney also would be obligated to take reasonable steps under the circumstances to document the report and the response thereto, and to retain such documentation for a reasonable time.

(Alternatively, the attorney may report evidence of a material violation "up the ladder" to an issuer's "qualified legal compliance committee" – if the issuer has established such a committee, as discussed below.)

When presented with a report of a possible material violation, the issuer's CLO would be obligated to determine whether to conduct an inquiry into the reported material violation to ascertain whether in fact a violation has occurred, is occurring or about to occur. A CLO who reasonably concludes that there has been no material violation must so advise the reporting attorney of this conclusion. A CLO who concludes that a material violation has occurred, is occurring or is about to occur would be required to take reasonable steps to ensure that the issuer adopts appropriate remedial measures and/or sanctions - including appropriate disclosures. Furthermore, the CLO would be required to report "up the ladder" within the issuer what remedial measures have been adopted, and to advise the reporting attorney of his or her conclusions.

A reporting attorney who receives an appropriate response within a reasonable time and has taken reasonable steps to document his or her report and response would have satisfied all obligations under the rule. The Commission believes that most situations involving reporting to the CLO or CEO by an attorney will be resolved in this manner. In the event a reporting attorney does not receive an appropriate response within a reasonable time, he or she would be required to report the evidence of a material violation to the issuer's audit committee, another committee of independent directors, or to the full board. Similarly, if the attorney reasonably believes that it would be futile to report evidence of a material violation to the CLO and CEO, the attorney may report directly to the issuer's audit committee, another committee of independent directors, or to the full board. A reporting attorney who has reported a matter all the way "up the ladder" within the issuer and who reasonably believes that the issuer has not responded appropriately would be required to explain to the CLO, CEO, or directors why he or she thinks the response is not appropriate, take reasonable steps under the circumstances to document the response (or absence thereof) and to retain any such documentation for a reasonable time.

'Noisy Withdrawal'. The proposed rule also deals with the obligation of an attorney who has not received an appropriate response from the issuer and, in certain instances, requires or permits a "noisy withdrawal." While this provision is not specifically mandated by Section 307, a provision that obligates a reporting attorney under certain circumstances to disaffirm a submission to the Commission which the attorney believes has been tainted by a material violation (and permits the attorney to disaffirm under other circumstances) is important to the effective operation of the reporting obligation in those instances where an issuer does not respond appropriately. The provision would distinguish between outside attorneys retained by the issuer and attorneys employed by the issuer because the personal cost of compliance to an attorney employed by the issuer is greater. The provision would impose an affirmative obligation on attorneys to disaffirm a document or filing that the attorneys participated in preparing where they reasonably believe a violation is ongoing or is about to occur and is likely to cause substantial financial harm to the issuer or to investors. Where the attorney reasonably believes that a material violation has already occurred and has no continuing effect and is likely to have caused substantial financial harm, the attorney may (but is not required to) notify the Commission of his or her withdrawal and disaffirm a document or filing that the attorney participated in preparing. "Noisy withdrawal" is mandatory if the material violation is ongoing or about to occur because of the greater potential of harm to investors inherent in such violations. A "noisy withdrawal" does not violate the attorney/client privilege because it does not reveal confidential communications or the evidence of a material violation.

'QLCC'. As an alternative process for considering reports of material violations, an issuer may establish a qualified legal compliance committee (QLCC) comprised of at least one member of the issuer's audit committee, and two or more members of the issuer's board, all of whom must be independent, for the purpose of investigating reports made by attorneys of evidence of a material violation. The QLCC would be authorized and would have the responsibility to require the issuer to take remedial actions that the CLCC decides are appropriate and to notify the CLO and the CEO of the remedial actions the QLCC has decided are appropriate. If the issuer were to fail to act as directed by the QLCC in any material respect, each QLCC member, as well as the issuer's CLO and CEO, would have the responsibility to notify the Commission that a material violation has occurred, is occurring, or is about to occur and to disaffirm any filings by the issuer that are materially false or misleading. Attorneys who report evidence of a material violation to a QLCC would not be subject to the rule's "noisy withdrawal" requirement.

Final rules are due to be issued within 180 days of enactment (Jan. 26).

Section 401(a) – Disclosure of Material Off-Balance Sheet Arrangements

On October 30, 2002, the Commission proposed rules to require periodic reports filed with the Commission to disclose material off-balance sheet arrangements.

The proposed rules would explicitly require a company to disclose these arrangements and relationships in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" (MD&A) section of the company's disclosure documents. While current MD&A rules already require a company to provide disclosure about its off-balance sheet arrangements to the extent necessary to an understanding of the company's financial condition, changes in financial condition and results of operations, the proposed rules will more specifically address the types of disclosure that companies must provide.

In addition to fulfilling the statutory mandate, the proposed rules codify many of the views expressed in the Jan. 22, 2002 statement focusing on the need for improved MD&A disclosure. The proposed rules would, however, lower the threshold that triggers disclosure relating to off-balance sheet transactions discussed in the January statement consistent with Congressional intent. While MD&A disclosure about an off-balance sheet transaction currently is required if the transaction is "reasonably likely" to have a material effect on the company, the proposed rules would require disclosure if the likelihood of the transaction having a material effect on the company is more than "remote."

Although Exchange Act Section 13(j) directs the SEC to require the off-balance sheet arrangement disclosure only in a company's annual and quarterly reports, the Commission proposed to also require a company to include this disclosure in the MD&A section of its Securities Act registration statements.

The proposals also would require a registrant, other than a small business issuer, to provide an overview of its aggregate contractual obligations in a tabular format and an overview of its contingent liabilities and commitments in either a textual or tabular format.

Final rules are to be issued not later than 180 days after enactment (Jan. 26).

Section 401(b) – Pro Forma Financial Information

On October 30, 2002, the Commission proposed rules to address public companies' disclosure or release of "pro forma," or non-GAAP, financial information. Section 401(b) of the Sarbanes-Oxley Act of 2002 directs the Commission to issue final rules by

Jan. 26, 2003, requiring that any public disclosure or release of "pro forma financial information" by a public company be presented in a manner that (1) does not contain an untrue statement of a material fact or omit to state a material fact necessary in order to make the "pro forma financial information," in light of the circumstances under which it is presented, not misleading; and (2) reconciles the "pro forma financial information" presented with the financial condition and results of operations of the company under GAAP. The Commission proposed to meet the mandate of Section 401(b) by defining the category of financial information that is subject to that mandate and then taking a two-step approach to regulating the use of that financial information.

(1) The Commission proposed that the rules apply to the public disclosure or release of material information that includes a "non-GAAP financial measure."

(2) The Commission proposed new Regulation G, which would prohibit material misstatements or omissions that would make the presentation of the material non-GAAP financial measure misleading. Regulation G would provide a limited exception for foreign private issuers where (1) the securities of the issuer are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States; (2) the non-GAAP financial measure and the most comparable GAAP financial measure are not calculated and presented in accordance with generally accepted accounting principles in the United States; and (3) the disclosure is made by or on behalf of the issuer outside the United States, or is included in a written communication that is released by or on behalf of the issuer only outside the United States.

<u>Section 403 – Accelerated Deadlines for Disclosures of Insider Transactions</u>

On August 27, 2002, the Commission adopted rules to require insiders to report a change in ownership or purchase or sale of a security-based swap agreement "before the end of the second business day following the day on which the subject transaction has been executed." This rule became effective on August 29, 2002.

<u>Section 404 – Internal Control Report as Part of Annual Report</u>

On October 16, 2002, the Commission proposed rules requiring companies to file an annual internal control report as part of its annual report. This report would address management's responsibility to establish internal controls and procedures for financial reporting and require management to evaluate the effectiveness of those controls and procedures as of the last day of the company's fiscal year. Under Section 404(b) of the Sarbanes-Oxley Act, the company's auditor must attest to, and report on, management's assertions in the internal control report. The company must state this fact and file the auditor's attestation in its annual report.

Section 406 – Code of Ethics for Senior Financial Officers

On October 16, 2002, the Commission proposed rules to require companies to disclose in its annual report whether the company has adopted a code of ethics for the company's principal executive officer and senior financial officers, or if it has not, why it has not; and to disclose on a current basis amendments to, and waivers from, the code of ethics relating to any of those officers.

The proposed rules would define a code of ethics as a codification of standards that is reasonably necessary to deter wrongdoing and to promote:

- honest and ethical conduct;
- avoidance of conflicts of interest;
- full, fair, accurate, timely, and understandable disclosure in reports and documents;
- compliance with applicable governmental laws, rules and regulations;
- prompt internal reporting of code violations to an appropriate person or persons identified in the code; and
- accountability for adherence to the code.

Final rules are to be issued not later than 180 days after enactment (Jan. 26).

Section 407 – Disclosure of Audit Committee Financial Experts

On October, 16, 2002, the Commission proposed rules to require companies to disclose whether the audit committee of the Board of Directors has at least one member who is a "financial expert." The proposed rules would define the term "financial expert" by requiring such a person to have all of the attributes listed in Section 407 of the Sarbanes-Oxley Act. They also would provide a list of factors that companies should consider when determining whether a member of the audit committee is a financial expert.

Final rules are to be issued not later than 180 days after enactment (Jan. 26).

Section 802 - Document retention by Auditors

On Nov. 19, 2002, the Commission proposed rules that would specify the information that must be retained by auditors for a five-year period subsequent to the completion of an audit or review of a registrant's financial statements. In particular, the proposed rules would specify that auditors should retain workpapers and other documents that form the basis of the audit or review and memoranda, correspondence, communications, other documents, and records (including electronic records), which are created, sent or received in connection with the audit or review and contain conclusions, opinions, analyses, or financial data related to the audit or review.

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